Paylocity Holding Corp
Form 10-Q
November 02, 2018
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

Form 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2018

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 001-36348

PAYLOCITY HOLDING CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	46-4066644
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

1400 American Lane

Schaumburg, Illinois	60173
(Address of principal executive offices)	(Zip Code)

(847) 463-3200

(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 has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer	Accelerated Filer
Non-Accelerated Filer	Smaller Reporting Company
	Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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: 52,798,602 shares of Common Stock, $0.001 par value per share, as of October 26, 2018.

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Paylocity Holding Corporation

Form 10-Q

For the Quarterly Period Ended September 30, 2018

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

PAYLOCITY HOLDING CORPORATION

Unaudited Consolidated Balance Sheets

(in thousands, except per share data)

	June 30, 2018	September 30, 2018
Assets		
Current assets:		
Cash and cash equivalents	$ 137,193	$ 63,662
Corporate investments	732	21,225
Accounts receivable, net	3,453	2,992
Deferred contract costs	—	16,215
Prepaid expenses and other	11,248	14,220
Total current assets before funds held for clients	152,626	118,314
Funds held for clients	1,225,614	1,168,156
Total current assets	1,378,240	1,286,470
Capitalized internal-use software, net	21,094	22,034
Property and equipment, net	62,029	61,823
Intangible assets, net	13,002	12,439
Goodwill	9,590	9,590
Long-term deferred contract costs	—	59,061
Long-term prepaid expenses and other	1,504	3,132
Deferred income tax assets, net	22,140	9,554
Total assets	$ 1,507,599	$ 1,464,103
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 2,990	$ 3,559
Accrued expenses	42,241	35,678
Total current liabilities before client fund obligations	45,231	39,237
Client fund obligations	1,225,614	1,168,156

Total current liabilities	1,270,845	1,207,393
Deferred rent	22,812	22,660
Other long-term liabilities	1,118	1,424
Total liabilities	$ 1,294,775	$ 1,231,477
Stockholders' equity:		
Preferred stock, $0.001 par value, 5,000 authorized, no shares issued and outstanding at June 30, 2018 and September 30, 2018	$ —	$ —
Common stock, $0.001 par value, 155,000 shares authorized at June 30, 2018 and September 30, 2018; 52,758 shares issued and outstanding at June 30, 2018 and 52,796 shares issued and outstanding at September 30, 2018	53	53
Additional paid-in capital	219,588	176,851
Retained earnings (accumulated deficit)	(6,678)	55,846
Accumulated other comprehensive loss	(139)	(124)
Total stockholders' equity	$ 212,824	$ 232,626
Total liabilities and stockholders' equity	$ 1,507,599	$ 1,464,103

See accompanying notes to unaudited consolidated financial statements.

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PAYLOCITY HOLDING CORPORATION

Unaudited Consolidated Statements of Operations and Comprehensive Income

(in thousands, except per share data)

	Three Months Ended September 30, 2017	2018
Revenues:		
Recurring fees	$ 77,294	$ 95,761
Interest income on funds held for clients	1,617	3,502
Total recurring revenues	78,911	99,263
Implementation services and other	2,589	1,241
Total revenues	81,500	100,504
Cost of revenues:		
Recurring revenues	24,091	29,231
Implementation services and other	10,868	6,711
Total cost of revenues	34,959	35,942
Gross profit	46,541	64,562
Operating expenses:		
Sales and marketing	21,180	26,418
Research and development	8,895	11,400
General and administrative	15,951	22,968
Total operating expenses	46,026	60,786
Operating income	515	3,776
Other income	109	269
Income before income taxes	624	4,045
Income tax expense (benefit)	81	(5,807)
Net income	$ 543	$ 9,852
Other comprehensive income (loss)		
Unrealized gains (losses) on securities, net of tax	(5)	15
Total other comprehensive income (loss)	(5)	15
Comprehensive income	$ 538	$ 9,867

Net income per share:

Basic	$ 0.01	$ 0.19
Diluted	$ 0.01	$ 0.18
Weighted-average shares used in computing net income per share:		
Basic	51,893	52,865
Diluted	54,610	55,487

See accompanying notes to unaudited consolidated financial statements.

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PAYLOCITY HOLDING CORPORATION

Unaudited Consolidated Statement of Changes in Stockholders' Equity

(in thousands)

	Stockholders' Equity					
	Common Stock		Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
	Shares	Amount				
Balances at June 30, 2018	52,758	$ 53	$ 219,588	$ (6,678)	$ (139)	$ 212,824
Cumulative effect of change in accounting policy (adoption of Topic 606)	—	—	—	52,672	—	52,672
Stock-based compensation	—	—	10,050	—	—	10,050
Stock options exercised	182	—	2,241	—	—	2,241
Issuance of common stock upon vesting of restricted stock units	579	—	—	—	—	—
Net settlement for taxes and/or exercise price related to equity awards	(281)	—	(20,037)	—	—	(20,037)
Repurchases of common shares	(442)	—	(34,991)	—	—	(34,991)
Unrealized gains on securities, net of tax	—	—	—	—	15	15
Net income	—	—	—	9,852	—	9,852
Balances at September 30, 2018	52,796	$ 53	$ 176,851	$ 55,846	$ (124)	$ 232,626

See accompanying notes to the unaudited consolidated financial statements.

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PAYLOCITY HOLDING CORPORATION

Unaudited Consolidated Statements of Cash Flows

(in thousands)

	Three Months Ended September 30,	
	2017	2018
Cash flows from operating activities:		
Net income	$ 543	$ 9,852
Adjustments to reconcile net income to net cash provided by operating activities:		
Stock-based compensation expense	6,606	9,425
Depreciation and amortization expense	6,673	8,232
Deferred income tax expense (benefit)	37	(5,809)
Provision for doubtful accounts	4	30
Net accretion of discounts and amortization of premiums on available-for-sale securities	(108)	(407)
Loss on disposal of equipment	31	241
Changes in operating assets and liabilities:		
Accounts receivable	(529)	431
Deferred contract costs	—	(7,169)
Prepaid expenses and other	(305)	(853)
Accounts payable	(101)	(415)
Accrued expenses	(6,304)	(6,214)
Tenant improvement allowance	1,656	—
Net cash provided by operating activities	8,203	7,344
Cash flows from investing activities:		
Purchases of available-for-sale securities	(58,844)	(75,804)
Proceeds from sales and maturities of available-for-sale securities	421	56,446
Net change in funds held for clients' cash and cash equivalents	59,001	55,844
Capitalized internal-use software costs	(3,751)	(5,001)
Purchases of property and equipment	(2,693)	(2,428)
Lease allowances used for tenant improvements	(1,466)	—
Net cash provided by (used in) investing activities	(7,332)	29,057
Cash flows from financing activities:		
Net change in client fund obligations	(470)	(57,458)
Repurchases of common shares	—	(34,679)
Proceeds from exercise of stock options	—	85
Taxes paid related to net share settlement of equity awards	(6,470)	(17,880)

Net cash used in financing activities	(6,940)	(109,932)
Net Change in Cash and Cash Equivalents	(6,069)	(73,531)
Cash and Cash Equivalents—Beginning of Period	103,468	137,193
Cash and Cash Equivalents—End of Period	$ 97,399	$ 63,662
Supplemental Disclosure of Non-Cash Investing and Financing Activities		
Purchase of property and equipment and internal-use software, accrued but not paid	$ 4,317	$ 1,064
Repurchases of common shares, accrued but not paid	$ —	$ 313
Supplemental Disclosure of Cash Flow Information		
Cash paid for income taxes, net of refunds	$ 53	$ 351

See accompanying notes to unaudited consolidated financial statements.

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PAYLOCITY HOLDING CORPORATION

Notes to the Unaudited Consolidated Financial Statements

(all amounts in thousands, except per share data)

(1) Organization and Description of Business

Paylocity Holding Corporation (the “Company”) is a cloud-based provider of payroll and human capital management software solutions for medium-sized organizations. Services are provided in a Software-as-a-Service (“SaaS”) delivery model utilizing the Company’s cloud-based platform. Payroll services include collection, remittance and reporting of payroll liabilities to the appropriate federal, state and local authorities.

(2) Summary of Significant Accounting Policies

(a) Consolidation and Use of Estimates

These unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). The unaudited consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Future events and their effects cannot be predicted with certainty; accordingly, accounting estimates require the exercise of judgment. Accounting estimates used in the preparation of these consolidated financial statements change as new events occur, as more experience is acquired, as additional information is obtained and as the operating environment changes.

The Company began investing corporate funds in available-for-sale securities during the first quarter of fiscal 2019 and as a result, reclassified $732 as of June 30, 2018 from prepaid expenses and other on the unaudited consolidated balance sheets to corporate investments for comparability purposes in order to conform to the current year’s presentation.

(b) Interim Unaudited Consolidated Financial Information

The accompanying unaudited consolidated financial statements and notes have been prepared in accordance with GAAP and applicable rules and regulations of the Securities and Exchange Commission ("SEC") regarding interim financial reporting. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, the interim financial information includes all adjustments of a normal recurring nature necessary for a fair presentation of the Company's financial position, results of operations, changes in stockholders' equity and cash flows. The results of operations for the three months ended September 30, 2018 are not necessarily indicative of the results for the full year or the results for any future periods. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes for the year ended June 30, 2018 included in the Company's Annual Report on Form 10-K filed with the SEC on August 10, 2018.

(c) Revenue Recognition

The Company adopted ASU 2014-09, Revenue from Contracts with Customers ("Topic 606") effective as of July 1, 2018. Topic 606 requires revenue to be recognized when an entity transfers control of goods or services to a customer in an amount that reflects the consideration to which a company expects to be entitled to for those goods or services. To achieve this core principle, the Company recognizes revenue from contracts with customers based on the following five steps:

1) Identify the contract with a customer;

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2) Identify the performance obligations in the contract;
3) Determine the transaction price;
4) Allocate the transaction price to performance obligations in the contract; and
5) Recognize revenue when or as the Company satisfies a performance obligation.

The Company derives its revenue from contracts predominantly from recurring and non-recurring service fees. While the majority of its agreements are generally cancellable by the client on 60 days' notice or less, the Company began entering into term arrangements in fiscal 2018, which are generally two years long. Recurring fees are derived from payroll, timekeeping, and HR-related cloud-based computing services as follows:

· Payroll processing and related services, including payroll reporting and tax filing services are delivered on a weekly, biweekly, semi-monthly, or monthly basis depending upon the payroll frequency of the client and on an annual basis if a client selects W-2 preparation and processing services,

· Time and attendance reporting services, including time clock rentals, are delivered on a monthly basis, and

· Cloud-based HR software solutions, including employee administration and benefits enrollment and administration, are delivered on a monthly basis.

The majority of the Company's recurring fees are satisfied over time as services are provided. The performance obligations related to payroll services are satisfied upon the processing of the client's payroll with the fee charged and collected based on a per employee per payroll frequency fee. The performance obligations related to time and attendance services and HR related services are satisfied over time each month with the fee charged and collected based on a per employee per month fee. For subscription based fees which can include payroll, time and attendance and HR related services, the Company recognizes the applicable recurring fees over time each month with the fee charged and collected based on a per employee per month fee. The Company has certain optional performance obligations that are satisfied at a point in time including the sales of time clocks and W-2 services.

Non-recurring service fees consist mainly of nonrefundable implementation fees, which involve setting the client up in, and loading data into, the Company's cloud-based applications. These implementation activities are considered set-up activities. The Company has determined that the nonrefundable upfront fees provide certain clients with a material right to renew the contract. Implementation fees are deferred and amortized generally over a period up to 24 months.

Sales taxes collected from clients and remitted to governmental authorities where applicable are accounted for on a net basis and therefore are excluded from revenues in the statements of operations and comprehensive income.

Interest income collected on funds held for clients is recognized in recurring revenues when earned as the collection, holding and remittance of these funds are components of providing these services.

The following table, consistent with the presentation of its unaudited consolidated statements of operations and comprehensive income, disaggregates revenue by recurring fees and implementation services and other, which it believes represents the major categories of revenue:

	Three Months Ended September 30, 2018
Recurring fees	$ 95,761
Implementation services and other	1,241
Total revenues from contracts	$ 97,002

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Deferred revenue

The timing of revenue recognition for recurring revenue is consistent with the timing of invoicing as they occur simultaneously upon the client payroll-processing period or by month. As such, the Company does not recognize contract assets or liabilities related to recurring revenue.

The nonrefundable upfront fees related to implementation services are invoiced with the client's first payroll period. The Company defers these nonrefundable upfront fees generally over a period up to 24 months based on the type of contract. The following table summarizes the changes in deferred revenue (i.e. contract liability) related to these nonrefundable upfront fees as follows:

	Three Months Ended September 30, 2018
Balance at July 1, 2018	$ —
Deferral of revenue	2,518
Revenue recognized	(499)
Balance at September 30, 2018	$ 2,019

Deferred revenue related to these nonrefundable upfront fees are recorded within accrued expenses and other long-term liabilities on the unaudited consolidated balance sheets. The Company expects to recognize these deferred revenue balances of $1,382 in fiscal 2019, $504 in fiscal 2020, and $133 thereafter.

Deferred contract costs

The Company defers certain selling and commission costs that meet the capitalization criteria under ASC 340-40, which prior to the adoption of Topic 606 were previously expensed as incurred. The Company also capitalizes certain costs to fulfill a contract related to its proprietary products if they are identifiable, generate or enhance resources used to satisfy future performance obligations and are expected to be recovered under ASC 340-40. As discussed in Note 2(e), the Company determined that implementation services related to its proprietary products are not separate performance obligations for contracts entered into after July 1, 2018. Implementation fees are treated as nonrefundable upfront fees and the related implementation costs are required to be capitalized and amortized over the expected period of benefit, which is the period in which the Company expects to recover the costs and enhance its ability to satisfy future performance obligations.

The Company utilizes the portfolio approach to account for both the cost of obtaining a contract and the cost of fulfilling a contract. These capitalized costs are amortized over the expected period of benefit, which has been determined to be over 7 years based on the Company's average client life and other qualitative factors, including rate of technological changes. The Company does not incur any additional costs to obtain or fulfill contracts upon renewal. The Company recognizes additional selling and commission costs and fulfillment costs when an existing client purchases additional services. These additional costs only relate to the additional services purchased and do not relate to the renewal of previous services.

The following table presents the deferred contract costs balances and the related amortization expense for these deferred contract costs:

	Beginning Balance July 1, 2018	Capitalized Costs	Amortization	Ending Balance September 30, 2018
Costs to obtain a new contract	$ 68,107	$ 5,711	$ (3,885)	$ 69,933
Costs to fulfill a contract	—	5,474	(131)	5,343
Total	$ 68,107	$ 11,185	$ (4,016)	$ 75,276

Deferred contract costs are recorded within deferred contract costs and long-term deferred contract costs on the unaudited consolidated balance sheets. Amortization of deferred contracts costs is recorded in implementation services

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and other cost of revenue, sales and marketing, and general and administrative in the unaudited consolidated statements of operations and comprehensive income.

Remaining Performance Obligations

The Company has applied the practical expedients as allowed under Topic 606 and elects not to disclose the value of unsatisfied performance obligations for contracts that have an original expected duration of one year or less and contracts for which the variable consideration is allocated entirely to wholly unsatisfied performance obligations. The Company's remaining performance obligations related to minimum monthly fees on its term based contracts was approximately $29,000 as of September 30, 2018, which will be generally recognized over the next 24 months.

(d) Income Taxes

Income taxes are accounted for in accordance with ASC 740, Income Taxes, using the asset and liability method. The Company's provision for income taxes is based on the annual effective rate method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company recognizes deferred tax assets to the extent that it believes that these assets are more likely than not to be realized. In making such a determination, the Company considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. If the Company determines that it would be able to realize its deferred tax assets in the future in excess of their net-recorded amount, it would make an adjustment to the deferred tax asset valuation allowance, which would reduce the provision for income taxes.

(e) Recently Adopted Accounting Standards

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). Topic 606 supersedes a majority of existing revenue recognition guidance under GAAP, and requires companies to recognize revenue when it transfers goods or services to a customer in an amount that reflects the consideration to which a company expects to be entitled. The standard also provides guidance on the recognition of costs related to obtaining and fulfilling a contract under Subtopic 340-40, Other Assets and Deferred Costs – Contracts with Customers. The

Company adopted the new standard, including subsequent amendments and Subtopic 340-40, effective as of July 1, 2018 using the modified retrospective method of transition, which limited the application of the new standard only to contracts that were not completed as of the effective date. The adoption of Topic 606 did not have a material impact in the timing or amount of revenue recognized. However, it did have a material impact on its unaudited consolidated balance sheet due to the deferral of costs of obtaining and fulfilling a contract as detailed below. The Company has updated its control framework for new internal controls and has updated existing controls relating to the new standard.

Under the legacy revenue standard through fiscal 2018, the Company accounted for implementation and recurring services each as a separate unit of account. The Company was able to establish standalone value for implementation services as supported by the activity of third-party resellers and other vendors that performed certain implementation services. The Company has observed that third party implementation activity has continued to decrease over time and at the same time, the Company has invested in proprietary applications and processes that impact implementation activities. The Company determined that from July 1, 2018 forward it no longer had a sufficient basis to establish standalone value of implementations for its proprietary products due to the culmination of the changes to the Company's applications and processes that eliminated the ability of third parties to perform implementation services. Similarly, the Company determined that these implementation services are not a separate performance obligation under Topic 606 for contracts entered into after July 1, 2018 and the associated implementation fees are treated as nonrefundable upfront fees which are deferred and amortized over a period of time instead of recognized upon completion. The Company recognized $2,191, net of deferred taxes, of contract assets for implementation fees related to open contracts as of July 1, 2018 which began when the Company was still able to establish stand-alone value for

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implementation activities. This adjustment was recorded through retained earnings (accumulated deficit) in the statement of changes in stockholder's equity upon adoption on July 1, 2018.

The Company also finalized the treatment of costs of obtaining and fulfilling a new contract under the new standard. The Company is now required to defer these costs and amortize them over the expected period of benefit, which it has determined to be 7 years. The Company recognized the cumulative effect related to the deferral of the costs of obtaining new contracts of $50,481, net of deferred taxes, which was recorded through retained earnings (accumulated deficit) in the statement of changes in stockholder's equity upon adoption on July 1, 2018.

The cumulative effect of the changes made to the July 1, 2018 balance sheet due to the adoption of Topic 606 were as follows:

	As Reported June 30, 2018	Adjustments due to Topic 606	Balances at July 1, 2018
Balance Sheet			
Assets			
Deferred contract costs	$ —	$ 14,783	$ 14,783
Prepaid expenses and other	11,248	1,730	12,978
Long-term deferred contract costs	—	53,324	53,324
Long-term prepaid expenses and other	1,504	1,226	2,730
Deferred income tax assets, net	22,140	(18,391)	3,749
Stockholders' Equity			
Retained earnings (accumulated deficit)	(6,678)	52,672	45,994

The following table summarizes the impact from the adoption of Topic 606 on the Company's unaudited consolidated statement of operations and comprehensive income:

	Three Months Ended September 30, 2018		
	As Reported (Topic 606)	Balances under ASC 605	Impact from Adoption
Statement of Operations			
Revenues			
Recurring fees	$ 95,761	$ 96,197	$ (436)

Implementation services and other	1,241	800	441
Cost of Revenues			
Implementation services and other	6,711	11,956	(5,245)
Operating expenses			
Sales and marketing	26,418	28,209	(1,791)
General and administrative	22,968	23,101	(133)
Income tax expense (benefit)	(5,807)	(7,664)	1,857
Net income	9,852	4,535	5,317

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The following table summarizes the impact from the adoption of Topic 606 on the Company’s unaudited consolidated balance sheet:

	Three Months Ended September 30, 2018		
	As Reported (Topic 606)	Balances under ASC 605	Impact from Adoption
Balance Sheet			
Assets			
Deferred contract costs	$ 16,215	$ —	$ 16,215
Prepaid expenses and other	14,220	12,506	1,714
Long-term deferred contract costs	59,061	—	59,061
Long-term prepaid expenses and other	3,132	2,326	806
Deferred income tax assets, net	9,554	29,802	(20,248)
Liabilities			
Accrued expenses	35,678	34,479	1,199
Other long-term liabilities	1,424	3,064	(1,640)
Stockholders' Equity			
Retained earnings (accumulated deficit)	55,846	(2,143)	57,989

The following table summarizes the impact from the adoption of Topic 606 on the Company’s unaudited consolidated statement of cash flows:

	Three Months Ended September 30, 2018		
	As Reported (Topic 606)	Balances under ASC 605	Impact from Adoption
Statement of Cash Flows			
Net income	$ 9,852	$ 4,535	$ 5,317
Adjustments to reconcile net income to net cash provided by operating activities:			
Deferred income tax expense (benefit)	(5,809)	(7,666)	1,857
Changes in operating assets and liabilities:			
Deferred contract costs	(7,169)	—	(7,169)
Prepaid expenses and other	(853)	(1,289)	436
Accrued expenses	(6,214)	(5,773)	(441)
Net cash provided by operating activities	7,344	7,344	—

In March 2018, the FASB issued ASU 2018-05, Income Taxes (Topic 740) (“ASU 2018-05”) which incorporates the SEC’s Staff Accounting Bulletin 118 (“SAB 118”) issued on December 22, 2017. SAB 118 provides for a provisional measurement period for entities to finalize their accounting for certain income tax effects related to the Tax Cuts and Jobs Act (the “Act”), not to exceed one year from enactment of the new tax law. Entities are permitted to utilize reasonable estimates until they have finished analyzing the effects of the Act. The Company recognized provisional income tax effects of the Act during fiscal 2018 in accordance with SAB 118, and expects to complete its accounting under the Act by the end of December 2018. Refer to Note 8 for additional information.

(f) Recently Issued Accounting Standards

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) (“ASU 2016-02”) which amends various aspects of existing guidance for leases. ASU 2016-02 requires an entity to recognize assets and liabilities arising from a lease with terms greater than twelve months, along with additional qualitative and quantitative disclosures. ASU 2016-02 also requires the use of the modified retrospective method, which will require adjustment to all comparative periods presented. In March 2018, the FASB affirmed its proposed guidance by issuing ASU 2018-01, Leases (Topic 842): Targeted Improvements, which provides an additional transition method allowing an entity to apply the new lease accounting and disclosure requirements only for the year of adoption with the comparative periods continuing to be in accordance with current GAAP. In July 2018, the FASB issued ASU 2018-10, Codification Improvements to Topic 842, Leases, and ASU 2018-11, Leases (Topic 842): Targeted Improvements to amend and clarify the original guidance established in the new lease standard. ASU 2016-02, including all of its amendments, is effective for fiscal years

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beginning after December 15, 2018, with early adoption permitted. While the Company is still assessing the impact of the new standard, it expects the adoption of this standard will have a material effect on its consolidated balance sheets. The Company is evaluating the transition methods and will adopt this new standard in its fiscal year beginning July 1, 2019.

In August 2018, the FASB issued ASU 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement ("ASU 2018-13"), which amends the requirements for fair value measurement disclosures. ASU 2018-13 removes, modifies or adds certain disclosure requirements under GAAP. This standard is effective for fiscal years beginning after December 15, 2019, with early adoption permitted. Any new disclosure requirements must be applied on a prospective basis in the interim and annual periods of initial adoption; all removed or modified requirements must be applied retrospectively to all periods presented. The Company is assessing the impact of ASU 2018-13 including the timing and method of adoption.

From time to time, new accounting pronouncements are issued by the FASB or other standard setting bodies that are adopted by the Company as of the specified effective date. Unless otherwise discussed, the Company believes that the impact of other recently issued standards that are not yet effective will not have a material impact on the Company's consolidated financial statements upon adoption.

(3) Balance Sheet Information

The following tables provide details of selected consolidated balance sheet items:

Activity in the allowance for doubtful accounts was as follows:

Balance at June 30, 2018	$ 375
Charged to expense	30
Write-offs	(29)
Balance at September 30, 2018	$ 376

Capitalized internal-use software and accumulated amortization were as follows:

	June 30, 2018	September 30, 2018
Capitalized internal-use software	$ 67,678	$ 72,830
Accumulated amortization	(46,584)	(50,796)
Capitalized internal-use software, net	$ 21,094	$ 22,034

Amortization of capitalized internal-use software costs is included in Cost of Revenues-Recurring Revenues and amounted to $3,389 and $4,212 for the three months ended September 30, 2017 and 2018, respectively.

Property and equipment, net consist of the following:

	June 30, 2018	September 30, 2018
Office equipment	$ 3,743	$ 3,965
Computer equipment	29,768	31,239
Furniture and fixtures	10,382	10,274
Software	5,965	6,181
Leasehold improvements	36,366	36,910
Time clocks rented by clients	4,534	4,508
Total	90,758	93,077
Accumulated depreciation	(28,729)	(31,254)
Property and equipment, net	$ 62,029	$ 61,823

Depreciation expense amounted to $2,925 and $3,457 for the three months ended September 30, 2017 and 2018, respectively.

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The Company’s amortizable intangible assets and estimated useful lives are as follows:

	June 30, 2018	September 30, 2018	Useful Life
Client relationships	$ 18,130	$ 18,130	7 - 9 years
Non-solicitation agreements	600	600	2 - 4 years
Total	18,730	18,730	
Accumulated amortization	(5,728)	(6,291)	
Intangible assets, net	$ 13,002	$ 12,439	

Amortization expense for acquired intangible assets was $359 and $563 for the three months ended September 30, 2017 and 2018, respectively.

Future amortization expense for acquired intangible assets is as follows, as of September 30, 2018:

Remainder of fiscal 2019	$ 1,688
Fiscal 2020	2,251
Fiscal 2021	2,251
Fiscal 2022	2,232
Fiscal 2023	2,118
Thereafter	1,899
Total	$ 12,439

The components of accrued expenses were as follows:

	June 30, 2018	September 30, 2018
Accrued payroll and personnel costs	$ 31,206	$ 21,883
Lease exit obligations	2,143	1,808
Other	8,892	11,987
Total accrued expenses	$ 42,241	$ 35,678

In June 2018, the Company ceased using approximately 110 rentable square feet of its former headquarters in Arlington Heights, Illinois in conjunction with relocating to its new Schaumburg, Illinois headquarters. The following table is a summary of the changes in the remaining lease exit obligations related to the Company’s former headquarters, which is recorded in accrued expenses and other long-term liabilities on the unaudited consolidated balance sheets:

Balance at June 30, 2018	$ 3,261
Payments	(604)
Adjustments	38
Balance at September 30, 2018	$ 2,695

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(4) Corporate Investments and Funds Held for Clients

Corporate investments and funds held for clients consist of the following:

	June 30, 2018			
Type of Issue	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Cash and cash equivalents	$ 137,193	$ —	$ —	$ 137,193
Funds held for clients' cash and cash equivalents	1,102,541	—	(3)	1,102,538
Available-for-sale securities:				
Commercial paper	50,703	3	(4)	50,702
Corporate bonds	37,508	8	(134)	37,382
Asset-backed securities	25,901	1	(55)	25,847
U.S. treasury securities	9,879	—	(2)	9,877
Total available-for-sale securities (1)	123,991	12	(195)	123,808
Total investments	$ 1,363,725	$ 12	$ (198)	$ 1,363,539

(1) Included within the fair value of total available-for-sale securities above is $732 of corporate investments and $123,076 of funds held for clients

	September 30, 2018			
Type of Issue	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Cash and cash equivalents	$ 63,663	$ —	$ (1)	$ 63,662
Funds held for clients' cash and cash equivalents	1,046,696	—	(5)	1,046,691
Available-for-sale securities:				
Commercial paper	56,651	1	(18)	56,634
Corporate bonds	32,268	11	(91)	32,188
Asset-backed securities	38,711	4	(44)	38,671
U.S. treasury securities	16,126	—	(24)	16,102
Total available-for-sale securities (2)	143,756	16	(177)	143,595
Total investments	$ 1,254,115	$ 16	$ (183)	$ 1,253,948

(2) Included within the fair value of total available-for-sale securities above is $22,130 of corporate investments and $121,465 of funds held for clients

The Company began investing corporate funds in available-for-sale securities during the first quarter of fiscal 2019 and as a result, reclassified $732 as of June 30, 2018 from prepaid expenses and other on the unaudited consolidated balance sheets to corporate investments for comparability purposes in order to conform to the current year's presentation. Cash and cash equivalents and funds held for clients' cash and cash equivalents include demand deposit accounts, money market funds and commercial paper as of June 30, 2018 and September 30, 2018.

Classification of investments on the unaudited consolidated balance sheets is as follows:

	June 30, 2018	September 30, 2018
Cash and cash equivalents	$ 137,193	$ 63,662
Corporate investments	732	21,225
Funds held for clients	1,225,614	1,168,156
Long-term prepaid expenses and other	—	905
Total investments	$ 1,363,539	$ 1,253,948

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Available-for-sale securities that have been in an unrealized loss position for a period of less and greater than 12 months are as follows:

	June 30, 2018					
	Securities in an unrealized loss position for less than 12 months		Securities in an unrealized loss position for greater than 12 months		Total	
	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value
Commercial paper	$ (4)	$ 23,657	$ —	$ —	$ (4)	$ 23,657
Corporate bonds	(134)	29,122	—	—	(134)	29,122
Asset-backed securities	(55)	17,960	—	—	(55)	17,960
U.S. treasury securities	(2)	4,933	—	—	(2)	4,933
Total available-for-sale securities	$ (195)	$ 75,672	$ —	$ —	$ (195)	$ 75,672

	September 30, 2018					
	Securities in an unrealized loss position for less than 12 months		Securities in an unrealized loss position for greater than 12 months		Total	
	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value
Commercial paper	$ (18)	$ 46,006	$ —	$ —	$ (18)	$ 46,006
Corporate bonds	(70)	21,357	(21)	4,814	(91)	26,171
Asset-backed securities	(40)	28,332	(4)	1,064	(44)	29,396
U.S. treasury securities	(24)	16,102	—	—	(24)	16,102
Total available-for-sale securities	$ (152)	$ 111,797	$ (25)	$ 5,878	$ (177)	$ 117,675

The Company regularly reviews the composition of its portfolio to determine the existence of other-than-temporary-impairment (“OTTI”). The Company did not recognize any OTTI charges in accumulated other comprehensive loss during the three months ended September 30, 2017 or 2018, nor does it believe that OTTI exists in its portfolio as of September 30, 2018. The Company plans to retain the securities in an unrealized loss position for a period of time sufficient enough to recover their amortized cost basis or until their maturity date. The Company believes that the unrealized losses on these securities were not due to deterioration in credit risk. The securities in an unrealized loss position held an A-1 rating or better as of September 30, 2018.

The Company did not make any material reclassification adjustments out of accumulated other comprehensive loss for realized gains and losses on the sale of available-for-sale securities during the three months ended September 30, 2017 or 2018. Gross realized gains and losses on the sale of available-for-sale securities were immaterial for both the three months ended September 30, 2017 and 2018.

Expected maturities of available-for-sale securities at September 30, 2018 are as follows:

	Amortized cost	Fair value
One year or less	$ 126,192	$ 126,062
One year to two years	16,064	16,028
Two years to three years	1,500	1,505
Total available-for-sale securities	$ 143,756	$ 143,595

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(5) Fair Value Measurement

The Company applies the fair value measurement and disclosure provisions of ASC 820, Fair Value Measurements and Disclosures, and ASU 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A three-level fair value hierarchy prioritizes the inputs used to measure fair value. The hierarchy requires entities to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1—Quoted prices in active markets for identical assets and liabilities.

- Level 2—Quoted prices in active markets for similar assets and liabilities, or other inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

- Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The Company measures certain cash and cash equivalents, accounts receivable, accounts payable and client fund obligations at fair value on a recurring basis using Level 1 inputs. The Company considers the recorded value of these financial assets and liabilities to approximate the fair value of the respective assets and liabilities at June 30, 2018 and September 30, 2018 based upon the short-term nature of these assets and liabilities.

Marketable securities, consisting of securities classified as available-for-sale as well as certain cash equivalents, are recorded at fair value on a recurring basis using Level 2 inputs obtained from an independent pricing service. Available-for-sale securities include commercial paper, corporate bonds, asset-backed securities and U.S. treasury securities. The independent pricing service utilizes a variety of inputs including benchmark yields, broker/dealer quoted prices, reported trades, issuer spreads as well as other available market data. The Company, on a sample basis, validates the pricing from the independent pricing service against another third-party pricing source for reasonableness. The Company has not adjusted any prices obtained by the independent pricing service, as it believes they are appropriately valued. There were no available-for-sale securities classified in Level 3 of the fair value hierarchy at June 30, 2018 or September 30, 2018, and the Company did not transfer assets between Levels during the three months ended September 30, 2017 or 2018.

The fair value level for the Company’s cash and cash equivalents and available-for-sale securities is as follows:

	June 30, 2018			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	$ 137,193	$ 137,193	$ —	$ —
Funds held for clients' cash and cash equivalents	1,102,538	1,076,414	26,124	—
Available-for-sale securities:				
Commercial paper	50,702	—	50,702	—
Corporate bonds	37,382	—	37,382	—
Asset-backed securities	25,847	—	25,847	—
U.S. treasury securities	9,877	—	9,877	—
Total available-for-sale securities	123,808	—	123,808	—
Total investments	$ 1,363,539	$ 1,213,607	$ 149,932	$ —

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	September 30, 2018			
	Total	Level 1	Level 2	Level 3
Cash and cash equivalents	$ 63,662	$ 60,215	$ 3,447	$ —
Funds held for clients' cash and cash equivalents	1,046,691	1,018,208	28,483	—
Available-for-sale securities:				
Commercial paper	56,634	—	56,634	—
Corporate bonds	32,188	—	32,188	—
Asset-backed securities	38,671	—	38,671	—
U.S. treasury securities	16,102	—	16,102	—
Total available-for-sale securities	143,595	—	143,595	—
Total investments	$ 1,253,948	$ 1,078,423	$ 175,525	$ —

The Company began investing corporate funds in available-for-sale securities during the first quarter of fiscal 2019 and as a result, reclassified $732 as of June 30, 2018 from prepaid expenses and other on the unaudited consolidated balance sheets to corporate investments for comparability purposes in order to conform to the current year's presentation.

(6) Benefit Plans

(a) Equity Incentive Plan

The Company maintains a 2008 Equity Incentive Plan (the "2008 Plan") and a 2014 Equity Incentive Plan (the "2014 Plan") pursuant to which the Company has reserved shares of its common stock for issuance to its employees, directors and non-employee third parties. The 2014 Plan serves as the successor to the 2008 Plan and permits the granting of options to purchase common stock and other equity incentives at the discretion of the compensation committee of the Company's board of directors. No new awards have been or will be issued under the 2008 Plan since the effective date of the 2014 Plan. Outstanding awards under the 2008 Plan continue to be subject to the terms and conditions of the 2008 Plan. The number of shares of common stock reserved for issuance under the 2014 Plan will increase automatically each calendar year, continuing through and including January 1, 2024. The number of shares added each year will be equal to the lesser of (a) four and five tenths percent (4.5%) of the number of shares of common stock of the Company issued and outstanding on the immediately preceding December 31, or (b) an amount determined by the Company's board of directors.

As of September 30, 2018, the Company had 13,295 shares allocated to the plans, of which 3,646 shares were subject to outstanding options or awards. Generally, the Company issues previously unissued shares for the exercise of stock options or vesting of awards; however, shares previously subject to 2014 Plan grants or awards that are forfeited or net settled at exercise or release may be reissued to satisfy future issuances.

The following table summarizes changes in the number of shares available for grant under the Company's equity incentive plans during the three months ended September 30, 2018:

	Number of Shares
Available for grant at July 1, 2018	10,030
RSUs granted	(715)
Shares withheld in settlement of taxes and/or exercise price	281
Forfeitures	94
Shares removed	(41)
Available for grant at September 30, 2018	9,649

Shares removed represents forfeitures of shares and shares withheld in settlement of taxes and/or payment of exercise price related to grants made under the 2008 Plan. As noted above, no new awards will be issued under the 2008 Plan.

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Stock-based compensation expense related to stock options, restricted stock units ("RSUs"), and the Employee Stock Purchase Plan (as described below) is included in the following line items in the accompanying unaudited consolidated statements of operations and comprehensive income:

	Three Months Ended September 30,	
	2017	2018
Cost of revenue – recurring	$ 622	$ 852
Cost of revenue – non-recurring	372	386
Sales and marketing	1,938	1,697
Research and development	871	1,278
General and administrative	2,803	5,212
Total stock-based compensation expense	$ 6,606	$ 9,425

In addition, the Company capitalized $433 and $625 of stock-based compensation expense in its capitalized internal-use software costs in the three months ended September 30, 2017 and 2018, respectively.

Under the 2008 and 2014 Plans, the exercise price of each option cannot be less than the fair value of a share of common stock on the grant date. The options typically vest ratably over a three or four year period and expire 10 years from the grant date. Stock-based compensation expense for the fair value of the options at their grant date is recognized ratably over the vesting schedule for each separately vesting portion of the award.

There were no stock options granted during the three months ended September 30, 2017 or 2018. The table below presents stock option activity during the three months ended September 30, 2018:

	Outstanding Options			
	Number of shares	Weighted average exercise price	Weighted average remaining contractual term (years)	Aggregate intrinsic value
Balance at July 1, 2018	1,907	$ 12.40	5.00	$ 88,595
Options forfeited	(1)			