

CERIDIAN CORP /DE/  
Form 10-Q  
February 18, 2005

**Table of Contents**

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, DC 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, 2004

or

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

For transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 1-15168

**CERIDIAN CORPORATION**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

41-1981625  
(IRS Employer  
Identification No.)

3311 East Old Shakopee Road, Minneapolis,  
Minnesota  
(Address of principal executive offices)

55425  
(Zip Code)

Registrant's telephone number, including area code: (952) 853-8100

Former name, former address and former fiscal year if changed from last report: Not Applicable

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

The number of shares of registrant's Common Stock, par value \$.01 per share, outstanding as of October 31, 2004, was 149,203,580.

---

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

INDEX

	Pages
<u>Part I. Financial Information</u>	
<u>Item 1. Financial Statements</u>	
<u>Consolidated Statements of Operations for the three and nine month periods ended September 30, 2004 and 2003</u>	3
<u>Consolidated Balance Sheets as of September 30, 2004 and December 31, 2003</u>	4
<u>Consolidated Statements of Cash Flows for the nine month periods ended September 30, 2004 and 2003</u>	5
<u>Notes to Consolidated Financial Statements</u>	6
The consolidated financial statements should be read in conjunction with the notes to consolidated financial statements.	
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	37
<u>Item 4. Controls and Procedures</u>	38
<u>Part II. Other Information</u>	
<u>Item 1. Legal Proceedings</u>	46
<u>Item 2. Unregistered Sale of Equity Securities and Use of Proceeds</u>	48
<u>Item 6. Exhibits</u>	49
<u>Signature</u>	52
<u>Amendment No. 3 to Receivables Purchase Agreement</u>	
<u>Amendment No. 4 to Receivables Purchase Agreement</u>	
<u>Second Amendment to Credit Agreement</u>	
<u>Third Amendment to Credit Agreement</u>	
<u>Form of Non-Qualified Stock Option Award Agreement</u>	
<u>Form of Restricted Stock Award Agreement</u>	
<u>Amendment No. 5 to Receivables Purchase Agreement</u>	
<u>Amendment No. 6 to Receivables Purchase Agreement</u>	

Amendment No. 7 to Receivables Purchase Agreement

Fourth Amendment to Credit Agreement

Fifth Amendment to Credit Agreement

Sixth Amendment to Credit Agreement

Certification of CEO Pursuant to Section 302

Certification of CFO Pursuant to Section 302

Certification of CEO Pursuant to Section 906

Certification of CFO Pursuant to Section 906

**Table of Contents**

## FORM 10-Q

## PART I. FINANCIAL INFORMATION

## ITEM I. FINANCIAL STATEMENTS

## CONSOLIDATED STATEMENTS OF OPERATIONS

Ceridian Corporation  
and Subsidiaries

(Unaudited)

(Dollars in millions, except per share data)

	For Periods Ended September 30,			
	Three Months		Nine Months	
	2004	2003	2004	2003
		(restated)		(restated)
Revenue	\$ 328.7	\$ 291.6	\$ 959.1	\$ 889.6
Costs and Expenses				
Cost of revenue	192.1	169.7	547.0	513.5
Selling, general and administrative	110.8	86.1	325.0	269.5
Research and development	7.0	5.0	19.9	13.3
(Gain) loss on derivative instruments	(7.9)	0.5	(2.6)	(18.7)
Other expense (income)	(0.8)	(1.1)	(2.5)	(1.3)
Interest income	(0.7)	(0.5)	(1.7)	(1.5)
Interest expense	1.2	1.3	3.2	3.6
Total costs and expenses	301.7	261.0	888.3	778.4
Earnings before income taxes	27.0	30.6	70.8	111.2
Income tax provision	9.1	11.1	24.5	39.4
Net earnings	\$ 17.9	\$ 19.5	\$ 46.3	\$ 71.8
Earnings per share				
Basic	\$ 0.12	\$ 0.13	\$ 0.31	\$ 0.48
Diluted	\$ 0.12	\$ 0.13	\$ 0.31	\$ 0.48
Shares used in calculations (in 000 s)				
Weighted average shares (basic)	149,098	148,426	148,985	148,282
Dilutive securities	1,544	2,156	2,271	1,098
Weighted average shares (diluted)	150,642	150,582	151,256	149,380
Antidilutive shares excluded (in 000 s)	6,833	4,054	6,282	9,924

See notes to consolidated financial statements.



**Table of Contents**

## FORM 10-Q

CONSOLIDATED BALANCE SHEETS (Unaudited)  
(Dollars in millions)Ceridian Corporation  
and Subsidiaries

	September 30, 2004	December 31, 2003
Assets		
Cash and equivalents	\$ 156.3	\$ 124.2
Trade receivables, less allowance of \$16.1 and \$17.3	511.2	436.4
Other receivables	29.2	30.9
Current portion of deferred income taxes	36.8	28.5
Other current assets	51.9	56.0
Total current assets	785.4	676.0
Property, plant and equipment, net	138.7	148.0
Goodwill	916.2	904.8
Other intangible assets, net	93.9	101.1
Software and development costs, net	89.4	85.8
Prepaid pension cost	13.1	12.2
Deferred income taxes, less current portion	7.0	6.0
Investments	17.7	23.2
Derivative instruments	37.0	55.7
Other noncurrent assets	8.9	8.7
Total assets before customer funds	2,107.3	2,021.5
Customer funds	3,310.0	3,141.3
Total assets	\$ 5,417.3	\$ 5,162.8
Liabilities and Stockholders Equity		
Short-term debt and current portion of long-term obligations	\$ 14.2	\$ 6.5
Accounts payable	43.1	39.1
Drafts and settlements payable	180.8	113.7
Customer advances	37.2	31.0
Deferred income	58.8	66.9
Accrued taxes	31.1	26.4
Employee compensation and benefits	47.8	53.9
Other accrued expenses	45.2	35.2
Total current liabilities	458.2	372.7
Long-term obligations, less current portion	108.8	157.0
Deferred income taxes	55.6	37.8
Employee benefit plans	206.9	198.0
Other noncurrent liabilities	14.6	12.0

Total liabilities before customer funds obligations	844.1	777.5
Customer funds obligations	3,285.7	3,141.3
Total liabilities	4,129.8	3,918.8
Stockholders' equity	1,287.5	1,244.0
Total liabilities and stockholders' equity	\$ 5,417.3	\$ 5,162.8

---

See notes to consolidated financial statements.



**Table of Contents**FORM 10-Q  
CONSOLIDATED STATEMENTS OF CASH FLOWSCeridian Corporation  
and Subsidiaries

(Unaudited) (Dollars in millions)	For Periods Ended September 30, Nine Months	
	2004	2003
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		(restated)
Net earnings	\$ 46.3	\$ 71.8
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Deferred income tax provision (benefit)	1.1	(3.4)
Depreciation and amortization	62.7	60.9
Provision for doubtful accounts	7.3	8.9
Asset write-downs	2.5	
Unrealized (gain) loss on derivative instruments	20.6	4.2
Gain on sale of marketable securities	(4.5)	(3.4)
Contribution to retirement plan trusts		(29.2)
Other	8.3	4.3
Decrease (Increase) in trade and other receivables	(76.1)	(33.0)
Increase (Decrease) in accounts payable	3.4	0.4
Increase (Decrease) in drafts and settlements payable	67.1	17.3
Increase (Decrease) in employee compensation and benefits	(6.8)	(13.6)
Increase (Decrease) in accrued taxes	8.9	1.5
Increase (Decrease) in other current assets and liabilities	11.4	(3.8)
Net cash provided by (used for) operating activities	152.2	82.9
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Expended for property, plant and equipment	(21.7)	(22.1)
Expended for software and development costs	(24.2)	(19.6)
Expended for acquisition of investments and businesses, less cash acquired	(14.1)	(1.7)
Proceeds from sales of businesses and assets	11.3	12.7
Net cash provided by (used for) investing activities	(48.7)	(30.7)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Revolving credit facilities and overdrafts, net	(37.7)	(50.8)
Repayment of other debt	(3.2)	(0.6)
Repurchase of common stock	(80.3)	(28.3)
Proceeds from stock option exercises and stock sales	47.3	25.2
Net cash provided by (used for) financing activities	(73.9)	(54.5)
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>	2.5	3.1

NET CASH FLOWS PROVIDED (USED)	32.1	0.8
Cash and equivalents at beginning of period	124.2	134.3
Cash and equivalents at end of period	\$ 156.3	\$ 135.1

---

See notes to consolidated financial statements.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

Notes to Consolidated Financial Statements  
(Dollars in millions, except per share data)  
(Unaudited)

**STOCKHOLDERS EQUITY**

	September 30, 2004	December 31, 2003
Common Stock		
Par value \$.01, shares authorized - 500,000,000		
Shares issued - 151,039,408 and 150,028,289	\$ 1.5	\$ 1.5
Shares outstanding - 149,179,552 and 150,022,441		
Additional paid-in capital	936.2	925.1
Retained earnings	579.9	533.6
Treasury stock, at cost (1,859,856 and 5,848 common shares)	(37.5)	(0.1)
Accumulated other comprehensive income, net of deferred income taxes:		
Unrealized gain (loss) on marketable securities	3.8	3.9
Unrealized gain (loss) on customer fund securities	15.5	
Cumulative translation adjustment	23.1	15.1
Pension liability adjustment	(235.0)	(235.1)
Total stockholders equity	\$ 1,287.5	\$ 1,244.0

**COMPREHENSIVE INCOME (LOSS)**

	For Periods Ended September 30,			
	Three Months		Nine Months	
	2004	2003	2004	2003
Net earnings	\$ 17.9	\$ 19.5 (restated)	\$ 46.3	\$ 71.8 (restated)
Items of other comprehensive income before income taxes:				
Change in foreign currency translation adjustment	9.3	(0.6)	8.0	14.5
Change in unrealized gain (loss) from marketable securities	0.4	5.8	4.1	7.7
Change in unrealized gain (loss) from customer funds securities	19.1		24.4	

Edgar Filing: CERIDIAN CORP /DE/ - Form 10-Q

Change in pension liability			0.1	
Less unrealized gain previously reported on:				
Marketable securities sold or settled in this period	(0.9)	(3.4)	(4.4)	(3.4)
Customer funds securities sold or settled in this period			(0.1)	
Other comprehensive income (loss) before income taxes	27.9	1.8	32.1	18.8
Income tax (provision) benefit	(6.8)	(0.8)	(8.6)	(1.6)
Other comprehensive income (loss) after income taxes	21.1	1.0	23.5	17.2
Comprehensive income	\$ 39.0	\$ 20.5	\$ 69.8	\$ 89.0

-6-

---

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004  
Notes to Consolidated Financial Statements  
(Dollars in millions, except per share data)  
(Unaudited)

INTRODUCTION

In the opinion of Ceridian Corporation, the unaudited consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments, except as set forth in the notes to consolidated financial statements) necessary to present fairly our financial position as of September 30, 2004, and results of operations for the three and nine month periods and cash flows for the nine month periods ended September 30, 2004 and 2003. Results of operations and cash flows for the 2003 periods have been restated as described in the accompanying note entitled Restatement of Prior Period Financial Statements. The results of operations for the nine month period ended September 30, 2004 are not necessarily indicative of the results to be expected for the full year.

RESTATEMENT OF PRIOR PERIOD FINANCIAL STATEMENTS

As described in Amendment No. 1 on Form 10-K/A to our Annual Report on Form 10-K for the year ended December 31, 2003 (the 2003 Form 10-K/A ), we have restated our consolidated financial statements for the years 1999 through 2003 and for the first quarter of 2004 (the Restatement ). This Note should be read in conjunction with Note B, Restatement of Financial Statements in the notes to our consolidated financial statements included in Part II, Item 8, Financial Statements and Supplementary Data of the 2003 Form 10-K/A, which we are filing concurrently with this Form 10-Q and which provides further information on the nature and impact of the Restatement.

The determination to restate prior period financial statements was made as a result of:

The determinations from an investigation directed by the Audit Committee of the Company's Board of Directors (the Audit Committee Investigation ), which examined, among other things, the Company's policies and practices for the capitalization of software development costs, the timing of amortization of capitalized software development costs and the accuracy and timeliness of accruing for costs and expenses;

Our determination, during the Audit Committee Investigation of the above-referenced items, that certain other adjustments and reclassifications were required to our consolidated financial statements; and

Our subsequent determination, following consultation with our independent registered public accountants, that it was also necessary to make certain additional corrections to our consolidated financial statements for the quarter ended March 31, 2004 and the years ended December 31, 2003, 2002 and 2001 in light of our conclusion that our interest rate and fuel price derivative contracts did

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004  
Notes to Consolidated Financial Statements  
(Dollars in millions, except per share data)  
(Unaudited)

not satisfy the requirements of Statement of Financial and Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities ( FAS 133 ) and as such, did not qualify for hedge accounting treatment.

The Restatement included the following classes of adjustments:

adjustments concerning the capitalization and expensing of software development costs

adjustments to the accrual of certain other costs and expenses

adjustments to revenue and related costs for timing of recognition and transactions involving third party vendors

changes in accounting for interest rate and fuel price derivative instruments

reduction of the number of dilutive shares for calculation of earnings per share

reclassification between cost and expense categories

reclassification of Comdata assets and liabilities

transfer of excess pre-1999 restructuring liabilities directly to retained earnings

In addition, certain amounts in other notes to our consolidated financial statements within this Form 10-Q have been restated to reflect the Restatement adjustments.

The adjustments that had the most significant effect on our consolidated statements of operations related to the capitalization and expensing of software development costs (net of amortization effects) and the recent change in accounting for interest rate and fuel price derivative instruments.

The adjustments for capitalization and expensing of software development costs (net of amortization effects) largely resulted in the charging to expense of previously capitalized software costs, including the reversal of related amortization expense. The adjustments resulted in a decrease in pre-tax earnings of \$5.0 in the third quarter of 2003 and \$11.9 for the nine months ended September 30, 2003.

In January 2005, we determined that our interest rate and fuel price derivative contracts did not satisfy the requirements of FAS 133, and as such, did not qualify for hedge accounting treatment. The correction of accounting for these derivative instruments affected the timing of gain or loss recognition on our consolidated statements of operations. The unrealized gains and losses previously reported under hedge accounting treatment in accumulated other comprehensive income within stockholders' equity on our consolidated balance sheets are now reported in net earnings on our consolidated statements of operations. The pre-tax earnings impact of the correction of unrealized gains and losses on derivative instruments was a decrease of \$8.2 for the third quarter of 2003 and \$3.5 for the nine months ended September 30, 2003. The correction of accounting for realized gains and losses had no effect on pre-tax earnings but did require us to reclassify the realized gains and losses from revenue to costs and expenses. As a result of the Restatement, both realized and unrealized gains or losses on interest rate and fuel price derivative instruments

now appear on our consolidated statements of operations in a line item entitled (gain) loss on derivative instruments.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004  
Notes to Consolidated Financial Statements  
(Dollars in millions, except per share data)  
(Unaudited)

The effect of the Restatement on the consolidated statements of operations for the three and nine months ended September 30, 2003 is shown in an accompanying table. The primary impact on the historical consolidated balance sheets and consolidated statements of cash flows related to the software capitalization and amortization changes. We restated the consolidated balance sheet as of December 31, 2003 in the 2003 Form 10-K/A. As a result of expensing software development costs previously capitalized, net cash provided by operating activities was reduced by \$13.6 for the nine months ended September 30, 2003. The change had no impact on historical cash balances or net cash flows since the entire reduction in operating cash flows is offset by the reduction of \$13.1 in capital expenditures included in investing cash flows and a \$0.5 correction to financing cash flows. The effect of the Restatement on the consolidated statement of cash flows for the nine months ended September 30, 2003 is shown in an accompanying table. The correction of the number of dilutive shares used for earnings per share calculations reduced weighted average diluted shares by 1,248,000 for the three months ended September 30, 2003 and 635,000 for the nine months ended September 30, 2003 due to the addition of the tax benefit from appreciation in value to the proceeds from the assumed exercised stock options.



**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004  
Notes to Consolidated Financial Statements  
(Dollars in millions, except per share data)  
(Unaudited)

The following table presents the effect of the Restatement on the consolidated statements of operations:

	As Previously Reported	Software Capitalization Adjustments	Derivative Adjust- ments	Other Earnings Adjust- ments	Costs & Expenses Reclass	Total Adjustments	As Restated
<b>Three months ended September 30, 2003</b>							
Revenue	\$ 303.9	\$	\$ (7.7)	\$ (4.6)	\$	\$ (12.3)	\$ 291.6
Costs and expenses							
Cost of revenue	142.7	2.4		(1.9)	26.5	27.0	169.7
Selling, general and administrative	100.1	0.6		(0.9)	(13.7)	(14.0)	86.1
Research and development	15.9	2.0		(0.1)	(12.8)	(10.9)	5.0
(Gain) loss on derivative instruments			0.5			0.5	0.5
Other expense (income)	(1.1)						(1.1)
Interest income	(0.5)						(0.5)
Interest expense	1.3						1.3
Total costs and expenses	258.4	5.0	0.5	(2.9)		2.6	261.0
Earnings before income taxes	45.5	(5.0)	(8.2)	(1.7)		(14.9)	30.6
Income tax provision	16.2	(1.5)	(3.0)	(0.6)		(5.1)	11.1
Net earnings	\$ 29.3	\$ (3.5)	\$ (5.2)	\$ (1.1)	\$	\$ (9.8)	\$ 19.5
<b>Nine months ended September 30, 2003</b>							
Revenue	\$ 917.5	\$	\$ (22.2)	\$ (5.7)	\$	\$ (27.9)	\$ 889.6
Costs and expenses							
Cost of revenue	428.9	7.5		(2.9)	80.0	84.6	513.5
Selling, general and administrative	309.3	0.7		0.2	(40.7)	(39.8)	269.5
Research and development	49.0	3.8		(0.2)	(39.3)	(35.7)	13.3
(Gain) loss on derivative instruments			(18.7)			(18.7)	(18.7)
Other expense (income)	(1.3)						(1.3)
Interest income	(1.5)						(1.5)

Edgar Filing: CERIDIAN CORP /DE/ - Form 10-Q

Interest expense	3.7	(0.1)			(0.1)	3.6
Total costs and expenses	788.1	11.9	(18.7)	(2.9)	(9.7)	778.4
Earnings before income taxes	129.4	(11.9)	(3.5)	(2.8)	(18.2)	111.2
Income tax provision	46.0	(4.2)	(1.3)	(1.1)	(6.6)	39.4
Net earnings	\$ 83.4	\$ (7.7)	\$ (2.2)	\$ (1.7)	\$ (11.6)	\$ 71.8

-10-

---

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004  
Notes to Consolidated Financial Statements  
(Dollars in millions, except per share data)  
(Unaudited)

The following table presents the effect of the Restatement on the consolidated statement of cash flows:

	For the Nine Months Ended September 30, 2003	
	As Previously Reported	As Restated
<b>Cash Flows from Operating Activities</b>		
Net earnings	\$ 83.4	\$ 71.8
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Deferred income tax provision (benefit)	2.1	(3.4)
Depreciation and amortization	64.0	60.9
Unrealized (gain) loss on derivative instruments		4.2
Decrease (increase) in trade and other receivables	(35.1)	(33.0)
Increase (decrease) in accounts payable	(1.2)	0.4
Increase (decrease) in accrued taxes	3.3	1.5
Increase (decrease) in other current assets and liabilities	(5.3)	(3.8)
Other	(14.7)	(15.7)
 Net cash provided by (used for) operating activities	 96.5	 82.9
<b>Cash Flows from Investing Activities</b>		
Expended for property, plant and equipment	(21.8)	(22.1)
Expended for software and development costs	(33.0)	(19.6)
Other	11.0	11.0
 Net cash provided by (used for) investing activities	 (43.8)	 (30.7)
<b>Cash Flows from Financing Activities</b>		
Net cash provided by (used for) financing activities	(55.0)	(54.5)
 <b>Effect of Exchange Rate Changes on Cash</b>	 3.1	 3.1
 Net cash flows provided (used)	 0.8	 0.8
Cash and equivalents at beginning of period	134.3	134.3
 Cash and equivalents at end of period	 \$ 135.1	 \$ 135.1



**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
 FORM 10-Q  
 September 30, 2004  
 Notes to Consolidated Financial Statements  
 (Dollars in millions, except per share data)  
 (Unaudited)

**RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In December 2004, the Financial Accounting Standards Board ( FASB ) issued a Statement of Financial Accounting Standards entitled Share-Based Payment, an amendment of FASB Statements No. 123 and 95 ( FAS 123R ). The principal effect of FAS 123R will be to require the inclusion in our earnings of a compensation expense for stock option grants and employee stock plan purchases that previously was only reported as a disclosure in a note to our consolidated financial statements. FAS 123R will become effective for our quarterly report for the period ended September 30, 2005. We are presently studying FAS 123R and believe that the compensation expense that would be determined as a result of adoption of its provisions would not differ materially from the amounts previously presented in the notes to our consolidated financial statements.

**OTHER EXPENSE (INCOME)**

	For Periods Ended September 30,			
	Three Months		Nine Months	
	2004	2003	2004	2003
Dispute settlement costs	\$	\$ 1.9	\$	\$ 1.9
Gain on sale of marketable securities	(1.0)	(3.4)	(4.5)	(3.4)
Foreign currency translation expense (income)		0.4	(0.8)	0.3
Loss (gain) on sale of assets		0.1	(0.1)	(0.1)
Asset write-downs			2.5	
Other expense (income)	0.2	(0.1)	0.4	
Total	\$ (0.8)	\$ (1.1)	\$ (2.5)	\$ (1.3)

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
 FORM 10-Q  
 September 30, 2004  
 Notes to Consolidated Financial Statements  
 (Dollars in millions, except per share data)  
 (Unaudited)

In January 2004, we committed to the internal development of a replacement for our Human Resource Solutions LifeWorks customer management system as a result of the failure of an external contractor to meet our requirements for such a project. In connection with our restatement of software development costs described in an accompanying note, we recorded an asset write-down of \$2.3 in the first quarter of 2004 representing the carrying value of the capitalized software related to work performed by the external contractor that was abandoned and determined to have no future value to us.

**EMPLOYEE PLANS***Stock Plans*

We account for our stock-based compensation plans under the intrinsic method of Accounting Principles Board Opinion No. 25 and related Interpretations. We are also required on an interim basis to disclose the pro forma effects on reported net earnings and earnings per share that would have resulted if we elected to use the fair value method of accounting for stock-based compensation. This disclosure is presented in the accompanying table. We employ the Black-Scholes-Merton option pricing model to determine the fair value of stock option grants and employee stock purchase plan purchases.

	For Periods Ended September 30,			
	Three Months		Nine Months	
Pro Forma Effect of Fair Value Accounting	2004	2003	2004	2003
		(restated)		(restated)
Net earnings as reported	\$ 17.9	\$ 19.5	\$ 46.3	\$ 71.8
Add: Stock-based compensation expense included in reported net income, net of related tax effects	0.4	0.2	1.2	0.6
Deduct: Total stock-based employee compensation expense determined under the fair value method for all awards, net of related tax effects	(4.0)	(3.7)	(11.7)	(11.6)
Pro forma net earnings	\$ 14.3	\$ 16.0	\$ 35.8	\$ 60.8
Basic earnings per share as reported	\$ 0.12	\$ 0.13	\$ 0.31	\$ 0.48
Pro forma basic earnings per share	\$ 0.10	\$ 0.11	\$ 0.24	\$ 0.41
Diluted earnings per share as reported	\$ 0.12	\$ 0.13	\$ 0.31	\$ 0.48
Pro forma diluted earnings per share	\$ 0.10	\$ 0.11	\$ 0.24	\$ 0.41
<i>Weighted-Average Assumptions</i>				
Expected lives in years	3.62	4.42	3.91	3.94
Expected volatility	37.4%	41.0%	38.7%	41.0%

Edgar Filing: CERIDIAN CORP /DE/ - Form 10-Q

Expected dividend rate				
Risk-free interest rate	3.2%	2.6%	2.6%	2.3%
Weighted-average fair value of stock options granted in the period	\$ 6.26	\$ 6.77	\$ 6.84	\$ 5.40

-13-

---

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004  
Notes to Consolidated Financial Statements  
(Dollars in millions, except per share data)  
(Unaudited)

## EMPLOYEE PLANS (Continued)

*Retirement Plans*

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Medicare Act), was enacted which introduced a Medicare prescription drug benefit, as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to the Medicare benefit. On May 19, 2004, the FASB issued Financial Staff Position ( FSP ) No. 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 to discuss certain accounting and disclosure issues raised by the Medicare Act. FSP 106-2 addresses accounting for the federal subsidy for the sponsors of single employer defined benefit postretirement healthcare plans and disclosure requirements for such plans. Except for certain nonpublic entities, FSP 106-2 is effective for the first interim or annual period beginning after June 15, 2004 or upon earlier adoption if elected.

We have concluded that the prescription drug benefits provided under our postretirement plan are actuarially equivalent to the Medicare benefit as necessary to qualify for the subsidy and have elected to apply FSP 106-2 in the second quarter of 2004. The adoption of FSP 106-2 reduced our accumulated postretirement benefits obligation by \$4.8, which will reduce our future postretirement liability and net periodic postretirement benefit cost by approximately \$0.6 on an annual basis. The reduction in net periodic postretirement benefit cost amounted to \$0.1 for the third quarter of 2004 and \$0.3 for the nine-month period ended September 30, 2004.

The components of net periodic pension cost for our defined benefit pension plans and for our postretirement benefit plans are included in the following tables.

	For Periods Ended September 30,			
	Three months		Nine months	
Net Periodic Pension Cost	2004	2003	2004	2003
Service cost	\$ 0.9	\$ 1.1	\$ 2.7	\$ 3.0
Interest cost	10.4	10.8	31.3	32.3
Expected return on plan assets	(11.7)	(11.4)	(35.0)	(34.3)
Net amortization and deferral	3.8	2.2	11.4	6.7
Net periodic pension cost	\$ 3.4	\$ 2.7	\$ 10.4	\$ 7.7

	For Periods Ended September 30,			
	Three months		Nine months	
Net Periodic Postretirement Benefit Cost	2004	2003	2004	2003



Service cost	\$ 0.1	\$ 0.1	\$ 0.1	\$ 0.1
Interest cost	0.8	0.9	2.5	2.7
Actuarial loss amortization			0.2	
Net periodic postretirement benefit cost	\$ 0.9	\$ 1.0	\$ 2.8	\$ 2.8

## INVESTING ACTIVITY

### *Derivative Instruments*

During the reported periods we maintained interest rate contracts to mitigate interest rate risk in our customer funds and corporate cash portfolios. These derivative instruments provide that if one-month LIBOR is below a floor, the counterparty makes a payment to us. Likewise, if one-month LIBOR is above a cap, we make a payment to the counterparty. These payments increase or decrease (gain) loss on derivative instruments in our consolidated statements of operations. Counterparties are all commercial banks with debt ratings of A or better.

The fair market value of these interest rate derivative instruments is reported in the noncurrent asset section of our consolidated balance sheets. The fair market value decreased from \$55.7 at December 31, 2003 to \$37.0 at September 30, 2004. This decrease in value was primarily due to rising forward interest rates and collections of cash payments from counterparties of \$23.0 during the first nine months of 2004. Unrealized gains and losses due to changes in the fair value of derivative instruments are reflected in (gain) loss on derivative instruments in our consolidated statements of operations.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004  
Notes to Consolidated Financial Statements  
(Dollars in millions, except per share data)  
(Unaudited)

INVESTING ACTIVITY (Continued)

In March 2004, Comdata executed diesel fuel price derivative contracts to limit the effect on earnings related to the variability of Comdata revenue from customer contracts in which Comdata fees are determined as a percentage of pump fuel prices. These contracts, which have the effect of reducing the exposure to price variability of diesel fuel by approximately one half of the expected change in total Comdata revenue due to changes in diesel fuel prices, effectively establish an average fixed price of \$1.51 per gallon of diesel fuel for the effected transactions during the period from July 1 to December 31, 2004. The impact of both realized and unrealized gains and losses on the fuel price derivative instruments is reflected in (gain) loss on derivative instruments in our consolidated statements of operations. These contracts are recorded as a liability of \$1.9 at September 30, 2004.

See Note A, Accounting Policies Cash and Investments, including Derivatives and Note B, Restatement of Financial Statements in the notes to our consolidated financial statements included in Part II, Item 8, Financial Statements and Supplementary Data of the 2003 Form 10-K/A for a further discussion of the reclassification of realized and unrealized gains and losses on derivative instruments as part of the Restatement.

*Investments*

At December 31, 2003, we held 750,000 shares of The Ultimate Software Group, Inc. ( Ultimate ) common stock and a warrant to purchase an additional 75,000 Ultimate common shares at a price of \$4.00 per share. In March 2004, we sold 50,000 shares of Ultimate for \$0.7 and a net gain of \$0.5. In June 2004, we sold 106,600 shares of Ultimate for \$1.3 and a net gain of \$0.9. In August 2004, we sold 36,689 shares of Ultimate for \$0.4 and a net gain of \$0.2. Our holdings of Ultimate as of September 30, 2004 included 556,711 shares and the warrant. In addition, we held 782,069 common shares of U.S.I. Holdings Corporation ( USIH ) at December 31, 2003 and 199,311 shares of USIH at September 30, 2004. In June 2004, we sold 360,758 shares of USIH for \$5.7 and a net gain of \$2.1. In September 2004, we sold 222,000 shares of USIH for \$3.0 and a net gain of \$0.8. Gains and losses on sales of marketable securities are reported in other expense (income) in our consolidated statements of operations.

The Ultimate and USIH securities are treated as available for sale securities. The carrying value of these securities has been adjusted at each balance sheet date to reflect the market price reported by the stock exchange that lists those securities. The amount of this change is reported as unrealized gain or loss from marketable securities in accumulated other comprehensive income. The carrying values of our holdings of Ultimate amounted to \$7.5 at September 30, 2004 and \$6.9 at December 31, 2003. The carrying values of our holdings of USIH amounted to \$2.7 at September 30, 2004 and \$10.2 at December 31, 2003. At September 30, 2004, the net unrealized gain on marketable securities amounted to \$3.8, after reduction for deferred income taxes of \$2.2, and is reported in accumulated other comprehensive income. This compares to a net unrealized gain on marketable securities of \$3.9, after reduction for deferred income taxes of \$2.4, at December 31, 2003. During the first nine months of 2004, net investing cash outflows included \$11.0 for the April acquisition of Recruiting Solutions International, Inc. ( RSI ), a provider of

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004  
Notes to Consolidated Financial Statements  
(Dollars in millions, except per share data)  
(Unaudited)

INVESTING ACTIVITY (Continued)

web-based recruiting products. The acquisition resulted in the recording of \$10.1 of goodwill and intangible assets. RSI's revenue for its most recent fiscal year was \$5.5. In July 2004, we paid net cash of \$0.7 to acquire ITS Information Technology Systems Ltd. (ITS), a leading provider of HR software solutions in Ireland. We also paid \$1.5 for a minority interest in ProfitPoint, Inc., a loyalty and gift card business, in July 2004 and \$0.9 for a customer base for COBRA services from a major insurance company near the end of the first quarter of 2004.

FINANCING

*Debt Instruments*

In June 2002, Comdata entered into a \$150.0 receivables securitization facility with a three-year term that uses selected Comdata trade receivables as collateral for borrowings. The interest rate on this facility is based on the lender's commercial paper rate plus program fees, which approximates LIBOR plus 0.5% per annum. The amount outstanding under this facility was \$140.0 at December 31, 2003, which we reduced by \$10.0 in June 2004 and \$35.0 in September 2004 with a remaining amount outstanding of \$95.0 at September 30, 2004. The aggregate amount of receivables serving as collateral amounted to \$176.9 at September 30, 2004 and \$187.0 at December 31, 2003. The amounts outstanding as long-term debt and the collateralized receivables remain on our consolidated balance sheet since the terms of the facility permit us to repurchase the receivables and are classified as noncurrent since we have the intent and the ability to maintain the amount outstanding beyond the next 12 months.

The domestic revolving credit facility that we initiated in January 2001 provides up to \$350.0 for a combination of advances and up to \$50.0 of letters of credit until March 2006 at an interest rate at 1% per annum over LIBOR. At September 30, 2004 and December 31, 2003, we had utilized \$2.3 of the facility for letters of credit and had unused borrowing capacity under the domestic revolving credit facility of \$347.7, which we have also designated as backup to the Comdata receivables securitization facility.

In May 2004, Ceridian Centrefile replaced its £3.0 million overdraft facility with a £6.5 million overdraft facility available through February 2005 at an interest rate of 1% per annum over the bank's base rate (5.25% per annum at September 30, 2004) and used drawings on this facility to retire an intercompany note due to Ceridian Canada. The amount outstanding under Ceridian Centrefile's borrowing arrangements amounted to \$10.2 at September 30, 2004 and \$2.7 at December 31, 2003.

Our capital lease obligations for equipment amounted to \$17.8 at September 30, 2004 and \$20.8 at December 31, 2003.

During the third quarter of 2003, we paid off the remaining \$40.0 of advances on our domestic revolving credit facility and reduced our borrowings on our Comdata receivables securitization facility by \$10.0.

We remain in compliance with covenants under our credit facilities at September 30, 2004. We amended our domestic revolving credit facility and Comdata receivables securitization facility to allow additional time to deliver this report

and our Form 10-Q for the second quarter of 2004 to our lenders without the delayed delivery constituting a default under these agreements.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004  
Notes to Consolidated Financial Statements  
(Dollars in millions, except per share data)  
(Unaudited)

FINANCING (Continued)

*Equity Instruments*

During the first nine months of 2004, we paid \$80.3 to repurchase 4,012,400 shares of our common stock on the open market at an average net price of \$20.01 per share. As of September 30, 2004, we may repurchase up to 6,350,500 additional shares of our common stock under an existing authorization from our board of directors. We generally use our treasury stock to address our obligations under our stock compensation and employee stock purchase plans.

CUSTOMER FUNDS

Customer funds are invested in high quality collateralized short-term investments or money market mutual funds as well as long-term debt securities issued by U.S. or Canadian governments and agencies, AAA-rated asset-backed securities and corporate securities rated A3/A- or better.

Effective May 1, 2004, we transferred our investments of customer funds from the held-to-maturity category to the available-for-sale category in order to provide additional flexibility in managing credit risks for this portfolio. As a result, investments of customer funds are reported at fair value rather than amortized cost at all dates subsequent to the change. The after tax impact of unrealized gains and losses resulting from periodic revaluation of these securities are reported as accumulated other comprehensive income in stockholders equity.

At September 30, 2004, the fair value of investments of customer funds exceeded the related amortized cost by \$24.3. This change resulted in a net of tax unrealized gain of \$15.5 in accumulated other comprehensive income.

Investment income from investments of customer funds includes the yield on these securities as well as realized gains and losses upon disposition and constitutes a component of our compensation for providing services under agreements with our customers. Investment income from investment of customer funds included in revenue for the periods ended September 30, 2004 and 2003 amounted to \$19.0 and \$14.1 for the quarterly periods and \$54.7 and \$47.5 for the year-to-date periods. Sale of customer funds securities in May 2004 resulted in a net realized gain of \$0.1 on a specific identification basis. The average cost basis of invested customer funds amounted to \$2,191.9 and \$2,504.7 for the three and nine month periods ended September 30, 2004 and \$1,969.2 and \$2,217.3 for the comparative periods of 2003.

The following tables provide information on amortized cost and fair value for selected classifications of investments of customer funds and amounts by maturity date. The value reported in the consolidated balance sheet is indicated by the asterisk. None of the securities that constituted the unrealized loss have been in an unrealized loss position continuously for twelve months or longer.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004  
Notes to Consolidated Financial Statements  
(Dollars in millions, except per share data)  
(Unaudited)

CUSTOMER FUNDS (Continued)

Investments of Customer Funds at September 30, 2004

<i>(Available-for-sale)</i>	Cost	Market*	Gross Unrealized Gain	Loss
Money market securities and other cash equivalents	\$ 1,890.6	\$ 1,890.6	\$	\$
U.S. government and agency securities	746.9	756.9	10.3	(0.3)
Canadian and provincial government securities	275.0	283.0	8.6	(0.6)
Corporate debt securities	248.9	253.3	4.9	(0.5)
Asset-backed securities	84.4	85.7	1.5	(0.2)
Mortgage-backed and other debt securities	39.9	40.5	0.6	
Customer funds	\$ 3,285.7	\$ 3,310.0	\$ 25.9	\$ (1.6)

---

(\*) As reported in the consolidated balance sheet  
Investments of Customer Funds at December 31, 2003

<i>(Held-to-maturity)</i>	Cost*	Market
Money market securities and other cash equivalents	\$ 2,202.0	\$ 2,202.0
U.S. government and agency securities	311.1	317.4
Canadian and provincial government securities	201.0	208.1
Corporate debt securities	209.0	216.0
Asset-backed securities	159.5	163.0
Mortgage-backed and other debt securities	58.7	59.6
Customer funds	\$ 3,141.3	\$ 3,166.1

---

(\*) As reported in the consolidated balance sheet  
Investments of Customer Funds by Maturity Date

September 30, 2004  
Cost            Market\*

Edgar Filing: CERIDIAN CORP /DE/ - Form 10-Q

Due in one year or less	\$ 1,965.7	\$ 1,966.8
Due in one to three years	331.0	340.7
Due in three to five years	404.8	408.6
Due after five years	584.2	593.9
Total	\$ 3,285.7	\$ 3,310.0

---

(\*) As reported in the consolidated balance sheet

-18-

---

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
 FORM 10-Q  
 September 30, 2004  
 Notes to Consolidated Financial Statements  
 (Dollars in millions, except per share data)  
 (Unaudited)

## CAPITAL ASSETS

	September 30, 2004	December 31, 2003
<b>Property, Plant and Equipment</b>		
Land	\$ 10.4	\$ 10.4
Machinery and equipment	284.7	281.6
Buildings and improvements	99.6	96.7
Total property, plant and equipment	394.7	388.7
Accumulated depreciation	(256.0)	(240.7)
Property, plant and equipment, net	\$ 138.7	\$ 148.0
<b>Goodwill</b>		
At beginning of year (HRS \$787.8 and \$773.3, Comdata \$117.0 and \$117.0)	\$ 904.8	\$ 890.3
Acquisitions (HRS)	7.5	
Translation and other adjustments (HRS)	3.9	14.5
At end of period (HRS \$799.2 and \$787.8, Comdata \$117.0 and \$117.0)	\$ 916.2	\$ 904.8
<b>Other Intangible Assets</b>		
Customer lists (accumulated amortization of \$31.7 and \$26.7)	\$ 53.5	\$ 49.4
Trademarks (accumulated amortization of \$25.2 and \$20.7)	76.9	74.7
Technology (accumulated amortization of \$37.4 and \$32.1)	53.9	52.2
Non-compete agreements (accumulated amortization of \$10.0 and \$8.6)	13.9	12.9
Total other intangible assets	198.2	189.2
Accumulated amortization	(104.3)	(88.1)
Other intangible assets, net	\$ 93.9	\$ 101.1

**Software and Development Costs**



Edgar Filing: CERIDIAN CORP /DE/ - Form 10-Q

Purchased software	\$	81.0	\$	75.8
Other software development cost		102.1		86.1
Total software and development costs		183.1		161.9
Accumulated amortization		(93.7)		(76.1)
Software and development costs, net	\$	89.4	\$	85.8

<b>Depreciation and Amortization</b>	For Periods Ended September 30, Nine Months	
	2004	2003
		(restated)
Depreciation of property, plant and equipment	\$ 31.7	\$ 32.4
Amortization of other intangible assets	12.7	12.3
Amortization of software and development costs	18.3	16.2
Total	\$ 62.7	\$ 60.9

Amortization for other intangible assets held at September 30, 2004 is estimated to be \$17.0 for 2004, \$15.6 for 2005, \$13.3 for 2006, \$10.9 for 2007 and \$6.3 for 2008.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
 FORM 10-Q  
 September 30, 2004  
 Notes to Consolidated Financial Statements  
 (Dollars in millions, except per share data)  
 (Unaudited)

## SEGMENT DATA

	For Periods Ended September 30,			
	Three Months		Nine Months	
	2004	2003	2004	2003
		(restated)		(restated)
<b>HRS</b>				
Revenue	\$ 235.1	\$ 211.5	\$ 695.1	\$ 651.1
Earnings (loss) before interest and taxes	\$ (1.6)	\$ 4.3	\$ (11.4)	\$ 34.9
Total assets at September 30, 2004 and December 31, 2003 before customer funds			\$ 1,373.1	\$ 1,381.7
Customer funds			3,296.5	3,132.1
Total assets at September 30, 2004 and December 31, 2003			\$ 4,669.6	\$ 4,513.8
<b>Comdata</b>				
Revenue	\$ 93.6	\$ 80.1	\$ 264.0	\$ 238.5
Earnings before interest and taxes	\$ 29.1	\$ 27.1	\$ 83.7	\$ 78.4
Total assets at September 30, 2004 and December 31, 2003 before customer funds			\$ 658.6	\$ 586.1
Customer funds			13.5	9.2
Total assets at September 30, 2004 and December 31, 2003			\$ 672.1	\$ 595.3
<b>Other</b>				
Revenue	\$	\$	\$	\$
Earnings before interest and taxes	\$	\$	\$	\$
Total assets at September 30, 2004 and December 31, 2003			\$ 75.6	\$ 53.7
<b>Total Ceridian</b>				
Revenue	\$ 328.7	\$ 291.6	\$ 959.1	\$ 889.6
Earnings before interest and taxes	\$ 27.5	\$ 31.4	\$ 72.3	\$ 113.3
Interest income (expense), net	(0.5)	(0.8)	(1.5)	(2.1)

Edgar Filing: CERIDIAN CORP /DE/ - Form 10-Q

Earnings before income taxes	\$ 27.0	\$ 30.6	\$ 70.8	\$ 111.2
Total assets at September 30, 2004 and December 31, 2003 before customer funds			\$ 2,107.3	\$ 2,021.5
Customer funds			3,310.0	3,141.3
Total assets at September 30, 2004 and December 31, 2003			\$ 5,417.3	\$ 5,162.8

-20-

---

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004  
Notes to Consolidated Financial Statements  
(Dollars in millions, except per share data)  
(Unaudited)

SUBSEQUENT EVENTS

*Disposal of SourceWeb Assets*

On December 31, 2004, we sold certain customer relationships and other assets associated with our SourceWeb payroll platform (the SourceWeb Assets ) to RSM McGladrey Employer Services, Inc. ( RSM ) for \$4.0 pursuant to the terms and conditions of an Asset Purchase Agreement. In accordance with the provisions of Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Asset, we recorded a \$9.1 pre-tax impairment charge on assets associated with this platform representing the excess of net book value of the SourceWeb Assets over sale proceeds. The impaired assets primarily consist of a purchased software license from Ultimate and capitalized software development costs. In addition to this asset impairment, we also recorded a \$19.5 pre-tax loss on disposal which comprises the fair value of the future minimum royalty obligations to Ultimate of \$19.3 and \$0.2 of employee severance costs.

SourceWeb is a payroll platform within the small business division of our HRS business segment. Pursuant to the terms of the Asset Purchase Agreement, we will provide certain transitional and third party services to RSM for up to nine months.

*Change in Measurement Date for U.S. Retirement Plans*

In December 2004, we determined that the measurement date for the two defined benefit pension plans and the postretirement health and life insurance plans for U.S. employees should be changed from September 30 to December 31. The later measurement date would permit the use of more current data and coincide with the end of our reporting year. An accounting change of this nature requires a letter of preferability from our independent registered public accounting firm, which we are pursuing. The change, if approved, would result in a reduction in 2004 net periodic pension cost of approximately \$3.9 and a 2004 cumulative gain from change in accounting principle of approximately \$0.9.

*Disposition of Interest Rate Derivative Instruments*

On February 3, 2005, we disposed of our interest rate derivative instruments for cash proceeds of \$21.0 and recorded a loss of \$2.3 on the disposition.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

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

*This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The statements regarding Ceridian Corporation contained in this report that are not historical in nature, particularly those that utilize terminology such as may, will, should, likely, expects, anticipates, estimates, believes or plans, or comparable terminology, are forward-looking statements. Forward-looking statements are based on current expectations and assumptions, and entail various risks and uncertainties that could cause actual results to differ materially from those expressed in these forward-looking statements. Important factors known to us that could cause such material differences are identified and discussed from time to time in our filings with the Securities and Exchange Commission, including those factors discussed in Part I, Item 2, Management's Discussion and Analysis of Financial Condition and Results of Operations of our Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2004. Such important factors include:*

*Our ability to attract and retain customers*

*The effect of changes in governmental regulations relating to employee benefits, taxes, funds transfer and other matters*

*Success in introducing and selling new or enhanced products and services*

*Economic factors such as trade, monetary and fiscal policies and political and economic conditions*

*Risks associated with litigation, SEC and other governmental investigations and similar matters*

*Problems effecting system upgrades and conversions*

*Our ability to adapt to changing technology*

*Acquisition risks*

*Competitive conditions*

*International operations risks*

*Success of implementation of plans to improve performance of U.S. HRS business*

*Government regulatory changes*

*Our ability to increase operating efficiencies and reduce costs*

*Liability for failures in legal compliance*

*Relationships with key vendors and suppliers*

*Material weaknesses in our internal controls over financial reporting*

*You should carefully consider each cautionary factor and all of the other information in this report. We undertake no obligation to correct or update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any future disclosure we make on related subjects in future reports to the SEC.*

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

**MANAGEMENT SUMMARY**

This discussion should be read in conjunction with (i) the accompanying consolidated financial statements and related notes to such financial statements included elsewhere in this Form 10-Q and (ii) the consolidated financial statements and related notes to such financial statements included in Part II, Item 8, Financial Statements and Supplementary Data of the 2003 10-K/A, which we are filing concurrently with this report. We have restated our consolidated financial statements for the three and nine month periods ended September 30, 2003 as described in the note to the consolidated financial statements entitled Restatement of Prior Period Financial Statements contained in this report. All applicable disclosures in the following discussion have been modified to reflect the Restatement, as described below under Results of Operations Restatement.

**Operations**

Ceridian Corporation provides human resource solutions to employers through our HRS business segment operations located in the United States, Canada and the United Kingdom. We also provide transaction processing and related services primarily to the transportation and retail industries through our Comdata business segment operations located principally in the United States.

Our net earnings for the third quarter of 2004 amounted to \$17.9 million, or 12¢ per diluted share, compared to net earnings of \$19.5 million, or 13¢ per diluted share, in the same quarter of 2003. Our revenue for the third quarter of 2004 amounted to \$328.7 million compared to \$291.6 million in the same quarter of 2003. For the year-to-date periods ended September 30, our net earnings in 2004 amounted to \$46.3 million, or 31¢ per diluted share, on revenue of \$959.1 million compared to net earnings of \$71.8 million, or 48¢ per diluted share, on revenue of \$889.6 million in 2003. The comparisons of net earnings between these reporting periods were significantly affected by the decrease in the carrying value of our interest rate derivative instruments, which are required to be marked-to-market on a current basis and the resulting gain or loss recognized on our consolidated statements of operations. During the first nine months of 2004, rising interest rates and the expectation of future increases resulted in a reduction of the carrying value of these instruments, which reduced our gain from derivative instruments from \$18.7 million in the 2003 period to \$2.6 million in the 2004 period. The offsetting benefit of rising interest rates is recognized in revenue in future periods if market expectations are realized.

Further information on our consolidated financial condition, including business segment operating results, appear in the following sections of this discussion.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

**Financial Condition****Balance Sheet Comparisons***(Dollars in millions, except per share data)*

	Amount		Inc (Dec)		% of Total	
	Sep 2004	Dec 2003	\$	%	Sep 2004	Dec 2003
Cash and equivalents	\$ 156.3	\$ 124.2	32.1	25.8	19.9	18.4
Receivables, net	540.4	467.3	73.1	15.6	68.8	69.1
Other current assets	88.7	84.5	4.2	5.0	11.3	12.5
Total current assets	\$ 785.4	\$ 676.0	109.4	16.2	100.0	100.0
Ratio of current assets to total operating assets					37.2	33.4
Current Ratio					1.71	1.81
Capital assets	\$ 1,238.2	\$ 1,239.7	(1.5)	(0.1)	93.7	92.1
Investments, including derivatives	54.7	78.9	(24.2)	(30.7)	4.1	5.9
Other noncurrent assets	29.0	26.9	2.1	7.8	2.2	2.0
Total noncurrent assets	\$ 1,321.9	\$ 1,345.5	(23.6)	(1.8)	100.0	100.0
Total operating assets	\$ 2,107.3	\$ 2,021.5	85.8	4.2	38.9	39.2
Customer funds	3,310.0	3,141.3	168.7	5.4	61.1	60.8
Total assets	\$ 5,417.3	\$ 5,162.8	254.5	4.9	100.0	100.0
Current debt	\$ 14.2	\$ 6.5	7.7	118.5	3.1	1.7
Drafts and settlements payable	180.8	113.7	67.1	59.0	39.5	30.5
Other current liabilities	263.2	252.5	10.7	4.1	57.4	67.8
Total current liabilities	\$ 458.2	\$ 372.7	85.5	22.9	100.0	100.0
Noncurrent debt	\$ 108.8	\$ 157.0	(48.2)	(30.7)	28.2	38.8
Employee benefit plans	206.9	198.0	8.9	4.5	53.6	48.9
Other noncurrent liabilities	70.2	49.8	20.4	41.0	18.2	12.3
Total noncurrent liabilities	\$ 385.9	\$ 404.8	(18.9)	(4.7)	100.0	100.0
Total operating liabilities	\$ 844.1	\$ 777.5	66.6	8.6	15.6	15.1
Customer funds obligations	3,285.7	3,141.3	144.4	4.6	60.7	60.8
Stockholders equity	1,287.5	1,244.0	43.5	3.5	23.7	24.1
Total liabilities and stockholders equity	\$ 5,417.3	\$ 5,162.8	254.5	4.9	100.0	100.0
Total Debt	\$ 123.0	\$ 163.5	(40.5)	(24.8)	8.7	11.6
Stockholders Equity	1,287.5	1,244.0	43.5	3.5	91.3	88.4
Total Capitalization	\$ 1,410.5	\$ 1,407.5	3.0	0.2	100.0	100.0





**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

Our consolidated balance sheets reflect operating assets and liabilities as well as assets and liabilities related to customer funds. Customer funds assets arise from amounts that our customers have advanced to us to pay their employees, remit to taxing authorities, or pay for benefits services to other third parties. Customer funds obligations represent our liability to pay the amounts due to these third parties on behalf of our customers. Customer funds assets are held substantially in trust accounts, are invested in high quality short-term investments or highly-rated fixed income securities, and are not utilized in our operations except for earnings from these investments that are included in our revenue. Additional information on customer funds assets and liabilities can be found in the note to our consolidated financial statements entitled Customer Funds.

Our operating assets increased by \$85.8 million during the first nine months of 2004 as current assets increased by \$109.4 million and noncurrent assets decreased by \$23.6 million. Our current assets increase was due primarily to increases of \$32.1 million in cash and equivalents and \$73.1 million in receivables. We discuss changes in cash and equivalents in a following section of this discussion entitled Cash Flows. The increase in receivables included a \$77.5 million increase in Comdata trade receivables due largely to the seasonally lower level of transportation services activity at the end of the calendar year and high level at the end of the third quarter. Our noncurrent assets decreased by \$23.6 million as the carrying value of our investments (including derivatives) declined by \$24.2 million. The decrease in the carrying value of investments reflected both the disposition of equity securities as well as settlements and revaluation of derivative instruments. Customer funds assets increased by \$168.7 million over the first nine months of 2004 as growth in customer deposits partially offset the reduction in customer funds caused by the seasonally high level of payments of customer funds obligations during the second quarter of each year.

Current liabilities increased by \$85.5 million during the first nine months of 2004 as current debt increased by \$7.7 million and Comdata drafts and settlements payable increased by \$67.1 million. The higher level of drafts and settlements payable at September 30, 2004 compared to the amount payable at December 31, 2003 largely reflected the seasonally low level of the related Comdata transportation receivables at year-end and high levels at the end of third quarter. The increase in current debt largely represents drawings of \$7.5 million by Ceridian Centrefile on its bank overdraft facility. The decrease of \$18.9 million in noncurrent liabilities includes a reduction in borrowings under our Comdata receivables securitization facility of \$45.0 million as well as increases related to employee benefit plans and deferred income taxes. Customer funds obligations increased by \$144.4 million in concert with the increase in customer funds assets, without regard to unrealized gains added to the assets as a result of revaluing these securities at market prices. The increase of \$43.5 million in stockholders equity is largely comprised of year-to-date net earnings of \$46.3 million and unrealized gains from customer funds and currency translation of \$23.5 million, further increased by \$52.6 million from exercises of stock options and sales of stock to employees and reduced by \$80.3 million representing the cost of reacquired Ceridian common shares held as treasury stock.

In the accompanying tables and text, we use certain abbreviations described below:

SG&A expense represents selling, general and administrative expense

-25-

---

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

R&D expense represents research and development costs

HRS relates to our human resource solutions division and subsidiaries

Comdata relates to the consolidated results of our transportation and stored value card subsidiary, Comdata Network, Inc., and its subsidiaries

Other relates to the results of our corporate center operations that were not allocated to our two business segments

NM represents percentage relationships in the tables that are not meaningful

**RESULTS OF OPERATIONS**

*Restatement of Prior Periods*

As described in the accompanying note to our consolidated financial statements entitled *Restatement of Prior Period Financial Statements*, we have restated our consolidated financial statements for the years 1999 through 2003 and for the first quarter of 2004. The adjustments that had the most significant effect on our consolidated statements of operations related to the capitalization and expensing of software development costs (net of amortization effects) and the recent change in accounting for interest rate and fuel price derivative instruments.

The adjustments for capitalization and expensing of software development costs (net of amortization effects) largely resulted in the charging to expense of previously capitalized software costs, including the reversal of related amortization expense. The adjustments resulted in a decrease in pre-tax earnings of \$5.0 million in the third quarter of 2003 and \$11.9 million for the nine months ended September 30, 2003.

In January 2005, we determined that our interest rate and fuel price derivative contracts did not satisfy the requirements of FAS 133, and as such, did not qualify for hedge accounting treatment. The correction of accounting for these derivative instruments affected the timing of gain or loss recognition on our consolidated statements of operations. The unrealized gains and losses previously reported under hedge accounting treatment in accumulated other comprehensive income within stockholders' equity on our consolidated balance sheets are now reported in net earnings on our consolidated statements of operations. The pre-tax earnings impact of the correction of unrealized gains and losses on derivatives instruments was a decrease of \$8.2 million for the third quarter of 2003 and \$3.5 million for the nine months ended September 30, 2003. The correction of accounting for realized gains and losses had no effect on pre-tax earnings but did require us to reclassify the realized gains and losses from revenue to costs and expenses. As a result of the Restatement, both realized and unrealized gains or losses on interest rate and fuel price derivative instruments now appear on our consolidated statements of operations in a line item entitled (gain) loss on derivative instruments.

The effect of the Restatement on the consolidated statements of operations for the three month and nine month periods ended September 30, 2003 are shown in a table in the accompanying note to our consolidated financial statements entitled *Restatement of Prior Period Financial Statements* contained in Part I, Item 1, *Financial Statements* of this report.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

**Consolidated Results Overview****Statements of Operations Third Quarter Comparisons (2003 restated)***(All amounts in millions, except per share data)*

	Amount		Inc (Dec)		% of Revenue	
	2004	2003 (restated)	\$	%	2004	2003 (restated)
Revenue	\$ 328.7	\$ 291.6	37.1	12.8	100.0	100.0
Cost of revenue	192.1	169.7	22.4	13.2	58.4	58.3
R&A expense	110.8	86.1	24.7	28.9	33.7	29.6
Goodwill expense	7.0	5.0	2.0	40.4	2.1	1.7
(Gain) loss on derivative instruments	(7.9)	0.5	(8.4)	NM	(2.3)	0.2
Other expense (income)	(0.8)	(1.1)	0.3	(33.8)	(0.2)	(0.4)
Interest income	(0.7)	(0.5)	(0.2)	28.1	(0.2)	(0.2)
Interest expense	1.2	1.3	(0.1)	(9.6)	0.4	0.4
Other costs and expenses	301.7	261.0	40.7	15.6	91.9	89.6
Income before income taxes	27.0	30.6	(3.6)	(11.8)	8.1	10.5
Income taxes	9.1	11.1	(2.0)	(17.9)	2.8	3.7
Income from continuing operations	\$ 17.9	\$ 19.5	(1.6)	(8.3)	5.4	6.7
Diluted EPS from continuing operations	\$ 0.12	\$ 0.13	(0.01)	(7.7)		

**Statements of Operations Year-To-Date September 30 Comparisons (2003 restated)***(All amounts in millions, except per share data)*

	Amount		Inc (Dec)		% of Revenue	
	2004	2003 (restated)	\$	%	2004	2003 (restated)
Revenue	\$ 959.1	\$ 889.6	69.5	7.8	100.0	100.0
Cost of revenue	547.0	513.5	33.5	6.5	57.0	57.8
R&A expense	325.0	269.5	55.5	20.6	33.9	30.3

Edgar Filing: CERIDIAN CORP /DE/ - Form 10-Q

Depreciation expense	19.9	13.3	6.6	50.3	2.1
(Gain) loss on derivative instruments	(2.6)	(18.7)	16.1	86.2	(0.3)
Other expense (income)	(2.5)	(1.3)	(1.2)	NM	(0.3)
Interest income	(1.7)	(1.5)	(0.2)	14.5	(0.2)
Interest expense	3.2	3.6	(0.4)	(10.6)	0.3
Other costs and expenses	888.3	778.4	109.9	14.2	92.6
Income before income taxes	70.8	111.2	(40.4)	(36.3)	7.4
Income taxes	24.5	39.4	(14.9)	(37.8)	2.6
Income from continuing operations	\$ 46.3	\$ 71.8	(25.5)	(35.5)	4.8
Adjusted EPS from continuing operations	\$ 0.31	\$ 0.48	(0.17)	(35.4)	

- 27 -

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

Our consolidated revenue increased by \$37.1 million in the quarterly comparison with \$23.6 million of the increase coming from HRS and \$13.5 million coming from Comdata. In the year-to-date comparison, our consolidated revenue increased by \$69.5 million with \$44.0 million of the increase coming from HRS and \$25.5 million coming from Comdata.

The following factors had the most significant impacts on our HRS revenue performance:

More revenue from LifeWorks and benefits services and new payroll services

Benefits from changes in currency exchange rates on our international revenue

Increased revenue due to higher levels of invested customer funds and rising yields

The recognition in December 2003 of \$9.2 million of W-2 revenue which previously would have been recognized in the first quarter of 2004

The following factors had the most significant impacts on our Comdata revenue performance:

Continued growth in Comdata's retail cards in use and transaction volume

Higher transportation card transaction volume and fuel prices

Interest income and interest expense, which are not allocated to our business segments, both remained at the same level in the 2004 quarterly and year-to-date periods as in 2003.

Our total costs and expenses, excluding net interest, increased by \$41.0 million in the quarterly comparison and \$110.5 million in the year-to-date comparison. HRS costs and expenses, excluding net interest, increased by \$29.5 million in the quarterly comparison and \$90.3 million in the year-to-date comparison. Comdata costs and expenses, excluding net interest, increased by \$11.5 million in the quarterly comparison and \$20.2 million in the year-to-date comparison. The principal factors affecting the comparison of total costs and expenses included:

Changes in the carrying value of interest rate derivative instruments

Higher HRS technology support and implementation expenses

Higher non-U.S. costs and expenses as a result of changes in currency exchange rates

Higher pension costs

Higher internal investigation and Sarbanes-Oxley compliance costs

Additional costs related to higher Comdata retail card sales and processing revenue

Further information on revenue and costs and expenses appear in the following section entitled Business Segment Results.

Our effective tax rates for the quarterly and year-to-date 2004 periods were 33.9% and 34.6%. For the comparative 2003 periods, our effective tax rate was 36.4% for the third quarter and 35.5% for first nine months of the year.



**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

**Business Segment Results****Segment Third Quarter Comparisons (2003 restated)***(Dollars in millions)*

	Amount		Inc (Dec)		% of Revenue	
	2004	2003 (restated)	\$	%	2004	2003 (restated)
<b>Revenue</b>						
HRS	\$ 235.1	\$ 211.5	23.6	11.2	71.5	72.5
Comdata	93.6	80.1	13.5	16.8	28.5	27.5
Total	\$ 328.7	\$ 291.6	37.1	12.8	100.0	100.0
<b>EBIT*</b>						
HRS	\$ (1.6)	\$ 4.3	(5.9)	NM	(0.6)	2.0
Comdata	29.1	27.1	2.0	7.2	31.1	33.9
Total	\$ 27.5	\$ 31.4	(3.9)	(12.4)	8.4	10.8

**Segment Year-To-Date September 30 Comparisons (2003 restated)***(Dollars in millions)*

	Amount		Inc (Dec)		% of Revenue	
	2004	2003 (restated)	\$	%	2004	2003 (restated)
<b>Revenue</b>						
HRS	\$ 695.1	\$ 651.1	44.0	6.8	72.5	73.2
Comdata	264.0	238.5	25.5	10.7	27.5	26.8
Total	\$ 959.1	\$ 889.6	69.5	7.8	100.0	100.0
<b>EBIT*</b>						



HRS	\$ (11.4)	\$ 34.9	(46.3)	NM	(1.7)	5.4
Comdata	83.7	78.4	5.3	6.8	31.7	32.9
Total	\$ 72.3	\$ 113.3	(41.0)	(36.2)	7.5	12.7

*\*We measure the financial performance of our business segments by reference to earnings before interest and taxes since consolidated interest income and interest expense are not allocated to those segments.*

**HRS**

Revenue from our HRS business increased by \$23.6 million in the third quarter and \$44.0 million in the first nine months of 2004 over the amounts reported in the same periods of 2003. Revenue from U.S. operations increased by \$15.7 million in the quarterly comparison and \$26.9 million in the year-to-date comparison as payroll and tax services contributed \$8.9 million to the quarterly comparison and \$11.2 million to the year-to-date comparison. Both comparisons benefited from increases in investment income from customer funds and tax service fees as well as growth in our Payments Solutions service. As previously reported, the acceleration of W-2 information delivery to customers of U.S. operations, made possible by technological advances and first accomplished at the end of 2003, resulted in the recognition of \$9.2 million of revenue in December 2003 that would otherwise not have been recognized until the first quarter of 2004. Growth in revenue from the LifeWorks contract with the U.S. Armed Services was the principal factor in increases in LifeWorks revenue of \$4.7 million in the quarterly comparison and \$11.3 million in the year-to-date comparison. Higher revenue for COBRA and flexible spending account services resulted in increases to benefits services operations revenue of \$2.1 million in the quarterly comparison and \$4.4 million in the year-to-date comparison.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

Our HRS revenue includes investment income from invested customer funds that constitutes a component of our compensation for providing services to those customers. Investment income from invested customer funds increased by \$4.9 million in the quarterly comparison to \$19.1 million in 2004 from \$14.2 million in 2003 and by \$7.1 million in the year-to-date comparison to \$54.6 million in 2004 from \$47.5 million in 2003 due to higher average balances of invested customer funds and rising yields. In the quarterly comparison, higher average balances contributed \$1.7 million to the increase in investment income and higher interest rates contributed \$3.2 million. The average balance of invested customer funds during the third quarter of 2004 rose by \$222.7 million or 11.3% over the average balance for the third quarter of 2003. In the year-to-date comparison, higher average balances contributed \$6.3 million to the increase in investment income and higher interest rates contributed \$0.8 million. The average balance of invested customer funds during the 2004 year-to-date period rose by \$287.4 million or 13.0% compared to the 2003 year-to-date period. The higher average invested balance reflected the continued success of our introduction of our Payment Solutions service where we make compensation payments to participating customers' employees from payroll deposits advanced to us by those customers.

Ceridian Canada revenue increased by \$2.0 million to \$33.3 million from \$31.3 million in the quarterly comparison and by \$8.5 million to \$99.7 million from \$91.2 million in the year-to-date comparison due largely to the effect of currency rate changes of \$1.4 million in the quarterly comparison and \$8.6 million in the year-to-date comparison. Without regard to currency rate changes, revenue increased in both comparisons due to improved order performance and customer retention. The year to date comparison was negatively effected by a \$2.0 million decrease in revenue from invested customer funds.

Revenue from Ceridian Centrefile operations increased by \$5.9 million to \$22.7 million from \$16.8 million in the quarterly comparison and by \$8.6 million to \$67.8 million from \$59.2 million in the year-to-date comparison as changes in currency exchange rates added \$1.8 million to the quarterly comparison and \$7.3 million to the year-to-date comparison. Without regard to the currency rate changes, revenue in both comparisons benefited from an increase in the number of customer employees, improved customer retention and the commencement of new outsourcing contracts.

Total costs and expenses, excluding net interest, for our HRS business increased by \$29.5 million in the quarterly comparison and \$90.3 million in the year-to-date comparison due primarily to changes in the carrying value of interest rate derivative instruments held for our U.S. operations, which are reported as (gain) loss on derivative instruments within costs and expenses. During the third quarter of 2004, the gain from interest rate derivative instruments amounted to

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

\$9.4 million compared to a gain of \$0.3 million during the third quarter of 2003, which decreased HRS costs and expenses by \$9.1 million. In the year-to-date comparison, the 2004 period reported a \$5.1 million gain while the 2003 period reported a \$19.5 million gain, which increased HRS costs and expenses by \$14.4 million. The changes in carrying value of these derivatives largely reflected a change in market expectations for future interest rates from falling in 2003 to rising in 2004. Without regard to the changes in (gain) loss from derivative instruments, HRS total costs and expenses, excluding net interest, increased by \$38.7 million in the quarterly comparison and by \$75.9 million in the year-to-date comparison.

For U.S. operations, total costs and expenses, excluding net interest, increased by \$24.3 million in the quarterly comparison including an increased gain on derivative instruments of \$9.1 million. Excluding the effect of this gain, the remaining quarterly increase of \$33.4 million included \$12.0 million for cost of revenue, \$5.6 million for selling expense and \$11.7 million for general and administrative expense. R&D expense increased by \$1.7 million and other expense (income) increased by \$2.4 million in the quarterly comparison. Other expense (income) included gains from sales of Ultimate and USIH common stock of \$1.0 million during the third quarter of 2004 compared to gains of \$3.4 million in the third quarter of 2003. In the year-to-date comparison, total costs and expenses, excluding net interest, for U.S. operations increased by \$75.0 million of which \$14.4 million related to the change in (gain) loss on derivative instruments. Of the remaining year-to-date increase of \$60.6 million, \$14.4 million related to cost of revenue, \$13.1 million related to selling expense and \$25.3 million related to general and administrative expense. R&D expense increased by \$5.9 million, due to a higher level of software development efforts, and other expense (income) increased by \$1.8 million. Other expense (income) included gains of \$4.5 million from sales of Ultimate and USIH common stock during the first nine months of 2004 compared to \$3.4 million during the same period of 2003. Also included in other expense (income) was a \$2.3 million software impairment loss in the first quarter of 2004.

Cost of revenue for U.S. operations increased by \$12.0 million in the quarterly comparison and \$14.4 million in the year-to-date comparison primarily due to increased costs in payroll and tax filing services of \$6.8 million in the quarterly comparison and \$7.9 million in the year-to-date comparison. Both comparisons for payroll and tax filing included higher technology support costs and a higher level of installation efforts. These cost increases were offset in part by cost reductions of \$1.5 million in the quarterly comparison and \$4.5 million in the year-to-date comparison resulting from the reassignment of certain personnel from production operations to selling operations. LifeWorks experienced increased cost of revenue of \$2.8 million in the quarterly comparison and \$4.4 million in the year-to-date comparison related to the additional revenue from the U.S. Armed Services contract referred to above. Benefits services operations cost of revenue increased by \$2.4 million in the quarterly comparison and \$2.1 million in the year-to-date comparison due to growth in COBRA and flexible spending services. The year-to-date increase was reduced by cost reductions associated with the consolidation of other operations with our Florida operation completed in 2003.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

SG&A expense for U.S. operations increased by \$17.4 million in the quarterly comparison and \$38.5 million in the year-to-date comparison due primarily to a higher level of and an increased emphasis on implementation of new orders and higher levels of compensation and benefits. The increase in selling expense of \$5.6 million in the quarterly comparison and \$13.1 million in the year-to-date comparison reflected additional costs of \$1.5 million in the quarterly comparison and \$7.9 million in the year-to-date comparison related to additional staffing, including the transfer of personnel from production positions to selling positions. The remainder of the increase in both comparisons was largely due to higher staff support costs. General and administrative expense increased by \$11.7 million in the quarterly comparison and \$25.3 million in the year-to-date comparison as incremental spending on the Audit Committee Investigation and Sarbanes-Oxley compliance added \$5.5 million in the quarterly comparison and \$6.4 million in the year-to-date comparison. Corporate allocations of pension costs contributed an additional \$1.0 million to the quarterly comparison and \$3.4 million to the year-to-date comparison. The remaining increase in both comparisons was largely due to higher compensation and staff support costs.

Total costs and expenses for Ceridian Canada increased by \$1.1 million in the quarterly comparison and \$8.5 million in the year-to-date comparison as currency rate changes contributed \$1.2 million to the quarterly comparison and \$6.9 million to the year-to-date comparison. The year-to-date comparison reflected severance costs of \$1.8 million recorded in the first quarter of 2004; and this action provided some cost reduction benefit to the quarterly comparison that helped offset higher selling expense resulting from increased marketing efforts in 2004.

Total costs and expenses for Ceridian Centrefile increased by \$4.1 million in the quarterly comparison and \$6.9 million in the year-to-date comparison as currency rate changes contributed \$3.0 million to the quarterly comparison and \$7.9 million to the year-to-date comparison. The year-to-date comparison reflected severance costs of \$1.0 million recorded in the first quarter of 2004, and this action provided some cost reduction benefit to the quarterly comparison.

**Comdata**

Comdata revenue grew by \$13.5 million in the quarterly comparison and \$25.5 million in the year-to-date comparison due primarily to increased revenue from retail card sales and processing. For arrangements that include retail card sales and related services, revenue from the card sale and the related services is deferred at the time of delivery of the cards or service. Revenue from both retail card sales and related services is substantially recognized within a six-month period after activation of the card. Therefore, the increased revenue in the comparisons largely reflected sales of retail cards and related services in late 2003. Revenue from retail card sales and related services recognized during the comparative quarters increased by \$8.0 million while revenue recognized during the comparative year-to-date periods increased by \$17.6 million. Gross billable fees for card sales and related services increased by \$5.6 million in the quarterly comparison and \$10.5 million in the year-to-date comparison reflecting the addition of new customers and increasing usage of retail cards. Over-the-road transportation services revenue increased by \$3.4 million in the quarterly comparison and \$8.0 million in the year-to-date comparison as higher fuel prices contributed \$1.8 million to the quarterly and \$3.7 million to the year-to-date comparisons. The remainder

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

of the increase in the quarterly comparison of over-the-road revenue related primarily to an increase in transportation card transaction volume, including the BusinessLink product.

Comdata's costs and expenses, excluding net interest, increased by \$11.5 million in the quarterly comparison and \$20.2 million in the year-to-date comparison as cost of revenue increased \$7.1 million in the quarterly comparison and \$12.3 million in the year-to-date comparison and other expenses increased \$4.4 million in the quarterly comparison and \$7.9 million in the year-to-date comparison. Higher levels of retail card sales and processing revenue resulted in increases to cost of revenue of \$6.5 million to the quarterly comparison and \$12.6 million in the year-to-date comparison. Bad debt expense in SG&A expense decreased by \$0.8 million in the quarterly comparison and, largely due to the provision for a particular doubtful account in the first quarter of 2003, decreased by \$2.1 million in the year-to-date comparison. On a year-to-date basis, selling expense increased by \$0.8 million due primarily to higher commissions. Incremental spending on the Audit Committee Investigation and Sarbanes-Oxley compliance added \$1.0 million to the quarterly and \$1.3 million to the year-to-date general and administrative expense. Corporate allocations of pension costs included in general and administrative expense contributed \$0.3 million to the quarterly comparison and \$1.1 million to the year-to-date comparison. The third quarter of 2004 included an increase of \$2.7 million of incentive compensation and business meetings expense compared to the third quarter of 2003. The loss on fuel price derivative instruments increased in the quarterly comparison by \$0.7 million to \$1.5 million in 2004 from \$0.8 million in 2003 and in the year-to-date comparison by \$1.7 million to \$2.5 million in 2004 from \$0.8 million in 2003. Other increases in operating expenses related primarily to contracted services and R&D expenses in both comparisons.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

**FINANCIAL CONDITION****CASH FLOWS****Consolidated Statements of Cash Flows Highlights**

<i>(Dollars in millions)</i>	Nine Months Ended September		
	2004	30, 2003 (restated)	Change
Operating activities	\$ 152.2	\$ 82.9	\$ 69.3
Investing activities	(48.7)	(30.7)	(18.0)
Financing activities	(73.9)	(54.5)	(19.4)
Effect of exchange rate changes on cash	2.5	3.1	(0.6)
Net cash flows provided (used)	\$ 32.1	\$ 0.8	\$ 31.3
Cash and equivalents at 9/30/04 and 12/31/03	\$ 156.3	\$ 124.2	\$ 32.1

**Reconciliation of Earnings to Cash Inflows (Outflows) from Operating Activities**

<i>(Dollars in millions)</i>	Nine Months Ended		
	2004	September 30, 2003 (restated)	Change
Earnings from continuing operations	\$ 46.3	\$ 71.8	\$ (25.5)
Provision for deferred income taxes	1.1	(3.4)	4.5
Depreciation and amortization	62.7	60.9	1.8
Unrealized (gain) loss on derivative instruments	20.6	4.2	16.4
Contributions to retirement plan trusts		(29.2)	29.2
Other reconciling items	13.6	9.8	3.8
From continuing operations earnings	144.3	114.1	30.2

From continuing operations working capital activities	7.9	(31.2)	39.1
Cash flows provided by operating activities	\$ 152.2	\$ 82.9	\$ 69.3

### ***Cash Balances***

Our cash and equivalents increased by \$32.1 million to \$156.3 million during the first nine months of 2004. Our net cash flows provided by operating activities amounted to \$152.2 million as we used operating cash flows and cash balances to fund investing activities, repurchases of our common stock and payment on our securitization facility. Our net cash flows provided by operating activities amounted to \$82.9 million for the first nine months of 2003 as cash inflows from continuing operations earnings of \$114.1 million exceeded cash outflows associated with an investment in net working capital of \$31.2 million.

### ***Operating Activities***

Net cash inflows from operating activities grew by \$69.3 million to \$152.2 million during the first nine months of 2004 compared to \$82.9 million during the first nine months of 2003. Net cash inflows from continuing operations earnings contributed \$30.2 million to the increase while changes in working capital items contributed \$39.1 million. We discussed the factors that determined the operating cash inflows from earnings activities in the previous section of this

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

discussion called Results of Operations. Higher cash inflows from Comdata drafts and settlements payable increased cash flows from working capital activities by \$49.8 million in the first nine months of 2004 compared to the same period in 2003. This was offset by an increase in trade receivables during the first nine months of 2004 than in the comparable 2003 period by \$43.1 million. We also received a tax refund of \$16.5 million during the first quarter of 2004 related to our \$75.0 million contribution to our principal pension plan made during the fourth quarter of 2003.

***Investing Activities***

During the first nine months of 2004, we made capital expenditures of \$21.7 million for property and equipment and \$24.2 million for software and development costs. The respective amounts for 2003 were \$22.1 million and \$19.6 million. During March 2003, at the request of Ultimate, we paid \$3.0 million to Ultimate to acquire 750,000 unregistered shares of Ultimate common stock and a warrant to purchase an additional 75,000 unregistered common shares at a price of \$4.00 per share. In June 2003, we received cash of \$10.9 million for assets sold relative to two sale and leaseback transactions involving data storage equipment. During the first nine months of 2004 we sold 193,289 shares of Ultimate common stock and recorded a gain of \$1.6 million. Proceeds from the sale of Ultimate stock amounted to \$2.4 million. During the first nine months of 2004 we also sold 582,758 shares of USIH common stock and recorded a gain of \$2.9 million with proceeds amounting to \$8.7 million which was received in July 2004. We also acquired a customer base for COBRA services from a major insurance company for \$0.9 million near the end of the first quarter of 2004. Investing cash flows also included an expenditure of \$11.0 million in April 2004 for the acquisition of RSI, \$0.7 million for ITS and \$1.5 million for a minority interest in ProfitPoint, Inc. in July 2004. We describe these transactions further in the note to our consolidated financial statements entitled Investing Activity.

***Financing Activities***

During the first six months of 2004, we paid \$80.3 million to repurchase 4,012,400 shares of our common stock on the open market at an average net price of \$20.01 per share under an existing stock repurchase program. We made no additional purchases during the third quarter of 2004. During the first nine months of 2003, we repurchased 1,844,100 shares of our common stock for \$28.8 million on the open market at an average net price of \$15.60 per share. Of the 1,844,100 total shares repurchased, 25,000 of the shares were repurchased in late September 2003 for \$0.5 million and payment did not occur until October 2003. We provide further information on our stock repurchase program in the following section entitled Liquidity and Capital Resources and in Part II, Item 2, Unregistered Sales of Equity Securities and Use of Proceeds of this report. We provide further information on changes in debt financing in the note to our consolidated financial statements entitled Financing.

Proceeds from exercises of stock options and employee stock plan purchases amounted to \$47.3 million during the first nine months of 2004 compared to \$25.2 million in the first nine months of 2003 due to higher market prices for Ceridian stock in 2004. During the first nine months of 2004, we paid down our Comdata receivables securitization facility by \$45.0 million and capital lease obligations by \$3.0 million. During the first nine months of 2004, Ceridian Centrefile increased



**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

borrowings from its overdraft facility by \$7.5 million principally to fund the retirement of an intercompany note held by Ceridian Canada.

During the third quarter of 2003, we paid off the remaining \$40.0 million of advances on our domestic revolving credit facility and reduced our borrowings on our Comdata receivables securitization facility by \$10.0 million.

**Liquidity and Capital Resources**

We expect to meet our liquidity needs from existing cash balances, cash flows from operations and borrowings under external credit facilities. Cash balances and cash flows are discussed under the section entitled "Cash Balances and Operations" above. Cash flows from operations are primarily influenced by the same factors that influence operating results. We discussed these in a preceding section of this discussion entitled "Results of Operations" and in several of the cautionary factors described at the beginning of this discussion. In addition to issues discussed in "Cash Balances and Operations" above, cautionary factors of particular relevance to our liquidity needs include those that refer to:

The effects of government regulations on such matters as the timing of tax payments, interest rates, employee benefits, and funds transfer activities

Our ability to attract new customers and retain our existing customers

General economic conditions

We have been opportunistically repurchasing Ceridian common stock under a program approved by our Board of Directors effective July 24, 2002 that authorized the repurchase of up to 12,500,000 Ceridian common shares. During the first nine months of 2004, we repurchased 4,012,400 shares for a total of \$80.3 million. As of September 30, 2004, we were authorized to purchase up to 6,350,500 additional shares of our common stock under the authorization from our Board of Directors. We generally use our treasury stock to address our obligations under our stock compensation and employee stock purchase plans.

At September 30, 2004, our committed credit arrangements included a domestic revolving credit facility that provides up to \$350.0 million for a combination of advances of which up to \$50.0 million can be used for letters of credit until March 2006. In addition at September 30, 2004, we had a \$150.0 million receivables securitization facility with a term ending in June 2005, which uses selected Comdata trade receivables as collateral for borrowing. In May 2004, Ceridian Centrefile replaced its £3.0 million overdraft facility with a £6.5 million overdraft facility available through February 2005.

As of September 30, 2004, we have unused borrowing capacity under the \$350.0 million revolving credit facility amounting to \$347.7 million of which we have designated \$95.0 million as backup to the Comdata receivables securitization facility. We are in compliance with all covenants related to these facilities. These covenants require that our consolidated debt must not exceed our stockholders' equity, as defined in the agreement, as of the end of any quarter, and the ratio of

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

earnings before interest and taxes to interest expense on a rolling four quarter basis must be at least 2.75 to 1. These covenants also limit liens, subsidiary debt, contingent obligations, operating leases, minority equity investments and divestitures, among other things. We amended our domestic revolving credit facility and Comdata receivables securitization facility to allow additional time to deliver this report and our Form 10-Q for the second quarter of 2004 to our lenders without the delayed delivery constituting a default under these agreements.

As of September 30, 2004, there have been no material changes since December 31, 2003 to our off-balance-sheet financing or the Table of Contractual Commitments and Contingencies presented in the Liquidity and Capital Resources section of Management's Discussion of Financial Condition and Results of Operations included in Part II, Item 7 of the 2003 Form 10-K/A.

**Critical Accounting Policies**

Our critical accounting policies are described in Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the 2003 Form 10-K/A. There have been no changes to these policies that materially affected this report.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Our market risk exposure is primarily due to the variability of interest income earned on the investment of customer funds in lieu of fees and reported as revenue. The fair value of our interest rate derivative instruments was \$37.0 million at September 30, 2004 and \$55.7 million at December 31, 2003. The September year-to-date payments received from interest rate derivative contracts amounted to \$23.0 million in 2004 and \$23.2 million in 2003. There has been no material change in our interest rate market risk during the three-month period ended September 30, 2004.

We also face market risk exposure due to variability in the prices of diesel fuel. In providing services to certain of our trucking customers, Comdata calculates a portion of the fees it charges as a fixed percentage of the total cost of fuel purchased. As fuel prices rise and fall, Comdata's revenue rises and falls accordingly. In March 2004, Comdata entered into fuel price derivative contracts to swap the floating price of fuel for an average fixed price of \$1.51 per gallon. These contracts had the effect of reducing the exposure to price variability of diesel fuel noted above by approximately one half for the period July 1 to December 31, 2004. The carrying amount of the fuel price derivatives at September 30, 2004 was a liability of \$1.9 million, representing the expected aggregate future payments to the counterparty over the term of the contracts.

We provide further information on interest rate and fuel price derivatives in accompanying notes entitled Restatement of Prior Period Financial Statements and Investing Activity to the consolidated financial statements contained in Part I, Item 1 of this report.

For additional information on market risk, refer to Part II, Item 7A, Quantitative and Qualitative Disclosures About Market Risk contained in the 2003 Form 10-K/A including a discussion of

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

certain changes in our market risk analysis as a result of the application of corrected hedge accounting principles under FAS 133.

**Item 4. Controls and Procedures**

At the end of June 2004, we became aware of an employee's concerns regarding the capitalization and expensing of certain costs in HRS. Upon becoming aware of these concerns, the Audit Committee of our Board of Directors (the Audit Committee) commenced an investigation with the assistance of independent legal counsel and Deloitte & Touche LLP. In October 2004, we announced the initial determinations from the Audit Committee Investigation which had examined, among other things, our policies and practices for the capitalization of software development costs, the timing of amortization of capitalized software development costs and the accuracy and timeliness of accruing for costs and expenses. The preliminary conclusions of the Audit Committee Investigation indicated that our capitalization guidelines and practices were, in certain respects, deficient and not consistent with accounting principles generally accepted in the United States of America ( U.S. GAAP ) and that this had led to errors in the recording of certain capitalized costs for internally developed software during the period from 1997 through 2003 and in the first quarter of 2004. The preliminary conclusions from the Audit Committee Investigation also indicated the presence of deficiencies related to the commencement of amortization of capitalized software development costs and the accuracy and timeliness of accruing for costs and expenses.

As a result of the Audit Committee Investigation, we have restated our historical financial statements for the period from 1999 through 2003 and for the first quarter of 2004. We have not restated our historical financial statements for periods other than those covered by the Restatement. The Restatement, as well as specific information regarding its impact, is discussed in a note entitled "Restatement of Prior Period Financial Statements" included in Part I, Item 1, "Financial Statements" of this Form 10-Q.

The Audit Committee Investigation identified the following deficiencies in our internal control over financial reporting, and management has determined that each of these deficiencies individually constitutes a material weakness (as defined under standards established by the Public Company Accounting Oversight Board or PCAOB) in our internal control over financial reporting:

*Deficiencies related to our internally developed software capitalization guidelines.* Our internally developed software capitalization guidelines, in particular those utilized by HRS, were inconsistent with U.S. GAAP and needed to be updated. In addition, we lacked personnel with sufficient expertise in software capitalization rules under U.S. GAAP and did not adequately train employees, such as financial analysts and project managers, who performed these accounting functions. We also failed to document sufficient support for the historical capitalization of certain software development costs and our system for tracking costs that qualify for capitalization needs improvement. Finally, our deterrent controls and detective controls related to the capitalization of internally developed software were insufficient.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

*Deficiencies pertaining to the commencement of amortization of our capitalized software development costs.* The Audit Committee Investigation also identified deficiencies in the accounting for the amortization of our capitalized software development costs. Specifically, these deficiencies included insufficient documentation relating to the commencement of such amortization. In addition, as a result of our failure to train relevant personnel in U.S. GAAP rules applicable to the amortization of internally developed software, such employees often misunderstood or improperly applied such rules. Finally, our deterrent controls and detective controls related to the amortization of our capitalized software development costs were insufficient.

*Deficiencies related to the month-end close and cost and expense accrual process.* The Audit Committee Investigation identified deficiencies in our month-end close and cost and expense accrual process. Specifically, in certain instances HRS had inappropriately deferred costs and expenses, which resulted in costs and expenses being recognized later than required under U.S. GAAP. This was due in part to errors in our accounts payable cut-off process and the failure to follow policies, processes and procedures that were in place for the timely recognition of costs and expenses. We also failed to segregate and define accounting duties at HRS relating to the identification, calculation and recording of liabilities. Finally, our deterrent controls and detective controls related to the month-end close and accrual process were insufficient.

As a result of Section 404 of the Sarbanes-Oxley Act of 2002 and the rules issued thereunder (the Section 404 Requirements ), we will be required to include in our Annual Report on Form 10-K for the year ending December 31, 2004 (the 2004 Form 10-K ) a report on management s assessment of the effectiveness of our internal control over financial reporting. As part of the process of preparing for compliance with the Section 404 Requirements, in 2003, we initiated a review of our internal control over financial reporting, conducted under the direction of senior management. This review, which was carried out with the involvement and assistance of various external consultants and advisers who dedicated substantial resources to the process, entailed a detailed review and documentation of the processes that impact the preparation of our financial statements, an assessment of the risks that could adversely affect the accurate and timely preparation of those financial statements and the identification of the controls in place to mitigate the risks of untimely or inaccurate preparation of those financial statements.

As a result of our efforts to ensure compliance with the Section 404 Requirements, since July 2004, management has become aware of additional deficiencies in our internal control over financial reporting. In the opinion of management, each of the following deficiencies identified as a result of our effort to comply with the Section 404 Requirements also individually constitutes a material weakness in our internal control over financial reporting:

*Deficiencies related to entity-level controls at Ceridian.* The PCAOB in its Auditing Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements* sets forth indicators of conditions that may be indicative of a material weakness in internal control over financial reporting. Two such indicators are the restatement of previously issued financial statements to correct errors and an ineffective control environment. We have restated our financial statements to correct errors as announced in February and October 2004 and

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

January 2005, and a number of events provide indications of an ineffective control environment at Ceridian, including the results of the Audit Committee Investigation and our compliance efforts with the Section 404 Requirements and the delayed filing of our Quarterly Reports on Form 10-Q for the quarterly periods ended June 30, 2004 and September 30, 2004. Management believes that such events are the result of (i) accounting policies, procedures and practices that were inconsistent with U.S. GAAP and needed to be updated, (ii) personnel lacking sufficient expertise in areas of U.S. GAAP, (iii) inadequately trained employees, such as financial analysts and project managers, who perform accounting functions, (iv) failure to document with sufficient support the prior application of our accounting policies, practices and procedures, and (v) lack of effective deterrent controls and detective controls to properly apply U.S. GAAP to our financial reporting process. As a result, management has concluded that there are deficiencies in the design and execution of our entity-level controls that constitute a material weakness in our internal control over financial reporting.

*Deficiencies related to inadequate or ineffective policies and practices relating to revenue recognition at HRS.* Our revenue recognition guidelines at HRS were inconsistent with U.S. GAAP and needed to be updated, particularly with respect to the adoption of Emerging Issues Task Force Issue No. 00-21, Revenue Arrangements with Multiple Deliverables. Additionally, we lacked personnel with adequate expertise in the revenue recognition rules, and failed to consistently include finance personnel in the analysis of the impact that new customer contracts would have on our financial reporting. Finally, our deterrent controls and detective controls related to revenue recognition were insufficient.

*Deficiencies related to inadequate or ineffective policies and practices relating to the classification of costs and expenses in our Statement of Operations.* Our cost and expense classification guidelines were inconsistent with U.S. GAAP and needed to be updated. Also, our deterrent controls and detective controls related to the classification of costs and expenses were insufficient. We had not performed an adequate review of whether our costs and expenses were being classified appropriately in our Statement of Operations.

*Deficiencies related to the untimely reconciliation of certain balance sheet accounts at HRS.* Although our stated account reconciliation policies require timely reconciliations of accounts, we failed to timely reconcile certain balance sheet accounts at HRS for the third quarter of 2004.

*Deficiencies related to the application of FAS 133 Accounting for Derivative Instruments and Hedging Activities.* In January 2005, we determined that our interest rate and fuel price derivative contracts did not satisfy the requirements of FAS 133 and as such, did not qualify for hedge accounting treatment.

*Deficiencies related to the internal control over financial reporting of our HRS operations in the United Kingdom.* Such deficiencies relate primarily to the aggregation of issues pertaining to revenue recognition, basic internal controls, and controls surrounding the use of certain information technology applications.

As demonstrated by the material weaknesses identified above, there are deficiencies related to the process of closing our accounting records for the periods reflected in this Form 10-Q.

As a result of the material weaknesses identified through the Audit Committee Investigation and our compliance efforts with the Section 404 Requirements, in July 2004, we began performing periodic internal accounting reviews of HRS. These reviews are performed at least once per quarter and



**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

evaluate compliance with our policies and U.S. GAAP related to the capitalization and amortization of internally developed software costs, and the month-end close and cost and expense accrual process.

These reviews are performed by HRS personnel, as well as by our Internal Audit Department, and have been completed through the end of the third quarter of 2004.

Furthermore, in order to remediate the material weaknesses in internal control over financial reporting and ensure the integrity of our financial reporting processes stated above, we have implemented in the third and fourth quarters of 2004 or are in the process of implementing the following actions:

a comprehensive review of internal control over financial reporting through our ongoing review being carried out in connection with our efforts to comply with the Section 404 Requirements, including additional remediation as necessary;

additional training for finance, accounting and certain other personnel at HRS in (i) appropriate accounting for the capitalization and amortization of internally developed software, (ii) month-end expense cut-off and cost and expense accrual processes, (iii) revenue recognition, (iv) procedures for identifying unusual events or transactions and obtaining appropriate accounting guidance prior to recording such transactions, (v) the importance of a robust internal control environment and (vi) the application of technical accounting pronouncements;

implementation of detailed, new internally developed software capitalization and amortization policy and formal procedures that are consistent with U.S. GAAP;

implementation of detailed, new revenue recognition policies at HRS that are consistent with U.S. GAAP;

establishment of new documentation requirements and monitoring procedures for HRS finance and accounting employees to ensure, among other things, that (i) accounting conclusions involving the interpretation of complex accounting standards are thoroughly documented and identify the critical factors that support the basis for such conclusions, and (ii) the factors upon which such employees rely are validated and adequately evidenced;

implementation of detective controls in the form of (i) random internal audits by our Internal Audit Department of selected HRS software development projects for compliance with our new capitalization policy, (ii) monthly testing processes at HRS to analyze whether costs and expenses have been accrued properly and (iii) quarterly monitoring procedures at HRS to analyze costs and expenses incurred during such period and determine whether such costs and expenses were classified correctly on our Statement of Operations;

modification of systems and procedures to (i) ensure that appropriate cut-off dates for the monthly accounts payable cycle are strictly observed, thereby preventing improper deferral of costs and expenses, (ii) ensure that purchases in an amount of over \$1,000 be evidenced by a written purchase order form and that appropriate purchase order reports are generated and analyzed monthly, and (iii)

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

establish appropriate deterrent controls, including clear and regular communication of operating policies and procedures by management to HRS employees emphasizing that noncompliance with such policies and procedures may result in corrective action, including termination;

creation of a new position, Director of Financial Accounting and Compliance, and retention of such person to review and coordinate the implementation of new revenue-related pronouncements and regulations under U.S. GAAP at Ceridian;

review of all new HRS contracts containing certain quantitative and qualitative characteristics in order to determine appropriate accounting treatment under U.S. GAAP;

creation of a revenue recognition steering committee comprised of financial and accounting personnel to discuss and review revenue recognition issues at HRS for policy amendments and interpretations;

periodic review of details supporting the Statement of Operations to determine whether significant costs and expenses are being classified appropriately on a historical and recurring basis and to reclassify where appropriate; and

reconciled the balance sheet accounts for HRS that were unreconciled for the third quarter of 2004. We have reviewed our account reconciliation process at HRS to ensure that, among other things, such accounts are being reconciled on a timely basis, the reconciliation is being independently reviewed, any reconciling items are cleared on a timely basis, and the accuracy of the underlying supporting detail, or subledger, has been substantiated and independently reviewed.

In addition, in an effort to improve internal control over financial reporting, we continue to emphasize the importance of establishing the appropriate environment in relation to accounting, financial reporting and internal control over financial reporting and the importance of identifying areas of improvement and to create and implement new policies and procedures where material weaknesses or significant deficiencies exist. Furthermore, in an effort to improve internal control over financial reporting, we have hired additional accounting expertise, continued our use of external resources, taken certain disciplinary actions, terminated certain individuals, and selected a new chief financial officer to join the Company following the retirement of Mr. Eickhoff.

Since July 2004, management has identified a number of deficiencies in our internal control over financial reporting that individually or in the aggregate constitute a significant deficiency (as defined under standards established by the PCAOB) in our internal control over financial reporting. In the opinion of management, these significant deficiencies do not, either individually or in the aggregate, constitute a material weakness in our internal control over financial reporting. The identified significant deficiencies involve:

*Deficiencies related to revenue recognition at SVS.* In February 2004 we announced the restatement of our financial statements for the years ended December 31, 2002, 2001 and 2000 and the first three quarterly periods in 2003 to correct the application of U.S. GAAP as it relates to



**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

multiple-element arrangements that include the sale of retail cards and related services such as activation, processing and reporting at our Stored Value Systems unit, a wholly owned subsidiary of our Comdata business unit. The change resulted from a reassessment of the accounting for revenue related to stored value card sales and transaction processing. The revised policy superseded the revenue recognition methodology previously applied by us for periods prior to July 1, 2003 which had been made with the concurrence of our outside auditors.

*Deficiencies related to controls surrounding the use of certain information technology applications.* Such deficiencies include inadequate system security, inappropriate access to systems and segregation of duties within systems, lack of appropriate system documentation, ineffective change management processes and insufficient disaster recovery plans pertaining to such applications.

*Deficiencies related to certain basic internal controls.* Such deficiencies include instances of failure to segregate conflicting duties, lack of documented policies and procedures, failure to receive or document appropriate approvals, incomplete or untimely account reconciliations and failure to appropriately assess and monitor the effectiveness of controls executed by third-party service providers.

We are actively remediating each of the significant deficiencies described above, and have taken or are in the process of taking appropriate remediation actions. The remediation efforts for the significant deficiencies generally involve the clarification of existing accounting policies, training of personnel, changes to segregation of duties, enhanced documentation support for accounting transactions, and policy changes where appropriate.

We have communicated to the Audit Committee and to our independent registered public accounting firm, KPMG LLP ( KPMG ), the material weaknesses and significant deficiencies identified to date in our internal control over financial reporting. Management, with the oversight of the Audit Committee, is committed to effectively remediating known material weaknesses and significant deficiencies as expeditiously as possible.

As part of our efforts to comply with the Section 404 Requirements by December 31, 2004, we initiated (i) an internal review, or walk-through, by management to evaluate the design effectiveness of our internal control over financial reporting (with a focus on the newly-developed controls described above) to mitigate, among other things, the risk of material misstatements occurring in our financial statements and (ii) a detailed process to evaluate the overall operating effectiveness of our internal control over financial reporting. This process involved testing the controls for effectiveness in the fourth quarter of 2004 and continuing into the first quarter of 2005. As we continue our compliance efforts with the Section 404 Requirements, including the testing of the effectiveness of our internal controls, we may continue to identify additional deficiencies in our system of internal control over

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

financial reporting that either individually or in the aggregate may represent a material weakness requiring additional remediation efforts.

While, as described above, we have taken and are continuing to take immediate steps to correct our material weaknesses and significant deficiencies in internal control, such material weaknesses and significant deficiencies will not be considered remediated until the new internal controls operate for a period of time, are tested, and management and KPMG conclude that these controls are operating effectively. Although, as described above, these controls are currently being implemented and evaluated for effectiveness, based upon our current action plans, we do not expect these tests to be completed until March 2005.

Pursuant to the Section 404 Requirements, KPMG must audit both the design and operating effectiveness of our internal controls and management's assessment of the design and the effectiveness of such internal controls. KPMG will perform its own evaluation and testing of the effectiveness of our internal control over financial reporting as soon as we complete the implementation of the remediation action plans currently in process. In the event that our material weaknesses described above are not remediated in a timely manner, KPMG could be required to issue an adverse opinion or to disclaim an opinion on our internal controls.

Due to the nature of and the time necessary to effectively remediate each of the material weaknesses identified above, we expect to conclude that some of the material weaknesses identified above will have not been effectively remediated by the filing deadline for the 2004 Form 10-K. As a result, we believe that KPMG will not be able to issue a positive opinion on our internal control over financial reporting in the 2004 Form 10-K. However, we do expect that KPMG will issue an unqualified opinion on our consolidated financial statements contained in the 2004 Form 10-K. If we fail to remediate any material weaknesses, we could be unable to provide timely and reliable financial information, which could have a material adverse effect on our business, results of operations or financial condition. Furthermore, it is uncertain what impact an adverse opinion or a disclaimed opinion would have upon our stock price or business.

We carried out a separate evaluation, under the supervision and with the participation of our management, including our President and Chief Executive Officer and our Executive Vice President and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended ( Exchange Act )), as of September 30, 2004. As a result of the material weaknesses identified above, we concluded that as of September 30, 2004, our disclosure controls and procedures were ineffective to ensure that information required to be disclosed in reports that we file or submit under the Exchange Act are recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. However, to address the material weaknesses described above, we have significantly expanded our disclosure controls and procedures to include additional analysis and other post-closing procedures to ensure that our disclosure controls and procedures were effective over the preparation of the financial statements included in this Form 10-Q. Accordingly, management believes that the

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

financial statements included in this Form 10-Q fairly present in all material respects our financial condition, results of operations and cash flows for the periods presented.

As discussed above, in the third quarter of 2004 we began to remediate identified deficiencies in our internal control over financial reporting. Other than such actions to remediate such deficiencies in our internal controls as noted above, there have been no other changes in our internal control over financial reporting that occurred during the period covered by this report that have materially affected, or are likely to materially affect, our internal control over financial reporting.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

**Part II. Other Information**

**Item 1. Legal Proceedings**

Ceridian and its subsidiaries are involved in a number of judicial and administrative proceedings considered normal in the course of our current and past operations, including employment-related disputes, contract disputes, government proceedings, customer disputes, and tort claims. In some proceedings, the claimant seeks damages as well as other relief, which, if granted, would require substantial expenditures on our part.

Some of these matters raise difficult and complex factual and legal issues, and are subject to many uncertainties, including the facts and circumstances of each particular action, and the jurisdiction, forum and law under which each action is proceeding. Because of this complexity, final disposition of some of these proceedings may not occur for several years. As such, we are not always able to estimate the amount of our possible future liabilities. There can be no certainty that we may not ultimately incur charges in excess of presently or established future financial accruals or insurance coverage. Although occasional adverse decisions (or settlements) may occur, it is management's opinion that the final disposition of these proceedings will not, considering the merits of the claims and available reserves and insurance and based upon the facts and circumstances currently known, have a material adverse effect on our financial position or results of operations.

**Securities Class Actions**

Since August 6, 2004, six shareholder lawsuits have been filed against Ceridian Corporation and certain executive officers in United States District Court, District of Minnesota. *Edmund Biancarelli v. Ceridian Corp., et al.*, filed August 16, 2004; *Garco Investments v. Ceridian Corp., et al.*, filed September 2, 2004; *Ellen Lear v. Ceridian Corp., et al.*, filed August 26, 2004; *Bruce Valentine Mickan v. Ceridian Corp., et al.*, filed September 24, 2004; *Richard Shaller v. Ceridian Corp., et al.*, filed August 6, 2004; and *Sharon Zaks v. Ceridian Corp., et al.*, filed August 25, 2004. The complaints for these actions are virtually identical. These actions purport to be class actions filed on behalf of all persons who purchased or otherwise acquired common stock of the company between April 17, 2003 through and including July 19, 2004, and allege claims against the company and certain of its officers under Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. Plaintiffs challenge the accuracy of certain public disclosures made by Ceridian regarding its financial performance, and in particular Ceridian's accounting for revenue at its Stored Value Systems business unit and accounting for capitalization and expensing of certain costs in Ceridian's U.S. Human Resource Solutions business.

Ceridian believes these claims are without merit and intends to vigorously defend itself in all of these actions. We cannot estimate the possible loss or range of loss from these matters.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

**Derivative Actions**

Since August 13, 2004, two shareholders have filed derivative suits on behalf of Ceridian against Ceridian, as nominal defendant, its directors and certain of its executive officers in United States District Court, District of Minnesota. *James Park, Derivatively On Behalf of Ceridian Corporation v. Ronald L. Turner, et al.*, and *Anthony Santiamo, Derivatively On Behalf of Ceridian Corporation v. Ronald L. Turner, et al.*, both served August 19, 2004. These complaints have been consolidated. The consolidated lawsuit alleges that the Ceridian Board of Directors and certain executive officers breached fiduciary duties, through abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment. These complaints rely on the same factual allegations as the purported class action shareholder lawsuits described above.

Ceridian is awaiting the filing of an amended complaint. Ceridian intends to appropriately defend itself in the consolidated action. We cannot estimate the possible loss or range of loss from these matters.

**SEC Investigation**

On January 22, 2004, we filed a Current Report on Form 8-K, under Item 5, stating that we announced that we are responding to a document request from the Securities and Exchange Commission, and that we have been advised that the SEC has issued a formal order of investigation. In February 2004, we provided documents responsive to the SEC. In July 2004, we advised the SEC of the Audit Committee Investigation. We kept the SEC advised on a regular basis of the Audit Committee Investigation. On December 10, 2004, we received a further formal confidential document request from the SEC. The second request has broadened the areas of inquiry to include, among other things, Ceridian's restatements, revenue recognition, capitalization, expense recognition, how we respond to any internal ethics complaints, and Ceridian's accounting policies and procedures. The formal document requests state that the SEC investigation is a non-public, fact-finding inquiry, and that the investigation and document requests do not mean that the SEC has concluded that we have violated any securities laws. We are fully cooperating with the SEC and are in the process of responding to the SEC's additional document request.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

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

The table below sets forth information with respect to our repurchases of our common stock during the three months ended September 30, 2004.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)
Month #1 (July 1, 2004- July 31, 2004)				6,350,500
Month #2 (August 1, 2004- August 31, 2004)	3,329(2)	\$ 18.00		6,350,500
Month #3 (September 1, 2004- September 30, 2004)	974(2)	\$ 18.8854		6,350,500
Total:	4,303(2)	\$ 18.2004		6,350,500

(1) On July 24, 2002, our Board of Directors approved a share repurchase program, pursuant to which up to 12,500,000 shares of our common stock may be repurchased. We disclosed this repurchase program in our periodic reports filed with the SEC, including the 2003 Form 10-K/A. The repurchase program is being effected from time to time, depending on market conditions and other factors, through open market purchases and privately negotiated transactions. The total remaining authorization under the repurchase program was 6,350,500 shares as of October 1, 2004; the repurchase program has no set expiration or termination date.

(2) 4,303 shares were repurchased from employees in connection with the payment of withholding taxes due in connection with the vesting of restricted stock awards.

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

**Item 6. Exhibits**

(a) Exhibits.

- 10.01 Amendment No. 3 to Receivables Purchase Agreement and Amendment No. 1 to Performance Undertaking entered into as of August 4, 2004 among Comdata Funding Corporation, Comdata Network, Inc., Jupiter Securitization Corporation, each Financial Institution party thereto, and Bank One, NA
- 10.02 Amendment No. 4 to Receivables Purchase Agreement and Amendment No. 2 to Performance Undertaking entered into as of September 30, 2004 among Comdata Funding Corporation, Comdata Network, Inc., Jupiter Securitization Corporation, each Financial Institution party thereto, and Bank One, NA
- 10.03 Second Amendment to Credit Agreement dated as of August 4, 2004 among Ceridian Corporation, the several financial institutions party to the Credit Agreement, dated as of January 31, 2001, and Bank of America, N.A.
- 10.04 Third Amendment to Credit Agreement dated as of September 30, 2004 among Ceridian Corporation, the several financial institutions party to the Credit Agreement, dated as of January 31, 2001, and Bank of America, N.A.
- 10.05 Form of Ceridian Corporation Non-Qualified Stock Option Award Agreement (under the Ceridian Corporation 2004 Long-Term Stock Incentive Plan).
- 10.06 Form of Ceridian Corporation Restricted Stock Award Agreement (under the Ceridian Corporation 2004 Long-Term Stock Incentive Plan).
- 10.07 Form of Ceridian Corporation Non-Statutory Stock Option Award Agreement (under the Amended and Restated 2001 Long-Term Stock Incentive Plan) (incorporated by reference to Exhibit 10.14 to Ceridian's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 001-15168)).
- 10.08 Form of Ceridian Corporation Restricted Stock Award Agreement (under the Amended and Restated 2001 Long-Term Stock Incentive Plan) (incorporated by reference to Exhibit 10.15 to Ceridian's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 001-15168)).
- 10.09 Form of Ceridian Corporation Non-Statutory Stock Option Award Agreement (under the Amended and Restated 2001 Director Performance Incentive Plan) (incorporated by reference to Exhibit 10.18 to Ceridian's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 001-15168)).

**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

- 10.10 Form of Ceridian Corporation Restricted Stock Award Agreement (under the Amended and Restated 2001 Director Performance Incentive Plan) (incorporated by reference to Exhibit 10.19 to Ceridian's Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 001-15168)).
- 10.11 Amendment No. 5 to Receivables Purchase Agreement and Amendment No. 3 to Performance Undertaking entered into as of November 9, 2004 among Comdata Funding Corporation, Comdata Network, Inc., Jupiter Securitization Corporation, each Financial Institution party thereto, and Bank One, NA
- 10.12 Amendment No. 6 to Receivables Purchase Agreement and Amendment No. 4 to Performance Undertaking entered into as of December 31, 2004 among Comdata Funding Corporation, Comdata Network, Inc., Jupiter Securitization Corporation, each Financial Institution party thereto, and Bank One, NA
- 10.13 Amendment No. 7 to Receivables Purchase Agreement and Amendment No. 5 to Performance Undertaking entered into as of January 14, 2005 among Comdata Funding Corporation, Comdata Network, Inc., Jupiter Securitization Corporation, each Financial Institution party thereto, and JPMorgan Chase Bank, N.A., as successor in merger to Bank One, NA
- 10.14 Fourth Amendment to Credit Agreement dated as of November 9, 2004 among Ceridian Corporation, the several financial institutions party to the Credit Agreement, dated as of January 31, 2001, and Bank of America, N.A.
- 10.15 Fifth Amendment to Credit Agreement dated as of December 31, 2004 among Ceridian Corporation, the several financial institutions party to the Credit Agreement, dated as of January 31, 2001, and Bank of America, N.A.
- 10.16 Sixth Amendment to Credit Agreement dated as of January 14, 2005 among Ceridian Corporation, the several financial institutions party to the Credit Agreement, dated as of January 31, 2001, and Bank of America, N.A.
- 31.01 Certification of our Chief Executive Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.02 Certification of our Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.01 Certification of our Chief Executive Officer required pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



**Table of Contents**

CERIDIAN CORPORATION AND SUBSIDIARIES  
FORM 10-Q  
September 30, 2004

32.02. Certification of our Chief Financial Officer required pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

-51-

---

**Table of Contents**

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Quarterly Report on Form 10-Q for the period ended September 30, 2004, to be signed on its behalf by the undersigned thereunto duly authorized.

CERIDIAN CORPORATION  
Registrant

Date: February 18, 2005

/s/ L. D. Gross

L. D. Gross  
Vice President and Corporate Controller  
(Principal Accounting Officer)

-52-