UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED AUGUST 31, 2005

OR

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

For the transition period from ___to ___

COMMISSION FILE NUMBER: 0-11330

PAYCHEX, INC.
(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	16-1124166 (I.R.S. Employer Identification No.)
911 PANORAMA TRAIL SOUTH, ROCHESTER, NEW YORK (Address of principal executive offices)	14625-2396 (Zip Code)

(585) 385-6666
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☑.

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

Common Stock, $0.01 Par Value	378,987,718 Shares
CLASS	OUTSTANDING AT AUGUST 31, 2005

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PAYCHEX, INC.
CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)
In thousands, except per share amounts

	For the three months ended	
	August 31, 2005	August 31, 2004
Revenues:		
Service revenues	$ 384,415	$ 334,203
Interest on funds held for clients	19,300	10,772
Total revenues	**403,715**	**344,975**
Expenses:		
Operating expenses	133,421	121,592
Selling, general and administrative expenses	107,474	94,715
Total expenses	**240,895**	**216,307**
Operating income	**162,820**	**128,668**
Investment income, net	4,859	2,259
Income before income taxes	**167,679**	**130,927**
Income taxes	52,651	43,206
Net income	**$ 115,028**	**$ 87,721**
Basic earnings per share	**$ 0.30**	**$ 0.23**
Diluted earnings per share	**$ 0.30**	**$ 0.23**
Weighted-average common shares outstanding	**378,810**	**378,107**
Weighted-average common shares outstanding, assuming dilution	**380,180**	**379,706**
Cash dividends per common share	**$ 0.13**	**$ 0.12**

See Notes to Consolidated Financial Statements.

PAYCHEX, INC.
CONSOLIDATED BALANCE SHEETS (UNAUDITED)
In thousands, except per share amounts

	August 31, 2005	May 31, 2005
ASSETS		
Cash and cash equivalents	$ 337,321	$ 280,944
Corporate investments	459,853	426,666
Interest receivable	19,501	31,108
Accounts receivable, net of allowance for doubtful accounts	189,317	161,849
Deferred income taxes	24,563	21,374
Prepaid income taxes	—	5,781
Prepaid expenses and other current assets	21,969	20,587
Current assets before funds held for clients	**1,052,524**	**948,309**
Funds held for clients	2,348,705	2,740,761
Total current assets	**3,401,229**	**3,689,070**
Property and equipment, net of accumulated depreciation	213,573	205,319
Intangible assets, net of accumulated amortization	68,412	71,458
Goodwill	405,842	405,992
Other long-term assets	6,786	7,277
Total assets	**$ 4,095,842**	**$ 4,379,116**
LIABILITIES		
Accounts payable	$ 28,978	$ 30,385
Accrued compensation and related items	95,838	106,635
Deferred revenue	3,542	4,271
Accrued income taxes	43,838	—
Legal reserve	23,931	25,271
Other current liabilities	31,184	28,391
Current liabilities before client fund deposits	**227,311**	**194,953**
Client fund deposits	2,356,191	2,746,871
Total current liabilities	**2,583,502**	**2,941,824**
Deferred income taxes	17,384	17,759
Other long-term liabilities	37,023	33,858
Total liabilities	**2,637,909**	**2,993,441**
COMMITMENTS AND CONTINGENCIES — NOTE I		
STOCKHOLDERS' EQUITY		
Common stock, $0.01 par value; Authorized: 600,000 shares; Issued and outstanding: 378,988 shares at August 31, 2005 and 378,629 shares at May 31, 2005, respectively	3,790	3,786
Additional paid-in capital	248,511	240,700
Retained earnings	1,213,377	1,147,611
Accumulated other comprehensive loss	(7,745)	(6,422)
Total stockholders' equity	**1,457,933**	**1,385,675**
Total liabilities and stockholders' equity	**$ 4,095,842**	**$ 4,379,116**

See Notes to Consolidated Financial Statements.

PAYCHEX, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
In thousands

	For the three months ended August 31, 2005	For the three months ended August 31, 2004
OPERATING ACTIVITIES		
Net income	$ 115,028	$ 87,721
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization on property and equipment and intangible assets	16,015	14,181
Amortization of premiums and discounts on available-for-sale securities	6,689	7,456
(Benefit)/provision for deferred income taxes	(2,847)	4,331
Tax benefit related to exercise of stock options	2,456	1,801
Provision for allowance for doubtful accounts	554	853
Net realized gains on sales of available-for-sale securities	(112)	(177)
Changes in operating assets and liabilities:		
Interest receivable	11,607	4,537
Accounts receivable	(28,022)	(30,859)
Prepaid expenses and other current assets	(1,382)	(4,974)
Accounts payable and other current liabilities	38,695	36,503
Net change in other assets and liabilities	2,991	3,995
Net cash provided by operating activities	**161,672**	**125,368**
INVESTING ACTIVITIES		
Purchases of available-for-sale securities	(337,797)	(583,402)
Proceeds from sales and maturities of available-for-sale securities	574,613	907,246
Net change in funds held for clients' money market securities and other cash equivalents	114,091	(296,276)
Net change in client fund deposits	(390,680)	(105,740)
Purchases of property and equipment	(20,584)	(10,675)
Proceeds from sales of property and equipment	18	—
Acquisition of businesses, net of cash acquired	(406)	—
Purchases of other assets	(647)	(293)
Net cash used in investing activities	**(61,392)**	**(89,140)**
FINANCING ACTIVITIES		
Dividends paid	(49,262)	(45,380)
Proceeds from exercise of stock options	5,359	2,793
Net cash used in financing activities	**(43,903)**	**(42,587)**
Increase/(decrease) in cash and cash equivalents	**56,377**	**(6,359)**
Cash and cash equivalents, beginning of period	280,944	219,492
Cash and cash equivalents, end of period	**$ 337,321**	**$ 213,133**

See Notes to Consolidated Financial Statements.

PAYCHEX, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
August 31, 2005

Note A: Description of Business and Significant Accounting Policies

Description of business: Paychex, Inc. and its wholly owned subsidiaries (the "Company") is a leading provider of comprehensive payroll and integrated human resource and employee benefits outsourcing solutions for small- and medium-sized businesses in the United States. The Company also has a subsidiary in Germany. The Company, a Delaware corporation formed in 1979, reports one segment based upon the provisions of Statement of Financial Accounting Standard ("SFAS") No. 131, "Disclosures about Segments of an Enterprise and Related Information."

Basis of presentation: The accompanying Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statement presentation. The Consolidated Financial Statements include the consolidated accounts of the Company with all significant intercompany transactions eliminated. In the opinion of management, the information furnished herein reflects all adjustments (consisting of items of a normal recurring nature), which are necessary for a fair presentation of the results for the interim period. These financial statements should be read in conjunction with the Company's Consolidated Financial Statements and related Notes to Consolidated Financial Statements presented in the Company's Annual Report on Form 10-K as of and for the year ended May 31, 2005. Operating results and cash flows for the three months ended August 31, 2005 are not necessarily indicative of the results that may be expected for other interim periods or the full fiscal year ended May 31, 2006.

Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications had no effect on reported consolidated earnings. Expenses have been reclassified between operating expenses and selling, general and administrative expenses to more appropriately reflect the Company's current way of conducting business. The role of the branch and its relationship to corporate support and information technology functions has evolved to the point where the classification of branch-related expenses needed to be revised. The new classification provides better year-over-year comparisons for operating expenses and selling, general and administrative expenses.

In addition, the prior period amounts reflect the reclassification of auction rate securities to available-for-sale securities from cash equivalents within funds held for clients. "Purchases of available-for-sale securities," "Proceeds from sales and maturities of available-for-sale securities," "Net change in funds held for clients' money market securities and other cash equivalents," and "Net realized gains on sales of available-for-sale securities" included in the accompanying Consolidated Statements of Cash Flows, have been revised to reflect the purchase and sale of auction rate securities during the periods presented.

PEO revenue recognition: Professional Employer Organization ("PEO") revenues are included in service revenues and are reported net of direct costs billed and incurred for PEO worksite employees, which include wages, taxes, benefit premiums, workers' compensation costs, and claims of PEO worksite employees. Direct costs billed and incurred for PEO worksite employees were $582.9 million and $540.0 million for the three months ended August 31, 2005 and August 31, 2004, respectively.

PEO workers' compensation insurance: Workers' compensation insurance for PEO worksite employees is provided under a deductible workers' compensation policy with a national insurance company. Claims are paid as incurred and the Company's maximum individual claims liability is $500,000 under the fiscal 2005 policy and $750,000 under the fiscal 2006 policy.

The Company has recorded the following amounts on its Consolidated Balance Sheets for workers' compensation claims:

In thousands	Prepaid expense	Current liability	Long-term liability
August 31, 2005	$3,152	$4,424	$ 15,740
May 31, 2005	$3,702	$7,164	$ 13,963

The amount included in prepaid expense on the Consolidated Balance Sheets relates to the fiscal 2004 policy, which was a pre-funded policy.

There have been no significant changes in this coverage or claims history since the fiscal year ended May 31, 2005. However, estimated losses under the workers' compensation policies, based on historical loss experience and independent actuarial loss projections, are subject to change based on changes in claims experience trends and other factors that management monitors on a regular basis. Any adjustment to previously established reserves is reflected in the operating results of the period in which the adjustment is determined to be necessary. Such adjustments could possibly be significant, reflecting any variety of new and adverse or favorable trends.

Stock-based compensation costs: SFAS No. 123, "Accounting for Stock-Based Compensation," establishes accounting and reporting standards for stock-based employee compensation plans. As permitted by SFAS No. 123, the Company accounts for such arrangements under Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. Accordingly, no compensation expense is recognized for stock option grants because the exercise price of the stock options equals the market price of the underlying stock on the date of the grant.

The following table illustrates the pro forma effect on net income and earnings per share as if the Company had applied the fair value recognition provision of SFAS No. 123 to stock-based compensation:

In thousands, except per share amounts	For the three months ended August 31, 2005	August 31, 2004
Net income, as reported	$ 115,028	$ 87,721
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	4,295	4,254
Pro forma net income	$ 110,733	$ 83,467
Earnings per share:		
Basic — as reported	$ 0.30	$ 0.23
Basic — pro forma	$ 0.29	$ 0.22
Diluted — as reported	$ 0.30	$ 0.23
Diluted — pro forma	$ 0.29	$ 0.22

For purposes of pro forma disclosures, the estimated fair value of the stock option is amortized to expense over the option's vesting period. There were approximately 3.1 million and 1.7 million stock option grants during the three months ended August 31, 2005 and 2004, respectively. The stock option grants during the three months ended August 31, 2005 vest at 20% each year over the next five years. The weighted-average fair value of stock options granted was $11.02 and $9.26 for the three months ended August 31, 2005 and 2004, respectively.

The fair value of these stock options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

	For the three months ended August 31, 2005	August 31, 2004
Risk-free interest rate	4.0%	3.7%
Dividend yield	1.5%	1.5%
Volatility factor	0.31	0.32
Expected option term life in years	6.5	5.0

Additional information related to the Company's stock option plans is detailed in Note G of these Notes to Consolidated Financial Statements.

New accounting pronouncements: On August 31, 2005, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position FAS 123(R)-1, "Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement 123(R)." This guidance applies to equity shares, as well as stock options, and requires that a freestanding financial instrument issued to an employee in exchange for past or future employee services that is subject to SFAS No. 123(R) "Share Based Payments" shall continue to be subject to the recognition and measurement provisions of SFAS No.123(R) throughout the life of the instrument, unless its terms are modified when the holder is no longer an employee. The effective date of this guidance is upon initial adoption of SFAS 123(R). The Company is currently evaluating the new guidance and anticipates adopting it with the implementation of SFAS 123(R) for its fiscal year beginning June 1, 2006.

Note B: Basic and Diluted Earnings Per Share

Basic and diluted earnings per share were calculated as follows:

	For the three months ended	
In thousands, except per share amounts	August 31, 2005	August 31, 2004
Basic earnings per share:		
Net income	$ 115,028	$ 87,721
Weighted-average common shares outstanding	378,810	378,107
Basic earnings per share	$ 0.30	$ 0.23
Diluted earnings per share:		
Net income	$ 115,028	$ 87,721
Weighted-average common shares outstanding	378,810	378,107
Effect of dilutive stock options at average market price	1,370	1,599
Weighted-average common shares outstanding, assuming dilution	380,180	379,706
Diluted earnings per share	$ 0.30	$ 0.23
Weighted-average anti-dilutive stock options	5,688	4,215

Weighted-average anti-dilutive stock options to purchase shares of common stock were excluded from the computation of diluted earnings per share. These options had an exercise price that was greater than the average market price of the common shares for the period; therefore, the effect would have been anti-dilutive.

For the three months ended August 31, 2005, stock options were exercised for 0.4 million shares of the Company's common stock compared with 0.2 million shares for the three months ended August 31, 2004.

Note C: Funds Held for Clients and Corporate Investments

Funds held for clients and corporate investments consisted of the following:

In thousands Type of issue:	August 31, 2005 Cost	 Market value	May 31, 2005 Cost	 Market value
Money market securities and other cash equivalents	$ 1,247,177	$ 1,247,177	$ 1,361,268	$ 1,361,268
Available-for-sale securities:				
General obligation municipal bonds	739,162	732,420	730,571	725,026
Pre-refunded municipal bonds	212,429	211,521	196,321	195,821
Revenue municipal bonds	412,694	409,119	414,358	411,249
Auction rate securities	9,425	9,425	293,550	293,550
Other debt securities	193,487	192,771	175,792	175,044
Other equity securities	20	67	20	68
Total available-for-sale securities	1,567,217	1,555,323	1,810,612	1,800,758
Other securities	5,567	6,058	5,169	5,401
Total funds held for clients and corporate investments	**$ 2,819,961**	**$ 2,808,558**	**$ 3,177,049**	**$ 3,167,427**
Classification of investments on the Consolidated Balance Sheets:				
Funds held for clients	$ 2,356,192	$ 2,348,705	$ 2,746,871	$ 2,740,761
Corporate investments	463,769	459,853	430,178	426,666
Total funds held for clients and corporate investments	**$ 2,819,961**	**$ 2,808,558**	**$ 3,177,049**	**$ 3,167,427**

The Company is exposed to credit risk from the possible inability of borrowers to meet the terms of their bonds. In addition, the Company is exposed to interest rate risk, as rate volatility will cause fluctuations in the market value of held investments and in the earnings potential of future investments. The Company attempts to limit these risks by investing primarily in AAA- and AA-rated securities and A-1-rated short-term securities, limiting amounts that can be invested in any single instrument, and by investing in short- to intermediate-term instruments whose market value is less sensitive to interest rate changes. At August 31, 2005, all short-term securities classified as cash equivalents and available-for-sale securities held at least an A-1 or equivalent rating, with approximately 99% of the available-for-sale bond securities holding an AA rating or better. The Company does not utilize derivative financial instruments to manage its interest rate risk.

Unrealized gains and losses of the Company's available-for-sale securities are as follows:

In thousands	Gross unrealized gains	Gross unrealized losses	Net unrealized losses
August 31, 2005	$ 1,997	$ (13,891)	$ (11,894)
May 31, 2005	$ 2,868	$ (12,722)	$ (9,854)

The change in the net unrealized loss position of the Company's available-for-sale portfolio from May 31, 2005 to August 31, 2005 resulted from increases in long-term market interest rates. The gross unrealized losses at August 31, 2005 were comprised of 355 available-for-sale securities, which had a total market value of $1,313.5 million. The gross unrealized losses at May 31, 2005 were comprised of 327 available-for-sale securities with a total market value of $1,211.5 million.

The Company reviews its investment portfolios on an ongoing basis to determine if any investment is other-than-temporarily impaired due to changes in credit risk or other potential valuation concerns. The Company believes that the investments it held at August 31, 2005 were not other-than-temporarily impaired. While certain available-for-sale debt securities have market values that are below cost, the Company believes that it is probable that the principal and interest will be collected in accordance with contractual terms, and that the decline in the market value is due to changes in interest rates and is not due to increased credit risk. At August 31, 2005 and May 31, 2005, substantially all of the securities in an unrealized loss position held an AA rating or better. The Company currently believes that it has the ability and intent to hold these investments until the earlier of market price recovery or maturity. The Company's assessment that an investment is not other-than-temporarily impaired could change in the future due to new developments or changes in the Company's strategies or assumptions related to any particular investment.

The cost and market value of available-for-sale securities at August 31, 2005, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations without prepayment penalties.

	August 31, 2005	
In thousands	Cost	Market value
Maturity date:		
Due in one year or less	$ 413,886	$ 412,012
Due after one year through three years	767,294	759,852
Due after three years through five years	242,254	240,177
Due after five years	143,783	143,282
Total available-for-sale securities	**$ 1,567,217**	**$ 1,555,323**

Note D: Property and Equipment, Net of Accumulated Depreciation

The components of property and equipment, at cost, consisted of the following:

In thousands	August 31, 2005	May 31, 2005
Land and improvements	$ 3,402	$ 3,402
Buildings and improvements	76,861	66,019
Data processing equipment	126,109	116,465
Software	59,558	58,463
Furniture, fixtures, and equipment	101,127	98,312
Leasehold improvements	38,877	35,958
Construction in progress	21,103	29,470
Total property and equipment, gross	427,037	408,089
Less: Accumulated depreciation and amortization	213,464	202,770
Property and equipment, net of accumulated depreciation	**$ 213,573**	**$205,319**

Depreciation expense was $12.3 million and $10.3 million for the three months ended August 31, 2005 and 2004, respectively. Construction in progress at August 31, 2005 and May 31, 2005 primarily represents costs for software being developed for internal use.

Note E: Intangible Assets, Net of Accumulated Amortization

The Company accounts for certain intangible assets with finite lives in accordance with SFAS No. 142, "Goodwill and Other Intangible Assets." The components of intangible assets, at cost, consisted of the following:

In thousands	August 31, 2005	May 31, 2005
Client lists and associate office license agreements	$ 119,396	$118,749
Other intangible assets	4,166	4,166
Total intangible assets, gross	123,562	122,915
Less: Accumulated amortization	55,150	51,457
Intangible assets, net of accumulated amortization	**$ 68,412**	**$ 71,458**

Amortization expense relating to intangible assets was $3.7 million and $3.9 million for the three months ended August 31, 2005 and 2004, respectively.

The estimated amortization expense relating to intangible asset balances for the full fiscal year 2006 and the following four fiscal years, as of August 31, 2005, is as follows:

In thousands Fiscal year ended May 31,	Estimated amortization expense
2006	$ 14,536
2007	$ 12,735
2008	$ 11,095
2009	$ 9,453
2010	$ 7,923

Note F: Business Acquisition Reserves

As a result of business acquisitions made during fiscal year 2003, the Company recorded reserves for severance and redundant lease costs in the allocation of purchase price under Emerging Issues Task Force 95-3, "Recognition of Liabilities in Connection With a Purchase Combination." The purchase price allocation for the acquisitions included reserves of $10.0 million for severance and $5.9 million for redundant lease costs. Activity for the three months ended August 31, 2005 for these reserves is summarized as follows:

In thousands	Balance at May 31, 2005	Utilization of reserve	Other reserve reductions	Balance at August 31, 2005
Severance costs	$ 618	$ 245	$ —	$ 373
Redundant lease costs	$ 2,490	$ 441	$ —	$ 2,049

The remaining severance payments will be completed by the end of fiscal 2008. The majority of redundant lease payments are expected to be complete in the fiscal year ended May 31, 2007, with the remaining payments extending until 2015. Payments of $1.7 million extend beyond one year and are included in other long-term liabilities on the Consolidated Balance Sheets at August 31, 2005.

Note G: Stock Option Plans

The Company's 2002 Stock Incentive Plan (the "2002 Plan") became effective on October 17, 2002 upon its approval by the Company's stockholders. The 2002 Plan authorizes the granting of options to purchase up to 9.1 million shares of the Company's common stock, of which 1.6 million shares were authorized by the stockholders for the Paychex, Inc. 1998 Stock Incentive Plan (the "1998 Plan"), but were not optioned under the 1998 Plan, and 7.5 million shares that were newly authorized for options.

The following table summarizes stock option activity for the three months ended August 31, 2005:

In thousands, except per share amounts	Shares subject to options	Weighted-average exercise price
Outstanding at May 31, 2005	**11,929**	**$ 29.15**
Granted	3,136	$ 33.68
Exercised	(358)	$ 14.95
Cancelled	(146)	$ 34.29
Outstanding at August 31, 2005	**14,561**	**$ 30.42**
Exercisable at May 31, 2005	**5,622**	**$ 25.50**
Exercisable at August 31, 2005	**6,159**	**$ 26.98**

The stock option grants during the three months ended August 31, 2005 vest 20% each year over the next five years. Options outstanding at August 31, 2005 had a weighted-average remaining contractual life of 7.1 years and exercise prices ranging from $5.98 to $51.38 per share.

Historically, the Company has granted options to purchase common stock equal to less than one percent of the outstanding common shares. With the July 2005 grant of options to purchase common stock, the Company has increased the percent to approximately one percent of outstanding common shares.

On July 7, 2005, the Board of Directors made a conditional stock option grant under the 2002 Plan, as amended and restated, to the Company's President and Chief Executive Officer of 250,000 options to purchase common stock at an exercise price of $33.68 per share. The grant was conditioned upon stockholder approval of the 2002 Plan, as amended and restated, at the 2005 Annual Meeting of Stockholders to be held on October 12, 2005. The amendments to the 2002 Plan include, among other changes, an increase of 20 million to the number of shares available under the 2002 Plan.

Note H: Comprehensive Income

Comprehensive income is comprised of two components: net income and other comprehensive income. Comprehensive income includes all changes in equity during a period except those resulting from transactions with owners of the Company. The unrealized gains and losses, net of applicable taxes, related to available-for-sale securities is the only component reported in accumulated other comprehensive income in the Consolidated Balance Sheets for the Company.

Comprehensive income, net of related tax effects, is as follows:

In thousands	For the three months ended August 31, 2005	August 31, 2004
Net income	$ 115,028	$ 87,721
Change in unrealized gains/losses of available-for-sale securities, net of taxes	(1,323)	8,464
Total comprehensive income	$ 113,705	$ 96,185

At August 31, 2005, the accumulated comprehensive loss was $7.7 million, which was net of taxes of $4.2 million. At May 31, 2005, the accumulated comprehensive loss was $6.4 million, which was net of taxes of $3.4 million.

Note I: Commitments and Contingencies

Commitments: The Company has unused borrowing capacity available under four uncommitted, secured, short-term lines of credit with financial institutions at market rates of interest as follows:

Financial Institution	Amount Available	Expiration Date
JP Morgan Chase Bank, N.A.	$350 million	February 2006
Fleet National Bank, a Bank of America company	$250 million	February 2006
PNC Bank, National Association	$150 million	February 2006
Wells Fargo Bank, National Association	$150 million	February 2006

The primary uses of the lines of credit would be to meet short-term funding requirements related to deposit account overdrafts and client fund deposit obligations arising from electronic payment transactions on behalf of clients in the ordinary course of business, if necessary. No amounts were outstanding against these lines of credit as of or during the three months ended August 31, 2005.

At August 31, 2005, the Company also had standby letters of credit outstanding totaling $53.1 million, required to secure commitments for certain insurance policies. These letters of credit expire at various dates between December 2005 and July 2006. The letters of credit are secured by investments held in the Company's corporate portfolio, including a $44.2 million letter of credit for which funds have been segregated into a separate account. No amounts were outstanding on these letters of credit as of or during the three months ended August 31, 2005.

The Company enters into various purchase commitments with vendors in the ordinary course of business. At August 31, 2005, the Company had outstanding commitments to purchase approximately $7.8 million of capital assets.

In the normal course of business, the Company makes representations and warranties that guarantee the performance of its services under service arrangements with clients. In addition, the Company has entered into indemnification agreements with its officers and directors, which require it to defend and, if necessary, indemnify these individuals for matters related to their services provided to the Company. Historically, there have been no material losses related to such guarantees and indemnifications.

The Company currently self-insures the deductible portion of various insured exposures under certain employee benefit plans. The Company's estimated loss exposure under these insurance arrangements is recorded in other current liabilities on the Consolidated Balance Sheets. Historically, the amounts accrued have not been material. The Company also has insurance coverage in addition to its purchased primary insurance policies for gap coverage for employment practices liability, errors and omissions, warranty liability, and acts of terrorism, and capacity for deductibles and self-insured retentions through its captive insurance company.

Contingencies: The Company is subject to various claims and legal matters that arise in the normal course of its business. These include disputes related to breach of contract, employment-related claims, and other matters.

The Company and its wholly owned subsidiary, Rapid Payroll, Inc. ("Rapid Payroll"), are currently defendants in lawsuits pending in Los Angeles Superior Court, the United States District Court for the Central District of California, the United States Court of Appeals for the Ninth Circuit, and the California Court of Appeal, Second District, all brought between calendar years 2002 and 2005 by licensees of payroll processing software owned by Rapid Payroll.

In August 2001, Rapid Payroll informed seventy-six licensees that it intended to stop supporting the software in August of 2002. Thereafter, lawsuits were commenced by licensees asserting various claims, including breach of contract and related tort and fraud causes of action. These lawsuits seek compensatory damages, punitive damages, and injunctive relief against Rapid Payroll, the Company, the Company's former Chief Executive Officer and its Senior Vice President of Sales and Marketing. In accordance with the Company's indemnification agreements with its senior executives, the Company will defend and, if necessary, indemnify the individual defendants as it relates to these pending matters.

On July 5, 2002, the federal court entered a preliminary injunction requiring that Rapid Payroll and the Company continue to support and maintain the subject software pursuant to the license agreements.

Court Rulings: In September 2004, the Los Angeles Superior Court granted certain post-trial motions in the *Payroll Partnership, L.P., et al. v. Rapid Payroll, Inc., et al*. matter, reducing the jury's June 2004 verdict against Rapid Payroll from $6.4 million to $5.1 million. The Superior Court dismissed all other claims against Rapid Payroll and all claims against the Company and the individual defendants, including fraud and tort causes of action. Subsequently, this case was settled for a reduced amount.

On February 23, 2005, a tentative ruling was issued by a Los Angeles Superior Court judge, following a bench trial of the *Accuchex, Inc. v. Rapid Payroll, Inc. et al.* matter. The court found that the limitation of liability clause in the parties' license agreement is valid and enforceable. The court awarded Accuchex damages of $30.5 thousand plus a refund of approximately $35.0 thousand in license fees. The court rejected all of the other causes of action asserted by the plaintiff. The plaintiff has filed a Notice of Appeal to the California Court of Appeal, Second District.

On February 28 and March 1, 2005, the federal district court entered judgment in thirteen of the cases pending before it. Those judgments provide that Rapid Payroll's liability is limited by the license fees paid to it by the plaintiff licensees, pursuant to express contractual provisions of the license agreements. Those judgments also provide that Rapid Payroll must support the licensed software until April 30, 2006, and, at that time, refund to each of the licensee plaintiffs the license fees paid by that plaintiff. The license fees received by Rapid Payroll under the agreements from these thirteen licensee plaintiffs in the cases currently pending in federal court, total approximately $2.5 million. The federal court also ordered the release of the source code pursuant to the escrow terms of the license agreements. The federal court judgments also rejected the fraud and other tort claims brought by those plaintiffs against all of the defendants. Plaintiffs have appealed the federal court rulings and the Company has cross-appealed.

Through August 31, 2005, the Company has entered into fifteen settlement agreements discussed above for approximately $8.2 million.

Based on the application of SFAS No. 5, “Accounting for Contingencies,” the Company is required to record a reserve if it believes an unfavorable outcome is probable and the amount of the probable loss can be reasonably estimated. The Company’s legal reserve totaled $23.9 million at August 31, 2005, and is included in current liabilities on the Consolidated Balance Sheets. The legal reserve has been reduced in fiscal 2005 and fiscal 2006 as actual settlements and incurred professional fees have been charged against the legal reserve.

In light of the legal reserve recorded, the Company’s management currently believes that resolution of these matters will not have a material adverse effect on the Company’s financial position or results of operations. However, these matters are subject to inherent uncertainties and there exists the possibility that the ultimate resolution of these matters could have a material adverse impact on the Company’s financial position and the results of operations in the period in which any such effect is recorded.

Note J: Supplemental Cash Flow Information

Supplemental disclosures of non-cash financing activities and cash flow information is as follows:

	For the three months ended	
In thousands	**August 31, 2005**	**August 31, 2004**
Income taxes paid	$ 3,346	$ 5,722
Tax benefit from the exercise of stock options	$ 2,456	$ 1,801

Note K: Related Party Transactions

During the three months ended August 31, 2005, the Company purchased approximately $2.2 million of data processing equipment and software from EMC Corporation. Purchases of data processing equipment and software from EMC Corporation were $1.8 million for the three months ended August 31, 2004. The President and Chief Executive Officer of EMC Corporation is a member of the Company’s Board of Directors.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations reviews Paychex, Inc. and its wholly owned subsidiaries ("we," "our," "us") operating results for the three months ended August 31, 2005 and August 31, 2004, and our financial condition at August 31, 2005. The focus of this review is on the underlying business reasons for significant changes and trends affecting our revenues, expenses, net income, and financial condition. This review should be read in conjunction with the August 31, 2005 Consolidated Financial Statements and the related Notes to Consolidated Financial Statements contained in this Form 10-Q. This review should also be read in conjunction with our Annual Report on Form 10-K for the year ended May 31, 2005. Forward-looking statements in this review are qualified by the cautionary statement included in this review under the next sub-heading, "Safe-Harbor Statement under the Private Securities Litigation Reform Act of 1995."

"Safe Harbor" Statement Under the Private Securities Litigation Reform Act of 1995: Certain written and oral statements made by us may constitute "forward-looking statements" as defined in the Private Securities Litigation Reform Act of 1995 (the "Reform Act"). Forward-looking statements are identified by such words and phrases as "we expect," "expected to," "estimates," "estimated," "current outlook," "we look forward to," "would equate to," "projects," "projections," "projected to be," "anticipates," "anticipated," "we believe," "could be," and other similar phrases. All statements addressing operating performance, events, or developments that we expect or anticipate will occur in the future, including statements relating to revenue growth, earnings, earnings-per-share growth, or similar projections, are forward-looking statements within the meaning of the Reform Act. Because they are forward-looking, they should be evaluated in light of important risk factors. These risk factors include, but are not limited to, the following and those that are described in our filings with the Securities and Exchange Commission ("SEC"), including the most recent Form 10-K filed on July 22, 2005:

- changes in demand for our products and services, ability to develop and market new products and services effectively, pricing changes and impact of competition, and the availability of skilled workforce;
- general market and economic conditions, including, among others, changes in United States employment and wage levels, changes in new hiring trends, changes in short- and long-term interest rates, and changes in the market value and the credit rating of securities held by us;
- changes in the laws regulating collection and payment of payroll taxes, professional employer organizations, and employee benefits, including 401(k) plans, workers' compensation, state unemployment, and section 125 plans;
- changes in technology, including use of the Internet;
- the possibility of failure of our operating facilities, computer systems, and communication systems during a catastrophic event;
- the possibility of third-party service providers failing to perform their functions;
- the possibility of penalties and losses resulting from errors and omissions in performing services;
- the possible inability of clients to meet payroll obligations;
- the possibility of failure in internal controls or the inability to implement business processing improvements; and

- potentially unfavorable outcomes related to pending legal matters.

All of these factors could cause our actual results to differ materially from our anticipated results. The information provided in this document is based upon the facts and circumstances known at this time. We undertake no obligation to update these forward-looking statements to reflect events or circumstances after the date of filing of this Form 10-Q with the SEC, or to reflect the occurrence of unanticipated events.

Overview

We are a leading provider of comprehensive payroll and integrated human resource and employee benefits outsourcing solutions for small- to medium-sized businesses. We offer a portfolio of products and services that allows our clients to meet their diverse payroll and human resource needs, which include:

- payroll processing;
- tax filing and payment services;
- employee payment services;
- regulatory compliance (new-hire reporting and garnishment processing);
- retirement services administration,
- employee benefits administration;
- workers' compensation insurance administration;
- time and attendance solutions; and
- comprehensive human resource administrative services.

We earn revenues primarily through recurring fees for services performed related to our products. Service revenues are primarily driven by the number of clients, utilization of ancillary services, and checks or transactions per client per pay period. We also earn interest on funds held for clients between the time of collection from our clients and remittance to the respective tax or regulatory agencies or client employees. Our strategy is focused on achieving strong long-term financial performance while providing high-quality, timely, accurate, and affordable services, growing our client base, increasing utilization of our ancillary services, and leveraging our technological and operating infrastructure.

For the three months ended August 31, 2005, we achieved record total revenues, net income, and diluted earnings per share. Our financial results for the three months ended August 31, 2005 as compared to the three months ended August 31, 2004 include the following highlights:

- Achieved record net income of $115.0 million, or $0.30 per share.
- Net income increased 31% and diluted earnings per share increased 30%.
- Total revenue was up 17%.
- Payroll service revenue was up 10%.
- Major Market Services revenue increased 28%.
- Retirement Services revenue grew 17%.
- Administrative fee revenue from Paychex Premier(SM) Human Resources ("Paychex Premier (SM)") and Professional Employer Organization ("PEO") increased 35%.
- Operating income increased 27% to $162.8 million.
- Cash flow from operations was strong at $161.7 million.

Our record financial performance during the three months ended August 31, 2005 was driven largely by service revenue growth of 15% as compared to the three months ended August 31, 2004. This growth in service revenue was attributable to higher check volume growth and positive trends in new-hire activity within our current client base, client base growth, and increased utilization of ancillary services.

Our financial growth was also impacted by the effects of increases in interest rates earned on our funds held for clients and corporate investments portfolios. The Federal Reserve has increased the Federal Funds rate 250 basis points since June 2004 to 3.50% as of August 31, 2005. On September 20, 2005, the Federal Reserve increased the Federal Funds rate to 3.75%. Our combined interest on funds held for clients and corporate investment income increased 85% for the three months ended August 31, 2005. Our combined funds held for clients and corporate investment portfolios earned an average rate of return of 2.7% during the three months ended August 31, 2005, compared with an average rate of return of 1.7% for the three months ended August 31, 2004. The impact of changes in interest rates and related risks are discussed in more detail in the “Market Risk Factors” section of this review.

At August 31, 2005, we maintained a strong financial position with total cash and corporate investments of $797.2 million. Our primary source of cash is from our ongoing operations. Cash flow from operations was $161.7 million for the three months ended August 31, 2005, as compared with $125.4 million for the three months ended August 31, 2004. Historically, we have funded operations, capital expenditures, purchases of corporate investments, and dividend payments from our operating activities. It is anticipated that current cash and corporate investment balances, along with projected operating cash flows, will support our normal business operations, capital expenditures, and current dividend payments for the foreseeable future.

For further analysis of our results of operations for the three months ended August 31, 2005, and our financial position as of August 31, 2005, refer to the analysis and discussion in the “Results of Operations,” “Liquidity and Capital Resources,” and “Critical Accounting Policies” sections of this review.

Hurricane Katrina

In August 2005, Hurricane Katrina changed the lives of hundreds of thousands living and working along the Gulf Coast. We join with companies throughout the United States in reaching out to those affected, including our own colleagues of more than 100 in the New Orleans and Baton Rouge, Louisiana area. We are fortunate and grateful that all of our employees in the affected area have been accounted for and are safe.

While our client records and facilities in New Orleans remained intact, we continue to assess the impact of the catastrophe on our clients served by the New Orleans office location and expect the impact to affect less than one percent of our client base. We successfully executed our business continuity plan ensuring that we continued to process payroll for our clients. Our operations in New Orleans experienced minimal disruption through an outstanding joint effort by our Baton Rouge, Dallas, Houston and numerous other branch locations. We are proud of the incredible work of our managers and their teams to continuously support our business and our clients.

Our more than 10,000 colleagues nationwide have joined forces to assist our colleagues affected by this catastrophe through efforts spearheaded by our corporate employee relations group, including fundraising activities and personal donations. All funds raised are being matched dollar for dollar by Paychex, Inc. to provide for the safety, well-being and peace of mind of our colleagues during this time.

Outlook

Our current outlook for the full fiscal year ended May 31, 2006 is summarized as follows:

- Payroll service revenue growth is projected to be in the range of 9% to 11%.
- Human Resource Services revenue growth is expected to be in the range of 25% to 28%.
- Total service revenue growth is projected to be in the range of 12% to 14%.
- Interest on funds held for clients is expected to increase approximately 40% to 45%.
- Total revenue growth is estimated to be in the range of 13% to 15%.
- Corporate investment income is anticipated to increase approximately 65% to 70%.
- The effective income tax rate is expected to approximate 31.5%.
- Net income growth is expected to be in the range of 22% to 24%.

Remaining unchanged, purchases of property and equipment are expected to be in the range of $75 million to $80 million, including anticipated purchases for printing equipment, communication system upgrades, and branch expansions. Depreciation expense is projected to be in the range of $50 million to $55 million. In addition, we project that amortization of intangible assets will be in the range of $14 million to $15 million.

Our projections are based on current economic and interest rate conditions, including the Federal Funds rate increase announced on September 20, 2005, continuing with no significant changes.

RESULTS OF OPERATIONS

Summary of Results of Operations for the Three Months Ended August 31,:

$ in millions, except per share amounts	2005	Change	2004	Change
Revenues:				
Payroll service revenue	$308.6	10%	$279.8	10%
Human Resource Services revenue	75.8	39%	54.4	31%
Total service revenues	384.4	15%	334.2	13%
Interest on funds held for clients	19.3	79%	10.8	-19%
Total revenues	**403.7**	**17%**	**345.0**	**12%**
Combined operating and SG&A expenses	**240.9**	**11%**	**216.3**	**11%**
Operating income	**162.8**	**27%**	**128.7**	**12%**
As a % of total revenues	40%		37%	
Investment income, net	4.9	115%	2.2	-43%
Income before income taxes	**167.7**	**28%**	**130.9**	**10%**
As a % of total revenues	42%		38%	
Income taxes	52.7	22%	43.2	12%
Net income	**$115.0**	**31%**	**$ 87.7**	**9%**
As a % of total revenues	28%		25%	
Diluted earnings per share	$ 0.30	30%	$ 0.23	10%

Details regarding our combined funds held for clients and corporate investment portfolios are as follows:

$ in millions	For the three months ended August 31, 2005	August 31, 2004
Average investment balances:		
Funds held for clients	$ 2,742.0	$ 2,461.5
Corporate investments	730.5	529.2
Total	$ 3,472.5	$ 2,990.7
Average interest rates earned:		
Funds held for clients	2.7%	1.7%
Corporate investments	2.5%	1.8%
Combined funds held for clients and corporate investment portfolios	2.7%	1.7%
Net realized gains:		
Funds held for clients	$ 0.1	$ 0.2
Corporate investments	—	—
Total	$ 0.1	$ 0.2

As of: ($ in millions)	August 31, 2005	May 31, 2005
Net unrealized loss on available-for-sale portfolio	$ (11.9)	$ (9.9)
Federal Funds rate (B)	3.50%	3.00%
Three-year "AAA" municipal securities yield	3.03%	2.85%
Total available-for-sale securities	$ 1,555.3	$ 1,800.8
Average duration of available-for-sale securities portfolio in years (A)	2.0	2.1
Weighted average yield-to-maturity of available-for-sale securities portfolio (A)	2.6%	2.6%

(A) These items exclude the impact of auction rate securities as they are tied to short-term interest rates.

(B) On September 20, 2005, the Federal Funds rate was increased to 3.75%.

Revenues: Our total service revenues are comprised of revenues from Payroll and Human Resource Services. Payroll service revenues are earned primarily from payroll processing, tax filing and payment services, employee payment services, and other ancillary services through either our Core Payroll or Major Market Services. Major Market Services are utilized by clients that have more complex payroll and benefits needs, including companies that have fifty or more employees. Human Resource Services revenue is earned primarily from retirement services, section 125 plan administration, workers' compensation insurance administration, time and attendance solutions, and Paychex Premier (SM) (previously referred to as Paychex Administrative Services or "PAS") and PEO services.

The increase in payroll service revenues for the three months ended August 31, 2005 compared with the same period last year was attributable to higher check volume growth and positive trends in new hire activity, as well as client base growth. In addition, growth in the utilization of our ancillary services and price increases contributed to the increase.

As of August 31, 2005, 91% of all clients utilized our tax filing and payment services, compared with 89% at August 31, 2004. We believe that the client utilization percentage of our tax filing and payment services is near maturity. Our employee payment services were utilized by 66% of all clients at August 31, 2005, compared with 63% at August 31, 2004. Approximately 95% of new clients purchase our tax filing and payment services and more than 75% of new clients purchase employee payment services.

Major Market Services revenues increased 28% for the three months ended August 31, 2005 to $52.4 million. Approximately one-third of new Major Market Services clients are conversions from our Core Payroll service.

The increase in Human Resource Services revenue in the three months ended August 31, 2005 compared with the same period last year was related to growth in the number of clients utilizing Retirement Services products, growth in client employees served by Paychex Premier (SM) and PEO services, and growth in our time and attendance solutions.

Retirement Services revenue increased 17% during the three months ended August 31, 2005 to $24.6 million. At August 31, 2005, we serviced more than 34,000 Retirement Services clients, as compared with over 30,000 clients at August 31, 2004.

Our Paychex Premier (SM) product is a combined package of payroll, employer compliance, human resources and employee benefit administration, and risk management outsourcing services designed to make it easier for small businesses to manage their payroll and benefit costs. Our PEO product provides primarily the same services as Paychex Premier (SM) , but we act as a co-employer of the client's employees. The PEO service is available primarily in the states of Florida and Georgia, where PEOs are more prevalent. Sales of the Paychex Premier (SM) and PEO products have been strong, as administrative fee revenues from these products increased 35% to $21.5 million for the three months ended August 31, 2005. As of August 31, 2005, our Paychex Premier (SM) and PEO products serviced over 237,000 client employees, as compared with over 168,000 client employees at August 31, 2004.

For the three months ended August 31, 2005, interest on funds held for clients increased due to higher average interest rates earned and higher average portfolio balances. The higher average portfolio balances were driven by client base growth, increased check volume within our current client base, and increased utilization of our tax filing and payment services and employee payment services.

Combined operating and SG&A expenses: The following tables summarize total combined operating and selling, general, and administrative ("SG&A") expenses:

	For the three months ended			
In millions	**August 31, 2005**	**Change**	**August 31, 2004**	**Change**
Compensation-related expenses	$ 150.7	14%	$ 132.0	11%
Facilities (excluding depreciation) expenses	11.5	3%	11.2	-1%
Depreciation of property and equipment	12.3	19%	10.3	7%
Amortization of intangible assets	3.7	-5%	3.9	-5%
Other expenses	62.7	6%	58.9	16%
Total operating and SG&A expenses	**$ 240.9**	**11%**	**$ 216.3**	**11%**

For the three months ended August 31, 2005, combined operating and SG&A expenses increased primarily as a result of our investments in personnel, information technology, and other costs incurred to support our revenue growth. At August 31, 2005, we had approximately 10,300 employees compared with approximately 9,600 at August 31, 2004.

Depreciation expense is primarily related to buildings, furniture and fixtures, data processing equipment, and software. Depreciation expense increased due to the purchase in May 2005 of a 127,000 square foot building in Rochester, New York and higher levels of capital expenditures. Amortization of intangible assets is primarily related to client lists obtained from previous acquisitions, which are amortized using accelerated methods. Other expenses include such items as delivery, forms and supplies, communications, travel and entertainment, professional services, and other costs incurred to support our business.

Operating income: The increases in operating income for the three months ended August 31, 2005, as compared with the same period last year are attributable to the factors previously discussed.

Investment income, net: Investment income, net primarily represents earnings from our cash and cash equivalents and investments in available-for-sale securities. Investment income does not include interest on funds held for clients, which is included in total revenues. The increase in investment income in the three months ended August 31, 2005 as compared to the same period last year is due to increases in average interest rates earned and increases in average portfolio balances resulting from investment of cash generated from our ongoing operations.

Income taxes: Our effective income tax rate was 31.4% during the three months ended August 31, 2005 compared with 33.0% in the same period last year. The decrease in our effective tax rate is attributable to higher levels of tax-exempt income derived from municipal debt securities held in our funds held for clients and corporate investment portfolios, and a lower effective state income tax rate.

Net income: The increases in net income for the three months ended August 31, 2005, as compared with the three months ended August 31, 2004 are attributable to the factors previously discussed.

LIQUIDITY AND CAPITAL RESOURCES

At August 31, 2005, our principal source of liquidity was $797.2 million in cash and corporate investments. Current cash and corporate investments and projected operating cash flows are expected to support our normal business operations, capital expenditures, and current dividend payments for the foreseeable future.

We have unused borrowing capacity available under four uncommitted, secured, short-term lines of credit with financial institutions at market rates of interest as follows:

Financial Institution	Amount Available	Expiration Date
JP Morgan Chase Bank, N.A.	$350 million	February 2006
Fleet National Bank, a Bank of America company	$250 million	February 2006
PNC Bank, National Association	$150 million	February 2006
Wells Fargo Bank, National Association	$150 million	February 2006

The primary uses of the lines of credit would be to meet short-term funding requirements related to deposit account overdrafts and client fund deposit obligations arising from electronic payment transactions on behalf of our clients in the ordinary course of business, if necessary. No amounts were outstanding against these lines of credit as of or during the three months ended August 31, 2005.

At August 31, 2005, we had standby letters of credit outstanding totaling $53.1 million, required to secure commitments for certain of our insurance policies. These letters of credit expire at various dates between December 2005 and July 2006. The letters of credit are secured by investments held in our corporate portfolios including a $44.2 million letter of credit for which funds have been segregated into a separate account. No amounts were outstanding on these letters of credit as of or during the three months ended August 31, 2005.

We enter into various purchase commitments with vendors in the ordinary course of business. At August 31, 2005, we had outstanding commitments to purchase approximately $7.8 million of capital assets.

In the normal course of business, we make representations and warranties that guarantee the performance of our services under service arrangements with clients. In addition, we have entered into indemnification agreements with our officers and directors, which require us to defend and, if necessary, indemnify these individuals for matters related to their services provided to us. Historically, there have been no material losses related to such guarantees and indemnifications.

We currently self-insure the deductible portion of various insured exposures under certain employee benefit plans. Our estimated loss exposure under these insurance arrangements is recorded in other current liabilities on the Consolidated Balance Sheets. Historically, the amounts accrued have not been material. We also have insurance coverage in addition to our purchased primary insurance policies for gap coverage for employment practices liability, errors and omissions, warranty liability, and acts of terrorism, and capacity for deductibles and self-insured retentions through our captive insurance company.

Off-Balance Sheet Arrangements

As part of our ongoing business, we do not participate in transactions with unconsolidated entities such as special purpose entities or structured finance entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other limited purposes. We do maintain investments as a limited partner in low-income housing projects that are not considered part of our ongoing operations. These investments are accounted for under the equity method of accounting.

Operating Cash Flow Activities

In millions	For the three months ended August 31, 2005	For the three months ended August 31, 2004
Net income	$ 115.0	$ 87.7
Non-cash adjustments to net income	22.8	28.5
Cash provided by changes to working capital and other assets and other liabilities	23.9	9.2
Net cash provided by operating activities	**$ 161.7**	**$ 125.4**

The increase in our operating cash flows for the three months ended August 31, 2005 reflects higher net income adjusted for non-cash items, and increased cash from working capital. The decrease in non-cash adjustments to net income is primarily attributable to a benefit for deferred income taxes in the three months ended August 31, 2005 offset by higher depreciation expense. The fluctuation in working capital between periods was primarily the result of an increase in interest received on investments, timing of accounts receivable billing and collections and timing of payments for compensation, PEO payroll, income tax, and other liabilities.

Investing Cash Flow Activities

In millions	For the three months ended August 31, 2005	For the three months ended August 31, 2004
Net change in funds held for clients and corporate investment activities	$ (39.8)	$ (78.1)
Purchases of property and equipment, net of proceeds from the sale of property and equipment	(20.6)	(10.7)
Acquisition of businesses, net of cash acquired	(0.4)	—
Purchases of other assets	(0.6)	(0.3)
Net cash used in investing activities	**$ (61.4)**	**$ (89.1)**

***Funds held for clients and corporate investments*:** Funds held for clients are primarily comprised of short-term funds and available-for-sale debt securities. Corporate investments are primarily comprised of available-for-sale debt securities. The portfolio of funds held for clients and corporate investments is detailed in Note C of the Notes to Consolidated Financial Statements.

The amount of funds held for clients will vary based upon the timing of collecting client funds, and the related remittance of funds to tax authorities for tax filing and payment services and to employees of clients utilizing employee payment services. Fluctuations in net funds held for clients and corporate investment activities mainly relate to timing of purchases, sales, or maturities of corporate investments. Additional discussion of interest rates and related risks is included in the “Market Risk Factors” section of this review.

Purchases of property and equipment: To support our continued client and ancillary product growth, purchases of property and equipment were made for data processing equipment and software, and for the expansion and upgrade of various operating facilities. Construction in progress totaled $21.1 million at August 31, 2005 and $29.5 million at May 31, 2005. A significant portion of these costs represents software being developed for internal use.

We purchased approximately $2.2 million and $1.8 million of data processing equipment and software from EMC Corporation during the three months ended August 31, 2005 and 2004, respectively. The President and Chief Executive Officer of EMC Corporation is a member of our Board of Directors.

Acquisition of businesses: At May 31, 2005, we had $0.6 million, subject to adjustment, in other current liabilities on the Consolidated Balance Sheets for the additional purchase price expected to be paid for the acquisition of substantially all the assets and certain liabilities of Stromberg LLC. This additional purchase price was settled in August 2005.

Financing Cash Flow Activities

In millions, except per share amounts	For the three months ended August 31, 2005	For the three months ended August 31, 2004
Dividends paid	$ (49.3)	$ (45.4)
Proceeds from exercise of stock options	5.4	2.8
Net cash used in financing activities	**$ (43.9)**	**$ (42.6)**
Cash dividends per common share	$ 0.13	$ 0.12

Dividends paid: During the three months ended August 31, 2005, our Board of Directors declared a quarterly dividend of $0.13 per share, which was paid August 15, 2005 to shareholders of record as of August 1, 2005. In October 2004, our Board of Directors declared an increase in the quarterly dividend from $0.12 per share to $0.13 per share. Future dividends are dependent on our future earnings and cash flow and are subject to the discretion of our Board of Directors.

Proceeds from exercise of stock options: The increase in proceeds from the exercise of stock options is due to an increase in the number of shares exercised from 0.2 million shares during the three months ended August 31, 2004 to 0.4 million shares during the three months ended August 31, 2005, and an increase in the average exercise price per share. We have recognized a tax benefit from the exercise of stock options of $2.5 million for the three months ended August 31, 2005 as compared to $1.8 million for the three months ended August 31, 2004. This tax benefit reduces the accrued income tax liability and increases additional paid-in capital, with no impact on the expense amount for income taxes.

MARKET RISK FACTORS

Changes in interest rates and interest rate risk: Funds held for clients are primarily comprised of short-term funds and available-for-sale securities and corporate investments are primarily comprised of available-for-sale debt securities. As a result of our operating and investing activities, we are exposed to changes in interest rates that may materially affect our results of operations and financial position. Changes in interest rates will impact the earnings potential of future investments and will cause fluctuations in the market value of our longer-term available-for-sale investments. In seeking to minimize the risks and/or costs associated with such activities, we generally direct investments towards high-credit-quality, fixed-rate municipal and government securities and manage the available-for-sale portfolio to a benchmark duration of two and one-half to three years. We do not utilize derivative financial instruments to manage our interest rate risk.

During the three months ended August 31, 2005, the average interest rate earned on our combined funds held for clients and corporate investment portfolios was 2.7% compared with 1.7% for the same period last year. While interest rates are rising, the full benefit of higher interest rates will not immediately be reflected in net income due to the interaction of long- and short-term interest rate changes as discussed below.

Increases in interest rates increase earnings from our short-term investments, which totaled approximately $1.2 billion at August 31, 2005, and over time will increase earnings from our longer-term available-for-sale investments, which totaled approximately $1.6 billion at August 31, 2005. Earnings from the available-for-sale-investments, which currently have an average duration of 2.0 years, excluding the impact of auction rate securities tied to short term interest rates, will not reflect increases in interest rates until the investments are sold or mature and the proceeds are reinvested at higher rates. An increasing interest rate environment will generally result in a decrease in the market value of our investment portfolio.

The cost and market value of available-for-sale securities at August 31, 2005, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations without prepayment penalties.

	August 31, 2005	
In thousands	**Cost**	**Market value**
Maturity date:		
Due in one year or less	$ 413,886	$ 412,012
Due after one year through three years	767,294	759,852
Due after three years through five years	242,254	240,177
Due after five years	143,783	143,282
Total available-for-sale securities	**$ 1,567,217**	**$ 1,555,323**

The following table summarizes recent changes in the Federal Funds rate:

	Fiscal year 2006 year-to-date	Fiscal year ended May 31, 2005	Fiscal year ended May 31, 2004
Federal Funds rate — beginning of period	3.00%	1.00%	1.25%
Rate increase/(decrease):			
First quarter	0.50%	0.50%	(0.25)%
Second quarter	NA	0.50%	—
Third quarter	NA	0.50%	—
Fourth quarter	NA	0.50%	—
Federal Funds rate — end of period	3.50%	3.00%	1.00%
Three-year “AAA” municipal securities yield — end of period	3.03%	2.85%	2.50%

On September 20, 2005, the Federal Funds rate was increased to 3.75%.

Calculating the future effects of changing interest rates involves many factors. These factors include, but are not limited to:

- daily interest rate changes;
- seasonal variations in investment balances;
- actual duration of short-term and available-for-sale investments;
- the proportional mix of taxable and tax-exempt investments; and
- changes in tax-exempt municipal rates versus taxable investment rates, which are not synchronized or simultaneous.

Subject to these factors, a 25-basis-point change generally affects our tax-exempt interest rates by approximately 17 basis points.

Our total investment portfolio (funds held for clients and corporate investments) is expected to average approximately $3.8 billion for the full year ended May 31, 2006. Our normal and anticipated allocation is approximately 60% invested in short-term securities with an average duration of 30 days and 40% invested in available-for-sale securities with an average duration of two and one-half to three years. Based on these current assumptions, we estimate that the earnings effect of a 25-basis-point change in interest rates (17 basis points for tax-exempt investments) at this point in time would be approximately $4.0 million to $4.5 million for the next twelve-month period.

The combined funds held for clients and corporate available-for-sale investment portfolios reflected a net unrealized loss of $11.9 million at August 31, 2005, compared with a net unrealized loss of $9.9 million at May 31, 2005, and a net unrealized gain of $9.1 million at August 31, 2004. During the three months ended August 31, 2005, the net unrealized loss position ranged from $16.7 million to $6.1 million. Our investment portfolios reflected a net unrealized loss position of approximately $11.5 million at September 22, 2005.

As of August 31, 2005 and May 31, 2005, we had $1.6 billion and $1.8 billion, respectively, invested in available-for-sale securities at market value, with weighted average yields to maturity of 2.6%. Assuming a hypothetical increase in both short-term and longer-term interest rates of 25 basis points, the resulting potential decrease in market value for our portfolio of securities at August 31, 2005, would be in the range of $7.5 million to $8.0 million. Conversely, a corresponding decrease in interest rates would result in a comparable increase in market value. This hypothetical decrease or increase in the market value of the portfolio would be recorded as an adjustment to the portfolio's recorded value, with an offsetting amount recorded in stockholders' equity. These fluctuations in market value would have no related or immediate impact on the results of operations, unless any declines in market value were considered to be other than temporary.

Credit Risk: We are exposed to credit risk in connection with these investments through the possible inability of the borrowers to meet the terms of the bonds. We attempt to limit credit risk by investing primarily in AAA- and AA-rated securities and A-1- rated short-term securities, and by limiting amounts that can be invested in any single instrument. At August 31, 2005, all available-for-sale and short-term securities classified as cash equivalents held an A-1 or equivalent rating, with approximately 99% of available-for-sale securities holding an AA rating or better.

CRITICAL ACCOUNTING POLICIES

Our critical accounting policies are described in Item 7 of our Annual Report on Form 10-K for the year ended May 31, 2005, filed with the SEC on July 22, 2005. On an ongoing basis, we evaluate the critical accounting policies used to prepare our Consolidated Financial Statements, including, but not limited to, those related to:

- revenue recognition;
- PEO workers' compensation insurance;
- valuation of investments;
- goodwill and intangible assets;
- accrual for client fund losses (inability to meet their payroll obligations);
- contingent liabilities; and
- income taxes.

There have been no changes in our critical accounting policies during the three months ended August 31, 2005.

NEW ACCOUNTING PROUNCEMENTS

On August 31, 2005, the Financial Accounting Standards Board ("FASB") issued FASB Staff Position FAS 123(R)-1, "Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement 123(R)." This guidance applies to equity shares, as well as stock options, and requires that a freestanding financial instrument issued to an employee in exchange for past or future employee services that is subject to Statement of Financial Accounting Standard ("SFAS") No. 123(R) "Share Based Payments" shall continue to be subject to the recognition and measurement provisions of SFAS No.123(R) throughout the life of the instrument, unless its terms are modified when the holder is no longer an employee. The effective date of this guidance is upon initial adoption of SFAS 123(R). We are currently evaluating the new guidance and anticipate adopting it with the implementation of SFAS 123(R) for our fiscal year beginning June 1, 2006.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE OF MARKET RISK

The information called for by this item is provided under the caption "Market Risk Factors" under ITEM 2 — MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS and is incorporated herein by reference.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures: As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer of the effectiveness of disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on such evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in applicable Securities and Exchange Commission rules and forms.

Changes in Internal Control Over Financial Reporting: We also carried out an evaluation of the internal control over financial reporting to determine whether any changes occurred during the period covered by this report. Based on such evaluation, there has been no change in our internal control over financial reporting that occurred during the most recently completed fiscal quarter ended August 31, 2005, that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

See Note I of the Notes to Consolidated Financial Statements, which is incorporated herein by reference thereto, for information regarding legal proceedings.

ITEM 6. EXHIBITS

(1) Exhibit 3(ii): By-laws of Paychex, Inc., as amended.

(2) Exhibit 31.1: Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended.

(3) Exhibit 31.2: Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as amended.

(4) Exhibit 32.1: Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(5) Exhibit 32.2: Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

PAYCHEX, INC.

Date: September 27, 2005	/s/ Jonathan J. Judge Jonathan J. Judge President and Chief Executive Officer
Date: September 27, 2005	/s/ John M. Morphy John M. Morphy Senior Vice President, Chief Financial Officer, and Secretary

EXHIBIT 3(ii):

BY-LAWS

OF

PAYCHEX, INC.

ARTICLE I

OFFICES

SECTION 1. The registered office of Paychex, Inc., a Delaware corporation (hereinafter referred to as the “Corporation”), shall be located within the State of Delaware.

SECTION 2. The Corporation may also have offices at such places, either within or without the State of Delaware and either within or without the United States of America, as the board of directors may from time to time designate or the business of the Corporation may require.

ARTICLE II

MEETINGS OF STOCKHOLDERS

SECTION 1. All meetings of the stockholders for the election of directors or for any other purpose shall be held at such time and place, either within or without the State of Delaware and either within or without the United States of America, as shall be stated in the notice of meeting or in a duly executed waiver thereof.

SECTION 2. The annual meeting of stockholders shall be held on such date and at such hour as shall be designated each year by the board of directors. At such annual meeting, the stockholders shall elect a board of directors and transact such other business as may be properly brought before the meeting.

SECTION 3. Special meetings of stockholders for any purpose or purposes, unless otherwise prescribed by statute or by the Corporation’s certificate of incorporation, may be called by the Chairman of the Board or the President and shall be called by the Chairman of the Board, the President or the Secretary at the request in writing of a majority of the board of directors, or at the request in writing of stockholders owning a majority in amount of the entire capital stock of the Corporation issued and outstanding and entitled to vote. Such request shall state the purpose or purposes of the proposed meeting.

SECTION 4. Except as otherwise expressly required by statute, written notice of each annual and special meeting of stockholders, stating the place, date and hour of the meeting, and, in the case of a special meeting, the purpose or purposes for which the meeting is called, shall be given to each stockholder of record entitled to vote thereat not less than ten (10) nor more than sixty (60) days before the date of the meeting. Notice shall be given personally or by mail and, if by mail, shall be sent in a postage prepaid envelope, addressed to the stockholder at his address as it appears on the records of the Corporation. Notice by mail shall be deemed given at the time when the same shall be deposited in the United States mail, postage prepaid. Attendance of a person at a meeting shall constitute a waiver of notice of such meeting, except when such person attends the meeting in person or by proxy for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened. A written waiver of notice signed by the person entitled to notice, whether before or after the time stated therein, shall be deemed equivalent to notice. Neither the business to be transacted at, nor the purpose of, an annual or special meeting of stockholders need be specified in any written waiver of notice. Business transacted at any special meeting of stockholders shall be limited to the purposes stated in the notice.

SECTION 5. The officer who has charge of the stock transfer books of the Corporation shall prepare and make, at the time and in the manner required by applicable law, a list of stockholders entitled to vote and shall make such list available for such purposes, at such places, at such times and to such persons as required by applicable law. The stock transfer books shall be the only evidence as to the identity of the stockholders entitled to examine the stock transfer books or to vote in person or by proxy at any meeting of stockholders.

SECTION 6. The holders of a majority of the voting power of the issued and outstanding stock of the Corporation entitled to vote thereat, present in person or represented by proxy, shall constitute a quorum for the transaction of business at any meeting of stockholders, except as otherwise provided by statute or by the Corporation’s certificate of incorporation. The stockholders present and entitled to vote at a duly called or held meeting at which a quorum is present may continue to do business until adjournment, notwithstanding the withdrawal of enough stockholders entitled to vote to leave less than a quorum then present and represented provided that the action taken (other than an adjournment) is approved by at least a majority of the holders of stock required to constitute a quorum. Any stockholders’ meeting, annual or special, whether or not a quorum is present or represented, may be adjourned from time to time by the vote of the holders of a majority of the stock entitled to vote thereat, the holders of which are either present in person or represented by proxy, or the chairman of the meeting, but in the absence of a quorum no other business may be transacted at such meeting. At any adjourned meeting, at which a quorum shall be present or represented, any business may be transacted which might have been transacted at the meeting as originally notified, except for such business as was duly transacted at any earlier meeting. If the adjournment is for more than thirty (30) days, or if after adjournment a new record date is set, a notice of the adjourned meeting shall be given as in the case of an original meeting to each stockholder of record entitled to vote at the meeting.

SECTION 7. At each meeting of stockholders, the Chairman of the Board or, in his absence or inability to act, such other person as the board of directors may have designated shall call to order and act as chairman of the meeting. The Secretary or, in his absence or inability to act, the person whom the chairman of the meeting shall appoint secretary of the meeting shall act as secretary of the meeting and keep the minutes thereof.

SECTION 8. The order of business and the procedure at all meetings of the stockholders shall be as determined by the chairman of the meeting, unless otherwise prescribed by law or regulation.

SECTION 9. Except as otherwise provided by statute or the Corporation's certificate of incorporation, each holder of common stock of the Corporation shall be entitled at each meeting of stockholders to one (1) vote for each share of such stock standing in his name on the record of stockholders of the Corporation

(a) on the date fixed pursuant to the provisions of Section 7 of Article V of these by-laws as the record date for the determination of the stockholders who shall be entitled to notice of and to vote at such meeting; or

(b) if no such record date shall have been so fixed, then at the close of business on the day next preceding the day on which notice thereof shall be given, or, if notice is waived, at the close of business on the day next preceding the day on which the meeting is held.

Each stockholder entitled to vote at any meeting of stockholders may authorize another person or persons to act for him by proxy, provided that such proxy shall comply with the requirements of Delaware law. No proxy shall be voted after three (3) years from its date, unless the proxy provides for a longer period. Any such proxy shall be delivered to the secretary of the meeting at or prior to the time designated in the order of business for so delivering such proxies. When a quorum is present at any meeting, the vote of the holders of a majority of the voting power of the issued and outstanding stock of the Corporation entitled to vote thereon, present in person or represented by proxy, shall decide any question brought before such meeting, unless the question is one upon which, by express provision of statute or of the Corporation's certificate of incorporation or of these by-laws, a different vote is required, in which case such express provision shall govern and control the decision of such question. On a vote by ballot, each ballot shall be signed by the stockholder voting, or by his proxy, if represented by proxy, and shall state the number of shares voted.

SECTION 10. The board of directors may, in advance of any meeting of stockholders, appoint one or more inspectors to act at, and make a written report of, such meeting or any adjournment thereof. If any of the inspectors so appointed shall fail to appear or act, the chairman of the meeting shall, or, if inspectors shall not have been appointed, the chairman of the meeting may, appoint one or more inspectors. Each inspector, before entering upon the discharge of his duties, shall take and sign an oath faithfully to execute the duties of inspector at such meeting with strict impartiality and according to the best of his ability. The inspectors shall determine the number of shares of capital stock of the Corporation outstanding and the voting power thereof, the number of shares represented at the meeting, the existence of a quorum and the authenticity, validity and effect of proxies, certify their determination of the number of shares represented at the meeting and shall receive votes or ballots, hear, determine and retain for a reasonable period a record of the disposition of, all challenges and questions arising in connection with the right to vote, count and tabulate all votes or ballots, determine the results and perform such acts as are proper to conduct the election or vote with fairness to all stockholders. If more than one inspector has been appointed, the decision, act or certificate of a majority of the inspectors is effective in all respects as the decision, act or certificate of all of the inspectors. On request of the chairman of the meeting, the inspector shall make a report in writing of any challenge, request or matter determined by them and shall execute a certificate of any fact found by them. No director or candidate for the office of director shall act as an inspector of election with respect to an election of directors. Inspectors need not be stockholders.

SECTION 11. Any action required or permitted to be taken at any annual or special meeting of the stockholders may be taken without a meeting, without prior notice and a vote, if a consent or consents in writing, setting forth the action so taken, shall be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted and shall be delivered to the Corporation by delivery to its registered office in Delaware, its principal place of business, or an officer or agent of the Corporation having custody of the book in which proceedings of meetings of stockholders are recorded. Delivery made to the Corporation’s registered office shall be by hand or by certified or registered mail, return receipt requested. Where corporate action is taken in such manner by less than unanimous written consent, prompt written notice of the taking of such action shall be given to all stockholders who have not consented in writing thereto.

Every written consent shall bear the date of signature of each stockholder who signs the consent and no written consent shall be effective to take the corporate action referred to therein unless, within sixty days of the earliest dated consent delivered in the manner required by statute to the Corporation, written consents signed by a sufficient number of holders to take action are delivered to the Corporation by delivery to its registered office in Delaware, its principal place of business, or an officer or agent of the Corporation having custody of the book in which proceedings of meetings of stockholders are recorded. Delivery made to the Corporation’s registered office shall be by hand or by certified or registered mail, return receipt requested.

ARTICLE III

BOARD OF DIRECTORS

SECTION 1. The number of directors which shall constitute the whole board of directors shall consist of one or more members, the exact number to be fixed from time to time by the board of directors. Each director shall hold office until such director's successor is elected and qualified or until such director's earlier resignation or removal.

SECTION 2. The business and affairs of the Corporation shall be managed by or under the direction of the board of directors. The board of directors may exercise all such authority and powers of the Corporation and do all such lawful acts and things as are not by statute, the Corporation's certificate of incorporation or these by-laws directed or required to be exercised or done by the stockholders.

SECTION 3. Meetings of the board of directors shall be held at such place or places, within or without the State of Delaware and either within or without the United States of America, as the board of directors may from time to time determine or as shall be specified in the notice of any such meeting.

SECTION 4. The board of directors shall meet for the purpose of organization, the election of officers and the transaction of other business, as soon as practicable after each annual meeting of stockholders. Notice of such meeting need not be given. In the event such annual meeting is not so held, the annual meeting of the board of directors may be held at such other time, within or without the State of Delaware and either within or without the United States of America, as shall be specified in a notice thereof given as provided in Section 7 of this Article III.

SECTION 5. Regular meetings of the board of directors shall be held at such time and place as the board of directors may fix. If any day fixed for a regular meeting shall be a legal holiday at the place where the meeting is to be held, then the meeting which would otherwise be held on that day shall be held at the same hour on the next succeeding business day. Notice of regular meetings of the board of directors need not be given.

SECTION 6. Special meetings of the board of directors may be called by the Chairman of the Board or the President and shall be called by the Secretary on the written request of a majority of the members of the Board of Directors.

SECTION 7. Notice of each special meeting of the board of directors shall be given by the President or the Secretary as hereinafter provided in this Section 7, in which notice shall be stated the time and place of the meeting. Except as otherwise required by these by-laws, such notice need not state the purpose or purposes of such meeting. Notice of each such meeting shall be mailed, postage prepaid, to each director, addressed to him at his residence or usual place of business, by first class mail, at least two (2) days before the time of the meeting, or shall be sent addressed to him at such place by telegraph, cable, telex, telefax, telecopier or other similar means, or be delivered to him personally or be given to him by telephone or other similar means, at least twelve (12) hours before the time of the meeting. A written waiver of notice signed by a director, whether before or after the time stated therein, shall be deemed equivalent to notice to such director. Attendance of a director at the meeting shall constitute a waiver of notice of such meeting by such director, except when such director attends a meeting for the express purpose of objecting, at the beginning of the meeting, to the transaction of any business because the meeting is not lawfully called or convened.

SECTION 8. At all meetings of the board of directors, a majority of the total number of directors shall be necessary and sufficient to constitute a quorum for the transaction of business and, except as otherwise expressly required by statute or the Corporation’s certificate of incorporation or these by-laws, the act of a majority of the directors present at any meeting at which a quorum is present shall be the act of the board of directors. In the absence of a quorum at any meeting of the board of directors, a majority of the directors present thereat may adjourn such meeting to another time and place. Notice of the time and place of any such adjourned meeting shall be given to all of the directors unless such time and place were announced at the meeting at which the adjournment was taken, in which case such notice shall only be given to the directors who were not present thereat. At any adjourned meeting at which a quorum is present, any business may be transacted which might have been transacted at the meeting as originally called. The directors shall act only as a board and the individual directors shall have no power as such.

SECTION 9. Any director of the Corporation may resign at any time by giving written notice of his resignation to the Corporation. Any such resignation shall take effect at the time specified therein or, if the time when it shall become effective shall not be specified therein, immediately upon its tender. Unless otherwise specified therein, the acceptance of such resignation shall not be necessary to make it effective. Any vacancy in the board of directors caused by such resignation may be filled by a majority vote of the board of directors for the unexpired portion of the term.

SECTION 10. Any director of the Corporation may be removed, at any time, with or without cause, by the affirmative vote of the holders of record of a majority of the outstanding shares of stock entitled to vote at a meeting of stockholders, and any vacancy in the board of directors caused by any such removal may be filled by the stockholders at said meeting in which the vacancy is created or, if not so filled, by a majority vote of the Board of Directors for the unexpired portion of the term.

SECTION 11. Unless restricted by the Corporation’s certificate of incorporation, the board of directors may, by resolution passed by a majority of the entire board of directors, designate one or more committees, including an executive committee, each committee to consist of one or more of the directors of the Corporation. The board of directors may designate one or more directors as alternate members of any committee, who may replace any absent or disqualified member at any meeting of the committee. In the absence or disqualification of a member of a committee, a member or members thereof present at any meeting and not disqualified from voting, whether or not he or they constitute a quorum, may unanimously appoint another member of the board of directors to act at the meeting in the place or any such absent or disqualified member. Except to the extent restricted by statute or the Corporation's certificate of incorporation, each such committee, to the extent provided in the resolution creating it, shall have and may exercise all of the powers and authority of the board of directors, including, if such resolution so provides, the power to declare a dividend, to authorize the issuance of stock or to adopt a certificate of ownership and merger pursuant to section 253 of Title 8 of the Delaware Code, and may authorize the seal of the Corporation to be affixed to all papers which require it. Each such committee shall serve at the pleasure of the board of directors and have such name as may be determined from time to time by resolution adopted by the board of directors. Each committee shall keep regular minutes of its meetings and report the same to the board of directors.

SECTION 12. Any action required or permitted to be taken by the board of directors or any committee thereof may be taken without a meeting if all members of the board of directors or such committee, as the case may be, consent thereto in writing, and the writing or writings are filed with the minutes of the proceedings of the board of directors or such committee, as the case may be.

SECTION 13. Any one or more members of the board of directors or any committee of the board of directors may participate in a meeting of the board of directors or such committee by means of a conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other. Participation by such means shall constitute presence in person at a meeting.

SECTION 14. A director of the Corporation who is present at a meeting of the board of directors or any committee thereof at which action is taken shall be presumed to have assented to the action taken unless his dissent or abstention there from shall be entered in the minutes of the meeting or unless he shall file a written dissent from such action with the person acting as the secretary of the meeting before the adjournment thereof or shall forward such dissent by registered mail to the Secretary of the Corporation within five days after the date a copy of the minutes of the meeting is received. Such right to dissent shall not apply to a director who voted in favor of such action.

SECTION 15. The Board of Directors shall have the authority to fix the compensation of directors for services in any capacity.

ARTICLE IV

OFFICERS

SECTION 1. The officers of the Corporation shall be elected annually by the board of directors at the first meeting of the board held after each annual meeting of stockholders, or as soon thereafter as possible. The board of directors shall elect from among its number a Chairman of the Board. The board of directors shall also elect a President, a Secretary and a Treasurer, who need not be directors. If the board of directors wishes, it may also elect such other officers (including, without limitation, one or more Vice Presidents, one or more Assistant Treasurers and one or more Assistant Secretaries) as may be necessary or desirable for the business of the Corporation. Any two or more offices may be held by the same person. Each officer shall hold office until his successor shall have been duly elected and qualified, or until his death, resignation or removal, as hereinafter provided. A vacancy in any office because of death, resignation, removal, disqualification or otherwise, shall be filled only by a majority vote of the board of directors for the unexpired portion of the term.

SECTION 2. Any officer of the Corporation may resign at any time by giving written notice of his resignation to the Corporation. Any such resignation shall take effect at the time specified therein or, if the time when it shall become effective shall not be specified therein, immediately upon its tender. Unless otherwise specified therein, the acceptance of any such registration shall not be necessary to make it effective.

SECTION 3. Any officer of the Corporation may be removed, either with or without cause, at any time, by the board of directors at any meeting thereof, but such removal shall be without prejudice to the contract rights, if any, of the person so removed.

SECTION. 4. The Chairman of the Board of Directors, if there be one, shall preside at all meetings of the stockholders and of the Board of Directors. During the absence or disability of the President, the Chairman of the Board of Directors shall exercise all the powers and discharge all the duties of the President. The Chairman of the Board of Directors shall also perform such other duties and may exercise such other powers as from time to time may be assigned to him by these By-Laws or by the Board of Directors.

SECTION 5. The President shall, subject to the control of the Board of Directors and, if there be one, the Chairman of the Board of Directors, have general supervision of the business of the Corporation and shall see that all orders and resolutions of the Board of Directors are carried into effect. He shall execute all bonds, mortgages, contracts and other instruments of the Corporation requiring a seal, under the seal of the Corporation, except where required or permitted by law to be otherwise signed and executed and except that the other officers of the Corporation may sign and execute documents when so authorized by these By-Laws, the Board of Directors or the President. In the absence or disability of the Chairman of the Board of Directors, or if there be none, the President shall preside at all meeting of the stockholders and the Board of Directors, the President shall be the chief executive and operating officer of the Corporation. He shall perform all duties incident to the office of chief executive and operating officer and such other duties as may from time to time be assigned to him by the Board of directors.

SECTION 6. Each Vice President, if any, shall perform all duties incident to his office and such other duties as from time to time may be assigned to him by the board of directors, the Chairman of the Board or the President.

SECTION 7. The Treasurer shall

(a) be the principal financial officer and principal accounting officer of the Corporation;

(b) have charge and custody of, and be responsible for, all the funds and securities of the Corporation;

(c) keep full and accurate accounts of receipts and disbursements in books belonging to the Corporation;

(d) deposit all moneys and other valuables to the credit of the Corporation in such depositories as may be designated by the board of directors or pursuant to its direction;

(e) receive, and give receipts for, moneys due and payable to the Corporation from any source whatsoever;

(f) disburse the funds of the Corporation and supervise the investment of its funds, taking proper vouchers therefore;

(g) render to the board of directors, whenever the board of directors may require, an accounting of the financial condition of the Corporation; and

(h) in general, perform all other duties incident to the office of Treasurer and such other duties as from time to time may be assigned to him by the board of directors or the President.

SECTION 8. Secretary. The Secretary shall

(a) keep or cause to be kept, in one or more books provided for the purpose, the minutes of all meetings of the board of directors, the committees of the board of directors and the stockholders;

(b) see that all notices are duly given in accordance with the provisions of these by-laws and as required by law;

(c) see that the books, reports, statements certificates and other documents and records required by law to be kept and filed are properly kept and filed; and

(d) in general, perform all other duties incident to the office of Secretary and such other duties as from time to time may be assigned to him by the board of directors or the President.

SECTION 9. The Assistant Treasurer, if any, or if there shall be more than one, the Assistant Treasurers in the order determined by the board of directors (or, if there be no such determination, then in the order of their election), shall, at the request of the President or the Treasurer or in the absence of the Treasurer or in the event of his inability or refusal to act, perform the duties of the Treasurer (and when so acting, shall have the powers of and be subject to the restrictions placed upon the Treasurer in respect of the performance of such duties) and shall perform such other duties as from time to time may be assigned by the board of directors or the President.

SECTION 10. The Assistant Secretary, if any, or if there be more than one, the Assistant Secretaries in the order determined by the board of directors (of, if there be no such determination, then in the order of their election),shall, at the request of the President or the Secretary or in the absence of the Secretary or in the event of his inability or refusal to act, perform the duties of the Secretary (and when so acting, shall have the powers of and be subject to the restrictions placed upon the Secretary in respect of the performance of such duties) and shall perform such other duties as from time to time may be assigned by the board of directors or the President.

SECTION 11. If required by the board of directors, any officer of the Corporation shall give a bond or other security for the faithful performance of his duties, in such amount and with such surety as the board of directors may require.

SECTION 12. The compensation of the officers of the Corporation for their services as such officers shall be fixed from time to time by the board of directors. An officer of the Corporation shall not be prevented from receiving compensation by reason of the fact that he is also a director of the Corporation.

ARTICLE V

STOCK CERTIFICATES AND THEIR TRANSFER

SECTION 1. Every holder of stock in the Corporation shall be entitled to have a certificate signed by, or in the name of the Corporation by the Chairman of the Board, the President or a Vice President and by the Treasurer or an Assistant Treasurer or the Secretary or an Assistant Secretary of the Corporation certifying the number of shares owned by him in the Corporation. If the Corporation shall be authorized to issue more than one class of stock or more than one series of any class, the designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preference and/or rights shall be set forth in full or summarized on the face or back of the certificate which the Corporation shall issue to represent such class or series of stock, provided that, except as otherwise provided in Section 202 of the General Corporation Law of the State of Delaware, in lieu of the foregoing requirements, there may be set forth, on the face or back of the certificate which the Corporation shall issue to represent such class or series of stock, a statement that the Corporation will furnish without charge to each stockholder who so requests the designations, preferences and relative, participating, optional or other special rights of each class of stock or series thereof and the qualifications, limitations or restrictions of such preferences and/or rights.

SECTION 2. Any or all of the signatures on a certificate may be a facsimile. In case any officer, transfer agent or registrar who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer, transfer agent or registrar before such certificate is issued, it may be issued by the Corporation with the same effect as if he were such officer, transfer agent or registrar at the date of issuance.

SECTION 3. The board of directors may direct that a new certificate or certificates be issued in place of any certificate or certificates theretofore issued by the Corporation alleged to have been lost, stolen or destroyed. When authorizing the issuance of a new certificate or certificates, the board of directors may, in its discretion and as a condition precedent to the issuance thereof, require the owner of such lost, stolen or destroyed certificate or certificates, or his legal representative, to give the Corporation a bond or other indemnity in such amount as it may direct sufficient to indemnify it against any claim that may be made against the Corporation on account of the alleged loss, theft or destruction of any such certificate or the issuance of such new certificate.

SECTION 4. Upon surrender to the Corporation or the transfer agent of the Corporation of a certificate for shares duly endorsed or accompanied by proper evidence of succession, assignment or authority to transfer, it shall be the duty of the Corporation to issue a new certificate to the person entitled thereto, cancel the old certificate and record the transaction upon its records; provided, however, that the Corporation shall be entitled to recognize and enforce any lawful restriction on transfer. Whenever any transfer of stock shall be made for collateral security, and not absolutely, it shall be so expressed in the entry of transfer if, when the certificates are presented to the Corporation for transfer, both the transferor and the transferee request the Corporation to do so. Persons whose stock is pledged shall be entitled to vote, unless in the transfer by the pledgor on the books of the Corporation he has expressly empowered the pledgee to vote thereon, in which case only the pledgee, or his proxy, may represent and vote such stock.

SECTION 5. The board of directors may appoint, or authorize any officer or officers to appoint, one or more transfer agents and one or more registrars.

SECTION 6. The board of directors may make such additional rules and regulations, not inconsistent with these by-laws, as it may deem expedient concerning the issuance, transfer and registration of certificates for shares of stock of the Corporation.

SECTION 7. In order that the Corporation may determine the stockholders entitled to notice of or to vote at any meeting of stockholders or any adjournment thereof, or entitled to receive payment of any dividend or other distribution or any allotment of rights, or entitled to exercise any rights in respect of any change, conversion or exchange of stock or for the purpose of any other lawful action, the board of directors may fix, in advance, a record date, which shall not be more than sixty (60) nor less than ten (10) days before the date of such meeting, nor more than sixty (60) days prior to any other action. A determination of stockholders of record entitled to notice of or to vote at a meeting of stockholders shall apply to any adjournment of the meeting; provided, however, that the board of directors fix a new record date for the adjourned meeting.

SECTION 8. The Corporation shall be entitled to recognize the exclusive right of a person registered on its records as the owner of shares of stock to receive dividends and to vote as such owner, shall be entitled to hold liable for calls and assessments a person registered on its records as the owner of shares of stock, and shall not be bound to recognize any equitable or other claim to or interest in such share or shares of stock on the part of any other person, whether or not it shall have express or other notice thereof, except as otherwise provided by the laws of Delaware.

ARTICLE VI

INDEMNIFICATION

SECTION 1. To the full extent authorized by law, the Corporation shall indemnify any person made, or threatened to be made, a party in any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative, by reason of the fact that he is or was a director or officer of the Corporation, or is serving or served any other corporation, or any partnership, joint venture, trust, employee benefit plan or other enterprise, in any such capacity at the request of the Corporation (“indemnitee”) against expenses (including attorneys’ and other fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by him in connection therewith.

SECTION 2. Expenses actually and reasonably incurred by an indemnitee in defending a civil or criminal action, suit or proceeding shall be paid by the Corporation in advance of the final disposition of such action, suit or proceeding upon an undertaking by or on behalf of such indemnitee to repay such amount if it shall ultimately be determined, by final judicial decision from which there is no further right of appeal, that he is not entitled to be indemnified by the Corporation. To be entitled to such advancement of expenses, the indemnitee shall cooperate in good faith with any request by the Corporation that common counsel be used by parties to such action or proceeding who are similarly situated unless it would be inappropriate to do so because of actual or potential conflicts between the interests of such parties.

SECTION 3. The Corporation may, to the extent authorized by the board of directors, grant rights of indemnification and advancement of expenses to any employee or agent of the Corporation to the full extent of the provisions of this Article with respect to indemnification and advancement of expenses of directors and officers of the Corporation.

SECTION 4. The indemnification provided by this Article shall not be deemed exclusive of any other rights to which any person covered hereby may be entitled other than pursuant to this Article.

ARTICLE VII

GENERAL PROVISIONS

SECTION 1. Subject to the provisions of law and the Corporation’s certificate of incorporation, dividends upon the shares of capital stock of the Corporation may be declared by the board of directors at any regular or special meeting. Dividends may be paid in cash, in property or in shares of stock of the Corporation, unless otherwise provided by law or the Corporation’s certificate of incorporation.

SECTION 2. The seal of the Corporation shall be in such form as shall be approved by the board of directors.

SECTION 3. The fiscal year of the Corporation shall begin the first day of June in each year and end on the next succeeding 31st day of May, or otherwise as the board of directors shall determine.

SECTION 4. All checks, notes, drafts or other orders for the payment of money of the Corporation shall be signed, endorsed or accepted in the name of the Corporation by such officer, officers, person or persons as from time to time may be designated by the board of directors or by an officer or officers authorized by the board of directors to make such designation.

SECTION 5. The board of directors may authorize any officer or officers, agent or agents, in the name and on behalf of the Corporation to enter into or execute and deliver any and all deeds, bonds, mortgages, contracts and other obligations or instruments, and such authority may be general or confined to specific instances.

SECTION 6. Unless otherwise provided by resolution of the board of directors, the Chairman of the Board or the President, from time to time, may (or may appoint one or more attorneys or agents to) cast the votes which the Corporation may be entitled to cast as a stockholder or otherwise in any other corporation, any of whose shares or securities may be held by the corporation, at meetings of the holders of the shares or other securities of such other corporation. In the event one or more attorneys or agents are appointed, the Chairman of the Board or the President, may instruct the person or persons so appointed as to the manner of casting such votes or giving such consent. The Chairman of the Board or the President may, or may instruct the attorneys or agents appointed to, execute or cause to be executed in the name and on behalf of the Corporation and under its seal or otherwise, such written proxies, consents, waivers or other instruments as may be necessary or proper in the circumstances.

SECTION 7. All nouns and pronouns and any variations thereof used herein shall be deemed to refer to the masculine, feminine or neuter, singular or plural, as the context may require.

ARTICLE VIII

AMENDMENTS

SECTION 1. These by-laws may be amended, altered or repealed by the stockholders or by the board of directors.

EXHIBIT 31.1:

CERTIFICATION PURSUANT TO RULE 13a-14(a) or 15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED

I, JONATHAN J. JUDGE, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Paychex, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
   - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
   - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
   - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 27, 2005

/s/ Jonathan J. Judge

President and Chief Executive Officer

EXHIBIT 31.2:

CERTIFICATION PURSUANT TO
RULE 13a-14(a) or 15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED

I, JOHN M. MORPHY, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Paychex, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:

   a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: September 27, 2005

/s/ John M. Morphy

Senior Vice President, Chief Financial Officer, and Secretary

EXHIBIT 32.1:

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Paychex, Inc. (the “Company”) on Form 10-Q for the three months ended August 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, JONATHAN J. JUDGE, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement has been provided to the Company and will be retained by the Company and furnished to the SEC upon request.

Date: September 27, 2005

/s/ Jonathan J. Judge

Jonathan J. Judge
President and Chief Executive Officer

EXHIBIT 32.2:

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Paychex, Inc. (the “Company”) on Form 10-Q for the three months ended August 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, JOHN M. MORPHY, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

A signed original of this written statement has been provided to the Company and will be retained by the Company and furnished to the SEC upon request.

Date: September 27, 2005

/s/ John M. Morphy

John M. Morphy
Senior Vice President, Chief Financial Officer, and Secretary