

PAYMENT DATA SYSTEMS INC
Form 10-Q
August 15, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2016

or

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

For the transition period from _____ to _____.

Commission File Number: 000-30152

PAYMENT DATA SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction of incorporation or organization)

98-0190072

(I.R.S. Employer Identification No.)

12500 San Pedro, Ste. 120, San Antonio, TX 78216

(Address of principal executive offices)

(Zip Code)

(210) 249-4100

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). ☒ Yes ☐ No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting 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 ☒

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 August 3, 2016, there were 12,075,806 shares of the issuer's common stock, \$0.001 par value, outstanding.

PAYMENT DATA SYSTEMS, INC.

INDEX

	Page
<u>PART I – FINANCIAL INFORMATION</u>	<u>1</u>
<u>Item 1. Financial Statements (Unaudited).</u>	<u>1</u>
<u>Condensed Consolidated Balance Sheets as of June 30, 2016 and December 31, 2015</u>	<u>1</u>
<u>Condensed Consolidated Statements of Operations for the Three and Six Months ended June 30, 2016 and 2015</u>	<u>2</u>
<u>Condensed Consolidated Statements of Cash Flows for the Six Months ended June 30, 2016 and 2015</u>	<u>3</u>
<u>Notes to Condensed Consolidated Financial Statements</u>	<u>4</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.</u>	<u>10</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk.</u>	<u>15</u>
<u>Item 4. Controls and Procedures.</u>	<u>15</u>
<u>PART II – OTHER INFORMATION</u>	<u>15</u>
<u>Item 1. Legal Proceedings.</u>	<u>15</u>
<u>Item 1A. Risk Factors.</u>	<u>16</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.</u>	<u>17</u>
<u>Item 3. Defaults Upon Senior Securities.</u>	<u>17</u>
<u>Item 4. Mine Safety Disclosures (Not applicable).</u>	<u>17</u>
<u>Item 5. Other Information.</u>	<u>17</u>
<u>Item 6. Exhibits.</u>	<u>19</u>

PART I – FINANCIAL INFORMATION**Item 1. Financial Statements.****PAYMENT DATA SYSTEMS, INC.****Condensed CONSOLIDATED BALANCE SHEETS**

	June 30, 2016 (Unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	\$4,378,405	\$ 4,059,606
Accounts receivable, net	1,070,236	1,135,384
Settlement processing assets	25,071,987	39,797,232
Prepaid expenses and other	217,416	149,118
Current assets before restricted cash	30,738,044	45,141,340
Restricted cash	18,316,160	17,972,065
Total current assets	49,054,204	63,113,405
Property and equipment, net	2,847,699	3,077,421
Other assets:		
Intangibles, net	260,247	341,816
Deferred tax asset	1,621,000	1,621,000
Note receivable	200,000	-
Other assets	202,298	202,849
Total other assets	2,283,545	2,165,665
Total assets	\$54,185,448	\$ 68,356,491
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$203,629	\$ 143,180
Accrued expenses	1,226,964	1,328,738
Deferred revenues	33,000	-
Settlement processing obligations	25,071,987	39,797,232
Current liabilities before restricted cash	26,535,580	41,269,150
Restricted cash	18,316,160	17,972,065
Total current liabilities	44,851,740	59,241,215
Stockholders' equity:		
Preferred stock, \$0.01 par value, 10,000,000 shares authorized; -0- shares outstanding at June 30, 2016 (unaudited) and December 31, 2015	-	-
	185,580	185,533

Edgar Filing: PAYMENT DATA SYSTEMS INC - Form 10-Q

Common stock, \$0.001 par value, 200,000,000 shares authorized; 12,419,816 and 12,379,537 issued, and 12,070,184 and 12,029,905 outstanding at June 30, 2016 (unaudited) and December 31, 2015, respectively

Additional paid-in capital	64,449,901	64,302,498
Treasury stock, at cost; 349,632 and 349,632 shares	(286,393)	(286,394)
Deferred compensation	(5,573,078)	(6,031,362)
Accumulated deficit	(49,442,302)	(49,054,999)
Total stockholders' equity	9,333,708	9,115,276

Total liabilities and stockholders' equity	\$54,185,448	\$ 68,356,491
--	--------------	---------------

See notes to interim consolidated financial statements.

PAYMENT DATA SYSTEMS, INC.**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Revenues	\$ 2,890,060	\$ 3,424,756	\$ 6,118,691	\$ 7,167,216
Operating expenses:				
Cost of services	2,034,439	2,426,612	4,189,222	4,802,006
Selling, general and administrative:				
Stock-based compensation	283,747	393,525	571,436	627,056
Cancellation of stock-based compensation	-	-	-	(163,936)
Other expenses	801,540	419,838	1,409,889	937,018
Depreciation and amortization	225,554	92,948	449,777	178,520
Total operating expenses	3,345,280	3,332,923	6,620,324	6,380,664
Operating income (loss)	(455,220)	91,833	(501,633)	786,552
Other income and (expense):				
Interest income	24,974	19,358	46,985	38,358
Other income (expense)	98,279	(32,305)	97,679	(32,409)
Total other income and (expense), net	123,253	(12,947)	144,664	5,949
Income (loss) before income taxes	(331,967)	78,886	(356,969)	792,501
Income taxes	23,334	54,036	30,334	59,036
Net income (loss)	\$ (355,301)	\$ 24,850	\$ (387,303)	\$ 733,465
Basic earnings per common share:	\$ (0.05)	\$ 0.00	\$ (0.05)	\$ 0.10
Diluted earnings per common share:	\$ (0.05)	\$ 0.00	\$ (0.05)	\$ 0.06
Weighted average common shares outstanding				
Basic	7,738,759	7,369,329	7,729,003	7,369,329
Diluted	7,738,759	12,081,754	7,729,003	12,102,919

See notes to interim consolidated financial statements.

PAYMENT DATA SYSTEMS, INC.**condensed CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)**

	Six months Ended June 30,	
	2016	2015
Operating activities:		
Net income (loss)	\$(387,303)	\$733,465
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	368,208	158,679
Amortization	81,569	19,841
Non-cash stock based compensation	571,436	627,056
Cancellation of stock based compensation	-	(163,936)
Issuance of stock to consultant	34,300	-
Changes in current assets and current liabilities:		
Accounts receivable	65,148	132,305
Prepaid expenses and other	(68,298)	(29,437)
Other assets	551	27,564
Accounts payable and accrued expenses	(41,325)	(161,673)
Deferred revenue	33,000	-
Settlement processing assets, net	-	-
Net cash provided by operating activities:	657,286	1,343,864
Investing activities:		
Purchases of property and equipment	(138,487)	(555,778)
Note receivable	(200,000)	-
Net cash (used) by investing activities:	(338,487)	(555,778)
Financing activities:		
Net cash (used) by financing activities:	-	-
Change in cash and cash equivalents	318,799	788,086
Cash and cash equivalents, beginning of period	4,059,606	2,803,455
Cash and cash equivalents, end of period	\$4,378,405	\$3,591,541
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	-	-
Income taxes	\$62,184	77,369

See notes to interim consolidated financial statements.

PAYMENT DATA SYSTEMS, INC.

Notes to INTERIM condensed Consolidated Financial Statements

(UNAUDITED)

Note 1. Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements of Payment Data Systems, Inc. and its subsidiaries (the "Company") have been prepared without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States generally accepted accounting principles have been omitted pursuant to such rules and regulations. In the opinion of management, the accompanying interim condensed consolidated financial statements reflect all adjustments of a normal recurring nature considered necessary to present fairly the Company's financial position, results of operations and cash flows for such periods. The accompanying unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's annual report on Form 10-K for the year ended December 31, 2015, as filed with the Securities and Exchange Commission on March 30, 2016. Results of operations for interim periods are not necessarily indicative of results that may be expected for any other interim periods or the full fiscal year.

Cash and Cash Equivalents: Cash and cash equivalents includes cash and other money market instruments. The Company considers all highly liquid investments with an original maturity of 90 days or less to be cash equivalents. Beginning December 31, 2015, the Company separated Restricted cash and Settlement processing assets and obligations from Cash and cash equivalents.

Settlement Processing Assets and Obligations: Settlement processing assets and obligations represent intermediary balances arising in our settlement process for merchants. Funds settlement refers to the process of transferring funds for sales and credits between card issuers and merchants. For transactions processed on our systems, we use our internal network to provide funding instructions to financial institutions that in turn fund the merchants.

Restricted Cash: Restricted cash includes certain funds collected from our merchants that serve as collateral to minimize contingent liabilities associated with any losses that may occur under our agreement with the merchant. The funds may be used to offset any returned items or chargebacks to the Company and to indemnify the Company against third-party claims and any expenses that may be created by the customer as a result of any claim or fine. The Company may require the customer security deposit based on estimated transaction volumes, amounts and chargebacks and may revise the deposit based on periodic review of the same items. Repayment of the deposit to the customer is generally within 90 to 180 days beyond the date the last item is processed by the Company on behalf of the customer. The customer security deposit does not accrue interest to the benefit of the customer.

Internal Use Software: The Company capitalizes the costs associated with software being developed or obtained for internal use when both the preliminary project stage is completed and it is probable that computer software being developed will be completed and placed-in service. Capitalized costs include only (i) external direct costs of materials and services consumed in developing or obtaining internal-use software, (ii) payroll and other related costs for employees who are directly associated with and who devote time to the internal-use software project, and (iii) interest costs incurred, when material, while developing internal-use software. The Company ceases capitalization of such costs no later than the point at which the project is substantially complete and ready for its intended purpose. In 2015, the Company began to develop software for internal use, and salaries capitalized for software development were \$447,259 at December 31, 2015, and are classified in Property and equipment on the balance sheet. In the quarter ended June 30, 2016, the Company capitalized an additional \$22,694 to total \$122,848 for the six months ended June 30, 2016.

Estimates: The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

New Accounting Pronouncement: In May 2014, the Financial Accounting Standards Board, or FASB, issued a new accounting pronouncement regarding revenue from contracts with customers. This new standard and related amendments provides guidance on recognizing revenue, including a five step model to determine when revenue recognition is appropriate. The standard requires that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Adoption of the new standard is effective for reporting periods beginning after December 15, 2017, with early adoption not permitted. The Company is currently evaluating the potential impact that the adoption of this standard will have on its financial position, results of operations, and related disclosures, and will adopt the provisions of this new standard in the first quarter of 2018.

In February 2016, the FASB issued, “Leases (Topic 842)”, which is intended to increase the transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. A lessee will be required to recognize on the balance sheet an asset (right to use) and a liability (lease obligation) for leases with terms of more than 12 months. Accounting by lessors will remain largely unchanged from current U.S. generally accepted accounting principles. The new standard is effective for public companies for fiscal years beginning after December 15, 2018, and interim periods within those years, with early adoption permitted. The Company is currently evaluating the effect that adopting this standard will have on our financial statements and related disclosures.

Reclassifications: Certain amounts from 2015 have been reclassified for comparative purposes for 2016.

Note 2. Accrued Expenses

Accrued expenses consisted of the following balances:

	June 30, 2016	December 31, 2015
Indemnification liability	\$ 425,000	\$ 450,000
Accrued commissions	264,501	440,232
Reserve for merchant losses	248,868	248,868
Other accrued expenses	152,730	112,414
Accrued taxes	24,862	54,077
Accrued salaries	111,003	23,147
Total accrued expenses	\$ 1,226,964	\$ 1,328,738

Note 3. Net Income Per Share

Basic earnings per share (EPS) were computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted EPS differs from basic EPS due to the assumed conversion of potentially dilutive awards and options that were outstanding during the period. The following is a reconciliation of the numerators and the denominators of the basic and diluted per share computations for net income for the three and six months ended June 30, 2016 and 2015. All of the share numbers used are after the 1-for-15 reverse split effected on July 23, 2015 by using the June 30, 2015 share numbers and dividing by 15. Any fractional shares were rounded up.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Numerator:				
Numerator for basic and diluted earnings per share, net income available to common shareholders	\$ (355,301)	\$ 24,850	\$ (387,303)	\$ 733,465
Denominator:				
Denominator for basic earnings per share, weighted average shares outstanding	7,738,759	7,369,329	7,729,003	7,369,329
Effect of dilutive securities	-	4,712,425	-	4,733,590
Denominator for diluted earnings per share, adjusted weighted average shares and assumed conversion	7,738,759	12,081,754	7,729,003	12,102,919
Basic earnings (loss) per common share	\$ (0.05)	\$ 0.00	\$ (0.05)	\$ 0.10
Diluted earnings (loss) per common share and common share equivalent	\$ (0.05)	\$ 0.00	\$ (0.05)	\$ 0.06

The awards and options to purchase shares of common stock that were outstanding at June 30, 2016 and 2015 that were not included in the computation of diluted earnings per share because the effect would have been anti-dilutive, are as follows:

	Six Months Ended June 30, 2016	2015
Anti-dilutive awards and options	4,325,711	-

Note 4. Acquisition

On December 22, 2014, the Company acquired the assets of Akimbo to increase market share of prepaid debit card services. The purchase price for the software, customer list, fixed assets and goodwill was \$3 million in common stock of the Company. The Akimbo operations are included in the Company's consolidated financial statements from the date of acquisition. The purchase price for Akimbo was allocated based on the fair values of the assets at the date of acquisition as follows:

Software	\$2,585,385
Equipment and other assets	2,252
Customer list and contracts	396,824
Goodwill	15,539
Trade accounts payable	(300,000)
Indemnification liability	(450,000)
Total	\$2,250,000

Goodwill is being amortized over 15 years for tax purposes.

Note 5. Income Taxes

The Company has recognized a deferred tax asset of \$1.6 million and has recorded a valuation allowance of \$12.2 million to reduce the other deferred tax assets. The Company reviewed the assessment of the deferred tax asset and valuation allowance for the period ending June 30, 2016 and will reevaluate the assessment on December 31, 2016.

Note 6. Related Party TransactionsHerb Authier

During the six months ended June 30, 2016 and the year ended December 31, 2015, the Company paid Herb Authier a total of \$24,231 and \$45,750 in cash, respectively, for services related to network engineering and administration that he provided to the Company. Mr. Authier was the father-in-law of Louis Hoch, the Company's President, Chief Executive Officer and Chief Operating Officer.

Louis Hoch

During the six months ending June 30, 2016 and the year ended December 31, 2015, the Company purchased a total of \$2,250 and \$857, respectively, of corporate imprinted sportswear and caps from Angry Pug Sportswear. Louis Hoch, the Company's President, Chief Executive Officer and Chief Operating Officer, is a co-owner of Angry Pug Sportswear.

Miguel Chapa

During the six months ending June 30, 2016 and the year ended December 31, 2015, the Company received \$24,876 and \$20,901, respectively, in revenue from Club Rio Maroc Bar, Lush Rooftop, and Nirvana Bar and Rock. Miguel Chapa, a member of our Board of Directors, is an owner in Club Rio Maroc Bar, Lush Rooftop, and Nirvana Bar and Rock. Louis Hoch, the Company's President, Chief Executive Officer and Chief Operating Officer, is also a minority owner in Lush Rooftop.

Note 7. Employment Agreements

Pursuant to the Company's respective employment agreements with Michael Long, Chairman, and Louis Hoch, President, Chief Executive Officer, and Chief Operating Officer, as amended, in the event of change in control, termination without cause, or non-renewal of the employment agreement the Company will be liable for separation payments, equaling an amount of (a) 2.95 the respective base salary and bonus payments, plus (b) a pro rata portion of the respective annual bonus based on the number of days elapsed in the year prior, plus (c) 2.0 times the respective base salary for non-competition, and (d) continuing other benefits. The Company will also accelerate vesting of stock incentive awards, which as of June 30, 2016 are approximately \$1.3 million each, and although it may not impact our cash position, will negatively affect our financial performance. The Company estimates the cash disbursements over time to be \$1.5 to \$2.0 million each for the respective agreements with Mr. Long and Mr. Hoch.

In the case of termination of the agreement due to death of the executive, the Company will be liable for separation payments, equaling an amount of (a) 2.95 the respective base salary and bonus payments, plus (b) a pro rata portion of the respective annual bonus based on the number of days elapsed in the year prior to death, and (c) continuing other benefits. The Company estimates the cash disbursements over time to be around to be \$1.0 million each for the respective agreements with Mr. Long and Mr. Hoch.

In the case of termination of the agreement due to disability without death, the Company will be liable for separation payments, equaling an amount of (a) 2.95 the respective base salary and bonus payments, plus (b) a pro rata portion of the respective annual bonus based on the number of days elapsed in the year prior to death, plus (c) continuing other benefits, plus (d) disability benefits constituting salary for 3 years. The Company estimates the cash disbursement over time to be \$1.8 to \$2.2 million for each for the respective agreements with Mr. Long and Mr. Hoch.

The Compensation Committee of the Board of Directors has indicated it is in the process of renegotiating the amendments to the employment agreements with respect to the death and disability separation payments, which, if finalized, would greatly reduce the amounts due in those instances. Both Mr. Long and Mr. Hoch have agreed that the 5th amendment to the employment agreements should have only allowed for deferred compensation in the case of death calculations using only the executive's salary and nothing for bonus compensation or any other benefits and or deferred compensation in the case of disability the only deferred compensation will be the continuation of only salary payments for thirty-six months to be paid by the company and or any disability insurance carrier. Both Mr. Long and Mr. Hoch have agreed to execute the amendments once the Compensation Committee approves the changes. While there is no guarantee that these amendments will be executed, both management and the Compensation Committee have indicated this is their intent.

Note 8. Purchases of Equity Securities

On December 27, 2006, the Company issued 589,488 shares of common stock for compensation purposes subject to a ten year vesting schedule. These shares will vest on December 27, 2016. Assuming the price of the Company's common stock is \$2.00 on the day of vesting, the recipients' share of taxes will be approximately \$400,000 to \$500,000, depending on respective individual income tax rates. The Company has no legal obligation to assist recipients with their share of taxes, however, the Company may choose to pay cash bonuses, or repurchase shares from the recipient to assist in paying some or all of the taxes due. If the Company elects to repurchase shares from the recipients, such repurchase would require Board of Director approval and Audit Committee review.

Note 9. Reverse Stock Split

On July 23, 2015, pursuant to shareholder and board approval, the Company effected a 1-for-15 reverse stock split of the outstanding common stock by filing a certificate of change with the Secretary of State of the State of Nevada and obtaining approval by the Financial Industry Regulatory Authority. The number of the Company's authorized common shares remained unchanged at 200,000,000 shares, par value \$0.001 per share, after the reverse stock split. The number of the Company's authorized preferred stock remains unchanged at 10,000,000 shares, par value \$0.01 per share.

As a result of the reverse split, the Company issued 1,117 shares due to rounding of fractional shares because the Company agreed to issue to each shareholder a full share for any fractional shares that resulted from the reverse split.

All figures and calculations using a share count assuming the 1-for-15 reverse stock split even if the numbers were for a period prior to the reverse stock split.

Note 10. Legal Proceedings

The Company was involved in a lawsuit with a customer that alleged it did not warn or stop the processing of \$181,709 in fraudulent credit transactions from occurring. The Company believes that the customer breached the Company's processing agreement and that a security breach occurred because of the customer's lack of controls over the login and password information utilized by the customer to process transactions resulting in the customer becoming a victim of a malware attack. The agreement between the customer and the Company has a limitation of liability provision that allows for the maximum liability of the Company to not exceed the amount of fees of a single month of service. On April 29, 2015, Brightmoore Church filed a notice of voluntary dismissal, which the Court accepted on April 30, 2015, and dismissed the lawsuit without prejudice. On November 3, 2015, the Company filed a lawsuit against Brightmoore Church in the District Court for the judicial district of Bexar County, Texas, alleging a breach of contract by Brightmoore Church resulting in the fraudulent credit transactions described before and demanding payment of damages. On March 24, 2016, the Company entered into a settlement agreement with Brightmoore Church and on March 28, 2016, the Company filed to dismiss the lawsuit for no consideration. The case was dismissed by Brightmoore Church on April 4, 2016.

On March 1, 2016, the Company was granted a temporary restraining order against Shelby Systems, Inc. by the District Court for the judicial district of Bexar County, Texas to prevent Shelby Systems from, among others, publishing false information about the Company and interfering with the Company's customers after the termination of the Company's referral agreement with Shelby Systems. On July 5, 2016, the Company agreed to dismiss the lawsuit with no further fees due Shelby Systems which netted the Company \$97,493 in income.

On June 26, 2015, Michael McFarland, derivatively on behalf the Company, and individually on behalf of himself and all other similarly situated shareholders of the Company, filed a class-action lawsuit in United States District Court, District of Nevada. The suit alleges breach of fiduciary duties and unjust enrichment by the Company's Board of Directors and certain executive officers and directors in connection with excessive and unfair compensation paid or awarded during fiscal years 2013 and 2014. The lawsuit seeks disgorgement of excessive compensation as well as damages in an unspecified amount. As of March 17, 2016 the Court signed an order dismissing the claims against Peter Kirby and Michael Long, but did not rule as to the other defendants. On March 22, 2016 the Company filed an unopposed motion for final judgment as to everyone else and confirmed again with the Plaintiff that they do not oppose dismissal of the whole case. On April 5, 2016, the case was dismissed without prejudice.

On April 26, 2016, Michael McFarland, derivatively on behalf the Company, re- filed the same class-action lawsuit in United States District Court, District of Nevada.

The Company believes the claims are without merit and it is unlikely that a loss will be incurred, therefore the Company has not accrued for a potential loss. However, the outcomes of the disputes are still uncertain and it is possible the Company may incur legal fees and losses in the future.

Aside from the lawsuits described above, the Company may be involved in legal matters arising in the ordinary course of business from time to time. While the Company believes that such matters are currently not material, there can be no assurance that matters arising in the ordinary course of business for which the Company is or could become involved in litigation will not have a material adverse effect on the Company's business, financial condition or results of operations.

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

FORWARD-LOOKING STATEMENTS DISCLAIMER

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in the forward-looking statements for many reasons, including the risks described in our annual report on Form 10-K and other reports we file with the Securities and Exchange Commission. Although we believe the expectations reflected in the forward-looking statements are reasonable, they relate only to events as of the date on which the statements are made. We do not intend to update any of the forward-looking statements after the date of this report to conform these statements to actual results or to changes in our expectations, except as required by law.

This discussion and analysis should be read in conjunction with the unaudited interim condensed consolidated financial statements and the notes thereto included in this report, and our annual report on Form 10-K for the fiscal year ended December 31, 2015, filed March 30, 2016, including the audited consolidated financial statements and the notes contained therein.

Overview

We provide integrated electronic payment processing services to merchants and businesses, including all types of Automated Clearing House, or ACH, processing, credit, prepaid card and debit card-based processing services. We also operate an online payment processing service, under the domain name www.billx.com system, which allows consumers to process online payments to pay any other individual, including family and friends. Through our recently acquired business Akimbo, under the domain name www.akimbocard.com, we offer Visa prepaid cards to consumers for use as a tool to stay on budget, manage allowances and share money with family and friends. The Akimbo MasterCard program became live on our processing platform in early April 2015. The Akimbo Visa card program was decommissioned of all services on May 30, 2015 and the card customers were transitioned to the Akimbo MasterCard card program. Since then we have further developed our Akimbo platform to include Akimbo Now for businesses, Akimbo Gift for consumers and support for Apple Pay™.

We reported a net loss of \$387,303 for the six months ended June 30, 2016 and net income of \$1,016,088 for year ended December 31, 2015. Second quarter 2016 credit card processing volumes were the fourth highest in company history, with the number of transactions processed up 4% over the second quarter of 2015. Credit card dollars processed during the second quarter of 2016 decreased 4% compared to the same time period in 2015. Electronic check transaction (ACH) volumes during the second quarter of 2016 were down 17% over the same time period in 2015.

Due to our strong sales pipeline, we believe the downward trend in ACH transactions processed will reverse in the second half of 2016 and early 2017. We also expect to see an increase in the number of enrolled merchant customers, for whom we provide processing for credit and debit card transactions, and we expect to add new clients from our sales pipeline, which we believe will create increased transaction volumes. We believe we will return to profitability we experienced in years 2015 and 2014 in the foreseeable future, but it is possible that we will not regain profitability. We may incur future operating losses. To regain and sustain profitability, we must, among other things, grow and maintain our customer base, implement a successful marketing strategy, continue to maintain and upgrade our technology and transaction-processing systems, provide superior customer service, respond to competitive developments, attract, retain and motivate qualified personnel, and respond to unforeseen industry developments and other factors. We believe that our success will depend in large part on our ability to (a) manage our operating expenses, (b) add quality customers to our client base, (c) meet evolving customer requirements and (d) adapt to technological changes in an emerging market. Accordingly, we intend to focus on customer acquisition activities and outsource some of our processing services to third parties to allow us to maintain an efficient operating infrastructure and expand our operations without significantly increasing our fixed operating expenses.

Critical Accounting Policies

General

Our management's discussion and analysis of financial condition and results of operations is based upon our interim condensed consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us 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 our estimates, including those related to the reported amounts of revenues and expenses, bad debt, investments, intangible assets, income taxes, and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed 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 could differ from these estimates under different assumptions or conditions. We consider the following accounting policies to be critical because the nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change or because the impact of the estimates and assumptions on financial condition or operating performance is material.

Revenue Recognition

Revenue consists primarily of fees generated through the electronic processing of payment transactions and related services, and is recognized as revenue during the period the transactions are processed or when the related services are performed. Merchants may be charged for these processing services at a bundled rate based on a percentage of the dollar amount of each transaction and, in some instances, additional fees are charged for each transaction. Certain merchant customers are charged a flat fee per transaction, while others may also be charged miscellaneous fees, including fees for chargebacks or returns, monthly minimums, and other miscellaneous services. Revenues derived from electronic processing of credit, debit, and prepaid card transactions that are authorized and captured through third-party networks are reported gross of amounts paid to sponsor banks as well as interchange and assessments paid to credit card associations (Visa, MasterCard and Discover). Revenue also includes any up-front fees for the work involved in implementing the basic functionality required to provide electronic payment processing services to a customer. Revenue from such implementation fees is recognized over the term of the related service contract. Sales taxes billed are reported directly as a liability to the taxing authority, and are not included in revenue.

Reserve for Processing Losses

If, due to insolvency or bankruptcy of one of our merchant customers, or for any other reason, we are not able to collect amounts from our credit card, ACH or prepaid customers that have been properly "charged back" by the customer, or if a prepaid cardholder incurs a negative balance, we must bear the credit risk for the full amount of the

transaction. We may require cash deposits and other types of collateral from certain merchants to minimize any such risk. In addition, we utilize a number of systems and procedures to manage merchant risk. ACH, prepaid and credit card merchant processing loss reserves are primarily determined by performing a historical analysis of our loss experience and considering other factors that could affect that experience in the future, such as the types of transactions processed and nature of the merchant relationship with its consumers and our relationship with our prepaid card holders. This reserve amount is subject to the risk that actual losses may be greater than our estimates. We have not incurred any significant processing losses to date. Estimates for processing losses are variable based on the volume of transactions processed and could increase or decrease accordingly. At June 30, 2016 our reserve for processing losses was \$248,868 and was the same at December 31, 2015.

Settlement Processing Assets and Obligations

Settlement processing assets and obligations represent intermediary balances arising in our settlement process for merchants. Funds settlement refers to the process of transferring funds for sales and credits between card issuers and merchants. For transactions processed on our systems, we use our internal network to provide funding instructions to financial institutions that in turn fund the merchants.

Restricted Cash

Restricted cash includes certain funds collected from our merchants that serve as collateral to minimize contingent liabilities associated with any losses that may occur under our agreement with the merchant. The funds may be used to offset any returned items or chargebacks to the Company and to indemnify the Company against third-party claims and any expenses that may be created by the customer as a result of any claim or fine. The Company may require the customer security deposit based on estimated transaction volumes, amounts and chargebacks and may revise the deposit based on periodic review of the same items. Repayment of the deposit to the customer is generally within 90 to 180 days beyond the date the last item is processed by the Company on behalf of the customer. The customer security deposit does not accrue interest to the benefit of the customer.

Bad Debts

We maintain an allowance for doubtful accounts for estimated losses resulting from the inability or failure of our customers to make required payments. We determine the allowance for doubtful accounts based on an account-by-account review, taking into consideration such factors as the age of the outstanding balance, historical pattern of collections and financial condition of the customer. Past losses incurred by us due to bad debts have been within our expectations. If the financial conditions of our customers were to deteriorate, resulting in an impairment of their ability to make contractual payments, additional allowances might be required. Estimates for bad debt losses are variable based on the volume of transactions processed and could increase or decrease accordingly. At June 30, 2016 and December 31, 2015, our allowance for doubtful accounts was \$30,938 and \$35,033, respectively.

Valuation of Long-Lived and Intangible Assets

We assess the impairment of long-lived and intangible assets periodically, or at least annually, and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors considered important, which could trigger an impairment review, include the following: significant underperformance relative to historical or projected future cash flows; significant changes in the manner of use of the assets or the strategy of the overall business; and significant negative industry trends. When management determines that the carrying value of long-lived

and intangible assets may not be recoverable, impairment is measured as the excess of the assets' carrying value over the estimated fair value. No impairment losses were recorded in 2015 or during the six months ended June 30, 2016. Management is not aware of any impairment changes that may currently be required; however, we cannot predict the occurrence of events that might adversely affect the reported values in the future.

Income Taxes

Deferred tax assets and liabilities are recorded based on the difference between financial reporting and tax bases of assets and liabilities and are measured by the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Deferred tax assets are computed with the presumption that they will be realizable in future periods when taxable income is generated. Predicting the ability to realize these assets in future periods requires a great deal of judgment by management. U.S. generally accepted accounting principles prescribe a recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. Income tax benefits that meet the "more likely than not" recognition threshold should be recognized. Goodwill is amortized over 15 years for tax purposes.

At December 31, 2015, we had available net operating loss carryforwards of approximately \$39.7 million, which expire beginning in the year 2020. Approximately \$0.1 million of the total net operating loss is subject to an IRS Section 382 limitation from 1999. However, we cannot predict with reasonable certainty that all of the available net operating loss carryforwards will be realized in future periods. Accordingly, we recorded a valuation allowance of \$12.2 million. As of December 31, 2015 we recognized net deferred tax assets of \$1.6 million. The Company reviewed the assessment of the deferred tax asset and valuation allowance for the period ended June 30, 2016 and will reevaluate the assessment on December 31, 2016.

Management is not aware of any tax positions that would have a significant impact on our financial position.

Results of Operations

Our revenues are principally derived from providing integrated electronic payment services to merchants and businesses, including credit and debit card-based processing services and transaction processing via the Automated Clearing House, or ACH, network and the program management and processing of prepaid debit cards. We also operate an online payment processing service for consumers under the domain name www.billx.com and sell this service as a private-label application to resellers.

Revenues

Revenues for the quarter ended June 30, 2016 decreased 16% to \$2,890,060, as compared to \$3,424,756 for the quarter ended June 30, 2015. Revenues for the six months ended June 30, 2016 decreased 15% to \$6,118,691, as compared to \$7,167,216 for the six months ended June 30, 2015. The decrease for the quarter and six months ended June 30, 2016, as compared to the same period in the prior year, was due to the decreases in the volume of ACH processing transactions, and return transactions processed.

Cost of Services

Cost of services includes the cost of personnel dedicated to the creation and maintenance of connections to third-party payment processors and the fees paid to such third-party providers for electronic payment processing services. Through our contractual relationships with our payment processors and sponsoring banks, we are able to process ACH and debit, credit or prepaid card transactions on behalf of our customers and their consumers. We pay volume-based fees for debit, credit, ACH and prepaid transactions initiated through these processors or sponsoring banks, and pay fees for other transactions such as returns, notices of change to bank accounts and file transmission.

Cost of services decreased 16% to \$2,034,439 for the quarter ended June 30, 2016, as compared to \$2,426,612 for the same period in the prior year. Cost of services decreased 13% to \$4,189,222 for the six months ended June 30, 2016, as compared to \$4,802,006 for the same period in the prior year. The decrease for the six months ended June 30, 2016, as compared to the same period in the prior year, was due to the decrease in the volume of ACH processing transactions, and return transactions processed.

Stock-based Compensation

Stock-based compensation expenses were \$283,747 and \$393,525 for the quarters ended June 30, 2016 and June 30, 2015, respectively. Stock-based compensation expenses were \$571,436 and \$627,056 for the six months ended June 30, 2016 and June 30, 2015, respectively. The decrease in stock-based compensation expense is due to shares that vested in December 2015 that we no longer have to amortize.

Cancellation of stock-based compensation expense (income) was \$0 and \$0 for the quarters ended June 30, 2016 and June 30, 2015, respectively and \$0 and \$163,936 of income for the six months ended June 30, 2016 and June 30, 2015, respectively. This amount represents non-vested stock-based awards to former employees that were expensed in prior years that were cancelled during the six months ended June 30, 2015.

Other Selling, General and Administrative Expenses

Other selling, general and administrative expenses increased 91% to \$801,540 for the quarter ended June 30, 2016, as compared to \$419,838 for the same period in the prior year. The increase in other selling, general and administrative expenses for the three months ended June 30, 2016, as compared to the same period in the prior year, represented increases in salaries and benefits of approximately \$212,000, investor outreach fees of approximately \$85,000; marketing and advertising of approximately \$58,000, and an increase in legal and professional fees of approximately \$27,000.

Other selling, general and administrative expenses increased 50% to \$1,409,889 the six months ended June 30, 2016, as compared to \$937,018 for the same period in the prior year. The increase in other selling, general and administrative expenses for the six months ended June 30, 2016, as compared to the same period in the prior year, represented an increase in salaries and benefits of approximately \$418,000, a decrease in cancellation of stock based compensation of \$163,936, increase in investor outreach fees of approximately \$158,000, decrease in bonuses of \$90,000, increase in marketing and advertising of approximately \$61,000, an increase in director compensation of \$38,500, and an increase in legal and professional fees of approximately \$30,000.

Depreciation and Amortization

Depreciation and amortization totaled \$225,554 for the quarter ended June 30, 2016, compared to depreciation and amortization of \$92,948 for the same period in 2015. Depreciation and amortization totaled \$449,777 for the six months ended June 30, 2016, compared to depreciation of \$178,520 for the same period in the prior year. The increases are primarily due to a change in the useful life for \$2,585,385 of software acquired from Akimbo from 10 years to 5 years in the quarter ended December 31, 2015.

Other Income (Expense)

Other income (expense), were income of \$123,253 and \$144,664 for the quarter and six months ended June 30, 2016 compared to net expense of \$12,947 and net income of \$5,949 for the quarter and six months ended June 30, 2015, respectively. The increase for the quarter and six months, as compared to the same periods in the prior year is primarily due to the settlement of a legal case in our favor resulting in \$97,493.

Interest income was \$24,974 and \$19,358, for the quarters ended June 30, 2016 and June 30, 2015, respectively. The increase in interest for the quarter, as compared to the same period in the prior year was primarily due to the increase in interest earned on higher cash balances.

Interest income was \$46,985 and \$38,358, for the six months ended June 30, 2016 and June 30, 2015, respectively. The increase in interest for the six months, as compared to the same period in the prior year was primarily due to the increase in interest earned on higher cash balances.

We reported net loss of \$355,301 and \$387,303 for the quarter and six months ended June 30, 2016, as compared to net income of \$24,850 and \$733,465 for the same periods in the prior year.

Liquidity and Capital Resources

At June 30, 2016, we had \$4,378,405 of cash and cash equivalents, as compared to \$4,059,606 of cash and cash equivalents at December 31, 2015. The increase in cash for the six months ended June 30, 2015 was primarily due to cash generated from operations. Beginning with December 31, 2015 we separated Restricted cash and Settlement processing assets and obligations from Cash and cash equivalents. We have reclassified the 2015 balance sheet to the same format so that the presentation is consistent with the 2016 presentation.

We reported a net loss of \$387,303 for the first two quarters of 2016 and net income of \$1,016,088 for the year ended December 31, 2015 and at June 30, 2016 we have an accumulated deficit of \$49,442,302. Additionally, we reported working capital of \$4,202,464 and \$3,872,190 at June 30, 2016 and December 31, 2015, respectively.

Net cash provided by operating activities was \$657,286 and \$1,343,864 for the six months ended June 30, 2016 and 2015, respectively. The decrease in net cash provided by operating activities for the six months ended June 30, 2016 as compared to the same period in the prior year was attributable to lower net income.

Net cash used by investing activities was \$338,487 for the six months ended June 30, 2016, as compared to net cash used by investing activities of \$555,778 for the same period in the prior year; the decrease in net cash used for investing activities was primarily due to lower capitalization of expenses incurred for the development of software upgrades for internal use. Net cash used by financing activities was \$0 for the six months ended June 30, 2016 and June 30, 2015.

Off-Balance Sheet Arrangements

We currently have no off-balance sheet arrangements that have or are reasonably likely to have a current or future material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

As a smaller reporting company as defined by Rule 12b-2 of the Exchange Act and in Item 10(f)(1) of Regulation S-K, we are electing scaled disclosure reporting obligations and therefore are not required to provide the information requested by this Item.

Item 4. CONTROLS AND PROCEDURES.

Evaluation of Disclosure Controls and Procedures

Our management evaluated, with the participation of our Chief Executive and Chief Financial Officers, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the period covered by this quarterly report on Form 10-Q. Based on that evaluation, our Chief Executive and Chief Financial Officers concluded that our disclosure controls and procedures as of June 30, 2016 were effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act (i) is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) is accumulated and communicated to our management, including our Chief Executive and Chief Financial Officers, as appropriate, to allow timely decisions regarding required disclosure. Our disclosure controls and procedures are designed to provide reasonable assurance that such information is accumulated and communicated to our management. Our evaluation of disclosure controls and procedures included an evaluation of certain components of our internal control over financial reporting. Management’s assessment of the effectiveness of our internal control over financial reporting is expressed at the level of reasonable assurance that the control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system's objectives will be met.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting that occurred during the quarter ended June 30, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

We were involved in a lawsuit with a customer that alleged we did not warn or stop the processing of \$181,709 in fraudulent credit transactions from occurring. We believe that the customer breached our processing agreement and that a security breach occurred because of the customer's lack of controls over the login and password information utilized by the customer to process transactions resulting in the customer becoming a victim of a malware attack. Our agreement with the customer has a limitation of liability provision that allows for our maximum liability to not exceed the amount of fees of a single month of service. On April 29, 2015, Brightmoore Church filed a notice of voluntary dismissal, which the Court accepted on April 30, 2015, and dismissed the lawsuit without prejudice. On November 3, 2015, we filed a lawsuit against Brightmoore Church in the District Court for the judicial district of Bexar County, Texas, alleging a breach of contract by Brightmoore Church resulting in the fraudulent credit transactions described before and demanding payment of damages. On March 24, 2016, we entered into a settlement agreement with Brightmoore Church and on March 28, 2016, we filed to dismiss the lawsuit for no consideration. The case was dismissed by Brightmoore Church on April 4, 2016.

On March 1, 2016, we were granted a temporary restraining order against Shelby Systems, Inc. by the District Court for the judicial district of Bexar County, Texas to prevent Shelby Systems from, among others, publishing false information about the Company and interfering with our customers after the termination of our referral agreement with Shelby Systems. On July 5, 2016, we agreed to dismiss the lawsuit with no further fees due Shelby Systems which netted us \$97,493 in income.

On June 26, 2015, Michael McFarland, derivatively on behalf the Company, and individually on behalf of himself and all other similarly situated shareholders of the Company, filed a class-action lawsuit in United States District Court, District of Nevada. The suit alleges breach of fiduciary duties and unjust enrichment by the our Board of Directors and certain executive officers and directors in connection with excessive and unfair compensation paid or awarded during fiscal years 2013 and 2014. The lawsuit seeks disgorgement of excessive compensation as well as damages in an unspecified amount. As of March 17, 2016 the Court signed an order dismissing the claims against Peter Kirby and Michael Long, but did not rule as to the other defendants. On March 22, 2016, we filed an unopposed motion for final judgment as to everyone else and confirmed again with the Plaintiff that they do not oppose dismissal of the whole case. On April 5, 2016, the case was dismissed without prejudice.

On April 26, 2016, Michael McFarland, derivatively on behalf the Company, re-filed the same class-action lawsuit in United States District Court, District of Nevada.

We believe this claim is without merit and it is unlikely that a loss will be incurred, therefore we have not accrued for a potential loss. However, the outcome of the dispute is still uncertain and it is possible we may incur legal fees and losses in the future.

Aside from the lawsuits described above, we may be involved in legal matters arising in the ordinary course of business from time to time. While we believe that such matters are currently not material, there can be no assurance that matters arising in the ordinary course of business for which we are or could become involved in litigation will not have a material adverse effect on our business, financial condition or results of operations.

Item 1A. RISK FACTORS.

Except as discussed below, there have been no material changes from risk factors previously disclosed in our annual report on Form 10-K for the fiscal year ended December 31, 2015, as filed with the Securities and Exchange Commission on March 30, 2016.

We will be liable for separation payments in case of change in control, termination without cause, non-renewal of the agreement, death, or disability under the respective employment agreements with our Chairman, Mr. Long and our President, Chief Executive Officer, and Chief Operating Officer, Mr. Hoch, which will have an adverse effect on our cash position and on our financial results.

Pursuant to the our respective employment agreements with Michael Long, Chairman, and Louis Hoch, President, Chief Executive Officer, and Chief Operating Officer, as amended, in the event of change in control, termination without cause, or non-renewal of the employment agreement we will be liable for separation payments, equaling an amount of (a) 2.95 the respective base salary and bonus payments, plus (b) a pro rata portion of the respective annual bonus based on the number of days elapsed in the year prior, plus (c) 2.0 times the respective base salary for non-competition, and (d) continuing other benefits. We will also accelerate vesting of stock incentive awards, which as of June 30, 2016 are approximately \$1.3 million each, and although may not impact our cash position, will negatively affect our financial performance. We estimate the cash disbursements over time to be \$1.5 to \$2.0 million each for the respective agreements with Mr. Long and Mr. Hoch.

In the case of termination of the agreement due to death of the executive, we will be liable for separation payments, equaling an amount of (a) 2.95 the respective base salary and bonus payments, plus (b) a pro rata portion of the respective annual bonus based on the number of days elapsed in the year prior to death, and (c) continuing other

benefits. We estimate the cash disbursements over time to be around to be \$1.0 million each for the respective agreements with Mr. Long and Mr. Hoch.

In the case of termination of the agreement due to disability without death, we will be liable for separation payments, equaling an amount of (a) 2.95 the respective base salary and bonus payments, plus (b) a pro rata portion of the respective annual bonus based on the number of days elapsed in the year prior to death, plus (c) continuing other benefits, plus (d) disability benefits constituting salary for 3 years. We estimate the cash disbursement over time to be \$1.8 to \$2.2 million for each for the respective agreements with Mr. Long and Mr. Hoch.

In addition, the amendments clarify that in case of death or disability no further compensation will be due for compliance with the agreements' non-compete, non-solicitation and disparagement clause.

The Compensation Committee of the Board of Directors has indicated it is in the process of renegotiating the amendments to the employment agreements with respect to the death and disability separation payments, which, if finalized, would greatly reduce the amounts due in those instances. Both Mr. Long and Mr. Hoch have agreed that the 5th amendment to the employment agreements should have only allowed for deferred compensation in the case of death calculations using only the executive's salary and nothing for bonus compensation or any other benefits and or deferred compensation in the case of disability the only deferred compensation will be the continuation of only salary payments for thirty-six months to be paid by the company and or any disability insurance carrier. Both Mr. Long and Mr. Hoch have agreed to execute the amendments once the Compensation Committee approves the changes. While there is no guarantee that these amendments will be executed, both management and the Compensation Committee have indicated this is their intent.

Depending on when such an event might occur, it could have a substantial adverse effect on our operating capital and cash on hand. If our cash position is not sufficient, we may need to raise additional cash which could involve selling equity securities which would dilute our shareholders. In addition, the loss of our Chairman or Chief Executive Officer may adversely affect our business and results of operations.

Item 2. Unregistered Sales of Equity Securities AND USE OF PROCEEDS.

On May 15, 2016 we issued 10,000 shares of unregistered equity securities valued at \$1.53 per share to a consultant for investor relations services.

We relied on the Section 4(a)(2) exemption from securities registration under the federal securities laws for transactions not involving any public offering. No advertising or general solicitation was employed in offering the securities. The securities were issued to an accredited investor. The securities were offered for investment purposes only and not for the purpose of resale or distribution. The transfer thereof was appropriately restricted by us.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. MINE SAFETY DISCLOSURES.

Not applicable.

Item 5. Other Information.

On August 1, 2016, Kirk E. Taylor resigned as chair of the Audit Committee and as a member of our Board of Directors.

On August 3, 2016 we entered into amendments to the employment agreements with Michael R. Long and Louis A. Hoch, respectively, to update their agreements and responsibilities.

The amendments reflect the change in corporate responsibilities as of August 5, 2016, with Mr. Hoch assuming the role of Chief Executive Officer in addition to his position as our President, Chief Operating Officer and Vice Chairman of the Board of Directors and Mr. Long remaining Chairman of the Board. The foregoing change in responsibilities will not trigger any termination, nor any obligations to pay deferred compensation, nor compensation for the non-compete obligation during such time that Michael Long remains employed as Chairman of the Board, Louis A. Hoch remains employed as Chief Executive Officer and the individuals who serve on the Board of Directors continue to constitute at least a majority of the Board of Directors; provided, however, any person who becomes a director subsequent to August 3, 2016, whose election or nomination for election was approved by a vote of at least a majority of the directors then constituting the incumbent board, shall for purposes of this amendment be considered a member of the incumbent board.

Further, the amount of deferred compensation owed to the executive officers in case of termination due to death or disability was amended to comprise an amount equal to 2.95 times of the executive's base salary and bonus compensation, as such terms are defined in the employment agreements. For the avoidance of doubt, the deferred compensation does not include amounts paid or accrued to executive for benefits or equity awards. Further bonus compensation is forfeited. Further, all stock options issued to the executive and all restricted stock granted to executive shall continue on their vesting schedule. In case of disability, no deferred compensation will be due as long as the Company and/or an insurance continues to pay executive's base salary for a period of up to 36 months. In addition, the amendments clarify that in case of death or disability no further compensation will be due for compliance with the agreements' non-compete, non-solicitation and disparagement clause.

The Compensation Committee of the Board of Directors has indicated it is in the process of renegotiating the amendments to the employment agreements with respect to the death and disability separation payments, which, if finalized, would greatly reduce the amounts due in those instances. Both Mr. Long and Mr. Hoch have agreed that the 5th amendment to the employment agreements should have only allowed for deferred compensation in the case of death calculations using only the executive's salary and nothing for bonus compensation or any other benefits and or deferred compensation in the case of disability the only deferred compensation will be the continuation of only salary payments for thirty-six months to be paid by the company and or any disability insurance carrier. Both Mr. Long and Mr. Hoch have agreed to execute the amendments once the Compensation Committee approves the changes. While there is no guarantee that these amendments will be executed, both management and the Compensation Committee have indicated this is their intent.

Item 6. Exhibits.

<u>Exhibit Number</u>	<u>Description</u>
3.1	Amended and Restated Articles of Incorporation (included as exhibit 3.1 to the Form 10-KSB filed March 31, 2006, and incorporated herein by reference).
3.2	Amended and Restated By-laws (included as exhibit 3.2 to the Form 10-KSB filed March 31, 2006, and incorporated herein by reference).
3.3	Articles of Amendment to the Amended and Restated By-laws (included as exhibit A to the Schedule 14C filed April 18, 2007, and incorporated herein by reference).
4.1	Amended and Restated 1999 Employee Comprehensive Stock Plan (included as exhibit 4.1 to the Form S-8 filed May 25, 2006, and incorporated herein by reference).
4.2	Amended and Restated 1999 Non-Employee Director Plan (included as exhibit 10.2 to the Form 8-K filed January 3, 2006, and incorporated herein by reference).
4.3	Employee Stock Purchase Plan (included as exhibit 4.3 to the Form S-8, File No. 333-30958, filed February 23, 2000, and incorporated herein by reference).
10.1	Lease Agreement between the Company and Frost National Bank, Trustee for a Designated Trust, dated August 22, 2003 (included as exhibit 10.3 to the Form 10-Q filed November 14, 2003, and incorporated herein by reference).
10.2	Employment Agreement between the Company and Michael R. Long, dated February 27, 2007 (included as exhibit 10.1 to the Form 8-K filed March 2, 2007, and incorporated herein by reference).
10.3	Employment Agreement between the Company and Louis A. Hoch, dated February 27, 2007 (included as exhibit 10.2 to the Form 8-K filed March 2, 2007, and incorporated herein by reference).
10.4	Affiliate Office Agreement between the Company and Network 1 Financial, Inc. (included as exhibit 10.11 to the Form SB-2 filed April 28, 2004, and incorporated herein by reference).
10.5	Stock Purchase Agreement between the Company and Robert D. Evans, dated January 18, 2007 (included as exhibit 10.1 to the Form 8-K filed January 23, 2007, and incorporated herein by reference).
10.6	Stock Purchase Agreement between the Company and Robert D. Evans, dated March 1, 2007 (included as exhibit 10.1 to the Form 8-K filed March 5, 2007, and incorporated herein by reference).
10.7	First Amendment to Employment Agreement between the Company and Michael R. Long, dated November 12, 2009 (included as exhibit 10.15 to the Form 10-Q filed November 16, 2009, and incorporated herein by reference).

- 10.8 First Amendment to Employment Agreement between the Company and Louis A. Hoch, dated November 12, 2009 (included as exhibit 10.16 to the Form 10-Q filed November 16, 2009, and incorporated herein by reference).

- 10.9 Second Amendment to Employment Agreement between the Company and Michael R. Long, dated April 12, 2010 (included as exhibit 10.16 to the Form 10-K filed April 15, 2010, and incorporated herein by reference).
- 10.10 Second Amendment to Employment Agreement between the Company and Louis A. Hoch, dated April 12, 2010 (included as exhibit 10.17 to the Form 10-K filed April 15, 2010, and incorporated herein by reference).
- 10.11 Bank Sponsorship Agreement between the Company and University National Bank, dated August 29, 2011 (included as exhibit 10.18 to the Form 10-K filed April 3, 2012, and incorporated herein by reference).
- 10.12 Third Amendment to Employment Agreement between the Company and Michael R. Long, dated January 14, 2011 (included as exhibit 10.19 to the Form 10-K filed April 3, 2012, and incorporated herein by reference).
- 10.13 Third Amendment to Employment Agreement between the Company and Louis A. Hoch, dated January 14, 2011 (included as exhibit 10.20 to the Form 10-K filed April 3, 2012, and incorporated herein by reference).
- 10.14 Fourth Amendment to Employment Agreement between the Company and Michael R. Long, dated July 2, 2012 (included as exhibit 10.18 to the Form 10-Q filed August 20, 2012, and incorporated herein by reference).
- 10.15 Fourth Amendment to Employment Agreement between the Company and Louis A. Hoch, dated July 2, 2012 (included as exhibit 10.19 to the Form 10-Q filed August 20, 2012, and incorporated herein by reference).
- 10.16 Confidential Compromise Settlement Agreement and Full and Final Release by and between FiCentive, Inc. and SmartCard Marketing Systems, Inc., dated November 20, 2012 (included as exhibit 10.1 to the Form 8-K filed November 28, 2012).
- 10.17 First Amendment to Lease Agreement dated August 22, 2003 between the Company and Frost National Bank, Trustee for a Designated Trust, dated February 6, 2006 (included as exhibit 10.17 to the Form 10-K filed April 1, 2013 and incorporated herein by reference).
- 10.18 Second Amendment to Lease Agreement dated August 22, 2003 between the Company and Frost National Bank, Trustee for a Designated Trust, dated October 7, 2009 (included as exhibit 10.18 to the Form 10-K filed April 1, 2013 and incorporated herein by reference).
- 10.19 Third Amendment to Lease Agreement dated August 22, 2003 between the Company and Frost National Bank, Trustee for a Designated Trust, dated October 12, 2013 (included as exhibit 10.19 to the Form 10-K filed April 1, 2013 and incorporated herein by reference).
- 10.20 Asset Purchase Agreement, dated December 22, 2014, by and between Akimbo Financial, Inc. and Payment Data Systems, Inc. (included as exhibit 10.1 to the Form 8-K filed December 23, 2014, and incorporated herein by reference).
- 10.21 Transition Agreement, dated December 22, 2014, by and between Akimbo Financial, Inc. and Payment Data Systems, Inc. (included as exhibit 10.2 to the Form 8-K filed December 23, 2014, and incorporated herein by reference).
- 10.22 Employment Agreement, dated December 23, 2014, by and between Payment Data Systems, Inc. and Houston Frost (included as exhibit 10.3 to the Form 8-K filed December 23, 2014, and incorporated herein by reference).

reference).

- 10.23 Employment Agreement, dated March 3, 2015, by and between Payment Data Systems, Inc. and Habib Yunus (included as exhibit 10.1 to the Form 8-K filed March 6, 2015, and incorporated herein by reference).
- 10.24 Fourth Amendment to Lease Agreement, dated August 22, 2003, by and between Payment Data Systems, Inc. and Domicilio OC, LLC as successor-in-interest to Frost National Bank, dated February 12 2015 (included as exhibit 10.24 to the Form 10-K filed March 30, 2015, and incorporated herein by reference).
- 10.25 Lease Agreement, dated February 12, 2015, by and between FiCentive, Inc. and Domicilio OC, LLC (included as exhibit 10.25 to the Form 10-K filed March 30, 2015, and incorporated herein by reference).
- 10.26 Bank Sponsorship Agreement between the Company and Metropolitan Commercial Bank, dated December 11, 2014 (included as exhibit 10.26 to the Form 10-K filed March 30, 2015, and incorporated herein by reference).
- 10.27 Independent Director Agreement, dated April 24, 2015, by and between Payment Data Systems, Inc. and Kirk Taylor (included as exhibit 10.27 to the Form 10-Q filed August 14, 2015, and incorporated herein by reference).
- 10.28 Independent Director Agreement, dated April 24, 2015, by and between Payment Data Systems, Inc. and Dr. Peter Kirby (included as exhibit 10.28 to the Form 10-Q filed August 14, 2015, and incorporated herein by reference).
- 10.29 Independent Director Agreement, dated April 24, 2015, by and between Payment Data Systems, Inc. and Miguel A. Chapa (included as exhibit 10.29 to the Form 10-Q filed August 14, 2015, and incorporated herein by reference).
- 10.30 Loan and Security Agreement, dated February 2, 2016, by and between C2Go, Inc., as Debtor and FiCentive, Inc., as Lender. (included as exhibit 10.1 to the Form 8-K filed February 8, 2016, and incorporated herein by reference).
- 10.31† Card Marketing and Processing Agreement, dated February 2, 2016, by and between FiCentive, Inc. and C2Go, Inc. (included as exhibit 10.2 to the Form 8-K filed February 8, 2016, and incorporated herein by reference).
- 10.32 Fifth Amendment to Employment Agreement between the Company and Michael R. Long, dated August 3, 2016 (included as exhibit 10.1 to the Form 8-K filed August 9, 2016, and incorporated herein by reference).
- 10.33 Fifth Amendment to Employment Agreement between the Company and Louis A. Hoch, dated August 3, 2016 (included as exhibit 10.2 to the Form 8-K filed August 9, 2016 and incorporated herein by reference).
- 14.1 Code of Ethics (included as exhibit 14.1 to the Form 10-K filed March 30, 2004, and incorporated herein by reference).
- 16.1 Letter from Ernst and Young LLP to the Securities and Exchange Commission dated February 10, 2004 (included as exhibit 16 to the Form 8-K filed February 11, 2004, and incorporated herein by reference).
- 31.1

Edgar Filing: PAYMENT DATA SYSTEMS INC - Form 10-Q

Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).

31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).

32.1 Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (filed herewith).

101.INS XBRL Instance Document (filed herewith).

101.SCH XBRL Taxonomy Extension Schema Document (filed herewith).

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document (filed herewith).

101.DEF XBRL Taxonomy Extension Definition Linkbase Document (filed herewith).

101.LAB XBRL Taxonomy Extension Label Linkbase Document (filed herewith).

101.PRE XBRL Taxonomy Presentation Linkbase Document (filed herewith).

† Confidential treatment has been granted with respect to certain portions of this agreement.

SIGNATURES

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

**Payment Data
Systems, Inc.**

Date: August 15, 2016 By: /s/ Louis A.
Hoch
Louis A. Hoch
Chief
Executive
Officer
(Principal
Executive
Officer)