AFFILIATED COMPUTER SERVICES INC
Form 10-Q
February 09, 2006

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549
FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2005
OR
o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the period from __________ to __________
Commission file number 001-12665
AFFILIATED COMPUTER SERVICES, INC.

(Exact name of registrant as specified in its charter)

| Delaware | 51-0310342 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 2828 North Haskell, Dallas, Texas | 75204 |
| (Address of principal executive offices) | (Zip Code) |

Registrant s telephone number, including area code (214) 841-6111
**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report.)
Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act). (Check one):

Large accelerated filer x Accelerated filer o Non-accelerated filer o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of Exchange Act). Yes o No x
Indicate the number of shares outstanding of each of the registrant s classes of common stock, as of the latest practicable date.

| Title of each class | Number of shares outstanding as of February 5, 2006 |
|---|---|
| Class A Common Stock, $.01 par value | 118,302,227 |
| Class B Common Stock, $.01 par value | 6,599,372 |

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**PART I**
**ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS**
**AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**
**(in thousands)**

| | December 31, 2005 (Unaudited) | June 30, 2005 (Audited) |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 107,263 | $ 62,685 |
| Accounts receivable, net | 1,232,322 | 1,061,590 |
| Prepaid expenses and other current assets | 159,446 | 119,822 |
| Assets held for sale | 8,385 | |
| Total current assets | 1,507,416 | 1,244,097 |
| Property, equipment and software, net | 768,315 | 677,241 |
| Goodwill | 2,396,626 | 2,334,655 |
| Other intangibles, net | 480,423 | 466,312 |
| Other assets | 158,224 | 128,533 |
| Total assets | $ 5,311,004 | $ 4,850,838 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $ 88,106 | $ 62,788 |
| Accrued compensation and benefits | 157,328 | 175,782 |
| Other accrued liabilities | 521,395 | 471,577 |
| Income taxes payable | 29,194 | 2,310 |
| Deferred taxes | 28,939 | 34,996 |
| Current portion of long-term debt | 7,489 | 6,192 |
| Current portion of unearned revenue | 98,837 | 84,469 |
| Total current liabilities | 931,288 | 838,114 |
| Senior Notes, net of unamortized discount | 499,328 | 499,288 |
| Other long-term debt | 426,275 | 251,067 |
| Deferred taxes | 287,285 | 240,210 |
| Other long-term liabilities | 196,979 | 183,731 |
| Total liabilities | 2,341,155 | 2,012,410 |

Commitments and contingencies (See Notes 10, 13 and 16)

| | | |
|---|---|---|
| Stockholders equity: | | |
| Class A common stock | 1,389 | 1,379 |
| Class B common stock | 66 | 66 |
| Additional paid-in capital | 1,837,051 | 1,792,629 |
| Accumulated other comprehensive loss, net | (13,449) | (10,910) |
| Retained earnings | 2,213,516 | 2,016,197 |
| Treasury stock at cost, 21,256 and 19,255 shares, respectively | (1,068,724) | (960,933) |
| Total stockholders equity | 2,969,849 | 2,838,428 |
| Total liabilities and stockholders equity | $ 5,311,004 | $ 4,850,838 |

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

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**AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF INCOME**
**(UNAUDITED)**
**(in thousands, except per share amounts)**

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | **2005** | **2004** | **2005** | **2004** |
| Revenues | $ 1,347,587 | $ 1,027,286 | $ 2,658,504 | $ 2,073,468 |
| Expenses: | | | | |
| Wages and benefits | 632,889 | 435,970 | 1,261,008 | 867,818 |
| Services and supplies | 305,889 | 251,006 | 596,661 | 526,068 |
| Rent, lease and maintenance | 163,541 | 121,124 | 318,713 | 240,117 |
| Depreciation and amortization | 70,444 | 55,586 | 138,524 | 109,905 |
| Gain on sale of business | (29,765) | | (29,765) | |
| Other operating expenses | 28,595 | 8,676 | 42,606 | 19,595 |
| Total operating expenses | 1,171,593 | 872,362 | 2,327,747 | 1,763,503 |
| Operating income | 175,994 | 154,924 | 330,757 | 309,965 |
| Interest expense | 13,333 | 2,869 | 25,461 | 6,824 |
| Other non-operating income, net | (1,994) | (1,776) | (6,375) | (1,342) |
| Pretax profit | 164,655 | 153,831 | 311,671 | 304,483 |
| Income tax expense | 61,459 | 57,686 | 114,351 | 114,181 |
| Net income | $ 103,196 | $ 96,145 | $ 197,320 | $ 190,302 |
| Earnings per share: | | | | |
| Basic | $ 0.83 | $ 0.75 | $ 1.58 | $ 1.48 |
| Diluted | $ 0.81 | $ 0.73 | $ 1.55 | $ 1.45 |
| Shares used in computing earnings per share: | | | | |
| Basic | 124,849 | 128,619 | 125,139 | 128,283 |
| Diluted | 126,865 | 131,933 | 127,044 | 131,501 |

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

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**AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(UNAUDITED)**
**(in thousands)**

| | Six Months Ended December 31, 2005 | Six Months Ended December 31, 2004 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 197,320 | $ 190,302 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 138,524 | 109,905 |
| Stock-based compensation expense | 17,371 | |
| Excess tax benefits from stock-based compensation arrangements | (9,480) | |
| Tax benefit on stock options | | 14,389 |
| Gain on sale of business | (29,765) | |
| Provision for uncollectible accounts receivable | 4,495 | 1,128 |
| Deferred income tax expense | 34,698 | 43,813 |
| Asset impairments | 5,755 | |
| Contract inducement amortization | 7,613 | 6,249 |
| Gain on investments | (4,903) | (1,311) |
| Other non-cash activities | 3,244 | (110) |
| Changes in assets and liabilities, net of effects from acquisitions: | | |
| (Increase) decrease in accounts receivable | (26,848) | 37,827 |
| Increase in prepaid expenses and other current assets | (5,044) | (8,493) |
| Decrease in other assets | 2,987 | 6,599 |
| Increase (decrease) in accounts payable | 8,451 | (1,195) |
| Decrease in accrued compensation and benefits | (21,866) | (53,342) |
| Decrease in other accrued liabilities | (31,058) | (67,222) |
| Increase in income taxes payable | 41,138 | 19,621 |
| Increase (decrease) in unearned revenue | 19,521 | (1,253) |
| Increase in other long-term liabilities | 3,596 | 2,367 |
| Total adjustments | 158,429 | 108,972 |
| Net cash provided by operating activities | 355,749 | 299,274 |
| Cash flows from investing activities: | | |
| Purchases of property, equipment and software, net | (184,973) | (106,553) |
| Payments for acquisitions, net of cash acquired | (153,760) | (95,838) |
| Additions to other intangible assets | (13,046) | (24,925) |
| Intangible assets acquired in subcontract termination | (16,530) | |
| Purchases of investments | (25,439) | (4,587) |
| Other | 24 | 463 |
| Net cash used in investing activities | (393,724) | (231,440) |
| Cash flows from financing activities: | | |

| | | |
|---|---|---|
| Proceeds from issuance of long-term debt, net | 1,003,629 | 865,472 |
| Repayments of long-term debt | (835,213) | (992,002) |
| Proceeds from stock options exercised | 30,965 | 18,595 |
| Executive stock option settlement | (18,353) | |
| Excess tax benefits from stock-based compensation arrangements | 9,480 | |
| Purchase of treasury shares | (115,804) | (14,849) |
| Proceeds from issuance of treasury shares | 7,849 | 13,917 |
| Net cash provided by (used in) financing activities | 82,553 | (108,867) |
| Net increase (decrease) in cash and cash equivalents | 44,578 | (41,033) |
| Cash and cash equivalents at beginning of period | 62,685 | 76,899 |
| Cash and cash equivalents at end of period | $ 107,263 | $ 35,866 |

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

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**AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(UNAUDITED)**

## 1. BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Affiliated Computer Services, Inc. ( ACS or the Company ) and its majority-owned subsidiaries. All material intercompany profits, transactions and balances have been eliminated. We are a Fortune 500 and S&P 500 company with more than 55,000 people providing business process and information technology outsourcing solutions to commercial and government clients.

The financial information presented should be read in conjunction with our consolidated financial statements for the year ended June 30, 2005. The foregoing unaudited consolidated financial statements reflect all adjustments (all of which are of a normal recurring nature), which are, in the opinion of management, necessary for a fair presentation of the results of the interim periods. The results for the interim periods are not necessarily indicative of results to be expected for the year. Prior period amounts have been restated to conform to current period presentation.

Significant accounting policies are detailed in our Annual Report on Form 10-K for the year ended June 30, 2005. For discussion of our critical accounting policies, please refer to Management s Discussion and Analysis of Financial Condition and Results of Operations.

## 2. STOCK-BASED COMPENSATION

On December 16, 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment ( SFAS 123(R) ). SFAS 123(R) requires companies to measure all employee stock-based compensation awards using a fair value method and recognize compensation cost in its financial statements. SFAS 123(R) is effective beginning as of the first annual reporting period beginning after June 15, 2005. We adopted SFAS 123(R) on a prospective basis beginning July 1, 2005 for stock-based compensation awards granted after that date and for unvested awards outstanding at that date using the modified prospective application method. We recognize the fair value of stock-based compensation awards as wages and benefits in the Consolidated Statements of Income on a straight-line basis over the vesting period.

Prior to July 1, 2005, we followed Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, ( APB 25 ) in accounting for our stock-based compensation plans. Under APB 25, no compensation expense was recognized for our stock-based compensation awards since the exercise prices of awards under our plans were at the current market price of our stock on the date of grant. Had compensation cost for our stock-based compensation plans been determined based on the fair value at the grant date under those plans consistent with the fair value method of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ( SFAS 123 ), our net income and earnings per share would have been reduced to the pro forma amounts indicated below (in thousands, except per share amounts):

| | Three Months Ended December 31, 2004 | Six Months Ended December 31, 2004 |
|---|---|---|
| Net Income | | |
| As reported | $ 96,145 | $ 190,302 |
| Less: Pro forma cost of employee stock-based compensation plans, net of income taxes of $3,248 and $5,916, respectively | (5,749) | (11,315) |
| Pro forma | $ 90,396 | $ 178,987 |
| Basic earnings per share | | |

| | | | | |
|---|---|---|---|---|
| As reported | $ | 0.75 | $ | 1.48 |
| Pro forma | $ | 0.70 | $ | 1.40 |
| | | | | |
| Diluted earnings per share | | | | |
| As reported | $ | 0.73 | $ | 1.45 |
| Pro forma | $ | 0.69 | $ | 1.37 |

The adoption of SFAS 123(R) in the first quarter of fiscal year 2006 resulted in prospective changes in our accounting for stock-based compensation awards including recording stock-based compensation expense and the related deferred income tax benefit on a prospective basis and reflecting the excess tax benefit from the exercise of stock-based compensation awards in cash flows from financing activities.

**AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)**

The adoption of SFAS 123(R) resulted in the recognition of compensation expense of $8.6 million and $17.4 million ($5.7 million and $11.6 million, net of deferred income tax benefits), or $0.04 and $0.09 per diluted share, in wages and benefits in the Consolidated Statements of Income for the three and six months ended December 31, 2005, respectively. In accordance with the modified prospective application method of SFAS 123(R), prior period amounts have not been restated to reflect the recognition of stock-based compensation costs. The total compensation cost related to non-vested awards not yet recognized at December 31, 2005 was approximately $94.3 million, which is expected to be recognized over a weighted average of 3.63 years.

In periods ending prior to July 1, 2005, the income tax benefits from the exercise of stock options were classified as net cash provided by operating activities pursuant to Emerging Issues Task Force Issue No. 00-15 Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option. However, for periods ending after July 1, 2005, pursuant to SFAS 123(R), the income tax benefits exceeding the recorded deferred income tax benefit and any pre-adoption as-if deferred tax benefit from stock-based compensation awards (the excess tax benefits) are required to be reported in net cash provided by financing activities. For the six months ended December 31, 2005, excess tax benefits from stock-based compensation awards of $9.5 million were reflected as an outflow in cash flows from operating activities and an inflow in cash flows from financing activities in the Consolidated Statements of Cash Flows. In the prior year period, income tax benefits from the exercise of stock options of $14.4 million were reflected as an inflow in cash flows from operating activities in the Consolidated Statements of Cash Flows.

Under our 1997 Stock Incentive Plan (the Stock Incentive Plan ), we originally reserved approximately 7.4 million shares of Class A common stock for issuance to key employees at exercise prices determined by the Board of Directors. In May 2000, February 2001, October 2001, July 2003, February 2005 and July 2005, the Board of Directors approved the additional allotment of approximately 1.7 million, 1.6 million, 4.1 million, 3.8 million, 2.7 million and 0.8 million shares, respectively, to the Stock Incentive Plan in accordance with the terms and conditions of the Stock Incentive Plan authorized by our shareholders pursuant to our November 14, 1997 Proxy Statement. Options granted under the Stock Incentive Plan to our current employees cannot exceed 12.8% of our issued and outstanding shares, and consequently, any share repurchases (as discussed in Note 9) reduce the number of options to purchase shares that we may grant under the Stock Incentive Plan. Our 1988 Stock Option Plan (the 1988 Plan ), which originally reserved 12 million shares of Class A common stock for issuance, was discontinued for new grants during fiscal year 1998 and terminated (except for the exercise of then existing option grants as of September 1997) and subsequently, 3.2 million unissued shares expired. Generally, the options under each plan vest in varying increments over a five-year period, become exercisable as they vest, expire ten years from the date of grant and are issued at exercise prices no less than 100% of the fair market value of our Class A common stock at the time of the grant.

In order to conform our stock option program with standard market practice, on February 2, 2005, our Board of Directors approved an amendment to stock options previously granted that did not become exercisable until five years from the date of grant to provide that such options become exercisable on the day they vest. Options granted under both our Stock Incentive Plan and our 1988 Plan generally vest in varying increments over a five year period. It is expected that future option grants will contain matching vesting and exercise schedules, which we believe will result in a lower expected term. This amendment does not amend or affect the vesting schedule, exercise price, quantity of options granted, shares into which such options are exercisable or life of any award under any outstanding option grant. Therefore, no compensation expense was recorded.

The fair value of each stock option is estimated on the date of grant using the Black-Scholes valuation model utilizing the assumptions noted below. The expected volatility of our stock price is based on historical monthly volatility over the expected term based on daily closing stock prices. The expected term of the option is based on historical employee stock option exercise behavior, the vesting term of the respective award and the contractual term. Separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. Our stock

price volatility and expected option lives are based on management s best estimates at the time of grant, both of which impact the fair value of the option calculated under the Black-Scholes methodology and, ultimately, the expense that will be recognized over the vesting term of the option. The weighted-average fair value of options granted was $13.62 and $16.57 for the three months ended December 31, 2005 and 2004, respectively and $12.98 and $17.29 for the six months ended December 31, 2005 and 2004, respectively. The weighted-average fair value of options granted has declined in the three and six months ended December 31, 2005 compared to the prior year period periods due primarily to decreased volatility and expected term. The estimated fair value is not intended to predict actual future events or the value ultimately realized by employees who receive equity awards.

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**AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(UNAUDITED)**

The following weighted-average assumptions were used to determine the fair value of grants:

| | Three Months ended December 31, 2005 | Six Months ended December 31, 2005 |
|---|---|---|
| Expected volatility | 22.56% | 22.20% |
| Expected term | 4.21 years | 4.21 years |
| Risk-free interest rate | 3.91% | 3.49% |
| Expected dividend yield | 0% | 0% |

As discussed above, prior to the adoption of SFAS 123(R), we determined the fair value of grants for disclosure of pro forma stock-based compensation costs in accordance with SFAS 123. We used the following weighted-average assumptions to determine the fair value of grants:

| | Three Months ended December 31, 2004 | Six Months ended December 31, 2004 |
|---|---|---|
| Expected volatility | 26.93% | 27.58% |
| Expected term | 5.25 years | 5.35 years |
| Risk-free interest rate | 3.42% | 3.92% |
| Expected dividend yield | 0% | 0% |

The total intrinsic value of options exercised during the three and six months ended December 31, 2005 was $12.1 million and $23.7 million, respectively, resulting in income tax benefits of $4.4 million and $8.6 million, respectively. In addition, we also recorded income tax benefits of $6.7 million in the first quarter of fiscal year 2006 related to the purchase of vested options from our former Chief Executive Officer (see Note 14 for further discussion). Of the total income tax benefit of $15.3 million for the six months ended December 31, 2005, $9.5 million is reflected as excess tax benefits in net cash provided by financing activities in the Consolidated Statements of Cash Flows.

Option activity for the three and six months ended December 31, 2005 is summarized as follows:

| | Options | Weighted Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding at September 30, 2005 | 14,474,220 | $ 41.30 | 7.47 | |
| Granted | 226,500 | 53.39 | | |
| Exercised | (516,460) | 31.42 | | |
| Canceled | (437,300) | 44.78 | | |

| | | | | |
|---|---|---|---|---|
| Outstanding as of December 31, 2005 | 13,746,960 | $ 41.76 | 7.32 | $ 239,505 |
| Outstanding at June 30, 2005 | 15,356,700 | $ 39.61 | 7.42 | |
| Granted | 1,588,500 | 53.05 | | |
| Exercised | (1,027,440) | 30.14 | | |
| Canceled (1) | (2,170,800) | 40.30 | | |
| Outstanding as of December 31, 2005 | 13,746,960 | $ 41.76 | 7.32 | $ 239,505 |
| Vested and exercisable at December 31, 2005 | 4,978,410 | $ 32.68 | 5.65 | $ 131,938 |

(1) Includes the purchase of 610,000 vested options and the cancellation of 640,000 unvested options related to the departure of our former Chief Executive Officer.

**AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(UNAUDITED)**

SFAS 123(R) requires that we recognize compensation expense for only the portion of share-based payment arrangements that are expected to vest. Therefore, we apply estimated forfeiture rates that are based on historical employee termination behavior. We periodically adjust the estimated forfeiture rates so that only the compensation expense related to share-based payment arrangements that vest are included in wages and benefits. If the actual number of forfeitures differs from those estimated by management, additional adjustments to compensation expense may be required in future periods.

We follow the transition method described in SFAS 123(R) for calculating the excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption of SFAS 123(R) (the APIC Pool ). Tax deficiencies arise when actual tax benefits we realize upon the exercise of stock options are less than the recorded tax benefit. In November 2005, the Financial Accounting Standards Board issued FASB Staff Position FAS 123(R)-3, Transition Election to Accounting for the Tax Effects of Share-Based Payment Awards ( FSP FAS 123(R)-3 ), which provides an alternative one-time transition election for calculating the APIC Pool. We are currently evaluating whether to elect the one-time transition election provided in FSP FAS 123(R)-3.

## 3. ACQUISITIONS

In December 2005, we completed the acquisition of the Transport Revenue division of Ascom AG ( Ascom ), a Switzerland based communications company. Ascom consists of three business units - fare collection, airport parking solutions and toll collection with office locations across nine countries. The transaction was valued at approximately $100.5 million plus related transaction costs and was funded from borrowings under our Existing Credit Facility (as defined in Note 16). The purchase price was allocated to assets acquired and liabilities assumed based on the estimated fair value as of the date of acquisition. We acquired assets of $212.8 million and assumed liabilities of $112.3 million. We recorded goodwill of $68.6 million, 37% of which is deductible for income tax purposes, and intangible assets of $4 million. The $4 million of intangible assets is attributable to customer relationships, non-compete agreements and patents with weighted average useful lives of approximately 5 years. Our Consolidated Balance Sheet as of December 31, 2005 reflects the preliminary allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition and is expected to be finalized upon receipt of the final third party valuation. We believe this acquisition launches us into the international transportation services industry and will expand our portfolio in the transit and parking payment markets and adds toll collection customers to our existing customer base. The operating results of the acquired business are included in our financial statements in the Government segment from the effective date of the acquisition, December 1, 2005.

In July 2005, we completed the acquisition of LiveBridge, Inc. ( LiveBridge ), a customer care service provider primarily serving the financial and telecommunications industries. The transaction was valued at approximately $32 million plus a working capital adjustment of $2.5 million, excluding contingent consideration of up to $32 million based upon future financial performance and was funded from cash on hand and borrowings under our Existing Credit Facility. The purchase price was allocated to assets acquired and liabilities assumed based on the estimated fair value as of the date of acquisition. We acquired assets of $42 million and assumed liabilities of $7.5 million. We recorded goodwill of $11.5 million, 49% of which is deductible for income tax purposes, and intangible assets of $12.9 million. The $12.9 million of intangible assets is attributable to customer relationships and non-compete agreements with weighted average useful lives of approximately 6 years. We believe this acquisition will expand our customer care service offerings in the finance and telecommunications industries and will extend our global capabilities and operations by adding the LiveBridge operational centers in Canada, India and Argentina. The operating results of the acquired business are included in our financial statements in the Commercial segment from the effective date of the acquisition, July 1, 2005.

## 4. SALE OF GOVERNMENT WELFARE-TO-WORKFORCE SERVICES BUSINESS

In December 2005, we completed the divestiture of substantially all of our Government welfare-to-workforce services business to Arbor E&T, LLC ( Arbor ), a wholly owned subsidiary of ResCare, Inc., for approximately $69 million, less transaction costs. The Government welfare-to-workforce services business is no longer strategic or core to our

operating philosophy. This divestiture allows us to focus on our technology-enabled business process outsourcing and information technology outsourcing service offerings. Assets sold were approximately $27.1 million and liabilities assumed by Arbor were approximately $0.2 million, both of which were included in the Government segment. We retained the net working capital, including receivables of $27 million at December 31, 2005, related to the welfare-to-workforce services business. The $69 million in proceeds was included in accounts receivable in our Consolidated Balance Sheet as of December 31, 2005. We received the proceeds in January 2006, which will be included in cash flows from investing activities in our Consolidated Statements of Cash Flow in the third quarter of fiscal year 2006. We recognized a pretax gain of $29.8 million ($17.9 million, net of income tax) in the second quarter of fiscal year 2006. Approximately $10.6 million of the consideration relates to certain customer contracts whose assignment to Arbor was not complete as of December 31, 2005, and is reflected as deferred proceeds in other accrued liabilities in our Consolidated Balance Sheet as of December 31, 2005.

**AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**
**(UNAUDITED)**

We expect to complete the transfer of these remaining contracts to Arbor by the end of fiscal year 2006 upon receipt of customer consents. The after tax proceeds from the divestiture will generally be used to pay down debt or for general corporate purposes.

In the second quarter of fiscal year 2006, we recorded a provision for an estimated litigation settlement related to the welfare-to-workforce services business. In connection with the transfer of the contracts and ongoing customer relationships to Arbor and due to a change in our estimate of collectibility of the retained outstanding receivables, we recorded a provision for uncollectible accounts receivable related to the welfare-to-workforce services business. Total provisions recorded were $3.3 million ($2.1 million, net of income tax).

Revenues from the divested business were $47.6 million and $55.8 million for the three months ended December 31, 2005 and 2004, respectively, and $101.1 million and $113.3 million for the six months ended December 31, 2005 and 2004, respectively. Operating income from the divested business, excluding the gain on sale, was $1.4 million and $5.1 million for the three months ended December 31, 2005 and 2004, respectively, and $6.3 million and $11.4 million for the six months ended December 31, 2005 and 2004, respectively.

**5. RESTRUCTURING AND OTHER ACTIVITIES**

During the second quarter of fiscal year 2006, and in connection with our new executive leadership, we began a comprehensive assessment of our operations, including our overall cost structure, competitive position, technology assets and operating platform and foreign operations. As a result, we initiated certain restructuring initiatives and activities that are expected to enhance our competitive position in certain markets, and recorded certain restructuring charges and asset impairments arising from our discretionary decisions. We estimate a total of 1,700 employees will be involuntarily terminated as a result of these initiatives, consisting primarily of offshore processors and related management; however, we anticipate that a majority of these positions will be migrated to lower cost markets. As of December 31, 2005, approximately 400 employees had been involuntarily terminated. We anticipate the costs savings related to these involuntary terminations will be approximately $13 million of wages and benefits per year beginning in fiscal year 2007; however, some of the cost savings from these involuntary terminations will be reinvested in subject matter experts, project management talent and sales personnel as we look to further promote those lines of businesses that reflect the most potential for growth. We expect to complete our assessment activities over the third and fourth quarters of fiscal year 2006, which may result in further restructuring and related charges, the amount and timing of which cannot be determined at this time.

In our Commercial segment, we began an assessment of the cost structure of our global production model, particularly our offshore processing activities. We identified offshore locations in which our labor costs are no longer competitive or where the volume of work processed by the site no longer justifies retaining the location, including one of our Mexican facilities. In connection with this assessment, we recorded a restructuring charge for involuntary termination of employees related to the closure of those duplicative facilities of $4.3 million which is reflected in wages and benefits in our Consolidated Statements of Income, and $0.3 million for impairments of duplicative technology equipment, which is reflected in other operating expenses in our Consolidated Statements of Income. We expect these activities will consolidate our global production activities and enhance our competitive position.

In our Government segment, we began an assessment of our competitive position, and evaluated our market strategies. We began to implement operating practices that we utilize in our Commercial segment, including leveraging our proprietary workflow technology and implementing activity-based-compensation, which is expected to reduce our operating costs and enhance our competitive position. We also evaluated our competitive position in our markets, and the technology used to support certain of our service offerings. In connection with these activities, we recorded a restructuring charge for involuntary termination of employees of $0.3 million which is reflected in wages and benefits in our Consolidated Statements of Income, and $1.4 million in asset impairment charges, which is reflected in other operating expenses in our Consolidated Statements of Income, principally for duplicative software as a result of recent acquisition activity. And as discussed earlier, we completed the sale of substantially all of our welfare-to-workforce services business, which allows us to focus on our technology-enabled business process outsourcing and information

technology outsourcing service offerings.

In our Corporate segment, we determined that the costs related to the ownership of a corporate aircraft outweighed the benefits to the Company. We recorded an asset impairment charge of $4.1 million related to corporate aircraft, which is reflected in other operating expenses in our Consolidated Statements of Income, in connection with its classification as held for sale at December 31, 2005. We do not expect the sale of the corporate aircraft in this fiscal year, due to conditions in the aircraft marketplace.

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The following table summarizes activity for the accrual for involuntary termination of employees for the quarter ended December 31, 2005 (in thousands):

| | |
|---|---|
| Balance at September 30, 2005 | $ |
| Accrual recorded | 4,671 |
| Payments | (1,888) |
| Balance at December 31, 2005 | $ 2,783 |

The December 31, 2005 accrual for involuntary termination of employees is expected to be paid in the third and fourth quarters of fiscal year 2006 from cash flows from operating activities or cash flows from financing activities.

As part of our acquisition of the human resources consulting and outsourcing business of Mellon Financial Corporation (the Acquired HR Business ) in the fourth quarter of fiscal year 2005, we recorded $22.3 million in involuntary employee termination costs for employees of the Acquired HR Business in accordance with EITF Issue No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination. During the first half of fiscal year 2006, $8.9 million in involuntary employee termination payments have been made and charged against accrued compensation. As of December 31, 2005, the balance of the related accrual was $11.6 million and is expected to be paid principally in the third and fourth quarters of fiscal year 2006 from cash flows from operating activities.

## 6. ASSETS HELD FOR SALE

At December 31, 2005, we classified as assets held for sale certain customer contracts in our Government welfare-to-workforce services business whose transfer to Arbor was not complete as of December 31, 2005 (see Note 4). In addition, as part of our restructuring activities to reduce costs as discussed in Note 5, we classified the fair value of our corporate aircraft as held for sale and recognized an impairment loss in other operating expenses of $4.1 million. The following table sets forth the assets included in assets held for sale as of December 31, 2005 (in thousands):

| **Assets held for sale** | |
|---|---|
| Intangible assets related to welfare-to-workforce services business, net | $ 1,607 |
| Goodwill related to welfare-to-workforce services business | 2,778 |
| Corporate aircraft | 4,000 |
| Total assets held for sale | $ 8,385 |

## 7. GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill for the six months ended December 31, 2005 are as follows (in thousands):

| | **Commercial** | **Government** | **Total** |
|---|---|---|---|
| Balance as of June 30, 2005 | $ 1,217,727 | $ 1,116,928 | $ 2,334,655 |
| Acquisition activity | 9,029 | 70,694 | 79,723 |
| Divested business | | (14,974) | (14,974) |
| Assets held for sale | | (2,778) | (2,778) |
| Balance as of December 31, 2005 | $ 1,226,756 | $ 1,169,870 | $ 2,396,626 |

Goodwill activity for the first six months of fiscal year 2006 was primarily due to the acquisition of Ascom and LiveBridge (see Note 3) offset by the sale of our Government welfare-to-workforce services business (see Note 4). Approximately $2 billion, or 81%, of the original gross amount of goodwill recorded is deductible for income tax purposes.

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The following information relates to our other intangible assets (in thousands):

| | December 31, 2005 | | June 30, 2005 | |
|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Amortized intangible assets: | | | | |
| Acquired customer-related intangibles | $ 368,377 | $ (86,491) | $ 377,314 | $ (76,515) |
| Customer-related intangibles | 214,798 | (80,975) | 175,571 | (74,336) |
| All other | 14,433 | (4,607) | 12,708 | (3,318) |
| Total | $ 597,608 | $ (172,073) | $ 565,593 | $ (154,169) |
| Unamortized intangible assets: | | | | |
| Title plant | $ 51,045 | | $ 51,045 | |
| Trade name | 3,843 | | 3,843 | |
| Total | $ 54,888 | | $ 54,888 | |
| Aggregate Amortization: | | | | |
| For the quarter ended December 31, 2005 | | | $ 18,089 | |
| For the quarter ended December 31, 2004 | | | 12,936 | |
| For the six months ended December 31, 2005 | | | 36,101 | |
| For the six months ended December 31, 2004 | | | 27,252 | |
| Estimated amortization for the years ended June 30, | | | | |
| 2006 | | | $ 72,615 | |
| 2007 | | | 67,251 | |
| 2008 | | | 63,240 | |
| 2009 | | | 55,418 | |
| 2010 | | | 43,495 | |

Aggregate amortization includes amounts charged to amortization expense for customer-related intangibles and other intangibles, other than contract inducements. Amortization of contract inducements of $3.9 million and $3.2 million for the three months ended December 31, 2005 and 2004, respectively, and $7.6 million and $6.2 million for the six months ended December 31, 2005 and 2004, respectively, is recorded as a reduction of related contract revenue. Amortization expense includes approximately $9.4 million and $6.6 million for acquired customer-related intangibles for the three months ended December 31, 2005 and 2004, respectively, and $19.2 million and $12.9 million for the six months ended December 31, 2005 and 2004, respectively. Amortized intangible assets are amortized over the related contract term. The amortization period of customer-related intangible assets ranges from 1 to 11 years, with a weighted average of approximately 10 years. The amortization period for all other intangible assets, including trademarks, ranges from 3 to 20 years, with a weighted average of approximately 6 years.

During the first six months of fiscal year 2006, we acquired intangible assets of $16.5 million with a weighted average useful life of approximately 8 years in connection with the termination of a subcontractor arrangement.

**8. PENSION AND OTHER POST-EMPLOYMENT PLANS**

*U.S. Pension Plan*

In December 2005, we adopted a pension plan for the U.S. employees of Buck Consultants, LLC, a wholly owned subsidiary, which was acquired in connection with the Acquired HR Business. The U.S. pension plan is a funded plan. We have established June 30 as our measurement date for this defined benefit plan. The plan recognizes service for eligible employees from May 26, 2005, the date of the acquisition of the Acquired HR Business. We recorded prepaid pension costs and projected benefit obligation of $2.1 million related to this prior service which will be amortized over 8.7 years and included in the net periodic benefit costs which is included in wages and benefits in our Consolidated Statements of Income.

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*Multi-employer Pension Plan*

A group of employees acquired with Ascom participate in a multi-employer pension plan in Switzerland. Contributions to the plan are not considered material to our Consolidated Statements of Income.

*Net periodic benefit cost*

The following table provides the components of net periodic benefit cost for the three and six months ended December 31, 2005 (in thousands):

| | Three Months ended December 31, 2005 | | Six Months ended December 31, 2005 | |
|---|---|---|---|---|
| | U.S. Plan | Non-U.S. Plans | U.S. Plan | Non-U.S. Plans |
| Components of net periodic benefit cost: | | | | |
| Defined benefit plans: | | | | |
| Service cost | $ 345 | $ 1,155 | $ 345 | $ 2,565 |
| Interest cost | 10 | 1,160 | 10 | 2,326 |
| Expected return on assets | (15) | (1,218) | (15) | (2,445) |
| Amortization of prior service cost | 20 | | 20 | |
| Net periodic benefit cost for defined benefit plans | $ 360 | $ 1,097 | $ 360 | $ 2,446 |

We made contributions to the pension plans of approximately $2.3 million in the first six months of fiscal year 2006. We expect to contribute between $7.2 million and $8.1 million to our pension plans in fiscal year 2006.

**9. EQUITY**

Our Board of Directors previously authorized three share repurchase programs totaling $1.75 billion of our Class A common stock. On September 2, 2003, we announced that our Board of Directors authorized a share repurchase program of up to $500 million of our Class A common stock; on April 29, 2004, we announced that our Board of Directors authorized a new, incremental share repurchase program of up to $750 million of our Class A common stock, and on October 20, 2005, we announced that our Board of Directors authorized an incremental share repurchase program of up to $500 million of our Class A common stock. The programs, which were open-ended, allowed us to repurchase our shares on the open market from time to time in accordance with Securities and Exchange Commission ( SEC ) rules and regulations, including shares that could be purchased pursuant to SEC Rule 10b5-1. The number of shares purchased and the timing of purchases was based on the level of cash and debt balances, general business conditions and other factors, including alternative investment opportunities, and purchases under these plans were funded from various sources, including, but not limited to, cash on hand, cash flow from operations, and borrowings under our Existing Credit Facility (as defined in Note 16). As of December 31, 2005, we had repurchased approximately 22.1 million shares at a total cost of approximately $1.1 billion and reissued 0.8 million shares for proceeds totaling $41.1 million to fund contributions to our employee stock purchase plan and 401(k) plan. These share repurchase plans were terminated on January 25, 2006 by our Board of Directors in contemplation of our tender offer, which was announced January 26, 2006 (see Note 16).

**10. COMPREHENSIVE INCOME**

Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income ( SFAS 130 ), establishes standards for reporting and display of comprehensive income and its components in financial statements. The objective of SFAS 130 is to report a measure of all changes in equity of an enterprise that result from transactions and other economic events of the period other than transactions with owners. Comprehensive income is the total of net income and all other non-owner changes within a company s equity.

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The components of comprehensive income are as follows (in thousands):

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | **2005** | **2004** | **2005** | **2004** |
| Net income | $ 103,196 | $ 96,145 | $ 197,320 | $ 190,302 |
| Other comprehensive income (loss): | | | | |
| Foreign currency translation adjustment | (3,385) | 3,833 | (3,610) | 4,611 |
| Amortization of unrealized loss on hedging instruments (net of income tax of $0.2 million and $0.4 million, respectively) | 397 | | 794 | |
| Unrealized gains on foreign exchange forward agreements (net of income tax of $166) | 277 | | 277 | |
| Comprehensive income | $ 100,485 | $ 99,978 | $ 194,781 | $ 194,913 |

We hedge the variability of our anticipated future Mexican peso cash flows through foreign exchange forward agreements. The agreements are designated as cash flow hedges of forecasted payments related to certain operating costs of our Mexican operations. As of December 31, 2005, the notional amount of these agreements totaled 186 million pesos ($17.2 million) and expire at various dates over the next 12 months. Upon termination of these agreements, we will purchase Mexican pesos at the exchange rates specified in the forward agreements to be used for payments on our forecasted Mexican peso operating costs. The unrealized gain on these foreign exchange forward agreements of $0.3 million, net of income tax, was reflected in other comprehensive income as of December 31, 2005.
The unrealized loss on hedging instruments relates to interest rate hedges, which were settled in June 2005. The agreements were designated as cash flow hedges of forecasted interest payments in anticipation of the issuance of our $250 million aggregate principal amount of 4.70% Senior Notes due June 1, 2010 and $250 million aggregate principal amount of 5.20% Senior Notes due June 1, 2015 (collectively, the Senior Notes ). The settlement of the forward interest rate agreements of $19 million ($12 million, net of income tax) is reflected in accumulated other comprehensive income, and will be amortized as an increase in reported interest expense over the term of the Senior Notes, with approximately $2.5 million to be amortized over the next 12 months. During the three and six months ended December 31, 2005, we amortized approximately $0.6 million and $1.3 million, respectively, to interest expense.
The following table represents the components of accumulated other comprehensive income (loss) at December 31, 2005 and June 30, 2005 (in thousands):

| | As of December 31, 2005 | As of June 30, 2005 |
|---|---|---|
| Foreign currency gains (losses) | $ (2,731) | $ 879 |
| Unrealized gains on foreign exchange forward agreements, net | 277 | |
| Unrealized loss on hedging instruments, net | (10,995) | (11,789) |
| Total | $ (13,449) | $ (10,910) |

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## 11. EARNINGS PER SHARE

In accordance with Statement of Financial Accounting Standards No. 128, Earnings per Share, the following table sets forth the computation of basic and diluted earnings per share (in thousands except per share amounts):

| | Three Months Ended December 31, | | Six Months Ended December 31, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| Numerator: | | | | |
| Income available to common stockholders | $ 103,196 | $ 96,145 | $ 197,320 | $ 190,302 |
| Denominator: | | | | |
| Weighted average shares outstanding (basic) | 124,849 | 128,619 | 125,139 | 128,283 |
| Effect of dilutive securities: | | | | |
| Stock options | 2,016 | 3,314 | 1,905 | 3,218 |
| Total potential common shares | 2,016 | 3,314 | 1,905 | 3,218 |
| Denominator for earnings per share assuming dilution | 126,865 | 131,933 | 127,044 | 131,501 |
| Earnings per share (basic) | $ 0.83 | $ 0.75 | $ 1.58 | $ 1.48 |
| Earnings per share assuming dilution | $ 0.81 | $ 0.73 | $ 1.55 | $ 1.45 |

Additional dilution from assumed exercises of stock options is dependent upon several factors, including the market price of our common stock. Options to purchase approximately 5,799,000 and 5,769,000 shares of common stock were outstanding during the three and six months ended December 31, 2005 but were not included in the computation of diluted earnings per share because the options exercise price was greater than the average market price during the period. We had no antidilutive shares for the three and six months ended December 31, 2004.

The calculation of diluted earnings per share requires us to make certain assumptions related to the use of proceeds that would be received upon the assumed exercise of stock options. These assumed proceeds include the excess tax benefit that we receive upon assumed exercises. We calculate the assumed proceeds from excess tax benefits based on the deferred tax assets actually recorded without consideration of as if deferred tax assets calculated under the provisions of SFAS 123(R).

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**12. SEGMENT INFORMATION**

The following is a summary of certain financial information by reportable segment (in thousands):

| | Commercial | Government | Corporate | Consolidated |
|---|---|---|---|---|
| Three months ended December 31, 2005 | | | | |
| Revenues(a) | $ 784,767 | $ 562,820 | $ | $ 1,347,587 |
| Operating expenses (excluding depreciation and amortization) (b) | 650,829 | 449,099 | 30,986 | 1,130,914 |
| Gain on sale of business | | (29,765) | | (29,765) |
| Depreciation and amortization | 47,544 | 22,514 | 386 | 70,444 |
| Operating income | $ 86,394 | $ 120,972 | $ (31,372) | $ 175,994 |
| Three months ended December 31, 2004 | | | | |
| Revenues (a) | $ 484,743 | $ 542,543 | $ | $ 1,027,286 |
| Operating expenses (excluding depreciation and amortization) (b) | 379,503 | 424,586 | 12,687 | 816,776 |
| Depreciation and amortization | 34,623 | 20,487 | 476 | 55,586 |
| Operating income | $ 70,617 | $ 97,470 | $ (13,163) | $ 154,924 |
| Six months ended December 31, 2005 | | | | |
| Revenues (a) | $ 1,550,773 | $ 1,107,731 | $ | $ 2,658,504 |
| Operating expenses (excluding depreciation and amortization) (b) | 1,287,383 | 871,775 | 59,830 | 2,218,988 |
| Gain on sale of business | | (29,765) | | (29,765) |
| Depreciation and amortization | 92,630 | 45,086 | 808 | 138,524 |
| Operating income | $ 170,760 | $ 220,635 | $ (60,638) | $ 330,757 |
| Six months ended December 31, 2004 | | | | |
| Revenues (a) | $ 979,406 | $ 1,094,062 | $ | $ 2,073,468 |
| Operating expenses (excluding depreciation and amortization) (b) | 764,272 | 864,546 | 24,780 | 1,653,598 |
| Depreciation and amortization | 68,951 | 39,962 | 992 | 109,905 |
| Operating income | $ 146,183 | $ 189,554 | $ (25,772) | $ 309,965 |

(a) Revenues in our Government segment include revenues from operations divested during fiscal year 2004

of $0.2 million and $0.3 million for the three and six months ended December 31, 2005, respectively, and $0.6 million for the six months ended December 31, 2004.

(b) Corporate operating expenses for the three and six months ended December 31, 2005 include $8.6 million and $17.4 million, respectively, of stock-based compensation expense pursuant to SFAS 123(R) and $0 for both the three and six months ended December 31, 2004 under our previous accounting method, APB 25.

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**13. COMMITMENTS AND CONTINGENCIES**

One of our subsidiaries, ACS Defense, LLC, and several other government contractors received a grand jury document subpoena issued by the U.S. District Court for the District of Massachusetts in October 2002. The subpoena was issued in connection with an inquiry being conducted by the Antitrust Division of the U.S. Department of Justice ( DOJ ). The inquiry concerns certain IDIQ (Indefinite Delivery Indefinite Quantity) procurements and their related task orders, which occurred in the late 1990s at Hanscom Air Force Base in Massachusetts. In February 2004, we sold the contracts associated with the Hanscom Air Force Base relationship to ManTech International Corporation ( ManTech ); however, we have agreed to indemnify ManTech with respect to this DOJ investigation. The DOJ is continuing its investigation, but we have no information as to when the DOJ will conclude this process. We have cooperated with the DOJ in producing documents in response to the subpoena, and our internal investigation and review of this matter through outside legal counsel will continue through the conclusion of the DOJ investigatory process. We are unable to express an opinion as to the likely outcome of this matter at this time.

Another of our subsidiaries, ACS State & Local Solutions, Inc. ( ACS SLS ), and a teaming partner of this subsidiary, Tier Technologies, Inc. ( Tier ), received a grand jury document subpoena issued by the U.S. District Court for the Southern District of New York in May 2003. The subpoena was issued in connection with an inquiry being conducted by the Antitrust Division of the DOJ. We believe that the inquiry concerns the teaming arrangements between ACS SLS and Tier on child support payment processing contracts awarded to ACS SLS, and Tier as a subcontractor to ACS SLS, in New York, Illinois and Ohio but may also extend to the conduct of ACS SLS and Tier with respect to the bidding process for child support contracts in certain other states. Effective June 30, 2004, Tier was no longer a subcontractor to us in Ohio. Our revenue from the contracts for which Tier was a subcontractor was approximately $11.6 million and $8.4 million in the second quarter of fiscal years 2006 and 2005, respectively, and $22.9 million and $18.6 million in the first six months of fiscal years 2006 and 2005, respectively, representing approximately 0.9% and 0.8% of our revenues for the second quarter of fiscal years 2006 and 2005, respectively, and 0.9% of our revenues for the first six months of both fiscal years 2006 and 2005, Our teaming arrangement with Tier also contemplated the California child support payment processing request for proposals, which was issued in late 2003; however, we did not enter into a teaming agreement with Tier for the California request for proposals. Based on Tier s filings with the Securities and Exchange Commission, we understand that on November 20, 2003 the DOJ granted conditional amnesty to Tier in connection with this inquiry pursuant to the DOJ s Corporate Leniency Policy. The policy provides that the DOJ will not bring any criminal charges against Tier as long as it continues to fully cooperate in the inquiry (and makes restitution payments if it is determined that parties were injured as a result of impermissible anticompetitive conduct). The DOJ is continuing its investigation, but we have no information as to when the DOJ will conclude this process. We have cooperated with the DOJ in producing documents in response to the subpoena, and our internal investigation and review of this matter through outside legal counsel will continue through the conclusion of the DOJ investigatory process. We are unable to express an opinion as to the likely outcome of this matter at this time.

On January 30, 2004, the Florida Agency for Workforce Innovation s ( AWI ) Office of Inspector General ( OIG ) issued a report that reviewed 13 Florida workforce regions, including Dade and Monroe counties, and noted concerns related to the accuracy of customer case records maintained by our local staff. Our total revenue generated from the Florida workforce services amounts to approximately 0.8% and 1% of our revenues for the second quarter of fiscal years 2006 and 2005, respectively, and 0.8% and 1% of our revenues for the first six months of fiscal years 2006 and 2005, respectively. In March 2004, we filed our response to the OIG report. The principal workforce policy organization for the State of Florida, which oversees and monitors the administration of the State s workforce policy and the programs carried out by AWI and the regional workforce boards, is Workforce Florida, Inc. ( WFI ). On May 20, 2004, the Board of Directors of WFI held a public meeting at which the Board announced that WFI did not see a systemic problem with our performance of these workforce services and that it considered the issue closed. There were also certain contract billing issues that arose during the course of our performance of our workforce contract in Dade County,

Florida, which ended in June 2003. However, during the first quarter of fiscal year 2005, we settled all financial issues with Dade County with respect to our workforce contract with that county and the settlement is fully reflected in our results of operations for the first quarter of fiscal year 2005. We were also advised in February 2004 that the SEC had initiated an informal investigation into the matters covered by the OIG s report, although we have not received any request for information or documents since the middle of calendar year 2004. On March 22, 2004, ACS SLS received a grand jury document subpoena issued by the U.S. District Court for the Southern District of Florida. The subpoena was issued in connection with an inquiry being conducted by the DOJ and the Inspector General s Office of the U.S. Department of Labor ( DOL ) into the subsidiary s workforce contracts in Dade and Monroe counties in Florida, which also expired in June 2003, and which were included in the OIG s report. On August 11, 2005, the South Florida Workforce Board notified us that all deficiencies in our Dade County workforce contract have been appropriately addressed and all findings are considered resolved. On August 25, 2004, ACS SLS received a grand jury document subpoena issued by the U.S. District Court for the Middle District of Florida in connection with an inquiry being conducted by the DOJ and the Inspector General s Office of the DOL. The subpoena relates to a workforce contract in Pinellas County in Florida for the period from January 1999 to the contract s

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expiration in March 2001, which was prior to our acquisition of this business from Lockheed Martin Corporation in August 2001. Further, we settled a civil lawsuit with Pinellas County in December 2003 with respect to claims related to the services rendered to Pinellas County by Lockheed Martin Corporation prior to our acquisition of ACS SLS (those claims having been transferred with ACS SLS as part of the acquisition), and the settlement resulted in Pinellas County paying ACS SLS an additional $600,000. We are continuing our internal investigation of these matters through outside legal counsel and we are continuing to cooperate with the DOJ, the SEC and DOL to produce documents in connection with their investigations. At this stage of these investigations, we are unable to express an opinion as to their likely outcome. We anticipate that we may receive additional subpoenas for information in other Florida Workforce regions as a result of the AWI report issued in January 2004. During the second quarter of fiscal year 2006, we sold substantially all of our welfare-to-workforce services business (see Note 4). However, we retained the liabilities for this business which arose from activities prior to the date of closing, including the contingent liabilities discussed above.

Certain contracts, primarily in our Government segment, require us to provide a surety bond or a letter of credit as a guarantee of performance. As of December 31, 2005, outstanding surety bonds of $421.1 million and $93.3 million of our outstanding letters of credit secure our performance of contractual obligations with our clients. Surety bonds outstanding at December 31, 2005 include approximately $125 million related to Ascom s contractual obligations. Approximately $19.1 million of letters of credit and $1.9 million of surety bonds secure our casualty insurance and vendor programs and other corporate obligations. In general, we would only be liable for the amount of these guarantees in the event of default in our performance of our obligations under each contract, the probability of which we believe is remote. We believe that we have sufficient capacity in the surety markets and liquidity from our cash flow and our Existing Credit Facility to respond to future requests for proposals. We also believe that, subsequent to our tender offer and related financing (see Note 16), we will continue to have sufficient capacity in the surety markets and liquidity from our cash flow and new financing facilities to respond to future requests for proposals.

During the quarter we purchased approximately $17.3 million of U.S. Treasury Notes in conjunction with a contract in our Government segment, and pledged them in accordance with the terms of the contract to secure our performance. The U.S. Treasury Notes are accounted for as held to maturity pursuant to Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities and reflected in other assets in our Consolidated Balance Sheet at December 31, 2005.

We are obligated to make certain contingent payments to former shareholders of acquired entities upon satisfaction of certain contractual criteria in conjunction with certain acquisitions. During the first six months of fiscal year 2006, we made contingent consideration payments of $8.4 million related to acquisitions completed in prior years. As of December 31, 2005, the maximum aggregate amount of the outstanding contingent obligations to former shareholders of acquired entities is approximately $70.5 million. Any such payments primarily result in a corresponding increase in goodwill.

We have indemnified Lockheed Martin Corporation against certain specified claims from certain pre-sale litigation, investigations, government audits and other issues related to the sale of the majority of our Federal business to Lockheed Martin Corporation in fiscal year 2004. Our maximum exposure under these indemnifications is $85 million; however, we believe the actual exposure to be significantly less. As of December 31, 2005, other accrued liabilities include a reserve for these claims in an amount we believe to be adequate at this time.

Our Education Services business, which is included in our Commercial segment, performs third party student loan servicing in the Federal Family Education Loan program ( FFEL ) on behalf of various financial institutions. We service these loans for investors under outsourcing arrangements and do not acquire any servicing rights that are transferable by us to a third party. At December 31, 2005, we serviced a FFEL portfolio of approximately 1.9 million loans with an outstanding principal balance of approximately $25.6 billion. Some servicing agreements contain provisions that, under certain circumstances, require us to purchase the loans from the investor if the loan guaranty has been permanently terminated as a result of a loan default caused by our servicing error. If defaults caused by us are

cured during an initial period, any obligation we may have to purchase these loans expires. Loans that we purchase may be subsequently cured, the guaranty reinstated and then we repackage the loans for sale to third parties. We evaluate our exposure under our purchase obligations on defaulted loans and establish a reserve for potential losses, or default liability reserve, through a charge to the provision for loss on defaulted loans purchased. The reserve is evaluated periodically and adjusted based upon management s analysis of the historical performance of the defaulted loans. As of December 31, 2005, other accrued liabilities include reserves which we believe to be adequate.

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In April 2004, we were awarded a contract by the North Carolina Department of Health and Human Services ( DHHS ) to replace and operate the North Carolina Medicaid Management Information System ( NCMMIS ). Prior to DHHS award of the contract, our proposal was reviewed and approved by the State of North Carolina s Information Technology Services group and the Federal Center for Medicare and Medicaid Services. Two competitors protested the contract award. In considering the protests, DHHS again reviewed our proposal and determined that our technical solutions did, in fact, comply with all technical requirements and denied the protests on June 3, 2004. EDS protested the denial. On January 12, 2005, an administrative law judge made a non-binding recommendation to sustain EDS protest of the contract between us and DHHS. Notwithstanding the reviews, approvals, and decisions in awarding the contract and in considering the protests, the administrative law judge based his recommendation on his assessment that our technical solution did not fully comply with DHHS technical standards for proposals. The non-binding recommendation was issued to the North Carolina State Chief Information Officer ( CIO ), Office of Technology Services. We, DHHS and EDS each presented written arguments to the CIO. A hearing was held before the CIO on March 15, 2005 during which each of the parties presented oral arguments. On April 28, 2005, the CIO issued a decision in favor of the DHHS and us as to the issues of: (i) the sufficiency of our technical solution, (ii) our satisfaction of RFP requirements relative to our integrated testing facility, and (iii) whether the State s evaluation was consistent with the RFP s evaluation criteria. However, his ruling also found insufficient evidence or argument had been submitted to address three other issues raised by EDS in its initial protest filing. Therefore, the CIO directed that a hearing be conducted on the issues of whether (a) our proposal complied with RFP requirements relative to experience of proposed key personnel; (b) our proposal complied with RFP requirements for pricing; and (c) any perceived price advantage is illusory and in any event was miscalculated by DHHS. EDS subsequently waived its right to a hearing before the CIO on these three remaining issues and on May 18, 2005, EDS appealed the CIO s decision to Wake County Superior Court. By Order entered on January 5, 2006, the Superior Court Judge of Wake County entered an Order affirming the Final Agency Decision and denying EDS claims. On February 3, 2006, EDS appealed the Superior Court s January 5, 2006 Order to the North Carolina Court of Appeals. We intend to vigorously pursue affirmation of the Superior Court s Order. DHHS has instructed us to continue performance of our services under the contract.

In addition to the foregoing, we are subject to certain other legal proceedings, inquiries, claims and disputes, which arise in the ordinary course of business. Although we cannot predict the outcomes of these other proceedings, we do not believe these other actions, in the aggregate, will have a material adverse effect on our financial position, results of operations or liquidity.

**14. DEPARTURE OF OUR FORMER CHIEF EXECUTIVE OFFICER**

On September 29, 2005, Jeffrey A. Rich submitted his resignation as a director and as our Chief Executive Officer. In recognition of Mr. Rich s long and successful service to us and our stockholders as well as our accomplishments under his leadership, on September 30, 2005 we entered into an Agreement with Mr. Rich, which, among other things, provided the following: (i) Mr. Rich will remain on our payroll and be paid his current base salary (of $820,000 annually) through June 30, 2006; (ii) Mr. Rich will not be eligible to participate in our performance-based incentive compensation program in fiscal year 2006; (iii) we purchased from Mr. Rich all options previously granted to Mr. Rich that were vested as of the date of the Agreement in exchange for an aggregate cash payment, less applicable income and payroll taxes, equal to the amount determined by subtracting the exercise price of each such vested option from $54.08 per share and all such vested options were terminated and cancelled; (iv) all options previously granted to Mr. Rich that were unvested as of the date of the Agreement were terminated (such options had an in-the-money value of approximately $4.6 million based on the closing price of our stock on the New York Stock Exchange on September 29, 2005); (v) Mr. Rich received a lump sum cash payment of $4,100,000; (vi) Mr. Rich will continue to receive executive benefits for health, dental and vision through September 30, 2007; (vii) Mr. Rich will also receive limited administrative assistance through September 30, 2006; and (viii) in the event Mr. Rich establishes an M&A advisory firm by January 1, 2007, we will retain such firm for a two year period from its formation for $250,000 per

year plus a negotiated success fee for completed transactions. The Agreement also contains certain standard restrictions, including restrictions on soliciting our employees for a period of three years and soliciting our customers or competing with us for a period of two years.

In the first quarter of fiscal year 2006, we accrued $5.4 million ($3.4 million, net of income taxes) of compensation expense (recorded in wages and benefits in our Consolidated Statement of Income) related to this Agreement. In addition, the purchase of Mr. Rich s unexercised vested stock options for approximately $18.4 million ($11.7 million, net of income taxes) was recorded as a reduction of additional paid-in capital. We made payments of $23 million related to this Agreement in the second quarter of fiscal year 2006.

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## 15. NEW ACCOUNTING PRONOUNCEMENTS

On October 22, 2004, the President signed into law the American Jobs Creation Act of 2004 (the Act ). The Act creates a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85% dividends received deduction for certain dividends from controlled foreign corporations. Financial Accounting Standards Board Staff Position 109-2 Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004 allows companies additional time beyond that provided in Statement of Financial Accounting Standards No. 109 Accounting for Income Taxes to determine the impact of the Act on its financial statements and provides guidance for the disclosure of the impact of the Act on the financial statements. At December 31, 2005, cumulative undistributed earnings of non-U.S. subsidiaries for which U.S. taxes had not been recorded totaled $36.5 million, the tax effects on which, if repatriated, could not be reasonably estimated at that time. Although this incentive is available to us until June 30, 2006, we have made a preliminary determination that we do not expect to repatriate any amounts prior to the expiration of this provision.

## 16. SUBSEQUENT EVENT

On January 26, 2006, we announced that our Board of Directors has authorized a modified Dutch Auction tender offer to purchase up to 55.5 million shares of our Class A common stock at a price per share not less than $56 and not greater than $63. The tender offer is expected to commence on or about February 9, 2006, and to expire on or about March 10, 2006, unless extended, and is expected to be funded with cash on hand and proceeds from the financing facility discussed below. The number of shares proposed to be purchased in the tender offer represents approximately 47% of our currently outstanding Class A common stock. In the tender offer, our stockholders will have the opportunity to tender some or all of their shares at a price within the $56 to $63 per share range. Based on the number of shares tendered and the prices specified by the tendering stockholders, we will determine the purchase price per share by selecting the lowest per share price within the range that will enable us to buy 55.5 million shares, or such lesser number of shares that are properly tendered. All shares accepted in the tender offer will be purchased at the same price per share even if the stockholder tendered at a lower price. If stockholders tender more than 55.5 million shares at or below the purchase price per share, we will purchase the shares tendered by those stockholders on a pro rata basis, as will be specified in the offer to purchase that will be distributed to stockholders upon the commencement of the tender offer. Our intent is to purchase up to $3.5 billion of our shares in the offer. In the event the purchase price is less than the maximum of $63.00 per share and more than 55.5 million shares are tendered in the offer at or below the purchase price selected by us, we may exercise our right to purchase up to an additional 2% of our outstanding Class A shares without extending the offer, so that we repurchase up to $3.5 billion of our shares. Our directors and executive officers, including our Chairman, Darwin Deason, do not intend to tender shares pursuant to the offer. None of ACS, our Board of Directors, the dealer manager, the information agent or the depositary is making any recommendation to shareholders as to whether to tender or refrain from tendering their shares into the tender offer. Shareholders must decide how many shares they will tender, if any, and the price within the stated range at which they will tender their shares. The tender offer will not be contingent upon any minimum number of shares being tendered. The tender offer, however, will be subject to a number of conditions, including the receipt of financing as noted below as well as any applicable regulatory or other consents, all of which will be specified in the offer to purchase.

If we purchase 55.5 million Class A shares in the tender offer, the number of options we will be permitted to grant under the 1997 Stock Incentive Plan (the Stock Incentive Plan ) would be reduced to 8,883,404, but such reduction would have no impact on options granted under such plan prior to the consummation of the tender offer. As a result, depending on the number of shares tendered in the tender offer, we may be unable to grant any additional options after the consummation of the tender offer, except as discussed below. The Compensation Committee of our Board of Directors may grant additional options to eligible individuals under our Stock Incentive Plan prior to consummation, including grants to executive officers, in an amount not to exceed the plan limit described above. For option grants following consummation of the tender offer, we will either seek approval of a new stock option plan from our

shareholders at the next shareholders meeting, which may be a special meeting called for this purpose, or we may grant additional options under our existing Stock Incentive Plan subject to shareholder approval being obtained prior to such options becoming exercisable, in accordance with New York Stock Exchange listing standards.

The information regarding our tender offer in this Form 10-Q is for informational purposes only and is not an offer to buy, or the solicitation of an offer to sell, any shares. The full details of the tender offer, including complete instructions on how to tender shares, along with the letter of transmittal and related materials, are expected to be mailed to stockholders promptly following commencement of the offer. Stockholders should carefully read the offer to purchase, the letter of transmittal and other related materials when they are available because they will contain important information. Stockholders may obtain free copies, when available, of the tender offer statement and other filed documents relating thereto that will be filed by the Company with the U.S. Securities and Exchange Commission at the Commission s website at www.sec.gov or from the Company s information agent to be appointed in connection with the offer. Stockholders are urged to read these materials carefully prior to making any decision with respect to the tender offer.

In connection with the tender offer, we have entered into a commitment letter, dated January 26, 2006 (the Commitment Letter ), with Citigroup Global Markets Inc., on behalf of itself and its affiliates (collectively, Citigroup ), under which Citigroup has committed, subject to the terms and conditions set forth in the Commitment Letter, to provide us with the following two loan facilities totaling in the aggregate up to $5 billion: (a) a senior secured 7-year term loan facility in the aggregate principal amount of up to $4 billion (the Term Facility ), and (b) a senior secured 6-year revolving loan facility in the aggregate principal amount of $1 billion (the Revolving Facility , and together with the Term Facility, the Facilities ). Under certain circumstances, we will be permitted to add one or more incremental term loan facilities to the Facilities and/or increase commitments under the Revolving Facility in an aggregate amount of up to $750 million (any such addition or increase, an Incremental Facility ). If fewer than the maximum number of shares are tendered, we may need to seek to borrow less than the full amount contemplated under the Term Facility.

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The proceeds of the Term Facility may be used to finance the tender offer, to refinance our existing 5-Year Competitive Advance and Revolving Credit Facility Agreement dated as of October 27, 2004 (the Existing Credit Facility ) which will be terminated, and to pay related transaction costs, fees and expenses. The Term Facility will be made in a single drawing on the Closing Date (as that term is defined in the Commitment Letter), will provide for a 7-year maturity and will amortize in quarterly installments in an aggregate annual amount equal to 1% of its original principal amount, with the balance payable on the final maturity date. Interest on the outstanding balances under the Term Facility is payable, at our option, at a rate equal to the Applicable Margin (as defined in the Commitment Letter) plus the fluctuating Base Rate (as defined in the Commitment Letter), or at the Applicable Margin plus the current LIBO Rate (as defined in the Commitment Letter).

The proceeds of the Revolving Facility may be used to repay related transaction costs, fees and expenses, to provide working capital from time to time, to finance permitted acquisitions, and to refinance local foreign currency advances under the Existing Credit Facility and letters of credit outstanding thereunder. Amounts under the Revolving Facility will be available on a revolving basis commencing on the Closing Date and ending on the sixth anniversary of the Closing Date. Portions of the Revolving Facility will be available for issuances of up to $1 billion of letters of credit and borrowings of up to $150 million of swing loans. Interest on the outstanding balances under the Revolving Facility is payable, at our option, at a rate equal to the Applicable Margin plus the fluctuating Base Rate, or at the Applicable Margin plus the current LIBO Rate.

We may make optional prepayments of loans under either of the Facilities, in whole or in part, without premium or penalty (other than applicable breakage costs), in principal amounts to be agreed upon with Citigroup. Optional prepayments on the Term Facility shall be applied to the remaining installments of the Term Facility on a pro rata basis.

Subject to certain exceptions and conditions described in greater detail in the Commitment Letter, we will be obligated to use the following amounts to prepay the Term Facility: 100% of the net cash proceeds from any issuance or incurrence of indebtedness; 100% of the net sale proceeds from asset sales; 50% (with a stepdown to 25% in certain circumstances) of annual excess cash flow; and 100% of insurance and condemnation proceeds. The percentages specified above for excess cash flow shall be subject to reduction upon achievement by us of certain financial performance targets. Mandatory prepayments of the Term Facility will be applied on a pro rata basis.

Each of the Facilities will be guaranteed by us (in the case of obligations of our borrowing subsidiaries) and all of our direct and indirect material subsidiaries (to the extent that it would not result in materially adverse tax consequences). Each of the Facilities will be secured by (i) a first priority perfected pledge of (x) all notes owned by us and the guarantors and (y) all of the capital stock of our subsidiaries (except to the extent the pledge would give rise to additional SEC reporting requirements for our subsidiaries) subject to certain exceptions, and (ii) a first priority perfected security interest in all other assets owned by the borrower and the guarantors, subject to customary exceptions. The above-noted collateral will also be subject to equal and ratable liens granted for the benefit of our currently outstanding 4.70% Senior Notes due 2010 and our 5.20% Senior Notes due 2015 to the extent required pursuant to the terms thereof.

The terms of the Facilities will include customary representations and warranties, customary affirmative and negative covenants, customary financial covenants, and customary events of default.

The commitments of Citigroup, and the availability of each of the Facilities described above, are and will be subject to customary conditions precedent, including: all necessary governmental and third party approvals necessary in connection with the tender offer, the Facilities and the transactions contemplated thereby shall have been obtained and shall be in full force and effect; there shall not exist any action, suit, investigation, litigation or proceeding pending or threatened in any court or before any arbitrator or governmental authority that could reasonably be expected to result in a Material Adverse Change (as defined in the Commitment Letter) or imposes or reasonably can be expected to impose material adverse conditions upon the tender offer, the Facilities or the transactions contemplated thereby; the lenders shall have obtained a valid and perfected first priority lien on and security interest in the collateral referred to

above; and the repayment and termination of our Existing Credit Facility.

This summary description of the Commitment Letter does not purport to be complete and is qualified in its entirety by reference to the Commitment Letter, a copy of which will be filed as an exhibit to our Schedule TO to be filed with the Securities and Exchange Commission upon the commencement of the tender offer.

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In connection with the tender offer, Darwin Deason, the chairman of our Board of Directors, has entered into a voting agreement dated February 9, 2006 (the Voting Agreement ) with us, in which he has agreed to limit his ability to cause the additional voting power he will hold as a result of the tender offer to affect the outcome of any matter submitted to the vote of our shareholders after consummation of the tender offer. Mr. Deason has agreed that to the extent his voting power immediately after the tender offer increases above the percentage amount of his voting power immediately prior to the tender offer (which is approximately 37% based on February 5, 2006 share data), Mr. Deason would cause the shares representing such additional voting power (the Excess Voting Power ) to appear, not appear, vote or not vote at any meeting or pursuant to any consent solicitation in the same manner, and in proportion to, the votes or actions of all shareholders including Mr. Deason s Class A and Class B Shares on a one-for-one vote basis (notwithstanding the ten-for-one vote of the Class B Shares).

The Voting Agreement will have no effect on shares representing the approximately 37% voting power of the Company held by Mr. Deason prior to the tender offer, which Mr. Deason will continue to have the right to vote in his sole discretion. The Voting Agreement also does not apply to any Class A shares that Mr. Deason may acquire after the tender offer through his exercise of stock options, open market purchases or in any future transaction that we may undertake. The Voting Agreement will only become effective if the tender offer closes. Other than as expressly set forth in the Voting Agreement, Mr. Deason continues to have the power to exercise all rights attached to the shares he owns, including the right to dispose of his shares and the right to receive any distributions thereon.

The Voting Agreement will terminate on the earlier of (i) the withdrawal or termination of the tender offer by the Company, (ii) the mutual agreement of the Company (authorized by not less than a majority of the vote of the then independent and disinterested directors) and Mr. Deason, (iii) the date on which the Excess Voting Power as calculated is reduced to zero as a result of acquisitions of shares by Mr. Deason after the tender offer or issuance of shares by the Company, (iv) the date on which all Class B shares are converted into Class A shares and (v) the date, prior to the expiration date of the tender offer, on which Mr. Deason gives notice to the Company of termination as a result of any litigation pending or threatened against the Company or Mr. Deason arising out of the tender offer or any events or circumstances relating thereto (provided that the Company shall be entitled to have the corresponding right to terminate or withdraw the tender offer under such circumstances).

A special committee of our Board of Directors, consisting of our four independent directors, will engage in good faith discussions with Mr. Deason to reach agreement on fair compensation to be paid to Mr. Deason for entering into the Voting Agreement within six months following the closing of the tender offer. However, whether or not Mr. Deason and our special committee are able to reach agreement on compensation to be paid to Mr. Deason, the Voting Agreement will remain in effect.

This summary description of the Voting Agreement does not purport to be complete and is qualified in its entirety by reference to the finalized version of the Voting Agreement, a copy of which is filed as an exhibit to this Form 10-Q.

## ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

All statements in this Management s Discussion and Analysis of Financial Condition and Results of Operations that are not based on historical fact are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and the provisions of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (which Sections were adopted as part of the Private Securities Litigation Reform Act of 1995). While management has based any forward-looking statements contained herein on its current expectations, the information on which such expectations were based may change. These forward-looking statements rely on a number of assumptions concerning future events and are subject to a number of risks, uncertainties, and other factors, many of which are outside of our control, that could cause actual results to materially differ from such statements. Such risks, uncertainties, and other factors include, but are not necessarily limited to, those set forth under the caption Risks Related to Our Business. In addition, we operate in a highly competitive and rapidly changing environment, and new risks may arise. Accordingly, investors should not place any reliance on forward-looking statements as a prediction of actual results. We disclaim any intention to, and undertake no obligation to, update or revise any forward-looking statement.

The information regarding our tender offer in this Form 10-Q is for informational purposes only and is not an offer to buy, or the solicitation of an offer to sell, any shares. The full details of the tender offer, including complete instructions on how to tender shares, along with the letter of transmittal and related materials, are expected to be mailed to stockholders promptly following commencement of the offer. Stockholders should carefully read the offer to purchase, the letter of transmittal and other related materials when they are available because they will contain important information. Stockholders may obtain free copies, when available, of the tender offer statement and other filed documents relating thereto that will be filed by the Company with the U.S. Securities and Exchange Commission at the Commission s website at www.sec.gov or from the Company s information agent to be appointed in connection with the offer. Stockholders are urged to read these materials carefully prior to making any decision with respect to the tender offer.

We report our financial results in accordance with generally accepted accounting principles in the United States ( GAAP ). However, we believe that certain non-GAAP financial measures and ratios, used in managing our business, may provide users of this financial information with additional meaningful comparisons between current results and prior reported results. Certain of the information set forth herein and certain of the information presented by us from time to time (including free cash flow and internal revenue growth) may constitute non-GAAP financial measures within the meaning of Regulation G adopted by the Securities and Exchange Commission. We have presented herein and we will present in other information we publish that contains any of these non-GAAP financial measures a reconciliation of these measures to the most directly comparable GAAP financial measure. The presentation of this additional information is not meant to be considered in isolation or as a substitute for comparable amounts determined in accordance with generally accepted accounting principles in the United States.

**GENERAL**

We are a Fortune 500 and S&P 500 company with more than 55,000 people providing business process and information technology outsourcing solutions to commercial and government clients. Our clients have time-critical, transaction-intensive business and information processing needs, and we typically service these needs through long-term contracts.

*New Business*

During the quarter ended December 31, 2005, we signed contracts with new clients and incremental business with existing clients representing approximately $251.4 million of annualized recurring revenue and approximately $867.8 million in estimated total contract value. Based on annual recurring revenues, the Commercial segment contributed 79% of the new business signings and the Government segment contributed 21% of the new business signings.

There are no third party standards or requirements governing the calculation of new business signings or total contract value. We define new business signings as recurring revenue from new contracts, including the incremental portion of renewals, signed during the period and represent the estimated first twelve months of revenue to be recorded under

that contract after full implementation. We define total contract value as the estimated total revenues from contracts signed during the period and represents estimated total revenue over the term of the contract. We use both new business signings and estimated total contract value as additional measures of estimating total revenue represented by contractual commitments, both to forecast prospective revenues and to estimate capital commitments. Revenues for both new business signings and estimated total contract value are measured under GAAP.

*Stock-based Compensation*

On December 16, 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment ( SFAS 123(R) ). SFAS 123(R) requires companies to measure all employee stock-based compensation awards using a fair value method and recognize compensation cost in its financial statements. We adopted SFAS 123(R) on a prospective basis beginning July 1, 2005 for stock-based compensation awards granted after that date and for unvested awards outstanding at that date using the modified prospective application method.

Prior to July 1, 2005, we followed Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, ( APB 25 ) in accounting for our stock-based compensation plans. Under APB 25, no compensation expense was recognized for our stock-based compensation awards since the exercise prices of awards under our plans were at the current market price of our stock on the date of grant.

The adoption of SFAS 123(R) in the first quarter of fiscal year 2006 resulted in prospective changes in our accounting for stock-based compensation awards, including recording stock-based compensation expense and the related deferred income tax benefit on a prospective basis and reflecting the excess tax benefits from the exercise of stock-based compensation awards in cash flows from financing activities.

The adoption of SFAS 123(R) resulted in the recognition of compensation expense of $8.6 million and $17.4 million ($5.7 million and $11.6 million, net of deferred income tax benefits), or $0.04 and $0.09 per diluted share, in wages and benefits in the Consolidated Statements of Income for the three and six months ended December 31, 2005, respectively. In accordance with the modified prospective application method of SFAS 123(R), prior period amounts have not been restated to reflect the recognition of stock-based compensation costs. The total compensation cost related to non-vested awards not yet recognized at December 31, 2005 was approximately $94.3 million, which is expected to be recognized over a weighted average of 3.63 years.

In periods ending prior to July 1, 2005, the income tax benefits from the exercise of stock options were classified as net cash provided by operating activities pursuant to Emerging Issues Task Force ( EITF ) Issue No. 00-15 Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option. However, for periods ending after July 1, 2005, pursuant to SFAS 123(R), the income tax benefits exceeding the recorded deferred income tax benefit and any pre-adoption as-if deferred tax benefit from stock- based compensation awards (the excess tax benefits) are required to be reported in net cash provided by financing activities. For the six months ended December 31, 2005, excess tax benefits from stock-based compensation awards of $9.5 million were reflected as an outflow in cash flows from operating activities and an inflow in cash flows from financing activities in the Consolidated Statements of Cash Flows. In the prior year period, income tax benefits from the exercise of stock options of $14.4 million were reflected as an inflow in cash flows from operating activities in the Consolidated Statements of Cash Flows.

As discussed in Note 2 to our consolidated financial statements, on February 2, 2005, our Board of Directors approved an amendment to stock options previously granted that did not become exercisable until five years from the date of grant to provide that such options become exercisable when they vest. It is expected that future option grants will contain matching vesting and exercise schedules which we believe will result in a lower expected term.

*Acquisitions*

In December 2005, we completed the acquisition of the Transport Revenue division of Ascom AG ( Ascom ), a Switzerland based communications company. Ascom consists of three business units - fare collection, airport parking solutions and toll collection with office locations across nine countries. The transaction was valued at approximately $100.5 million plus related transaction costs and was funded from borrowings under our Existing Credit Facility (defined below). The purchase price was allocated to assets acquired and liabilities assumed based on the estimated fair value as of the date of acquisition. We acquired assets of $212.8 million and assumed liabilities of $112.3 million. We recorded goodwill of $68.6 million, 37% of which is deductible for income tax purposes, and intangible assets of $4 million. The $4 million of intangible assets is attributable to customer relationships, non-compete agreements and patents with weighted average useful lives of approximately 5 years. Our Consolidated Balance Sheet as of December 31, 2005 reflects the preliminary allocation of the purchase price to the assets acquired and liabilities assumed based on their estimated fair values at the date of acquisition and is expected to be finalized upon receipt of the final third party valuation. We believe this acquisition launches us into the international transportation services industry and will expand our portfolio in the transit and parking payment markets and adds toll collection customers to our existing customer base. The operating results of the acquired business are included in our financial statements in the Government segment from the effective date of the acquisition, December 1, 2005.

In July 2005, we completed the acquisition of LiveBridge, Inc. ( LiveBridge ), a customer care service provider primarily serving the financial and telecommunications industries. The transaction was valued at approximately $32 million plus a working capital adjustment of $2.5 million, excluding contingent consideration of up to $32 million

based upon future financial performance and was funded from cash on hand and borrowings under our Existing Credit Facility. The purchase price was allocated to assets acquired and liabilities assumed based on the estimated fair value as of the date of acquisition. We acquired assets of $42 million and assumed liabilities of $7.5 million. We recorded goodwill of $11.5 million, 49% of which is deductible for income tax purposes, and intangible assets of $12.9 million. The $12.9 million of intangible assets is attributable to customer relationships and non-compete agreements with weighted average useful lives of approximately 6 years. We believe this acquisition will expand our customer care service offerings in the finance and telecommunications industries and will extend our global capabilities and operations by adding the

LiveBridge operational centers in Canada, India and Argentina. The operating results of the acquired business are included in our financial statements in the Commercial segment from the effective date of the acquisition, July 1, 2005.

*Sale of Government welfare- to-workforce services business*

In December 2005, we completed the divestiture of substantially all of our Government welfare-to-workforce services business to Arbor E&T, LLC ( Arbor ), a wholly owned subsidiary of ResCare, Inc., for approximately $69 million, less transaction costs. The Government welfare-to-workforce services business is no longer strategic or core to our operating philosophy. This divestiture allows us to focus on our technology-enabled business process outsourcing and information technology outsourcing service offerings. Assets sold were approximately $27.1 million and liabilities assumed by Arbor were approximately $0.2 million, both of which were included in the Government segment. We retained the net working capital, including receivables of approximately $27 million, at December 31, 2005, related to the welfare-to workforce services business. The $69 million in proceeds was included in accounts receivable in our Consolidated Balance Sheet as of December 31, 2005. We received the proceeds in January 2006, which will be included in cash flows from investing activities in our Consolidated Statements of Cash Flow in the third quarter of fiscal year 2006. We recognized a pretax gain of $29.8 million ($17.9 million, net of income tax) in the second quarter of fiscal year 2006. Approximately $10.6 million of the consideration relates to certain customer contracts whose assignment to Arbor was not complete as of December 31, 2005, and is reflected as deferred proceeds in other accrued liabilities in our Consolidated Balance Sheet as of December 31, 2005. We expect to complete the transfer of these remaining contracts to Arbor by the end of fiscal year 2006 upon receipt of customer consents. The after tax proceeds from the divestiture will generally be used to pay down debt or for general corporate purposes.

In the second quarter of fiscal year 2006, we recorded a provision for estimated litigation settlement related to the welfare-to-workforce services business. In connection with the transfer of the contracts and ongoing customer relationships to Arbor and due to a change in our estimate of collectibility of the retained outstanding receivables, we recorded a provision for uncollectible accounts receivable related to the welfare-to-workforce services business. Total provisions recorded were $3.3 million ($2.1 million, net of income tax).

Revenues from the divested business were $47.6 million and $55.8 million for the three months ended December 31, 2005 and 2004, respectively, and $101.1 million and $113.3 million for the six months ended December 31, 2005 and 2004, respectively. Operating income from the divested business, excluding the gain on sale, was $1.4 million and $5.1 million for the three months ended December 31, 2005 and 2004, respectively, and $6.3 million and $11.4 million for the six months ended December 31, 2005 and 2004, respectively.

*Restructuring and other activities*

During the second quarter of fiscal year 2006, and in connection with our new executive leadership, we began a comprehensive assessment of our operations, including our overall cost structure, competitive position, technology assets and operating platform and foreign operations. As a result, we initiated certain restructuring initiatives and activities that are expected to enhance our competitive position in certain markets, and recorded certain restructuring charges and asset impairments arising from our discretionary decisions. We estimate a total of 1,700 employees will be involuntarily terminated as a result of these initiatives, consisting primarily of offshore processors and related management; however, we anticipate that a majority of these positions will be migrated to lower cost markets. As of December 31, 2005, approximately 400 employees had been involuntarily terminated. We anticipate the costs savings related to these involuntary terminations will be approximately $13 million of wages and benefits per year beginning in fiscal year 2007; however, some of the cost savings from these involuntary terminations will be reinvested in subject matter experts, project management talent and sales personnel as we look to further promote those lines of businesses that reflect the most potential for growth. We expect to complete our assessment activities over the third and fourth quarters of fiscal year 2006, which may result in further restructuring and related charges, the amount and timing of which cannot be determined at this time.

In our Commercial segment, we began an assessment of the cost structure of our global production model, particularly our offshore processing activities. We identified offshore locations in which our labor costs are no longer competitive or where the volume of work processed by the site no longer justifies retaining the location, including one of our Mexican facilities. In connection with this assessment, we recorded a restructuring charge for involuntary termination

of employees related to the closure of those duplicative facilities of $4.3 million which is reflected in wages and benefits in our Consolidated Statements of Income, and $0.3 million for impairments of duplicative technology equipment, which is reflected in other operating expenses in our Consolidated Statements of Income. We expect these activities will consolidate our global production activities and enhance our competitive position.

In our Government segment, we began an assessment of our competitive position, and evaluated our market strategies. We began to implement operating practices that we utilize in our Commercial segment, including leveraging our proprietary workflow technology and implementing activity-based-compensation, which is expected to reduce our operating costs and enhance our competitive position. We also evaluated our competitive position in our markets, and the technology used to support certain of our service offerings. In connection with these activities, we recorded a restructuring charge for involuntary termination of employees of $0.3 million which is reflected in wages and benefits in our Consolidated Statements of Income, and $1.4 million in asset impairment charges, which is reflected in other operating expenses in our Consolidated Statements of Income, principally for duplicative software as a result of recent acquisition activity. And as discussed earlier, we completed the sale of substantially all of our welfare-to-workforce services

business, which allows us to focus on our technology-enabled business process outsourcing and information technology outsourcing service offerings.

In our Corporate segment, we determined that the costs related to the ownership of a corporate aircraft outweighed the benefits to the Company. We recorded an asset impairment charge of $4.1 million related to corporate aircraft, which is reflected in other operating expenses in our Consolidated Statements of Income, in connection with its classification as held for sale at December 31, 2005. We do not expect the sale of the corporate aircraft in this fiscal year, due to conditions in the aircraft marketplace.

The following table summarizes activity in the accrual for involuntary termination of employees for the quarter ended December 31, 2005 (in thousands):

| | |
|---|---|
| Balance at September 30, 2005 | $ |
| Accrual recorded | 4,671 |
| Payments | (1,888) |
| Balance at December 31, 2005 | $ 2,783 |

The December 31, 2005 accrual for involuntary termination of employees is expected to be paid in the third and fourth quarters of fiscal year 2006 from cash flows from operating activities or cash flows from financing activities.

As part of our acquisition of the human resources consulting and outsourcing business of Mellon Financial Corporation (the Acquired HR Business ) in the fourth quarter of fiscal year 2005, we recorded $22.3 million in involuntary employee termination costs for employees of the Acquired HR Business in accordance with EITF Issue No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination. During the first half of fiscal year 2006, $8.9 million in involuntary employee termination payments have been made and charged against accrued compensation. As of December 31, 2005, the balance of the related accrual was $11.6 million and is expected to be paid principally in the third and fourth quarters of fiscal year 2006 from cash flows from operating activities.

*Hedging instruments*

We hedge the variability of our anticipated future Mexican peso cash flows through foreign exchange forward agreements. The agreements are designated as cash flow hedges of forecasted payments related to certain operating costs of our Mexican operations. As of December 31, 2005, the notional amount of these agreements totaled 186 million pesos ($17.2 million) and will expire at various dates over the next 12 months. Upon termination of these agreements, we will purchase Mexican pesos at the exchange rates specified in the forward agreements to be used for payments on our forecasted Mexican peso operating costs. The unrealized gain on these foreign exchange forward agreements of $0.3 million, net of income tax, was reflected in other comprehensive income as of December 31, 2005.

*Departure of our former Chief Executive Officer*

On September 29, 2005, Jeffrey A. Rich submitted his resignation as a director and as our Chief Executive Officer. In recognition of Mr. Rich s long and successful service to us and our stockholders as well as our accomplishments under his leadership, on September 30, 2005 we entered into an Agreement with Mr. Rich, which, among other things, provided the following: (i) Mr. Rich will remain on our payroll and be paid his current base salary (of $820,000 annually) through June 30, 2006; (ii) Mr. Rich will not be eligible to participate in our performance-based incentive compensation program in fiscal year 2006; (iii) we purchased from Mr. Rich all options previously granted to Mr. Rich that were vested as of the date of the Agreement in exchange for an aggregate cash payment, less applicable income and payroll taxes, equal to the amount determined by subtracting the exercise price of each such vested option from $54.08 per share and all such vested options were terminated and cancelled; (iv) all options previously granted to Mr. Rich that were unvested as of the date of the Agreement were terminated (such options had an in-the-money value of approximately $4.6 million based on the closing price of our stock on the New York Stock Exchange on September 29, 2005); (v) Mr. Rich received a lump sum cash payment of $4,100,000; (vi) Mr. Rich will continue to receive executive benefits for health, dental and vision through September 30, 2007; (vii) Mr. Rich will also receive limited administrative assistance through September 30, 2006; and (viii) in the event Mr. Rich establishes an M&A advisory firm by January 1, 2007, we will retain such firm for a two year period from its formation for $250,000 per

year plus a negotiated success fee for completed transactions. The Agreement also contains certain standard restrictions, including restrictions on soliciting our employees for a period of three years and soliciting our customers or competing with us for a period of two years.

In the first quarter of fiscal year 2005, we accrued $5.4 million ($3.4 million, net of income taxes) of compensation expense (recorded in wages and benefits in our Consolidated Statement of Income) related to this Agreement. In addition, the purchase of Mr. Rich s unexercised vested stock options for approximately $18.4 million ($11.7 million, net of income taxes) was recorded as a reduction of additional paid-in capital. We made payments of $23 million related to this Agreement in the second quarter of fiscal year 2006.

*Government Healthcare Contract*

In April 2004, we were awarded a contract by the North Carolina Department of Health and Human Services ( DHHS ) to replace and operate the North Carolina Medicaid Management Information System ( NCMMIS ). Prior to DHHS award of the contract, our proposal was reviewed and approved by the State of North Carolina s Information Technology Services group and the Federal Center for Medicare and Medicaid Services. Two competitors protested the contract award. In considering the protests, DHHS again reviewed our proposal and determined that our technical solutions did, in fact, comply with all technical requirements and denied the protests on June 3, 2004. EDS protested the denial. On January 12, 2005, an administrative law judge made a non-binding recommendation to sustain EDS protest of the contract between us and DHHS. Notwithstanding the reviews, approvals, and decisions in awarding the contract and in considering the protests, the administrative law judge based his recommendation on his assessment that our technical solution did not fully comply with DHHS technical standards for proposals. The non-binding recommendation was issued to the North Carolina State Chief Information Officer ( CIO ), Office of Technology Services. We, DHHS and EDS each presented written arguments to the CIO. A hearing was held before the CIO on March 15, 2005 during which each of the parties presented oral arguments. On April 28, 2005, the CIO issued a decision in favor of the DHHS and us as to the issues of: (i) the sufficiency of our technical solution, (ii) our satisfaction of RFP requirements relative to our integrated testing facility, and (iii) whether the State s evaluation was consistent with the RFP s evaluation criteria. However, his ruling also found insufficient evidence or argument had been submitted to address three other issues raised by EDS in its initial protest filing. Therefore, the CIO directed that a hearing be conducted on the issues of whether (a) our proposal complied with RFP requirements relative to experience of proposed key personnel; (b) our proposal complied with RFP requirements for pricing; and (c) any perceived price advantage is illusory and in any event was miscalculated by DHHS. EDS subsequently waived its right to a hearing before the CIO on these three remaining issues and on May 18, 2005, EDS appealed the CIO s decision to Wake County Superior Court. By Order entered on January 5, 2006, the Superior Court Judge of Wake County entered an Order affirming the Final Agency Decision and denying EDS claims. On February 3, 2006, EDS appealed the Superior Court s January 5, 2006 Order to the North Carolina Court of Appeals. We intend to vigorously pursue affirmation of the Superior Court s Order. DHHS has instructed us to continue performance of our services under the contract.

*Subsequent Event*

On January 26, 2006, we announced that our Board of Directors has authorized a modified Dutch Auction tender offer to purchase up to 55.5 million shares of our Class A common stock at a price per share not less than $56 and not greater than $63. The tender offer is expected to commence on or about February 9, 2006, and to expire on or about March 10, 2006, unless extended, and is expected to be funded with cash on hand and proceeds from the financing facility discussed below. The number of shares proposed to be purchased in the tender offer represents approximately 47% of our currently outstanding Class A common stock. In the tender offer, our stockholders will have the opportunity to tender some or all of their shares at a price within the $56 to $63 per share range. Based on the number of shares tendered and the prices specified by the tendering stockholders, we will determine the purchase price per share by selecting the lowest per share price within the range that will enable us to buy 55.5 million shares, or such lesser number of shares that are properly tendered. All shares accepted in the tender offer will be purchased at the same price per share even if the stockholder tendered at a lower price. If stockholders tender more than 55.5 million shares at or below the purchase price per share, we will purchase the shares tendered by those stockholders on a pro rata basis, as will be specified in the offer to purchase that will be distributed to stockholders upon the commencement of the tender offer. Our intent is to purchase up to $3.5 billion of our shares in the offer. In the event the purchase price is less than the maximum of $63.00 per share and more than 55.5 million shares are tendered in the offer at or below the purchase price selected by us, we may exercise our right to purchase up to an additional 2% of our outstanding Class A shares without extending the offer, so that we repurchase up to $3.5 billion of our shares. Our directors and executive officers, including our Chairman, Darwin Deason, do not intend to tender shares pursuant to the offer. None of ACS, our Board of Directors, the dealer manager, the information agent or the depositary is making any recommendation to shareholders as to whether to tender or refrain from tendering their shares into the tender offer. Shareholders must decide how many shares they will tender, if any, and the price within the stated range at

which they will tender their shares. The tender offer will not be contingent upon any minimum number of shares being tendered. The tender offer, however, will be subject to a number of conditions, including the receipt of financing as noted below as well as any applicable regulatory or other consents, all of which will be specified in the offer to purchase.

If we purchase 55.5 million Class A shares in the tender offer, the number of options we will be permitted to grant under the 1997 Stock Incentive Plan (the Stock Incentive Plan ) would be reduced to 8,883,404, but such reduction would have no impact on options granted under such plan prior to the consummation of the tender offer. As a result, depending on the number of shares tendered in the tender offer, we may be unable to grant any additional options after the consummation of the tender offer, except as discussed below. The Compensation Committee of our Board of Directors may grant additional options to eligible individuals under our Stock Incentive Plan prior to consummation, including grants to executive officers, in an amount not to exceed the plan limit described above. For option grants following consummation of the tender offer, we will either seek approval of a new stock option plan from our shareholders at the next shareholders meeting, which may be a special meeting called for this purpose, or we may grant additional options under our existing Stock Incentive Plan subject to shareholder approval being obtained prior to such options becoming exercisable, in accordance with New York Stock Exchange listing standards.

The information regarding our tender offer in this Form 10-Q is for informational purposes only and is not an offer to buy, or the solicitation of an offer to sell, any shares. The full details of the tender offer, including complete instructions on how to tender shares, along with the letter of transmittal and related materials, are expected to be mailed to stockholders promptly following commencement of the offer. Stockholders should carefully read the offer to purchase, the letter of transmittal and other related materials when they are available because they will contain important information. Stockholders may obtain free copies, when available, of the tender offer statement and other filed documents relating thereto that will be filed by the Company with the U.S. Securities and Exchange Commission at the Commission s website at www.sec.gov or from the Company s information agent to be appointed in connection with the offer. Stockholders are urged to read these materials carefully prior to making any decision with respect to the tender offer.

In connection with the tender offer, we have entered into a commitment letter, dated January 26, 2006 (the Commitment Letter ), with Citigroup Global Markets Inc., on behalf of itself and its affiliates (collectively, Citigroup ), under which Citigroup has

committed, subject to the terms and conditions set forth in the Commitment Letter, to provide us with the following two loan facilities totaling in the aggregate up to $5 billion: (a) a senior secured 7-year term loan facility in the aggregate principal amount of up to $4 billion (the Term Facility ), and (b) a senior secured 6-year revolving loan facility in the aggregate principal amount of $1 billion (the Revolving Facility , and together with the Term Facility, the Facilities ). Under certain circumstances, we will be permitted to add one or more incremental term loan facilities to the Facilities and/or increase commitments under the Revolving Facility in an aggregate amount of up to $750 million (any such addition or increase, an Incremental Facility ). If fewer than the maximum number of shares are tendered, we may need to seek to borrow less than the full amount contemplated under the Term Facility.

The proceeds of the Term Facility may be used to finance the tender offer, to refinance our existing 5-Year Competitive Advance and Revolving Credit Facility Agreement dated as of October 27, 2004 (the Existing Credit Facility ) which will be terminated, and to pay related transaction costs, fees and expenses. The Term Facility will be made in a single drawing on the Closing Date (as that term is defined in the Commitment Letter), will provide for a 7-year maturity and will amortize in quarterly installments in an aggregate annual amount equal to 1% of its original principal amount, with the balance payable on the final maturity date. Interest on the outstanding balances under the Term Facility is payable, at our option, at a rate equal to the Applicable Margin (as defined in the Commitment Letter) plus the fluctuating Base Rate (as defined in the Commitment Letter), or at the Applicable Margin plus the current LIBO Rate (as defined in the Commitment Letter).

The proceeds of the Revolving Facility may be used to repay related transaction costs, fees and expenses, to provide working capital from time to time, to finance permitted acquisitions, and to refinance local foreign currency advances under the Existing Credit Facility and letters of credit outstanding thereunder. Amounts under the Revolving Facility will be available on a revolving basis commencing on the Closing Date and ending on the sixth anniversary of the Closing Date. Portions of the Revolving Facility will be available for issuances of up to $1 billion of letters of credit and borrowings of up to $150 million of swing loans. Interest on the outstanding balances under the Revolving Facility is payable, at our option, at a rate equal to the Applicable Margin plus the fluctuating Base Rate, or at the Applicable Margin plus the current LIBO Rate.

We may make optional prepayments of loans under either of the Facilities, in whole or in part, without premium or penalty (other than applicable breakage costs), in principal amounts to be agreed upon with Citigroup. Optional prepayments on the Term Facility shall be applied to the remaining installments of the Term Facility on a pro rata basis.

Subject to certain exceptions and conditions described in greater detail in the Commitment Letter, we will be obligated to use the following amounts to prepay the Term Facility: 100% of the net cash proceeds from any issuance or incurrence of indebtedness; 100% of the net sale proceeds from asset sales; 50% (with a stepdown to 25% in certain circumstances) of annual excess cash flow; and 100% of insurance and condemnation proceeds. The percentages specified above for excess cash flow shall be subject to reduction upon achievement by us of certain financial performance targets. Mandatory prepayments of the Term Facility will be applied on a pro rata basis.

Each of the Facilities will be guaranteed by us (in the case of obligations of our borrowing subsidiaries) and all of our direct and indirect material subsidiaries (to the event that it would not result in materially adverse tax consequences).

Each of the Facilities will be secured by (i) a first priority perfected pledge of (x) all notes owned by us and the guarantors and (y) all of the capital stock of our subsidiaries (except to the extent the pledge would give rise to additional SEC reporting requirements for our subsidiaries) subject to certain exceptions, and (ii) a first priority perfected security interest in all other assets owned by the borrower and the guarantors, subject to customary exceptions. The above-noted collateral will also be subject to equal and ratable liens granted for the benefit of our currently outstanding 4.70% Senior Notes due 2010 and our 5.20% Senior Notes due 2015 to the extent required pursuant to the terms thereof.

The terms of the facilities will include customary representations and warranties, customary affirmative and negative covenants, customary financial covenants, and customary events of default.

The commitments of Citigroup, and the availability of each of the Facilities described above, are and will be subject to customary conditions precedent, including: all necessary governmental and third party approvals necessary in connection with the tender offer, the Facilities and the transactions contemplated thereby shall have been obtained and

shall be in full force and effect; there shall not exist any action, suit, investigation, litigation or proceeding pending or threatened in any court or before any arbitrator or governmental authority that could reasonably be expected to result in a Material Adverse Change (as defined in the Commitment Letter) or imposes or reasonably can be expected to impose material adverse conditions upon the tender offer, the Facilities or the transactions contemplated thereby; the lenders shall have obtained a valid and perfected first priority lien on and security interest in the collateral referred to above; and the repayment and termination of our Existing Credit Facility.

This summary description of the Commitment Letter does not purport to be complete and is qualified in its entirety by reference to the Commitment Letter, a copy of which will be filed as an exhibit to our Schedule TO to be filed with the Securities and Exchange Commission upon the commencement of the tender offer.

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In connection with the tender offer, Darwin Deason, the chairman of our Board of Directors, has entered into a voting agreement dated February 9, 2006 (the Voting Agreement ) with us, in which he has agreed to limit his ability to cause the additional voting power he will hold as a result of the tender offer to affect the outcome of any matter submitted to the vote of our shareholders after consummation of the tender offer. Mr. Deason has agreed that to the extent his voting power immediately after the tender offer increases above the percentage amount of his voting power immediately prior to the tender offer (which is approximately 37% based on February 5, 2006 share data), Mr. Deason would cause the shares representing such additional voting power (the Excess Voting Power ) to appear, not appear, vote or not vote at any meeting or pursuant to any consent solicitation in the same manner, and in proportion to, the votes or actions of all shareholders including Mr. Deason s Class A and Class B Shares on a one-for-one vote basis (notwithstanding the ten-for-one vote of the Class B Shares).

The Voting Agreement will have no effect on shares representing the approximately 37% voting power of the Company held by Mr. Deason prior to the tender offer, which Mr. Deason will continue to have the right to vote in his sole discretion. The Voting Agreement also does not apply to any Class A shares that Mr. Deason may acquire after the tender offer through his exercise of stock options, open market purchases or in any future transaction that we may undertake. The Voting Agreement will only become effective if the tender offer closes. Other than as expressly set forth in the Voting Agreement, Mr. Deason continues to have the power to exercise all rights attached to the shares he owns, including the right to dispose of his shares and the right to receive any distributions thereon.

The Voting Agreement will terminate on the earlier of (i) the withdrawal or termination of the tender offer by the Company, (ii) the mutual agreement of the Company (authorized by not less than a majority of the vote of the then independent and disinterested directors) and Mr. Deason, (iii) the date on which the Excess Voting Power as calculated is reduced to zero as a result of acquisitions of shares by Mr. Deason after the tender offer or issuance of shares by the Company, (iv) the date on which all Class B shares are converted into Class A shares and (v) the date, prior to the expiration date of the tender offer, on which Mr. Deason gives notice to the Company of termination as a result of any litigation pending or threatened against the Company or Mr. Deason arising out of the tender offer or any events or circumstances relating thereto (provided that the Company shall be entitled to have the corresponding right to terminate or withdraw the tender offer under such circumstances).

A special committee of our Board of Directors, consisting of our four independent directors, will engage in good faith discussions with Mr. Deason to reach agreement on fair compensation to be paid to Mr. Deason for entering into the Voting Agreement within six months following the closing of the tender offer. However, whether or not Mr. Deason and our special committee are able to reach agreement on compensation to be paid to Mr. Deason, the Voting Agreement will remain in effect.

This summary description of the Voting Agreement does not purport to be complete and is qualified in its entirety by reference to the finalized version of the Voting Agreement, a copy of which is filed as an exhibit to this Form 10-Q.

**REVENUE GROWTH**

Internal revenue growth is measured as total revenue growth less acquired revenue from acquisitions and revenues from divested operations. At the date of acquisition, we identify the trailing twelve months of revenue of the acquired company as the pre-acquisition revenue of acquired companies. Pre-acquisition revenue of the acquired companies is considered acquired revenues in our calculation, and revenues from the acquired company, either above or below that amount are components of internal growth in our calculation. We use the calculation of internal revenue growth to measure revenue growth excluding the impact of acquired revenues and the revenue associated with divested operations and we believe these adjustments to historical reported results are necessary to accurately reflect our internal revenue growth. Revenues from divested operations are excluded from the internal revenue growth calculation in the periods following the effective date of the divestiture. Our measure of internal revenue growth may not be comparable to similarly titled measures of other companies. The following table sets forth the calculation of internal revenue growth (in thousands):

| | Three months ended December 31, | | | | Six months ended December 31, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2005 | 2004 | $ Growth | Growth % | 2005 | 2004 | $ Growth | Growth % |
| **Consolidated** | | | | | | | | |
| Total Revenues | $ 1,347,587 | $ 1,027,286 | $ 320,301 | 31% | $ 2,658,504 | $ 2,073,468 | $ 585,036 | 28% |
| Less: Divestitures | (169) | (21) | (148) | | (250) | (560) | 310 | |
| Adjusted | $ 1,347,418 | $ 1,027,265 | $ 320,153 | 31% | $ 2,658,254 | $ 2,072,908 | $ 585,346 | 28% |
| Acquired revenues | $ 227,522 | $ | $ 227,522 | 22% | $ 453,283 | $ 4,354 | $ 448,929 | 22% |
| Internal revenues | 1,119,896 | 1,027,265 | 92,631 | 9% | 2,204,971 | 2,068,554 | 136,417 | 6% |
| Total | $ 1,347,418 | $ 1,027,265 | $ 320,153 | 31% | $ 2,658,254 | $ 2,072,908 | $ 585,346 | 28% |
| **Commercial** | | | | | | | | |
| Total Revenues | $ 784,767 | $ 484,743 | $ 300,024 | 62% | $ 1,550,773 | $ 979,406 | $ 571,367 | 58% |
| Less: Divestitures | | | | | | | | |
| Adjusted | $ 784,767 | $ 484,743 | $ 300,024 | 62% | $ 1,550,773 | $ 979,406 | $ 571,367 | 58% |
| Acquired revenues | $ 210,855 | $ | $ 210,855 | 44% | $ 434,210 | $ 4,166 | $ 430,044 | 44% |
| Internal revenues | 573,912 | 484,743 | 89,169 | 18% | 1,116,563 | 975,240 | 141,323 | 14% |
| Total | $ 784,767 | $ 484,743 | $ 300,024 | 62% | $ 1,550,773 | $ 979,406 | $ 571,367 | 58% |
| **Government** | | | | | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Total Revenues | $ 562,820 | $ 542,543 | $ 20,277 | 4% | $ 1,107,731 | $ 1,094,062 | $ 13,669 | 1% |
| Less: Divestitures | (169) | (21) | (148) | | (250) | (560) | 310 | |
| Adjusted | $ 562,651 | $ 542,522 | $ 20,129 | 4% | $ 1,107,481 | $ 1,093,502 | $ 13,979 | 1% |
| Acquired revenues | $ 16,667 | $ | $ 16,667 | 3% | $ 19,073 | $ 188 | $ 18,885 | 2% |
| Internal revenues | 545,984 | 542,522 | 3,462 | 1% | 1,088,408 | 1,093,314 | (4,906) | (1)% |
| Total | $ 562,651 | $ 542,522 | $ 20,129 | 4% | $ 1,107,481 | $ 1,093,502 | $ 13,979 | 1% |

**RESULTS OF OPERATIONS**

The following table sets forth certain items from our Consolidated Statements of Income as a percentage of revenues:

| | Three months ended December 31, | | Six months ended December 31, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| Revenues | 100.0% | 100.0% | 100.0% | 100.0% |
| Expenses: | | | | |
| Wages and benefits | 47.0 | 42.4 | 47.4 | 41.9 |
| Services and supplies | 22.7 | 24.4 | 22.5 | 25.4 |
| Rent, lease and maintenance | 12.1 | 11.8 | 12.0 | 11.6 |
| Depreciation and amortization | 5.2 | 5.4 | 5.2 | 5.3 |
| Gain on sale of business | (2.2) | | (1.1) | |
| Other operating expenses | 2.1 | 0.9 | 1.6 | 0.9 |
| Total operating expenses | 86.9 | 84.9 | 87.6 | 85.1 |
| Operating income | 13.1 | 15.1 | 12.4 | 14.9 |
| Interest expense | 1.0 | 0.3 | 1.0 | 0.3 |
| Other non-operating income, net | (0.1) | (0.2) | (0.3) | (0.1) |
| Pretax profit | 12.2 | 15.0 | 11.7 | 14.7 |
| Income tax expense | 4.5 | 5.6 | 4.3 | 5.5 |
| Net income | 7.7% | 9.4% | 7.4% | 9.2% |

**COMPARISON OF THE THREE MONTHS ENDED DECEMBER 31, 2005 TO THE THREE MONTHS ENDED DECENBER 31, 2004**

*Revenues*

In the second quarter of fiscal year 2006, our revenue increased $320.3 million, or 31%, to $1.3 billion from $1 billion in the second quarter of fiscal year 2005. Internal revenue growth for the second quarter of fiscal year 2006 was 9% and the remainder of the revenue growth was related to acquisitions.

Revenue in our Commercial segment, which represents 58% of consolidated revenue for the second quarter of fiscal year 2006, increased $300 million, or 62%, to $784.8 million in the second quarter of fiscal year 2006 compared to the same period last year. Revenue growth from acquisitions was 44% for the three months ended December 31, 2005, which includes a full quarter of revenues from the acquisition of the Acquired HR Business, Superior Consultant Holdings Corporation ( Superior ) and LiveBridge. Internal revenue growth was 18%, due primarily to increased revenue related to contacts with Kaiser Permanente, Princeton Healthcare System, Southwest Washington Medical Center, Roy L. Schneider Hospital and Port Huron Hospital and contracts with Chubb & Sons, Nextel, Nextel Partners, Delta Airlines, Symetra, United Technologies, University of Phoenix, American Red Cross and Carefirst.

The items discussed above collectively represent 75% of our internal revenue growth for the period in this segment.
Revenue in our Government segment, which represents 42% of consolidated revenue for the second quarter of fiscal year 2006, increased $20.3 million, or 4%, to $562.8 million in the second quarter of fiscal year 2006 compared to the same period last year. Revenue growth from acquisitions was 3% primarily due to the acquisition of Ascom in December 2005. Internal revenue growth was 1% primarily due to increased revenue in our unclaimed property business and contracts with Texas Medicaid, New Jersey Department of Human Services and the State of Maryland, and higher revenues in our commercial vehicle operations. These increases were offset by decreases in revenue for our divested welfare-to-workforce services business and decreases in revenue related to our Department of Education contract and the termination of our New York Metropolitan Transportation Authority, Michigan payment processing and Iowa Medicaid contracts. The items discussed above collectively represent 89% of our internal revenue growth for the period in this segment.

*Operating Expenses*

Wages and benefits increased $196.9 million, or 45.2%, to $632.9 million. As a percentage of revenue, wages and benefits increased 4.6% to 47% in the second quarter of fiscal year 2006 from 42.4% in the same quarter of fiscal year 2005. As a percentage of revenue, approximately 1.3% of the increase was primarily due to the acquisition of the Acquired HR Business and Superior, which include consulting businesses, and LiveBridge, all of which have a higher component of wages and benefits related to revenue than our existing operations. During the second quarter of fiscal year 2006, we recorded stock-based compensation expense of $8.6 million, as discussed above, or 0.6% as a percentage of revenue, related to the adoption of SFAS 123(R). We also recorded $4.7 million, or 0.3% as a percentage of revenue, for involuntary termination of employees related to our restructuring activities discussed above.

Services and supplies increased $54.9 million, or 21.9%, to $305.9 million. As a percentage of revenue, services and supplies decreased 1.7% to 22.7% in the second quarter of fiscal year 2006 from 24.4% in the second quarter of fiscal year 2005. Approximately 2% of the decrease as a percentage of revenue was due to an increase in information technology outsourcing revenues, which have a lower component of services and supplies than our business process outsourcing business. This decrease was partially offset by an increase of 0.5% as a percentage of revenue due to higher unclaimed property revenues in the fiscal year 2006 quarter than the prior year. Unclaimed property revenues have a higher component of services and supplies than our other operations.

Rent, lease and maintenance increased $42.4 million, or 35%, to $163.5 million. As a percentage of revenue, rent, lease and maintenance increased 0.3% to 12.1% in the second quarter of fiscal year 2006 from 11.8% in the second quarter of fiscal year 2005. This increase was primarily due to increased software costs for new business.

Gain on sale of business was $29.8 million for the three months ended December 31, 2005. This gain was related to the sale of our Government welfare-to-workforce services business.

Other operating expense increased $19.9 million to $29 million. As a percentage of revenue, other operating expense increased 1.2%, to 2.1%, and consists primarily of the following (in thousands):

| | |
|---|---|
| Commercial segment: | |
| Asset impairment | $ 310 |
| | |
| Government segment: | |
| Provisions for estimated legal settlement and uncollectible accounts receivable related to the welfare-to-workforce services business | 3,267 |
| Asset impairments | 1,353 |
| | |
| Corporate: | |
| Aircraft impairment | 4,092 |
| Legal settlements and related costs | 3,175 |
| Legal costs associated with the review of certain recapitalization options related to our dual class structure and an unsolicited offer regarding a potential sale of the Company | 2,656 |
| | |
| Total | $ 14,853 |

*Interest Expense*

Interest expense increased $10.5 million, to $13.3 million, primarily due to interest expense on the Senior Notes (as defined below) issued in the fourth quarter of fiscal year 2005 and increased borrowings under our Existing Credit Facility for general corporate purposes, including the Ascom and Livebridge acquisitions and share repurchases.

*Income tax expense*

Our effective income tax rate decreased to 37.3% in the second quarter of fiscal year 2006 from 37.5% in the second

quarter of fiscal year 2005. This effective income tax rate is comprised of the following: an effective income tax rate of 39.9% related to the sale of our welfare-to-workforce services business, and an effective income tax rate on operations of 36.8%. Our effective income tax rate decreased primarily due to an increase in other deductions and credits. Our effective income tax rate is higher than the 35% federal statutory rate primarily due to the effect of state income taxes.

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**COMPARISON OF THE SIX MONTHS ENDED DECEMBER 31, 2005 TO THE SIX MONTHS ENDED DECEMBER 31, 2004**

*Revenues*

In the first six months of fiscal year 2006, our revenue increased $585 million, or 28%, to $2.7 billion from $2.1 billion in first six months of fiscal year 2005. Internal revenue growth was 6% and the remainder of the revenue growth was related to acquisitions.

Revenue in our Commercial segment, which represents 58% of consolidated revenue for the first six months of fiscal year 2006, increased $571.4 million, or 58%, to $1.6 billion in the first six months of fiscal year 2006 compared to the same period last year. Revenue growth from acquisitions was 44%, which includes a full six months of revenues from the acquisition of the Acquired HR Business, Superior and LiveBridge. Internal revenue growth was 14%, due primarily to increased revenue related to contracts with Kaiser Permanente, Southwest Washington Medical Center, Princeton Healthcare System, Port Huron Hospital, Roy L. Schneider Hospital and Central Connecticut Health and contracts with Chubb & Sons, Nextel, Delta Airlines, Symetra, University of Phoenix, United Technologies, Nextel Partners, Hallmark, American Red Cross, Scott s Company, and Carefirst. These increases were offset by decreases related to the Gateway contract termination in the first quarter of fiscal year 2005 and decreased revenues in our commercial unclaimed property business in the current year. The items discussed above collectively represent 77% of our internal revenue growth for the period in this segment.

Revenue in our Government segment, which represents 42% of consolidated revenue for the first six months of fiscal year 2006, increased $13.7 million, or 1%, to $1.1 billion in the first six months of fiscal year 2006 compared to the same period last year. Revenue growth from acquisitions was 2% primarily due to the acquisition of Ascom in December 2005. Internal revenue growth declined 1% primarily due to decreased revenues in our divested welfare-to-workforce services business and our unclaimed property business, and the termination of the Michigan payment processing, New York Metropolitan Transportation Authority and Iowa Medicaid contracts. These decreases were offset by increased revenues for contracts with Texas Medicaid, New Jersey Department of Human Services, the State of Maryland, Mississippi Medicaid, and higher revenues in our commercial vehicle operations and Georgia Department of Community Health contracts. The items discussed above collectively represent 83% of the net decline in our internal revenue growth for the period in this segment.

*Operating Expenses*

Wages and benefits increased $393.2 million, or 45.3%, to $1.3 billion. As a percentage of revenue, wages and benefits increased 5.5% to 47.4% in the first six months of fiscal year 2006 from 41.9% in the same period of last year. As a percentage of revenue, approximately 1.7% of this increase as a percentage of revenue was due to acquisitions, primarily the Acquired HR Business and Superior which include consulting businesses, and LiveBridge, all of which have a higher component of wages and benefits related to revenue than our existing operations. During the six months ended December 31, 2005, we recorded stock-based compensation expense of $17.4 million, or 0.7% as a percentage of revenue, related to the adoption of SFAS 123(R) and compensation expense of $5.4 million, or 0.2% as a percentage of revenue, related to the departure of our former Chief Executive Officer. We also recorded $4.7 million, or 0.2% as a percentage of revenue, for involuntary termination of employees related to our restructuring activities discussed above. Increased expenses related to our deferred compensation plans contributed 0.1% to the increase as a percentage of revenue. Gateway termination revenues recorded in the six months ended December 31, 2004, which had no associated wages and benefits resulted in an increase of wages and benefits as a percentage of revenue of 0.2% in the current year.

Services and supplies increased $70.6 million, or 13.4%, to $596.7 million. As a percentage of revenue, services and supplies decreased 2.9% to 22.5% in the first six months of fiscal year 2006 from 25.4% in the same period last year. Approximately 1.9% of the decrease as a percentage of revenue was primarily due to an increase in our information technology outsourcing revenues, which have a lower component of services and supplies than our business process outsourcing business. Another 0.5% of the decrease as a percentage of revenues was due to decreased unclaimed property revenues, which have a higher component of services and supplies compared to our other operations.

Rent, lease and maintenance increased $78.6 million, or 32.7%, to $318.7 million. As a percentage of revenue, rent, lease and maintenance increased 0.4% to 12% in the first six months of fiscal year 2006 from 11.6% in the same

period last year. This increase was primarily due to increased software costs for new business.

Gain on sale of business was $29.8 million for the six months ended December 31, 2005. This gain was related to the sale of our Government welfare-to-workforce services business in the second quarter of fiscal year 2006.

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Other operating expense increased $23 million to $42.6 million. As a percentage of revenue, other operating expense increased 0.7%, to 1.6%, and consists primarily of the following (in thousands):

| | |
|---|---|
| Commercial segment: | |
| Provision for doubtful accounts for an assessment of risk related to the bankruptcies of certain airline clients | $ 3,000 |
| Asset impairment | 310 |
| Government segment: | |
| Provisions for estimated legal settlement and uncollectible accounts receivable related to the welfare-to-workforce services business | 3,267 |
| Asset impairments | 1,353 |
| Corporate: | |
| Aircraft impairment | 4,092 |
| Legal settlements and related costs | 3,175 |
| Legal costs associated with the review of certain recapitalization options related to our dual class structure and an unsolicited offer regarding a potential sale of the Company | 2,656 |
| Total | $ 17,853 |

*Interest Expense*

Interest expense increased $18.6 million, to $25.5 million primarily due to interest expense on the Senior Notes (as defined below) issued in the fourth quarter of fiscal year 2005 and increased borrowings under our Existing Credit Facility for general corporate purposes, including the Ascom and Livebridge acquisitions and share repurchases.

*Other non-operating income, net*

Other non-operating income increased $5 million to $6.4 million from $1.3 million in the prior year period. Other non-operating income increased primarily due to long-term gains on investments, including those supporting our deferred compensation plans. These gains were largely offset by a corresponding increase in wages and benefits related to our deferred compensation plans.

*Income tax expense*

Our effective income tax rate decreased to 36.7% in the first six months of fiscal year 2006 from 37.5% in the same period last year. This effective income tax rate is comprised of the following: an effective income tax rate of 39.9% related to the sale of our welfare-to-workforce services business, and an effective tax rate on operations of 36.3%. Our effective income tax rate decreased primarily due to an increase in other deductions and credits. Our effective income tax rate is higher than the 35% federal statutory rate primarily due to the effect of state income taxes.

**LIQUIDITY AND CAPITAL RESOURCES**

We finance our ongoing business operations through cash flows from operations and utilize excess cash flow combined with the issuance of debt and equity to finance our acquisition strategy.

*Cash Flow*

During the first six months of fiscal year 2006, we generated approximately $355.7 million in net cash provided by operating activities compared to $299.3 million in the same period of fiscal year 2005. The increase from the prior year period was a result of increased net income, lower annual incentive compensation payments, collections of unearned revenue and timing of payments to vendors. These increases were offset by an increase in accounts receivable due to an increase in revenues and timing of collections, payments of $23 million related to the departure of our former Chief Executive Officer and the impact of classification of excess tax benefits from stock-based compensation arrangements. Effective July 1, 2005, excess tax benefits from stock-based compensation arrangements

of $9.5 million were reflected as an outflow of cash flows from operating activities and an inflow of cash flows from financing activities in the Consolidated Statements of Cash Flows. In the prior year period, income tax benefits from the exercise of stock options of $14.4 million were reflected as an inflow in cash flows from operating activities.

Free cash flow (as defined below) was approximately $157.7 million for the first six months of fiscal year 2006 versus approximately $167.8 million for the same period of fiscal year 2005. Our capital expenditures, defined as purchases of property, equipment and software, net, and additions to other intangible assets, were approximately $198 million, or 7.4% of total revenues, and $131.5 million, or 6.3% of total revenues, for the first six months of fiscal years 2006 and 2005, respectively.

Free cash flow is measured as cash flow provided by operating activities (as reported in our Consolidated Statements of Cash Flows), less capital expenditures (purchases of property, equipment and software, net of sales, as reported in our Consolidated Statements of Cash Flows) less additions to other intangible assets (as reported in our Consolidated Statements of Cash Flows). We believe this free cash flow metric provides an additional measure of available cash flow after we have satisfied the capital expenditure requirements of our operations, and should not be taken in isolation to be a measure of cash flow available for us to satisfy all of our obligations and execute our business strategies. We also rely on cash flows from investing and financing activities which, together with free cash flow, are expected to be sufficient for us to execute our business strategies. Our measure of free cash flow may not be comparable to similarly titled measures of other companies. The following table sets forth the calculations of free cash flow (in thousands):

| | Six months ended December 31, | |
|---|---|---|
| | **2005** | **2004** |
| Net cash provided by operating activities | $ 355,749 | $ 299,274 |
| Purchases of property, equipment and software, net | (184,973) | (106,553) |
| Additions to other intangible assets | (13,046) | (24,925) |
| Free cash flow | $ 157,730 | $ 167,796 |

During the first six months of fiscal year 2006, net cash used in investing activities was $393.7 million compared to $231.4 million in the first six months of fiscal year 2005. In the first six months of fiscal year 2006, we used $153.8 million for acquisitions, primarily for the purchase of Ascom, LiveBridge, contingent consideration payments for Heritage Information Systems, Inc. and a payment related to the first quarter fiscal year 2005 BlueStar Solutions, Inc. acquisition. In the first six months of fiscal year 2005, we used $95.8 million for acquisitions, primarily for the purchase of BlueStar Solutions, Inc. and Heritage Information Systems, Inc. Cash used for the purchase of property, equipment and software and additions to other intangible assets was $198 million and $131.5 million for the six months ended December 31, 2005 and 2004, respectively. The increase in purchases of property, equipment and software, net, and additions to other intangible assets includes software purchases related to our human resources outsourcing business, our Department of Education contract, a new data center and other new business. During the first six months of fiscal year 2006, we used $16.5 million to acquire intangible assets in connection with the termination of a subcontractor arrangement.

During the quarter ended December 31, 2005, we purchased approximately $17.3 million of U.S. Treasury Notes in conjunction with a contract in our Government segment and pledged them in accordance with the terms of the contract to secure our performance. The U.S. Treasury Notes are classified as held to maturity pursuant to Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities and reflected in other assets in our Consolidated Balance Sheet at December 31, 2005.

During the first six months of fiscal year 2006 net cash provided by financing activities was $82.6 million and during the first six months of fiscal year 2005 net cash used in financing activities was $108.9 million. Such financing activities include net borrowings under our Existing Credit Facility, share purchases under our share repurchase program, proceeds from the exercise of stock options, excess tax benefits from stock-based compensation arrangements and proceeds from the issuance of treasury shares. As discussed above, income tax benefits on stock options were reflected as net cash provided by operating activities in periods prior to July 1, 2005. Also, during the first six months of fiscal year 2006, we made payments of $23 million related to the departure of our former Chief

Executive Officer (see Note 14 to our Consolidated Financial Statements), of which $18.4 million is included in cash flows from financing activities and $4.7 million is included in cash flows from operating activities in the first six months of fiscal year 2006.

In the fourth quarter of fiscal year 2005, cash flows provided by operating activities included a temporary benefit of $75.9 million arising from Mellon Financial Corporation ( Mellon ) funding certain operating expenses of the Acquired HR Business that were not reimbursed to Mellon until July 2005 per the terms of a Transition Services Agreement. Mellon is providing certain accounting, treasury and payroll services for an interim period. As part of these services, Mellon is also paying certain operational costs on our behalf, such as employee related expenses and accounts payable. This agreement and the related timing of payments to Mellon had a favorable impact on our cash flows provided by operating activities for the fourth quarter of fiscal year 2005 and will negatively impact our

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cash flows provided by operating activities in the third quarter of fiscal year 2006 upon full integration of the Acquired HR Business employees and related accounting systems. At such time, we will no longer receive the transition services from Mellon and expect the temporary cash flow benefit we realized in our fourth quarter of fiscal year 2005 cash flows provided by operating activities to reverse, adversely affecting our third quarter fiscal year 2006 cash flows provided by operating activities. Also, there is approximately $17 million of incentive compensation that was earned by employees prior to the acquisition which will be paid out in the third quarter of fiscal year 2006.

*Tender Offer*

On January 26, 2006, we announced that our Board of Directors has authorized a modified Dutch Auction tender offer to purchase up to 55.5 million shares of our Class A common stock at a price per share not less than $56 and not greater than $63. The tender offer is expected to commence on or about February 9, 2006, and to expire on or about March 10, 2006, unless extended, and is expected to be funded with cash on hand and proceeds from the financing facility discussed below. The number of shares proposed to be purchased in the tender offer represents approximately 47% of our currently outstanding Class A common stock. In the tender offer, our stockholders will have the opportunity to tender some or all of their shares at a price within the $56 to $63 per share range. Based on the number of shares tendered and the prices specified by the tendering stockholders, we will determine the purchase price per share by selecting the lowest per share price within the range that will enable us to buy 55.5 million shares, or such lesser number of shares that are properly tendered. All shares accepted in the tender offer will be purchased at the same price per share even if the stockholder tendered at a lower price. If stockholders tender more than 55.5 million shares at or below the purchase price per share, we will purchase the shares tendered by those stockholders on a pro rata basis, as will be specified in the offer to purchase that will be distributed to stockholders upon the commencement of the tender offer. Our intent is to purchase up to $3.5 billion of our shares in the offer. In the event the purchase price is less than the maximum of $63.00 per share and more than 55.5 million shares are tendered in the offer at or below the purchase price selected by us, we may exercise our right to purchase up to an additional 2% of our outstanding Class A shares without extending the offer, so that we repurchase up to $3.5 billion of our shares. Our directors and executive officers, including our Chairman, Darwin Deason, do not intend to tender shares pursuant to the offer. None of ACS, our Board of Directors, the dealer manager, the information agent or the depositary is making any recommendation to shareholders as to whether to tender or refrain from tendering their shares into the tender offer. Shareholders must decide how many shares they will tender, if any, and the price within the stated range at which they will tender their shares. The tender offer will not be contingent upon any minimum number of shares being tendered. The tender offer, however, will be subject to a number of conditions, including the receipt of financing as noted below as well as any applicable regulatory or other consents, all of which will be specified in the offer to purchase.

If we purchase 55.5 million Class A shares in the tender offer, the number of options we will be permitted to grant under the 1997 Stock Incentive Plan (the Stock Incentive Plan ) would be reduced to 8,883,404, but such reduction would have no impact on options granted under such plan prior to the consummation of the tender offer. As a result, depending on the number of shares tendered in the tender offer, we may be unable to grant any additional options after the consummation of the tender offer, except as discussed below. The Compensation Committee of our Board of Directors may grant additional options to eligible individuals under our Stock Incentive Plan prior to consummation, including grants to executive officers, in an amount not to exceed the plan limit described above. For option grants following consummation of the tender offer, we will either seek approval of a new stock option plan from our shareholders at the next shareholders meeting, which may be a special meeting called for this purpose, or we may grant additional options under our existing Stock Incentive Plan subject to shareholder approval being obtained prior to such options becoming exercisable, in accordance with New York Stock Exchange listing standards.

The information regarding our tender offer in this Form 10-Q is for informational purposes only and is not an offer to buy, or the solicitation of an offer to sell, any shares. The full details of the tender offer, including complete instructions on how to tender shares, along with the letter of transmittal and related materials, are expected to be mailed to stockholders promptly following commencement of the offer. Stockholders should carefully read the offer to purchase, the letter of transmittal and other related materials when they are available because they will contain important information. Stockholders may obtain free copies, when available, of the tender offer statement and other

filed documents relating thereto that will be filed by the Company with the U.S. Securities and Exchange Commission at the Commission s website at www.sec.gov or from the Company s information agent to be appointed in connection with the offer. Stockholders are urged to read these materials carefully prior to making any decision with respect to the tender offer.

In connection with the tender offer, we have entered into a commitment letter, dated January 26, 2006 (the Commitment Letter ), with Citigroup Global Markets Inc., on behalf of itself and its affiliates (collectively, Citigroup ), under which Citigroup has committed, subject to the terms and conditions set forth in the Commitment Letter, to provide us with the following two loan facilities totaling in the aggregate up to $5 billion: (a) a senior secured 7-year term loan facility in the aggregate principal amount of up to $4 billion (the Term Facility ), and (b) a senior secured 6-year revolving loan facility in the aggregate principal amount of $1 billion (the Revolving Facility , and together with the Term Facility, the Facilities ). Under certain circumstances, we will be permitted to add one or more incremental term loan facilities to the Facilities and/or increase commitments under the Revolving Facility in an aggregate amount of up to $750 million (any such addition or increase, an Incremental Facility ). If fewer than the maximum number of shares are tendered, we may need to seek to borrow less than the full amount contemplated under the Term Facility.

The proceeds of the Term Facility may be used to finance the tender offer, to refinance our existing 5-Year Competitive Advance and Revolving Credit Facility Agreement dated as of October 27, 2004 (the Existing Credit Facility ) which will be terminated, and to pay related transaction costs, fees and expenses. The Term Facility will be made in a single drawing on the Closing Date (as that term is defined in the Commitment Letter), will provide for a 7-year maturity and will amortize in quarterly installments in an aggregate annual amount equal to 1% of its original principal amount, with the balance payable on the final maturity date. Interest on the outstanding balances under the Term Facility is payable, at our option, at a rate equal to the Applicable Margin (as defined in the Commitment Letter) plus the fluctuating Base Rate (as defined in the Commitment Letter), or at the Applicable Margin plus the current LIBO Rate (as defined in the Commitment Letter).

The proceeds of the Revolving Facility may be used to repay related transaction costs, fees and expenses, to provide working capital from time to time, to finance permitted acquisitions, and to refinance local foreign currency advances under the Existing Credit Facility and letters of credit outstanding thereunder. Amounts under the Revolving Facility will be available on a revolving basis commencing on the Closing Date and ending on the sixth anniversary of the Closing Date. Portions of the Revolving Facility will be available for issuances of up to $1 billion of letters of credit and borrowings of up to $150 million of swing loans. Interest on the outstanding balances under the Revolving Facility is payable, at our option, at a rate equal to the Applicable Margin plus the fluctuating Base Rate, or at the Applicable Margin plus the current LIBO Rate.

We may make optional prepayments of loans under either of the Facilities, in whole or in part, without premium or penalty (other than applicable breakage costs), in principal amounts to be agreed upon with Citigroup. Optional prepayments on the Term Facility shall be applied to the remaining installments of the Term Facility on a pro rata basis.

Subject to certain exceptions and conditions described in greater detail in the Commitment Letter, we will be obligated to use the following amounts to prepay the Term Facility: 100% of the net cash proceeds from any issuance or incurrence of indebtedness; 100% of the net sale proceeds from asset sales; 50% (with a stepdown to 25% in certain circumstances) of annual excess cash flow; and 100% of insurance and condemnation proceeds. The percentages specified above for excess cash flow shall be subject to reduction upon achievement by us of certain financial performance targets. Mandatory prepayments of the Term Facility will be applied on a pro rata basis.

Each of the Facilities will be guaranteed by us (in the case of obligations of our borrowing subsidiaries) and all of our direct and indirect material subsidiaries (to the event that it would not result in materially adverse tax consequences). Each of the Facilities will be secured by (i) a first priority perfected pledge of (x) all notes owned by us and the guarantors and (y) all of the capital stock of our subsidiaries (except to the extent the pledge would give rise to additional SEC reporting requirements for our subsidiaries) subject to certain exceptions, and (ii) a first priority perfected security interest in all other assets owned by the borrower and the guarantors, subject to customary exceptions. The above-noted collateral will also be subject to equal and ratable liens granted for the benefit of our currently outstanding 4.70% Senior Notes due 2010 and our 5.20% Senior Notes due 2015 to the extent required pursuant to the terms thereof.

The terms of the Facilities will include customary representations and warranties, customary affirmative and negative covenants, customary financial covenants, and customary events of default.

The commitments of Citigroup, and the availability of each of the Facilities described above, are and will be subject to customary conditions precedent, including: all necessary governmental and third party approvals necessary in connection with the tender offer, the Facilities and the transactions contemplated thereby shall have been obtained and shall be in full force and effect; there shall not exist any action, suit, investigation, litigation or proceeding pending or threatened in any court or before any arbitrator or governmental authority that could reasonably be expected to result in a Material Adverse Change (as defined in the Commitment Letter) or imposes or reasonably can be expected to impose material adverse conditions upon the tender offer, the Facilities or the transactions contemplated thereby; the lenders shall have obtained a valid and perfected first priority lien on and security interest in the collateral referred to above; and the repayment and termination of our Existing Credit Facility.

This summary description of the Commitment Letter does not purport to be complete and is qualified in its entirety by reference to the Commitment Letter, a copy of which will be filed as an exhibit to our Schedule TO to be filed with the Securities and Exchange Commission upon the commencement of the tender offer.

In connection with the tender offer, Darwin Deason, the chairman of our Board of Directors, has entered into a voting agreement dated February 9, 2006 (the Voting Agreement ) with us, in which he has agreed to limit his ability to cause the additional voting power he will hold as a result of the tender offer to affect the outcome of any matter submitted to the vote of our shareholders after consummation of the tender offer. Mr. Deason has agreed that to the extent his voting power immediately after the tender offer increases above the percentage amount of his voting power immediately prior to the tender offer (which is approximately 37% based on February 5, 2006 share data), Mr. Deason would cause the shares representing such additional voting power (the Excess Voting Power ) to appear, not appear, vote or not vote at any meeting or pursuant to any consent solicitation in the same manner, and in proportion to, the

votes or actions of all shareholders including Mr. Deason s Class A and Class B Shares on a one-for-one vote basis (notwithstanding the ten-for-one vote of the Class B Shares).
The Voting Agreement will have no effect on shares representing the approximately 37% voting power of the Company held by Mr. Deason prior to the tender offer, which Mr. Deason will continue to have the right to vote in his sole discretion. The Voting Agreement also does not apply to any Class A shares that Mr. Deason may acquire after the tender offer through his exercise of stock options, open market purchases or in any future transaction that we may undertake. The Voting Agreement will only become effective if the tender offer closes. Other than as expressly set forth in the Voting Agreement, Mr. Deason continues to have the power to exercise all rights attached to the shares he owns, including the right to dispose of his shares and the right to receive any distributions thereon.
The Voting Agreement will terminate on the earlier of (i) the withdrawal or termination of the tender offer by the Company, (ii) the mutual agreement of the Company (authorized by not less than a majority of the vote of the then independent and disinterested directors) and Mr. Deason, (iii) the date on which the Excess Voting Power as calculated is reduced to zero as a result of acquisitions of shares by Mr. Deason after the tender offer or issuance of shares by the Company, (iv) the date on which all Class B shares are converted into Class A shares and (v) the date, prior to the expiration date of the tender offer, on which Mr. Deason gives notice to the Company of termination as a result of any litigation pending or threatened against the Company or Mr. Deason arising out of the tender offer or any events or circumstances relating thereto (provided that the Company shall be entitled to have the corresponding right to terminate or withdraw the tender offer under such circumstances).
A special committee of our Board of Directors, consisting of our four independent directors, will engage in good faith discussions with Mr. Deason to reach agreement on fair compensation to be paid to Mr. Deason for entering into the Voting Agreement within six months following the closing of the tender offer. However, whether or not Mr. Deason and our special committee are able to reach agreement on compensation to be paid to Mr. Deason, the Voting Agreement will remain in effect.

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This summary description of the Voting Agreement does not purport to be complete and is qualified in its entirety by reference to the finalized version of the Voting Agreement, a copy of which is filed as an exhibit to this Form 10-Q.

*Credit arrangements*

Draws made under our Existing Credit Facility are made to fund cash acquisitions, share repurchases and for general working capital requirements. During the trailing twelve months ended December 31, 2005, the balance outstanding under our Existing Credit Facility for borrowings ranged from $232 million to $798.3 million. At December 31, 2005, we had approximately $971.1 million available under our Existing Credit Facility after giving effect to outstanding indebtedness of $416.5 million and $112.4 million of outstanding letters of credit that secure certain contractual performance and other obligations and which reduce the availability of our Existing Credit Facility. At December 31, 2005, we had $416.5 million outstanding under our Existing Credit Facility, which is reflected in long-term debt, and of which $390 million bore interest at approximately 4.8% and the remainder bore interest from 1.5% to 2.9%. As of December 31, 2005, we were in compliance with the covenants of both our Existing Credit Facility and our $250 million aggregate principal amount of 4.70% Senior Notes due June 1, 2010 and $250 million aggregate principal amount of 5.20% Senior Notes due June 1, 2015 (collectively, the Senior Notes ).

Certain contracts, primarily in our Government segment, require us to provide a surety bond or a letter of credit as a guarantee of performance. As of December 31, 2005, outstanding surety bonds of $421.1 million and $93.3 million of our outstanding letters of credit secure our performance of contractual obligations with our clients. Surety bonds outstanding at December 31, 2005 include approximately $125 million related to Ascom s contractual obligations. Approximately $19.1 million of letters of credit and $1.9 million of surety bonds secure our casualty insurance and vendor programs and other corporate obligations. In general, we would only be liable for the amount of these guarantees in the event of default in our performance of our obligations under each contract, the probability of which we believe is remote. We believe that we have sufficient capacity in the surety markets and liquidity from our cash flow and our Existing Credit Facility to respond to future requests for proposals. We also believe that, subsequent to our tender offer and related financing (see Subsequent Events), we will continue to have sufficient capacity in the surety markets and liquidity from our cash flow and new financing facilities to respond to future requests for proposals.

Following our announcement of the tender offer, our credit ratings were downgraded by each of the principal rating agencies. One of such downgrades reduced our rating to below investment grade, the other such downgrade reduced our rating to the lowest investment grade level used by the applicable rating agency. If we complete the tender offer and related financing, our remaining investment grade rating is likely to be reduced to below investment grade and our other credit rating may be further downgraded. As a result, the terms of any financings we choose to enter into in the future may be adversely affected. In addition, as a result of these downgrades the sureties which provide performance bonds backing our contractual obligations could reduce the availability of these bonds, increase the price of the bonds to us or require us to provide collateral such as a letter of credit. However, we believe that, subsequent to our tender offer and related financing (see Subsequent Events), we will continue to have sufficient capacity in the surety markets and liquidity from our cash flow and new financing facilities to respond to future requests for proposals. In addition, certain of our commercial outsourcing contracts provide that, in the event our credit ratings are downgraded to certain specified levels, the customer may elect to terminate its contract with us and either pay a reduced termination fee or in some instances, no termination fee. While we do not anticipate that the downgrading of our credit ratings in connection with the tender offer will result in a material loss of commercial outsourcing revenue due to the customer s exercise of these termination rights, there can be no assurance that such a credit ratings downgrade will not adversely affect these customer relationships.

*Derivatives*

We hedge the variability of our anticipated future Mexican peso cash flows through foreign exchange forward agreements. The agreements are designated as cash flow hedges of forecasted payments related to certain operating costs of our Mexican operations. As of December 31, 2005, the notional amount of these agreements totaled 186 million pesos ($17.2 million) and will expire at various dates over the next 12 months. Upon termination of these agreements, we will purchase Mexican pesos at the exchange rates specified in the forward agreements to be used for payments on our forecasted Mexican peso operating costs. The unrealized gain on these foreign exchange forward

agreements of $0.3 million, net of income tax, was reflected in other comprehensive income as of December 31, 2005.
*Share Repurchase Program*
Our Board of Directors previously authorized three share repurchase programs totaling $1.75 billion of our Class A common stock. On September 2, 2003, we announced that our Board of Directors authorized a share repurchase program of up to $500 million of our Class A common stock; on April 29, 2004, we announced that our Board of Directors authorized a new, incremental share repurchase program of up to $750 million of our Class A common stock, and on October 20, 2005, we announced that our Board of Directors

authorized an incremental share repurchase program of up to $500 million of our Class A common stock. The programs, which were open-ended, allowed us to repurchase our shares on the open market from time to time in accordance with Securities and Exchange Commission ( SEC ) rules and regulations, including shares that could be purchased pursuant to SEC Rule 10b5-1. The number of shares purchased and the timing of purchases was based on the level of cash and debt balances, general business conditions and other factors, including alternative investment opportunities, and purchases under these plans were funded from various sources, including, but not limited to, cash on hand, cash flow from operations, and borrowings under our Existing Credit Facility. As of December 31, 2005, we had repurchased approximately 22.1 million shares at a total cost of approximately $1.1 billion and reissued 0.8 million shares for proceeds totaling $41.1 million to fund contributions to our employee stock purchase plan and 401(k) plan. These share repurchase plans were terminated on January 25, 2006 by our Board of Directors in contemplation of our tender offer, which was announced January 26, 2006.

*Other*

At December 31, 2005, we had cash and cash equivalents of $107.3 million compared to $62.7 million at June 30, 2005. Our working capital (defined as current assets less current liabilities) increased $170.1 million to $576.1 million at December 31, 2005 from $406 million at June 30, 2005. Our current ratio (defined as total current assets divided by total current liabilities) was 1.6 and 1.5 at December 31, 2005 and June 30, 2005, respectively. Our debt-to-capitalization ratio (defined as the sum of short-term and long-term debt divided by the sum of short-term and long-term debt and equity) was 23.9% and 21% at December 31, 2005 and June 30, 2005, respectively.

We believe that available cash and cash equivalents, together with cash generated from operations and available borrowings under our Existing Credit Facility and the net proceeds we received from the sale of our welfare-to-workforce services business, will provide adequate funds for our anticipated internal growth and operating needs, including capital expenditures, and to meet the cash requirements of our contractual obligations. If we complete the tender offer, our indebtedness and interest expense may increase significantly and our indebtedness is expected to be substantial in relation to our stockholders equity. We believe that, should our tender offer and related financing be successful, our expected cash flow from operations, and anticipated access to the unused portion of our new credit facility and capital markets will be adequate for our expected liquidity needs, including capital expenditures, and to meet the cash requirements of our contractual obligations. In addition, we intend to continue our growth through acquisitions, which could require significant commitments of capital. In order to pursue such opportunities we may be required to incur debt or to issue additional potentially dilutive securities in the future. No assurance can be given as to our future acquisitions and expansion opportunities and how such opportunities will be financed.

**DISCLOSURES ABOUT CONTRACTUAL OBLIGATIONS AND COMMERCIAL COMMITMENTS AS OF DECEMBER 31, 2005 (IN THOUSANDS):**

| | | Payments Due by Period | | | |
|---|---|---|---|---|---|
| **Contractual Obligations** | **Total** | **Less than 1 Year** | **1-3 Years** | **4-5 Years** | **After 5 Years** |
| Senior Notes, net of unamortized discount (1) | $ 499,328 | $ | $ | $ 249,925 | $ 249,403 |
| Long-term debt (1) | 417,121 | 377 | 59 | 416,685 | |
| Capital lease obligations (1) | 16,643 | 7,112 | 9,047 | 484 | |
| Operating leases | 708,610 | 209,325 | 287,107 | 119,376 | 92,802 |
| Purchase obligations | 21,577 | 8,817 | 11,885 | 875 | |
| **Total Contractual Cash Obligations** | $ 1,663,279 | $ 225,631 | $ 308,098 | $ 787,345 | $ 342,205 |

**Amount of Commitment Expiration per Period**

| Other Commercial Commitments | Total Amounts Committed | Less than 1 Year | 1-3 Years | 4-5 Years | After 5 Years |
|---|---|---|---|---|---|
| Standby letters of credit | $ 112,405 | $ 112,405 | $ | $ | $ |
| Surety bonds | 423,026 | 412,728 | 8,426 | 10 | 1,862 |
| **Total Commercial Commitments** | $ 535,431 | $ 525,133 | $ 8,426 | $ 10 | $ 1,862 |

(1) Excludes accrued interest aggregating $3.9 million at December 31, 2005.

We have entered into various contractual agreements to purchase telecom services. These agreements provide for minimum annual spending commitments, and have varying terms through fiscal year 2009, and are included in purchase obligations in the table above.

We expect to contribute between $7.2 million and $8.1 million to our pension plans in fiscal year 2006. Minimum pension funding requirements are not included in the table above as such amounts are zero for our pension plans as of December 31, 2005.

Certain contracts, primarily in our Government segment, require us to provide a surety bond or a letter of credit as a guarantee of performance. As of December 31, 2005, outstanding surety bonds of $421.1 million and $93.3 million of our outstanding letters of credit secure our performance of contractual obligations with our clients. Surety bonds outstanding at December 31, 2005 include approximately $125 million related to Ascom s contractual obligations. Approximately $19.1 million of letters of credit and $1.9 million of surety bonds secure our casualty insurance and vendor programs and other corporate obligations. In general, we would only be liable for the amount of these guarantees in the event of default in our performance of our obligations under each contract, the probability of which we believe is remote. We believe that we have sufficient capacity in the surety markets and liquidity from our cash flow and our Existing Credit Facility to respond to future requests for proposals. We also believe that, subsequent to our tender offer and related financing (see Subsequent Events), we will continue to have sufficient capacity in the surety markets and liquidity from our cash flow and new financing facilities to respond to future requests for proposals. During the quarter we purchased approximately $17.3 million of U.S. Treasury Notes in conjunction with a contract in our Government segment, and pledged them in accordance with the terms of the contract to secure our performance. The U.S. Treasury Notes are accounted for as held to maturity pursuant to Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities and reflected in other assets in our Consolidated Balance Sheet at December 31, 2005.

We are obligated to make certain contingent payments to former shareholders of acquired entities upon satisfaction of certain contractual criteria in conjunction with certain acquisitions. During the first six months of fiscal year 2006, we paid $7 million related to acquisitions completed in prior years. As of December 31, 2005, the maximum aggregate amount of the outstanding contingent obligations to former shareholders of acquired entities is approximately $70.5 million. Upon satisfaction of the specified contractual criteria, any such payment would result primarily in a corresponding increase in goodwill.

We have indemnified Lockheed Martin Corporation against certain specified claims from certain pre-sale litigation, investigations, government audits and other issues related to the sale of the majority of our Federal business in fiscal year 2004. Our contractual maximum exposure under these indemnifications is $85 million; however, we believe the actual exposure to be significantly less. As of December 31, 2005, other accrued liabilities include a reserve for these claims in an amount we believe to be adequate at this time. As discussed in Part II, Item 1. Legal Proceedings, we have agreed to indemnify ManTech International Corporation with respect to the DOJ investigation related to purchasing activities at Hanscom Air Force Base during the period 1998-2000.

Our Education Services business, which is included in our Commercial segment, performs third party student loan servicing in the Federal Family Education Loan program ( FFEL ) on behalf of various financial institutions. We service these loans for investors under outsourcing arrangements and do not acquire any servicing rights that are transferable by us to a third party. At December 31, 2005, we serviced a FFEL portfolio of approximately 1.9 million loans with an outstanding principal balance of approximately $25.6 billion. Some servicing agreements contain provisions that, under certain circumstances, require us to purchase the loans from the investor if the loan guaranty has been permanently terminated as a result of a loan default caused by our servicing error. If defaults caused by us are cured during an initial period, any obligation we may have to purchase these loans expires. Loans that we purchase may be subsequently cured, the guaranty reinstated and then we repackage the loans for sale to third parties. We evaluate our exposure under our purchase obligations on defaulted loans and establish a reserve for potential losses, or default liability reserve, through a charge to the provision for loss on defaulted loans purchased. The reserve is evaluated periodically and adjusted based upon management s analysis of the historical performance of the defaulted loans. As of December 31, 2005, other accrued liabilities include reserves which we believe to be adequate.

**CRITICAL ACCOUNTING POLICIES**

The preparation of our financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions relating to the reporting of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses. We base our estimates on historical experience and

on various other assumptions or conditions that are believed to be reasonable under the circumstances. Actual results could differ from those estimates under different assumptions or conditions.

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties and may result in materially different results under different assumptions and conditions. We believe that the following critical accounting policies used in the preparation of our consolidated financial statements involve significant judgments and estimates.

*Revenue recognition*

A significant portion of our revenue is recognized based on objective criteria that does not require significant estimates or uncertainties. For example, transaction volumes and time and costs under time and material and cost reimbursable arrangements are based on specific, objective criteria under the contracts. Accordingly, revenues recognized under these methods do not require the use of

significant estimates that are susceptible to change. Revenue recognized using the percentage-of-completion accounting method does require the use of estimates and judgment as discussed below.

Our policy follows the guidance from SEC Staff Accounting Bulletin 104 Revenue Recognition ( SAB 104 ). SAB 104 provides guidance on the recognition, presentation, and disclosure of revenue in financial statements and updates Staff Accounting Bulletin Topic 13 to be consistent with Emerging Issues Task Force Issue No. 00-21, Revenue Arrangements with Multiple Deliverables ( EITF 00-21 ). We recognize revenues when persuasive evidence of an arrangement exists, the services have been provided to the client, the sales price is fixed or determinable, and collectibility is reasonably assured.

During fiscal year 2005, approximately 73% of our revenue was recognized based on transaction volumes, approximately 14% was fixed fee based, wherein our revenue is earned as we fulfill our performance obligations under the arrangement, approximately 8% was related to cost reimbursable contracts, approximately 3% of our revenue was recognized using percentage-of-completion accounting and the remainder is related to time and material contracts. Our revenue mix is subject to change due to the impact of acquisitions, divestitures and new business.

Revenues on cost reimbursable contracts are recognized by applying an estimated factor to costs as incurred, such factor being determined by the contract provisions and prior experience. Revenues on unit-price contracts are recognized at the contractual selling prices of work completed and accepted by the client. Revenues on time and material contracts are recognized at the contractual rates as the labor hours and direct expenses are incurred.

Revenues for business process outsourcing services are recognized as services are rendered, generally on the basis of the number of accounts or transactions processed. Information technology processing revenues are recognized as services are provided to the client, generally at the contractual selling prices of resources consumed or capacity utilized by our clients. Revenues from annual maintenance contracts are deferred and recognized ratably over the maintenance period. Revenues from hardware sales are recognized upon delivery to the client and when uncertainties regarding customer acceptance have expired.

Revenues on certain fixed price contracts where we provide information technology system development and implementation services are recognized over the contract term based on the percentage of development and implementation services that are provided during the period compared with the total estimated development and implementation services to be provided over the entire contract using Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts ( SOP 81-1 ). SOP 81-1 requires the use of percentage-of-completion accounting for long-term contracts that are binding agreements between us and our customers in which we agree, for compensation, to perform a service to the customer s specifications. These services require that we perform significant, extensive and complex design, development, modification and implementation activities for our customers systems. Performance will often extend over long periods, and our right to receive future payment depends on our future performance in accordance with the agreement.

The percentage-of-completion methodology involves recognizing revenue using the percentage of services completed, on a current cumulative cost to total cost basis, using a reasonably consistent profit margin over the period. Due to the longer term nature of these projects, developing the estimates of costs often requires significant judgment. Factors that must be considered in estimating the progress of work completed and ultimate cost of the projects include, but are not limited to, the availability of labor and labor productivity, the nature and complexity of the work to be performed, and the impact of delayed performance. If changes occur in delivery, productivity or other factors used in developing the estimates of costs or revenues, we revise our cost and revenue estimates, which may result in increases or decreases in revenues and costs, and such revisions are reflected in income in the period in which the facts that give rise to that revision become known.

EITF 00-21 addresses the accounting treatment for an arrangement to provide the delivery or performance of multiple products and/or services where the delivery of a product or system or performance of services may occur at different points in time or over different periods of time. The Emerging Issues Task Force reached a consensus regarding, among other issues, the applicability of the provisions regarding separation of contract elements in EITF 00-21 to contracts where one or more elements fall within the scope of other authoritative literature, such as SOP 81-1. EITF 00-21 does not impact the use of SOP 81-1 for contract elements that fall within the scope of SOP 81-1, such as the implementation or development of an information technology system to client specifications under a long-term

contract. Where an implementation or development project is contracted with a client, and we will also provide services or operate the system over a period of time, EITF 00-21 provides the methodology for separating the contract elements and allocating total arrangement consideration to the contract elements. We adopted the provisions of EITF 00-21 on a prospective basis to transactions entered into after July 1, 2003. We believe that EITF 00-21 did not have a material impact on our financial position or results of operations.

Revenues earned in excess of related billings are accrued, whereas billings in excess of revenues earned are deferred until the related services are provided. We recognize revenues for non-refundable, upfront implementation fees over the period between the initiation of the ongoing services through the end of the contract term on a straight-line basis.

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*Contingencies*

We account for claims and contingencies in accordance with Statement of Financial Accounting Standards No. 5, Accounting for Contingencies ( SFAS 5 ). SFAS 5 requires that we record an estimated loss from a claim or loss contingency when information available prior to issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Accounting for claims and contingencies requires us to use our judgment. We consult with legal counsel on those issues related to litigation and seek input from other experts and advisors with respect to matters in the ordinary course of business.

Our contracts with clients typically span several years. We continuously review and reassess our estimates of contract profitability. If our estimates indicate that a contract loss will occur, a loss accrual is recorded in the consolidated financial statements in the period it is first identified. Circumstances that could potentially result in contract losses over the life of the contract include decreases in volumes of transactions, variances from expected costs to deliver our services, and other factors affecting revenues and costs.

*Valuation of goodwill and intangibles*

Due to the fact that we are primarily a services company, our business acquisitions typically result in significant amounts of goodwill and other intangible assets, which affect the amount of future period amortization expense and possible expense we could incur as a result of an impairment. In addition, in connection with our revenue arrangements, we incur costs to originate contracts and to perform the transition and setup activities necessary to enable us to perform under the terms of the arrangement. We capitalize certain incremental direct costs which are related to the contract origination or transition, implementation and setup activities and amortize them over the term of the arrangement. From time to time, we also provide certain inducements to customers in the form of various arrangements, including contractual credits, which are capitalized and amortized as a reduction of revenue over the term of the contract. The determination of the value of goodwill and other intangibles requires us to make estimates and assumptions about future business trends and growth. We continually evaluate whether events and circumstances have occurred that indicate the balance of goodwill or intangible assets may not be recoverable. In evaluating impairment, we estimate the sum of expected future cash flows derived from the goodwill or intangible asset. Such evaluation is significantly impacted by estimates and assumptions of future revenues, costs and expenses and other factors. If an event occurs which would cause us to revise our estimates and assumptions used in analyzing the value of our goodwill or other intangible assets, such revision could result in a non-cash impairment charge that could have a material impact on our financial results.

*Share-Based Compensation*

We adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment ( SFAS 123(R) ) as of July 1, 2005. SFAS 123(R) requires us to recognize compensation expense for all share-based payment arrangements based on the fair value of the share-based payment on the date of grant. We elected the modified prospective application method for adoption, which requires compensation expense to be recorded for all stock-based awards granted after July 1, 2005 and for all unvested stock options outstanding as of July 1, 2005, beginning in the first quarter of adoption. For all unvested options outstanding as of July 1, 2005, the remaining previously measured but unrecognized compensation expense, based on the fair value at the original grant date, will be recognized as wages and benefits in the Consolidated Statements of Income on a straight-line basis over the remaining vesting period. For share-based payments granted subsequent to July 1, 2005, compensation expense, based on the fair value on the date of grant, will be recognized in the Consolidated Statements of Income in wages and benefits on a straight-line basis over the vesting period. In determining the fair value of stock options, we use the Black-Scholes option pricing model that employs the following assumptions:

- Expected volatility of our stock price based on historical monthly volatility over the expected term based on daily closing stock prices.

- Expected term of the option based on historical employee stock option exercise behavior, the vesting term of the respective option and the contractual term.

Risk-free interest rate for periods within the expected term of the option.

Dividend yield.

Our stock price volatility and expected option lives are based on management s best estimates at the time of grant, both of which impact the fair value of the option calculated under the Black-Scholes methodology and, ultimately, the expense that will be recognized over the vesting term of the option.

SFAS 123(R) requires that we recognize compensation expense for only the portion of share-based payment arrangements that are expected to vest. Therefore, we apply estimated forfeiture rates that are based on historical employee termination behavior. We periodically adjust the estimated forfeiture rates so that only the compensation expense related to share-based payment arrangements that vest are included in wages and benefits. If the actual number of forfeitures differs from those estimated by management, additional adjustments to compensation expense may be required in future periods.

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*Pension and post-employment benefits*

Statement of Financial Accounting Standards No. 87, Employers Accounting for Pensions ( SFAS 87 ), establishes standards for reporting and accounting for pension benefits provided to employees. In connection with the acquisition of the human resources consulting and outsourcing businesses of Mellon Financial Corporation ( Acquired HR Business ) in the fourth quarter of fiscal year 2005, we assumed pension plans for the Acquired HR Business employees located in Canada and the United Kingdom ( UK ). The Canadian Acquired HR Business has both a funded basic pension plan and an unfunded excess pension plan. The UK pension scheme is a funded plan. These defined benefit plans provide benefits for participating employees based on years of service and average compensation for a specified period before retirement. We have established June 30 as our measurement date for these defined benefit plans. The net periodic benefit costs for these plans are included in wages and benefits in our Consolidated Statements of Income.

The measurement of the pension benefit obligation of these plans at the acquisition date was accounted for using the business combination provisions in SFAS 87, therefore, all previously existing unrecognized net gain or loss, unrecognized prior service cost, or unrecognized net obligation or net asset existing prior to the date of the acquisition was included in our calculation of the pension benefit obligation recorded at acquisition.

In December 2005, we adopted a pension plan for the U.S. employees of Buck Consultants, LLC, a wholly owned subsidiary, which was acquired in connection with the Acquired HR Business. The U.S. pension plan is a funded plan. The plan recognizes service for eligible employees from May 26, 2005, the date of the acquisition of the Acquired HR Business. We recorded prepaid pension costs and projected benefit obligation related to this prior service which will be amortized over 8.7 years and included in the net periodic benefit costs which is included in wages and benefits in our Consolidated Statements of Income.

The following table summarizes the weighted-average assumptions used in the determination of our benefit obligation for our pension plans:

| | U.S. Plan As of December 1, 2005 (date of plan adoption) | Non-U.S. Plans As of June 30, 2005 |
|---|---|---|
| Discount rate | 5.75% | 5.00% - 5.25% |
| Rate of increase in compensation levels | 3.00% | 4.25% - 4.40% |

The following table summarizes the assumptions used in the determination of our net periodic benefit cost for the year ended June 30, 2006:

| | U.S. Plan | Non-U.S. Plans |
|---|---|---|
| Discount rate | 5.75% | 5.00% - 5.25% |
| Long-term rate of return on assets | 8.00% | 7.00% - 7.50% |
| Rate of increase in compensation levels | 3.00% | 4.25% - 4.40% |

Our discount rate is determined based upon high quality corporate bond yields as of the measurement date. The table below illustrates the effect of increasing or decreasing the discount rates by 25 basis points (in thousands):

| | U.S. Plan | | Non-U.S. Plans | |
|---|---|---|---|---|
| | Plus .25% | Less .25% | Plus .25% | Less .25% |
| Effect on pension benefit obligation | $ (105) | $ 100 | $ (4,490) | $ 4,692 |
| Effect on service and interest cost | $ 15 | $ (15) | $ 380 | $ (399) |

We estimate the long-term rate of return on U.S., UK and Canadian plan assets will be 8%, 7% and 7.5%, respectively, based on the long-term target asset allocation. Expected returns for the asset classes used in the plans are based on a combination of long-term historical returns and current and expected market conditions.

*Allowance for doubtful accounts*

We make estimates of the collectibility of our accounts receivable. We specifically analyze accounts receivable and historical bad debts, customer credit-worthiness, current economic trends, and changes in our customer payment terms and collection trends when evaluating the adequacy of our allowance for doubtful accounts. Any change in the assumptions used in analyzing a specific account receivable may result in additional allowance for doubtful accounts being recognized in the period in which the change occurs.

*Income taxes*

The determination of our provision for income taxes requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. Significant judgment is required in assessing the timing and amounts of deductible and taxable items. We establish reserves when, despite our belief that our tax return positions are fully supportable, we believe that certain positions may be challenged and that we may not succeed. Our provision for income taxes includes the impact of these reserve changes. We adjust these reserves in light of changing facts and circumstances. In the event that there is a significant unusual or one-time item recognized in our operating results, the taxes attributable to that item would be separately calculated and recorded at the same time as the unusual or one-time item.

Deferred income taxes are determined based on the difference between financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the years in which such differences are expected to reverse. We routinely evaluate all deferred tax assets to determine the likelihood of their realization.

**NEW ACCOUNTING PRONOUNCEMENTS**

On October 22, 2004, the President signed into law the American Jobs Creation Act of 2004 (the Act ). The Act creates a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85% dividends received deduction for certain dividends from controlled foreign corporations. Financial Accounting Standards Board Staff Position 109-2 Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004 allows companies additional time beyond that provided in Statement of Financial Accounting Standards No. 109 Accounting for Income Taxes to determine the impact of the Act on its financial statements and provides guidance for the disclosure of the impact of the Act on the financial statements. At December 31, 2005, cumulative undistributed earnings of non-U.S. subsidiaries for which U.S. taxes had not been recorded totaled $36.5 million, the tax effects on which, if repatriated, could not be reasonably estimated at that time. Although this incentive is available to us until June 30, 2006, we have made a preliminary determination that we do not expect to repatriate any amounts prior to the expiration of this provision.

**RISKS RELATED TO OUR BUSINESS**

The risks described below should not be considered to be comprehensive and all-inclusive. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations. If any events occur that give rise to the following risks, our business, financial condition, cash flow or results of operations could be materially and adversely affected, and as a result, the trading price of our Class A common stock could be materially and adversely impacted. These risk factors should be read in conjunction with other information set forth in this report, including our Consolidated Financial Statements and the related Notes.

*Leverage position*

As of December 31, 2005, we have approximately $500 million of Senior Notes we sold in a public offering in June 2005 and we have drawn $416.5 million under our Existing Credit Facility. Our announced tender offer for up to 55.5 million or more shares of our Class A common stock is expected to be financed by a loan of up to $4 billion and substantially all of our assets will be pledged to secure this loan and our Senior Notes. As the result of our existing indebtedness and the repurchase contemplated by the tender offer, and depending on the number of shares actually repurchased and the purchase price, the book value of our equity may be in a deficit position. It will be necessary to utilize cash flow from operating activities to fund debt service cost related to our indebtedness. If we fail to have sufficient cash flow to satisfy the debt service cost for our indebtedness, then we could default on our indebtedness resulting in foreclosure on the assets used to conduct our business. In addition, reduction of our available cash flow may negatively impact our business, including our ability to make future acquisitions, ability to compete for customer contracts requiring upfront capital costs, and our ability to meet our other obligations. Further, the amount of our indebtedness and our reduction in available cash flow may limit our ability to obtain further debt or equity financing.

*Reduction of credit rating*

Upon announcement of the tender offer, the ratings agencies reduced the ratings on our current outstanding obligations, resulting in one rating being below investment grade. We anticipate that there may be additional reductions in our ratings as a result of the closing of the announced tender offer. Failure to maintain our investment grade rating could negatively impact our ability to renew contracts with our existing customers, limit our ability to

compete for new customers, result in increased premiums for surety bonds to support our customer contracts, and/or result in a requirement that we provide collateral to secure our surety bonds. Further, certain of our commercial outsourcing contracts provide that in the event our credit ratings are downgraded to specified levels, the customer may elect to terminate its contract with us and either pay a reduced termination fee or, in some limited instances, no termination fee. A credit ratings downgrade could adversely affect these customer relationships.

*Loss of, or reduction of business from, significant clients*

Our revenues, profitability and cash flow could be materially adversely affected by the loss of significant clients and/or the reduction of volumes and services provided to our significant clients as a result of, among other things, their merger or acquisition, divestiture of assets or businesses, contract expiration, non-renewal or early termination, or business failure or deterioration. In addition, we incur fixed costs related to our information technology outsourcing and business process outsourcing clients. Therefore the loss of any one

of our significant clients could leave us with a significantly higher level of fixed costs than is necessary to serve our remaining clients, thereby reducing our profitability and cash flow.

*Impairment of investments made to attract clients*

In order to attract and retain large outsourcing contracts we sometimes make significant capital investments to perform the agreement, such as purchases of information technology equipment and costs incurred to develop and implement software. The net book value of such assets recorded, including a portion of our intangible assets, could be impaired, and our earnings and cash flow could be materially adversely affected in the event of the early termination of all or a part of such a contract or the reduction in volumes and services thereunder for reasons such as, among other things, the client s merger or acquisition, divestiture of assets or businesses, business failure or deterioration, or a client s exercise of contract termination rights.

*Competition*

We expect to encounter additional competition as we address new markets and new competitors enter our existing markets. If we are forced to lower our pricing or if demand for our services decreases, our business, financial condition, results of operations, and cash flow may be materially and adversely affected. Some of our competitors have substantially greater resources, and they may be able to use their resources to adapt more quickly to new or emerging technologies, to devote greater resources to the promotion and sale of their products and services, or to obtain client contracts where sizable asset purchases, investments or financing support are required. In addition, we must frequently compete with a client s own internal business process and information technology capabilities, which may constitute a fixed cost for the client.

In the future, competition could continue to emerge from large computer hardware or software providers as they shift their business strategy to include services. Competition has also emerged from European and Indian offshore service providers seeking to expand into our markets and from large consulting companies seeking operational outsourcing opportunities.

*Difficulties in executing our acquisition strategy*

We intend to continue to expand our business through the acquisition of complementary companies. We cannot, however, make any assurances that we will be able to identify any potential acquisition candidates or consummate any additional acquisitions or that any future acquisitions will be successfully integrated or will be advantageous to us. Without additional acquisitions, we are unlikely to maintain historical total growth rates.

*Failure to properly manage our operations and our growth*

We have rapidly expanded our operations in recent years. We intend to continue expansion in the foreseeable future to pursue existing and potential market opportunities. This rapid growth places a significant demand on our management and operational resources. In order to manage growth effectively, we must implement and improve our operational systems, procedures, and controls on a timely basis. If we fail to implement these systems, procedures and controls on a timely basis, we may not be able to service our clients needs, hire and retain new employees, pursue new business, complete future acquisitions or operate our businesses effectively. We could also trigger contractual credits to clients. Failure to properly transition new clients to our systems, properly budget transition costs or accurately estimate new contract operational costs could result in delays in our contract performance, trigger service level penalties or result in contracts whose profit margins did not meet our expectations or our historical profit margins. Failure to properly integrate acquired operations could result in increased cost. As a result of any of these problems associated with expansion, our business, financial condition, results of operations and cash flow could be materially and adversely affected.

*Government clients termination rights, audits and investigations*

Approximately 42% of our revenues are derived from contracts with state and local governments and from a contract with the Department of Education. Governments and their agencies may terminate most of these contracts at any time, without cause. Also, our Department of Education contract is subject to the approval of appropriations being made by the United States Congress to fund the expenditures to be made by the Federal government under this contract. Additionally, government contracts are generally subject to audits and investigations by government agencies. If the government finds that we improperly charged any costs to a contract, the costs are not reimbursable or, if already reimbursed, the cost must be refunded to the government. If the government discovers improper or illegal activities in

the course of audits or investigations, the contractor may be subject to various civil and criminal penalties and administrative sanctions, which may include termination of contracts, forfeiture of profits, suspension of payments, fines and suspensions or debarment from doing business with the government. Any resulting penalties or sanctions could have a material adverse effect on our business, financial condition, results of operations and cash flow. Further, the negative publicity that arises from findings in such audits, investigations or the penalties or sanctions therefore could have an adverse effect on our reputation in the industry and reduce our ability to compete for new contracts and may also have a material adverse effect on our business, financial condition, results of operations and cash flow.

*Government clients protests of contract awards*

After an award of a government contract, a competing bidder may protest the award. If we are awarded the contract and it is protested, it will be necessary to incur costs to defend the award of the contract, which costs may be significant and could include

hiring experts to defend the basis for the contract award. Some contract protests may take years to resolve. In some instances where we are awarded a contract, the contracting government entity may request that we sign a contract and commence services, even though the contract award has been protested. If the protest is upheld, then our contract would be terminated and the amounts due to us for services that have been performed to date would be subject to payment pursuant to the terms of the terminated contract. Such terms may not provide for full recovery of our incurred costs. In addition, if the government agency requests that we make changes to our contractual agreement during a protest period, but the government agency is unable or unwilling to modify the contract at the end of the protest period (whether or not we are successful in defending the protest), then we may be unable to recover the full costs incurred in making such changes. In addition, we may suffer negative publicity as the result of any contract protest being upheld and our contract being terminated. Further, if there is a re-bid of the contract, we would incur additional costs associated with the re-bid process and be subject to a potential protest if we are awarded a subsequent contract.

*Exercise of contract termination provisions and service level penalties*

Most of our contracts with our clients permit termination in the event our performance is not consistent with service levels specified in those contracts, or provide for credits to our clients for failure to meet service levels. In addition, if clients are not satisfied with our level of performance, our clients may seek damages as permitted under the contract and/or our reputation in the industry may suffer, which could materially and adversely affect our business, financial condition, results of operations, and cash flow.

*Pricing risks*

Many of our contracts contain provisions requiring that our services be priced based on a pre-established standard or benchmark regardless of the costs we incur in performing these services. Many of our contracts contain pricing provisions that require the client to pay a set fee for our services regardless of whether our costs to perform these services exceed the amount of the set fee. Some of our contracts contain re-pricing provisions which can result in reductions of our fees for performing our services. In such situations, we are exposed to the risk that we may be unable to price our services to levels that will permit recovery of our costs, and may adversely affect our operating results and cash flow.

*Actuarial consulting services and benefit plan management potential claims*

In May 2005, we acquired the human resources consulting business of Mellon Financial Corporation, which includes actuarial consulting services related to commercial, governmental and Taft-Hartley pension plans. Providers of these types of consulting services have experienced frequent claims, some of which have resulted in litigation and significant settlements or judgments, particularly when investment markets have performed poorly and pension funding levels have been adversely impacted. In addition, our total benefits outsourcing business unit manages and administers benefit plans on behalf of its clients and is responsible for processing numerous plan transactions for current and former employees of those clients. We are subject to claims from the client and its current and former employees if transactions are not properly processed. If any claim is made against us in the future related to our actuarial consulting services or benefit plan management services, our business, financial condition, results of operations and cash flow could be materially adversely affected as a result of the time and cost required to defend such a claim, the cost of settling such a claim or paying any judgments resulting therefrom, or the damage to our reputation in the industry that could result from the negative publicity surrounding such a claim.

*Loss of significant software vendor relationships*

Our ability to service our clients depends to a large extent on our use of various software programs that we license from a small number of primary software vendors. If our significant software vendors were to terminate, refuse to renew our contracts with them or offer to renew our contracts with them on less advantageous terms than previously contracted, we might not be able to replace the related software programs and would be unable to serve our clients or we would recognize reduced margins from the contracts with our clients, either of which could have a material adverse effect on our business, revenues, profitability and cash flow.

*Intellectual property infringement claims*

We rely heavily on the use of intellectual property. We do not own the majority of the software that we use to run our business; instead we license this software from a small number of primary vendors. If these vendors assert claims that we or our clients are infringing on their software or related intellectual property, we could incur substantial costs to

defend these claims, which could have a material effect on our profitability and cash flow. In addition, if any of our vendors infringement claims are ultimately successful, our vendors could require us (1) to cease selling or using products or services that incorporate the challenged software or technology, (2) to obtain a license or additional licenses from our vendors, or (3) to redesign our products and services which rely on the challenged software or technology. If we are unsuccessful in the defense of an infringement claim and our vendors require us to initiate any of the above actions, then such actions could have a material adverse effect on our business, financial condition, results of operations and cash flow.

*Rapid technological changes*

The markets for our business process and information technology services are subject to rapid technological changes and rapid changes in client requirements. We may be unable to timely and successfully customize products and services that incorporate new technology or to deliver the services and products demanded by the marketplace.

*United States and foreign jurisdiction laws relating to individually identifiable information*
We process, transmit and store information relating to identifiable individuals, both in our role as a service provider and as an employer. As a result, we are subject to numerous United States (both federal and state) and foreign jurisdiction laws and regulations designed to protect individually identifiable information, including social security numbers, financial and health information. For example, in 1996, Congress passed the Health Insurance Portability and Accountability Act and as required therein, the Department of Health and Human Services established regulations governing, among other things, the privacy, security and electronic transmission of individually identifiable health information. We have taken measures to comply with each of those regulations on or before the required dates. Another example is the European Union Directive on Data Protection, entitled Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data . We have also taken steps to address the requirements of that Directive. Other United States (both federal and state) and foreign jurisdiction laws apply to the processing of individually identifiable information as well, and additional legislation may be enacted at any time. Failure to comply with these types of laws may subject us to, among other things, liability for monetary damages, fines and/or criminal prosecution, unfavorable publicity, restrictions on our ability to process information and allegations by our clients that we have not performed our contractual obligations, any of which may have a material adverse effect on our profitability and cash flow.
*Breaches of our physical security systems and data privacy*
Security systems have been implemented with the intent of maintaining the physical security of our facilities and to protect confidential information and information related to identifiable individuals from unauthorized access through our information systems, but we are subject to breach of security systems at the facilities at which we maintain such confidential customer information and information relating to identifiable individuals. If unauthorized users gain physical access to the facility or electronic access to our information systems, such information may be subject to theft and misuse. Any theft or misuse of such information could result in, among other things, unfavorable publicity, difficulty in marketing our services, allegations by our clients that we have not performed our contractual obligations and possible financial obligations for damages related to the theft or misuse of such information, any of which may have a material adverse effect on our profitability and cash flow. We anticipate that breaches of security will occur from time to time, but the magnitude and impact on our business of any future breach cannot be ascertained.
*Budget deficits at, or fluctuations in the number of requests for proposals issued by, state and local governments and their agencies*
Approximately 42% of our revenues are derived from contracts with federal, state and local governments and their agencies. Currently, many state and local governments that we have contracts with are facing potential budget deficits. Also, the number of requests for proposals issued by state and local government agencies is subject to fluctuation. It is unclear what impact, if any, these deficits may have on our future business, revenues, results of operations and cash flow.
*International risks*
Recently we have expanded our international operations and also continually contemplate the acquisition of companies formed and operating in foreign countries. We have approximately 15,000 employees in Mexico, Guatemala, India, Ghana, Jamaica, Dominican Republic, Spain, Malaysia, Ireland, Germany, China, United Kingdom and Canada, as well as a number of other countries, that primarily support our commercial business process and information technology outsourcing services. Our international operations and acquisitions are subject to a number of risks. These risks include the possible impact on our operations of the laws of foreign countries where we may do business including, among others, data privacy, laws regarding licensing and labor council requirements. In addition, we may experience difficulty integrating the management and operations of businesses we acquire internationally, and we may have difficulty attracting, retaining and motivating highly skilled and qualified personnel to staff key managerial positions in our ongoing international operations. Further, our international operations and acquisitions are subject to a number of risks related to general economic and political conditions in foreign countries where we operate, including, among others, fluctuations in foreign currency exchange rates, cultural differences, political instability and additional expenses and risks inherent in conducting operations in geographically distant locations. Our

international operations and acquisitions may also be impacted by trade restrictions, such as tariffs and duties or other trade controls imposed by the United States or other jurisdictions, as well as other factors that may adversely affect our business, financial condition and operating results. Because of these foreign operations we are subject to regulations, such as those administered by the Department of Treasury s Office of Foreign Assets Controls ( OFAC ) and export control regulations administered by the Department of Commerce. Violation of these regulations could result in fines, criminal sanctions against our officers, and prohibitions against exporting, as well as damage to our reputation, which could adversely affect our business, financial condition and operating results.

*Armed hostilities and terrorist attacks*

Terrorist attacks and further acts of violence or war may cause major instability in the U.S. and other financial markets in which we operate. In addition, armed hostilities and acts of terrorism may directly impact our physical facilities and operations, which are located in North America, Central America, South America, Europe, Africa, Australia, Asia and the Middle East, or those of our clients. These developments subject our worldwide operations to increased risks and, depending on their magnitude, could have a material adverse effect on our business.

*Failure to attract and retain necessary technical personnel, skilled management and qualified subcontractors*
Our success depends to a significant extent upon our ability to attract, retain and motivate highly skilled and qualified personnel and to subcontract with qualified, competent subcontractors. If we fail to attract, train, and retain, sufficient numbers of these technically-skilled people or are unable to contract with qualified, competent subcontractors, our business, financial condition, and results of operations will be materially and adversely affected. Experienced and capable personnel in the technology industry remain in high demand, and there is continual competition for their talents. Our success also depends on the skills, experience, and performance of key members of our management team and on qualified, competent subcontractors. The loss of any key employee or the loss of a key subcontract relationship could have an adverse effect on our business, financial condition, cash flow, results of operations and prospects.
*Servicing Risks*
We service (for various lenders and under various service agreements) a portfolio of approximately $25.6 billion of loans, as of December 31, 2005, made under the Federal Family Education Loan Program, which loans are guaranteed by a Federal government agency. If a loan is in default, then a claim is made upon the guarantor. If the guarantor denies the claim because of a servicing error, then under certain of the servicing agreements we may be required to purchase the loan from the lender. Upon purchase of the loan, we attempt to cure the servicing errors and either sell the loan back to the guarantor (which must occur within a specified period of time) or sell the loan on the open market to a third party. We are subject to the risk that we may be unable to cure the servicing errors or sell the loan on the open market. Our reserves, which are based on historical information, may be inadequate if our servicing performance results in the requirement that we repurchase a substantial number of loans, which repurchase could have a material adverse impact on our cash flow and profitability.
*Disruption in Utility or Network Services*
Our services are dependent on the companies providing electricity and other utilities to our operating facilities, as well as network companies providing connectivity to our facilities and clients. While there are backup systems in many of our operating facilities, an extended outage of utility or network services may have a material adverse effect on our operations, revenues, cash flow and profitability.
*Indemnification Risk*
Our contracts, including our agreements with respect to divestitures, include various indemnification obligations. If we are required to satisfy an indemnification obligation, that may have a material adverse effect on our business, profitability and cash flow.
*Concentration of Voting Power*
Our chairman, Darwin Deason, beneficially owns 6,599,372 shares of Class B common stock and 2,349,030 shares of Class A common stock as of February 5, 2006. Mr. Deason controls approximately 37% of our total voting power (based on total shares of commons stock outstanding as of February 5, 2006). As a result, Mr. Deason has the requisite voting power to significantly affect virtually all of our decisions, including the power to block corporate actions such as an amendment to most provisions of our certificate of incorporation and certain provisions of our bylaws. As a result of the tender offer discussed elsewhere in this Form 10-Q, the proportional voting power of Mr. Deason will increase. If 55.5 million shares are tendered, the voting power held by Mr. Deason will increase from approximately 37% to approximately 53%, based on share data as of February 5, 2006. However, Mr. Deason has entered into a Voting Agreement with us which limits his ability to cause the additional voting power he will hold as a result of the consummation of the tender offer to affect the outcome of any future matter voted upon by our stockholders. In addition, Mr. Deason may significantly influence the election of directors and any other action requiring stockholder approval. Recommendations of our Nominating/Corporate Governance Committee of the Board of Directors regarding director nominees are subject to the approval of Mr. Deason pursuant to his employment agreement with us. Mr. Deason has an employment agreement, with a term that currently ends on May 18, 2010, provided that such term shall automatically be extended for an additional year on May 18 of each year, unless thirty days prior to May 18 of any year, Mr. Deason gives notice to us that he does not wish to extend the term or our Board of Directors (upon a unanimous vote of the directors, except for Mr. Deason) gives notice to Mr. Deason that it does not wish to extend the term.

*Other Risks*

We have attempted to identify material risk factors currently affecting our business and company. However, additional risks that we do not yet know of, or that we currently think are immaterial, may occur or become material. These risks could impair our business operations or adversely affect revenues, cash flow or profitability.

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## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk from changes in interest rates and foreign currency exchange rates. As of December 31, 2005, there have been no material changes in our interest rate market risk from June 30, 2005.

In the second quarter of fiscal year 2006, we entered into foreign exchange forward agreements to hedge the variability of our anticipated future cash flows resulting from fluctuations in the Mexican peso. We use sensitivity analysis to determine the effects that market risk exposures may have on the fair value of our foreign exchange forward agreements. The foreign exchange risk is computed based on the market value of the forward agreements as affected by changes in the corresponding foreign exchange rates. The sensitivity analysis represents the hypothetical changes in the value of the foreign exchange forward agreements and does not reflect the offsetting gain or loss on the underlying exposure. As of December 31, 2005, a 10% increase in the levels of Mexican peso exchange rate against the U.S. dollar with all other variables held constant would have resulted in a decrease in the fair value of our foreign exchange forward agreements of approximately $2 million, while a 10% decrease in the levels of Mexican peso exchange rate against the U.S. dollar would have resulted in an increase in the fair value of our foreign exchange forward agreements of $2 million.

There have been no material changes in our other foreign currency exchange market risk from June 30, 2005.

For further information regarding our market risk, refer to our Annual Report on Form 10-K for the fiscal year ended June 30, 2005.

## ITEM 4. CONTROLS AND PROCEDURES

Our management, including our principal executive officer and principal financial officer have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934) as of December 31, 2005. Based on such evaluation, our principal executive officer and principal financial officer have concluded that such disclosure controls and procedures were operating effectively as of December 31, 2005. There have not been any changes in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f) of the Securities Exchange Act of 1934) during the quarter ended December 31, 2005 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

## PART II

### ITEM 1. LEGAL PROCEEDINGS

One of our subsidiaries, ACS Defense, LLC, and several other government contractors received a grand jury document subpoena issued by the U.S. District Court for the District of Massachusetts in October 2002. The subpoena was issued in connection with an inquiry being conducted by the Antitrust Division of the U.S. Department of Justice ( DOJ ). The inquiry concerns certain IDIQ (Indefinite Delivery Indefinite Quantity) procurements and their related task orders, which occurred in the late 1990s at Hanscom Air Force Base in Massachusetts. In February 2004, we sold the contracts associated with the Hanscom Air Force Base relationship to ManTech International Corporation ( ManTech ); however, we have agreed to indemnify ManTech with respect to this DOJ investigation. The DOJ is continuing its investigation, but we have no information as to when the DOJ will conclude this process. We have cooperated with the DOJ in producing documents in response to the subpoena, and our internal investigation and review of this matter through outside legal counsel will continue through the conclusion of the DOJ investigatory process. We are unable to express an opinion as to the likely outcome of this matter at this time.

Another of our subsidiaries, ACS State & Local Solutions, Inc. ( ACS SLS ), and a teaming partner of this subsidiary, Tier Technologies, Inc. ( Tier ), received a grand jury document subpoena issued by the U.S. District Court for the Southern District of New York in May 2003. The subpoena was issued in connection with an inquiry being conducted by the Antitrust Division of the DOJ. We believe that the inquiry concerns the teaming arrangements between ACS SLS and Tier on child support payment processing contracts awarded to ACS SLS, and Tier as a subcontractor to ACS SLS, in New York, Illinois and Ohio but may also extend to the conduct of ACS SLS and Tier with respect to the bidding process for child support contracts in certain other states. Effective June 30, 2004, Tier was no longer a subcontractor to us in Ohio. Our revenue from the contracts for which Tier was a subcontractor was approximately $11.6 million and $8.4 million in the second quarter of fiscal years 2006 and 2005, respectively, and $22.9 million and $18.6 million in the first six months of fiscal years 2006 and 2005, respectively, representing approximately 0.9% and 0.8% of our revenues for the second quarter of fiscal years 2006 and 2005, respectively, and 0.9% of our revenues for the first six months of both fiscal years 2006 and 2005. Our teaming arrangement with Tier also contemplated the California child support payment processing request for proposals, which was issued in late 2003; however, we did not enter into a teaming agreement with Tier for the California request for proposals. Based on Tier s filings with the Securities and Exchange Commission, we understand that on November 20, 2003 the DOJ granted conditional amnesty to Tier in connection with this inquiry pursuant to the DOJ s Corporate Leniency Policy. The policy provides that the DOJ will not bring any criminal charges against Tier as long as it continues to fully cooperate in the inquiry (and makes restitution payments if it is determined that parties were injured as a result of impermissible anticompetitive conduct). The DOJ is continuing its investigation, but we have no information as to when the DOJ will conclude this process. We have cooperated with the DOJ in producing documents in response to the subpoena, and our internal investigation and review of this matter through outside legal counsel will continue through the conclusion of the DOJ investigatory process. We are unable to express an opinion as to the likely outcome of this matter at this time.

On January 30, 2004, the Florida Agency for Workforce Innovation s ( AWI ) Office of Inspector General ( OIG ) issued a report that reviewed 13 Florida workforce regions, including Dade and Monroe counties, and noted concerns related to the accuracy of customer case records maintained by our local staff. Our total revenue generated from the Florida workforce services amounts to approximately 0.8% and 1% of our total revenues for the second quarter of fiscal years 2006 and 2005, respectively, and 0.8% and 1% of our total revenues for the first six months of fiscal years 2006 and 2005, respectively. In March 2004, we filed our response to the OIG report. The principal workforce policy organization for the State of Florida, which oversees and monitors the administration of the State s workforce policy and the programs carried out by AWI and the regional workforce boards, is Workforce Florida, Inc. ( WFI ). On May 20, 2004, the Board of Directors of WFI held a public meeting at which the Board announced that WFI did not see a systemic problem with our performance of these workforce services and that it considered the issue closed. There were also certain contract billing issues that arose during the course of our performance of our workforce contract in Dade County, Florida, which ended in June 2003. However, during the first quarter of fiscal year 2005, we settled all financial issues with Dade County with respect to our workforce contract with that county and the

settlement is fully reflected in our results of operations for the first quarter of fiscal year 2005. We were also advised in February 2004 that the SEC had initiated an informal investigation into the matters covered by the OIG s report, although we have not received any request for information or documents since the middle of calendar year 2004. On March 22, 2004, ACS SLS received a grand jury document subpoena issued by the U.S. District Court for the Southern District of Florida. The subpoena was issued in connection with an inquiry being conducted by the DOJ and the Inspector General s Office of the U.S. Department of Labor ( DOL ) into the subsidiary s workforce contracts in Dade and Monroe counties in Florida, which also expired in June 2003, and which were included in the OIG s report. On August 11, 2005, the South Florida Workforce Board notified us that all deficiencies in our Dade County workforce contract have been appropriately addressed and all findings are considered resolved. On August 25, 2004, ACS SLS received a grand jury document subpoena issued by the U.S. District Court for the Middle District of Florida in connection with an inquiry being conducted by the DOJ and the Inspector General s Office of the DOL. The subpoena relates to a workforce contract in Pinellas County in Florida for the period from January 1999 to the contract s expiration in March 2001, which was prior to our acquisition of this business from Lockheed Martin Corporation in August 2001. Further, we settled a civil lawsuit with Pinellas County in December 2003 with respect to claims related to the services rendered to

Pinellas County by Lockheed Martin Corporation prior to our acquisition of ACS SLS (those claims having been transferred with ACS SLS as part of the acquisition), and the settlement resulted in Pinellas County paying ACS SLS an additional $600,000. We are continuing our internal investigation of these matters through outside legal counsel and we are continuing to cooperate with the DOJ, the SEC and DOL to produce documents in connection with their investigations. At this stage of these investigations, we are unable to express an opinion as to their likely outcome. We anticipate that we may receive additional subpoenas for information in other Florida Workforce regions as a result of the AWI report issued in January 2004. During the second quarter of fiscal year 2006, we sold substantially all of our welfare-to-workforce services business. However, we retained the liabilities for this business which arose from activities prior to the date of closing, including the contingent liabilities discussed above.

In addition to the foregoing, we are subject to certain other legal proceedings, inquiries, claims and disputes, which arise in the ordinary course of business. Although we cannot predict the outcomes of these other proceedings, we do not believe these other actions, in the aggregate, will have a material adverse effect on our financial position, results of operations or liquidity.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Our Board of Directors previously authorized three share repurchase programs totaling $1.75 billion of our Class A common stock. On September 2, 2003, we announced that our Board of Directors authorized a share repurchase program of up to $500 million of our Class A common stock; on April 29, 2004, we announced that our Board of Directors authorized a new, incremental share repurchase program of up to $750 million of our Class A common stock, and on October 20, 2005, we announced that our Board of Directors authorized an incremental share repurchase program of up to $500 million of our Class A common stock. The programs, which were open-ended, allowed us to repurchase our shares on the open market from time to time in accordance with Securities and Exchange Commission ( SEC ) rules and regulations, including shares that could be purchased pursuant to SEC Rule 10b5-1. The number of shares purchased and the timing of purchases was based on the level of cash and debt balances, general business conditions and other factors, including alternative investment opportunities, and purchases under these plans were funded from various sources, including, but not limited to, cash on hand, cash flow from operations, and borrowings under our Existing Credit Facility. As of December 31, 2005, we had repurchased approximately 22.1 million shares at a total cost of approximately $1.1 billion and reissued 0.8 million shares for proceeds totaling $41.1 million to fund contributions to our employee stock purchase plan and 401(k) plan. These share repurchase plans were terminated on January 25, 2006 by our Board of Directors in contemplation of our tender offer, which was announced January 26, 2006.

Repurchase activity for the quarter ended December 31, 2005 is reflected in the table below. Please refer to the discussion above for the cumulative repurchases under our previous share repurchase programs.

| Period | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs |
|---|---|---|---|---|
| Inception through September 30, 2005 | 19,914,514 | $ 49.91 | 19,914,514 | $ 256,010,038 |
| October 1 - October 31, 2005 | 1,008,000 | 53.15 | 1,008,000 | 702,439,160 |
| November 1 - November 30, 2005 | 831,000 | 53.63 | 831,000 | 657,875,063 |

| | | | | | | |
|---|---|---|---|---|---|---|
| December 1 - December 31, 2005 | 322,400 | | 54.80 | 322,400 | | 640,206,270 |
| Total Quarter ended December 31, 2005 | 2,161,400 | | 53.58 | 2,161,400 | | 640,206,270 |
| Inception through December 31, 2005 | 22,075,914 | $ | 50.27 | 22,075,914 | $ | 640,206,270 |

*Tender Offer*

On January 26, 2006, we announced that our Board of Directors has authorized a modified Dutch Auction tender offer to purchase up to 55.5 million shares of our Class A common stock at a price per share not less than $56 and not greater than $63. The tender offer is expected to commence on or about February 9, 2006, and to expire on or about March 10, 2006, unless extended, and is expected to be funded with cash on hand and proceeds from the committed financing facilities. The number of shares proposed to be purchased in the tender offer represents approximately 47% of our currently outstanding Class A common stock. In the tender offer, our stockholders will have the opportunity to tender some or all of their shares at a price within the $56 to $63 per share range. Based on the number of shares tendered and the prices specified by the tendering stockholders, we will determine the purchase price per share by selecting the lowest per share price within the range that will enable us to buy 55.5 million shares, or such lesser number of shares that are properly tendered. All shares accepted in the tender offer will be purchased at the same price per share even if the stockholder tendered at a lower price. If stockholders tender more than 55.5 million shares at or below the purchase price per share,

we will purchase the shares tendered by those stockholders on a pro rata basis, as will be specified in the offer to purchase that will be distributed to stockholders upon the commencement of the tender offer. Our intent is to purchase up to $3.5 billion of our shares in the offer. In the event the purchase price is less than the maximum of $63.00 per share and more than 55.5 million shares are tendered in the offer at or below the purchase price selected by us, we may exercise our right to purchase up to an additional 2% of our outstanding Class A shares without extending the offer, so that we repurchase up to $3.5 billion of our shares. Our directors and executive officers, including our Chairman, Darwin Deason, do not intend to tender shares pursuant to the offer. None of ACS, our Board of Directors, the dealer manager, the information agent or the depositary is making any recommendation to shareholders as to whether to tender or refrain from tendering their shares into the tender offer. Shareholders must decide how many shares they will tender, if any, and the price within the stated range at which they will tender their shares. The tender offer will not be contingent upon any minimum number of shares being tendered. The tender offer, however, will be subject to a number of conditions, including the receipt of financing as well as any applicable regulatory or other consents, all of which will be specified in the offer to purchase.

The information regarding our tender offer in this Form 10-Q is for informational purposes only and is not an offer to buy, or the solicitation of an offer to sell, any shares. The full details of the tender offer, including complete instructions on how to tender shares, along with the letter of transmittal and related materials, are expected to be mailed to stockholders promptly following commencement of the offer. Stockholders should carefully read the offer to purchase, the letter of transmittal and other related materials when they are available because they will contain important information. Stockholders may obtain free copies, when available, of the tender offer statement and other filed documents relating thereto that will be filed by the Company with the U.S. Securities and Exchange Commission at the Commission s website at www.sec.gov or from the Company s information agent to be appointed in connection with the offer. Stockholders are urged to read these materials carefully prior to making any decision with respect to the tender offer.

**ITEM 5. OTHER INFORMATION**

During the second quarter of fiscal year 2006 and in recognition of the significant expenditure of time by the members of the Special Committee of the Board of Directors in connection with the unsolicited offer to acquire 100% of the outstanding equity interests of the Company, the Board of Directors (with the members of the Special Committee abstaining) approved a one time payment of $75,000 to Joseph O Neill, as chairman of the Special Committee, and one time payments of $60,000 each to Frank Rossi, J. Livingston Kosberg and Dennis McCuistion, the other members of the Special Committee. Such payment was made to these directors in January 2006.

In connection with the tender offer, Darwin Deason, the chairman of our Board of Directors, has entered into a voting agreement dated February 9, 2006 (the Voting Agreement ) with us, in which he has agreed to limit his ability to cause the additional voting power he will hold as a result of the tender offer to affect the outcome of any matter submitted to the vote of our shareholders after consummation of the tender offer. Mr. Deason has agreed that to the extent his voting power immediately after the tender offer increases above the percentage amount of his voting power immediately prior to the tender offer (which is approximately 37% based on February 5, 2006 share data), Mr. Deason would cause the shares representing such additional voting power (the Excess Voting Power ) to appear, not appear, vote or not vote at any meeting or pursuant to any consent solicitation in the same manner, and in proportion to, the votes or actions of all shareholders including Mr. Deason s Class A and Class B Shares on a one-for-one vote basis (notwithstanding the ten-for-one vote of the Class B Shares).

The Voting Agreement will have no effect on shares representing the approximately 37% voting power of the Company held by Mr. Deason prior to the tender offer, which Mr. Deason will continue to have the right to vote in his sole discretion. The Voting Agreement also does not apply to any Class A shares that Mr. Deason may acquire after the tender offer through his exercise of stock options, open market purchases or in any future transaction that we may undertake. The Voting Agreement will only become effective if the tender offer closes. Other than as expressly set forth in the Voting Agreement, Mr. Deason continues to have the power to exercise all rights attached to the shares he owns, including the right to dispose of his shares and the right to receive any distributions thereon.

The Voting Agreement will terminate on the earlier of (i) the withdrawal or termination of the tender offer by the Company, (ii) the mutual agreement of the Company (authorized by not less than a majority of the vote of the then

independent and disinterested directors) and Mr. Deason, (iii) the date on which the Excess Voting Power as calculated is reduced to zero as a result of acquisitions of shares by Mr. Deason after the tender offer or issuance of shares by the Company, (iv) the date on which all Class B shares are converted into Class A shares and (v) the date, prior to the expiration date of the tender offer, on which Mr. Deason gives notice to the Company of termination as a result of any litigation pending or threatened against the Company or Mr. Deason arising out of the tender offer or any events or circumstances relating thereto (provided that the Company shall be entitled to have the corresponding right to terminate or withdraw the tender offer under such circumstances).

A special committee of our Board of Directors, consisting of our four independent directors, will engage in good faith discussions with Mr. Deason to reach agreement on fair compensation to be paid to Mr. Deason for entering into the Voting Agreement within six months following the closing of the tender offer. However, whether or not Mr. Deason and our special committee are able to reach agreement on compensation to be paid to Mr. Deason, the Voting Agreement will remain in effect.

This summary description of the Voting Agreement does not purport to be complete and is qualified in its entirety by reference to the finalized version of the Voting Agreement, a copy of which is filed as an exhibit to this Form 10-Q.

**ITEM 6. EXHIBITS**

a.) Exhibits

Reference is made to the Index to Exhibits beginning on page 52 for a list of all exhibits filed as part of this report.

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on the 9th day of February, 2006.

**AFFILIATED COMPUTER SERVICES, INC.**

By: /s/ Warren D. Edwards
Warren D. Edwards
Executive Vice President and Chief Financial Officer

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## INDEX TO EXHIBITS

| Exhibit Number | Exhibit Name |
| --- | --- |
| 2.1 | Amendment No. 2 to Purchase Agreement, dated as of November 11, 2005, among Mellon Financial Corporation, Mellon Consultants European Holdings Limited, Affiliated Computer Services, Inc., ACS Business Process Solutions Limited and Affiliated Computer Services of Germany GmbH (filed as Exhibit 2.1 to our Current Report on Form 8-K, filed November 16, 2005 and incorporated herein by reference). |
| 3.1 | Certificate of Incorporation of Affiliated Computer Services, Inc. (filed as Exhibit 3.1 to our Registration Statement on Form S-3, filed March 30, 2001, File No. 333-58038 and incorporated herein by reference). |
| 3.2 | Certificate of Correction to Certificate of Amendment of Affiliated Computer Services, Inc., dated August 30, 2001 (filed as Exhibit 3.2 to our Annual Report on Form 10-K, filed September 17, 2003 and incorporated herein by reference). |
| 3.3 | Bylaws of Affiliated Computer Services, Inc., as amended and in effect on September 11, 2003 (filed as Exhibit 3.3 to our Quarterly Report on Form 10-Q, filed February 17, 2004 and incorporated herein by reference). |
| 4.1 | Form of New Class A Common Stock Certificate (filed as Exhibit 4.3 to our Registration Statement on Form S-1, filed May 26, 1994, File No. 33-79394 and incorporated herein by reference). |
| 4.2 | Amended and Restated Rights Agreement, dated April 2, 1999, between Affiliated Computer Services, Inc. and First City Transfer Company, as Rights Agent (filed as Exhibit 4.1 to our Current Report on Form 8-K, filed May 19, 1999 and incorporated herein by reference). |
| 4.3 | Amendment No. 1 to Amended and Restated Rights Agreement, dated as of February 5, 2002, by and between Affiliated Computer Services, Inc. and First City Transfer Company (filed as Exhibit 4.1 to our Current Report on Form 8-K, filed February 6, 2002 and incorporated herein by reference). |
| 4.4 | Form of Rights Certificate (included as Exhibit A to the Amended and Restated Rights Agreement (Exhibit 4.3)). |
| 4.5 | Indenture, dated as of June 6, 2005, by and between Affiliated Computer Services, Inc. as Issuer and The Bank of New York Trust Company, N.A. as Trustee (filed as Exhibit 4.1 to our Current Report on Form 8-K, filed June 6, 2005 and incorporated herein by reference). |
| 4.6 | First Supplemental Indenture, dated as of June 6, 2005, by and between Affiliated Computer Services, Inc. as Issuer and The Bank of New York Trust Company, N.A. as Trustee, relating to our 4.70% Senior Notes due 2010 (filed as Exhibit 4.2 to our Current Report on Form 8-K, filed June 6, 2005 and incorporated herein by reference). |
| 4.7 | Second Supplemental Indenture, dated as of June 6, 2005, by and between Affiliated Computer Services, Inc. as Issuer and The Bank of New York Trust Company, N.A. as Trustee, relating to our 5.20% Senior Notes due 2015 (filed as Exhibit 4.3 to our Current Report on Form 8-K, filed June 6, |

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| | 2005 and incorporated herein by reference). |
| 4.8 | Specimen Note for 4.70% Senior Notes due 2010 (filed as Exhibit 4.4 to our Current Report on Form 8-K, filed June 6, 2005 and incorporated herein by reference). |
| 4.9 | Specimen Note for 5.20% Senior Notes due 2015 (filed as Exhibit 4.5 to our Current Report on Form 8-K, filed June 6, 2005 and incorporated herein by reference). |
| 9.1* | Voting Agreement dated February 9, 2006 by and between Affiliated Computer Services, Inc. and Darwin Deason. |
| 10.1 | Amendment No.1 to Affiliated Computer Services, Inc. 1997 Stock Incentive Plan, dated as of October 28, 2004 (filed as Exhibit 4.6 to our Registration Statement on Form S-8, filed December 6, 2005 and incorporated herein by reference). |
| 31.1* | Certification of Chief Executive Officer of Affiliated Computer Services, Inc. pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended. |
| 31.2* | Certification of Chief Financial Officer of Affiliated Computer Services, Inc. pursuant to Rule 13a-14(a) promulgated under the Securities Exchange Act of 1934, as amended. |
| 32.1* | Certification of Chief Executive Officer of Affiliated Computer Services, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended and Section 1350 of Chapter 63 of Title 18 of the United States Code. Pursuant to SEC Release 34-47551, this Exhibit is furnished to the SEC and shall not be deemed to be filed. |

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## INDEX TO EXHIBITS

| **Exhibit Number** | **Exhibit Name** |
|---|---|
| 32.2* | Certification of Chief Financial Officer of Affiliated Computer Services, Inc. pursuant to Rule 13a-14(b) promulgated under the Securities Exchange Act of 1934, as amended and Section 1350 of Chapter 63 of Title 18 of the United States Code. Pursuant to SEC Release 34-47551, this Exhibit is furnished to the SEC and shall not be deemed to be filed. |

*Filed herewith.

Management contract or compensatory plan or arrangement.