

AFFILIATED COMPUTER SERVICES INC

Form 10-Q

November 14, 2003

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2003

OR

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 No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes No

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

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| Title of each class | Number of shares outstanding as of November 11, 2003 |
|---------------------------------------|--|
| Class A Common Stock, \$.01 par value | 124,663,189 |
| Class B Common Stock, \$.01 par value | 6,599,372 |
| | <hr/> 131,262,561 |

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AFFILIATED COMPUTER SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands)

| | September 30, 2003 (Unaudited) | June 30, 2003 (Audited) |
|---|--------------------------------------|-------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 36,413 | \$ 51,170 |
| Accounts receivable, net | 759,079 | 835,478 |
| Inventory | 6,599 | 6,245 |
| Other current assets | 87,985 | 86,605 |
| Assets held for sale | 349,271 | |
| | <hr/> | <hr/> |
| Total current assets | 1,239,347 | 979,498 |
| Property, equipment and software, net | 439,981 | 478,212 |
| Goodwill, net | 1,764,150 | 1,905,878 |
| Intangibles, net | 255,648 | 265,091 |
| Other long-term assets | 68,535 | 70,026 |
| | <hr/> | <hr/> |
| Total assets | \$3,767,661 | \$3,698,705 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 45,101 | \$ 58,376 |
| Accrued compensation and benefits | 77,552 | 132,027 |
| Other accrued liabilities | 259,874 | 272,578 |
| Income taxes payable | 31,635 | 17,057 |
| Deferred taxes | 34,342 | 26,054 |
| Current portion of long-term debt | 2,197 | 1,764 |
| Current portion of unearned revenue | 42,501 | 49,620 |
| Liabilities related to assets held for sale | 66,732 | |
| | <hr/> | <hr/> |
| Total current liabilities | 559,934 | 557,476 |
| Convertible notes | 316,990 | 316,990 |
| Long-term debt | 190,208 | 181,350 |
| Deferred taxes | 180,449 | 176,484 |
| Other long-term liabilities | 35,263 | 37,217 |
| | <hr/> | <hr/> |
| Total liabilities | 1,282,844 | 1,269,517 |
| Stockholders' equity: | | |
| Class A common stock | 1,269 | 1,266 |
| Class B common stock | 66 | 66 |
| Additional paid-in capital | 1,364,099 | 1,358,418 |
| Accumulated other comprehensive income, net | (2,176) | (971) |
| Retained earnings | 1,157,217 | 1,070,409 |
| Treasury stock | (35,658) | |

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| | | |
|--|--------------------|--------------------|
| Total stockholders' equity | <u>2,484,817</u> | <u>2,429,188</u> |
| Total liabilities and stockholders' equity | <u>\$3,767,661</u> | <u>\$3,698,705</u> |

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 September 30, | |
|---|-------------------------------------|------------|
| | 2003 | 2002 |
| Revenues | \$ 1,036,635 | \$ 882,581 |
| Expenses: | | |
| Wages and benefits | 477,112 | 402,899 |
| Services and supplies | 264,964 | 226,490 |
| Rent, lease and maintenance | 95,930 | 84,335 |
| Depreciation and amortization | 41,411 | 36,142 |
| Other operating expenses | 13,289 | 13,060 |
| Total operating expenses | 892,706 | 762,926 |
| Operating income | 143,929 | 119,655 |
| Interest expense | 5,220 | 7,054 |
| Other non-operating (income) expense, net | (180) | 1,472 |
| Pretax profit | 138,889 | 111,129 |
| Income tax expense | 52,081 | 41,673 |
| Net income | \$ 86,808 | \$ 69,456 |
| Earnings per common share: | | |
| Basic | \$ 0.65 | \$ 0.53 |
| Diluted | \$ 0.62 | \$ 0.50 |
| Shares used in computing earnings per common share: | | |
| Basic | 133,235 | 132,073 |
| Diluted | 143,960 | 142,984 |

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)

| | Three Months Ended September 30, | |
|--|-------------------------------------|-----------|
| | 2003 | 2002 |
| Cash flows from operating activities: | | |
| Net income | \$ 86,808 | \$ 69,456 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 41,411 | 36,142 |
| Impairment of long-term assets | | 1,400 |
| Tax benefit on stock options | 2,688 | 1,024 |
| Deferred income tax expense | 21,671 | 13,717 |
| Other non-cash activities | 4,099 | 3,666 |
| Changes in assets and liabilities, net of effects from acquisitions: | | |
| Increase in accounts receivable | (72,994) | (16,574) |
| (Increase) decrease in inventory | (657) | 750 |
| (Increase) decrease in other current assets | (5,825) | 5,396 |
| Increase in other long-term assets | (2,213) | (2,817) |
| Increase (decrease) in accounts payable | (7,442) | 2,282 |
| Decrease in accrued compensation and benefits | (26,628) | (35,908) |
| Increase (decrease) in other accrued liabilities | 7,113 | (4,385) |
| Change in income taxes payable | 14,578 | 15,611 |
| Decrease in unearned revenue | (7,782) | (6,638) |
| Increase in other long-term liabilities | 4,555 | 3,759 |
| | (27,426) | 17,425 |
| Net cash provided by operating activities | 59,382 | 86,881 |
| Cash flows from investing activities: | | |
| Purchases of property, equipment and software, net | (42,760) | (44,788) |
| Payments for acquisitions, net of cash acquired | (1,037) | (4,905) |
| Proceeds from divestitures, net of transaction costs | (838) | 6,664 |
| Additions to other intangible assets | (7,531) | (14,842) |
| Additions to notes receivable | (335) | (1,584) |
| Proceeds received on notes receivable | 1,719 | 6,335 |
| Other | 23 | 50 |
| | (50,759) | (53,070) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of debt | 256,155 | 425,458 |
| Repayments of debt | (246,842) | (439,066) |
| Purchase of treasury shares | (35,658) | |
| Proceeds from stock options exercised | 3,778 | 589 |
| Other | (813) | (1,297) |
| | (23,380) | (14,316) |

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| | | |
|--|-------------------|-------------------|
| Net increase (decrease) in cash and cash equivalents | (14,757) | 19,495 |
| Cash and cash equivalents at beginning of period | 51,170 | 33,814 |
| | <u> </u> | <u> </u> |
| Cash and cash equivalents at end of period | \$ 36,413 | \$ 53,309 |
| | <u> </u> | <u> </u> |

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) and its majority-owned subsidiaries. All material intercompany profits, transactions and balances have been eliminated. We are a Fortune 500 company with more than 40,000 people supporting client operations in nearly 100 countries. We provide business process and technology outsourcing solutions to world-class commercial and government clients.

The financial information presented should be read in conjunction with our consolidated financial statements for the year ended June 30, 2003. Certain reclassifications have been made to prior period financial statements to conform to current presentation. 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.

Significant accounting policies are detailed in our Annual Report on Form 10-K for the year ended June 30, 2003. 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

We follow 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 is recognized for our stock-based compensation plans since the exercise prices of awards under our plans are at current market prices 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 , 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 September 30, | |
|---|---|-------------|
| | 2003 | 2002 |
| Net Income | | |
| As reported | \$ 86,808 | \$ 69,456 |
| Less: Pro forma employee compensation cost of stock-based compensation plans, net of tax | 4,806 | 3,920 |
| Pro forma | \$ 82,002 | \$ 65,536 |
| Basic earnings per share | | |
| As reported | \$ 0.65 | \$ 0.53 |
| Pro forma | \$ 0.62 | \$ 0.50 |
| Diluted earnings per share | | |
| As reported | \$ 0.62 | \$ 0.50 |
| Pro forma | \$ 0.59 | \$ 0.48 |

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

3. EQUITY

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 effective immediately. The program, which is open-ended, will allow 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 to be purchased and the timing of purchases will be based on the level of cash and debt balances, general business conditions and other factors, including alternative investment opportunities. We intend to fund the repurchase program from various sources, including, but not limited to, cash flow from operations, borrowings under our existing revolving credit facility and, if consummated, proceeds from the sale of the majority of our federal government business. As of September 30, 2003, we had repurchased 700,000 shares at a total cost of approximately \$35.7 million. Through November 11, 2003, we have repurchased approximately 2.3 million shares at a total cost of approximately \$113.3 million.

4. ASSETS HELD FOR SALE

In August 2003, we announced an agreement to sell the majority of our federal government business to Lockheed Martin Corporation for approximately \$658 million, which includes \$70 million payable pursuant to a five-year non-compete agreement. Revenues from the federal business to be divested were approximately \$685 million for fiscal 2003. This divestiture excludes our Department of Education relationship, which during fiscal year 2003 had revenues of approximately \$172 million. Additionally, our commercial and state and local government operations will continue to serve as a subcontractor on portions of the transferred business. In addition, we will acquire Lockheed Martin Corporation's commercial information technology business, with trailing, recurring annual revenues of approximately \$240 million, for approximately \$107 million. These transactions, which are subject to certain closing conditions, are expected to be completed during the second quarter of fiscal 2004. The expected after-tax proceeds from the divestiture will generally be used to pay down debt, fund our share repurchase program and for general corporate purposes. Revenues from the business to be divested were \$177 million and \$165 million for the three months ended September 30, 2003 and 2002, respectively.

At September 30, 2003, we classified as held for sale those assets and liabilities related to that portion of our federal government business expected to be disposed of in our previously announced pending sale. Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets requires that depreciation and amortization of long-lived assets held for sale be suspended during the holding period prior to sale. Accordingly, during the first quarter ended September 30, 2003, we suspended depreciation and amortization in the amount of \$4.3 million (\$2.7 million, net of tax) related to those long-lived assets classified as held for sale. The following table sets forth the assets and liabilities included in assets held for sale and the related liabilities as of September 30, 2003 (in thousands):

| Assets held for sale | |
|--|------------|
| Accounts receivable, net | \$ 148,729 |
| Property, equipment and software, net | 48,863 |
| Intangible assets, net | 3,587 |
| Goodwill, net | 142,513 |
| Other assets | 5,579 |
| | <hr/> |
| Total assets held for sale | \$ 349,271 |
| | <hr/> |
| Liabilities related to assets held for sale | |
| Accounts payable | \$ 5,833 |
| Accrued compensation and benefits | 27,847 |
| Accrued liabilities | 20,867 |
| Deferred taxes | 10,503 |
| Other liabilities | 1,682 |
| | <hr/> |
| Total liabilities related to assets held for sale | \$ 66,732 |
| | <hr/> |

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

5. GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill for the three months ended September 30, 2003 are as follow (in thousands):

| | State and Local | | Federal | Total |
|-------------------------------------|-----------------|------------|------------|--------------|
| | Government | Commercial | Government | |
| Balance as of June 30, 2003 | \$ 1,079,284 | \$ 690,287 | \$ 136,307 | \$ 1,905,878 |
| Goodwill activity during the period | 1,027 | (6,448) | (136,307) | (141,728) |
| Balance as of September 30, 2003 | \$ 1,080,311 | \$ 683,839 | \$ | \$ 1,764,150 |

Goodwill activity for the three months ended September 30, 2003 was primarily the classification of assets held for sale as a result of the announced sale of the majority of our federal government business (see Note 4 for further discussion of this transaction).

The following information relates to our intangibles (in thousands):

| | September 30, 2003 | | June 30, 2003 | |
|---------------------------------------|-----------------------|--------------------------|-----------------------|--------------------------|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization |
| Amortized intangible assets: | | | | |
| Acquired customer-related intangibles | \$ 151,772 | \$ (34,495) | \$ 154,771 | \$ (31,735) |
| Customer-related intangibles | 130,519 | (44,554) | 139,667 | (50,129) |
| All other | 3,107 | (1,501) | 4,031 | (2,314) |
| Total | \$ 285,398 | \$ (80,550) | \$ 298,469 | \$ (84,178) |
| Unamortized intangible asset: | | | | |
| Title plant | \$ 50,800 | | \$ 50,800 | |

Aggregate amortization:

| | |
|--|----------|
| For the quarter ended September 30, 2003 | \$ 9,864 |
|--|----------|

| | |
|--|-------|
| For the quarter ended September 30, 2002 | 8,786 |
|--|-------|

Estimated amortization:

| | |
|----------------------------------|-----------|
| For the year ended June 30, 2004 | \$ 37,353 |
|----------------------------------|-----------|

| | |
|----------------------------------|--------|
| For the year ended June 30, 2005 | 33,744 |
|----------------------------------|--------|

| | |
|----------------------------------|--------|
| For the year ended June 30, 2006 | 28,891 |
|----------------------------------|--------|

| | |
|----------------------------------|--------|
| For the year ended June 30, 2007 | 24,483 |
|----------------------------------|--------|

| | |
|----------------------------------|--------|
| For the year ended June 30, 2008 | 21,114 |
|----------------------------------|--------|

Amortization includes amounts charged to amortization expense for customer-related intangibles and other intangibles, other than contract inducements. Amortization of contract inducements of \$2.6 million and \$1.2 million for the three months ended September 30, 2003 and 2002, respectively, is recorded as a reduction of related contract revenue. Amortization expense includes approximately \$4.2 million and \$4.0 million for acquired customer-related intangibles for the three months ended September 30, 2003 and 2002, respectively. Amortized intangible assets are amortized over the related contract term. The amortization period of customer-related intangible assets equates to a weighted average of approximately 8 years. The amortization period for all other intangible assets also equates to a weighted average of 8 years.

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

6. 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.

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

| | Three months ended September 30, | |
|--|-------------------------------------|-----------|
| | 2003 | 2002 |
| Net income | \$ 86,808 | \$ 69,456 |
| Other comprehensive income (loss): | | |
| Foreign currency translation adjustment (net of tax effect of (\$723)) | (1,205) | |
| Comprehensive income | \$ 85,603 | \$ 69,456 |

7. EARNINGS PER SHARE

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

| | Three Months Ended September 30, | |
|---|-------------------------------------|-----------|
| | 2003 | 2002 |
| Numerator: | | |
| Numerator for basic earnings per share - | | |
| Income available to common stockholders | \$ 86,808 | \$ 69,456 |
| Effect of dilutive securities: | | |
| Interest on 3.5% convertible debt, net of tax | 2,054 | 2,054 |
| Numerator for diluted earnings per share - | | |
| Income available to common stockholders | \$ 88,862 | \$ 71,510 |
| Denominator: | | |
| Weighted average basic shares outstanding | 133,235 | 132,073 |
| Effect of dilutive securities: | | |
| 3.5% convertible debt | 7,298 | 7,298 |
| Stock options | 3,427 | 3,613 |
| Total potential common shares | 10,725 | 10,911 |
| Denominator for weighted average diluted shares | 143,960 | 142,984 |
| Earnings per common share (basic) | \$ 0.65 | \$ 0.53 |

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| | | |
|---|----------------|----------------|
| Earnings per common share assuming dilution | <u>\$ 0.62</u> | <u>\$ 0.50</u> |
|---|----------------|----------------|

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

8. SEGMENT INFORMATION

Based on the criteria set forth in Statement of Financial Accounting Standards No. 131, Disclosure about Segments of an Enterprise and Related Information, we have three reportable segments: state and local government, commercial and federal government. The following is a summary of certain financial information by reportable segment (in thousands):

| | <u>State and Local Government</u> | <u>Commercial</u> | <u>Federal Government</u> | <u>Corporate</u> | <u>Consolidated</u> |
|--|---|-------------------|-------------------------------|------------------|---------------------|
| Three Months Ended September 30, 2003 | | | | | |
| Revenues | \$477,044 | \$339,852 | \$219,739 | \$ | \$1,036,635 |
| Operating expenses | 379,337 | 262,749 | 196,310 | 12,899 | 851,295 |
| Adjusted EBITDA (a) | 97,707 | 77,103 | 23,429 | (12,899) | 185,340 |
| Depreciation and amortization expense | 16,310 | 22,449 | 2,081 | 571 | 41,411 |
| Operating income | \$ 81,397 | \$ 54,654 | \$ 21,348 | \$(13,470) | \$ 143,929 |
| Three Months Ended September 30, 2002 | | | | | |
| Revenues | \$387,382 | \$287,528 | \$207,671 | \$ | \$ 882,581 |
| Operating expenses | 309,679 | 219,715 | 186,909 | 10,481 | 726,784 |
| Adjusted EBITDA (a) | 77,703 | 67,813 | 20,762 | (10,481) | 155,797 |
| Depreciation and amortization expense | 11,921 | 18,600 | 5,017 | 604 | 36,142 |
| Operating income | \$ 65,782 | \$ 49,213 | \$ 15,745 | \$(11,085) | \$ 119,655 |

- (a) Adjusted EBITDA is earnings before interest expense, income taxes, depreciation and amortization, and additionally excludes other net non-operating expenses. We use Adjusted EBITDA, together with operating income, as a measure of segment and consolidated performance. We believe the exclusion of depreciation and amortization charges and net non-operating expense provides a meaningful measure of operating performance, and consistently excludes only these items in the calculation of Adjusted EBITDA. We believe that net income is the most directly comparable financial measure calculated in accordance with GAAP, therefore, we have reconciled Adjusted EBITDA to net income. We do not use Adjusted EBITDA as a measure of liquidity. Adjusted EBITDA is not a measure of financial performance or liquidity under GAAP and should not be considered in isolation or as an alternative to net income or as an indicator of our performance or to cash flows from operating activities as a measure of liquidity. Our measure of Adjusted EBITDA may not be comparable to similarly titled measures of other companies.

The following reconciles consolidated Adjusted EBITDA to consolidated net income (in thousands):

| | Three Months Ended September 30, | |
|---|---|-------------|
| | 2003 | 2002 |
| Adjusted EBITDA | \$ 185,340 | \$ 155,797 |
| Depreciation and amortization | 41,411 | 36,142 |
| Operating income | 143,929 | 119,655 |
| Interest expense | 5,220 | 7,054 |
| Other non-operating expense (income), net | (180) | 1,472 |
| Income tax expense | 52,081 | 41,673 |

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| | | |
|------------|-----------|-----------|
| Net income | \$ 86,808 | \$ 69,456 |
|------------|-----------|-----------|

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

9. COMMITMENTS AND CONTINGENCIES

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. At September 30, 2003, we serviced a FFEL portfolio of 1.4 million loans with an outstanding principal balance of more than \$15.7 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 we repackage the loans for sale to third parties. We evaluate the collectibility of any purchased 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 purchased loans. This reserve was approximately \$4.4 million at September 30, 2003.

On December 16, 1998, a state district court in Houston, Texas entered final judgment against us in a lawsuit brought by 21 former employees of Gibraltar Savings Association and/or First Texas Savings Association (collectively, GSA/FTSA). The GSA/FTSA employees alleged that they were entitled to the value of 803,082 shares of our stock (adjusted for February 2002 stock split) pursuant to options issued to the GSA/FTSA employees in 1988 in connection with a former technology outsourcing services agreement between GSA/FTSA and us. The judgment against us was for approximately \$17 million, which includes attorneys' fees and pre-judgment interest, but excludes additional attorneys' fees of approximately \$0.9 million and post-judgment interest at the statutorily mandated rate of 10% per annum, which could be awarded in the event the plaintiffs are successful upon appeal and final judgment. The judgment was appealed by the plaintiffs and us.

On August 29, 2002, the Fourteenth Court of Appeals, Houston, Texas, reversed the trial court's judgment and remanded the case to the trial court for further proceedings. However, the court of appeals affirmed the trial court judgment in part as to one of the plaintiffs. The court of appeals also held that the trial court did not err in dismissing certain of our affirmative defenses at a pretrial conference. We and the plaintiffs filed motions for rehearing with the court of appeals. On January 16, 2003, the court of appeals denied both motions for rehearing (except the court reversed its previous ruling that the trial court should have applied prejudgment interest at 6% rather than 10%).

On March 3, 2003, we filed a Petition for Review with the Texas Supreme Court requesting that the Court reverse the decision of the court of appeals and render judgment that the plaintiffs take nothing or, alternatively, remand the case to the trial court for further proceedings. The plaintiffs did not file a petition for review with the Texas Supreme Court. On June 19, 2003, the Texas Supreme Court requested that the parties file briefs on the merits of the appeal. The parties have completed the briefing to the Texas Supreme Court and are awaiting a notice of hearing or a decision from the Court.

We continue to believe that we have a meritorious defense to all or a substantial portion of the plaintiffs' claims, and accordingly, have not accrued any amount on our balance sheet related to the lawsuit.

One of our subsidiaries, ACS Defense, Inc., 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. 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. Our revenue from the contracts that we believe to be the focus of the Justice Department's inquiry is approximately \$25 million per year representing approximately 0.6% of our annual revenue. We are conducting an ongoing internal investigation of this matter through outside legal counsel and we are cooperating with the Department of Justice in producing documents in response to the subpoena and arranging for Department of Justice interviews of employees and former employees.

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

Another of our subsidiaries, ACS State & Local Solutions, Inc., 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 U.S. Department of Justice. The inquiry concerns the teaming arrangement between ACS and Tier Technologies on child support payment processing contracts awarded to ACS and Tier Technologies, as a subcontractor to ACS, in New York, Illinois and Ohio. Our annual revenue from these three contracts will be approximately \$70 million when the services are fully implemented, representing approximately 1.8% of our annual revenue. Our teaming arrangement also contemplated the California child support payment processing request for proposals which is expected to be issued in late 2003 or early 2004; however, we have not entered into a teaming agreement with Tier for California and do not expect that we and Tier Technologies, Inc. will team together on a proposal in response to this request for proposals. We are conducting an ongoing internal investigation of this matter through outside legal counsel and we are cooperating with the Department of Justice in producing documents in response to the subpoena.

Due to the preliminary nature of these government inquiries, it is difficult to assess the impact, if any, of these inquiries on ACS.

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 proceedings, we do not believe these actions, in the aggregate, will have a material adverse effect on our financial position, results of operations or liquidity.

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**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 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 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.

We report our financial results in accordance with generally accepted accounting principles (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 and Item 10 of Regulation S-K adopted by the SEC. We have presented herein 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

During the three months ended September 30, 2003, we signed contracts with new clients and incremental business with existing clients representing \$149 million of annualized recurring revenue. The commercial segment contributed 68% of the new contract signings including a multi-year contract with Gateway, Inc. to provide IT, human resources outsourcing and finance and accounting outsourcing services. The state and local governments segment contributed 18% of the new contract signings and the federal government segment contributed the remaining 14%. We define new business signings as recurring revenue from new contracts, including the incremental portion of renewals, signed during the period and represents the estimated annual recurring revenues, as measured under GAAP, to be recorded under that contract after full implementation.

In August 2003, we announced an agreement to sell the majority of our federal government business to Lockheed Martin Corporation for approximately \$658 million, which includes \$70 million payable pursuant to a five-year non-compete agreement. Revenues from the federal business to be divested were approximately \$685 million for fiscal 2003. This divestiture excludes our Department of Education relationship, which during fiscal year 2003 had revenues of approximately \$172 million. Additionally, our commercial and state and local government operations will continue to serve as a subcontractor on portions of the transferred business. In addition, we will acquire Lockheed Martin Corporation's commercial information technology business, with trailing, recurring annual revenues of approximately \$240 million, for approximately \$107 million. These transactions, which are subject to certain closing conditions, are expected to be completed during the second quarter of fiscal 2004. The expected after-tax proceeds from the divestiture will generally be used to pay down debt, fund our share repurchase program and for general corporate purposes.

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 effective immediately. The program, which is open-ended, will allow us to repurchase our shares on the open market from time to time in accordance with SEC rules and regulations, including shares that could be purchased pursuant to SEC Rule 10b5-1. The number of shares to be purchased and the timing of purchases will be based on the level of cash and debt balances, general business conditions and other factors, including alternative investment opportunities. We intend to fund the repurchase program from various sources, including, but not limited to, cash flow from operations, borrowings under our existing revolving credit facility and, if consummated, proceeds from the sale of the majority of our federal government business. As of September 30, 2003 we had repurchased 700,000 shares at a total costs of approximately \$35.7 million. Through November 11, 2003, we have repurchased approximately 2.3 million shares at a total cost of approximately \$113.3 million.

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Our largest contract is with the Department of Education (the Department), for which we service student loans under the Department of Education's Direct Student Loan program administered by its Office of Federal Student Aid (FSA). Revenues from this contract represent approximately 4% of our consolidated revenues. This contract was scheduled to run through September 30, 2003. In November 2001, the Department extended the contract term through September 30, 2006, with an option for further extension through September 30, 2007. In December 2001, SLM Corporation (Sallie Mae) challenged the Department's sole-source extension in a protest filed with the Department. The FSA initially took the position that the Sallie Mae protest was without merit and that the contract extension was lawful. In July 2002, the Department's deciding official sustained the protest, concluding that further market research was needed to support the sole-source extension of our contract. However, the deciding official declined to rescind our contract extension and directed the FSA to analyze its direct loan servicing needs and procure the services in compliance with law.

On January 31, 2003 FSA officials notified us that they would conduct a competitive procurement for Common Services for Borrowers which will be an integrated solution for FSA for servicing, consolidation and collections functions for federally insured student aid obligations and will absorb all loan servicing requirements for the Department. The Department announced that the competitive procurement would be conducted in two phases with phase one being the determination of eligibility to participate and phase two being the selection process. We, along with Sallie Mae and a third participant who subsequently withdrew from the competition were selected as eligible to participate. On July 7, 2003, we submitted our proposal to the Department. In August 2003, the Department notified us that it had determined that we are in the competitive range for award, and that negotiations would begin shortly to be followed by the Department's request for submission of final proposal revisions and an award determination. We submitted a final proposal to the Department in November 2003. The Department has indicated it will make a decision on the procurement in November 2003. Although we believe we are positioned favorably because of our performance record with the Department, there can be no assurance that we will be awarded the new contract for Common Services to Borrowers.

In May 2003, the Department provided public notice that it intended to enter into negotiations with us to modify our existing contract for the purpose of revising the period of performance for a period of up to 36 months, with the use of appropriate options, through September 30, 2006. The Department further stated that this contract action would be on a sole source basis and would accommodate a prompt and successful transition to the Common Services for Borrowers vendor. We are continuing discussions with the Department regarding this modification; however, the terms of the proposed modification have not been negotiated at this time and it is likely that the negotiations will not be completed until final award by the Department of the Common Services for Borrowers contract.

In 2001, we were awarded a contract by the Department of Community Health of the State of Georgia (DCH) to develop, implement and operate a system to administer health benefits to Georgia Medicaid recipients as well as state government employees. This system development project is large and complex and involves development of the first system in the industry that will process both Medicaid and state employee claims. The Medicaid phase of this project was implemented on April 1, 2003. As with any large, complex system development and implementation project certain delays and operational issues were encountered in this phase. The initial phase operational issues have been substantially addressed. We are working in collaboration with DCH and the Georgia healthcare providers to address ongoing program issues, including the implementation of new policy changes by DCH as well as changes required by HIPAA. We believe, based on our analysis to date, that the savings to the State of Georgia associated with this initial phase of the contract will exceed the savings initially anticipated. We are also in continuing discussions with DCH regarding claims that we and DCH have asserted against each other related to delays in the initial phase development. Both we and DCH have agreed to resolve the issues in a collaborative manner. Any final amount that we may agree to pay DCH has not been negotiated; however, the cost associated with delays in system implementation, including incremental transition costs incurred by DCH, have been properly and fully reflected in our financial results. As of September 30, 2003, we had approximately \$84.5 million of unbilled receivables related to this contract and had \$48.1 million of billed receivables, of which \$42.8 million was past due. We expect to resolve this matter over the next several months in an amicable fashion; however, there can be no assurance as to the ultimate outcome of this matter.

Table of Contents**REVENUE GROWTH**

Internal revenue growth is measured as total revenue growth less acquired revenue from acquisitions. Acquired revenue from acquisitions is based on pre-acquisition normalized revenue of acquired companies. We use the calculation of internal revenue growth to measure revenue growth excluding the impact of acquired revenues and believe these adjustments to historical reported results are necessary to accurately reflect our internal revenue growth. The following table sets forth the calculation of internal revenue growth (in thousands):

| | Three months ended September 30, | | | |
|-------------------------------------|----------------------------------|-------------------|-------------------|------------|
| | 2003 | 2002 | \$ Growth | Growth % |
| Consolidated | | | | |
| Total Revenues | \$ 1,036,635 | \$ 882,581 | \$ 154,054 | 17% |
| Acquired revenues | 20,004 | | 20,004 | 2% |
| Internal revenues | 1,016,631 | 882,581 | 134,050 | 15% |
| | <u>1,036,635</u> | <u>882,581</u> | <u>154,054</u> | <u>17%</u> |
| Total | <u>\$ 1,036,635</u> | <u>\$ 882,581</u> | <u>\$ 154,054</u> | <u>17%</u> |
| State & Local Government | | | | |
| Total Revenues | \$ 477,040 | \$ 387,382 | \$ 89,658 | 23% |
| Acquired revenues | 5,004 | | 5,004 | 1% |
| Internal revenues | 472,036 | 387,382 | 84,654 | 22% |
| | <u>477,040</u> | <u>387,382</u> | <u>89,658</u> | <u>23%</u> |
| Total | <u>\$ 477,040</u> | <u>\$ 387,382</u> | <u>\$ 89,658</u> | <u>23%</u> |
| Commercial | | | | |
| Total Revenues | \$ 339,852 | \$ 287,528 | \$ 52,324 | 18% |
| Acquired revenues | 15,000 | | 15,000 | 5% |
| Internal revenues | 324,852 | 287,528 | 37,324 | 13% |
| | <u>339,852</u> | <u>287,528</u> | <u>52,324</u> | <u>18%</u> |
| Total | <u>\$ 339,852</u> | <u>\$ 287,528</u> | <u>\$ 52,324</u> | <u>18%</u> |
| Federal Government | | | | |
| Total Revenues | \$ 219,738 | \$ 207,670 | \$ 12,068 | 6% |
| Acquired revenues | | | | |
| Internal revenues | 219,738 | 207,670 | 12,068 | 6% |
| | <u>219,738</u> | <u>207,670</u> | <u>12,068</u> | <u>6%</u> |
| Total | <u>\$ 219,738</u> | <u>\$ 207,670</u> | <u>\$ 12,068</u> | <u>6%</u> |

Table of Contents**RESULTS OF OPERATIONS**

The following table sets forth certain items from our consolidated statements of income as a percentage of revenues:

| | Three months ended September 30, | |
|----------------------------------|---|-------------|
| | 2003 | 2002 |
| Revenues | 100% | 100% |
| Expenses: | | |
| Wages and benefits | 46.0 | 45.6 |
| Services and supplies | 25.5 | 25.6 |
| Rent, lease and maintenance | 9.3 | 9.6 |
| Depreciation and amortization | 4.0 | 4.1 |
| Other operating expenses | 1.3 | 1.5 |
| | <hr/> | <hr/> |
| Total operating expenses | 86.1 | 86.4 |
| | <hr/> | <hr/> |
| Operating income | 13.9 | 13.6 |
| Interest expense | 0.5 | 0.8 |
| Other non-operating expense, net | 0.0 | 0.2 |
| | <hr/> | <hr/> |
| Pretax profit | 13.4 | 12.6 |
| | <hr/> | <hr/> |
| Income tax expense | 5.0 | 4.7 |
| | <hr/> | <hr/> |
| Net income | 8.4% | 7.9% |
| | <hr/> | <hr/> |

COMPARISON OF THE THREE MONTHS ENDED SEPTEMBER 30, 2003 TO THE THREE MONTHS ENDED SEPTEMBER 30, 2002*Revenues*

In the first quarter of fiscal year 2004, our revenue increased \$154.1 million, or 17%, to \$1.04 billion from \$882.6 million in the first quarter of fiscal year 2003. Internal revenue growth for the first quarter of fiscal year 2004 was 15%. The remaining revenue growth was due to acquisitions.

Revenue in our state and local government segment, which represents 46% of consolidated revenue for the first quarter of fiscal year 2004, increased \$89.7 million, or 23%, to \$447.0 million in the first quarter of fiscal year 2004 compared to the same period last year. Internal revenue growth of 22% resulted from the ramp up of revenue on our Georgia and Texas Medicaid contracts and our New Jersey EZPass contract.

Revenue in our commercial segment, which represents 33% of consolidated revenue for the first quarter of fiscal year 2004, increased \$52.3 million, or 18%, to \$339.9 million in the first quarter of fiscal year 2004 compared to the same period last year. Internal revenue growth of 13% resulted primarily from the ramp of new business, including the Motorola and Ingram Micro contracts signed in fiscal year 2003.

Revenue in our federal government segment, which represents 21% of consolidated revenue for the first quarter of fiscal year 2004, increased \$12.1 million, or 6%, to \$219.7 million in the first quarter of fiscal year 2004 compared to the same period last year as a result of increased revenues with Department of Defense agencies.

Operating Expenses

As a percentage of revenue, our operating expenses decreased 0.3% to 86.1% in the first quarter of fiscal year 2004 from 86.4% in the first quarter of fiscal year 2003. Our operating expenses increased \$129.8 million, or 17.0% to \$892.7 million in the first quarter of fiscal year 2004 from \$762.9 million in the first quarter of fiscal 2003. During the first quarter of fiscal year 2004, we suspended depreciation and amortization of the assets related to our federal government business that were classified as held for sale during the quarter of approximately \$4.3 million

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(\$2.7 million, net of tax). This increase was offset by higher incentive compensation expense recorded in the fiscal year 2004 quarter.

Wages and benefits increased \$74.2 million, or 18.4%, to \$477.1 million. As a percentage of revenue, wages and benefits increased 0.4% to 46%, primarily due to higher incentive compensation expense recorded in the first quarter of fiscal 2004.

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Services and supplies increased \$38.5 million, or 17.0%, to \$265.0 million. As a percentage of revenue, services and supplies decreased 0.1% to 25.5%, primarily due to costs associated with the pursuit of a potential outsourcing transaction recorded in the first quarter of fiscal year 2003.

Rent, lease and maintenance increased \$11.6 million, or 13.7%, to \$95.9 million. As a percentage of revenue, rent, lease and maintenance decreased 0.3% to 9.3% due to increased BPO services in our revenue mix, which has a lower component of rent, lease and maintenance than traditional IT outsourcing and systems integration.

Depreciation and amortization increased \$5.3 million, or 14.6%, to \$41.4 million. As a percentage of revenue, depreciation and amortization decreased 0.1%, to 4.0% due to the cessation of \$4.3 million in depreciation and amortization expense related to the assets held for sale in our federal government business. This decrease was partially offset by increased depreciation and amortization primarily due to capital expenditures to support new business.

Other operating expenses increased \$0.2 million, or 1.8%, to \$13.3 million. As a percentage of revenue, other operating expenses decreased 0.2% to 1.3% primarily due to costs associated with the pursuit of a potential outsourcing transaction recorded in the first quarter of fiscal year 2003.

Operating Margins

Our operating margins increased 0.3%, to 13.9% in the first quarter of fiscal year 2004 from 13.6% for the same period last year primarily due to the cessation of \$4.3 million in depreciation and amortization expense related to the assets held for sale in our federal government business offset by higher incentive compensation expense recorded in the first quarter of fiscal year 2004.

Interest expense

Interest expense decreased \$1.8 million in the first quarter of fiscal year 2004 compared to the first quarter of fiscal year 2003, primarily as a result of lower outstanding debt during the fiscal year 2004 quarter.

Other non-operating expense (income), net

Other non-operating expense (income), net decreased \$1.7 million in the first quarter of fiscal year 2004 compared to the first quarter of fiscal year 2003. The first quarter of fiscal year 2003 included \$1.4 million of writedowns of long-term assets.

Tax Expense

Our effective tax rate of approximately 37.5% in fiscal year 2004 exceeds the federal statutory rate of 35% due primarily to the net 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. One of our primary financial goals is to maintain an adequate level of liquidity through active management of assets and liabilities.

During the three months ended September 30, 2003, we generated approximately \$59.4 million in cash flow from operations versus approximately \$86.9 million in the same period in fiscal year 2003. Free cash flow was approximately \$16.6 million for the first three months of fiscal year 2004 versus approximately \$42.1 million for the first three months of fiscal year 2003, a decrease of 61% due to decreased accounts receivable collections and increased annual incentive compensation payments compared to the prior year. Free cash flow is measured as operating cash flows (net cash 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). The following table sets forth the calculations of free cash flow (in thousands):

| | Three months ended September 30, | |
|--|---|-------------|
| | 2003 | 2002 |
| Net cash provided by operating activities | \$ 59,382 | \$ 86,881 |
| Purchases of property, equipment and software, net | (42,760) | (44,788) |

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| | | |
|----------------|-----------|-----------|
| Free cash flow | \$ 16,622 | \$ 42,093 |
|----------------|-----------|-----------|

During the three months ended September 30, 2003, we used \$50.8 million for investing activities. This includes \$42.8 million in the first quarter of fiscal year 2004 related to the purchase of property, equipment and software versus \$44.8 million in the same period in fiscal year 2003. Our capital expenditures declined approximately 4.1% of total revenues for the three months ended September 30, 2003 compared to 5.1% in the same period in fiscal year 2003, primarily as a result of the timing of capital expenditures related to new business signings.

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During the first three months of fiscal year 2004, cash used by financing activities was \$23.4 million. During the first three months of fiscal year 2004, we used \$35.7 million to repurchase 700,000 shares of our common stock pursuant to our share repurchase program. We had net borrowings of \$9.3 million on our \$875 million credit facility during the quarter.

As of September 30, 2003, we had approximately \$509.4 million of long-term debt outstanding, which was primarily comprised of approximately \$317.0 million of our 3.5% Convertible Subordinated Notes due February 15, 2006 and approximately \$187.0 million outstanding under our \$875.0 million credit facility. At September 30, 2003, we had approximately \$510.6 million available on our \$875.0 million revolving credit facility after considering outstanding letters of credit of \$177.4 million that secure certain contractual performance and other obligations.

We have certain contracts, primarily in our state and local business that require us to provide a surety bond or a letter of credit as a guarantee of performance. As of September 30, 2003, outstanding surety bonds of \$311.3 million and \$170.9 million of our outstanding letters of credit secure our performance of contractual obligations with our clients. In general, we would only be liable for the amount of these guarantees in the event of default in the 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 revolving credit facility to meet ongoing business needs and to respond to future requests for proposals from state and local governments.

At September 30, 2003, we had cash and cash equivalents of \$36.4 million compared to \$51.2 million at June 30, 2003. Our working capital (defined as current assets of \$1.2 billion less current liabilities of \$559.9 million) increased \$257.4 million to \$679.4 million at September 30, 2003 from \$422.0 million at June 30, 2003, which included the impact of the classification of the assets and related liabilities of our federal government business as held for sale (see Note 4). Our current ratio (defined as total current assets of \$1.2 billion million divided by total current liabilities of \$559.9 million) was 2.2 and 1.8 at September 30, 2003 and June 30, 2003, 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 17.0% at September 30, 2003 and June 30, 2003.

Management believes that available cash and cash equivalents, together with cash generated from operations and available borrowings under our credit facility, will provide adequate funds for our anticipated internal growth needs, including capital expenditures. Our management also believes that cash provided by operations will be sufficient to satisfy all existing debt obligations as they become due. However, we intend to continue our growth through acquisitions and from time to time to engage in discussions with potential acquisition candidates, 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 SEPTEMBER 30, 2003 (IN THOUSANDS):

| Contractual Obligations | Total | Payments Due by Period | | | |
|---|------------------|------------------------|------------------|-----------------|-----------------|
| | | Less than | | | |
| | | 1 Year | 1-3 Years | 4-5 Years | After 5 Years |
| Long-term debt | \$503,990 | \$ | \$503,990 | \$ | \$ |
| Capital lease obligations | 5,405 | 2,197 | 2,219 | 989 | |
| Operating leases | 337,722 | 99,102 | 126,993 | 60,973 | 50,654 |
| Purchase obligations | 50,000 | 5,000 | 10,000 | 10,000 | 25,000 |
| Total Contractual Cash Obligations | \$897,117 | \$106,299 | \$643,202 | \$71,962 | \$75,654 |

| Other Commercial Commitments | Total Amounts Committed | Amount of Commitment Expiration per Period | | | |
|------------------------------|-------------------------|--|-----------|-----------|---------------|
| | | Less than | | | |
| | | 1 Year | 1-3 Years | 4-5 Years | After 5 Years |
| | | | | | |

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| | | | | | |
|-------------------------------------|-------------------|-------------------|------------------|--------------|-----------|
| Standby letters of credit | \$ 177,379 | \$ 177,379 | \$ | \$ | \$ |
| Surety Bonds | 311,272 | 293,535 | 17,700 | 37 | |
| Total Commercial Commitments | \$ 488,651 | \$ 470,914 | \$ 17,700 | \$ 37 | \$ |

During the first quarter of fiscal year 2004, we entered into an agreement with a customer to purchase \$50 million of products and services over a seven-year term, with a minimum purchase of \$5 million annually, at prices consistent with the customer's commercial pricing and discount guidelines.

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We are obligated to make certain contingent payments to former shareholders of acquired entities upon satisfaction of certain contractual criteria. As of September 30, 2003, the maximum aggregate amount of the outstanding contingent obligations is approximately \$21.9 million. Upon satisfaction of the specified contractual criteria, a corresponding increase in goodwill would be recorded. During the first quarter of fiscal year 2004, we paid \$1.0 million related to these obligations.

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. At September 30, 2003, we serviced a FFEL portfolio of 1.4 million loans with an outstanding principal balance of more than \$15.7 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 we repackage the loans for sale to third parties. We evaluate the collectibility of any purchased 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 purchased loans. This reserve was approximately \$4.4 million at September 30, 2003.

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 involve significant judgments and estimates used in the preparation of our consolidated financial statements.

Revenue recognition. Our policy follows the guidance from SEC Staff Accounting Bulletin 101 Revenue Recognition in Financial Statements (SAB 101). SAB 101 provides guidance on the recognition, presentation, and disclosure of revenue in financial statements. We recognize revenues when persuasive evidence of an arrangement exists, the product has been shipped or the services have been provided to the client, the sales price is fixed or determinable, and collectibility is reasonably assured.

Approximately 60% of our revenue is recognized based on transaction volumes, approximately 12% is related to time and material contracts, approximately 14% is related to cost reimbursable contracts, approximately 7% of our revenues are recognized using percentage-of-completion accounting and the remainder is fixed fee based.

Generally, information technology processing revenues are recognized as services are provided to the client. 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 for business process outsourcing services are recognized as services are rendered, generally on the basis of the number of accounts or transactions processed.

In the federal government segment, our contracts are typically cost reimbursable, fixed price, unit price, or time and material contracts. 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 on certain fixed price contracts where we provide information technology development and implementation services and certain contracts in our federal government segment 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. Performance will often extend over long periods, and our right to receive payment depends on our 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 long-term nature of these

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contracts, 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 contract include, but are not limited to, the availability of labor and labor productivity, the nature and complexity of the work to be performed, the impact of delayed performance, and availability and timing of funding from the client. 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.

Emerging Issues Task Force Issue 00-21 Accounting for Revenue Arrangements with Multiple Deliverables (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. The provisions of EITF 00-21 are applicable on a prospective basis to transactions entered into in fiscal years beginning after June 15, 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. Immediate recognition is made of any anticipated losses.

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. 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 intangibles, such revision could result in an impairment charge that could have a material impact on our financial results.

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.

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.

Loss of, or reduction of business from, clients. The loss of clients and/or the reduction of volumes and services provided to our clients could materially affect our revenues, profitability and cash flows. In addition, we incur a high level of fixed costs related to our 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 revenues, profitability and cash flow.

Termination of a contract by a client or deterioration of the financial condition of a client. We must make significant capital investments in order to attract and retain large outsourcing agreements. The termination of a client contract or the deterioration of the financial condition or prospects of a client has in the past, and may in the future, result in an impairment of the net book value of the assets recorded, including a portion of our intangible assets, and a reduction in our earnings and cash flow.

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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. Many of our competitors have greater resources, and they may be able to use their resources to adapt more quickly to new or emerging technologies or to devote greater resources to the promotion and sale of their products and services. 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.

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 integrate acquired operations with vendors' systems could result in increased cost.

Government clients' termination rights, audits and investigations. A substantial portion of our revenues are derived from contracts with the United States government and its agencies and from contracts with state and local governments and their agencies. Governments and their agencies may terminate most of these contracts at any time, without cause. Also, our federal government contracts are 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 these contracts. 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 results and cash flow.

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 reputation in the industry may suffer, which could materially and adversely affect our business, financial condition, results of operations, and cash flow.

Pricing risks. Some 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. Some 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.

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 or refuse to renew our contracts with them, we might not be able to replace the related software programs and would be unable to serve our clients, which could have a material adverse effect on our business, revenues, profitability and cash flow.

Rapid technological changes. The markets for our 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.

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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.

Federal regulations relating to confidentiality of health data. In 1996, Congress passed the Health Insurance Portability and Accountability Act (HIPAA) and as required therein, the Secretary of Health and Human Services (HHS) has established standards for information sharing, security and confidentiality with regard to health information of individuals. We process individually identifiable health information for many of our clients. We and our clients are required to comply with HIPAA and we will be required to comply with HIPAA for individually identifiable health information which we maintain for our employees. Health information privacy regulations promulgated under HIPAA took effect on April 14, 2003. On or prior to that date, we implemented procedures, training and security features designed to protect the privacy and integrity of such health information. On October 15, 2003, regulations related to the standardization of information used in processing healthcare transactions took effect, and on or prior to that date, we took measures to comply with such regulations. Other regulations have been published under HIPAA (such as those related to additional security measures that must be implemented by April 2005) and other regulations required by HIPAA have yet to be published. In addition, various states, including Texas, have passed legislation that addresses medical record privacy and restricts the use and disclosure of individually identifiable health information, and other federal or state privacy legislation may be enacted at any time. HIPAA subjects us, as a service provider and as an employer, to liability and monetary penalties for failure to comply with HIPAA regulations. If we fail to comply with HIPAA regulations and applicable state laws, we could incur liability under these provisions, which could have a material adverse effect on our profitability and cash flow.

Budget deficits at state and local governments and their agencies. A substantial portion of our revenues are derived from contracts with state and local governments and their agencies. Currently, many state and local governments that we have contracts with are facing potential budget deficits. While this has not had a material adverse impact on our results of operations through the first quarter of fiscal year 2004, 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. International operations are subject to a number of risks including, but not limited to the following: fluctuations in foreign exchange currency rates; licensing and labor counsel requirements; staffing key managerial positions; data privacy laws adopted by various countries in which ACS does business, including but not limited to member states of the European Union; general economic conditions in foreign countries; additional expenses and risks inherent in conducting operations in geographically distant locations; laws of those foreign countries; political instability; trade restrictions such as tariffs and duties or other controls affecting foreign operations, and other factors that may 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 and 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. 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 and results of operations and prospects.

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Servicing Risks. We service (for various lenders and under various service agreements) a portfolio of over \$15 billion of loans made under the Federal Family Loan 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 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.

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.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We have fixed rate and variable rate debt instruments. Our variable rate debt instruments are subject to market risk from changes in interest rates. Sensitivity analysis is one technique used to measure the impact of changes in the interest rates on the value of market-risk sensitive financial instruments. A hypothetical 10% movement in interest rates would not have a material impact on our future earnings, fair value, or cash flows.

ITEM 4. CONTROLS AND PROCEDURES

The management of the Company, including the Company's principal executive officer and principal financial officer have evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934) as of September 30, 2003. Based on such evaluation, the Company's principal executive officer and principal financial officer have concluded that as of September 30, 2003, such disclosure controls and procedures are effective for the purpose of ensuring that material information required to be in this Quarterly Report is made known to them by others on a timely basis. There have not been any changes in the Company's 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 September 30, 2003 that have materially affected or are reasonably likely to materially affect the Company's internal control over financial reporting.

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PART II

ITEM 1. LEGAL PROCEEDINGS

On December 16, 1998, a state district court in Houston, Texas entered final judgment against us in a lawsuit brought by 21 former employees of Gibraltar Savings Association and/or First Texas Savings Association (collectively, GSA/FTSA). The GSA/FTSA employees alleged that they were entitled to the value of 803,082 shares of our stock (adjusted for February 2002 stock split) pursuant to options issued to the GSA/FTSA employees in 1988 in connection with a former technology outsourcing services agreement between GSA/FTSA and us. The judgment against us was for approximately \$17 million, which includes attorneys' fees and pre-judgment interest, but excludes additional attorneys' fees of approximately \$0.9 million and post-judgment interest at the statutorily mandated rate of 10% per annum, which could be awarded in the event the plaintiffs are successful upon appeal and final judgment. The judgment was appealed by the plaintiffs and us.

On August 29, 2002, the Fourteenth Court of Appeals, Houston, Texas, reversed the trial court's judgment and remanded the case to the trial court for further proceedings. However, the court of appeals affirmed the trial court judgment in part as to one of the plaintiffs. The court of appeals also held that the trial court did not err in dismissing certain of our affirmative defenses at a pretrial conference. We and the plaintiffs filed motions for rehearing with the court of appeals. On January 16, 2003, the court of appeals denied both motions for rehearing (except the court reversed its previous ruling that the trial court should have applied prejudgment interest at 6% rather than 10%).

On March 3, 2003, we filed a Petition for Review with the Texas Supreme Court requesting that the Court reverse the decision of the court of appeals and render judgment that the plaintiffs take nothing or, alternatively, remand the case to the trial court for further proceedings. The plaintiffs did not file a petition for review with the Texas Supreme Court. On June 19, 2003, the Texas Supreme Court requested that the parties file briefs on the merits of the appeal. The parties have completed the briefing to the Texas Supreme Court and are awaiting a notice of hearing or a decision from the Court.

We continue to believe that we have a meritorious defense to all or a substantial portion of the plaintiffs' claims, and accordingly, have not accrued any amount on our balance sheet related to the lawsuit.

One of our subsidiaries, ACS Defense, Inc., 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. 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. Our revenue from the contracts that we believe to be the focus of the Justice Department's inquiry is approximately \$25 million per year representing approximately 0.6% of our annual revenue. We are conducting an ongoing internal investigation of this matter through outside legal counsel and we are cooperating with the Department of Justice in producing documents in response to the subpoena and arranging for Department of Justice interviews of employees and former employees.

Another of our subsidiaries, ACS State & Local Solutions, Inc., and a teaming partner of this subsidiary, Tier Technologies, Inc., 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 U.S. Department of Justice. The inquiry concerns the teaming arrangement between ACS and Tier Technologies on child support payment processing contracts awarded to ACS and Tier Technologies, as a subcontractor to ACS, in New York, Illinois and Ohio. Our annual revenue from these three contracts will be approximately \$70 million when the services are fully implemented, representing approximately 1.8% of our annual revenue. Our teaming arrangement also contemplated the California child support payment processing request for proposals which is expected to be issued in late 2003 or early 2004; however, we have not entered into a teaming agreement with Tier for California and do not expect that we and Tier Technologies, Inc. will team together on a proposal in response to this request for proposals. We are conducting an ongoing internal investigation of this matter through outside legal counsel and we are cooperating with the Department of Justice in producing documents in response to the subpoena.

Due to the preliminary nature of these government inquiries, it is difficult to assess the impact, if any, of these inquiries on ACS.

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 proceedings, we do not believe these actions, in the aggregate, will have a material adverse effect on our financial position, results of operations or liquidity.

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At our 2003 Annual Meeting of Stockholders held on October 30, 2003, the following actions were taken:

1. The following Directors were elected for terms of office expiring in 2004:

| Name | For | Withheld |
|-----------------------|-------------|-----------|
| Darwin Deason | 171,732,385 | 2,839,678 |
| Jeffrey A. Rich | 172,054,451 | 2,517,612 |
| Mark A. King | 172,054,451 | 2,517,612 |
| Joseph P. O'Neill | 168,733,292 | 5,838,771 |
| Frank A. Rossi | 168,733,292 | 5,838,771 |
| J. Livingston Kosberg | 172,075,112 | 2,496,951 |
| Dennis McCuiston | 172,106,663 | 2,465,400 |

Pursuant to the terms of our Notice of Annual Meeting and Proxy Statement, proxies received were voted, unless authority was withheld, in favor of the election of the seven nominees named.

2. A proposal by the Board of Directors to approve Performance Based Incentive Compensation for our executive officers was approved by the stockholders. The stockholders cast 158,210,358 votes in favor of this proposal and 2,159,140 votes were cast against this proposal. There were 375,633 abstentions and 13,826,932 broker non-votes.
3. A proposal by the Board of Directors to ratify the appointment of PricewaterhouseCoopers LLP as our independent auditors for fiscal year 2004 was approved by the stockholders. The stockholders cast 168,530,710 votes in favor of the proposal and 5,950,302 votes against the proposal. There were 118,051 abstentions.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

- a.) Exhibits

Reference is made to the Index to Exhibits beginning on page 25 for a list of all exhibits filed as part of this report.

- b.) Reports on Form 8-K

- On July 29, 2003, the Company filed a Current Report on Form 8-K (dated as of July 29, 2003) for the purpose of furnishing the earnings press release, announcing the telephone conference and webcast to disclose the Company's financial results and disclosing the location of the Company's Supplementary Financial Information used during the conference for the year ended June 30, 2003.
- On July 31, 2003, the Company filed a Current Report on Form 8-K (dated as of July 29, 2003) for the purpose of the furnishing the transcript of the Company's presentation during the telephone conference disclosing the Company's financial results, the questions and answers following the presentation and furnishing a copy of the slides presented during the call on the Company's website.
- On August 1, 2003, the Company filed a Current Report on Form 8-K (dated as of August 1, 2003) for the purpose of furnishing a copy of the press release announcing the signing of a definitive agreement to sell a significant portion of its federal government business to Lockheed Martin Corporation and the signing of a definitive agreement to acquire the commercial information technology business of Lockheed Martin, and furnishing a copy of the slides presented on the Company's website during the conference call on August 1, 2003.
- On September 2, 2003 the Company filed a Current Report on Form 8-K (dated as of September 2, 2003) for the purposes of furnishing the press release announcing that its Board of Directors had authorized a share repurchase program for the purchase of up to \$500 million of its outstanding shares of Class A common stock.
- On September 15, 2003, the Company filed a Current Report on Form 8-K (dated as of September 11, 2003) for the purpose of furnishing the press release announcing the appointment of new directors and changes to the corporate governance policies necessary to adopt certain provisions of the Sarbanes-Oxley Act of 2002 and the proposed New York Stock Exchange listing

standards.

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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 14th day of November, 2003.

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

| <u>Exhibit Number</u> | <u>Exhibit Name</u> |
|-----------------------|--|
| 3.1 | Certificate of Incorporation of the Company (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 the Company, 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 the Company, as amended and in effect on August 13, 2002 (filed as Exhibit 3.3 to our Annual Report on Form 10-K, filed September 17, 2003 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 the Company 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 | Indenture, dated as of February 21, 2001, between the Company, as Issuer, and U.S. Trust Company of Texas, N.A., as Trustee, relating to the Company's 3.5% Convertible Subordinated Notes due February 15, 2006 (filed as Exhibit 4.1 to our Registration Statement on Form S-3, filed March 30, 2001, File No. 333-58038 and incorporated herein by reference) |
| 4.4 | Registration Rights Agreement, dated February 21, 2001, by and between the Company and Goldman, Sachs & Co., as representative of the several purchasers named therein relating to the Company's 3.5% Convertible Subordinated Notes due February 15, 2006 (filed as Exhibit 4.4 to our Registration Statement on Form S-3, filed March 30, 2001, File No. 333-58038 and incorporated herein by reference) |
| 4.5 | Specimen Note for the Company's 3.5% Convertible Subordinated Notes due February 15, 2006 (filed as Exhibit 4.2 to our Registration Statement on Form S-3, filed March 30, 2001, File No. 333-58038 and incorporated herein by reference) |
| 4.6 | Amendment No. 1 to First Amended and Restated Rights Agreement, dated as of February 5, 2002, by and between the Company 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) |
| 4.7 | Form of Rights Certificate (included as Exhibit A to the Amended and Restated Rights Agreement (Exhibit 4.2)) |
| 10.1* | Stock Purchase Agreement, dated as of July 31, 2003 between Lockheed Martin Corporation and the Company. |
| 10.2* | |

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Asset Purchase Agreement, dated as of July 31, 2003 between Lockheed Martin Service, Inc. and the Company.

- 31.1* Certification of Chief Executive Officer
- 31.2* Certification of Chief Financial Officer

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| <u>Exhibit Number</u> | <u>Exhibit Name</u> |
|------------------------------|--|
| 32.1* | Certification of Chief Executive Officer pursuant to 18 U.S.C., Section 1350, as adopted pursuant to Section 9.06 of the Sarbanes-Oxley Act of 2002. Pursuant to SEC Release 34-47551, this Exhibit is furnished to the SEC and shall not be deemed to be filed. |
| 32.2* | Certification of Chief Financial Officer pursuant to 18 U.S.C., Section 1350, as adopted pursuant to Section 9.06 of the Sarbanes-Oxley Act of 2002. Pursuant to SEC Release 34-47551, this Exhibit is furnished to the SEC and shall not be deemed to be filed. |

* Filed herewith