

PAYCHEX INC
Form DEF 14A
August 31, 2004

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**SCHEDULE 14A
(RULE 14a-101)**

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

PROXY STATEMENT PURSUANT TO SECTION 14(a) OF THE SECURITIES

EXCHANGE ACT OF 1934

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive Additional Materials
- Soliciting Material Pursuant to Section 240.14a-11c or Section 240.14a-12

PAYCHEX, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14a-6(i)(1) and 0-11.

(1) Title of each class of securities to which transaction applies:

(2) Aggregate number of securities to which transaction applies:

(3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):

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(1) Amount Previously Paid:

(2) Form, Schedule or Registration Statement No.:

(3) Filing Party:

(4) Date Filed:

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August 31, 2004

Dear Paychex Stockholder:

The Board of Directors cordially invites you to attend our Annual Meeting of Stockholders (the Annual Meeting) on Wednesday, October 6, 2004 at 10:00 a.m. at the Rochester Riverside Convention Center, 123 East Main Street, Rochester, New York.

This booklet includes the formal Notice of Annual Meeting of Stockholders and the Proxy Statement. The Proxy Statement tells you about the agenda items and the procedures for the Annual Meeting. It also provides certain information about the Company, its Board of Directors, and its executive officers.

It is important that your shares be represented at the Annual Meeting. Whether or not you plan to attend the Annual Meeting, you are encouraged to vote. You may vote by Internet, telephone, written proxy, or written ballot at the Annual Meeting. We encourage you to use the Internet because it is the most cost-effective way to vote.

We hope you will be able to attend the Annual Meeting and would like to take this opportunity to remind you that your vote is important. If you need special assistance at the Annual Meeting, please contact the Secretary of the Company at (585) 385-6666, or write to Paychex, Inc., c/o Secretary, 911 Panorama Trail South, Rochester, New York 14625-2396.

Sincerely,

B. Thomas Golisano
*Chairman, President, and
Chief Executive Officer*

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PAYCHEX, INC.

911 Panorama Trail South Rochester, New York 14625-2396

NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

Time: 10:00 a.m. on Wednesday, October 6, 2004. Continental breakfast will be available from 9:00 a.m. to 10:00 a.m.

Location: Rochester Riverside Convention Center
123 East Main Street
Rochester, NY 14604

Items of Business: (1) To elect seven members of the Board of Directors for one-year terms; and
(2) To transact such other business as may properly come before the Annual Meeting.

Record Date: Stockholders of record as of the close of business on August 9, 2004, are entitled to notice of, and to vote at, the Annual Meeting.

Proxy Voting: Whether or not you plan to attend the Annual Meeting, it is important that your shares be represented and voted at the Annual Meeting. Please vote in one of these ways:

- (1) **Visit the Web site** noted on your proxy card to vote via the Internet;
- (2) **Call the toll-free telephone number** shown on the proxy card; or
- (3) **Mark, sign, date, and promptly return** the enclosed proxy card in the postage-paid envelope.

Signing and returning the proxy card or submitting your proxy via the Internet or by telephone does not affect your right to vote in person if you attend the Annual Meeting and your shares are registered in your name. Any proxy can be revoked at any time prior to its exercise at the Annual Meeting.

Annual Meeting Webcast: The Annual Meeting will be simultaneously broadcast over the Internet at 10:00 a.m. on October 6, 2004. It will then be archived and available for replay for approximately one month. You can listen to the live Webcast or the archived replay by visiting the Investor Relations home page on the Paychex, Inc. Web site at www.paychex.com. You are encouraged to visit the Web site in advance of the broadcast to ensure that your PCs are properly configured.

August 31, 2004

John M. Morphy
Secretary

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PROXY STATEMENT

**ANNUAL MEETING OF STOCKHOLDERS OF PAYCHEX, INC.
TO BE HELD ON OCTOBER 6, 2004**

This Proxy Statement is first being sent or given to stockholders of Paychex, Inc. (Paychex or the Company) beginning on or about August 31, 2004, in connection with the solicitation of proxies by the Board of Directors (the Board) to be voted at the 2004 Annual Meeting of Stockholders (the Annual Meeting). The Annual Meeting will be held on October 6, 2004 at 10:00 a.m. at the Rochester Riverside Convention Center, 123 East Main Street, Rochester, New York.

Stockholders Entitled to Vote

The Board has fixed the close of business on August 9, 2004, as the record date for determining the holders of common stock entitled to notice of, and to vote at, the Annual Meeting. Stockholders will be entitled to one vote for each share of common stock held as of the record date.

How to Vote

Your vote is very important and we hope that you will attend the Annual Meeting. However, whether or not you plan to attend the Annual Meeting, please vote by proxy in accordance with the instructions on your proxy card, voting instruction form (from your bank or broker), or that you received through electronic mail. There are three convenient ways of submitting your vote:

Voting by Internet You can vote via the Internet by visiting the Web site noted on your proxy card. Internet voting is available 24 hours a day. We encourage you to vote via the Internet, as it is the most cost-effective way to vote.

Voting by telephone You can also vote your shares by telephone by calling the toll-free telephone number indicated on your proxy card and following the voice prompt instructions. Telephone voting is available 24 hours a day.

Voting by mail If you choose to vote by mail, simply mark your proxy card, date and sign it, and return it in the postage-paid envelope provided.

The deadline for Internet or telephone voting is 11:59 p.m. Eastern Time on October 4, 2004. If you vote by telephone or the Internet, you do not need to return your proxy card. Signing and returning your proxy card or submitting your proxy via the Internet or by telephone does not affect your right to vote in person if you attend the Annual Meeting and your shares are registered in your name. If your shares are held in the name of a bank, broker, or other holder of record, you must obtain a proxy, executed in your favor, from the holder of record to be able to vote at the Annual Meeting.

Revoking Your Proxy

You can revoke your proxy at any time prior to it being voted at the Annual Meeting by either:

Providing written notice of revocation to the Secretary of the Company;

Submitting a later-dated proxy via the Internet, telephone, or mail; or

Voting in person at the Annual Meeting.

General Information on Voting

The Company had outstanding on August 9, 2004, the record date, 378,180,769 shares of common stock, each of which entitles the holder to one vote. A majority of the outstanding shares (189,090,386 shares) present at the Annual Meeting in person or by proxy will constitute a quorum.

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All votes properly cast and not revoked will be voted at the Annual Meeting in accordance with the stockholder's directions. Shares voted by proxy card received without choices specified will be voted **FOR** the seven nominees for election to the Board of Directors of the Company.

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A plurality of votes cast is required for the election of Directors, meaning the nominees receiving the most votes will be elected. Only votes cast for nominees will be counted. You may choose to vote for a nominee or withhold your vote. Votes that are withheld will be excluded entirely from the vote and will have no effect on the outcome of the vote. A broker non-vote will have no effect on the outcome of the election of Directors.

Voting by Participants in the Paychex Employee Stock Ownership Plan Stock Fund

If a stockholder is a participant in the Paychex Employee Stock Ownership Plan Stock Fund (ESOP) of the Paychex, Inc. 401(k) Incentive Retirement Plan, the proxy card also will serve as a voting instruction for the Trustee of the ESOP, where all accounts are registered in the same name. If shares of common stock in the ESOP are not voted, those shares will be voted by the Trustee in the same proportions as the shares properly voted by other participants in the ESOP. Voting by ESOP participants will close at 11:59 p.m. Eastern Time on October 2, 2004. The Trustee will then vote shares of common stock in the ESOP not voted by the participants by the established deadline.

Cost of Solicitation of Proxies

The Company will pay the cost of solicitation of proxies. The Company will reimburse any banks, brokers and other custodians, nominees, and fiduciaries for their expenses in forwarding proxies and proxy solicitation material to the beneficial owners of the shares held by them.

Delivery of Proxy Materials and Annual Report

The Notice of Annual Meeting of Stockholders, Proxy Statement, Proxy Card, and 2004 Annual Report are being mailed to stockholders on or about August 31, 2004. You may also obtain a copy of the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission, without charge, upon written request submitted to Paychex, Inc., c/o Secretary, 911 Panorama Trail South, Rochester, New York 14625-2396.

Under U.S. Securities and Exchange Commission (SEC) rules, a single set of Annual Reports and Proxy Statements may be sent to any household at which two or more stockholders reside, if they appear to be members of the same family, unless otherwise requested. This procedure, called "householding", allows the Company to reduce printing and mailing expenses of delivering duplicate disclosure materials to stockholders who may have more than one stock account or who share an address with another Paychex stockholder. Stockholders who participate in householding will continue to receive separate proxy cards.

If you are a registered stockholder (owning your stock directly and not through a bank or broker) who shares an address with another stockholder of record, you may be eligible for householding for future mailings. If you wish to affirmatively consent to participate in householding, please indicate "Yes" in the householding election on your proxy card. If you wish to continue to receive separate annual reports and proxy statements for each account in your household, you must withhold your consent to householding by indicating "No" in the householding election on your proxy card. If you do not respond, your consent will be implied, and householding of future mailings will start sixty days after the mailing of this Proxy Statement. Affirmative or implied consent will be perpetual unless you withhold it or revoke it.

You may revoke your consent at any time by calling toll-free (800) 542-1061. If you revoke your consent, you will be removed from the householding program within thirty days of receipt of your revocation, and each stockholder at your address will receive individual copies of our disclosure documents.

If you own Paychex stock beneficially through a bank or broker, you may already be subject to householding if you meet the criteria. If you wish to receive a separate Annual Report and Proxy Statement in future mailings, you should contact your bank or broker.

The Notice of Annual Meeting of Stockholders, Proxy Statement, and 2004 Annual Report are also available on the Company's Web site at www.paychex.com. Instead of receiving paper copies of the Annual Report and Proxy Statement in the mail, stockholders can elect to receive an e-mail message, which will provide a link to these documents on the Internet. Opting to receive your proxy materials online saves the Company the cost of producing and mailing bulky documents. To give your consent to receive future documents via electronic delivery, please vote your proxy via the Internet and follow the instructions to register for electronic delivery.

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Stockholders annually elect Directors to serve for one year and until their successors have been elected and shall have qualified. The Board of Directors has nominated for election to the Board of Directors the seven persons listed below, each of whom currently serves as a Director. Four of the seven nominees are neither employees nor former employees of the Company. If elected, each nominee will hold office until the Annual Meeting to be held in 2005, and until their successor is elected and has qualified.

Although the Board of Directors believes that all of the nominees will be available to serve, the proxies may exercise discretionary authority to vote for substitutes proposed by the Board of Directors of the Company.

Biographies are provided below setting forth certain information with respect to the nominees for election as Directors of the Company, none of whom is related to any other nominee or executive officer.

Name	Age	Director Since	Position, Principal Occupation, Business Experience, and Directorships
B. Thomas Golisano	62	1979	Mr. Golisano founded Paychex, Inc. in 1971 and is Chairman, President, and Chief Executive Officer of the Company. He is a member of the Board of Directors of Iron Mountain Corporation and several privately held companies. He serves on the Board of Trustees of Rochester Institute of Technology. He owns the Buffalo Sabres of the National Hockey League. Mr. Golisano is former Chairman of Greater Rochester Fights Back (a coalition to combat illegal drugs and alcohol abuse), has served as a member of the Board of Directors of numerous non-profit organizations, and is the founder of the B. Thomas Golisano Foundation.
G. Thomas Clark	66	1980	Mr. Clark retired as Senior Vice President of Finance, Secretary, and Treasurer of Paychex, Inc. in October 1996. He joined Paychex in 1979 after spending eighteen years in the commercial banking business. He is a member of the Board of Directors of Unity Health Systems, the Rochester School of the Holy Childhood, the Heritage Christian Services Foundation, and two privately held companies. Mr. Clark is a Trustee of the B. Thomas Golisano Foundation.
David J. S. Flaschen	48	1999	Mr. Flaschen is Managing Director of Flagship Ventures, a venture capital firm that focuses on life science, information technology, and communications companies. From 1997 to 1999, he was the President and Chief Executive Officer of Thomson Financial, an information services company focused on the financial industry. Previously, he served as Chairman and Chief Executive Officer of Donnelley Marketing, Inc., a consumer information services company. Prior to 1995, he was with Dun & Bradstreet for ten years as the President and Chief Operating Officer of A.C. Nielsen, North America, and held senior management positions at IMS and DataQuest. Mr. Flaschen is a member of the Board of Directors of various private companies and a member of the Board of Advisors of SI Ventures.
Phillip Horsley	65	1982	Mr. Horsley is a Managing Director of Horsley Bridge Partners. Horsley Bridge manages private equity investments for institutional investors.

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Name	Age	Director Since	Position, Principal Occupation, Business Experience, and Directorships
Grant M. Inman	62	1983	Mr. Inman is the founder and General Partner of Inman Investment Management, a private venture capital investment company formed in 1998. Prior to 1998, he co-founded and was General Partner of Inman & Bowman, a private venture capital partnership formed in 1985. He is a member of the Board of Directors of Lam Research Corporation, Wind River Systems, Inc., and several privately held companies. Mr. Inman is a Trustee of the University of California, Berkeley Foundation.
J. Robert Sebo	68	1979	Mr. Sebo retired as Senior Vice President/Director of Eastern Operations of Paychex, Inc. in December 1994, where he also held many sales and operations positions within the Company. In 1974, he started his own Paychex franchise operation in Cleveland, Ohio. For fourteen years prior to that he held sales, marketing, and business management positions in the Cadillac Motor Car Division of General Motors Corporation.
Joseph M. Tucci	57	2000	Mr. Tucci is the President and Chief Executive Officer of EMC Corporation, a leading provider of intelligent enterprise information storage systems, software, networks, and services. From January 2000 to January 2001, he was President and Chief Operating Officer of EMC Corporation. Prior to joining EMC, Mr. Tucci served as Deputy Chief Executive Officer of Getronics NV, an information technology services company, from June 1999 through December 1999. From 1993 to June 1999, he served as Chairman and Chief Executive Officer of Wang Global, a leader in networked technology services and solutions, which was acquired by Getronics NV in June 1999.

The Board of Directors recommends the election of each of the nominees identified above and, unless otherwise directed, the proxies named will vote the proxy FOR the election of these nominees.

Retiring Director

Betsy S. Atkins, a member of the Board of Directors since 2001, has declined to stand for re-election to the Board of Directors.

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CORPORATE GOVERNANCE

Board Meetings

The *Board of Directors* of the Company (the Board) met five times during the fiscal year ended May 31, 2004 (fiscal 2004). To the extent practicable, Directors are expected to attend Board meetings and meetings of the Committees on which they serve. Each Director attended more than 75% of all meetings of the Board of Directors and of the Committees on which such Director served during fiscal 2004. Directors are encouraged to attend annual meetings of stockholders. Last year, seven Directors attended the Annual Meeting.

In fiscal 2004, non-employee Directors were paid \$12,000 annually plus \$1,250 for each Board meeting attended and \$750 for each Committee meeting attended. The Chairman of the Audit Committee, currently Mr. Flaschen, was paid an additional \$750 for each meeting chaired. In July 2004, the compensation for non-employee Directors was increased to \$25,000 annually plus \$2,500 for each Board meeting attended and \$1,000 for each Committee meeting attended. The Chairman of the Audit Committee is paid an additional \$1,000 for each meeting chaired. In July 2003, each non-employee director was awarded a stock option grant under the Paychex, Inc. 2002 Stock Incentive Plan for 10,000 shares of common stock at an exercise price of \$29.55 per share, which expires in July 2013. The exercise price of these stock options is equal to the market price of the underlying stock on the date of the grant.

The Board has determined that each of the Directors, other than Mr. Golisano, is independent within the meaning of applicable Securities and Exchange Commission (SEC) and The NASDAQ Stock Market® (NASDAQ) director independence standards.

Executive Sessions

Regularly scheduled executive sessions of the independent members of the Board of Directors without members of management are held in conjunction with meetings of the Board. The Board has selected Mr. Tucci to preside at all executive sessions of the independent Directors.

Board Committees

During fiscal 2004, the Board had the following four standing committees:

The *Executive Committee*, which is comprised of Mr. Golisano (Chairman), Mr. Clark, and Mr. Horsley, may exercise all the powers and authority of the Board of Directors except as limited by law. The Executive Committee held one meeting during fiscal 2004.

The *Audit Committee* is comprised of Ms. Atkins, Mr. Clark, Mr. Flaschen (Chairman), and Mr. Inman. The Board has determined that all members of the Audit Committee meet the independence, experience, and other applicable NASDAQ listing requirements, and that Mr. Flaschen qualifies as an Audit Committee Financial Expert, as defined by applicable rules. The Audit Committee's responsibilities are described in the Audit Committee Charter adopted by the Board, which is attached as Appendix A to this Proxy Statement. The Audit Committee held six meetings during fiscal 2004.

The *Compensation Committee* was comprised of Mr. Flaschen, Mr. Horsley, Mr. Inman, and Mr. Tucci (Chairman). The Compensation Committee's responsibilities were as described in the Compensation Committee Charter adopted by the Board, which is attached as Appendix B to this Proxy Statement. The Compensation Committee held two meetings during fiscal 2004.

The *Investment Committee* is comprised of Mr. Clark, Mr. Horsley, and Mr. Inman (Chairman). The Investment Committee's responsibilities are described in the Investment Committee Charter adopted by the Board, which is attached as Appendix C to this Proxy Statement. The Investment Committee held one meeting during fiscal 2004.

In July 2004, the Board of Directors created a new *Governance and Compensation Committee* comprised of Mr. Tucci (Chairman), Mr. Flaschen, Mr. Horsley, and Mr. Inman. The Board has determined that all members of the Governance and Compensation Committee meet the NASDAQ independence criteria. The Governance and

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Compensation Committee's responsibilities include governance, compensation, and nominations as described in the Governance and Compensation Committee Charter adopted by the Board, which is attached as Appendix D to this Proxy Statement. The Governance and Compensation Committee held no meetings during fiscal 2004.

Nomination Process

The Company has a standing Governance and Compensation Committee, which performs the function of a nominating committee. The Board has determined that it is necessary for the continued success of the Company to ensure that the Board is composed of individuals having a variety of complementary experience, education, training, and relationships relevant to the then-current needs of the Board and the Company. The Nomination Policy included in the Governance and Compensation Committee Charter is intended to achieve this result.

In evaluating candidates for nomination to the Board, the Nomination Policy requires Governance and Compensation Committee members to consider the contribution that a candidate for nomination would be expected to make to the Board and the Company, based upon the current composition and needs of the Board, and the candidate's demonstrated business judgment, leadership abilities, integrity, prior experience, education, training, relationships, and other factors that the Board determines relevant. In identifying candidates for nomination to fill vacancies created by the expiration of the term of any incumbent Director, the Nomination Policy requires Governance and Compensation Committee members to determine whether such incumbent Director is willing to stand for re-election and, if so, to take into consideration the value to the Board and to the Company of continuity and familiarity with the Company's business. The Board has previously used a third party search firm to identify Director candidates and the Nomination Policy authorizes the Governance and Compensation Committee to continue this practice.

The Nomination Policy requires the Governance and Compensation Committee to consider candidates for nomination to the Board recommended by any reasonable source, including stockholders. Stockholders who wish to do so may recommend candidates for nomination by identifying such candidates in written communications to the chairperson of the Governance and Compensation Committee in accordance with the policy described below in the Section entitled Communications with the Board of Directors.

Communications with the Board of Directors

The Board has an adopted policy that permits stockholders to communicate in writing with the Board and with chairpersons of standing committees of the Board by mailing their communications to the Company Secretary. Such communications must be clearly marked

Shareholder Board Communication, and in the case of communications intended for committee chairpersons, must identify the committee. Any such communications that do not identify a standing committee will be forwarded to the Board. The Company Secretary will forward such communications to the Board or to the appropriate standing committee of the Board, as the case may be.

CODE OF ETHICS

The Company has adopted a Code of Ethics that applies to all of its Directors, officers, and employees. The Code of Ethics is available for review on the Company's Web site at www.paychex.com at the Investor Relations section under Corporate Governance. The Company intends to disclose any amendment to, or waiver from, a provision of its Code of Ethics that relates to any element of the Code of Ethics definition enumerated in Item 406 of SEC Regulation S-K by posting such information on its Web site at the address specified above.

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REPORT OF THE AUDIT COMMITTEE

The Audit Committee of the Board of Directors oversees the Company's financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the financial statements and the reporting process, including the systems of internal controls. In fulfilling its oversight responsibilities, the Audit Committee reviewed the audited financial statements in the Fiscal Year 2004 Annual Report on Form 10-K with management including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments, and the clarity of disclosures in the financial statements.

The Company's independent registered public accounting firm, Ernst & Young LLP, is responsible for expressing an opinion on the conformity of the audited financial statements with the standards of the Public Company Accounting Oversight Board (United States). The Audit Committee reviewed with the independent auditors their judgments as to the quality, not just the acceptability, of the Company's accounting principles and such other matters as are required to be discussed with the Audit Committee under Generally Accepted Auditing Standards. The Committee discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61, as amended by Statement on Auditing Standard No. 90 (Communications With Audit Committees). In addition, the Audit Committee has discussed with the independent auditors the auditors' independence from management and the Company, including the matters in the written disclosures required by the Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees). The Audit Committee has also considered whether the independent auditor's provision of other non-audit services to the Company is compatible with the auditor's independence. The Audit Committee held six meetings during fiscal 2004.

The Audit Committee discussed with the Company's internal auditors and independent auditors the overall scope and plans for their respective audits. The Audit Committee meets with the internal and independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of the Company's internal controls, and the overall quality of the Company's financial reporting.

In reliance on the reviews and discussions referred to above, the Audit Committee recommended and the Board of Directors approved that the audited financial statements be included in the Company's Annual Report on Form 10-K for the year ended May 31, 2004 for filing with the Securities and Exchange Commission. The Audit Committee will recommend to the Board of Directors, which will approve, the selection of the Company's independent auditors.

The Audit Committee:

David J. S. Flaschen, *Chairman*

Betsy S. Atkins

G. Thomas Clark

Grant M. Inman

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REPORT OF THE COMPENSATION COMMITTEE

The Compensation Committee of the Board of Directors is responsible for making recommendations with respect to officers' salaries and grants of stock options to the Company's employees. The Compensation Committee's recommendations are presented to the Board for discussion and decision.

The compensation for executive officers is designed to be competitive with companies of similar size and performance, reward exceptional individual performance, tie compensation to overall Company objectives, and align the interest of executive officers with the interests of the stockholders. The components of the compensation program are base salary, annual incentive bonus, and stock option awards under the Company's Stock Incentive Plan.

Base Salary and Annual Incentive Plan (Bonus)

Annual compensation is composed primarily of base salary and an annual incentive bonus. The salaries of the executive officers are determined based on their performance and comparisons with base salaries paid to executive officers having similar responsibilities in comparable companies. The Compensation Committee and the Board have instituted an Officer Incentive Program, which provides for the executive officers the opportunity for annual cash bonuses of up to 50% of base salary based primarily on the Company's annual revenue and operating income growth. The purpose of this bonus plan is to make a significant component of the executive officers' annual compensation tied directly to overall Company financial performance.

Stock Incentive Plan

The Company's Stock Incentive Plan is designed to align executive officers' compensation with long-term performance of the Company's stock. Stock options are granted to executive officers, with the exception of Mr. Golisano, who receives no grants, in amounts based upon their individual performance. Stock options are granted at fair market value as of the date of the grant, and have a term of up to ten years. These options vest one-third each year commencing two years after the date of the grant. Stock options provide incentive for the executive officers to create stockholder value over the long term.

Compensation of Chief Executive Officer

The Compensation Committee meets annually without the Chief Executive Officer to evaluate his performance and recommends to the Board the compensation to be paid to him. In performing that function, the Compensation Committee reviews the range and components of compensation paid to CEOs of other public companies. In particular, the Compensation Committee looks to those public companies whose size and performance are similar to those of Paychex, Inc.

Mr. Golisano's substantial stock position in the Company assures the Compensation Committee of his close identification with the interests of its stockholders. In view of his substantial stock position, Mr. Golisano has chosen not to receive any stock option grants. His compensation is reflective in part of the Compensation Committee's evaluation of the Company's performance in the areas of revenue, profitability, return on stockholders' equity, and other areas. Salary adjustments reflect the Compensation Committee's opinion of the impact, both short- and long-term, which Mr. Golisano's creativity, strategic focus, and leadership had on these and other factors.

Mr. Golisano's fiscal 2004 compensation increased approximately 2% compared with his compensation for fiscal 2003. Mr. Golisano earned a bonus of approximately 39% of his base salary for fiscal 2004, compared with a bonus of approximately 40% of his base salary for fiscal 2003. Mr. Golisano's bonus was determined based on the Officer Incentive Program described above. In fiscal 2004, Paychex achieved its fourteenth straight year of record revenues and net income. The Company's total revenues increased 18% and net income increased 3% in fiscal 2004 over the prior year's figures, while return on stockholders' equity was 28%.

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Compensation of Other Executive Officers

The Compensation Committee sets compensation for executive officers other than the CEO after the CEO provides the Compensation Committee with his evaluation of the performance of each executive officer and his recommendation with respect to base salary, bonus, and stock options. Compensation Committee members discuss his recommendations in light of their own experiences and familiarity with levels and components of compensation for persons with similar responsibilities in other public companies. The goal of the Compensation Committee is to compensate fairly for the job done, to reward extraordinary performance or promise, and to encourage long-term identification with stockholder interests through the award of stock options under the Company's Stock Incentive Plan. Company performance is also considered.

Impact of Section 162(m) of the Internal Revenue Code

Section 162(m) of the Internal Revenue Code generally limits the tax deductibility of annual compensation paid to certain executive officers to \$1 million, unless specified requirements are met. The Compensation Committee has carefully considered the impact of this provision. At this time, it is the Compensation Committee's intention to continue to compensate all executive officers based on overall performance. The Compensation Committee expects that most compensation paid to executive officers will qualify as a tax-deductible expense. For fiscal 2004, the Compensation Committee authorized compensation in excess of \$1 million for Mr. Golisano. The Committee may in the future authorize compensation that is not deductible. The Stock Incentive Plan is designed to provide incentive compensation that will not count against the \$1 million limitation.

The Compensation Committee:

Joseph M. Tucci, *Chairman*
David J. S. Flaschen
Phillip Horsley
Grant M. Inman

Compensation Committee Interlocks and Insider Participation

None of the members of the Compensation Committee were at any time during fiscal 2004, or at any other time, an officer or employee of the Company. During fiscal 2004, no member of the Committee or Board of Directors was an executive officer of another entity on whose compensation committee or board of directors an executive officer of Paychex served.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934 requires Directors, officers, and beneficial owners of more than 10% of the Company's common stock to file with the SEC reports of transactions in the stock. Based on information supplied to the Company and filings made with the SEC, the Company believes that during the fiscal year ended May 31, 2004, all Section 16(a) filing requirements applicable to its Directors, officers, and greater than ten percent beneficial owners were complied with, with the exception of one late filing for Mr. William Kuchta, an executive officer of the Company, covering a transaction involving 50 shares.

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The following table sets forth certain compensation information for the Company's Chief Executive Officer and the Company's four other most highly compensated executive officers.

SUMMARY COMPENSATION TABLE

Name and Principal Position	Fiscal Year	Annual Compensation		Long-term Compensation	All Other Compensation ⁽¹⁾
		Salary	Bonus	Number of Common Shares Underlying Options Granted	
B. Thomas Golisano Chairman, President, and Chief Executive Officer	2004	\$797,690	\$313,328		\$6,000
	2003	\$776,540	\$309,660		\$6,000
	2002	\$744,230	\$		\$5,500
Walter Turek Senior Vice President, Sales and Marketing	2004	\$355,220	\$149,301	10,000	\$6,216
	2003	\$339,030	\$124,165	10,000	\$5,626
	2002	\$327,440	\$	20,000	\$5,758
John M. Morphy Senior Vice President, Chief Financial Officer, and Secretary	2004	\$352,150	\$139,385	25,000	\$6,411
	2003	\$321,755	\$128,440	20,000	\$5,695
	2002	\$305,490	\$	15,000	\$5,709
Martin Mucci ⁽²⁾ Senior Vice President, Operations	2004	\$337,425	\$133,556	25,000	\$6,354
	2003	\$257,040	\$123,070	40,000	\$1,611
	2002	\$33,655	\$		\$
Diane Rambo Vice President, Human Resource Services	2004	\$299,485	\$113,428	10,000	\$6,182
	2003	\$285,530	\$113,860	10,000	\$5,640
	2002	\$272,875	\$	20,000	\$5,708

(1) The amounts reported in this column consist solely of the Company's matching contributions under the Paychex, Inc. 401(k) Incentive Retirement Plan.

(2) Mr. Mucci joined Paychex in March 2002 and was appointed an executive officer in October 2002.

Table of Contents**OPTION GRANTS IN LAST FISCAL YEAR**

The following table sets forth stock options granted in fiscal 2004 to the Company's Chief Executive Officer and the Company's four other most highly compensated executive officers. Under SEC regulations, companies are required to project an estimate of appreciation of the underlying shares of stock during the option term.

Name	Individual Grants				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term ⁽²⁾	
	Number of Common Shares Underlying Options Granted ⁽¹⁾	% of Total Options Granted to Employees in 2004	Exercise Price Per Share	Expiration Date	5%	10%
B. Thomas Golisano		%	\$		\$	\$
Walter Turek	10,000	.30%	\$29.55	7/10/2013	\$ 185,838	\$ 470,951
John M. Morphy	25,000	.74%	\$29.55	7/10/2013	\$464,596	\$1,177,377
Martin Mucci	25,000	.74%	\$29.55	7/10/2013	\$464,596	\$1,177,377
Diane Rambo	10,000	.30%	\$29.55	7/10/2013	\$ 185,838	\$ 470,951

- (1) Non-qualified stock options were granted under the Paychex, Inc. 2002 Stock Incentive Plan. Options are granted at prices not less than 100% of the fair market value of the common stock at the date of the grant. The options granted are exercisable after two years in cumulative annual installments of 33 1/3% and expire after a term of ten years from the date of the grant.
- (2) In accordance with SEC rules, these columns show potential realizable values net of the option exercise price, but before any potential income taxes, assuming the market price of the Company's common stock appreciates from the date of the grant over a period of ten years at the annualized rates of five and ten percent, respectively. However, the ultimate value will depend on the market value of the Company's stock at a future date, which may or may not correspond to the projections above.

AGGREGATED OPTION EXERCISES IN LAST FISCAL YEAR AND FISCAL YEAR-END OPTION VALUES

The following table sets forth stock options exercised in fiscal 2004 by the Company's Chief Executive Officer and the Company's four other most highly compensated executive officers, and the number and value of all unexercised options at May 31, 2004. The value of in-the-money options refers to options having an exercise price that is less than the market price of the Company's common stock at May 31, 2004.

Name	Number of Common Shares Acquired on Exercise	Net Value Realized ⁽¹⁾	Number of Common Shares Underlying Unexercised Options at May 31, 2004		Value of Unexercised In-The-Money Options at May 31, 2004 ⁽²⁾	
			Exercisable	Unexercisable	Exercisable	Unexercisable
B. Thomas Golisano		\$			\$	\$
Walter Turek	68,345	\$2,237,677	233,357	33,333	\$6,498,979	\$173,300
John M. Morphy	28,500	\$ 508,901	15,000	60,000	\$	\$386,400
Martin Mucci		\$		65,000	\$	\$552,550
Diane Rambo	41,000	\$1,159,543	48,417	37,333	\$ 591,503	\$173,300

- (1) Represents the market value of the Company's common stock at the exercise date less the exercise price.
- (2) Represents the difference between the exercise price of the stock options and the \$37.51 per share closing price of the Company's common stock on May 28, 2004, for all in-the-money options held by each named executive officer. The in-the-money stock option exercise prices range from \$3.14 per share to \$29.55 per share. These stock options were granted at exercise prices equal to the fair market value of the stock on the date of the grant.

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**BENEFICIAL OWNERSHIP OF PRINCIPAL STOCKHOLDERS,
DIRECTORS, AND MANAGEMENT**

The following table sets forth information, based upon reports filed by such persons with the SEC, as of July 31, 2004, with respect to the beneficial ownership of common stock of the Company by (i) any person (including any group as that term is used in Section 13(d)(3) of the Exchange Act) who is known by the Company to be the beneficial owner of more than five percent (5%) of the Company's voting securities, (ii) each Director and nominee for Director of the Company, (iii) each of the executive officers of the Company named in the Summary Compensation Table, and (iv) all Directors and executive officers of the Company as a group. Under the rules of the SEC, beneficial ownership is deemed to include shares for which the individual, directly or indirectly, has or shares voting or disposition power, whether or not they are held for the individual's benefit.

Name	Amount of Beneficial Ownership of Common Stock	Percent of Class ⁽¹⁾
More than 5% owners:		
B. Thomas Golisano ⁽³⁾ 911 Panorama Trail South Rochester, NY 14625	39,579,605	10.4%
Directors:		
B. Thomas Golisano ⁽³⁾	39,579,605	10.4%
Betsy S. Atkins ⁽²⁾	9,167	**
G. Thomas Clark ^{(2),(3),(4)}	1,019,102	**
David J. S. Flaschen ⁽²⁾	33,084	**
Phillip Horsley ⁽²⁾	240,484	**
Grant M. Inman ⁽²⁾	178,537	&nbs