

INSPERITY, INC.
Form 10-K
February 12, 2018

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

FORM 10-K
(Mark One)

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

For the fiscal year ended December 31, 2017

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 No. 1-13998
Insperty, Inc.
(Exact name of registrant as specified in its charter)

Delaware 76-0479645
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

19001 Crescent Springs Drive
Kingwood, Texas 77339
(Address of principal executive offices) (Zip Code)

Registrant's Telephone Number, Including Area Code: (281) 358-8986

Securities Registered Pursuant to Section 12(b) of the Act:

Common Stock, par value \$0.01 per share New York Stock Exchange
(Title of class) (Name of Exchange on Which Registered)

Securities Registered Pursuant to Section 12(g) of the Act: NONE

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Yes No

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 and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes

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No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definition of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

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

As of February 5, 2018, 41,484,357 shares of the registrant's common stock, par value \$0.01 per share, were outstanding. As of the last business day of the registrant's most recently completed second quarter, the aggregate market value of the common stock held by non-affiliates (based upon the June 30, 2017 closing price of the common stock as reported by the New York Stock Exchange) was approximately \$1.3 billion.

DOCUMENTS INCORPORATED BY REFERENCE

Part III information is incorporated by reference from the proxy statement for the 2018 annual meeting of stockholders, which the registrant intends to file within 120 days of the end of the fiscal year.

TABLE OF CONTENTS

Part I

Item 1.	<u>Business</u>	<u>2</u>
Item 1A.	<u>Risk Factors</u>	<u>17</u>
Item 1B.	<u>Unresolved Staff Comments</u>	<u>23</u>
Item 2.	<u>Properties</u>	<u>23</u>
Item 3.	<u>Legal Proceedings</u>	<u>24</u>
Item S-K 401(b).	<u>Executive Officers of the Registrant</u>	<u>24</u>

Part II

Item 5.	<u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>26</u>
Item 6.	<u>Selected Financial Data</u>	<u>29</u>
Item 7.	<u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>31</u>
Item 7A.	<u>Quantitative and Qualitative Disclosures about Market Risk</u>	<u>50</u>
Item 8.	<u>Financial Statements and Supplementary Data</u>	<u>50</u>
Item 9.	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>50</u>
Item 9A.	<u>Controls and Procedures</u>	<u>51</u>
Item 9B.	<u>Other Information</u>	<u>51</u>

Part III

Item 10.	<u>Directors, Executive Officers and Corporate Governance</u>	<u>52</u>
Item 11.	<u>Executive Compensation</u>	<u>52</u>
Item 12.	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>52</u>
Item 13.	<u>Certain Relationships and Related Transactions, and Director Independence</u>	<u>52</u>
Item 14.	<u>Principal Accounting Fees and Services</u>	<u>52</u>

Part IV

Item 15.	<u>Exhibits, Financial Statement Schedules</u>	<u>53</u>
Item 16.	<u>Form 10-K Summary</u>	<u>53</u>

Table of Contents

PART I

Unless otherwise indicated, “Insperty,” “we,” “our” and “us” are used in this annual report to refer to Insperty, Inc. and its consolidated subsidiaries. This annual report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. You can identify such forward-looking statements by the words “expects,” “intends,” “plans,” “projects,” “believes,” “estimates,” “likely,” “possibly,” “probably,” “goal,” “opportunity,” “objective,” “target,” “assume,” “outlook,” “guidance,” “predicts,” “appears,” “indicator” and other expressions. In the normal course of business, in an effort to help keep our stockholders and the public informed about our operations, from time to time, we may issue such forward-looking statements, either orally or in writing. Generally, these statements relate to business plans or strategies, projected or anticipated benefits or other consequences of such plans or strategies, or projections involving anticipated revenues, earnings or other operating results. We base the forward-looking statements on our current expectations, estimates and projections. We caution you that these statements are not guarantees of future performance and involve risks, uncertainties and assumptions that we cannot predict. In addition, we have based many of these forward-looking statements on assumptions about future events that may prove to be inaccurate. Therefore, the actual results of the future events described in such forward-looking statements in this annual report, or elsewhere, could differ materially from those stated in such forward-looking statements. Among the factors that could cause actual results to differ materially are the risks and uncertainties discussed in this annual report, including, without limitation, factors discussed in Item 1, “Business,” Item 1A, “Risk Factors,” and Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

ITEM 1. BUSINESS.

General

We provide an array of human resources (“HR”) and business solutions designed to help improve business performance. Since our formation in 1986, we have evolved from being solely a professional employer organization (“PEO”), an industry we pioneered, to our current position as a comprehensive business performance solutions provider. Our long-term strategy is to provide the best small and medium-sized businesses in the United States with our specialized human resources service offering and to leverage our buying power and expertise to provide additional valuable services to clients. Our most comprehensive HR services offerings are provided through our Workforce Optimization[®] and Workforce Synchronization[™] solutions (together, our “PEO HR Outsourcing solutions”), which encompass a broad range of human resources functions, including payroll and employment administration, employee benefits, workers’ compensation, government compliance, performance management and training and development services, along with our cloud-based human capital management platform, our Insperty Premier[™] solution. Our Workforce Optimization solution is our most comprehensive HR outsourcing solution and is our primary offering. Our Workforce Synchronization solution, which is generally offered only to our middle market client segment, is a lower cost offering with a typically longer commitment that includes the same compliance and administrative services as our Workforce Optimization solution and allows those clients to select, for an additional fee, from the strategic HR products and organizational development services that are included with our Workforce Optimization solution. In addition to our PEO HR Outsourcing solutions, we offer a number of other business performance solutions, including Human Capital Management, Payroll Services, Time and Attendance, Performance Management, Organizational Planning, Recruiting Services, Employment Screening, Expense Management Services, Retirement Services and Insurance Services, many of which are offered as a cloud-based software solution. These other products and services are offered separately, along with our PEO HR Outsourcing solutions or as a bundle, such as our Workforce Administration[™] solution that provides a comprehensive human capital management and payroll service solution.

Our PEO HR Outsourcing solutions are designed to improve the productivity and profitability of small and medium-sized businesses. These solutions relieve business owners and key executives of many employer-related administrative and regulatory burdens, which enable them to focus on the core competencies of their businesses. Our PEO HR Outsourcing solutions also promote employee performance through human resources management techniques designed to improve employee satisfaction. We enter into a Client Service Agreement (“CSA”) with each of our PEO HR Outsourcing solutions clients, under which we and our client act as co-employers of the employees who

work at the client's worksite ("worksite employees"). Under the CSA, we assume responsibility for personnel administration and assist our clients in complying with employment-related governmental regulations, while the client retains the employees' services in its business and remains the employer for various other purposes. We charge a comprehensive service fee ("comprehensive service fee" or "gross billing"), which is invoiced concurrently with the processing of payroll for the worksite employees of the client. The comprehensive service fee consists of the payroll of our worksite employees plus an additional amount reflected as a percentage of the payroll cost of the worksite employees.

- 2 -

Table of Contents

We accomplish the objectives of our PEO HR Outsourcing solutions through a “high-touch/high-tech” approach to service delivery. In advisory areas, such as recruiting, employee performance management and employee training, we employ a high-touch approach designed to ensure that our clients receive the personal attention and expertise needed to create a customized human resources solution. We utilize a variety of information technology capabilities to deliver our PEO HR Outsourcing solutions, including Insperty Premier, our cloud-based human capital management platform, which provides an online platform through which we, along with our clients and worksite employees, manage worksite employee information, payroll, benefits and retirement solutions, creating efficiencies for all parties. As of December 31, 2017, we had 68 offices, including 60 sales offices in 29 markets. In addition, we had four regional service centers along with human resources and client service personnel located in a majority of our 29 sales markets, which serviced an average of 189,513 worksite employees per month in the fourth quarter of 2017. Our service centers coordinate PEO HR Outsourcing solutions for clients on a regional basis and localized face-to-face human resources services.

We were organized as a corporation in 1986. Our principal executive offices are located at 19001 Crescent Springs Drive, Kingwood, Texas 77339. Our telephone number at that address is (281) 358-8986, and our website address is www.insperity.com. Our stock is traded on the New York Stock Exchange under the symbol “NSP.” We file or furnish periodic reports with the Securities and Exchange Commission (“SEC”), including our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and if applicable, amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934. Through the investor relations section of our website, we make available electronic copies of the documents that we file or furnish to the SEC, the charters of the standing committees of our Board of Directors (the “Board”) and other documents related to our corporate governance, including our Code of Conduct. Access to these electronic filings is available free of charge as soon as reasonably practicable after filing or furnishing them to the SEC. Printed copies of our committee charters and other governance documents and filings can be requested by writing to our corporate secretary at the address above.

PEO Industry

The PEO industry began to evolve in the early 1980s largely in response to the burdens placed on small and medium-sized employers by an increasingly complex legal and regulatory environment. While various service providers were available to assist these businesses with specific tasks, PEOs emerged as providers of a more comprehensive range of services relating to the employer/employee relationship. In a PEO arrangement, the PEO assumes certain aspects of the employer/employee relationship as defined in the contract between the PEO and its client. Because PEOs provide employer-related services to a large number of employees, they can achieve economies of scale that allow them to perform employment-related functions more efficiently, provide a greater variety of employee benefits, and devote more attention to human resources management than a client can individually.

We believe the key factors driving demand for PEO services include:

- the focus on growth and productivity of the small and medium-sized business community in the United States, utilizing outsourcing to concentrate on core competencies
 - the need to provide competitive health care and related benefits to attract and retain employees
- the increasing costs associated with health and workers’ compensation insurance coverage, workplace safety programs, employee-related complaints and litigation
- complex regulation of employment issues and the related costs of compliance, including the allocation of time and effort to such functions by owners and key executives

A significant factor in the development of the PEO industry has been increasing recognition and acceptance of PEOs and the co-employer relationship by federal and state governmental authorities. Insperty and other industry leaders, in concert with the National Association of Professional Employer Organizations (“NAPEO”), have worked with the relevant governmental entities for the establishment of a regulatory framework that protects clients and employees, discourages unscrupulous and financially unsound PEOs, and promotes further development of the industry.

Currently, 41 states have enacted legislation either recognizing PEOs or requiring licensing, registration, or certification, and several others are considering such regulation. Such laws vary from state to state but generally provide for monitoring the fiscal responsibility of PEOs. State regulation assists in screening insufficiently capitalized

PEO operations and helps to resolve interpretive issues concerning employer/employee status for specific purposes under applicable state law. We have actively supported such regulatory efforts and are currently recognized, licensed, registered, certified or pursuing registration in all of these states. The cost of compliance with these regulations is not material to our financial position or results of operations.

- 3 -

Table of Contents

In 2014, the Small Business Efficiency Act (“SBEA”) was enacted. The SBEA created a federal regulatory framework for the payment of wages to worksite employees and the reporting and remittance of federal payroll taxes on those wages paid by PEOs certified under the statute (“CPEOs”). We actively supported the enactment of this law. The SBEA clarifies that a CPEO, rather than the client, will be treated as the employer for purposes of reporting and remitting payroll taxes. It also clarifies that a CPEO shall be treated as a successor employer for purposes of the wage base of worksite employees on which federal payroll taxes are applied. In addition, the law clarifies that clients of a CPEO remain eligible for specified tax credits for which they would have been eligible absent the CPEO relationship. Following the establishment of the certification program by the Internal Revenue Service of the United States (“IRS”) and Treasury Department, our PEO subsidiary, Insperty PEO Services, L.P., filed an application with the IRS and, in the second quarter of 2017 received its designation as a CPEO from the IRS, which was retroactively effective to January 1, 2017.

Service Offerings

PEO HR Outsourcing Solutions

We serve small and medium-sized businesses by providing our PEO HR Outsourcing solutions, which encompass a broad range of services. Both of our PEO HR Outsourcing solutions offer the following:

- benefits and payroll administration
- health and workers’ compensation insurance programs
- personnel records management
- employer liability management
- assistance with government compliance
- general HR advice
- access to Insperty Premier for employees, managers and client owners
- 401(k) retirement plan sponsored by us

Our Workforce Optimization solution also provides additional services that our Workforce Synchronization clients can purchase for an additional fee, including the following:

- employee recruiting and support
- employee performance management
- training and development services

Our PEO HR Outsourcing solutions are designed to attract and retain high-quality employees, while relieving client owners and key executives of many employer-related administrative and regulatory burdens. Among the employment-related laws and regulations that may affect a client are the following:

Table of Contents

Internal Revenue Code (the “Code”)	The Family and Medical Leave Act (FMLA)
Federal Income Contribution Act (FICA)	Genetic Information Nondiscrimination Act of 2008
Federal Unemployment Tax Act (FUTA)	Drug-Free Workplace Act
Fair Labor Standards Act (FLSA)	Occupational Safety and Health Act (OSHA)
Employee Retirement Income Security Act, as amended (ERISA)	Worker Adjustment and Retraining Notification Act (WARN)
Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA)	Uniformed Services Employment and Reemployment Rights Act (USERRA)
Immigration Reform and Control Act (IRCA)	State unemployment and employment security laws
Title VII (Civil Rights Act of 1964)	State workers’ compensation laws
Health Insurance Portability and Accountability Act (HIPAA)	Health Care and Education Reconciliation Act of 2010 (the “Reconciliation Act”)
Age Discrimination in Employment Act (ADEA)	Patient Protection and Affordable Care Act (PPACA)
Americans with Disabilities Act (ADA)	State and local law equivalents of the foregoing

While these laws and regulations are complex, and in some instances overlapping, we assist our PEO HR Outsourcing solutions clients in complying with these laws and regulations by providing services in the categories set forth below: Administrative Functions. Administrative functions encompass a wide variety of processing and recordkeeping tasks, mostly related to payroll administration and regulatory compliance. Specific examples include:

- payroll processing
 - payroll tax deposits
 - quarterly payroll tax reporting
 - employee file maintenance
 - unemployment claims processing
 - workers’ compensation claims reporting and monitoring
- Benefit Plans Administration. We maintain several benefit plans for eligible worksite employees including the following:
- a group health plan
 - a health savings account program
 - a health care flexible spending account plan
 - an educational assistance program
 - an adoption assistance program
 - group term life insurance
 - group universal life insurance
 - accidental death and dismemberment insurance
 - short-term and long-term disability insurance
 - a 401(k) retirement plan
 - cafeteria plans for group health and health savings account contributions

The group health plan includes medical, dental, vision and prescription drug coverage, as well as a work-life program. All benefit plans are provided to eligible employees based on the specific eligibility provisions of each plan. We are the policyholder responsible for the costs and premiums associated with any group insurance policies that provide benefits under these plans, and we act as plan sponsor and administrator of the plans. We negotiate the terms and costs of the plans, maintain

Table of Contents

the plans in accordance with applicable federal and state regulations and serve as liaison for the delivery of these benefits to worksite and corporate employees. COBRA coverage is extended to eligible terminated worksite employees and other eligible individuals, in accordance with applicable law. We believe that the variety and comprehensive nature of our benefit plan offerings are generally not available to employees in our small and medium-sized business target market and are usually offered only by larger companies that can spread program costs over a much larger group of employees. As a result, we believe the availability of these benefit plans provides our clients with a competitive advantage that small and medium-sized businesses are typically unable to attain on their own.

Insperty Premier. Insperty Premier is our cloud-based human capital management platform for our PEO HR Outsourcing solutions and is available to our clients with almost no implementation effort or cost. It is designed to provide our service providers with insight into client and worksite employee HR information to better support their needs. Insperty Premier provides role-based access to a wide range of human capital management functions, along with personalized content to the managers, owners and worksite employees of our PEO HR Outsourcing solutions clients, including:

For managers and client owners:

- WebPayroll for the submission, approval and reporting of payroll data
- tools to manage the onboarding of new employees
- employee administration functions such as viewing or changing information about employees
- access to client-specific compliance-related information relevant to many HR areas, including the Affordable Care Act
- a reporting and analytics tool to create, view, save and export reports and data about employees
 - ability to manage employee time and attendance information, absences and paid time off
- access to Talent Management tools in the areas of Recruiting, Performance Management and Learning Management
- access to a library of online human resources forms
- access to a wide range of best-practices human resources management content through Insperty Mobile, access to review and approve payroll transactions and employee time entry from most mobile devices

For worksite employees:

- access to view, edit and change a range of employee profile information
- online check stubs, pay history reports and W-2s
- employee-specific benefits content, including summary plan descriptions, enrollment status and tools to assist with benefits selection
- access to 401(k) retirement plan information
- e-Learning web-based training
- links to benefits providers and other key vendors
- performance management tools including self-reviews and review history
 - ability to submit time and attendance information, absences and paid time off requests
 - access to view a wide range of employee-specific information such as pay stub, insurance coverage and ID card, 401(k) balances and other commonly accessed data through Insperty Mobile

Personnel Management. In addition to the services that we deliver through Insperty Premier, we provide a wide variety of personnel management services that give our clients access to HR advisors and additional resources normally found only in the human resources departments of large companies. All PEO HR Outsourcing solutions clients have access to our

Table of Contents

advice concerning personnel policies and practices, including recruiting, discipline and termination procedures. Other personnel management services we provide include:

- drafting and reviewing personnel policies and employee handbooks
- designing job descriptions
- performing prospective employee screening and background investigations
- designing performance appraisal processes and forms
- professional development and issues-oriented training
- employee counseling
- substance abuse awareness training
- outplacement services
- compensation guidance

Employer Liability Management. Under the CSA, we assume many of the employment-related responsibilities associated with the administrative functions, benefit plans administration and personnel management services we provide. For many of those employment-related responsibilities that are the responsibility of the client or of both the client and us, we may assist our clients in managing and limiting exposure. This assistance may include safety-related risk management reviews as well as the implementation by our clients of safety programs designed to reduce workplace accidents and, consequently, workers' compensation claims. We also provide guidance to clients for avoiding discrimination, sexual harassment and civil rights violations, and we assist with termination decisions when consulted to attempt to minimize liability on those grounds. While we do not provide legal services to our clients, we employ in-house and external counsel who specialize in several areas of employment law, have broad experience in disputes concerning the employer/employee relationship and provide support to our internal human resources professionals. As part of our comprehensive service, we also maintain employment practice liability insurance coverage for ourselves and our clients, monitor developments in HR-related laws and regulations, and notify clients of the potential effect of such changes on employer liability.

MarketPlaceSM provided by Insperty[®]. Through our many alliances with best-of-class providers, Insperty's MarketPlace is an e-commerce portal that brings a wide range of products and services to our clients, worksite employees and their families. Through MarketPlace, which is provided through Insperty Premier, our clients also have the opportunity to offer their products and services to other clients and worksite employees.

Middle Market Solutions.TM We believe the middle market sector, which we generally define as those companies with employees ranging from approximately 150 to 2,000 worksite employees, has historically been under-served by the PEO industry. Currently, we have a dedicated sales management, service personnel and consulting staff who concentrate solely on the middle market sector. Our average number of worksite employees per month in our middle market sector increased 5.8% over 2016, representing approximately 23.6% of our total paid worksite employees during 2017.

Other Product and Services Offerings

We offer other product and services offerings on a stand-alone basis and to our PEO HR Outsourcing solutions clients. We also strive to leverage our relationships with our customers to enable cross-selling of our various products and services.

During 2017 and 2016, revenues from our other products and services offerings as a percentage of our total revenues were 1.3% and 1.4%, respectively.

The following are the key components of our other products and services, which are offered separately or as a bundle: **Traditional Payroll and Human Capital Management.** In 2016, we began offering our Insperty Workforce AdministrationTM solution, a comprehensive human capital management and payroll services solution for clients that do not choose our PEO HR Outsourcing solutions. This solution combines a cloud-based human resources software suite that provides integrated payroll, HR administration and employee onboarding, benefits administration, performance management, and time and attendance functionality with HR guidance and tools, as well as reporting and analytics.

Time and Attendance. Our Time and Attendance products and services provide small to medium-sized businesses with software, hardware and services to track, allocate, and analyze employee resources and provide inputs into clients'

payroll

- 7 -

Table of Contents

processing and accounting systems. The service is delivered as an “on-premise” client-server solution or as a cloud-based solution with access through Insperty Premier for our PEO HR Outsourcing solutions clients.

Performance Management. Our Performance Management products and services provide human resources software offerings including Insperty® PerformSmart® a performance management cloud-based offering. Insperty PerformSmart is available, for a fee, to both our Workforce Optimization and Workforce Synchronization clients. For customers utilizing PerformSmart in conjunction with our PEO HR Outsourcing solutions, we provide access through Insperty Premier. In addition, we offer a suite of desktop products: Insperty® Descriptions Now®, Insperty® Policies Now®, Insperty® Performance Now®, and Insperty® Ultimate Employer®. Performance Management products are sold through online subscription arrangements and through various reseller arrangements.

Organizational Planning. Organizational planning offers cloud-based and desktop software used by companies to facilitate the creation, management and communication of detailed organizational management charts. For customers utilizing OrgPlus RealTime in conjunction with our PEO HR Outsourcing solutions, we provide access through Insperty Premier.

Recruiting Services. Our Recruiting Services offer direct hire placement on an as-needed basis and provides outsourced support for individual requisitions or large-scale hiring projects. In addition, we provide consulting services to assist in the creation and maintenance of consistent hiring practices and retention strategies. We also provide compensation services, behavior-based interview training and talent assessment.

Employment Screening. Our Employment Screening services offer a customized approach to background-check reporting for companies. Services include criminal records checks; verification of employment history or education; driving record, civil record and credit history checks; and confirmation of extraordinary credentials.

Expense Management. Our Expense Management product delivers employee expense management solutions that automate employee expense reporting, enforce travel and expense policies, and provide management reporting and analysis. The service is delivered as a cloud-based solution.

Retirement Services. Our Retirement Services solutions deliver comprehensive 401(k) retirement plan recordkeeping and administrative services to small and medium-sized businesses, primarily in connection with a 401(k) retirement plan we sponsor for our PEO HR Outsourcing solutions clients. Services include employee education and enrollment, participant communications, elective deferral withholding and transmission, matching contribution calculation, loan and distribution processing, regulatory filing preparation and nondiscrimination testing.

Insurance Services. Our Insurance Services solutions offer assistance through our licensed insurance agency to small and medium-sized businesses, including Workforce Administration clients, in all 50 states to secure affordable, customizable business insurance packages and life, health and disability insurance policies. Insurance Services also assists individuals in obtaining insurance coverages.

Client Service Agreement

All PEO HR Outsourcing solutions clients execute a CSA with us. The CSA provides for an ongoing relationship between Insperty and the PEO HR Outsourcing solutions client. For most clients, the CSA generally is an annual contract subject to earlier termination by Insperty or the client upon 30 days’ written notice or upon shorter notice in the event of default. CSAs for our middle market clients are generally two-year contracts, subject to earlier termination by clients upon payment of a termination fee or otherwise by the parties upon an event of default. The CSA establishes our comprehensive service fee, which is subject to periodic adjustments to account for changes in the composition of the client’s workforce, employee benefit election changes and statutory changes that affect our costs. Under the CSA, clients active in January of any year are obligated to pay the estimated payroll tax component of the comprehensive service fee in a manner that reflects the pattern of incurred payroll tax costs. This practice aligns clients’ payments to us with our obligations to make payments to tax authorities, which are higher in the earlier part of the year and decrease as limits on wages subject to payroll tax are reached.

The CSA also establishes the division of responsibilities between us and the client as co-employers. Pursuant to the CSA, we are responsible for personnel administration and for compliance with certain employment-related government regulations. In addition, we assume liability for payment of salaries and wages (as well as related payroll taxes) of our worksite employees and responsibility for providing specified employee benefits to such persons. These liabilities are not contingent on the prepayment by the client of the associated comprehensive service fee. Instead, as a

result of our employment relationship with each of our worksite employees, we are liable for payment of salary and wages to the worksite employees as reported by the client and are responsible for providing specified employee benefits to such persons regardless of whether the client pays the associated comprehensive service fee. The client retains the employees' services and remains liable for complying with certain government regulations that require control of the worksite or daily supervisory responsibility or is otherwise beyond

- 8 -

Table of Contents

our ability to assume. A third group of responsibilities and liabilities are assumed by both Insuperity and the client where such concurrent responsibility is appropriate. The specific division of applicable responsibilities under our CSAs generally is as follows:

Insuperity

- Payment of wages and salaries as reported by the client and related tax reporting and remittance (local, state and federal withholding, FICA, FUTA, state unemployment)
- Workers' compensation compliance, procurement, management and reporting
- Compliance with the Code, COBRA, HIPAA and ERISA (for each employee benefit plan sponsored by Insuperity), as well as monitoring changes in other governmental laws and regulations governing the employer/employee relationship and updating the client when necessary
- Offering benefits under Insuperity-sponsored employee benefit plans that comply with PPACA requirements
- Employee benefits administration of plans sponsored solely by Insuperity

Client

- Payment, through Insuperity, of commissions, bonuses, vacations, paid time off, sick pay, paid leaves of absence and severance payments
- Payment and related tax reporting and remittance of non-qualified deferred compensation and equity-based compensation
- Ownership and protection of all client intellectual property rights
- Compliance with OSHA regulations, EPA regulations, FLSA, FMLA, WARN, USERRA and state and local equivalents and compliance with government contracting provisions
- Compliance with federal, state and local pay or play health care mandates and all such other similar federal, state and local legislation
- Compliance with the National Labor Relations Act ("NLRA"), including all organizing efforts and expenses related to a collective bargaining agreement and related benefits
- Professional licensing requirements, fidelity bonding and professional liability insurance
- Products produced and/or services provided
- COBRA, HIPAA, PPACA, the Code and ERISA compliance for client-sponsored benefit plans

Concurrent

- Implementation of policies and practices relating to the employee/employer relationship
- Compliance with all federal, state and local employment laws, including, but not limited to Title VII of the Civil Rights Act of 1964, ADEA, Title I of ADA, the Consumer Credit Protection Act and immigration laws and regulations

We maintain employment practice liability insurance coverages (including coverages for our clients) to manage our exposure for various employee-related claims. Our incurred costs in excess of annual premiums with respect to this exposure have historically been insignificant to our operating results.

Because we are a co-employer with the client for some purposes, it is possible that we could incur liability for violations of such laws, even if we are not responsible for the conduct giving rise to such liability. Our CSA ordinarily addresses this issue by providing that the client will indemnify us for liability incurred to the extent the liability is attributable to conduct by the client. Notwithstanding this contractual right to indemnification, it is possible that we could be unable to collect on a claim for indemnification and may therefore be ultimately responsible for satisfying the liability in question.

In most instances, clients are required to remit their comprehensive service fees no later than one day prior to the applicable payroll date by wire transfer or automated clearinghouse transaction. Although we are ultimately liable, as the employer for payroll purposes, to pay employees for work previously performed, we retain the ability to terminate immediately

Table of Contents

the CSA and associated worksite employees or to require prepayment, letters of credit or other collateral upon deterioration in a client's financial condition or upon non-payment by a client. These rights, the periodic nature of payroll, and the overall quality of our client base have resulted in an excellent overall collections history.

PEO HR Outsourcing Solutions Clients

Insperty's PEO HR Outsourcing solutions provide value-added, full-service human resources solutions we believe are most suitable to a specific segment of the small and medium-sized business community. We target successful businesses with approximately 10 to 2,000 employees that recognize the advantage in the strategic use of high-performance human resources practices. We have set a long-term goal to serve approximately 10% of the overall small and medium-sized business community in terms of worksite employees. We serve clients and worksite employees located throughout the United States. By region, our 2017 revenue change compared to 2016 and revenue distribution for the year ended December 31, 2017, was as follows:

	Revenue Change	% of Total Revenues		%
Northeast	13.8 %	26.3 %		
Southeast	19.4 %	11.7 %		
Central	16.3 %	16.7 %		
Southwest	11.3 %	23.6 %		
West	5.8 %	21.7 %		

All prospective PEO HR Outsourcing solutions clients are evaluated on the basis of a comprehensive analysis of employer-related risks entailing many factors, including industry and operations, workplace safety and workers' compensation, unemployment history, operating stability, group medical information, human resources practices and other employer risks. As part of our client selection strategy, we strive to minimize offering our PEO HR Outsourcing solutions to businesses falling within certain specified NAICS (North American Industry Classification System) codes for those industries that we believe present a higher employer risk such as employee injury, high turnover or litigation. Our PEO HR Outsourcing solutions client base is broadly distributed throughout a wide variety of industries including:

Industry	% of Client Base
Computer and information services	18 %
Management, administration and consulting services	14 %
Finance, insurance and real estate	14 %
Manufacturing	11 %
Wholesale trade	9 %
Engineering, accounting and legal services	8 %
Medical services	7 %
Not-for-profit and similar organizations	5 %
Retail trade	4 %
Construction	4 %
Other	6 %

This diverse client base lowers our exposure to downturns or volatility in any particular industry. However, our performance could be affected by a downturn in one of these industries or by general economic conditions within the small and medium-sized business community.

We focus heavily on client retention. During 2017 and 2016, our retention rate was approximately 85% and 86%, respectively. For all PEO HR Outsourcing solutions clients, the average annual retention rate over the last five years was approximately 83%. Client attrition is attributable to a variety of factors, including: (1) client non-renewal due to price or service factors; (2) client business failure, sale, merger, or disposition; (3) our termination of the CSA resulting from the client's non-compliance or inability to make timely payments; and (4) competition from other PEOs

or business services firms.

- 10 -

Table of Contents

Marketing and Sales

As of December 31, 2017, we had 60 PEO HR Outsourcing solutions sales offices located in 29 markets. Our sales offices typically consist of six to eight Business Performance Advisors (“BPAs”), a district sales manager and an office administrator. To take advantage of economic efficiencies, multiple sales offices may share a physical location.

Insperty’s markets and their respective year of entry are as follows:

Market	Sales Offices	Initial Entry Date
Houston	6	1986
San Antonio	1	1989
Austin	1	1989
Orlando	1	1989
Dallas/Fort Worth	5	1993
Atlanta	3	1994
Phoenix	1	1995
Chicago	4	1995
Washington D.C.	2	1995
Denver	2	1996
Los Angeles	5	1997
Charlotte	1	1997
St. Louis	1	1998
San Francisco	3	1998
New York	5	1999
Maryland	2	2000
New Jersey	2	2000
San Diego	1	2001
Boston	3	2001
Minneapolis	2	2002
Raleigh	1	2006
Kansas City	1	2007
Columbus	1	2010
Nashville	1	2011
Philadelphia	1	2012
Seattle	1	2015
Indianapolis	1	2016
Fort Lauderdale	1	2017
Milwaukee	1	2017

We identify markets using a systematic market evaluation and selection process. We continue to evaluate a broad range of factors in the selection process, using a market selection model that weighs various criteria that, based on our experience, we believe are reliable predictors of successful penetration. Among the factors we consider are:

- market size, in terms of small and medium-sized businesses engaged in selected industries that meet our risk profile
- market receptivity to PEO services, including the regulatory environment and relevant history with other PEO providers
- existing relationships within a given market, such as vendor or client relationships
- expansion cost issues, such as advertising and overhead costs

Table of Contents

• direct cost issues that bear on our effectiveness in controlling and managing the cost of our services, such as workers' compensation and health insurance costs, unemployment risks and various legal and other factors

• a comparison of the services we offer to alternatives available to small and medium-sized businesses in the relevant market, such as the cost to the target clients of procuring services directly or through other PEOs

• long-term strategy issues, such as the general perception of markets and our estimate of the long-term revenue growth potential of the market

We develop a mix of national and local advertising media and a placement strategy tailored to each individual market. After selecting a market and developing our marketing mix, but prior to entering the market, we engage in an organized media and public relations campaign to prepare the market for our entry and to begin the process of generating sales leads. We market our services through various business promotions and a broad range of media outlets, including the Internet, television, radio, newspapers, periodicals and direct mail. We employ public relations firms for most of our markets as well as advertising consultants to coordinate and implement our marketing campaigns. We have developed an inventory of television, radio and newsprint advertisements, which are utilized in this effort.

We routinely seek to develop new marketing approaches and campaigns to capitalize on changes in the competitive landscape for our human resources services and to more successfully reach our target market. We have an agreement with the Professional Golf Association Champions Tour to be the title sponsor of the annual Insperty Invitational™ presented by UnitedHealthcare® professional golf tournament held annually in The Woodlands, Texas (a suburb of Houston). In addition, we have an arrangement with Jim Nantz, a sports commentator, to serve as our national spokesperson. Our marketing campaigns use this event and the relationship with Mr. Nantz as a focal point of our brand marketing efforts.

Our organic growth model generates sales leads from five primary sources: direct sales efforts, advertising, referrals, marketing alliances and the Internet. These leads result in initial presentations to prospective PEO HR Outsourcing solutions clients, and ultimately, prospective PEO HR Outsourcing solutions client census reports. A prospective PEO HR Outsourcing solutions client's census report reflects information gathered by the BPA about the prospect's employees, including base compensation, level of benefits coverage options, job classification, state of employment and workers' compensation classification. This information is used to generate a bid from our customized bid system, which applies Insperty's proprietary pricing model to the census data. Concurrent with this process, we evaluate prospective clients through the previously described comprehensive employer risk analysis. Upon completion of a favorable employer risk evaluation, the BPA presents the bid and attempts to complete the sale and enroll the prospect. Our selling process typically takes approximately 90 days for clients with less than 150 employees, and 180 days or longer for middle market clients. The process can be extended during economic downturns.

We have implemented cross-selling channels between our PEO HR Outsourcing solutions business and our other products and services. This cross-selling strategy focuses on using our PEO HR Outsourcing solutions to increase market penetration in each of our other products and services and using our other product and service offerings as a source of leads for our PEO HR Outsourcing solutions. The cross-selling channels attempt to reduce barriers to selling our products and services and allow us to tailor service packages to better meet the specific needs of the business.

Competition

We provide a value-added, full-service human resources solution through our PEO HR Outsourcing solutions, which we believe is most suitable to a specific segment of the small and medium-sized business community. This full-service approach is exemplified by our commitment to provide a high level of service and technology personnel, which has produced a ratio of corporate staff to worksite employees (the "staff support ratio") that is higher than average for the PEO industry. Based on an analysis of the 2014 through 2016 annual NAPEO surveys of the PEO industry, we have successfully leveraged our full-service approach into significantly higher returns for Insperty on a per worksite employee per month basis. During the three-year period from 2014 through 2016, our staff support ratio averaged 55% higher than the PEO industry average. During the same three-year period, our gross profit per worksite employee and operating income per worksite employee exceeded industry averages by 143% and 133%, respectively.

Competition in the PEO industry revolves primarily around quality of services, scope of services, choice and quality of benefits packages, reputation and price. We believe reputation, national presence, regulatory expertise, financial

resources, risk management and information technology capabilities distinguish leading PEOs from the rest of the industry. We also believe we compete favorably in these areas; however, other PEOs may offer their PEO services at lower prices than we offer.

Due to the differing geographic regions and market segments in which most PEOs operate, and the relatively low level of market penetration by the industry, we consider our primary competition for our PEO HR Outsourcing solutions to be the

- 12 -

Table of Contents

traditional in-house provision of human resources services. The PEO industry is highly fragmented, and we believe Insperty is one of the largest PEO service providers in the United States. Our largest national competitors include the PEO divisions of large business services companies such as Automatic Data Processing, Inc. and Paychex, Inc., and other national PEOs, such as TriNet Group, Inc. In addition, we also face competition from: (1) fee-for-service providers such as payroll processors and human resources consultants; (2) human resources technology solution companies; and (3) large regional PEOs in certain areas of the country. As Insperty and other large PEOs expand nationally, we expect that competition may intensify.

Vendor Relationships

Insperty provides benefits to its worksite employees under arrangements with a variety of vendors. We consider our contracts with UnitedHealthcare (“United”) and the Chubb Group of Insurance Companies (“Chubb”) to be the most significant elements of our employee benefits package, as they would be the most difficult to replace.

We provide group health insurance coverage to our worksite employees through a national network of carriers including United, UnitedHealthcare of California, Kaiser Permanente, Blue Shield of California, HMSA BlueCross BlueShield of Hawaii and Tufts, all of which provide fully insured policies or service contracts. The health insurance contract with United provides approximately 87% of our health insurance coverage and expires on December 31, 2019, subject to cancellation by either party upon 180 days’ notice. For a discussion of our contract with United, which is accounted for using a partially self-funded insurance accounting model, please read Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates—Benefits Costs.”

Our workers’ compensation coverage (the “Chubb Program”) has been provided through an arrangement with Chubb (formerly ACE American Insurance Company) since 2007. The Chubb Program is a fully insured program whereby Chubb has the responsibility to pay all claims incurred under the policies regardless of whether we satisfy our responsibilities. For additional discussion of the Chubb Program, which includes terms shifting some of the economic burden to us, please read Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates—Workers’ Compensation Costs.”

Information Technology

Insperty utilizes a variety of information technology capabilities to provide its PEO HR Outsourcing solutions and business performance improvement services to its clients and worksite employees and for its own administrative and management information requirements.

Insperty’s PEO HR Outsourcing solutions information systems, which include Insperty Premier, are a proprietary set of applications that utilizes both internally developed and licensed software applications. This system manages transactions and information specific to our PEO HR Outsourcing solutions, to Insperty and to our clients and worksite employees, including:

- worksite employee enrollment
- human resources management and employee administration
- benefits and defined contribution plan administration
- payroll processing
- client invoicing and collection
- management information and reporting
- sales bid calculations

Central to these systems are transaction processing capabilities that allow us to process a high volume of employee enrollment, employee administration, payroll, invoice and bid transactions that meet the specific needs of our clients and prospects. We administer our employee benefits through a proprietary application designed to process employee eligibility and enrollments, manage carrier relationships and maintain a variety of plan offerings. Our retirement services operations are conducted utilizing an industry-leading retirement plan administration application in a third-party hosted environment. Aspects of all of these components are delivered to our PEO HR Outsourcing solutions clients and worksite employees through Insperty Premier. We utilize commercially available software for other business functions such as finance and accounting, sales force activity management and customer relationship management.

Our products and services utilize a variety of owned and licensed software applications to deliver business performance improvement services to our clients, including to some of our PEO HR Outsourcing solutions clients.

- 13 -

Table of Contents

Insperty has hosting facilities located at two separate leased facilities, located in Bryan, Texas and The Woodlands, Texas. These facilities host the majority of our business applications, telecommunications equipment, information security infrastructure and network equipment. Each hosting facility houses a mix of primary production applications, disaster recovery, replication and back-up applications, and pre-production environments, with the Bryan facility acting as our primary data center for all mission-critical applications. Both hosting facilities are designed to run all of our critical business applications and have sufficient capacity to handle all of our operations on a stand-alone basis, if required. Periodically, we perform testing to ensure our disaster recovery capabilities remain effective and available. Our network infrastructure is designed to ensure appropriate connectivity exists among all of our facilities and employees and provides appropriate Internet connectivity to conduct business with our clients and worksite employees. The network infrastructure is provided through industry standard core network hardware and via high-speed network services provided by multiple vendors.

We have incorporated a variety of measures to maintain the security and privacy of the information managed through our systems and applications. These measures include industry standard technologies designed to protect, monitor and assess our data centers and network environment; best practice security policies and procedures; and a variety of measures designed to control access to sensitive and private information.

Industry Regulations

The operations for our PEO HR Outsourcing solutions are affected by numerous federal and state laws relating to tax, insurance and employment matters. By entering into a co-employer relationship with our worksite employees, we assume certain obligations and responsibilities of an employer under these federal and state laws. Because many of these federal and state laws were enacted prior to the development of nontraditional employment relationships, such as PEOs, temporary employment and outsourcing arrangements, many of these laws do not specifically address the obligations and responsibilities of nontraditional employers. Currently, 41 states have passed laws that recognize PEOs or require licensing, registration or certification requirements for PEOs, and several others are considering such regulation. The SBEA, which was enacted in 2014, established a certification program and created a federal regulatory framework for the payment of wages to worksite employees and for the reporting and remittance of federal payroll taxes on those wages paid by CPEOs. In 2016, our PEO subsidiary, Insperty PEO Services, L.P., filed an application with the IRS to become a CPEO and in the second quarter of 2017, Insperty PEO Services, L.P. received its designation as a CPEO from the IRS, which was retroactively effective to January 1, 2017. Please read Item 1.

“Business – PEO Industry” for further information.

As an employer, we are subject to federal statutes and regulations governing the employer/employee relationship. Subject to the issues discussed below, we believe that our operations are in compliance, in all material respects, with all applicable federal statutes and regulations.

Employee Benefit Plans

We offer various employee benefits plans to eligible employees, including our worksite employees. These plans include:

- 401(k) retirement plan
- cafeteria plans under Code Section 125
- a group health plan, which includes medical, dental, vision and prescription drug coverage, as well as a work-life program
- a health savings account program
- a welfare benefits plan, which includes life, disability and accidental death and dismemberment coverage
- a health care flexible spending account plan
- an educational assistance program
- an adoption assistance program
- a commuter benefits program

Generally, employee benefit plans are subject to provisions of the Code, ERISA and COBRA. The number and complex nature of federal and state regulations relating to employer-sponsored health plans has continued to increase over time.

Table of Contents

We believe that additional regulatory burdens placed on employers can increase the demand for our services because small and medium-sized businesses are especially challenged in their efforts to comply with governmental regulations due to limited resources and a lack of expertise. As a co-employer in the PEO relationship, we assume or share many of the employer-related responsibilities and assist our clients in complying with many employment-related governmental laws and regulations. Historically, we believe that we have successfully marketed the compliance component of our service offering and that our compliance-related services have increased the value proposition of our service offering.

Employer Status. In order to qualify for favorable tax treatment under the Code, employee benefit plans must be established and maintained by an employer for the exclusive benefit of its employees. Generally, an entity is an “employer” of individuals for federal employment tax purposes if an employment relationship exists between the entity and the individuals under the common law test of employment. In addition, the officers of a corporation are deemed to be employees of that corporation for federal employment tax purposes. The common law test of employment, as applied by the IRS, involves an examination of approximately 20 factors to ascertain whether an employment relationship exists between a worker and a purported employer. Generally, the test is applied to determine whether an individual is an independent contractor or an employee for federal employment tax purposes and not to determine whether each of two or more companies is a “co-employer.” Substantial weight is typically given to the question of whether the purported employer has the right to direct and control the details of an individual’s work. Among the factors that appear to have been considered more important by the IRS are:

- the employer’s degree of behavioral control (the extent of instructions, training and the nature of the work)
- the financial control or the economic aspects of the relationship
- the intended relationship of the parties (whether employee benefits are provided, whether any contracts exist, whether services are ongoing or for a project, whether there are any penalties for discharge/termination, and the frequency of the business activity)

ERISA Requirements. Employee pension and welfare benefit plans are also governed by ERISA. ERISA defines “employer” as “any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan.” ERISA defines the term “employee” as “any individual employed by an employer.” The United States Supreme Court has held that the common law test of employment must be applied to determine whether an individual is an employee or an independent contractor under ERISA. A definitive judicial interpretation of “employer” in the context of a PEO or employee leasing arrangement has not been established.

If Insperty were found not to be an employer with respect to worksite employees for ERISA purposes, its plans would not comply with ERISA. Further, as a result of such finding, Insperty and its plans would not enjoy, with respect to worksite employees, the preemption of state laws provided by ERISA and could be subject to varying state laws and regulations as well as to claims based upon state common laws. Even if such a finding were made, we believe we would not be materially adversely affected because we would endeavor to make available similar benefits at comparable costs.

In addition to ERISA and the Code provisions discussed herein, issues related to the relationship between Insperty and its worksite employees may also arise under other federal laws, including other federal income tax laws.

Patient Protection and Affordable Care Act. The PPACA was signed into law on March 23, 2010. The PPACA was subsequently amended on March 30, 2010, by the Reconciliation Act. The PPACA and the Reconciliation Act (collectively the “Act”) entail sweeping health care reforms with original staggered effective dates from 2010 through 2018, some of which were subsequently extended until as late as 2020. While the Act did not have a material adverse impact on our results of operations in 2017, the future impact of the following provisions or changes to the provisions, including any changes or a repeal that may be proposed by this Congressional session, is unknown at this time.

Beginning in 2014, the Act provided for the establishment of state insurance exchanges (“Exchanges”) to make health insurance available to individuals and small employers (initially defined as 100 employees or less). States had the option of building a state-based exchange, entering into a state-federal partnership exchange or accepting the federally-facilitated exchange. States that accept the federally-facilitated exchange can transition to a state-based exchange at a later date. The Exchanges provide consumers with educational services and information on available options and offer a variety of health plans. Small business tax credits and subsidies are available to qualifying

businesses and individuals who purchase health insurance through the Exchanges. As part of the Tax Cuts and Jobs Act enacted in December 2017, the requirements that individuals maintain health insurance coverage or pay a penalty, which was known as the individual mandate, was effectively eliminated beginning in 2019. At this time, the Exchanges, tax credits and subsidies have not had a material impact on our operations, but the impact of future changes to these provisions is unknown.

- 15 -

Table of Contents

Additionally in 2014, the Act ushered in a number of insurance market reforms for the small group and individual markets. The reforms required guaranteed issue and renewability of coverage, eliminated certain underwriting practices by issuers, consolidated the number of risk pools in each state and restricted the permissible factors and variable ranges of those factors that can be considered in determining health insurance premiums. Transition relief permitted states to delay the effective date of some of these reforms. At this time, we are unable to determine whether the insurance market reforms will have an adverse impact on our business operations, our ability to attract and retain clients, or our ability to increase service fees to offset any increased costs.

The health insurance industry became subject to additional excise taxes in 2014, and reinsurance taxes were imposed on insurers and third-party administrators for the purpose of helping to offset the cost for insurance covering high-risk individuals. As the policyholder, all or a portion of these increased costs were passed on to us by our carriers. At this time, these taxes have not had a material impact on our operations, but the impact of future changes to these provisions is unknown.

Effective January 1, 2015, “pay or play” requirements applied to large employers with at least 50 full-time and full-time equivalent employees in the prior calendar year (“Applicable Large Employers” or “ALEs”). ALEs who fail to offer “minimum essential coverage” satisfying minimum value and affordability requirements may be subject to a penalty if a full-time employee obtains coverage from an Exchange and receives a subsidy or tax credit for such coverage. While clients are responsible for employer pay or play health care mandates under the CSA, the Insperty Group Health Plan qualifies as minimum essential coverage and is designed to satisfy the minimum value and affordability requirements. Clients are not required to use the affordability safe harbor utilized by us.

Information contained in the Congressional Record, which specifically references PEOs, indicates that any pay or play penalties should apply separately to clients of a PEO and not at the PEO level. However, the Act and subsequently issued IRS guidance do not expressly address the issue of whether the pay or play penalties apply only at the client level or whether the penalties can be applied at the PEO level. At this time, we are unable to determine if pay or play penalties may be assessed against a PEO for coverage provided to worksite employees under a PEO sponsored plan. The effective date of the rules imposing excise taxes on employers and insurers who offer excessive health benefits under so-called “Cadillac plans” has been delayed until 2022. We anticipate taking appropriate steps to avoid, to the extent necessary and possible, benefits under our group health plan from triggering such excise taxes, which our carrier may pass on to us in the form of increased premiums. At this time, we are unable to determine the effect that the excise taxes will have on our ability to match pricing with any increased costs.

401(k) Retirement Plans. Our 401(k) Retirement Plans are operated pursuant to guidance provided by the IRS under Revenue Procedure 2002-21 and Revenue Procedure 2003-86, each of which provides guidance for the operation of defined contribution plans maintained by PEOs that benefit worksite employees. This guidance provides qualification standards for PEO plans which, if met, negate the inquiry of common law employer status for purposes of the exclusive benefit rule. All of Insperty’s 401(k) Retirement Plans have received determination letters from the IRS confirming the qualified status of the plans.

Employment Taxes

As a co-employer, Insperty assumes responsibility and liability for the payment of federal and state employment taxes with respect to wages and salaries paid to our worksite employees. There are essentially three types of federal employment tax obligations:

- withholding of income tax requirements governed by Code Section 3401, et seq.
- obligations under FICA, governed by Code Section 3101, et seq.
- obligations under FUTA, governed by Code Section 3301, et seq.

Under these Code sections, employers have the obligation to withhold and remit the employer portion and, where applicable, the employee portion of these taxes.

Code Section 3401, which applies to federal income tax withholding requirements, contains an exception to the general common law test applied to determine whether an entity is an “employer” for purposes of federal income tax withholding. Code Section 3401(d)(1) states that if the person for whom services are rendered does not have control of the payment of wages, the “employer” for this purpose is the person having control of the payment of wages. The Treasury regulations issued under Code Section 3401(d)(1) state that a third party can be deemed to be the employer

of workers under this section for income tax withholding purposes where the person for whom services are rendered does not have legal control of the payment of wages. While several courts have examined Code Section 3401(d)(1), its ultimate scope has not been

- 16 -

Table of Contents

delineated. Moreover, the IRS has to date relied extensively on the common law test of employment in determining liability for failure to comply with federal income tax withholding requirements.

Accordingly, while we believe that we can assume the withholding obligations for worksite employees, in the event we fail to meet these obligations, the client may be held ultimately liable for those obligations. While this interpretive issue has not to our knowledge discouraged clients from enrolling with Insperty, there can be no assurance that a definitive adverse resolution of this issue would not do so in the future. These interpretive uncertainties may also impact our ability to report employment taxes on our own account rather than the accounts of our clients.

The SBEA provides that a CPEO shall be treated as the employer under Subtitle C – Employment Taxes of the Code, and shall be responsible for reporting federal employment taxes rather than the CPEO clients. Following a delay in the implementation of the certification program, Insperty PEO Services, L.P. received its designation as a CPEO from the IRS in the second quarter of 2017, which designation was retroactively effective to January 1, 2017.

Unemployment Taxes

We record our state unemployment (“SUI”) tax expense based on taxable wages and tax rates assigned by each state. State unemployment tax rates vary by state and are determined, in part, based on Insperty’s prior years’ compensation experience in each state. Certain rates are determined, in part, by each client’s own compensation experience. In addition, states have the ability under law to increase unemployment tax rates, including retroactively, to cover deficiencies in the unemployment tax funds. Rate notices are typically provided by the states during, or prior to, the first quarter of each year; however, some notices are received later. Until we receive the final tax rate notices, we estimate our expected SUI rate in those particular states.

Employers in certain states are experiencing higher FUTA tax rates as a result of states not repaying their unemployment loans from the federal government in a timely manner. We are obligated to pay the federal government at a higher rate in these situations. As such, we estimate the additional tax owed in states that have had a history of not repaying their federal loans in a timely manner.

State Regulation

While some states do not explicitly regulate PEOs, 41 states have adopted provisions for licensing, registration, certification or recognition of PEOs, and several others are considering such regulation. Such laws vary from state to state but generally provide for monitoring the fiscal responsibility of PEOs, and in some cases codify and clarify the co-employment relationship for unemployment, workers’ compensation and other purposes under state law. We believe that we are in compliance with the material requirements in all 41 states that have such laws. Regardless of whether a state has licensing, registration or certification requirements for PEOs, we must comply with a number of other state and local regulations that could impact our operations.

Corporate Office Employees

We had approximately 2,900 corporate employees as of December 31, 2017. We believe our relations with our corporate employees are good. None of our corporate employees are covered by a collective bargaining agreement.

Intellectual Property

Insperty currently has registered trademarks, copyrights and other intellectual property. We believe that our trademarks as a whole are of considerable importance to our business.

ITEM 1A. RISK FACTORS.

The statements in this section describe the known material risks to our business and should be considered carefully.

Adverse Economic Conditions Could Negatively Affect Our Industry, Business and Results of Operations

The small and medium-sized business market is sensitive to changes in economic activity levels as well as the credit markets. As a result, the demand for the outsourced HR services we provide clients could be adversely impacted by weak economic conditions or difficulty obtaining credit. Current and prospective clients may respond to such conditions by reducing employment levels, compensation levels, employee benefit levels and outsourced HR services. In addition, during periods of weak economic conditions, current clients may have difficulty meeting their financial obligations to us and may select alternative HR services at more competitive rates than we offer. Such developments could adversely impact our financial condition, results of operations and future growth rates.

Table of Contents

We Assume Liability for Worksite Employee Payroll, Payroll Taxes and Benefits Costs and Are Responsible for Their Payment Regardless of the Amount Billed to or Paid by Our Clients

Under the CSA, we become a co-employer of worksite employees and assume the obligations to pay the salaries, wages and related benefits costs and payroll taxes of such worksite employees. We assume such obligations as a principal, not as an agent of the client. Our obligations include responsibility for:

• payment of the salaries and wages for work performed by worksite employees, regardless of whether the client timely pays us the associated service fee

• withholding and payment of federal and state payroll taxes with respect to wages and salaries reported by Insperty

• providing benefits to worksite employees even if our costs to provide such benefits exceed the fees the client pays us

If a client does not pay us, or if the costs of benefits we provide to worksite employees exceed the fees a client pays us, our ultimate liability for worksite employee payroll and benefits costs could have a material adverse effect on our financial condition or results of operations.

Increases in Health Insurance Costs or Inability to Secure Replacement Contracts on Competitive Terms Could Have a Material Adverse Effect on Our Financial Condition or Results of Operations

Maintaining health insurance plans that cover worksite employees is a significant part of our business. Our primary health insurance contract expires on December 31, 2019, subject to cancellation by either party upon 180 days' notice. In the event we are unable to secure replacement contracts on competitive terms, significant disruption to our business could occur.

Health insurance costs are in part determined by our claims experience and comprise a significant portion of our direct costs. If we experience an increase in the number or severity of claims, our health insurance costs could increase.

Claim activity levels and costs are impacted by a number of factors, including, but not limited to, macro-economic changes, proposed and enacted regulatory changes and medical outbreaks. Contractual arrangements with our clients limit or delay our ability to incorporate increases in costs into our service fees. As a result, such increases could have a material adverse effect on our financial condition or results of operations. For additional information related to our health insurance costs, please read Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates—Benefits Costs."

Health Care Reform Could Affect Our Health Insurance Plan and Could Lead to a Significant Disruption in Our Business

The PPACA was signed into law on March 23, 2010. The PPACA was subsequently amended on March 30, 2010 by the Reconciliation Act. The Act entails sweeping health care reforms with original staggered effective dates from 2010 through 2018, some of which were subsequently extended out as far as 2022. Some provisions in the Act still require the issuance of additional guidance from the U.S. Department of Health and Human Services ("HHS") and the states.

Beginning in 2014, a number of key provisions of the Act took effect, including the Exchanges, insurance market reforms and the imposition of excise taxes on the health insurance industry and reinsurance taxes on insurers and third-party administrators. Additionally, the pay or play penalties on Applicable Large Employers were fully phased-in by 2016. As part of the Tax Cuts and Jobs Act enacted in December 2017, the requirements that individuals maintain health insurance coverage or pay a penalty, which was known as the individual mandate, was effectively eliminated beginning in 2019. In January 2018, the excise tax for offering "Cadillac Plans" was further delayed until 2022. In addition, supporters in various states are advocating for adoption of healthcare-related reforms at the state level. Collectively, these items have the potential to significantly change the insurance marketplace for small and medium sized businesses and how employers provide insurance to employees. In addition, as a co-employer in the PEO relationship, we assume or share many of the employer-related responsibilities and assist our clients in complying with many employment-related governmental regulations. Generally, the Act and subsequently issued guidance by the IRS and HHS have not addressed or in some instances are unclear as to their application in the PEO relationship or whether such provisions should be applied at the PEO or client level.

Although we do not believe that the Act has had a material adverse effect on our benefit plans, business model or operations to date, the elimination of the penalty associated with the individual mandate and subsequent changes resulting from action that may be taken at the federal or state level, including repeal or repeal and replacement of the

Act as has been advocated by Congressional leaders and the administration of President Trump, may impact our benefit plans, business model and future results of operations. In future periods, changes may result in increased costs to us and could affect our ability to attract and retain clients. Additionally, contractual arrangements and competitive market conditions may limit or delay our

- 18 -

Table of Contents

ability to increase service fees to offset any associated potential increased costs. For additional information related to the Act, please read Item 1. “Business - Industry Regulations - Patient Protection and Affordable Care Act.” We are currently unable to determine whether potential future changes to the Act or other regulatory action, including at the state level, may adversely affect our business or market conditions.

Increases in Workers’ Compensation Costs or Inability to Secure Replacement Coverage on Competitive Terms Could Lead to a Significant Disruption to Our Business

Our workers’ compensation coverage has been provided through an arrangement with Chubb (formerly ACE American Insurance Company) since 2007. Under our current arrangement with Chubb, we have a financial responsibility to Chubb for the first \$1 million layer of claims per occurrence and for claims over \$1 million, up to a maximum aggregate amount of \$5 million per policy year for claims that exceed the first \$1 million. Chubb bears the financial responsibility for all claims in excess of these levels. The Chubb Program is a fully insured program whereby Chubb has the responsibility to pay all claims incurred under the policies regardless of whether we satisfy our responsibilities. For additional discussion of our policy with Chubb, please read Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates—Workers’ Compensation Costs.”

Workers’ compensation costs are a significant portion of our direct costs. If we were to experience an unexpected large increase in the number or severity of claims, our workers’ compensation costs could increase, which could have a material adverse effect on our results of operations or financial condition.

The current workers’ compensation coverage with Chubb expires on September 30, 2018. In the event we are unable to secure replacement coverage on competitive terms, significant disruption to our business could occur.

Our Ability to Adjust and Collect Service Fees for Increases in Unemployment Tax Rates May be Limited

We record our SUI tax expense based on taxable wages and tax rates assigned by each state. SUI tax rates vary by state and are determined, in part, based on prior years’ compensation experience in each state. Prior to the receipt of final tax rate notices, we estimate our expected SUI tax rate in those states for which tax rate notices have not yet been received for purposes of pricing. In a period of adverse economic conditions state unemployment funds may experience a significant increase in the number of unemployment claims. Accordingly, SUI tax rates would likely increase substantially. Some states have the ability under law to increase SUI tax rates retroactively to cover deficiencies in the unemployment fund.

In addition, FUTA may be retroactively increased in certain states in the event the state fails to timely repay federal unemployment loans. Employers in such states are experiencing higher FUTA tax rates as a result of not repaying their unemployment loans from the federal government in a timely manner. The Benefit Cost Ratio Add-On (“BCR”) is an additional tax on the FUTA wage base for employers in states that continue to have outstanding federal unemployment insurance loans beginning with the fifth year in which there is a balance due on the loan. States have the option to apply for a waiver before July 1st of the year in which the BCR is applicable.

Generally, our contractual agreements allow us to incorporate such statutory tax increases into our service fees upon the effective date of the rate change. However, our ability to fully adjust service fees in our billing systems and collect such increases over the remaining term of the clients’ contracts could be limited, resulting in a potential tax increase not being fully recovered. As a result, such increases could have a material adverse effect on our financial condition or results of operations.

Many of Our Contracts for Our PEO HR Outsourcing Solutions May be Canceled on Short Notice. Our Inability to Renew Client Contracts or Attract New Clients Could Materially and Adversely Affect Our Financial Conditions or Results of Operations

Our standard CSA can generally be canceled by us or the client with 30 days’ notice. Accordingly, the short-term nature of the CSA makes us vulnerable to potential cancellations by existing PEO HR Outsourcing Solution clients, which could materially and adversely affect our financial condition or results of operations. In addition, in the event we have a high proportion of terminating clients from our middle market client base (which are generally subject to CSAs with two-year terms), the financial impact of such an event could be significant due to the number of worksite employees involved and the longer time it takes to replace middle market clients. Also, our results of operations are dependent in part upon our ability to retain or replace our clients upon the termination or cancellation of the CSA. Our

client attrition rate was approximately 15% in 2017. There can be no assurance that the number of contract cancellations will continue at these levels and such cancellations may increase in the future due to various factors, including economic conditions in the markets we operate. Clients electing to purchase our services or electing an alternative solution often do so at the beginning of the calendar year. As a result, we typically experience our largest concentration of new client additions and attrition in the first quarter of each year.

- 19 -

Table of Contents

We May Be Subject to Liabilities for Client and Employee Actions

A number of legal issues remain unresolved with respect to the co-employment arrangement between a PEO and its worksite employees, including questions concerning the ultimate liability for violations of employment, payroll and discrimination laws. Our CSA establishes the contractual division of responsibilities between Insperty and our clients for various personnel management matters, including compliance with and liability under various governmental regulations.

Because we act as a co-employer, we may be subject to liability for violations of various employment, payroll and discrimination laws despite these contractual provisions, even if we do not participate in such violations. Although the CSA generally requires the client to indemnify us for certain liabilities attributable to the client's conduct, we may not be able to collect on such a contractual indemnification claim and thus may be responsible for satisfying such liabilities to the extent that such liabilities are not covered or insured against under our insurance policies. In addition, worksite employees may be deemed to be our agents, which may subject us to liability for the actions of such worksite employees.

Competition and Other Developments in the HR Services Industry May Impact Our Growth and/or Profitability

The human resources services industry, including the PEO industry, is highly fragmented. Many PEOs have limited operations and fewer than 1,000 worksite employees, but there are several industry participants that are comparable to our size or larger. We also encounter competition from "fee for service" companies such as payroll processing firms, insurance companies, human resources consultants and human resources technology solutions as well as cloud-based self-service bundled human resources offerings. Our competitors include the PEO divisions of large business services companies, such as Automatic Data Processing, Inc. and Paychex, Inc., and other national PEOs such as TriNet Group, Inc. In many cases, these competitors offer a reduced service PEO offering at a lower price than our PEO HR Outsourcing solutions. We expect that as the PEO industry grows and its regulatory framework becomes better established, well organized competition with greater resources than we have may enter the PEO market, possibly including large "fee for service" companies currently providing a more limited range of services. In addition, competitors may be able to offer or develop new technology-based lower service models that may require us to make substantial investments in order to effectively compete.

We offer a lower priced reduced service level PEO offering referred to as Workforce Synchronization in response to certain middle market client needs and the evolving PEO marketplace. As of December 2017, approximately 12% of our worksite employees were co-employed by Workforce Synchronization clients. In the event we were to experience a significant increase in the number of clients using the Workforce Synchronization offering or increased pricing pressures in the PEO marketplace without corresponding reductions in operating costs, our operating margins may decline, which could have a material adverse impact on our financial condition or results of operations.

Changes in Federal, State and Local Regulation or Our Inability to Obtain Licenses Under New Regulatory Frameworks Could Have a Material Adverse Effect on Our Results of Operations or Financial Condition

As a major employer, our operations are affected by numerous federal, state and local laws and regulations relating to labor, tax, benefit, insurance and employment matters. By entering into a co-employer relationship with employees assigned to work at client locations, we assume certain obligations and responsibilities of an employer under these laws. However, many of these current laws (such as the Act, ERISA and federal and state employment tax laws) do not specifically address the obligations and responsibilities of non-traditional employers such as PEOs, and the definition of "employer" under these laws is not uniform despite the SBEA having provided clarification under federal employment tax laws for CPEOs. In addition, many of the states in which we operate have not addressed the PEO relationship for purposes of compliance with applicable state laws governing the employer/employee relationship.

Any adverse application of new or existing federal or state laws to the PEO relationship with our worksite employees and client companies could have a material adverse effect on our results of operations or financial condition.

While some states do not explicitly regulate PEOs, 41 states have passed laws that have recognition, licensing, certification or registration requirements for PEOs and several other states are considering such regulation. Such laws vary from state to state, but generally provide for monitoring the fiscal responsibility of PEOs, and in some cases codify and clarify the co-employment relationship for unemployment, workers' compensation and other purposes under state law. In addition, the SBEA provides certain benefits for companies that qualify as a CPEO. While we

generally support licensing regulation because it serves to validate the PEO relationship, we may not be able to satisfy licensing requirements or other applicable regulations for all states. In addition, there can be no assurance that we will be able to renew our licenses in all states or that we will be able to maintain our CPEO designation.

- 20 -

Table of Contents

Geographic Market Concentration Makes Our Results of Operations Vulnerable to Regional Economic Factors
Our New York, California and Texas markets accounted for approximately 10%, 17% and 22% (including 10% in Houston), respectively, of our worksite employees for the year ended December 31, 2017. Accordingly, while we have a goal of expanding in our current markets and into new markets, for the foreseeable future, a significant portion of our revenues may be subject to economic factors specific to New York, California and Texas.

A Determination that a Client is Liable for Employment Taxes Not Paid by a PEO May Discourage Clients from Contracting with Us in the Future

Under the CSA, we assume sole responsibility and liability for paying federal employment taxes imposed under the Code with respect to wages and salaries we pay our worksite employees. There are essentially three types of federal employment tax obligations:

• income tax withholding requirements

• FICA

• FUTA

Under the Code, employers have the obligation to withhold and remit the employer portion and, where applicable, the employee portion of these taxes. The SBEA clarifies that a CPEO is treated as the employer for purposes of federal payroll taxes on wages it pays to worksite employees. Most states impose similar employment tax obligations on the employer. While the CSA provides that we have sole legal responsibility for making these tax contributions, the applicable state taxing authority could conclude that such liability cannot be completely transferred to us.

Accordingly, in the event that we fail to meet our tax withholding and payment obligations, the client may be held jointly and severally liable for those obligations. While this interpretive issue has not, to our knowledge, discouraged clients from enrolling with Insperty, a definitive adverse resolution of this issue may discourage clients from enrolling in the future.

Failure of Our Information Technology Systems, Including From Cyber Attacks and Data Breaches, Could Damage Our Reputation, Materially Disrupt Our Business Operations, and Increase Our Costs and Cause Losses

Many of the HR services offerings we provide to clients are conducted through a technology infrastructure using both internally developed and purchased commercial software, a wide variety of hardware infrastructure technologies, and a multi-carrier wide area network. The processing of payroll, benefits and other transactions is dependent upon this complex infrastructure, some of which is provided by third party vendors. Hardware or applications we develop or procure from third party vendors may contain defects in design or other problems that could unexpectedly compromise the confidentiality, integrity or availability of data or our systems. Any delays or failures caused by network outages, software or hardware failures, or other data processing disruptions, could result in our inability to timely process transactions. If such failures cause us to not meet client service expectations, we may lose existing clients and may have difficulty attracting new clients.

In connection with our HR services offerings, we collect, use, transmit and store large amounts of personal and business information about our worksite employees and clients, including payroll information, personal and business financial data, social security numbers, bank account numbers, tax information and other sensitive personal and business information. We are focused on ensuring that the technology infrastructure that we use safeguards and protects personal and business information. We have programs in place to prevent, detect and respond to data security incidents, and we take steps to require that our third party vendors protect sensitive information. Nonetheless, attacks on information technology systems continue to grow in frequency and sophistication, and we and our third party vendors are targeted by unauthorized parties using malicious tactics, code and viruses. Because the techniques used to obtain unauthorized access and disable or sabotage systems change frequently and may be difficult to detect for long periods of time, we and our third party vendors may be unable to anticipate these techniques or implement adequate preventive measures. As these threats continue to evolve, we may be required to invest significant additional resources to modify and enhance our information security and controls or to investigate and remediate any security vulnerabilities. While our technology infrastructure is designed to safeguard and protect personal and business information, we do not have the ability to monitor the implementation of similar safeguards by our vendors, clients or worksite employees.

Any cyber-attack, unauthorized intrusion, malicious software infiltration, network disruption, corruption of data, or theft of private or other sensitive information, or inadvertent acts by our own employees, could result in the disclosure or misuse of confidential or proprietary information, and could have a material adverse effect on our business operations or that of our clients, result in liability or regulatory sanction, or cause a loss of confidence in our ability to serve clients. Although we

- 21 -

Table of Contents

believe that we maintain a stringent program of information security and controls, the impact of a data security incident could have a material adverse effect on our business, results of operations and financial condition.

We are also subject to various federal and state laws, rules and regulations relating to the collection, use, transmission and security of personal and business information. Most states and the District of Columbia have enacted notification rules that may require notification to regulators, clients or employees in the event of a privacy breach. It is possible that these federal and states laws may be interpreted and applied in a manner that is inconsistent with our data practices. If so, in addition to the possibility of fines, this could result in an order requiring that we change our data practices, which could have a material adverse effect on our business. Complying with these various laws could cause us to incur substantial costs or require us to change our business practices in a manner adverse to our business. The future enactment of more restrictive laws, rules or regulations could have a material adverse impact on us through increased costs or restrictions on our businesses and noncompliance could result in regulatory penalties and significant liability.

The Failure of Our Insurance Carriers or Financial Institutions Could Have a Material Adverse Effect on Us

As part of our PEO HR Outsourcing solutions, we contract with various insurance carriers to provide insurance coverage including health insurance, workers' compensation insurance and employment practices liability insurance. In addition, we obtain insurance coverage for various commercial risks in our business such as property insurance, errors and omissions insurance, cyber liability insurance, general liability insurance, fiduciary liability insurance, automobile liability insurance, and directors' and officers' liability insurance. The failure of any insurance carrier providing such coverage could leave us exposed to uninsured risk and could have a material adverse effect on our business.

In conjunction with providing services to clients, we rely on financial institutions to electronically transfer funds for the collection of our comprehensive service fee as well as the payment of wages and associated payroll tax withholdings. Failure by these financial institutions, for any reason, to deliver their services in a timely manner could result in material interruptions to our operations, impact client relations, and result in significant penalties or liabilities to us.

New and Higher Federal, State and Local Taxes Could Have a Material and Adverse Impact on Our Financial Condition and Results of Operations

In times of economic slowdowns, states and municipalities in which we operate may experience reductions in tax revenues and corresponding budget deficits. In response to the budget shortfalls, many states and municipalities have in the past and may in the future increase or enact new taxes on businesses operating within their tax jurisdiction, including business activity taxes and income taxes. In addition, federal, state and local taxing agencies may increase their audit activity in an effort to identify additional tax revenues. New tax assessments on our operations could result in increased costs. Our ability to adjust our service fees and incorporate additional tax assessments into our billing system could be limited. As a result, such higher taxes could have a material adverse impact on our financial condition or results of operations.

Failure to Integrate or Realize the Expected Return on Our Acquisitions and Investments Could Have a Material Adverse Impact on Our Financial Condition or Results of Operations

We have adopted a strategy to market and sell additional products and services within and outside of traditional PEO HR Outsourcing solutions. As part of this strategy, periodically we make strategic long-term decisions to invest in and/or acquire new companies, business units or assets. Acquiring new businesses involves a number of risks such as over-valuation of the acquired companies, entering markets or businesses in which we have no prior experience, integrating the technology, operations, and personnel, diversion of management's attention from other business concerns and litigation resulting from the activities of the acquired company. The occurrence of one or more of these events could result in the loss of existing or prospective clients or employees, not achieving anticipated revenues or profitability, or impairment of acquired assets. Such developments could have a material impact to our financial condition, results of operations and future growth rates.

In connection with our goodwill impairment assessments, we recorded impairment charges of \$2.5 million in our Employment Screening reporting unit in 2014 and \$3.3 million in our Expense Management reporting unit in 2013. In addition, we recorded a \$2.7 million impairment charge related to our minority investment in The Receivables

Exchange in 2013. Based on market conditions or changes in operating plans, the fair value of our other acquired businesses could decline, requiring us to record additional impairment charges for all or portions of the investments.

Our Business Could Be Disrupted as a Result of Actions of Certain Stockholders

If any of our stockholders commence a proxy contest, advocate for change, make public statements critical of our performance or business, or engage in other similar activities, then our business could be adversely affected because we may have difficulty attracting and retaining clients due to perceived uncertainties as to our future direction and negative public

- 22 -

Table of Contents

statements about our business; responding to proxy contests and other similar actions by stockholders is likely to result in us incurring substantial additional costs and significantly divert the attention of management and our employees; and, if individuals are elected to our Board with a specific agenda, the execution of our strategic plan may be disrupted or a new strategic plan altogether may be implemented, which could have a material adverse impact on our business, financial condition or results of operations. Further, any of these matters or any such actions by stockholders may impact and result in volatility of the price of our common stock.

ITEM 1B. UNRESOLVED STAFF COMMENTS.

None.

ITEM 2. PROPERTIES.

We believe our current real estate and facilities are adequate for the purposes for which they are intended and provide for further expansion to accommodate our long-term growth and expansion goals. We believe that short-term leased facilities are readily available if needed to accommodate near-term needs if they arise. We will continue to evaluate the need for additional facilities based on the extent of our product and service offerings, the rate of client growth, the geographic distribution of our client base and our long-term service delivery requirements.

Corporate Facilities

Our corporate headquarters is located in Kingwood, Texas, in a campus-style facility. This 33-acre company-owned office campus includes approximately 9 acres of undeveloped land for future expansion. Development and support operations are located in the Kingwood facility.

In April 2017, we completed the construction of an additional 104,000 square foot office facility located on our corporate campus, which now comprises a total of 431,000 square feet. We relocated personnel from our Houston service center to this new facility in 2017.

We have hosting facilities, totaling approximately 2,000 square feet, located at two separate leased facilities. The hosting facilities house the majority of our business applications, telecommunications equipment and network equipment. The facilities, located in Bryan, Texas and The Woodlands, Texas, are under lease until 2019 and 2022, respectively.

Service Centers

We currently have four regional service centers located in Atlanta, Dallas, Houston and Los Angeles.

The Atlanta service center, which currently services approximately 34% of our worksite employee base, is located in a 40,500 square foot facility under lease until 2023.

The Dallas service center, which currently services approximately 23% of our worksite employee base, is located in a 42,500 square foot facility under lease until 2023. In addition to the service center operations, the facility also contains sales operations.

The Houston service center, which currently services approximately 20% of our worksite employee base, is located on our corporate campus.

The Los Angeles service center, which currently services approximately 23% of our worksite employee base, is located in a 38,000 square foot facility under lease until 2019.

Sales Offices

As of December 31, 2017, we had sales and service personnel in 53 facilities located in 29 sales markets throughout the United States. All of the facilities are leased and some are shared by multiple sales offices and/or client service personnel. As of December 31, 2017, we had 60 PEO HR Outsourcing solutions sales offices in these 29 markets. To take advantage of economic efficiencies, multiple sales offices may share a physical location. Each sales office is typically staffed by six to eight BPAs, a district sales manager and an office administrator. In addition, we have placed certain client service personnel in a majority of our sales markets to provide high-quality, localized service to our clients in those major markets. We expect to continue placing client service personnel in sales markets as a critical mass of clients is attained in each market.

Table of Contents

ITEM 3. LEGAL PROCEEDINGS.

We are not a party to any material pending legal proceedings other than ordinary routine litigation incidental to our business that we believe would not have a material adverse effect on our financial condition or results of operations, except as discussed in Note 13 to the Consolidated Financial Statements, "Commitments and Contingencies," which is incorporated herein by reference.

ITEM S-K 401 (b). EXECUTIVE OFFICERS OF THE REGISTRANT.

The following table sets forth the names, ages (as of February 5, 2018) and positions of Insperty's executive officers:

Name	Age	Position
Paul J. Sarvadi	61	Chairman of the Board and Chief Executive Officer
Richard G. Rawson	69	President
A. Steve Arizpe	60	Executive Vice President of Client Services and Chief Operating Officer
Jay E. Mincks	64	Executive Vice President of Sales and Marketing
Douglas S. Sharp	56	Senior Vice President of Finance, Chief Financial Officer and Treasurer
Daniel D. Herink	51	Senior Vice President of Legal, General Counsel and Secretary

Paul J. Sarvadi has served as Chairman of the Board and Chief Executive Officer since August 2003. Mr. Sarvadi co-founded Insperty in 1986 and served as Vice President and Treasurer of Insperty from its inception in 1986 through April 1987, as Vice President from April 1987 through 1989 and as President and Chief Executive Officer from 1989 to August 2003. Prior to founding Insperty, Mr. Sarvadi started and operated several small businesses. Mr. Sarvadi has served as President of NAPEO and was a member of its Board of Directors for five years. Mr. Sarvadi was selected as the 2001 National Ernst & Young Entrepreneur Of The Year[®] for service industries. In 2004, he received the Conn Family Distinguished New Venture Leader Award from Mays Business School at Texas A&M University. In 2007, he was inducted into the Texas Business Hall of Fame.

Richard G. Rawson is President of Insperty and a Class III director. He has been a director of Insperty since 1989 and has been President since August 2003. Before being elected President, he served as Executive Vice President of Administration, Chief Financial Officer and Treasurer of Insperty from February 1997 until August 2003. Prior to that, he served as Senior Vice President, Chief Financial Officer and Treasurer of Insperty since 1989. Prior to joining Insperty in 1989, Mr. Rawson served as a Senior Financial Officer and Controller for several companies in the manufacturing and seismic data processing industries. Mr. Rawson has served NAPEO as Chairman of the Accounting Practices Committee and several other offices and became President in 1999-2000. Mr. Rawson has a Bachelor of Business Administration in finance from the University of Houston and currently serves as a board member for the C.T. Bauer College of Business. Mr. Rawson announced that he will retire as an employee and from his position as President on May 18, 2018, after having served as an executive officer of Insperty for over 28 years. Mr. Rawson will continue to serve as a member of our Board.

A. Steve Arizpe has served as Executive Vice President of Client Services and Chief Operating Officer since August 2003. He joined Insperty in 1989 and has served in a variety of roles, including Houston Sales Manager, Regional Sales Manager and Vice President of Sales. Prior to joining Insperty, Mr. Arizpe served in sales and sales management roles for NCR Corporation and Clarke-American. He has also served as a director of the Texas Chapter of NAPEO. Mr. Arizpe graduated from Texas A&M University in 1979, earning his degree in Business Management. Jay E. Mincks has served as Executive Vice President of Sales and Marketing since January 1999. Mr. Mincks served as Vice President of Sales and Marketing from February 1997 through January 1999. He joined Insperty in 1990 and has served in a variety of other roles, including Houston Sales Manager and Regional Sales Manager for the Western United States. Prior to joining Insperty, Mr. Mincks served in a variety of positions, including management positions, in the sales and sales training fields with various large companies. He holds a business degree from the University of Houston.

Douglas S. Sharp has served as Senior Vice President of Finance, Chief Financial Officer and Treasurer since May 2008. He served as Vice President of Finance, Chief Financial Officer and Treasurer from August 2003 until May 2008. Mr. Sharp joined Insperty in January 2000 as Vice President of Finance and Controller. From July 1994 until he joined Insperty, he served as Chief Financial Officer for Rimkus Consulting Group, Inc. Prior to that, he served as Controller for a small publicly held company; as Controller for a software company; and as an Audit Manager for

Ernst & Young LLP. Mr. Sharp has served as a member of the Accounting Practices Committee of NAPEO. Mr. Sharp is also a certified public accountant.

- 24 -

Table of Contents

Daniel D. Herink has served as Senior Vice President of Legal, General Counsel and Secretary since May 2008. Mr. Herink joined Insperty in 2000 as Assistant General Counsel and was promoted to Associate General Counsel in 2002. He was elected to his current position in May 2007. Mr. Herink previously served as an attorney at Rodriguez, Colvin & Chaney, L.L.P. and McGinnis, Lochridge & Kilgore, L.L.P. He earned his Bachelor of Science degree in business administration from the University of Nebraska and a Doctorate of Jurisprudence from The University of Texas School of Law, where he was a member of the Texas Law Review and The Order of the Coif. Mr. Herink is also a certified public accountant.

- 25 -

Table of Contents

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Price Range of Common Stock

Our common stock is traded on the New York Stock Exchange under the symbol "NSP." As of February 5, 2018, there were 379 holders of record of our common stock. This number does not include stockholders for whom shares were held in "nominee" or "street name." The following table sets forth the high and low sales prices for the common stock as reported on the New York Stock Exchange transactional tape. These amounts have been adjusted to reflect the two-for-one stock split of our common stock effected on December 18, 2017 in the form of a 100% stock dividend.

2017	High	Low	Dividends per Share	
First Quarter	\$45.28	\$34.60	\$ 0.125	
Second Quarter	46.83	35.16	0.150	
Third Quarter	45.13	34.88	0.150	
Fourth Quarter	60.35	43.80	1.150	(1)
2016				
First Quarter	\$26.16	\$20.92	\$ 0.110	
Second Quarter	38.62	25.31	0.125	
Third Quarter	41.09	32.35	0.125	
Fourth Quarter	38.35	32.28	0.125	

(1)Includes a \$1.00 per share special dividend.

Dividend Policy

During 2017 and 2016, we paid dividends of \$65.8 million and \$20.6 million, respectively including a special cash dividend of \$41.7 million paid in the fourth quarter of 2017. The payment of dividends is made at the discretion of our Board and depends upon our operating results, financial condition, capital requirements, general business conditions and such other factors as our Board deems relevant.

Issuer Purchases of Equity Securities

The following table provides information about our purchases of Insperty common stock during the three months ended December 31, 2017:

Period	Total Number of Shares Purchased ⁽¹⁾⁽²⁾	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program ⁽¹⁾	Maximum Number of Shares that may yet be Purchased under the Program ⁽¹⁾
10/01/2017 – 10/31/2017	—	\$ —	—	1,747,564
11/01/2017 – 11/30/2017	—	—	—	2,747,564
12/01/2017 – 12/31/2017	202,888	57.00	70,000	2,677,564
Total	202,888	\$ 57.00	70,000	

(1) Our Board has approved a program to repurchase shares of our outstanding common stock, including an additional one million shares authorized for repurchase in November 2017. During the three months ended December 31, 2017, 70,000 shares were repurchased under the program. As of December 31, 2017, we were authorized to repurchase an additional 2,677,564 shares under the program. Unless terminated earlier by resolution of the Board, the repurchase program will expire when we have repurchased all the shares authorized for repurchase under the

repurchase program.

- 26 -

Table of Contents

During the three months ended December 31, 2017, 132,888 shares of restricted stock were withheld to satisfy (2) tax-withholding obligations arising in conjunction with the vesting of restricted stock. The required withholding is calculated using the closing sales price reported by the New York Stock Exchange on the date prior to the applicable vesting date. These shares are not subject to the repurchase program described above.

Performance Graph

The following graph compares our cumulative total stockholder return since December 31, 2012, with the S&P Smallcap 600 Index and the S&P 1500 Composite Human Resources and Employment Services Index. The graph assumes that the value of the investment in our common stock and each index (including reinvestment of dividends) was \$100 on December 31, 2012.

- 27 -

Table of Contents

	12/12	12/13	12/14	12/15	12/16	12/17
Insperty, Inc.	100.00	113.38	115.75	167.40	250.36	417.13
S&P Smallcap 600	100.00	141.31	149.45	146.50	185.40	209.94
S&P 1500 Composite Human Resources and Employment Services	100.00	167.71	175.38	181.34	201.09	257.35

This graph shall not be deemed “filed” for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended (the “Exchange Act”), or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Exchange Act, regardless of any general incorporation language in such filing.

Table of Contents

ITEM 6. SELECTED FINANCIAL DATA.

The selected consolidated financial data set forth below should be read in conjunction with the Consolidated Financial Statements and accompanying Notes and Item 7. “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” All per share data has been adjusted to reflect the two-for-one stock split of our common stock effected on December 18, 2017 in the form of a stock dividend.

	Year ended December 31,				
	2017	2016	2015	2014	2013
	(in thousands, except per share and statistical data)				
Income Statement Data:					
Revenues ⁽¹⁾	\$3,300,223	\$2,941,347	\$2,603,614	\$2,357,788	\$2,256,112
Gross profit	572,731	491,610	437,867	403,805	393,251
Operating income	129,941	106,306	65,699	⁽²⁾ 47,474	⁽³⁾ 56,223
Net income	84,402	65,991	39,390	28,004	⁽⁵⁾ 32,032
Diluted net income per share of common stock ⁽⁶⁾	2.01	1.54	0.79	0.53	⁽⁷⁾ 0.63
Adjusted net income ⁽⁸⁾	103,005	76,718	54,519	36,734	42,289
Adjusted diluted net income per share of common stock ⁽⁶⁾⁽⁸⁾	2.45	1.79	1.10	0.72	0.83
Adjusted EBITDA ⁽⁸⁾	177,681	141,183	110,014	84,124	92,303
Balance Sheet Data:					
Working capital	\$52,454	\$39,364	\$54,337	\$66,742	\$120,445
Total assets	1,063,695	907,174	784,912	792,595	758,864
Total debt	104,400	104,400	—	—	—
Total stockholders’ equity	66,321	60,525	172,455	204,096	253,272
Cash dividends per share ⁽⁶⁾	1.58	⁽⁹⁾ 0.49	0.43	1.37	⁽⁹⁾ 0.34
Statistical Data:					
Average number of worksite employees paid per month during period	182,696	165,850	145,830	130,718	127,517
Revenues per worksite employee per month ⁽¹⁰⁾	\$1,505	\$1,478	\$1,488	\$1,503	\$1,474
Gross profit per worksite employee per month	261	247	250	257	257
Operating income per worksite employee per month	59	53	38	30	37
Adjusted EBITDA per worksite employee per month ⁽⁸⁾	81	71	63	54	60

Gross billings of \$20.174 billion, \$17.933 billion, \$15.806 billion, \$14.187 billion and \$13.462 billion, less

⁽¹⁾ worksite employee payroll cost of \$16.874 billion, \$14.992 billion, \$13.202 billion, \$11.829 billion and \$11.206 billion, respectively.

Includes non-cash impairment and other charges in the first and second quarters of 2015 of \$9.8 million and \$1.3

⁽²⁾ million, respectively, partially offset by a reduction of \$0.6 million in the fourth quarter of 2015. Please read Note 6 to the Consolidated Financial Statements, “Impairment Charges and Other,” for additional information.

⁽³⁾ Includes a non-cash impairment charge in the second quarter of 2014 of \$2.5 million. Also includes a non-cash charge in 2014 of \$1.2 million.

⁽⁴⁾ Includes non-cash impairment charges of \$3.3 million in 2013.

Table of Contents

- (5) Includes a non-cash impairment charge in 2013 of \$2.7 million. Also includes a \$2.0 million tax benefit in 2013 related to tax years 2009 through 2012.
- (6) Adjusted to reflect the two-for-one split of our common stock effected on December 18, 2017 as a stock dividend.
- (7) Includes the impact of dividends exceeding earnings under the two-class method, resulting in a \$0.03 earnings per share decrease in 2014.
These are non-GAAP measures used by management to analyze Insperty's performance. Please read Item 7.
- (8) "Management's Discussion and Analysis of Financial Condition and Results of Operations – Non-GAAP Financial Measures" for a reconciliation of the non-GAAP financial measures to the most directly comparable financial measures calculated and presented in accordance with GAAP.
- (9) Includes a \$1.00 per share special dividend paid in both the fourth quarters of 2017 and 2014.
- (10) Gross billings of \$9,202, \$9,011, \$9,032, \$9,044 and \$8,797 per worksite employee per month, less payroll cost of \$7,697, \$7,533, \$7,544, \$7,541 and \$7,323 per worksite employee per month, respectively.

Table of Contents

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

You should read the following discussion in conjunction with our Consolidated Financial Statements and related Notes included elsewhere in this annual report. Historical results are not necessarily indicative of trends in operating results for any future period.

The statements contained in this annual report that are not historical facts are forward-looking statements that involve a number of risks and uncertainties. The actual results of the future events described in such forward-looking statements in this annual report could differ materially from those stated in such forward-looking statements. Among the factors that could cause actual results to differ materially are the risks and uncertainties discussed in Item 1A. Risk Factors and the uncertainties set forth from time to time in our other public reports and filings and public statements.

Overview

Our long-term strategy is to provide the best small and medium-sized businesses in the United States with our specialized human resources service offering and to leverage our buying power and expertise to provide additional valuable services to clients. Our most comprehensive HR services offerings are provided through our Workforce Optimization[®] and Workforce Synchronization[™] solutions (together, our PEO HR Outsourcing solutions), which encompass a broad range of human resources functions, including payroll and employment administration, employee benefits, workers' compensation, government compliance, performance management and training and development services. Our overall operating results can be measured in terms of revenues, payroll costs, gross profit or operating income per worksite employee per month. We often use the average number of worksite employees paid during a period as our unit of measurement in analyzing and discussing our results of operations.

In addition to our PEO HR Outsourcing solutions, we offer a number of other business performance solutions, including Human Capital Management, Payroll Services, Time and Attendance, Performance Management, Organizational Planning, Recruiting Services, Employment Screening and Expense Management Services, Retirement Services and Insurance Services, many of which are offered via desktop applications and cloud-based delivery models. These other products or services are offered separately, as a bundle, or along with our PEO HR Outsourcing solutions.

We ended 2017 averaging 189,513 paid worksite employees in the fourth quarter, which represents a 9.8% increase over the fourth quarter of 2016. Approximately 23.6% and 24.5% of our average paid worksite employees were in our middle market sector for the years ended December 31, 2017 and 2016, respectively, which is generally defined as companies with 150 to 2,000 worksite employees. We expect the average number of paid worksite employees per month to be between 193,500 and 195,300 in the first quarter of 2018.

Our average gross profit per worksite employee per month was \$261 in 2017 and \$247 in 2016.

Operating expenses increased 14.9% in 2017 to \$442.8 million. On a per worksite employee per month basis, operating expenses increased from \$194 in 2016 to \$202 in 2017. Adjusted operating expenses increased 14.5% in 2017 to \$440.8 million. On a per worksite employee per month basis, adjusted operating expenses increased from \$193 in 2016 to \$201 in 2017.

Net income in 2017 was \$84.4 million, a 27.9% increase compared to 2016. Our adjusted net income in 2017 was \$103.0 million, a 34.3% increase compared to 2016. Our adjusted EBITDA increased 25.9% over 2016 to \$177.7 million.

Our adjusted EBITDA per worksite employee per month increased 14.1% from \$71 in 2016 to \$81 in 2017.

We ended 2017 with working capital of \$52.5 million. During 2017, we paid \$65.8 million in dividends and repurchased shares of our common stock at a cost of \$38.7 million.

Revenues

We account for our revenues in accordance with Accounting Standards Codification ("ASC") 605-45, Revenue Recognition. Our PEO HR Outsourcing solutions gross billings to clients include the payroll cost of each worksite employee at the client location and a markup computed as a percentage of each worksite employee's payroll cost. We invoice the gross billings concurrently with each periodic payroll of our worksite employees. Revenues, which exclude the payroll cost component of gross billings, and therefore, consist solely of the markup, are recognized ratably over the payroll period as worksite employees perform their service at the client worksite. This markup

includes pricing components associated with our estimates of payroll taxes, benefits and workers' compensation costs, plus a separate component related to our HR services. We

- 31 -

Table of Contents

include revenues that have been recognized but not invoiced in unbilled accounts receivable on our Consolidated Balance Sheets.

Our revenues are primarily dependent on the number of clients enrolled, the resulting number of worksite employees paid each period and the number of worksite employees enrolled in our benefit plans. Because our total markup is computed as a percentage of payroll cost, certain revenues are also affected by the payroll cost of worksite employees, which may fluctuate based on the composition of the worksite employee base, inflationary effects on wage levels and differences in the local economies of our markets.

Direct Costs

The primary direct costs associated with revenue-generating activities for our PEO HR Outsourcing solutions are:

- employment-related taxes (“payroll taxes”)
- costs of employee benefit plans
- workers’ compensation costs

Payroll taxes consist of the employer’s portion of Social Security and Medicare taxes under FICA, federal unemployment taxes and state unemployment taxes. Payroll taxes are generally paid as a percentage of payroll cost. The federal unemployment tax rates are defined by federal regulations. State unemployment tax rates are subject to claim histories and vary from state to state.

Employee benefits costs are comprised primarily of health insurance premiums and claims costs (including dental and pharmacy costs), but also include costs of other employee benefits such as life insurance, vision care, disability insurance, education assistance, adoption assistance, a flexible spending account program and a work-life program. Workers’ compensation costs include administrative and risk charges paid to the insurance carrier, and claims costs, which are driven primarily by the frequency and severity of claims.

Gross Profit

Our gross profit per worksite employee is primarily determined by our ability to accurately estimate and control direct costs and our ability to incorporate changes in these costs into the gross billings charged to PEO HR Outsourcing solutions clients, which are subject to pricing arrangements that are typically renewed annually. We use gross profit per worksite employee per month as our principal measurement of relative performance at the gross profit level.

Operating Expenses

Salaries, wages and payroll taxes – Salaries, wages and payroll taxes are primarily a function of the number of corporate employees, their associated average pay and any additional incentive compensation. Our corporate employees include client services, sales and marketing, benefits, legal, finance, information technology, administrative support personnel and those associated with our other products and services.

Stock-based compensation – Our stock-based compensation relates to the recognition of non-cash compensation expense over the vesting period of restricted stock and long-term incentive plan awards.

Commissions – Commissions expense consists primarily of amounts paid to sales managers and BPAs. Commissions are based on new accounts sold and a percentage of revenue generated by such personnel.

Advertising – Advertising expense primarily consists of media advertising and other business promotions in our current and anticipated sales markets, including the Insperty Invitational™ presented by UnitedHealthcare® sponsorship.

General and administrative expenses – Our general and administrative expenses primarily include:

- rent expenses related to our service centers and sales offices
- outside professional service fees related to legal, consulting and accounting services
- administrative costs, such as postage, printing and supplies
- employee travel and training expenses

Table of Contents

technology and facility repairs and maintenance costs

Depreciation and amortization – Depreciation and amortization expense is primarily a function of our capital investments in corporate facilities, service centers, sales offices, technology infrastructure and that associated with our acquisitions.

Impairment charges and other – Impairment charges and other consist of non-cash expense associated with the decline in fair value of long-lived and intangible assets, including goodwill. Please read Note 1 “Accounting Policies” and Note 6 “Impairment Charges and Other,” to the Consolidated Financial Statements for additional information.

Other Income (Expense)

Other income (expense) includes interest charges incurred in connection with borrowings under our credit facility and interest income earned on our cash, cash equivalents and marketable securities. Please read “—Liquidity and Capital Resources” for additional information.

Income Taxes

On December 22, 2017, the Tax Cuts and Jobs Act (the “2017 Tax Reform Act”) was signed into law. The 2017 Tax Reform Act significantly changes U.S. corporate income tax laws by, among other things, reducing the U.S. corporate income tax rate from 35% to 21% beginning in 2018. As a result, we remeasured our deferred tax assets at the new lower corporate income tax rate and recorded a non-cash tax charge of \$2.5 million in 2017. Our provision for income taxes typically differs from the U.S. statutory rate of 35%, due primarily to state income taxes, non-deductible expenses and various tax credits. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities used for financial reporting purposes and the amounts used for income tax purposes. Significant items resulting in deferred income taxes include prepaid assets, accruals for workers’ compensation expenses, stock-based compensation, software development costs, accrued incentive compensation and depreciation. Changes in these items are reflected in our financial statements through a deferred income tax provision. Please read Note 8 to the Consolidated Financial statements, “Income Taxes,” for additional information.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based upon our Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”). The preparation of these financial statements requires our management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate these estimates, including those related to health and workers’ compensation insurance claims experience, client bad debts, income taxes, property and equipment, goodwill and other intangibles, and contingent liabilities. We base these estimates on historical experience and on various other assumptions that management believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

We believe the following accounting policies are critical and/or require significant judgments and estimates used in the preparation of our Consolidated Financial Statements:

Benefits costs – We provide group health insurance coverage to our worksite employees through a national network of carriers including United, UnitedHealthcare of California, Kaiser Permanente, Blue Shield of California, HMSA BlueCross BlueShield of Hawaii and Tufts, all of which provide fully insured policies or service contracts.

The health insurance contract with United provides the majority of our health insurance coverage. As a result of certain contractual terms, we have accounted for this plan since its inception using a partially self-funded insurance accounting model. Accordingly, we record the costs of the United plan, including an estimate of the incurred claims, taxes and administrative fees (collectively the “Plan Costs”), as benefits expense in the Consolidated Statements of Operations. The estimated incurred claims are based upon: (i) the level of claims processed during the quarter; (ii) estimated completion rates based upon recent claim development patterns under the plan; and (iii) the number of participants in the plan, including both active and COBRA enrollees. Each reporting period, changes in the estimated ultimate costs resulting from claim trends, plan design and migration, participant demographics and other factors are incorporated into the benefits costs.

Additionally, since the plan's inception, under the terms of the contract, United establishes cash funding rates 90 days in advance of the beginning of a reporting quarter. If the Plan Costs for a reporting quarter are greater than the premiums paid and owed to United, a deficit in the plan would be incurred and we would accrue a liability for the excess costs on our Consolidated Balance Sheets. On the other hand, if the Plan Costs for the reporting quarter are less than the premiums paid

- 33 -

Table of Contents

and owed to United, a surplus in the plan would be incurred and we would record an asset for the excess premiums on our Consolidated Balance Sheets. The terms of the arrangement with United require us to maintain an accumulated cash surplus in the plan of \$9.0 million, which is reported as long-term prepaid insurance. As of December 31, 2017, Plan Costs were less than the premiums paid and owed to United by \$12.1 million. As this amount is in excess of the agreed-upon \$9.0 million surplus maintenance level, the \$3.1 million difference is included in prepaid health insurance costs, a current asset, on our Consolidated Balance Sheets. In addition, the premiums owed to United at December 31, 2017, were \$21.9 million, which is included in accrued health insurance costs, a current liability, on our Consolidated Balance Sheets.

We believe that recent claims activity is representative of incurred and paid trends during the reporting period. The estimated completion rate and annual trend used to compute incurred but not reported claims involves a significant level of judgment. Accordingly, an increase (or decrease) in the completion rate or annual trend used to estimate the incurred claims would result in an increase (or decrease) in benefits costs and net income would decrease (or increase) accordingly.

The following table illustrates the sensitivity of changes in the completion rate and annual trend on our estimate of total benefit costs of \$1.5 billion in 2017:

Change in Completion Rate and Annual Trend	Change in Benefits Costs (in thousands)	Change in Net Income (in thousands)
(2.5)%	\$(18,458)	\$ 11,979
(1.0)%	(7,381)	4,790
1.0%	7,381	(4,790)
2.5%	18,458	(11,979)

Workers' compensation costs – Since 2007, our workers' compensation coverage has been provided through our arrangement with Chubb. The Chubb Program is fully insured in that Chubb has the responsibility to pay all claims incurred under the policy regardless of whether we satisfy our responsibilities. Under the Chubb Program, we have financial responsibility to Chubb for the first \$1 million layer of claims per occurrence and, for claims over \$1 million, up to a maximum aggregate amount of \$5 million per policy year for claims that exceed \$1 million. Our coverage from September 1, 2003 through September 30, 2007 was provided through selected member insurance companies of American International Group, Inc.

Because we bear the financial responsibility for claims up to the levels noted above, such claims, which are the primary component of our workers' compensation costs, are recorded in the period incurred. Workers' compensation insurance includes ongoing health care and indemnity coverage whereby claims are paid over numerous years following the date of injury. Accordingly, the accrual of related incurred costs in each reporting period includes estimates, which take into account the ongoing development of claims and therefore requires a significant level of judgment.

We utilize a third-party actuary to estimate our loss development rate, which is primarily based upon the nature of worksite employees' job responsibilities, the location of worksite employees, the historical frequency and severity of workers' compensation claims, and an estimate of future cost trends. Each reporting period, changes in the actuarial assumptions resulting from changes in actual claims experience and other trends are incorporated into our workers' compensation claims cost estimates. During the years ended December 31, 2017 and 2016, we reduced accrued workers' compensation costs by \$16.3 million and \$10.9 million, respectively, for changes in estimated losses related to prior reporting periods. Workers' compensation cost estimates are discounted to present value at a rate based upon the U.S. Treasury rates that correspond with the weighted average estimated claim payout period (the average discount rate was 1.6% in 2017 and 1.1% in 2016) and are accreted over the estimated claim payment period and included as a component of direct costs in our Consolidated Statements of Operations.

Our claim trends could be greater than or less than our prior estimates, in which case we would revise our claims estimates and record an adjustment to workers' compensation costs in the period such determination is made. If we

were to experience any significant changes in actuarial assumptions, our loss development rates could increase (or decrease), which would result in an increase (or decrease) in workers' compensation costs and a resulting decrease (or increase) in net income reported in our Consolidated Statements of Operations.

- 34 -

Table of Contents

The following table illustrates the sensitivity of changes in the loss development rate on our estimate of workers' compensation costs totaling \$81.0 million in 2017:

Change in Loss Development Rate	Change in Workers' Compensation Costs (in thousands)	Change in Net Income (in thousands)
(5.0)%	\$ (3,903)	\$ 2,533
(2.5)%	(1,951)	1,266
2.5%	1,951	(1,266)
5.0%	3,903	(2,533)

At the beginning of each policy period, the workers' compensation insurance carrier establishes monthly funding requirements comprised of premium costs and funds to be set aside for payment of future claims ("claim funds"). The level of claim funds is primarily based upon anticipated worksite employee payroll levels and expected workers' compensation loss rates, as determined by the insurance carrier. Monies funded into the program for incurred claims expected to be paid within one year are recorded as restricted cash, a short-term asset, while the remainder of claim funds are included in deposits, a long-term asset in our Consolidated Balance Sheets. In 2017, we received \$22.7 million for the return of excess claim funds related to the workers' compensation program, which decreased deposits. As of December 31, 2017, we had restricted cash of \$41.1 million and deposits of \$154.2 million. We have estimated and accrued \$207.6 million in incurred workers' compensation claim costs as of December 31, 2017. Our estimate of incurred claim costs expected to be paid within one year are recorded as accrued workers' compensation costs and is included in short-term liabilities, while our estimate of incurred claim costs expected to be paid beyond one year is included in long-term liabilities on our Consolidated Balance Sheets.

Contingent liabilities – We accrue and disclose contingent liabilities in our Consolidated Financial Statements in accordance with ASC 450-10, Contingencies. GAAP requires accrual of contingent liabilities that are considered probable to occur and that can be reasonably estimated. For contingent liabilities that are considered reasonably possible to occur, financial statement disclosure is required, including the range of possible loss if it can be reasonably determined. From time to time we disclose in our financial statements issues that we believe are reasonably possible to occur, although we cannot determine the range of possible loss in all cases. As issues develop, we evaluate the probability of future loss and the potential range of such losses. If such evaluation were to determine that a loss was probable and the loss could be reasonably estimated, we would be required to accrue our estimated loss, which would reduce net income in the period that such determination was made.

Deferred taxes – We have recorded a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized. While we have considered future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for the valuation allowance, our ability to realize our deferred tax assets could change from our current estimates. If we determine that we would be able to realize our deferred tax assets in the future in excess of the net recorded amount, an adjustment to reduce the valuation allowance would increase net income in the period that such determination is made. Likewise, should we determine that we will not be able to realize all or part of our net deferred tax assets in the future, an adjustment to increase the valuation allowance would reduce net income in the period such determination is made. In 2017, we reduced our deferred tax assets by \$2.5 million due to the enactment of the 2017 Tax Reform Act. This is a provisional amount reflecting our estimate of the impact of the income tax effect of the 2017 Tax Reform Act on our financial statements as of December 31, 2017. After we finalize certain tax positions when we file our 2017 US tax return, we will be able to conclude whether any further adjustments are required to our net deferred tax asset balance of \$4.3 million as of December 31, 2017. Any adjustments to these provisional amounts will be reported as a component of income tax expense in the reporting period the adjustments are made, which will be no later than the fourth quarter of 2018.

Allowance for doubtful accounts – We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our clients to pay their comprehensive service fees. We believe that the success of our business is heavily dependent on our ability to collect these comprehensive service fees for several reasons, including:

the fact that we are at risk for the payment of our direct costs and worksite employee payroll costs regardless of whether our clients pay their comprehensive service fees
the large volume and dollar amount of transactions we process
the periodic and recurring nature of payroll, upon which the comprehensive service fees are based

- 35 -

Table of Contents

To mitigate this risk, we have established very tight credit policies. We generally require our PEO HR Outsourcing solutions clients to pay their comprehensive service fees no later than one day prior to the applicable payroll date. In addition, we generally maintain the right to terminate the CSA and associated worksite employees or to require prepayment, letters of credit or other collateral if a client's financial position deteriorates or if the client does not pay the comprehensive service fee. As a result of these efforts, losses related to client nonpayment have historically been low as a percentage of revenues. However, if our clients' financial conditions were to deteriorate rapidly, resulting in nonpayment, our accounts receivable balances could grow and we could be required to provide for additional allowances, which would decrease net income in the period that such determination was made.

Property and equipment – Our property and equipment relate primarily to our facilities and related improvements, furniture and fixtures, computer hardware and software and capitalized software development costs. These costs are depreciated or amortized over the estimated useful lives of the assets. If we determine that the useful lives of these assets will be shorter than we currently estimate, our depreciation and amortization expense could be accelerated, which would decrease net income in the periods of such a determination. In addition, we periodically evaluate these costs for impairment. If events or circumstances were to indicate that any of our long-lived assets might be impaired, we would assess recoverability based on the estimated undiscounted future cash flows to be generated from the applicable asset. In addition, we may record an impairment loss, which would reduce net income, to the extent that the carrying value of the asset exceeded the fair value of the asset. Fair value is generally determined using an estimate of discounted future net cash flows from operating activities or upon disposal of the asset. Please read Note 1 to the Consolidated Financial Statements, "Accounting Policies," for additional information.

Goodwill and other intangibles – Goodwill is tested for impairment on an annual basis and between annual tests in certain circumstances, and is written down when impaired. Purchased intangible assets other than goodwill are amortized over their useful lives unless these lives are determined to be indefinite. Our purchased intangible assets are carried at cost less accumulated amortization. Amortization is computed over the estimated useful lives of the respective assets, which ranges from three to 10 years. Please read Note 1 to the Consolidated Financial Statements, "Accounting Policies," for additional information.

New Accounting Pronouncements

We believe that we have implemented the accounting pronouncements with a material impact on our financial statements and do not believe there are any new or pending pronouncements that will materially impact our financial position or results of operations.

In January 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2017-04, Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. The ASU eliminates the requirement to calculate the implied fair value of goodwill (formerly, Step 2) to measure a goodwill impairment charge. Instead, companies are required to record an impairment charge based on the excess of a reporting unit's carrying amount over its fair value (formerly, Step 1). The guidance is effective for goodwill impairment tests in fiscal years beginning after December 16, 2019 and early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. Companies should apply this ASU on a prospective basis. We adopted ASU No. 2017-04 on January 1, 2017.

In February 2016, the FASB issued ASU No. 2016-02, Leases. The new standard requires recognition of lease assets and lease liabilities for leases previously classified as operating leases. The guidance is effective for fiscal years beginning after December 15, 2018. We are currently reviewing the guidance and assessing the impact on our consolidated financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606). ASU No. 2014-09 outlines a single comprehensive revenue recognition model for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. Under ASU No. 2014-09, an entity recognizes revenue for the transfer of promised goods or services to customers in an amount that reflects the consideration for which the entity expects to be entitled in exchange for those goods or services. ASU No. 2014-09 is effective for annual reporting periods beginning after December 15, 2017, and early adoption is permitted. Companies may use either a full retrospective or a modified retrospective approach to adopt ASU No. 2014-09. We plan to adopt ASU No. 2014-09 effective January 1, 2018 using the modified retrospective

approach. Under this method, the guidance is applied only to the most current period presented in the financial statements. While our technical analysis is ongoing, we expect our revenue recognition policies to remain substantially unchanged as a result of adoption ASU No. 2014-09. Additionally, we do not anticipate any significant changes in our business processes or systems.

- 36 -

Table of Contents

Results of Operations

Year Ended December 31, 2017 Compared to Year Ended December 31, 2016.

The following table presents certain information related to our results of operations:

	Year ended December 31,		
	2017	2016	% Change
	(in thousands, except per share and statistical data)		
Revenues (gross billings of \$20.174 billion and \$17.933 billion, less worksite employee payroll cost of \$16.874 billion and \$14.992 billion, respectively)	\$3,300,223	\$2,941,347	12.2 %
Gross profit	572,731	491,610	16.5 %
Operating expenses	442,790	385,304	14.9 %
Operating income	129,941	106,306	22.2 %
Other income (expense)	200		