

**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 September 30, 2021

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period From _____ to _____
Commission File Number 0-21886

BARRETT BUSINESS SERVICES, INC.

(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of
Incorporation or organization)

8100 NE Parkway Drive, Suite 200
Vancouver, Washington
(Address of principal executive offices)

52-0812977
(IRS Employer
Identification No.)

98662
(Zip Code)

(360) 828-0700

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, Par Value \$0.01 Per Share	BBSI	The NASDAQ Stock Market LLC

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

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

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

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>
		Emerging growth company	<input type="checkbox"/>

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 October 20, 2021, 7,504,924 shares of the registrant's common stock (\$0.01 par value) were outstanding.

BARRETT BUSINESS SERVICES, INC.

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PART I – FINANCIAL INFORMATION

Item 1. Unaudited Interim Condensed Consolidated Financial Statements

Barrett Business Services, Inc.
Condensed Consolidated Balance Sheets
(Unaudited)
(In Thousands, Except Par Value)

	September 30, 2021	December 31, 2020
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 12,860	\$ 68,688
Investments	102,709	101,244
Trade accounts receivable, net	240,293	118,506
Income taxes receivable	1,732	6,485
Prepaid expenses and other	23,418	15,961
Restricted cash and investments	82,273	96,991
Total current assets	<u>463,285</u>	<u>407,875</u>
Property, equipment and software, net	35,965	34,916
Operating lease right-of-use assets	22,058	23,025
Restricted cash and investments	237,182	258,153
Goodwill	47,820	47,820
Other assets	2,657	3,161
	<u>\$ 808,967</u>	<u>\$ 774,950</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 3,565	\$ 221
Accounts payable	4,483	4,746
Accrued payroll, payroll taxes and related benefits	249,713	149,989
Current operating lease liabilities	7,435	7,539
Other accrued liabilities	8,190	7,275
Workers' compensation claims liabilities	78,225	102,040
Safety incentives liability	5,363	18,827
Total current liabilities	<u>356,974</u>	<u>290,637</u>
Long-term workers' compensation claims liabilities	218,774	255,706
Long-term debt	—	3,510
Deferred income taxes	2,946	4,518
Long-term operating lease liabilities	15,720	16,419
Customer deposits and other long-term liabilities	6,920	5,925
Total liabilities	<u>601,334</u>	<u>576,715</u>
Commitments and contingencies (Notes 4 and 6)		
Stockholders' equity:		
Common stock, \$.01 par value; 20,500 shares authorized, 7,505 and 7,566 shares issued and outstanding	75	76
Additional paid-in capital	27,981	24,885
Accumulated other comprehensive income	3,464	7,564
Retained earnings	176,113	165,710
Total stockholders' equity	<u>207,633</u>	<u>198,235</u>
	<u>\$ 808,967</u>	<u>\$ 774,950</u>

The accompanying notes are an integral part of these condensed consolidated financial statements.

Barrett Business Services, Inc.
Condensed Consolidated Statements of Operations
(Unaudited)
(In Thousands, Except Per Share Amounts)

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2021	2020	2021	2020
Revenues:				
Professional employer service fees	\$ 217,972	\$ 199,082	\$ 620,287	\$ 573,162
Staffing services	28,978	28,431	78,311	74,486
Total revenues	<u>246,950</u>	<u>227,513</u>	<u>698,598</u>	<u>647,648</u>
Cost of revenues:				
Direct payroll costs	21,870	21,452	58,818	56,325
Payroll taxes and benefits	115,012	100,142	349,514	313,275
Workers' compensation	49,833	46,685	141,693	146,120
Total cost of revenues	<u>186,715</u>	<u>168,279</u>	<u>550,025</u>	<u>515,720</u>
Gross margin	60,235	59,234	148,573	131,928
Selling, general and administrative expenses	41,170	35,587	113,939	100,957
Depreciation and amortization	1,342	1,341	3,967	3,512
Income from operations	<u>17,723</u>	<u>22,306</u>	<u>30,667</u>	<u>27,459</u>
Other income (expense):				
Investment income, net	1,825	1,664	5,559	6,431
Interest expense	(46)	(366)	(433)	(907)
Other, net	—	(4)	(4)	169
Other income, net	<u>1,779</u>	<u>1,294</u>	<u>5,122</u>	<u>5,693</u>
Income before income taxes	19,502	23,600	35,789	33,152
Provision for income taxes	4,573	5,089	8,324	6,538
Net income	<u>\$ 14,929</u>	<u>\$ 18,511</u>	<u>\$ 27,465</u>	<u>\$ 26,614</u>
Basic income per common share	<u>\$ 1.98</u>	<u>\$ 2.42</u>	<u>\$ 3.63</u>	<u>\$ 3.51</u>
Weighted average number of basic common shares outstanding	<u>7,545</u>	<u>7,639</u>	<u>7,559</u>	<u>7,572</u>
Diluted income per common share	<u>\$ 1.96</u>	<u>\$ 2.40</u>	<u>\$ 3.59</u>	<u>\$ 3.46</u>
Weighted average number of diluted common shares outstanding	<u>7,607</u>	<u>7,709</u>	<u>7,642</u>	<u>7,688</u>

The accompanying notes are an integral part of these condensed consolidated financial statements.

Barrett Business Services, Inc.
Condensed Consolidated Statements of Comprehensive Income
(Unaudited)
(In Thousands)

	Three Months Ended September 30,	
	2021	2020
Net income	\$ 14,929	\$ 18,511
Unrealized (losses) gains on investments, net of tax of (\$383) and \$263 in 2021 and 2020, respectively	(1,001)	688
Comprehensive Income	\$ 13,928	\$ 19,199

	Nine Months Ended September 30,	
	2021	2020
Net income	\$ 27,465	\$ 26,614
Unrealized (losses) gains on investments, net of tax of (\$1,567) and \$1,847 in 2021 and 2020, respectively	(4,100)	4,830
Comprehensive income	\$ 23,365	\$ 31,444

The accompanying notes are an integral part of these condensed consolidated financial statements.

Barrett Business Services, Inc.
Condensed Consolidated Statements of Stockholders' Equity
Three and Nine Months Ended September 30, 2021
(Unaudited)
(In Thousands)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total
	Shares	Amount				
Balance, December 31, 2020	7,566	\$ 76	\$ 24,885	\$ 7,564	\$ 165,710	\$ 198,235
Common stock issued on exercise of options, purchase of ESPP shares and vesting of restricted stock units and performance awards	38	—	815	—	—	815
Common stock repurchased on vesting of restricted stock units and performance awards	(1)	—	(107)	—	—	(107)
Share-based compensation expense	—	—	1,060	—	—	1,060
Company repurchase of common stock	(49)	—	(170)	—	(3,266)	(3,436)
Cash dividends on common stock (\$0.30 per share)	—	—	—	—	(2,278)	(2,278)
Unrealized loss on investments, net of tax	—	—	—	(5,250)	—	(5,250)
Net loss	—	—	—	—	(4,554)	(4,554)
Balance, March 31, 2021	<u>7,554</u>	<u>\$ 76</u>	<u>\$ 26,483</u>	<u>\$ 2,314</u>	<u>\$ 155,612</u>	<u>\$ 184,485</u>
Common stock issued on exercise of options and vesting of restricted stock units	15	—	61	—	—	61
Common stock repurchased on vesting of restricted stock units	(4)	—	(287)	—	—	(287)
Share-based compensation expense	—	—	1,335	—	—	1,335
Company repurchase of common stock	(42)	(1)	(155)	—	(2,986)	(3,142)
Cash dividends on common stock (\$0.30 per share)	—	—	—	—	(2,271)	(2,271)
Unrealized gain on investments, net of tax	—	—	—	2,151	—	2,151
Net income	—	—	—	—	17,090	17,090
Balance, June 30, 2021	<u>7,523</u>	<u>\$ 75</u>	<u>\$ 27,437</u>	<u>\$ 4,465</u>	<u>\$ 167,445</u>	<u>\$ 199,422</u>
Common stock issued on exercise of options, purchase of ESPP shares and vesting of restricted stock units	51	1	279	—	—	280
Common stock repurchased on vesting of restricted stock units	(14)	—	(1,010)	—	—	(1,010)
Share-based compensation expense	—	—	1,479	—	—	1,479
Company repurchase of common stock	(55)	(1)	(204)	—	(3,992)	(4,197)
Cash dividends on common stock (\$0.30 per share)	—	—	—	—	(2,269)	(2,269)
Unrealized loss on investments, net of tax	—	—	—	(1,001)	—	(1,001)
Net income	—	—	—	—	14,929	14,929
Balance, September 30, 2021	<u>7,505</u>	<u>\$ 75</u>	<u>\$ 27,981</u>	<u>\$ 3,464</u>	<u>\$ 176,113</u>	<u>\$ 207,633</u>

The accompanying notes are an integral part of these condensed consolidated financial statements.

Barrett Business Services, Inc.
Condensed Consolidated Statements of Stockholders' Equity
Three and Nine Months Ended September 30, 2020
(Unaudited)
(In Thousands)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Total
	Shares	Amount				
Balance, December 31, 2019	7,514	\$ 75	\$ 20,227	\$ 2,819	\$ 148,678	\$ 171,799
Common stock issued on exercise of options, purchase of ESPP shares and vesting of restricted stock units and performance awards	56	1	903	—	—	904
Common stock repurchased on vesting of restricted stock units and performance awards	(6)	—	(378)	—	—	(378)
Share-based compensation expense	—	—	342	—	—	342
Company repurchase of common stock	(59)	(1)	(169)	—	(2,817)	(2,987)
Cash dividends on common stock (\$0.30 per share)	—	—	—	—	(2,262)	(2,262)
Unrealized loss on investments, net of tax	—	—	—	(2,735)	—	(2,735)
Net loss	—	—	—	—	(3,407)	(3,407)
Balance, March 31, 2020	<u>7,505</u>	<u>\$ 75</u>	<u>\$ 20,925</u>	<u>\$ 84</u>	<u>\$ 140,192</u>	<u>\$ 161,276</u>
Common stock issued on exercise of options and vesting of restricted stock units	96	1	1,809	—	—	1,810
Common stock repurchased on vesting of restricted stock units	(3)	—	(110)	—	—	(110)
Share-based compensation expense	—	—	797	—	—	797
Cash dividends on common stock (\$0.30 per share)	—	—	—	—	(2,272)	(2,272)
Unrealized gain on investments, net of tax	—	—	—	6,877	—	6,877
Net income	—	—	—	—	11,510	11,510
Balance, June 30, 2020	<u>7,598</u>	<u>\$ 76</u>	<u>\$ 23,421</u>	<u>\$ 6,961</u>	<u>\$ 149,430</u>	<u>\$ 179,888</u>
Common stock issued on exercise of options, purchase of ESPP shares and vesting of restricted stock units	66	—	300	—	—	300
Common stock repurchased on vesting of restricted stock units	(18)	—	(928)	—	—	(928)
Share-based compensation expense	—	—	1,145	—	—	1,145
Cash dividends on common stock (\$0.30 per share)	—	—	—	—	(2,292)	(2,292)
Unrealized gain on investments, net of tax	—	—	—	688	—	688
Net income	—	—	—	—	18,511	18,511
Balance, September 30, 2020	<u>7,646</u>	<u>\$ 76</u>	<u>\$ 23,938</u>	<u>\$ 7,649</u>	<u>\$ 165,649</u>	<u>\$ 197,312</u>

The accompanying notes are an integral part of these condensed consolidated financial statements.

Barrett Business Services, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(In Thousands)

	Nine Months Ended September 30,	
	2021	2020
Cash flows from operating activities:		
Net income	\$ 27,465	\$ 26,614
Reconciliations of net income to net cash used in operating activities:		
Depreciation and amortization	3,967	3,512
Non-cash lease expense	5,937	5,394
Investment amortization and losses recognized	1,053	343
Deferred income taxes	(1)	3,890
Share-based compensation	3,874	2,284
Changes in certain operating assets and liabilities:		
Trade accounts receivable	(121,787)	(48,801)
Income taxes	4,753	(405)
Prepaid expenses and other	(7,457)	1,036
Accounts payable	(263)	454
Accrued payroll, payroll taxes and related benefits	100,792	32,554
Other accrued liabilities	835	(2,698)
Workers' compensation claims liabilities	(60,230)	(93,097)
Safety incentives liability	(13,464)	(4,596)
Operating lease liabilities	(5,773)	(5,215)
Other assets and liabilities, net	(5)	(130)
Net cash used in operating activities	<u>(60,304)</u>	<u>(78,861)</u>
Cash flows from investing activities:		
Purchase of property, equipment and software	(5,016)	(6,936)
Purchase of investments	(56,775)	(50,329)
Proceeds from sales and maturities of investments	72,130	46,791
Purchase of restricted investments	(253,778)	(32,508)
Proceeds from sales and maturities of restricted investments	110,131	45,160
Net cash (used in) provided by investing activities	<u>(133,308)</u>	<u>2,178</u>
Cash flows from financing activities:		
Proceeds from credit-line borrowings	2,718	—
Payments on credit-line borrowings	(2,718)	—
Payments on long-term debt	(166)	(165)
Repurchase of common stock	(10,775)	(2,987)
Common stock repurchased on vesting of stock awards	(1,404)	(1,416)
Dividends paid	(6,818)	(6,826)
Proceeds from exercise of stock options	1,156	3,014
Net cash used in financing activities	<u>(18,007)</u>	<u>(8,380)</u>
Net decrease in cash, cash equivalents and restricted cash	<u>(211,619)</u>	<u>(85,063)</u>
Cash, cash equivalents and restricted cash, beginning of period	233,837	273,341
Cash, cash equivalents and restricted cash, end of period	<u>\$ 22,218</u>	<u>\$ 188,278</u>

The accompanying notes are an integral part of these condensed consolidated financial statements.

Barrett Business Services, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Note 1 - Basis of Presentation of Interim Period Statements

The accompanying condensed consolidated financial statements are unaudited and have been prepared by Barrett Business Services, Inc. ("BBSI", the "Company", "our" or "we"), pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures typically included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the condensed consolidated financial statements include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods presented. The accompanying condensed financial statements are prepared on a consolidated basis. All intercompany account balances and transactions have been eliminated in consolidation. The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results may differ from such estimates and assumptions. The condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's 2020 Annual Report on Form 10-K at pages 34 – 61. The results of operations for an interim period are not necessarily indicative of the results of operations for a full year.

Revenue recognition

Professional employer ("PEO") services are normally used by organizations to satisfy ongoing needs related to the management of human capital and are governed by the terms of a client services agreement which covers all employees at a particular work site. Staffing revenues relate primarily to short-term staffing, contract staffing and on-site management services. The Company's performance obligations for PEO and staffing services are satisfied, and the related revenue is recognized, as services are rendered by our workforce.

Our PEO client service agreements have a minimum term of one year, are renewable on an annual basis, and typically require 30 days' written notice to cancel or terminate the contract by either party. In addition, our client service agreements provide for immediate termination upon any default of the client regardless of when notice is given. PEO customers are invoiced following the end of each payroll processing cycle, with payment generally due on the invoice date. Staffing customers are generally invoiced weekly based on agreed rates per employee and actual hours worked, typically with payment terms of 30 days. The amount of earned but unbilled revenue is classified as a receivable on the condensed consolidated balance sheets.

We report PEO revenues net of direct payroll costs because we are not the primary obligor for these payments to our clients' employees. Direct payroll costs include salaries, wages, health insurance, and employee out-of-pocket expenses incurred incidental to employment. We also present revenue net of safety incentives because these incentives represent consideration payable to customers.

Cost of revenues

Our cost of revenues for PEO services includes employer payroll-related taxes and workers' compensation costs. Our cost of revenues for staffing services includes direct payroll costs, employer payroll-related taxes, employee benefits, and workers' compensation costs. Direct payroll costs represent the gross payroll earned by staffing services employees based on salary or hourly wages. Payroll taxes and employee benefits consist of the employer's portion of Social Security and Medicare taxes, federal and state unemployment taxes, and staffing services employee reimbursements for materials, supplies and other expenses, which are paid by our customer. Workers' compensation costs consist primarily of premiums paid to third-party insurers, claims reserves, claims administration fees, legal fees, medical cost containment ("MCC") expense, state administrative agency fees, third-party broker commissions, risk manager payroll, as well as costs associated with operating our two wholly owned insurance companies, Associated Insurance Company for Excess ("AICE") and Ecole Insurance Company ("Ecole").

Cash and cash equivalents

We consider non-restricted short-term investments that are highly liquid, readily convertible into cash, and have maturities at acquisition of less than three months, to be cash equivalents for purposes of the condensed consolidated statements of cash flows and condensed consolidated balance sheets. The Company maintains cash balances in bank accounts that normally exceed FDIC insured limits. The Company has not experienced any losses related to its cash concentration.

Investments

The Company classifies investments as available-for-sale. The Company's investments are reported at fair value with unrealized gains and losses, net of taxes, shown as a component of accumulated other comprehensive income (loss) in stockholders' equity. Investments are recorded as current on the condensed consolidated balance sheets as the invested funds are available for current operations. Management considers available evidence in evaluating potential impairment of investments, including the extent to which fair value is less than cost and adverse conditions related to the security. In the event of a credit loss, an allowance would be recognized to the extent that the fair value of the security is less than the present value of the expected future cash flows. Realized gains and losses on sales of investments are included in investment income in our condensed consolidated statements of operations.

Restricted cash and investments

The Company holds restricted cash and investments primarily for the future payment of workers' compensation claims. These investments are categorized as available-for-sale. They are reported at fair value with unrealized gains and losses, net of taxes, shown as a component of accumulated other comprehensive income (loss) in stockholders' equity. Restricted cash and investments are classified as current and noncurrent on the condensed consolidated balance sheets based on the nature of the restriction. Management considers available evidence in evaluating potential impairment of restricted investments, including the extent to which fair value is less than cost and adverse conditions related to the security. In the event of a credit loss, an allowance would be recognized to the extent that the fair value of the security is less than the present value of the expected future cash flows. Realized gains and losses on sales of restricted investments are included in investment income in our condensed consolidated statements of operations.

Restricted cash and investments also includes investments held as part of the Company's deferred compensation plan. These investments are classified as trading securities and are recorded at fair value with unrealized gains and losses reported as a component of income (loss) from operations.

Allowance for doubtful accounts

The Company had an allowance for doubtful accounts of \$ 460,000 and \$757,000 at September 30, 2021 and December 31, 2020, respectively. We make estimates of the collectability of our accounts receivable for services provided to our customers based on future expected credit losses. Management analyzes historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in customers' payment trends when evaluating the adequacy of the allowance for doubtful accounts. If the financial condition of our customers deteriorates, resulting in an impairment of their ability to make payments, additional allowances may be required.

Workers' compensation claims liabilities

Our workers' compensation claims liabilities do not represent an exact calculation of liability but rather management's best estimate, utilizing actuarial expertise and projection techniques, at a given reporting date. The estimated liability for open workers' compensation claims is based on an evaluation of information provided by our third-party administrator for workers' compensation claims, coupled with an actuarial estimate of future loss development with respect to reported claims and incurred but not reported claims (together, "IBNR"). Workers' compensation claims liabilities include case reserve estimates for reported losses, plus additional amounts for estimated IBNR claims, MCC and legal costs, unallocated loss adjustment expenses and estimated future recoveries. The estimate of incurred costs expected to be paid within one year is included in current liabilities, while the estimate of incurred costs expected to be paid beyond one year is included in long-term liabilities on our condensed consolidated balance sheets. These estimates are reviewed at least quarterly and adjustments to estimated liabilities are reflected in current operating results as they become known.

The process of arriving at an estimate of unpaid claims and claims adjustment expense involves a high degree of judgment and is affected by both internal and external events, including changes in claims handling practices, changes in reserve estimation procedures, inflation, trends in the litigation and settlement of pending claims, and legislative changes.

Our estimates are based on actuarial analysis and informed judgment, derived from individual experience and expertise applied to multiple sets of data and analyses. We consider significant facts and circumstances known both at the time that loss reserves are initially established and as new facts and circumstances become known. Due to the inherent uncertainty underlying loss reserve estimates, the expenses incurred through final resolution of our liability for our workers' compensation claims will likely vary from the related loss reserves at the reporting date. Therefore, as specific claims are paid out in the future, actual paid losses may be materially different from our current loss reserves.

A basic premise in most actuarial analyses is that historical data and past patterns demonstrated in the incurred and paid historical data form a reasonable basis upon which to project future outcomes, absent a material change. Significant structural changes to the available data can materially impact the reserve estimation process. To the extent a material change affecting the ultimate claim liability becomes known, such change is quantified to the extent possible through an analysis of internal Company data and, if available and when appropriate, external data. Nonetheless, actuaries exercise a considerable degree of judgment in the evaluation of these factors and the need for such actuarial judgment is more pronounced when faced with material uncertainties.

Safety incentives

We accrue for and present expected safety incentives as a reduction of revenue. Safety incentives represent cash incentives paid to certain PEO client companies for maintaining safe-work practices and minimizing workplace injuries. The incentive is based on a percentage of annual payroll and is paid annually to customers who meet predetermined workers' compensation claims cost objectives. Safety incentive payments are made only after closure of all workers' compensation claims incurred during the customer's contract period. The safety incentive liability is estimated and accrued each month based upon contract year-to-date payroll and the then current amount of the customer's estimated workers' compensation claims reserves as established by us and our third-party administrator. In July 2020, the Company began limiting its safety incentive offering in certain markets. The Company provided \$5.4 million and \$ 18.8 million at September 30, 2021 and December 31, 2020, respectively, as an estimate of the liability for unpaid safety incentives.

Customer deposits

We require deposits from certain PEO customers to cover a portion of our accounts receivable due from such customers in the event of default of payment.

Comprehensive income (loss)

Comprehensive income (loss) includes all changes in equity during a period except those that resulted from investments by or distributions to the Company's stockholders.

Other comprehensive income (loss) refers to revenues, expenses, gains and losses that under U.S. generally accepted accounting principles ("GAAP") are included in comprehensive income (loss), but excluded from net income (loss) as these amounts are recorded directly as an adjustment to stockholders' equity. Our other comprehensive income (loss) comprises unrealized holding gains and losses on our available-for-sale investments.

Statements of cash flows

Interest paid during the nine months ended September 30, 2021 and 2020 did not materially differ from interest expense. Income taxes paid during the nine months ended September 30, 2021 totaled \$3.5 million. Income taxes paid during the nine months ended September 30, 2020 totaled \$ 3.2 million.

Bank deposits and other cash equivalents that are restricted for use are classified as restricted cash. The table below reconciles the cash, cash equivalents and restricted cash balances from our condensed consolidated balance sheets to the amounts reported on the condensed consolidated statements of cash flows (in thousands):

	September 30, 2021	December 31, 2020	September 30, 2020	December 31, 2019
Cash and cash equivalents	\$ 12,860	\$ 68,688	\$ 61,193	\$ 44,570
Restricted cash, included in restricted cash and investments	9,358	165,149	127,085	228,771
Total cash, cash equivalents and restricted cash shown in the statement of cash flows	<u>\$ 22,218</u>	<u>\$ 233,837</u>	<u>\$ 188,278</u>	<u>\$ 273,341</u>

Basic and diluted earnings per share

Basic earnings per share are computed based on the weighted average number of common shares outstanding for each year using the treasury method. Diluted earnings per share reflect the potential effects of the exercise of outstanding stock options, the issuance of stock associated with outstanding restricted stock units, performance share units and the Company's employee stock purchase plan. Basic and diluted shares outstanding are summarized as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2021	2020	2021	2020
Weighted average number of basic shares outstanding	7,545	7,639	7,559	7,572
Effect of dilutive securities	62	70	83	116
Weighted average number of diluted shares outstanding	<u>7,607</u>	<u>7,709</u>	<u>7,642</u>	<u>7,688</u>

Accounting estimates

The preparation of our condensed consolidated financial statements, in conformity with GAAP, requires management to make estimates and assumptions. These affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the reported amounts of revenues and expenses during the reporting periods. Management bases its 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. Estimates are used for fair value measurement of investments, allowance for doubtful accounts, deferred income taxes, carrying values for goodwill and property, equipment and software, accrued workers' compensation liabilities and safety incentive liabilities. Actual results may or may not differ from such estimates.

Note 2 - Fair Value Measurement

The following table summarizes the Company's investments at September 30, 2021 and December 31, 2020 measured at fair value on a recurring basis (in thousands):

	September 30, 2021			December 31, 2020		
	Cost	Gross Unrealized Gains (Losses)	Recorded Basis	Cost	Gross Unrealized Gains (Losses)	Recorded Basis
Current:						
Cash equivalents:						
Money market funds	\$ 10,742	\$ —	\$ 10,742	\$ 42,007	\$ —	\$ 42,007
Total cash equivalents	<u>10,742</u>	<u>—</u>	<u>10,742</u>	<u>42,007</u>	<u>—</u>	<u>42,007</u>
Investments:						
Corporate bonds	42,007	344	42,351	50,918	884	51,802
Asset backed securities	33,548	(25)	33,523	36,948	(146)	36,802
Mortgage backed securities	19,197	(296)	18,901	4,367	24	4,391
U.S. government agency securities	7,386	548	7,934	7,396	752	8,148
U.S. treasuries	—	—	—	100	1	101
Total current investments	<u>102,138</u>	<u>571</u>	<u>102,709</u>	<u>99,729</u>	<u>1,515</u>	<u>101,244</u>
Restricted cash and investments (1):						
Corporate bonds	127,026	1,209	128,235	88,902	4,091	92,993
Mortgage backed securities	71,546	1,331	72,877	48,795	2,356	51,151
U.S. treasuries	67,908	(32)	67,876	4,371	19	4,390
U.S. government agency securities	32,928	1,703	34,631	29,737	2,466	32,203
Mutual funds	6,104	—	6,104	5,036	—	5,036
Asset backed securities	150	1	151	256	4	260
Money market funds	143	—	143	40,063	(4)	40,059
Supranational bonds	—	—	—	4,775	3	4,778
Total restricted cash and investments	<u>305,805</u>	<u>4,212</u>	<u>310,017</u>	<u>221,935</u>	<u>8,935</u>	<u>230,870</u>
Total investments	<u>\$ 418,685</u>	<u>\$ 4,783</u>	<u>\$ 423,468</u>	<u>\$ 363,671</u>	<u>\$ 10,450</u>	<u>\$ 374,121</u>

(1) Included in restricted cash and investments within the condensed consolidated balance sheets is restricted cash of \$0.4 million and \$124.3 million as of September 30, 2021 and December 31, 2020, respectively, which is excluded from the table above. Restricted cash and investments are classified as current and noncurrent on the balance sheet based on the nature of the restriction.

The following table summarizes the Company's investments at September 30, 2021 and December 31, 2020 measured at fair value on a recurring basis by fair value hierarchy level (in thousands):

	September 30, 2021					December 31, 2020				
	Total Recorded Basis	Level 1	Level 2	Level 3	Other (1)	Total Recorded Basis	Level 1	Level 2	Level 3	Other (1)
Cash equivalents:										
Money market funds	\$ 10,742	\$ —	\$ —	\$ —	\$ 10,742	\$ 42,007	\$ —	\$ —	\$ —	\$ 42,007
Investments:										
Corporate bonds	42,351	—	42,351	—	—	51,802	—	51,802	—	—
Asset backed securities	33,523	—	33,523	—	—	36,802	—	36,802	—	—
Mortgage backed securities	18,901	—	18,901	—	—	4,391	—	4,391	—	—
U.S. government agency securities	7,934	—	7,934	—	—	8,148	—	8,148	—	—
U.S. treasuries	—	—	—	—	—	101	—	101	—	—
Restricted cash and investments:										
Corporate bonds	128,235	—	128,235	—	—	92,993	—	92,993	—	—
Mortgage backed securities	72,877	—	72,877	—	—	51,151	—	51,151	—	—
U.S. treasuries	67,876	—	67,876	—	—	4,390	—	4,390	—	—
U.S. government agency securities	34,631	—	34,631	—	—	32,203	—	32,203	—	—
Mutual funds	6,104	6,104	—	—	—	5,036	5,036	—	—	—
Asset backed securities	151	—	151	—	—	260	—	260	—	—
Money market funds	143	—	—	—	143	40,059	—	—	—	40,059
Supranational bonds	—	—	—	—	—	4,778	—	4,778	—	—
Total investments	<u>\$ 423,468</u>	<u>\$ 6,104</u>	<u>\$ 406,479</u>	<u>\$ —</u>	<u>\$ 10,885</u>	<u>\$ 374,121</u>	<u>\$ 5,036</u>	<u>\$ 287,019</u>	<u>\$ —</u>	<u>\$ 82,066</u>

(1) Investments in money market funds measured at fair value using the net asset value per share practical expedient are not subject to hierarchy level classification disclosure. The Company invests in money market funds that seek to maintain a stable net asset value. These investments include commingled funds that comprise high-quality short-term securities representing liquid debt and monetary instruments where the redemption value is likely to be the fair value. Redemption is permitted daily without written notice.

The following table summarizes the contractual maturities of the Company's available-for-sale securities at September 30, 2021 and December 31, 2020. Actual maturities may differ from contractual maturities because borrowers may have the right to prepay obligations with or without prepayment penalties.

(In thousands)	September 30, 2021					Total
	Less than 1 Year	Between 1 to 5 Years	Between 5 to 10 Years	After 10 Years		
	Corporate bonds	\$ 22,114	\$ 48,127	\$ 100,345	\$ —	
U.S. treasuries	1,005	1,987	64,884	—	67,876	
U.S. government agency securities	—	23,742	18,823	—	42,565	
Asset backed securities	—	153	2,200	31,321	33,674	
Money market funds	\$ 10,885	\$ —	\$ —	\$ —	\$ 10,885	
Total	\$ 34,004	\$ 74,009	\$ 186,252	\$ 31,321	\$ 325,586	

(In thousands)	December 31, 2020					Total
	Less than 1 Year	Between 1 to 5 Years	Between 5 to 10 Years	After 10 Years		
	Corporate bonds	\$ 49,308	\$ 61,315	\$ 34,172	\$ —	
Money market funds	82,066	—	—	—	82,066	
U.S. government agency securities	1,013	18,668	20,670	—	40,351	
Asset backed securities	2	267	—	36,793	37,062	
Supranational bonds	4,778	—	—	—	4,778	
U.S. treasuries	1,367	1,504	1,620	—	4,491	
Total	\$ 138,534	\$ 81,754	\$ 56,462	\$ 36,793	\$ 313,543	

The average contractual maturity of mortgage backed securities, which are excluded from the table above, was 23 years and 17 years as of September 30, 2021 and December 31, 2020, respectively.

Note 3 – Workers' Compensation Claims

The following table summarizes the aggregate workers' compensation reserve activity (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2021	2020	2021	2020
Beginning balance				
Workers' compensation claims liabilities	\$ 315,733	\$ 336,504	\$ 357,746	\$ 438,986
Add: claims expense accrual				
Current period	2,394	35,138	71,407	106,359
Prior periods	(823)	(2,977)	(7,486)	(5,163)
	1,571	32,161	63,921	101,196
Less: claim payments related to				
Current period	6,149	7,046	11,129	13,123
Prior periods	14,018	15,640	113,022	181,170
	20,167	22,686	124,151	194,293
Change in claims incurred in excess of retention limits	(138)	1,369	(517)	1,459
Ending balance				
Workers' compensation claims liabilities	\$ 296,999	\$ 347,348	\$ 296,999	\$ 347,348
Incurred but not reported (IBNR)	\$ 162,382	\$ 203,595	\$ 162,382	\$ 203,595
Ratio of IBNR to workers' compensation claims liabilities	55%	59%	55%	59%

Insured program

The Company provides workers' compensation coverage for client employees primarily through arrangements with fully licensed, third-party insurers (the "insured program"). Under this program, carriers issue policies to the Company's clients on behalf of the Company. Approximately 82% of the Company's workers' compensation exposure is covered through the insured program.

The Company entered into a new arrangement for its insured program effective July 1, 2021 whereby third-party insurers assume all risk of loss for claims incurred after June 30, 2021. The agreement continues to June 30, 2022 and includes a renewal commitment through June 30, 2023. The arrangement allows for premium adjustments depending on overall portfolio performance. If claims develop favorably, BBSI can participate in the savings up to \$20.0 million for a twelve-month policy period. If claims develop adversely, additional premium may be charged up to \$7.5 million for a twelve-month policy period.

For claims incurred under the insured program prior to July 1, 2021, the Company retains risk of loss up to the first \$ 3.0 million per occurrence on policies issued after June 30, 2020 and \$5.0 million per occurrence on policies issued before that date.

On June 29, 2020, the Company entered into a loss portfolio transfer agreement ("LPT 1") to remove all outstanding workers' compensation claims obligations for claims incurred under its insured program between February 1, 2014 and December 31, 2017. This transaction reduced the Company's outstanding workers' compensation liabilities and trust account balances by \$115.7 million.

On June 30, 2021, the Company entered into a loss portfolio transfer agreement ("LPT 2") to remove all remaining outstanding workers' compensation claims obligations for client policies issued under its insured program up to June 30, 2018. This transaction reduced the Company's outstanding workers' compensation liabilities by \$53.1 million. The payment terms of the LPT required \$ 5.0 million to be paid prior to June 30, 2021, with the remaining amount paid in July 2021.

The following is a summary of the risk retained by the Company under its insured program after considering the effects of the loss portfolio transfers and current insurance arrangements:

Year	Claims risk retained
2014	No
2015	No
2016	No
2017	No
2018 (1)	No
2019 (1)	Yes
2020	Yes
2021 - Through June 30	Yes
2021 - July 1 and after	No

(1) LPT 2 excluded approximately 10% of claims from 2018 and included an approximately offsetting amount of claims from 2019.

The Company is required to maintain minimum collateral levels for certain policies issued under the insured program, which is held in trust accounts (the "trust accounts"). The balance in the trust accounts was \$293.1 million and \$290.7 million at September 30, 2021 and December 31, 2020, respectively. The trust account balances are included as a component of the current and long-term restricted cash and investments in the Company's condensed consolidated balance sheets.

Self-insured programs

The Company is a self-insured employer with respect to workers' compensation coverage for all employees, including client employees, working in Colorado, Maryland and Oregon. In the state of Washington, state law allows only the Company's staffing services and internal management employees to be covered under the Company's self-insured workers' compensation program. The Company also operates a wholly owned, fully licensed insurance company, Ecole, which provides workers' compensation coverage to client employees working in Arizona and Utah. Approximately 18% of the Company's workers' compensation exposure is covered through self-insurance or Ecole (the "self-insured programs").

For all claims incurred under the Company's self-insured programs, the Company retains risk of loss up to the first \$ 3.0 million per occurrence, except in Maryland and Colorado, where the Company's retention per occurrence is \$1.0 million and \$2.0 million, respectively. For claims incurred under the Company's self-insured programs prior to July 1, 2020, the Company retains risk of loss up to the first \$5.0 million per occurrence, except in Maryland and Colorado, where the retention per occurrence is \$1.0 million and \$2.0 million, respectively.

The states of California, Maryland, Oregon, Washington, Colorado and Delaware required the Company to maintain collateral totaling \$ 58.4 million and \$60.1 million at September 30, 2021 and December 31, 2020, respectively, to cover potential workers' compensation claims losses related to the Company's current and former status as a self-insured employer. At September 30, 2021, the Company provided surety bonds and standby letters of credit to satisfy state collateral requirements.

Claims liabilities

The Company provided a total of \$ 297.0 million and \$357.7 million at September 30, 2021 and December 31, 2020, respectively, as an estimated future liability for unsettled workers' compensation claims liabilities. Of this amount, \$2.3 million and \$2.9 million at September 30, 2021 and December 31, 2020, respectively, represent case reserves incurred in excess of the Company's retention. The accrual for costs incurred in excess of retention limits is offset by a receivable from insurance carriers of \$2.3 million and \$2.9 million at September 30, 2021 and December 31, 2020, respectively, included in other assets in the condensed consolidated balance sheets.

Note 4 - Revolving Credit Facility and Long-Term Debt

The Company maintains an agreement (the "Agreement") with Wells Fargo Bank, N.A. (the "Bank") for a revolving credit line of \$ 33.0 million and a sublimit for standby letters of credit of \$8.0 million. At September 30, 2021, \$6.2 million of the sublimit for standby letters of credit was used. Advances under the revolving credit line bear interest, as selected by the Company, of (a) the daily floating rate of one-month LIBOR plus 1.75% or (b) the fixed rate of LIBOR plus 1.75%. The Agreement also provides for an unused commitment fee of 0.375% per year on the average daily unused amount of the revolving credit line, as well as a fee of 1.75% of the face amount of each letter of credit reserved under the line of credit. The Company had no outstanding borrowings on its revolving credit line at September 30, 2021 and December 31, 2020. The credit facility is collateralized by the Company's accounts receivable and other rights to receive payment.

The Agreement also provided a \$63.7 million standby letter of credit (the "Letter of Credit"). In April 2021, the Company and the insurance carrier reached an agreement to replace the Letter of Credit with other collateral assets and cancel the Letter of Credit in its entirety. As part of the transaction, the Bank released the \$38.7 million of collateral held in support of the Letter of Credit, and the Company transferred the \$ 38.7 million along with an additional \$ 25.0 million to the trust accounts to satisfy the collateral requirements of the insured program.

The Agreement requires the satisfaction of certain financial covenants as follows:

- EBITDA [net income before taxes plus interest expense (net of capitalized interest expense), depreciation expense, and amortization expense] on a rolling four-quarter basis must be not less than \$30 million at the end of each fiscal quarter; and
- the ratio of restricted and unrestricted cash and investments to workers' compensation and safety incentive liabilities must be at least 1.0:1.0, measured quarterly.

The Agreement imposes certain additional restrictions unless the Bank provides its prior written consent as follows:

- incurring additional indebtedness is prohibited, other than purchase financing for the acquisition of assets, provided that the aggregate of all purchase financing does not exceed \$1,000,000 at any time;
- the Company may not terminate or cancel any of the AICE policies; and
- if an event of default would occur, including on a pro forma basis, no dividends or distributions would be permitted to be paid and redemptions and repurchases of the Company's stock would be permitted only up to \$15 million in any rolling 12-month period.

The Agreement also contains customary events of default and specified cross-defaults under the Company's workers' compensation insurance arrangements. If an event of default under the Agreement occurs and is continuing, the Bank may declare any outstanding obligations under the Agreement to be immediately due and payable. At September 30, 2021, the Company was in compliance with all covenants.

The Company maintains a mortgage loan with the Bank with a balance of approximately \$ 3.6 million and \$3.7 million at September 30, 2021 and December 31, 2020, respectively, secured by the Company's corporate office building in Vancouver, Washington. This loan requires payment of monthly installments of \$18,375, bearing interest at the one-month LIBOR plus 2.0%, with the unpaid principal balance due July 1, 2022. LIBOR likely will no longer be in general use as a reference rate by financial institutions by December 31, 2021.

Note 5 – Income Taxes

Under ASC 740, "Income Taxes," management evaluates the realizability of the deferred tax assets on a quarterly basis under a "more likely than not" standard. As part of this evaluation, management reviews all evidence, both positive and negative, to determine if a valuation allowance is needed. One component of this analysis is to determine whether the Company was in a cumulative loss position for the most recent 12 quarters. The Company was in a cumulative income position for the 12 quarters ended September 30, 2021.

The Company's realization of a portion of net deferred tax assets is based in part on our estimates of the timing of reversals of certain temporary differences and on the generation of taxable income before such reversals.

The Company is subject to income taxes in U.S. federal and multiple state and local tax jurisdictions. The Internal Revenue Service is examining the Company's federal tax returns for the years ended December 31, 2011, 2012, 2013 and 2014. In July 2020, BBSI received notice that the IRS intends to disallow certain wage-based tax credits claimed for years 2011 to 2014, which would result in an estimated total additional tax due of approximately \$ 2.3 million for the tax years 2012 through 2015, including the impact on carryover tax attributes. The Company disagrees with the IRS determination and believes that it has technical merits to defend its position. Based on management's more-likely-than-not assessment that the position is sustainable, no reserve for the aforementioned IRS notice of disallowance of wage-based tax credits has been recorded in the financial statements. In July 2021, the Company received a notice from the IRS indicating the IRS plans to audit the Company's federal tax returns for the years ended December 31, 2017, 2018, and 2019.

In the major jurisdictions where it operates, the Company is generally no longer subject to income tax examinations by tax authorities for the 2015 and 2016 tax years and tax years before 2011. As of September 30, 2021, the Company had no material unrecognized tax benefits.

A portion of the consolidated income the Company generates is not subject to state income tax. Depending on the percentage of this income as compared to total consolidated income, the Company's state effective tax rate could fluctuate from expectations.

Note 6 – Litigation

On November 21, 2012, David Kaanaana ("Kaanaana"), a former staffing employee, filed a class action wage and hour lawsuit against BBSI in the California Superior Court on behalf of himself and certain other employees who worked at County Sanitation District No. 2 of Los Angeles County ("the District"). The trial court ruled in plaintiffs' favor regarding certain alleged meal breach violations but ruled in favor of BBSI with respect to the application of the California prevailing wage law to the District and other claims. These latter rulings were appealed by the plaintiffs to the California Court of Appeal. On November 30, 2018, the California Court of Appeal for the Second Appellate District returned its decision in Kaanaana v. Barrett Business Services, Inc., overruling the trial court's decision to dismiss the prevailing wage claim, ruling that the work in question at the District constitutes "public works" under the applicable law, and also ruling that plaintiffs' are entitled to additional remedies with regard to the meal break violations under California law. On January 9, 2019, BBSI filed a petition of review to the California Supreme Court.

On February 27, 2019, the California Supreme Court granted the petition to review the Court of Appeal's decision with respect to the prevailing wage issue. An amicus brief in support of BBSI's appeal was filed by the District and certain associations of special districts, cities and counties in California. Oral argument took place on January 5, 2021. A decision from the California Supreme Court was issued March 29, 2021 affirming the Court of Appeal decision and concluding that the recycling sorting work performed by the staffing employees in question was a "public work" and therefore would be subject to prevailing wage requirements. No damages were awarded in the appeals process. The case has been remanded to Superior Court for any such determination with respect to both the prevailing wage issue and any additional remedies for the meal break violations.

Although certain costs from the Kaanaana case are estimable and accrued, potential liability from the public work determination is not currently considered estimable and is therefore not accrued. There is not precedent on how this type of ruling would impact historical work performed prior to a relevant prevailing wage rate being established by the California Department of Industrial Relations. There remain many possible outcomes, including that a prevailing wage rate could be set considerably higher than actual wages paid, which totaled approximately \$2.2 million, or that actual wages paid may be determined to be equivalent to prevailing wages. There may also be other procedural outcomes.

BBSI believes it has the right to recover from the District any increased costs that may result from the court's past or future decisions related to prevailing wage requirements, including any fees and penalties that may be incurred.

In addition to the matter above, BBSI is subject to other legal proceedings and claims that arise in the ordinary course of our business. There are significant uncertainties surrounding litigation, including the possible liabilities in the Kaanaana case. For this case and others, management has recorded estimated liabilities of \$4.0 million in other accrued liabilities in the condensed consolidated balance sheets.

Note 7 – Subsequent Events

We have evaluated events and transactions occurring after the balance sheet date through our filing date and noted no events that are subject to recognition or disclosure.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

General

Company Background. Barrett Business Services, Inc. (“BBSI,” the “Company,” “our” or “we”), is a leading provider of business management solutions for small and mid-sized companies. The Company has developed a management platform that integrates a knowledge-based approach from the management consulting industry with tools from the human resource outsourcing industry. This platform, through the effective leveraging of human capital, helps our business owner clients run their businesses more effectively. We believe this platform, delivered through a decentralized organizational structure, differentiates BBSI from our competitors. BBSI was incorporated in Maryland in 1965.

Business Strategy. Our strategy is to align local operations teams with the mission of small and mid-sized business owners, driving value to their business. To do so, BBSI:

- partners with business owners to leverage their investment in human capital through a high-touch, results-oriented approach;
- brings predictability to each client organization through a three-tiered management platform; and
- enables business owners to focus on their core business by reducing organizational complexity and maximizing productivity.

Business Organization. We operate a decentralized delivery model using operationally-focused business teams, typically located within 50 miles of our client companies. These teams are led by senior level business generalists and include senior level professionals with expertise in human resources, organizational development, risk mitigation and workplace safety and various types of administration, including payroll. These teams are responsible for growth of their operations, and for providing strategic leadership, guidance and expert consultation to our client companies. The decentralized structure fosters autonomous decision-making in which business teams deliver plans that closely align with the objectives of each business owner client. This structure also provides a means of incubating talent to support increased growth and capacity. We support clients with employees located in 43 states and the District of Columbia through a network of 53 branch locations in California, Oregon, Arizona, Colorado, Pennsylvania, Washington, Idaho, Maryland, Nevada, Utah, Delaware, North Carolina, New Mexico, Tennessee, and Virginia. We also have several smaller recruiting locations in our general market areas, which are under the direction of a branch office.

Services Overview. BBSI’s core purpose is to advocate for business owners, particularly in the small and mid-sized business segment. Our evolution from an entrepreneurially run company to a professionally managed organization has helped to form our view that all businesses experience inflection points at key stages of growth. The insights gained through our own growth, along with the trends we see in working with more than 7,500 companies each day, define our approach to guiding business owners through the challenges associated with being an employer. BBSI’s business teams align with each business owner client through a structured three-tiered progression. In doing so, business teams focus on the objectives of each business owner and deliver planning, guidance and resources in support of those objectives.

Tier 1: Tactical Alignment

The first stage focuses on the mutual setting of expectations and is essential to a successful client relationship. It begins with a process of assessment and discovery in which the business owner’s business objectives, attitudes, and culture are aligned with BBSI’s processes, controls and culture. This stage includes an implementation process, which addresses the administrative components of employment.

Tier 2: Dynamic Relationship

The second stage of the relationship emphasizes organizational development as a means of achieving each client's business objectives. There is a focus on process improvement, development of best practices, supervisor training and leadership development.

Tier 3: Strategic Counsel

With an emphasis on advocacy on behalf of the business owner, the third stage of the relationship is more strategic and forward-looking with a goal of cultivating an environment in which all efforts are directed by the mission and long-term objectives of the business owner.

In addition to serving as a resource and guide, BBSI has the ability to provide workers' compensation coverage as a means of meeting statutory requirements and protecting our clients from employment-related injury claims. Through our third-party administrators, we provide claims management services for our clients. We work to manage and reduce job injury claims, identify fraudulent claims and structure optimal work programs, including modified duty.

Results of Operations

The spread of COVID-19 and resulting restrictions and labor shortages across the United States are having, and will continue to have, a negative impact on the operating results of the Company. As our clients respond to the effects of efforts to address the consequences of the pandemic, including the measures taken at various levels of government to contain the virus's spread, we expect that our ability to add new customers, as well as to grow revenues from existing customers, will be adversely affected due to economic slowdown, business closures, labor shortages and reductions in hours worked.

The following table sets forth the percentages of total revenues represented by selected items in the Company's condensed consolidated statements of operations for the three and nine months ended September 30, 2021 and 2020 (\$ in thousands):

	Percentage of Total Net Revenues								
	Three Months Ended				Nine Months Ended				
	September 30,		September 30,		September 30,		September 30,		
	2021	2020		2021	2020		2021	2020	
Revenues:									
Professional employer service fees	\$ 217,972	88.3	% \$ 199,082	87.5	% \$ 620,287	88.8	% \$ 573,162	88.5	%
Staffing services	28,978	11.7	28,431	12.5	78,311	11.2	74,486	11.5	
Total revenues	246,950	100.0	227,513	100.0	698,598	100.0	647,648	100.0	
Cost of revenues:									
Direct payroll costs	21,870	8.9	21,452	9.4	58,818	8.4	56,325	8.7	
Payroll taxes and benefits	115,012	46.6	100,142	44.0	349,514	50.0	313,275	48.4	
Workers' compensation	49,833	20.2	46,685	20.5	141,693	20.3	146,120	22.6	
Total cost of revenues	186,715	75.7	168,279	73.9	550,025	78.7	515,720	79.6	
Gross margin	60,235	24.3	59,234	26.1	148,573	21.3	131,928	20.4	
Selling, general and administrative expenses	41,170	16.7	35,587	15.6	113,939	16.3	100,957	15.6	
Depreciation and amortization	1,342	0.5	1,341	0.6	3,967	0.6	3,512	0.5	
Income from operations	17,723	7.1	22,306	9.9	30,667	4.4	27,459	4.2	
Other income, net	1,779	0.7	1,294	0.6	5,122	0.7	5,693	0.9	
Income before income taxes	19,502	7.9	23,600	10.4	35,789	5.1	33,152	5.1	
Provision for income taxes	4,573	1.9	5,089	2.2	8,324	1.2	6,538	1.0	
Net income	\$ 14,929	6.0	% \$ 18,511	8.1	% \$ 27,465	3.9	% \$ 26,614	4.1	%

We report professional employer (“PEO”) services revenues net of direct payroll costs because we are not the primary obligor for wage payments to our clients’ employees. However, management believes that gross billings and wages are useful in understanding the volume of our business activity and serve as an important performance metric in managing our operations, including the preparation of internal operating forecasts and establishing executive compensation performance goals. We therefore present for purposes of analysis gross billings and wage information for the three and nine months ended September 30, 2021 and 2020.

(in thousands)	(Unaudited) Three Months Ended September 30,		(Unaudited) Nine Months Ended September 30,	
	2021	2020	2021	2020
	Gross billings	\$ 1,689,313	\$ 1,511,908	\$ 4,762,193
PEO and staffing wages	\$ 1,462,982	\$ 1,300,352	\$ 4,119,235	\$ 3,710,788

Because safety incentives represent consideration payable to PEO customers, safety incentive costs are netted against PEO revenue in our consolidated statements of operations. We therefore present below for purposes of analysis non-GAAP gross workers’ compensation expense, which represents workers’ compensation costs including safety incentive costs. We believe this non-GAAP measure is useful in evaluating the total costs of our workers’ compensation program. In July 2020, the Company began limiting its safety incentive offering in certain markets, resulting in a reduction to safety incentive costs.

(in thousands)	(Unaudited) Three Months Ended September 30,		(Unaudited) Nine Months Ended September 30,	
	2021	2020	2021	2020
	Workers’ compensation	\$ 49,833	\$ 46,685	\$ 141,693
Safety incentive costs	687	5,369	2,163	19,150
Non-GAAP gross workers’ compensation	\$ 50,520	\$ 52,054	\$ 143,856	\$ 165,270

In monitoring and evaluating the performance of our operations, management also reviews the following ratios, which represent selected amounts as a percentage of gross billings. Management believes these ratios are useful in understanding the efficiency and profitability of our service offerings.

	(Unaudited) Percentage of Gross Billings Three Months Ended September 30,		(Unaudited) Percentage of Gross Billings Nine Months Ended September 30,	
	2021	2020	2021	2020
	PEO and staffing wages	86.6%	86.0%	86.5%
Payroll taxes and benefits	6.8%	6.6%	7.3%	7.3%
Non-GAAP gross workers’ compensation	3.0%	3.4%	3.0%	3.8%
Gross margin	3.6%	3.9%	3.1%	3.1%

The presentation of revenue on a net basis and the relative contributions of staffing and PEO services revenue can create volatility in our gross margin as a percentage of revenue. A relative increase in PEO services revenue will result in a higher gross margin as a percentage of revenue. Improvement in gross margin percentage occurs because incremental client services revenue dollars are reported as revenue net of all related direct payroll and safety incentive costs.

We refer to employees of our PEO clients as worksite employees (“WSEs”). Management reviews average and ending WSE growth to monitor and evaluate the performance of our operations. Average WSEs are calculated by dividing the number of unique individuals paid in each month by the number of months in the period. Ending WSEs represents the number of unique individuals paid in the last month of the period.

	(Unaudited) Three Months Ended September 30,			
	2021	% Change	2020	% Change
Average WSEs	116,258	8.0%	107,600	-8.1%
Ending WSEs	115,949	7.7%	107,612	-7.6%

	(Unaudited) Nine Months Ended September 30,			
	2021	% Change	2020	% Change
Average WSEs	111,640	3.6%	107,809	-5.2%
Ending WSEs	115,949	7.7%	107,612	-7.6%

Three Months Ended September 30, 2021 and 2020

Net income for the third quarter of 2021 amounted to \$14.9 million compared to net income of \$18.5 million for the third quarter of 2020. Diluted income per share for the third quarter of 2021 was \$1.96 compared to diluted income per share of \$2.40 for the third quarter of 2020.

Revenue for the third quarter of 2021 totaled \$247.0 million, an increase of \$19.4 million or 8.5% over the third quarter of 2020, which reflects an increase in the Company’s PEO service fee revenue of \$18.9 million or 9.5% and an increase in staffing services revenue of \$0.5 million or 1.9%.

Our growth in PEO service revenues was primarily attributable to an increase in average billing per WSE as well as an increase in the average number of WSEs. The increase in staffing services revenue was due primarily to the reopening of business after the impacts of COVID-19 during the prior year period.

Gross margin for the third quarter of 2021 totaled \$60.2 million or 24.3% of revenue compared to \$59.2 million or 26.1% of revenue for the third quarter of 2020. The decrease in gross margin as a percentage of revenues is a result of the factors discussed within the separate components of gross margin below.

Direct payroll costs for the third quarter of 2021 totaled \$21.9 million or 8.9% of revenue compared to \$21.5 million or 9.4% of revenue for the third quarter of 2020. The decrease in direct payroll costs percentage was primarily due to the increase in PEO services and decrease in staffing services within the mix of our customer base compared to the third quarter of 2020.

Payroll taxes and benefits for the third quarter of 2021 totaled \$115.0 million or 46.6% of revenue compared to \$100.1 million or 44.0% of revenue for the third quarter of 2020. The increase in payroll taxes and benefits as a percentage of revenues is due primarily to an increase in newly hired WSEs, which increased the amount of payroll subject to payroll taxes in the third quarter of 2021 as compared to the third quarter of 2020.

Workers’ compensation expense for the third quarter of 2021 totaled \$49.8 million or 20.2% of revenue compared to \$46.7 million or 20.5% for the third quarter of 2020. The decrease in workers’ compensation expense as a percentage of revenue is primarily related to favorable claims development as compared to the third quarter of 2020.

Selling, general and administrative (“SG&A”) expenses for the third quarter of 2021 totaled \$41.2 million or 16.7% of revenue compared to \$35.6 million or 15.6% of revenue for the third quarter of 2020. The increase of \$5.6 million in SG&A expense was primarily attributable to lower employee related expenses in the prior year due to reductions implemented in response to the COVID-19 pandemic that have since been reversed as well as increased variable employee compensation and incentive pay in the current year related to stronger than expected financial results.

Other income, net for the third quarter of 2021 was \$1.8 million, compared to other income, net of \$1.3 million for the third quarter of 2020. The increase was primarily attributable to an increase in investment income in the third quarter of 2021.

Our effective income tax rate for the third quarter of 2021 was 23.4%, compared to 21.6% for the third quarter of 2020. Our income tax rate typically differs from the federal statutory tax rate of 21% primarily due to state taxes and federal and state tax credits.

Nine Months Ended September 30, 2021 and 2020

Net income for the first nine months of 2021 amounted to \$27.5 million compared to net income of \$26.6 million for the first nine months of 2020. Diluted income per share for the first nine months of 2021 was \$3.59 compared to diluted income per share of \$3.46 for the first nine months of 2020.

Revenues for the first nine months of 2021 totaled \$698.6 million, an increase of \$51.0 million or 7.9% over the first nine months of 2020, which reflects an increase in the Company’s PEO service fee revenue of \$47.1 million or 8.2% and an increase in staffing services revenue of \$3.8 million or 5.1%.

The increase in PEO service revenues was primarily attributable to an increase in average billing per WSE as well as an increase in the average number of WSEs. The increase in staffing services revenue was due primarily to the reopening of business after the impacts of COVID-19 during the prior year period.

Gross margin for the first nine months of 2021 totaled \$148.6 million or 21.3% of revenue compared to \$131.9 million or 20.4% of revenue for the first nine months of 2020. The increase in gross margin as a percentage of revenues is primarily a result of the factors discussed within the separate components of gross margin below.

Direct payroll costs for the first nine months of 2021 totaled \$58.8 million or 8.4% of revenue compared to \$56.3 million or 8.7% of revenue for the first nine months of 2020. The decrease in direct payroll costs percentage was primarily due to the increase in PEO services and decrease in staffing services within the mix of our customer base in the first nine months of 2021 as compared to the first nine months of 2020.

Payroll taxes and benefits for the first nine months of 2021 totaled \$349.5 million or 50.0% of revenue compared to \$313.3 million or 48.4% of revenue for the first nine months of 2020. The increase in payroll taxes and benefits as a percentage of revenues is primarily due to an increase in newly hired WSEs, which increased the amount of payroll subject to payroll taxes in the first nine months of 2021 as compared to the first nine months of 2020.

Workers’ compensation expense for the first nine months of 2021 totaled \$141.7 million or 20.3% of revenue compared to \$146.1 million or 22.6% of revenue for the first nine months of 2020. The decrease in workers’ compensation expense as a percentage of revenue was primarily due to favorable claims development as well as a favorable adjustment of \$7.5 million related to prior period claims during the first nine months of 2021, compared to a favorable adjustment of \$5.2 million in the first nine months of 2020.

SG&A expenses for the first nine months of 2021 totaled \$113.9 million or 16.3% of revenue compared to \$101.0 million or 15.6% of revenue for the first nine months of 2020. The increase of \$12.9 million in SG&A expense was primarily attributable to an increase in IT expense related to the launch of the myBBSI portal in 2020 and increased employee related expenses due to prior year reductions during the COVID-19 pandemic that have since been reversed and increased variable employee compensation and incentive pay in the current year related to stronger than expected financial results.

Other income, net for the first nine months of 2021 was \$5.1 million as compared to other income, net of \$5.7 million for the first nine months of 2020. The decrease was primarily attributable to a decrease in investment income in the first nine months of 2021 because of lower interest rates.

Our effective income tax rate for the first nine months of 2021 was 23.3% compared to 19.7% for the first nine months of 2020. Our income tax rate typically differs from the federal statutory tax rate of 21% primarily due to state taxes and federal and state tax credits.

Fluctuations in Quarterly Operating Results

We have historically experienced significant fluctuations in our quarterly operating results, including losses in the first quarter of each year, and expect such fluctuations to continue in the future. Our operating results may fluctuate due to a number of factors such as seasonality, wage limits on statutory payroll taxes, claims experience for workers' compensation, demand for our services, and competition. Payroll taxes, as a component of cost of revenues, generally decline throughout a calendar year as the applicable statutory wage bases for federal and state unemployment taxes and Social Security taxes are exceeded on a per employee basis. Our revenue levels may be higher in the third quarter due to the effect of increased business activity of our customers' businesses in the agriculture, food processing and forest products-related industries. In addition, revenues in the fourth quarter may be reduced by many customers' practice of operating on holiday-shortened schedules. Workers' compensation expense varies with both the frequency and severity of workplace injury claims reported during a quarter and the estimated future costs of such claims. In addition, positive or adverse loss development of prior period claims during a subsequent quarter may also contribute to the volatility in the Company's estimated workers' compensation expense.

Liquidity and Capital Resources

The Company's cash balance of \$22.2 million, which includes cash, cash equivalents, and restricted cash, decreased \$211.6 million for the nine months ended September 30, 2021, compared to a decrease of \$85.1 million for the comparable period of 2020. The decrease in cash at September 30, 2021 as compared to December 31, 2020 was primarily due to purchases of investments and restricted investments, increased trade accounts receivable and decreased workers' compensation claims liabilities, which was due primarily to the loss portfolio transfer agreement, partially offset by proceeds from sales and maturities of investments and restricted investments and increased accrued payroll, payroll taxes and related benefits.

Net cash used by operating activities for the nine months ended September 30, 2021 was \$60.3 million, compared to net cash used of \$78.9 million for the comparable period of 2020. For the nine months ended September 30, 2021, cash used by operating activities was primarily due to increased trade accounts receivable of \$121.8 million, decreased workers' compensation claims liabilities of \$60.2 million and decreased safety incentive liabilities of \$13.5 million, partially offset by increased accrued payroll, payroll taxes and related benefits of \$100.8 million and net income of \$27.5 million.

Net cash used in investing activities for the nine months ended September 30, 2021 was \$133.3 million, compared to net cash provided of \$2.2 million for the comparable period of 2020. For the nine months ended September 30, 2021, cash used in investing activities consisted primarily of purchases of investments and restricted investments of \$310.6 million and purchases of property, equipment and software of \$5.0 million, partially offset by proceeds from sales and maturities of investments and restricted investments of \$182.3 million.

Net cash used in financing activities for the nine months ended September 30, 2021 was \$18.0 million, compared to net cash used of \$8.4 million for the comparable period of 2020. For the nine months ended September 30, 2021, cash was primarily used for repurchases of common stock of \$10.8 million and dividend payments of \$6.8 million, partially offset by proceeds from exercises of stock options of \$1.2 million.

The Company is required to maintain minimum collateral levels for certain policies issued under the insured program, which is held in trust accounts (the "trust accounts"). The balance in the trust accounts was \$293.1 million and \$290.7 million at September 30, 2021 and December 31, 2020, respectively. The trust account balances are included as a component of the current and long-term restricted cash and investments in the Company's condensed consolidated balance sheets.

On June 30, 2021, the Company entered into a loss portfolio transfer agreement to remove all remaining outstanding workers' compensation claims obligations for client policies issued under its insured program up to June 30, 2018. This transaction reduced the Company's outstanding workers' compensation liabilities by \$53.1 million. The payment terms of the LPT required \$5.0 million to be paid prior to June 30, 2021, with the remaining amount paid in July 2021.

The Company maintains an agreement (the "Agreement") with the Bank for a revolving credit line of \$33.0 million and a sublimit for standby letters of credit of \$8.0 million. At September 30, 2021, \$6.2 million of the sublimit for standby letters of credit was used. Advances under the revolving credit line bear interest, as selected by the Company, of (a) the daily floating rate of one-month LIBOR plus 1.75% or (b) the fixed rate of LIBOR plus 1.75%. The Agreement also provides for an unused commitment fee of 0.375% per year on the average daily unused amount of the revolving credit line, as well as a fee of 1.75% of the face amount of each letter of credit reserved under the line of credit. The Company had no outstanding borrowings on its revolving credit line at September 30, 2021 and December 31, 2020. The credit facility is collateralized by the Company's accounts receivable and other rights to receive payment.

The Agreement also provided a \$63.7 million standby letter of credit (the "Letter of Credit"). In April 2021, the Company and the insurance carrier reached an agreement to replace the Letter of Credit with other collateral assets and cancel the Letter of Credit in its entirety. As part of the transaction, the Bank released the \$38.7 million of collateral held in support of the Letter of Credit, and the Company transferred the \$38.7 million along with an additional \$25.0 million to the trust accounts to satisfy the collateral requirements of the insured program.

The Agreement requires the satisfaction of certain financial covenants as follows:

- EBITDA [net income before taxes plus interest expense (net of capitalized interest expense), depreciation expense, and amortization expense] on a rolling four-quarter basis must be not less than \$30 million at the end of each fiscal quarter; and
- the ratio of restricted and unrestricted cash and investments to workers' compensation and safety incentive liabilities must be at least 1.0:1.0, measured quarterly.

The Agreement imposes certain additional restrictions unless the Bank provides its prior written consent as follows:

- incurring additional indebtedness is prohibited, other than purchase financing for the acquisition of assets, provided that the aggregate of all purchase financing does not exceed \$1,000,000 at any time;
- the Company may not terminate or cancel any of the AICE policies; and
- if an event of default would occur, including on a pro forma basis, no dividends or distributions would be permitted to be paid and redemptions and repurchases of the Company's stock would be permitted only up to \$15 million in any rolling 12-month period.

The Agreement also contains customary events of default and specified cross-defaults under the Company's workers' compensation insurance arrangements. If an event of default under the Agreement occurs and is continuing, the Bank may declare any outstanding obligations under the Agreement to be immediately due and payable. At September 30, 2021, the Company was in compliance with all covenants.

The Company maintains a mortgage loan with the Bank with a balance of approximately \$3.6 million and \$3.7 million at September 30, 2021 and December 31, 2020, respectively, secured by the Company's corporate office building in Vancouver, Washington. This loan requires payment of monthly installments of \$18,375, bearing interest at the one-month LIBOR plus 2.0%, with the unpaid principal balance due July 1, 2022. LIBOR likely will no longer be in general use as a reference rate by financial institutions by December 31, 2021.

Inflation

Inflation generally has not been a significant factor in the Company's operations during the periods discussed above. The Company has taken into account the impact of escalating medical and other costs in establishing reserves for future workers' compensation claims payments.

Forward-Looking Information

Statements in this report include forward-looking statements which are not historical in nature and are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, among others, discussion of economic conditions in our market areas and their effect on revenue levels, the effects of the COVID-19 pandemic on our business operations, the competitiveness of our service offerings, our ability to attract and retain clients and to achieve revenue growth, the effect of changes in our mix of services on gross margin, the effect of tight labor market conditions, the adequacy of our workers' compensation reserves, the effect of changes in estimates of our future claims liabilities on our workers' compensation reserves, including the effect of changes in our reserving practices and claims management process on our actuarial estimates, expected levels of required surety deposits and letters of credit, our ability to generate sufficient taxable income in the future to utilize our deferred tax assets, the effect of our formation and operation of two wholly owned licensed insurance subsidiaries, the risks of operation and cost of our insured program, the financial viability of our excess insurance carriers, the effectiveness of our management information systems, our relationship with our primary bank lender and the availability of financing and working capital to meet our funding requirements, litigation costs, the effect of changes in the interest rate environment on the value of our investment securities and long-term debt, the adequacy of our allowance for doubtful accounts, and the potential for and effect of acquisitions.

All of our forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company or industry to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors with respect to the Company include our ability to retain current clients and attract new clients, the effects of governmental orders imposing business closures and shelter-in-place and social distancing requirements, difficulties associated with integrating clients into our operations, economic trends in our service areas, the potential for material deviations from expected future workers' compensation claims experience, changes in the workers' compensation regulatory environment in our primary markets, security breaches or failures in the Company's information technology systems, collectability of accounts receivable, changes in effective payroll tax rates and federal and state income tax rates, the carrying values of deferred income tax assets and goodwill (which may be affected by our future operating results), the impact of and potential changes to the Patient Protection and Affordable Care Act, escalating medical costs, and other health care legislative initiatives on our business, the effect of conditions in the global capital markets on our investment portfolio, and the availability of capital, borrowing capacity on our revolving credit facility, or letters of credit necessary to meet state-mandated surety deposit requirements for maintaining our status as a qualified self-insured employer for workers' compensation coverage or our insured program. Additional risk factors affecting our business are discussed in Item 1A of Part II of this report and Item 1A of Part I of our Annual Report on Form 10-K for the year ended December 31, 2020, which was filed with the SEC on March 8, 2021. We disclaim any obligation to publicly announce any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

The Company's exposure to market risk for changes in interest rates primarily relates to its investment portfolio and its outstanding borrowings on its line of credit and long-term debt. As of September 30, 2021, the Company's investments consisted principally of \$170.6 million in corporate bonds, \$91.8 million in mortgage backed securities, \$67.9 million in U.S. treasuries, \$42.6 million in U.S. government agency securities, \$33.7 million in asset backed securities, \$10.9 million in money market funds and \$6.1 million in mutual funds. The Company's outstanding debt totaled approximately \$3.6 million at September 30, 2021. Based on the Company's overall interest exposure at September 30, 2021, a 50 basis point increase in market interest rates would have a \$7.0 million effect on the fair value of the Company's investment portfolio. A 50 basis point increase would have an immaterial effect on the Company's outstanding borrowings because of the relative size of the outstanding borrowings.

Item 4. Controls and Procedures**Evaluation of Disclosure Controls and Procedures**

Management is responsible for establishing and maintaining adequate internal control over financial reporting ("ICFR") as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our ICFR is a process designed by, or under the supervision of, our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our condensed consolidated financial statements for external purposes in accordance with GAAP.

We maintain "disclosure controls and procedures" that are designed with the objective of providing reasonable assurance that information required to be disclosed in the reports we file or submit under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management is required to apply their judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Based on their evaluation, the Company's CEO and CFO have concluded that the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) were effective as of September 30, 2021.

Changes in Internal Control over Financial Reporting

There have been no changes in the Company's internal control over financial reporting that occurred during the quarter ended September 30, 2021 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Inherent Limitations

Control systems, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control systems' objectives are being met. Further, the design of any control systems must reflect the fact that there are resource constraints, and the benefits of all controls must be considered relative to their costs. Due to the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple errors or mistakes. Control systems can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

PART II-OTHER INFORMATION

Item 1. Legal Proceedings

Refer to "Note 6 - Litigation," to the condensed consolidated financial statements included in Part I, Item 1 of this report for information regarding legal proceedings in which we are involved.

Item 1A. Risk Factors

Other than the information below, there have been no material changes in the risk factors that were included in our Annual Report on Form 10-K for the year ended December 31, 2020, which was filed with the SEC on March 8, 2021.

The Company's business may be negatively affected by outbreaks of disease, such as epidemics or pandemics, including the ongoing COVID-19 pandemic.

In March 2020, the World Health Organization and the United States government declared COVID-19 a pandemic and recommended containment and mitigation measures worldwide. In response to the COVID-19 pandemic, preventative actions such as shelter-in-place orders, restrictions on travel, temporary closures of businesses deemed to be high-risk or non-essential, and other government mandates have affected many areas of the country, including states where BBSI and our clients operate, particularly on the West Coast. These restrictions on business operations have significantly disrupted the U.S. economy, including small-and mid-sized businesses, which comprise our primary client base. As our PEO fees are based on client payroll, workforce reductions or shortages related to the pandemic could have a material adverse effect on our business. Clients who are impacted by government restrictions and economic disruptions may experience liquidity and other financial issues, which may reduce their capacity to pay for our services.

In response to the pandemic, federal and state government agencies have enacted numerous laws and regulatory guidelines designed to help the economy, individuals and employers, including retroactively. Many of these legislative and regulatory changes, including the American Rescue Plan Act enacted on March 11, 2021, directly impact the Company and our clients. Several of these programs use payroll tax credits and other payroll tax-related reductions or deferrals as the mechanism to provide benefits to small businesses and employees. The guidance surrounding these programs is limited and continuously evolving. Failure to appropriately interpret and comply with legal and regulatory changes arising from the COVID-19 pandemic could have a material adverse effect on our business and reputation. Additionally, failure to incorporate changes to laws and regulations resulting from COVID-19 into our PEO business model may decrease our ability to attract and retain clients.

Additionally, many states have revised their workers' compensation standards of coverage to include COVID-19 related illnesses for certain groups of workers. While effects on the Company's workers' compensation exposure in the states in which we operate have been limited to date, these changes in laws and regulations or in the pattern of COVID-19 illnesses could increase our exposure to workers' compensation claims.

As our employees may work from home more frequently and access the Company's systems remotely, the Company may be exposed to heightened security risks, including the risk of cyber-attacks. Additionally, if any of the Company's key management employees are unable to perform their duties for an extended period, including as the result of illness, the Company's business could be adversely affected.

The COVID-19 pandemic has also caused significant volatility and uncertainty in the U.S. economy that may result in another economic downturn, which could in turn lead to increases in workers' compensation and unemployment claims, increased unemployment taxes, increased uncollectable receivables and reductions in the value of the Company's investment portfolio.

Continuation or exacerbation of the consequences of the pandemic is likely to have a material adverse effect on our business, cash flows, results of operations and financial condition, which may also result in our inability to comply with financial covenants under our credit facilities, our inability to obtain necessary additional financing and a decline in stockholder value.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table summarizes information related to stock repurchases during the quarter ended September 30, 2021.

Month	Total Number of Shares Repurchased	Average Price Paid Per Share	Total Number of Shares Repurchased as Part of Publicly Announced Plan ⁽¹⁾	Approximate Dollar Value of Shares that May Yet Be Repurchased Under the Plan ⁽¹⁾
July	7,687	\$ 71.54	7,687	\$ 34,819,079
August	—	—	—	34,819,079
September	47,860	76.19	47,860	31,172,822
Total	55,547		55,547	

(1) In August 2019, the Board authorized the repurchase of up to \$50.0 million of shares of the Company's stock from time to time in open market purchases over a three-year period beginning August 15, 2019. As of September 30, 2021, the Company had repurchased 290,953 shares at an aggregate purchase amount of \$18.8 million.

Item 6. Exhibits

- 31.1 [Certification of Chief Executive Officer pursuant to Rule 13a-14\(a\).](#)
- 31.2 [Certification of Chief Financial Officer pursuant to Rule 13a-14\(a\).](#)
- 32* [Certification pursuant to 18 U.S.C. Section 1350.](#)
- 101.INS Inline XBRL Instance Document- the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
- 101.SCH Inline XBRL Taxonomy Extension Schema Document
- 101.CAL Inline XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF Inline XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB Inline XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE Inline XBRL Taxonomy Extension Presentation Linkbase Document
- 104 The cover page from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2021, has been formatted in Inline XBRL.

*Furnished, not filed.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

BARRETT BUSINESS SERVICES, INC.
Registrant

Date: November 3, 2021

By: /s/ Anthony J. Harris
Anthony J. Harris
Executive Vice President and Chief Financial Officer and Treasurer

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Gary E. Kramer, certify that:

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

Date: November 3, 2021

/s/ Gary E. Kramer

Gary E. Kramer

Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Anthony J. Harris, certify that:

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

Date: November 3, 2021

/s/ Anthony J. Harris
Anthony J. Harris
Chief Financial Officer

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350**

In connection with the Quarterly Report of Barrett Business Services, Inc. (the "Company") on Form 10-Q for the period ended September 30, 2021 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned certify, pursuant to 18 U.S.C. § 1350, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Gary E. Kramer

Gary E. Kramer
Chief Executive Officer

November 3, 2021

/s/ Anthony J. Harris

Anthony J. Harris
Chief Financial Officer

November 3, 2021

A signed original of this written statement required by Section 906 has been provided to Barrett Business Services, Inc. and will be retained by Barrett Business Services, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.