

BARRETT BUSINESS SERVICES INC

Form 10-K

April 01, 2011

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-K**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2010

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)

(360) 828-0700

(Registrant's telephone number, including area code)

52-0812977  
(IRS Employer

Identification No.)

98662  
(Zip Code)

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

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Title of each class	Name of each exchange on which registered
Common Stock, Par Value \$0.01 Per Share	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company (as indicated by Exchange Act Rule 12b-2).

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

State the aggregate market value of the common equity held by non-affiliates of the registrant: \$94,014,000 at June 30, 2010.

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date:

Class	Outstanding at March 18, 2011
Common Stock, Par Value \$.01 Per Share	10,201,072 Shares

## DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the 2011 Annual Meeting of Stockholders are hereby incorporated by reference into Part III of Form 10-K.

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**PART I**

**Item 1. BUSINESS**

***General***

Barrett Business Services, Inc. ( Barrett, the Company, our or we ), was incorporated in the state of Maryland in 1965. We offer a comprehensive range of human resource management services to assist small and medium-sized businesses in managing the increasing costs and complexities of a broad array of employment-related issues. Our principal services, Professional Employer Organization ( PEO ) and staffing, assist our clients in leveraging their investment in human capital. We believe that the combination of these two principal services enables us to provide our clients with a unique blend of services not offered by our competition. Our platform of outsourced human resource management services is built upon our expertise in payroll processing, employee benefits and administration, workers compensation coverage, effective risk management and workplace safety programs and human resource administration.

In a PEO arrangement, we enter into a contract to become a co-employer of the client s existing workforce and assume responsibility for some or all of the client s human resource management responsibilities. Staffing services include on-demand or short-term staffing assignments, long-term or indefinite-term contract staffing and comprehensive on-site management. Our staffing services also include direct placement services, which involve fee-based search efforts for specific employee candidates at the request of our PEO clients, staffing customers or other companies.

Our ability to offer clients a broad mix of services allows us to effectively become the human resource department and a strategic business partner for our clients. We believe our approach to human resource management services is designed to positively affect our clients business results by:

allowing our clients to focus on core business activities instead of human resource matters;

increasing our clients productivity by improving employee satisfaction and generating greater employee retention;

reducing overall payroll expenses due to lower workers compensation costs; and

assisting our clients in complying with complex and evolving human resource related regulatory and tax issues.

We provide services to a diverse array of customers, including, among others, electronics manufacturers, various light-manufacturing industries, forest products and agriculture-based companies, transportation and shipping enterprises, food processing, telecommunications, public utilities, general contractors in numerous construction-related fields and various professional services firms. During 2010, we provided staffing services to approximately 1,750 staffing services customers, which compares to approximately 1,800 customers during 2009. In addition, at December 31, 2010, we served approximately 1,565

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PEO clients and employed approximately 32,800 employees pursuant to PEO contracts, as compared to approximately 1,340 PEO clients and approximately 26,600 employees as of December 31, 2009. We serve our clients, who have employees located in 24 states and the District of Columbia, through a network of 43 branch offices in California, Oregon, Washington, Idaho, Arizona, Utah, Colorado, Maryland, Delaware and North Carolina. We also have several smaller recruiting offices in our general market areas, which are under the direction of a branch office. See the table on page 33 of this report for the percentages of total net revenues from our staffing and PEO services for the three years in the period ended December 31, 2010.

### ***Market Opportunity***

The human resource outsourcing industry is large and continuing to expand. Some of the key factors driving growth include the desire of businesses to outsource non-core business functions, to reduce regulatory compliance risk, to rationalize the number of service providers that they use, and to reduce costs by integrating human resource systems and processes.

The outsourcing of business processes continues to represent a growing trend within the United States. By utilizing the expertise of outsourcing service providers, businesses are able to reduce processing costs and administrative burdens while at the same time offering competitive benefits for their employees. The technical capabilities, knowledge and operational expertise that we have built, along with our broad portfolio of services for clients, have enabled us to capitalize on the growing business processing outsourcing trend.

We believe that the small and medium-sized business segment of the human resource outsourcing market is particularly attractive because:

    this segment is large and has a low penetration rate by providers of outsourced comprehensive human resource services;

    small and medium-sized businesses typically have fewer in-house resources than larger businesses and, as a result, are generally more dependent on their service providers;

    quality of service, ease-of-use and responsiveness to clients' needs are key considerations of this business segment in selecting a service provider;

    small and medium-sized businesses generally do not require customized solutions, enabling service providers to achieve significant economies of scale through an integrated technology and service platform; and

    this segment is generally characterized by a relatively high client retention rate and lower client acquisition costs.

### ***Our Strategic Approach***

Our long-term goal is to become the leading provider of human resource outsourcing services for small and medium-sized businesses in the markets we serve. We seek to differentiate our strategic position by offering a full spectrum of PEO and staffing services. To

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a far lesser extent, we also provide permanent placement and preferred payroll services, which involves payroll processing of customers non-BBSI employees. We believe that the integrated nature of our service platform assists our clients and customers in successfully aligning and strengthening their organizational structure to meet the demands of their businesses. In pursuit of this goal, we have adopted the operating and growth strategies described below to provide the framework for our future growth, while maintaining the quality and integrity of our current service offerings.

### ***Operating Strategy***

*Provide a broad scope of services.* We provide our clients with a broad range of human resource management tools and professional services that meet their critical human resource needs. We believe that most human resource service providers offer discrete services, requiring client companies to engage and manage multiple vendors in order to obtain a comprehensive human resource management solution. Companies that purchase services from multiple vendors typically fail to realize the benefits and economies of scale of having a single, integrated source of human resource information. Our comprehensive solutions allow our clients to maximize the value realized from integrating information and establishing a partnership with a single vendor to address all of their human resource needs. We believe that the aggregate cost of purchasing discrete services from multiple vendors is greater than the cost of purchasing our integrated solution, such that we can offer cost savings and managerial efficiencies to our clients.

*Promote a decentralized and autonomous management philosophy and structure.* We hire senior-level managers to oversee, develop and expand our business at the branch-office level. We believe that highly experienced senior-level branch managers possess the skill set to handle the day-to-day demands of our business and still be proactive in solving client needs and focusing on further business development. We believe that by making significant investments in the best management talent available, within their respective areas of expertise, we can leverage the value of this investment many times over. We have also found that this philosophy facilitates our ability to attract and retain additional experienced senior-level managers to oversee our branch offices.

*Motivate employees through a competitive compensation package.* We offer a very competitive base salary structure at the branch-office level and provide the opportunity to earn additional profit sharing on a quarterly basis. This profit sharing is earned by each branch-level employee based upon branch office profitability after achieving certain minimum profitability standards. Our risk managers have an opportunity to earn incentive compensation based upon the workers' compensation claims experience of their specific client base. All profit sharing and incentive compensation measures are tangible and objective, with few subjective components.

*Control workers' compensation costs through effective risk management.* We are committed to the proactive mitigation of workers' compensation risk through stringent underwriting and disciplined management processes. Our senior management defines and maintains our strict underwriting standards. Our underwriting process begins with the selection of high quality candidate companies. Next, our professional

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risk managers in the field corroborate the underwriting data by assessing the candidate's operating culture, workplace safety standards and human resource administration philosophies, including compensation rates and benefit levels. If the candidate company satisfies all underwriting standards, then we accept the company and immediately implement a plan to further strengthen their workplace safety standards and practices. If the client's safe-work culture or adherence to workplace safety procedures declines to unsatisfactory levels, we will terminate the relationship under the terms of our contract.

### ***Growth Strategy***

*Support, strengthen and expand branch office operations.* We believe that increasing the penetration of our existing markets is an effective and cost-efficient means of growth as we are able to capitalize on our reputation and growing brand awareness in the territories in which we operate. We believe that there is substantial opportunity to further penetrate these territories. We intend to increase our penetration in our existing markets by continued growth through the effective use of referrals from current clients, insurance broker networks and marketing efforts within the local business community.

*Increase client utilization of our services.* We believe that we will be able to continue to maintain our average level of professional service fees per client employee and improve client retention as our clients more fully utilize our current service offerings, including cross selling among staffing, PEO, ASO and permanent placement. We invest substantial time integrating our services into our client organizations to optimize their effectiveness and measure their results. Our long-term partnership philosophy provides us with the opportunity to expand our PEO and staffing services.

*Enhance management information systems.* We continue to invest in developing our information technology infrastructure. We believe that our platform gives us a competitive advantage by allowing us to provide a high level of flexibility to satisfy a variety of demands of our small and medium-sized business clients on a cost-effective basis. Furthermore, we believe that our current technology platform is capable of supporting our planned development of new business units and increased market share for the foreseeable future.

*Penetrate new markets.* We intend to open additional branch offices in new geographic markets as opportunities arise. We have developed a well-defined approach to geographic expansion which we will use as a guide for entering new markets.

*Pursue strategic acquisitions.* Since our initial public offering in June 1993, we have completed 27 acquisitions of complementary businesses. In order to increase our client base, expand our presence in existing markets, enter new markets and broaden our service offerings, we may continue to pursue strategic acquisitions, particularly in the staffing area.

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### ***Our Services***

Our services are typically provided under a variety of contractual arrangements through which we offer a continuum of proactive human resource management services. While some services are more frequently associated with our PEO arrangements, our expertise in such areas as safety services and personnel-related regulatory compliance may also be used by our staffing services customers. Our human resource management services are built upon the following five areas of expertise:

*Payroll Processing.* For both our PEO and staffing services employees, we assist our clients in managing employment-related administration by providing payroll processing, employment-related tax filings and administration. These services are administered at each branch office, as well as centralized at our headquarters in Vancouver, Washington.

*Employee Benefits and Administration.* We assist our PEO clients in retaining the best employees for their businesses by helping them obtain, at their cost, comprehensive health benefits, including medical, dental and vision benefits, life and accident insurance, short-term and long-term disability. We also provide, at no cost to our PEO clients and our staffing employees, a 401(k) retirement savings plan and a Section 125 cafeteria plan.

*Human Resource Management.* We focus on developing and implementing a client-specific proactive human resource management system for each PEO client company. Through these efforts, clients achieve a more productive workforce through the disciplined application of standards for hiring and firing. Specifically, we assist our clients in attracting the right people by providing best recruiting practices, job description development, skills testing, salary information, drug testing, interview guidelines and assistance, evaluating job applications and references and compliance with a broad range of employment regulations.

*Risk Management.* We focus on developing and implementing a client-specific proactive risk management program so as to further mitigate risk of injury associated with workplace practices. These efforts enable our clients and us to achieve a reduction in accidents and workers' compensation claims. We provide such tactical services as safety training and safety manuals for both workers and supervisors, job-site visits and meetings, improvements in workplace procedures and equipment to further reduce the risk of injury and workplace regulations of the U.S. Department of Labor and state agencies and leading accident investigations. We have at least one risk manager available at each branch office to perform workplace safety assessments for each prospective client and to implement systems to improve work practices. All risk managers report directly to our Chief Executive Officer. Each risk manager has the authority to cancel our business relationship with any customer or client company.

*Workers' Compensation Coverage.* We assist our clients in protecting their businesses from employment-related injury claims by providing workers' compensation coverage. Through our internal claims managers and our third-party administrators, we provide claims management services for our PEO clients. We



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work aggressively to manage and reduce job injury claims, including identifying fraudulent claims and taking advantage of our staffing services to return injured workers to active employment earlier. As a result of our efforts to manage workers' compensation costs, we are often able to reduce our clients' overall expenses arising out of job-related injuries and insurance.

PEO Services. In a PEO services arrangement, we enter into a contract to become a co-employer of the client's existing workforce and assume responsibility for some or all of the human resource management responsibilities, including payroll and payroll taxes, employee benefits, health insurance, workers' compensation coverage, workplace safety programs, compliance with federal and state employment laws, labor and workplace regulatory requirements, and related administrative responsibilities. We have the right to hire and fire our PEO employees, although the client remains responsible for day-to-day assignments, supervision and training and, in most cases, recruiting.

We began offering PEO services to Oregon customers in 1990 and subsequently expanded these services to other states, primarily California. In 2010, approximately 87% of our PEO service fee revenues were generated from customers in California with an additional 5% of revenues generated in Oregon.

We have entered into co-employer arrangements with a wide variety of clients, including companies involved in moving and shipping, professional services firms, construction, retail, manufacturing and distribution businesses. PEO clients are typically small to mid-sized businesses with up to several hundred employees. None of our PEO clients individually represented more than 2% of our total revenues in 2010.

Prior to entering into a co-employer arrangement, we perform an analysis of the potential client's actual personnel and workers' compensation costs based on information provided by the prospect. We introduce our workplace safety program and recommend improvements in procedures and equipment following a risk assessment of the prospect's facilities. The potential client must agree to implement recommended changes as part of the co-employer arrangement. We also offer financial incentives to PEO clients to maintain a safe-work environment.

Our standard PEO services agreement typically provides for an initial term of one year with automatic renewal for one-year periods. Our agreements generally permit cancellation by either party upon 30 days' written notice. In addition, we may terminate the agreement at any time for specified reasons, including nonpayment or failure to follow our workplace safety program.

The PEO services agreement also provides for indemnification of us by the client against losses arising out of any default by the client under the agreement, including failure to comply with any employment-related, health and safety, or immigration laws or regulations. We require our PEO clients to maintain comprehensive liability coverage in the amount of \$1.0 million for acts of our work-site employees. Although no claims exceeding such policy limits have been paid by us to date, the possibility exists that claims for amounts in excess of sums available to us through indemnification or insurance may be asserted in the future, which could adversely affect our profitability.

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**Staffing Services.** Our staffing services include on-demand or short-term staffing assignments, contract staffing, long-term or indefinite-term on-site management, direct placement and human resource administration. Short-term staffing involves demands for employees caused by such factors as seasonality, fluctuations in customer demand, vacations, illnesses, parental leave and special projects without incurring the ongoing expense and administrative responsibilities associated with recruiting, hiring and retaining additional permanent employees. As more and more companies focus on effectively managing variable costs and reducing fixed overhead, the use of employees on a short-term basis allows firms to utilize the just-in-time approach for their personnel needs, thereby converting a portion of their fixed personnel costs to a variable expense.

Contract staffing refers to our responsibilities to provide employees for our clients for a period of more than three months or an indefinite period. This type of arrangement often involves outsourcing an entire department in a large corporation or providing the workforce for a large project.

In an on-site management arrangement, we place an experienced manager on site at a client's place of business. The manager is responsible for conducting all recruiting, screening, interviewing, testing, hiring and employee placement functions at the client's facility for a long-term or indefinite period.

Direct placement services involve fee-based search efforts for specific employee candidates at the request of our PEO clients, staffing customers or other companies.

Our staffing services customers operate in a broad range of businesses, including agriculture-based companies, electronic manufacturers, transportation and logistics companies, food processors, professional firms and construction. Such customers generally range in size from small local firms to companies with international operations that use our services on a domestic basis. None of our staffing services customers individually represented more than 2% of our total revenues in 2010.

In 2010, the light-industrial sector generated approximately 86% of our staffing services revenues, while clerical office staff accounted for 11% of such revenues and technical personnel represented the balance of 3%. Our light-industrial workers perform such tasks as operation of machinery, manufacturing, loading and shipping, site preparation for special events, construction-site cleanup and janitorial services. Technical personnel include electronic parts assembly workers and designers of electronic parts.

We employ a variety of methods to recruit our work force for staffing services, including among others, referrals by existing employees, online job boards, our Web site for job postings, job fairs, newspaper advertising, and marketing brochures distributed at colleges and vocational schools. The employee application process may include an interview, skills assessment test, reference verification, drug screening, criminal background checks and pre-employment physicals. The recruiting of qualified employees requires more effort when unemployment rates are low. We use various types of pre-employment screen testing to ensure that applicants are appropriately qualified for employment.

Our staffing services employees are not under our direct control while working at a customer's business. While we have not experienced any significant liability due to claims

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arising out of negligent acts or misconduct by our staffing services employees, claims could be asserted against us which could have a material adverse effect on our financial condition and results of operations.

### ***Sales and Marketing***

Our sales and marketing efforts are led by our branch managers and a small team of sales professionals, coupled with strong ties with the insurance brokerage community. Our marketing efforts are principally focused on branch-level development of local business relationships. On a regional and national level, efforts are made to expand and align our services to fulfill the needs of local customers with multiple locations, which may include using our on-site personnel and the opening of additional offices to better serve a customer's broader geographic needs. We also rely on an extensive network of insurance brokers for referrals for PEO services, particularly in California, in exchange for an ongoing fee equal to a very small percentage of payroll. Business development is the primary function of our branch managers.

### ***Risk Assessment***

All prospective clients are evaluated individually on the basis of total predicted profitability. This analysis takes into account workers compensation risk and claims history, unemployment claims history and creditworthiness. The workers' compensation risk profile also includes an assessment of the prospect's internal culture regarding workplace safety, compensation rates and benefits provided to its employees.

### ***Management Information Systems***

We perform all functions associated with payroll administration through our internal management information system. Each branch office performs payroll data entry functions and maintains an independent database of employees and customers, as well as payroll and invoicing records. All processing functions are centralized at our corporate headquarters in Vancouver, Washington.

### ***Acquisitions***

We have completed 27 acquisitions since our initial public offering in June 1993. Our acquisition targets are typically traditional light industrial staffing companies. We have acquired PEO companies less frequently due to underwriting issues associated with the target company's existing customers; we prefer to apply our own underwriting criteria prior to establishing a business relationship with a PEO customer. Due to the current concentration of our operations in California and Oregon, our acquisition plans will likely focus on expanding our geographic footprint into contiguous regions. There can be no assurance, however, that any additional transactions will be consummated in the future.

### ***Competition***

The staffing services and PEO businesses are characterized by intense competition. The staffing services market includes competitors of all sizes, including national competitors such as Manpower, Inc. and Kelly Services, Inc., that have substantially greater financial, marketing and other resources than we do. In addition to national companies, we compete with numerous regional and local firms for both customers and employees. There are

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relatively few barriers to entry into the staffing services business. The principal competitive factors in the staffing services industry are price, the ability to provide qualified workers in a timely manner and the monitoring of job performance.

We may face additional PEO competition in the future from new entrants to the field, including other staffing services companies, payroll processing companies and insurance companies. Certain PEO companies that periodically compete with us in the same markets have greater financial and marketing resources than we do, such as Administaff, Inc. and Paychex, Inc., among others. Competition in the PEO industry is based largely on price, although service and quality can also provide competitive advantages. A significant limiting factor to the growth of the PEO industry is the perception of potential clients that they have the capacity to handle human resource issues internally. We believe that our past growth in PEO service fee revenues is attributable to our ability to provide small and medium-sized companies with the opportunity to reduce workers' compensation costs and to provide enhanced benefits to their employees while reducing their overall personnel administration costs. Our competitive advantage may be adversely affected by a substantial increase in the costs of maintaining our self-insured workers' compensation program, or changes in the regulatory environment, particularly in California. A general market decrease in the level of workers' compensation insurance premiums likely would decrease demand for PEO services among some prospective client companies.

### ***Self-Insured Workers' Compensation Program***

A principal service we provide to our customers, particularly our PEO clients, is workers' compensation coverage. As the employer of record, we are responsible for complying with applicable statutory requirements for workers' compensation coverage. Our workplace safety services are closely tied to our approach to the management of workers' compensation risk.

Elements of Workers' Compensation System. State law (and for certain types of employees, federal law) generally mandates that an employer reimburse its employees for the costs of medical care and other specified benefits for injuries or illnesses, including catastrophic injuries and fatalities, incurred in the course and scope of employment. The benefits payable for various categories of claims are determined by state regulation and vary with the severity and nature of the injury or illness and other specified factors. In return for this guaranteed protection, workers' compensation is an exclusive remedy and employees are generally precluded from seeking other damages from their employer for workplace injuries. Most states require employers to maintain workers' compensation insurance or otherwise demonstrate financial responsibility to meet workers' compensation obligations to employees. In many states, employers who meet certain financial and other requirements are permitted to self-insure.

Self Insurance for Workers' Compensation. In August 1987, we became a self-insured employer for workers' compensation coverage in Oregon. We subsequently obtained self-insured employer status for workers' compensation in four additional states, California, Delaware, Maryland and Colorado, as well as in Washington for our non-PEO services. Regulations governing self-insured employers in each jurisdiction typically require the employer to maintain surety deposits of government securities, letters of credit or other financial instruments to cover workers' claims in the event the employer is unable to pay for such claims.

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To manage our financial exposure from the incidence of catastrophic injuries and fatalities, we maintain excess workers' compensation insurance coverage. We maintain a wholly owned, fully licensed captive insurance company, Associated Insurance Company for Excess ( AICE ), to provide us with excess workers' compensation coverage from \$1.0 million up to \$5.0 million per occurrence. Additional excess workers' compensation insurance coverage is provided through annual policies issued by a major insurance company from \$5.0 million to \$15.0 million per occurrence, except for our Maryland and Colorado operations. Our excess insurance policy in Maryland has a \$1.0 million retention with a \$25.0 million limit and our excess insurance policy in Colorado has a \$500,000 retention and statutory limits on a per occurrence basis. This approach results in an effective per occurrence retention, on a consolidated basis, of \$5.0 million. This higher per occurrence retention may result in higher workers' compensation costs to us with a corresponding negative effect on our operating results. AICE provides us with access to an alternative mechanism for excess insurance coverage, as well as certain income tax benefits arising from the ability to accelerate the deduction, for tax purposes, of certain accruals for workers' compensation claims.

Effective January 5, 2010, we formed Ecole Insurance Company, a wholly owned fully licensed insurance company in Arizona ( Ecole ). Ecole provides workers' compensation coverage to our employees working in Arizona for claims occurring on or after March 1, 2010. Additional excess workers' compensation insurance coverage for Ecole is provided by a major insurance company from \$5.0 million to statutory limits per occurrence.

Claims Management. As a self-insured employer, our workers' compensation expense is tied directly to the incidence and severity of workplace injuries to our employees. We seek to contain our workers' compensation costs through an aggressive approach to claims management. We use managed-care systems to reduce medical costs and keep time-loss costs to a minimum by assigning injured workers, whenever possible, to short-term assignments which accommodate the workers' physical limitations. We believe that these assignments minimize both time actually lost from work and covered time-loss costs. We employ internal, professionally licensed claims adjusters and engage third-party claims administrators ( TPAs ) to provide the principal claims management expertise. Typical management procedures include performing thorough and prompt on-site investigations of claims filed by employees, working with physicians to encourage efficient medical management of cases, denying questionable claims and attempting to negotiate early settlements to eliminate future development of claims costs. We also maintain a corporate-wide pre-employment drug screening program and a mandatory post-injury drug test. The program is believed to have resulted in a reduction in the frequency of fraudulent claims and in accidents in which the use of illegal drugs appears to have been a contributing factor.

Elements of Self-Insurance Costs. The costs associated with our self-insured workers' compensation program include case reserves for reported claims, an additional expense provision for potential future increases in the cost of open injury claims (known as adverse loss development ) and claims incurred in prior periods but not reported (referred to as IBNR ), fees payable to our TPAs, additional claims administration expenses, administrative fees payable to state workers' compensation regulatory agencies, legal fees, broker commissions for business referrals, premiums for excess workers' compensation insurance, and costs associated with forming and operating our wholly owned, fully licensed captive insurance company for excess coverage. The state assessments are typically based

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on payroll amounts and, to a limited extent, the amount of permanent disability awards during the previous year. Excess insurance premiums are also based in part on the size and risk profile of our payroll and loss experience.

### ***Workers Compensation Claims Experience and Reserves***

We recognize our liability for the ultimate payment of incurred claims and claims adjustment expenses by accruing liabilities which represent estimates of future amounts necessary to pay claims and related expenses with respect to covered events that have occurred. When a claim involving a probable loss is reported, our internal claims management personnel or our TPA establishes a case reserve for the estimated amount of ultimate loss. The estimate reflects an informed judgment based on established case reserving practices and the experience and knowledge of our claims management staff and the TPA regarding the nature and expected value of the claim, as well as the estimated expense of settling the claim, including legal and other fees and expenses of administering claims. The adequacy of such case reserves in part depends on the professional judgment of both our claims management staff and our TPA to properly and comprehensively evaluate the economic consequences of each claim. Our reserves include an additional component for both estimated future adverse loss development in excess of initial case reserves on open claims and for incurred but not reported claims (together IBNR) based upon an actuarial estimate provided by the Company's independent actuary. Our reserves do not include an estimated provision for the incidence of unknown or unreported catastrophic claims.

As part of the case reserving process, historical data is reviewed and consideration is given to the anticipated effect of various factors, including known and anticipated legal developments, inflation and economic conditions. Reserve amounts are based on management's estimates, and as other data becomes available, these estimates are revised, which may result in increases or decreases in existing case reserves. Management's internal accrual process for workers' compensation expense is based upon the immediate recognition of an expense and the related liability at the time a claim occurs; the value ascribed to the expense and liability is based upon our internal claims management and the TPAs' estimate of ultimate claim cost coupled with a provision for estimated future development based upon an actuarial review performed quarterly by our independent actuary. We believe our total accrued workers' compensation claims liabilities at December 31, 2010, are adequate. It is possible, however, that our actual future workers' compensation obligations may exceed the amount of our accrued liabilities, with a corresponding negative effect on future earnings, due to such factors as unanticipated adverse loss development of known claims and, to a much lesser extent, of claims incurred but not reported.

Failure to successfully manage the severity and frequency of workplace injuries would result in increased workers' compensation expense and would have a negative effect, which may be substantial, on our operating results and financial condition. Management maintains clear guidelines for our branch office managers, account managers, and risk managers directly tying their continued employment to their diligence in understanding and addressing the risks of accident or injury associated with the industries in which client companies operate and in monitoring the compliance by clients with workplace safety requirements. We have a policy of "zero tolerance" for avoidable workplace injuries. Each of our risk managers has the authority to cancel any staffing customer or PEO client at any time based upon their assessment of their safe-work practices or philosophies.

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### ***Employees and Employee Benefits***

At December 31, 2010, we had approximately 40,935 employees, including approximately 7,800 staffing services employees, approximately 32,800 PEO employees, approximately 335 managerial, sales and administrative employees and four executive officers. The number of employees at any given time may vary significantly due to business conditions at customer or client companies. During 2010, approximately 2% of our employees were covered by a collective bargaining agreement. Substantially all of our managerial, sales and administrative employees have entered into a standard form of employment agreement which, among other provisions, contains covenants not to engage in certain activities in competition with us for 18 months following termination of employment and to maintain the confidentiality of certain proprietary information. We believe our employee relations are good.

Benefits offered to our staffing services employees include a limited-benefit medical insurance plan, a Section 125 cafeteria plan which permits employees to use pretax earnings to fund various services, including health insurance premiums and childcare expenses, and a retirement savings plan (the 401(k) plan) under Section 401(k) of the Internal Revenue Code pursuant to which employees may begin making contributions upon reaching 21 years of age and completing 1,000 hours of service in any consecutive 12-month period. We may also make contributions to the 401(k) plan, which vest over six years and are subject to certain legal limits, at the sole discretion of our Board of Directors. We make matching contributions to the 401(k) plan under a safe harbor provision, whereby we match 100% of contributions by management and staffing employees to the 401(k) plan up to 3% of each participating employee's annual compensation and 50% of the employee's contributions up to an additional 2% of annual compensation. Employees subject to a co-employer arrangement may participate in our benefit plans at the election of the co-employer.

### ***Regulatory and Legislative Issues***

**Business Operations.** We are subject to the laws and regulations of the jurisdictions within which we operate, including those governing self-insured employers under the workers' compensation systems in Oregon, California, Maryland, Delaware and Colorado, as well as in Washington for non-PEO services. We are also subject to laws and regulations governing, our two wholly owned, fully licensed insurance companies in Arizona. While the specific laws and regulations vary among these jurisdictions, they typically require some form of licensing and often have statutory requirements for workplace safety and notice of change in obligation of workers' compensation coverage in the event of contract termination. Although compliance with these requirements imposes some additional financial risk on us, particularly with respect to those clients who breach their payment obligation to us, such compliance has not had a material adverse effect on our business to date.

**Employee Benefit Plans.** Our operations are affected by numerous federal and state laws relating to labor, tax and employment matters. By entering into a co-employer relationship with employees who are assigned to work at client locations (sometimes referred to as work-site employees), we assume certain obligations and responsibilities of an employer under these federal and state laws. Because many of these federal and state laws were enacted prior to the development of nontraditional employment relationships, such as professional employer, temporary employment, and outsourcing arrangements, many of these laws do not specifically address the obligations and responsibilities of nontraditional employers. In addition, the definition of employer under these laws is not uniform.

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As an employer, we are subject to all federal statutes and regulations governing our employer-employee relationships. Subject to the discussion of risk factors below, we believe that our operations are in compliance in all material respects with applicable federal statutes and regulations.

We offer various qualified employee benefit plans to our employees, including employees of our PEO clients who so elect. These qualified employee benefit plans include our 401(k) plan, a cafeteria plan under Section 125 of the Internal Revenue Code, and group health, life insurance and disability insurance plans. Generally, qualified employee benefit plans are subject to provisions of both the Internal Revenue Code and the Employee Retirement Income Security Act of 1974 ( ERISA ). In order to qualify for favorable tax treatment under the Internal Revenue Code, qualified plans must be established and maintained by an employer for the exclusive benefit of its employees.

## **Additional Information**

Our filings with the SEC, including our annual report on Form 10-K, quarterly reports on Form 10-Q, periodic reports on Form 8-K and amendments to these reports, are accessible free of charge at <http://www.barrettbusiness.com> as soon as reasonably practicable after filing with the SEC. By making this reference to our website, we do not intend to incorporate into this report any information contained in the website. The website should not be considered part of this report.

The SEC maintains a website at <http://www.sec.gov> that contains reports, proxy and information statements, and other information regarding issuers with publicly traded securities, including the Company.

## **Item 1A. RISK FACTORS**

In addition to other information contained in this report, the following risk factors should be considered carefully in evaluating our business.

### **Our workers compensation loss reserves may be inadequate to cover our ultimate liability for workers compensation costs.**

We maintain reserves (recorded as accrued liabilities on our balance sheet) to cover our estimated liabilities for our self-insured workers compensation claims. The determination of these reserves is based upon a number of factors, including current and historical claims activity, claims payment patterns and medical cost trends and developments in existing claims. Accordingly, reserves do not represent an exact calculation of liability. Reserves can be affected by both internal and external events, such as adverse developments on existing claims or changes in medical costs, medical condition of the claimant, claims handling procedures, administrative costs and legal fees, inflation, and legal trends and legislative changes. Reserves are adjusted from time to time to reflect new claims, claim developments, or systemic changes, and such adjustments are reflected in the results of the periods in which the reserves are changed. The Company's estimated accrual for workers compensation claims liabilities is based upon an actuarial estimate provided by the Company's independent actuary. The estimated accrual does not include an estimated provision for the incidence of



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unknown catastrophic claims. Moreover, because of the uncertainties that surround estimating workers' compensation loss reserves, we cannot be certain that our reserves are adequate. If our reserves are insufficient to cover our actual losses, we would have to increase our reserves and incur charges to our earnings that could be material to our results of operations and financial condition.

### **Our self-insured retention for workers' compensation claims is \$5.0 million per occurrence in the majority of our self-insured states.**

In view of the Company's favorable historical experience with large catastrophic claims and an opportunity to realize savings from lower excess workers' compensation insurance premiums, we maintain our self-insured retention at \$5.0 million per occurrence, except in Maryland and Colorado where our retention is at \$1.0 million and \$500,000 per occurrence, respectively. Additionally, Ecole's retention is at \$5.0 million per occurrence for coverage in Arizona. Thus, the Company has financial risk for most workers' compensation claims under \$5.0 million, on a per occurrence basis. This level of per occurrence retention may result in higher workers' compensation costs to us with a corresponding negative effect on our operating results and financial condition.

### **Adverse developments in the market for excess workers' compensation insurance could lead to increases in our costs.**

We are a state-approved self-insured employer for workers' compensation coverage in California, Oregon, Delaware, Maryland and Colorado, as well as in Washington for our non-PEO services and management employees. To manage our financial exposure in the event of catastrophic injuries or fatalities, we maintain excess workers' compensation insurance with a per occurrence retention of \$5.0 million effective January 1, 2007, except in Maryland and Colorado where our retention is at \$1.0 million and \$500,000 per occurrence, respectively. Additionally, Ecole's retention is at \$5.0 million per occurrence for coverage in Arizona. Changes in the market for excess workers' compensation insurance may lead to limited availability of such coverage, additional increases in our insurance costs or further increases in our self-insured retention, any of which may have a material adverse effect on our financial condition.

We maintain excess workers' compensation insurance coverage with American International Group, Inc. (AIG) between \$5.0 million and \$15.0 million per occurrence, except in Maryland, where coverage with AIG is between \$1.0 million and \$25.0 million per occurrence, and in Colorado, where coverage with AIG is between \$500,000 and statutory limits per occurrence. Ecole's coverage with AIG is between \$5.0 million and statutory limits per occurrence. AIG's financial losses resulting from credit default swaps combined with the turbulence in worldwide equity and credit markets have adversely impacted AIG. Although AIG's commercial insurance subsidiary continues to be a fully accepted insurance carrier for all major brokers, should AIG become insolvent or cease to underwrite excess coverage, we could be forced to seek alternative coverage at higher costs, which could have a material negative impact on our results of operations and financial condition.

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**Economic conditions, particularly in California, may impact our ability to attract new PEO clients and cause our existing PEO clients to reduce staffing levels or cease operations.**

Weak economic conditions typically have a negative impact on small and medium size businesses, which make up the majority of our PEO clients. In turn, these businesses could cut costs, including trimming employees from their payrolls, or ceasing operations altogether. In addition, businesses may be reluctant to enter into new PEO arrangements because of the uncertainty regarding the timing of any economic recovery. These forces may result in decreased PEO revenues due both to the downsizing of our current clients and difficulties in attracting new clients, and may also result in additional bad debt expense to the extent that existing clients cease operations.

**Our staffing business is vulnerable to economic fluctuations. Companies tend to use fewer temporary employees as economic activity slows, while recruiting employees to fill our customers' needs becomes increasingly difficult during robust economic periods.**

Demand for our staffing services is sensitive to changes in the level of economic activity in the regions in which we do business. As economic activity slows down, companies often reduce their use of temporary employees before undertaking layoffs of permanent staff, resulting in decreased demand for staffing services. A continued significant economic downturn, particularly in the Western United States, could have a material adverse effect on our results of operations and financial condition. During strong economic periods, on the other hand, we often experience shortages of qualified employees to meet customer needs.

**Changes in the market for workers' compensation insurance in the state of California could adversely affect our business.**

Our concentration of PEO business in California subjects our business to market risks involving the California workers' compensation environment as the Company is a state-approved self-insured employer with respect to workers' compensation coverage in that state. During recent years, California has enacted several legislative reforms in an attempt to address the crisis in its workers' compensation system, and it may attempt additional legislative or regulatory reforms in the future. Any successful legislative reforms or non-governmental changes in market conditions in California could lessen a key advantage we have in that state, leading to a reduction in our new business opportunities and a potential slowing in the growth of our PEO business in California. Any such slowing would adversely affect our results of operations.

**Because we assume the obligation to make wage, tax and regulatory payments in respect of some employees, we are exposed to client credit risks.**

We generally assume responsibility for and manage the risks associated with our clients' employee payroll obligations, including liability for payment of salaries and wages (including payroll taxes), as well as group health and retirement benefits. These obligations are fixed, whether or not the client makes payments to us as required by our services agreement, which exposes us to credit risks. We attempt to mitigate this risk by invoicing our

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staffing customers weekly and our PEO clients at the end of their specific payroll processing cycle. We also carefully monitor the timeliness of our clients' payments and impose strict credit standards on our customers. If we fail to successfully manage our credit risk, our results of operations and financial condition could be materially and adversely affected.

### **Increases in unemployment claims could raise our state and federal unemployment tax rates which we may not be able to pass on to our customers.**

During weak economic conditions in our markets, the level of unemployment claims tend to rise as a result of employee layoffs at our PEO clients and lack of work in our temporary staffing pool. The rise in unemployment claims often results in higher state and federal unemployment tax rates which in most instances cannot be concurrently passed on to our customers either due to existing PEO contracts or competitive pricing pressures. Increases in our state and federal unemployment tax rates could have a material adverse effect on our results of operations, particularly in the early part of the calendar year when effective payroll tax rates are at or near their maximum.

### **If we are determined not to be an employer under certain laws and regulations, our clients may stop using our services, and we may be subject to additional liabilities.**

We believe that we are an employer of employees provided to our PEO clients on a co-employment basis under the various laws and regulations of the Internal Revenue Service and the U.S. Department of Labor. If we are determined not to be an employer under such laws and regulations and are therefore unable to assume obligations of our clients for employment and other taxes, our clients may be held jointly and severally liable for payment of such taxes. Some clients or prospective clients may view such potential liability as an unacceptable risk, discouraging current clients from continuing a relationship with us or prospective clients from entering into a new relationship with us. Any determination that we are not an employer for purposes of ERISA could adversely affect our cafeteria benefits plan operated under Section 125 of the Internal Revenue Code and result in liabilities to us under the plan.

### **We may be exposed to employment-related claims and costs and periodic litigation that could adversely affect our business and results of operations.**

We either co-employ employees in connection with our PEO arrangements or place our employees in our customers' workplace in connection with our staffing business. As such, we are subject to a number of risks inherent to our status as an employer, including without limitation:

claims of misconduct or negligence on the part of our employees, discrimination or harassment claims against our employees, or claims by our employees of discrimination or harassment by our clients;

immigration-related claims;

claims relating to violations of wage, hour and other workplace regulations;

claims relating to employee benefits, entitlements to employee benefits, or errors in the calculation or administration of such benefits; and

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possible claims relating to misuse of customer confidential information, misappropriation of assets or other similar claims. If we experience significant incidents involving any of the above-described risk areas we could face substantial out-of-pocket losses, fines or negative publicity. In addition, such claims may give rise to litigation, which may be time consuming, distracting and costly, and could have a material adverse effect on our business. With respect to claims involving our co-employer relationship with our PEO clients, although our PEO services agreement provides that the client will indemnify us for any liability attributable to the conduct of the client or its employees, we may not be able to enforce such contractual indemnification, or the client may not have sufficient assets to satisfy its obligations to us.

### **We operate in a complex regulatory environment, and failure to comply with applicable laws and regulations could adversely affect our business.**

Corporate human resource operations are subject to a broad range of complex and evolving laws and regulations, including those applicable to payroll practices, benefits administration, employment practices and privacy. Because our clients have employees in many states throughout the United States, we must perform our services in compliance with the legal and regulatory requirements of multiple jurisdictions. Some of these laws and regulations may be difficult to ascertain or interpret and may change from time to time. Violation of such laws and regulations could subject us to fines and penalties, damage our reputation, constitute a breach of our client agreements, impair our ability to obtain and renew required licenses, and decrease our profitability or competitiveness. If any of these effects were to occur, our operating results and financial condition could be adversely affected.

### **Changes in government regulations may result in restrictions or prohibitions applicable to the provision of employment services or the imposition of additional licensing, regulatory or tax requirements.**

Our PEO and staffing businesses are heavily regulated in most jurisdictions in which we operate. We cannot assure you that the states in which we conduct or seek to conduct business will not:

impose additional regulations that prohibit or restrict employment-related businesses like ours;

require additional licensing or add restrictions on existing licenses to provide employment-related services; or

increase taxes or make changes in the way in which taxes are calculated for providers of employment-related services. Any changes in applicable laws and regulations may make it more difficult or expensive for us to do business, inhibit expansion of our business, or result in additional expenses that limit our profitability or decrease our ability to attract and retain clients.

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### **The tax status of our captive insurance subsidiaries could be challenged resulting in an acceleration of income tax payments.**

In conjunction with our workers' compensation program, we operate two wholly owned captive insurance subsidiaries, AICE and Ecole. We recognize the two captives as insurance companies for federal income tax purposes, with respect to our consolidated federal income tax return. In the event the Internal Revenue Service ( IRS ) were to determine that the captives do not qualify as insurance companies, we could be required to make accelerated income tax payments to the IRS that we otherwise would have deferred until future periods.

### **We may find it difficult to expand our business into additional states due to varying state regulatory requirements.**

Future growth in our operations depends, in part, on our ability to offer our services to prospective clients in new states, which may subject us to different regulatory requirements and standards. In order to operate effectively in a new state, we must obtain all necessary regulatory approvals, adapt our procedures to that state's regulatory requirements and modify our service offerings to adapt to local market conditions. In the event that we expand into additional states, we may not be able to duplicate in other markets the financial performance experienced in our current markets.

### **Acquisitions subject us to various risks, including risks relating to selection and pricing of acquisition targets, integration of acquired companies into our business and assumption of unanticipated liabilities.**

We have completed 27 acquisitions since 1993 and may pursue additional acquisitions and investment opportunities. We cannot assure, however, that we will be able to identify or consummate any additional acquisitions. If we do pursue acquisitions, we may not realize the anticipated benefits of such acquisitions. Acquisitions involve many risks, including risks relating to the assumption of unforeseen liabilities of an acquired business, adverse accounting charges resulting from the acquisition, and difficulties in integrating acquired companies into our business, both from a cultural perspective, as well as with respect to personnel and client retention and technological integration. Acquired liabilities may be significant and may adversely affect our financial condition and results of operations. Our inability to successfully integrate acquired businesses may lead to increased costs, failure to generate expected returns, accounting charges, or even a total loss of amounts invested, any of which could have a material adverse effect on our financial condition and results of operations.

### **Our business is subject to risks associated with geographic market concentration.**

Our California and Oregon operations accounted for approximately 55% and 14%, respectively, of our total net revenues in 2010. As a result of the current importance of our California and Oregon operations and anticipated continued growth from these operations, our profitability over the next several years is expected to be largely dependent on economic and regulatory conditions in these markets, particularly in California. If these states experience a further economic downturn, or if the regulatory environment changes in a way

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that adversely affects our ability to do business in these states or limits our competitive advantages in these markets, our profitability and growth prospects may be materially and adversely affected.

### **We face competition from a number of other companies.**

We face competition from various companies that may provide all or some of the services we offer. Our competitors include companies that are engaged in staffing services such as Kelly Services, Inc. and Manpower Inc., companies that are focused on co-employment or PEO services, such as Administaff, Inc. and companies that primarily provide payroll processing services or ASO services, such as Automatic Data Processing, Inc. and Paychex, Inc. We also face competition from information technology outsourcing firms and broad-based outsourcing and consulting firms that perform individual projects.

Several of our existing or potential competitors have substantially greater financial, technical and marketing resources than we do, which may enable them to:

develop and expand their infrastructure and service offerings more quickly and achieve greater cost efficiencies;

invest in new technologies;

expand operations into new markets more rapidly;

devote greater resources to marketing;

compete for acquisitions more effectively and complete acquisitions more easily; and

aggressively price products and services and increase benefits in ways that we may not be able to match financially.

In order to compete effectively in our markets, we must target our potential clients carefully, continue to improve our efficiencies and the scope and quality of our services, and rely on our service quality, innovation, education and program clarity. If our competitive advantages are not compelling or sustainable, then we are unlikely to increase or sustain profits and our stock price could decline.

### **We are dependent upon certain key personnel and recruitment and retention of key employees may be difficult and expensive.**

We believe that the successful operation of our business is dependent upon our retention of the services of key personnel, including our Chief Executive Officer, other executive officers and branch managers. We may not be able to retain all of our executives, senior managers and key personnel in light of competition for their services. If we lose the services of one of our executive officers or a significant number of our senior managers, our operations and profitability likely would be adversely affected.

### **We do not have an expansive in-house sales staff and therefore rely extensively on brokers to make referrals.**

We maintain only a minimal internal professional sales force. Instead, we rely heavily on insurance brokers to provide referrals to new business, especially in California, although

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each branch office manager is expected to be an effective leader in business development, including marketing efforts and sales closures. In connection with these arrangements, we pay a fee to brokers for new clients. As a result of our reliance on brokers, we are dependent on firms and individuals that do not have an exclusive relationship with us. If we are unable to maintain our relationships with brokers, if brokers increase their fees or if brokers lose confidence in our services, we could face declines in our business and additional costs and uncertainties as we attempt to hire and train an internal sales force.

**We depend on attracting and retaining qualified employees; during periods of economic growth, our costs to do so increase and it becomes more difficult to attract and retain people.**

The success of our staffing services depends on our ability to attract and retain qualified employees for placement with our customers. Our ability to attract and retain qualified personnel could be impaired by rapid improvement in economic conditions resulting in lower unemployment and increases in compensation. During periods of economic growth, we face growing competition for retaining and recruiting qualified personnel, which in turn leads to greater advertising and recruiting costs and increased salary expenses. If we cannot attract and retain qualified employees, the quality of our services may deteriorate and our reputation and results of operations could be adversely affected.

**Our service agreements may be terminated on short notice, leaving us vulnerable to loss of a significant amount of customers in a short period of time, if business or regulatory conditions change or events occur that negatively affect our reputation.**

Our PEO services agreements are generally terminable on 30 days' notice by either us or the client. As a result, our clients may terminate their agreement with us at any time, making us particularly vulnerable to changing business or regulatory conditions or changes affecting our reputation or the reputation of our industry.

**Our industry has at times received negative publicity and had some stigma associated with it that, if it were to become more prevalent, could cause our business to decline.**

Both PEOs and staffing services companies periodically have been tarnished by negative publicity or scandals from poor business judgment or even outright fraud. If we or our industry face negative publicity, customers' confidence in the use of temporary personnel or co-employed workers may deteriorate, and they may be unwilling to enter into or continue our staffing or co-employment relationships. If a negative perception were to prevail, it would be more difficult for us to attract and retain customers.

**Changes in state unemployment tax laws and regulations could adversely affect our business.**

In past years, there has been significant negative publicity relating to the use of staffing or PEO companies to shield employers from poor unemployment history and high unemployment taxes. New legislation enacted at the state or federal level to try to counter this perceived problem could have a material adverse effect on our business by limiting our ability to market our services or making our services less attractive to our customers and potential customers.

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**We are dependent upon technology services and if we experience damage, service interruptions or failures in our computer and telecommunications systems, or if our security measures are breached, our client relationships and our ability to attract new clients may be adversely affected.**

Our business could be interrupted by damage to or disruption of our computer and telecommunications equipment and software systems, and we may lose data. Our clients' businesses may be adversely affected by any system or equipment failure we experience. As a result of any of the foregoing, our relationships with our clients may be impaired, we may lose clients, our ability to attract new clients may be adversely affected and we could be exposed to contractual liability. Precautions in place to protect ourselves from, or minimize the effect of, such events, may not be adequate.

In addition, our business involves the storage and transmission of clients' proprietary information and confidential personal data of employees and security breaches could expose us to a risk of loss of this information, litigation and possible liability. If our security measures are breached as a result of third-party action, employee error, malfeasance or otherwise, and, as a result, someone obtains unauthorized access to client or employee data, our reputation will be damaged, our business may suffer and we could incur significant liability. Techniques used to obtain unauthorized access or to sabotage systems change frequently and are growing increasingly sophisticated. As a result, we may be unable to anticipate these techniques or to implement adequate preventative measures. If an actual or perceived breach of our security occurs, we could be liable and the market perception of our services could be harmed.

**Item 1B. UNRESOLVED STAFF COMMENTS**

None.

**Item 2. PROPERTIES**

We provide PEO and staffing services through all 43 of our branch offices. The following table shows the number of branch offices located in each state in which we operate. We also lease office space in other locations in our market areas which we use to recruit and place employees.

<b>Offices</b>	<b>Number of Branch Offices</b>
California	16
Oregon	8
Utah	4
Washington	4
Arizona	2
Colorado	2
Idaho	3
Maryland	2
Delaware	1
North Carolina	1



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We lease office space for our branch offices. At December 31, 2010, our leases had expiration dates ranging from less than one year to nine years, with total minimum payments through 2019 of approximately \$5.5 million. Our corporate headquarters office in Vancouver, Washington occupies approximately 32 percent of the 63,500 square foot building we purchased during 2005.

**Item 3. LEGAL PROCEEDINGS**

See Note 14, Litigation, in the Notes to Consolidated Financial Statements included in Item 15 of this report.

**Item 4. RESERVED****EXECUTIVE OFFICERS OF THE REGISTRANT**

The following table identifies, as of March 31, 2011, each executive officer of the Company. Executive officers are elected annually and serve at the discretion of the Board of Directors.

<b>Name</b>	<b>Age</b>	<b>Principal Positions and Business Experience</b>	<b>Officer Since</b>
Michael L. Elich	46	President and Chief Executive Officer	2005
James D. Miller	47	Vice President-Finance, Treasurer and Secretary; Chief Financial Officer; Principal Accounting Officer	1994
Gregory R. Vaughn	55	Vice President and Assistant Secretary	1998

Michael L. Elich joined the Company in October 2001 as Director of Business Development. He was appointed Vice President and Chief Operating Officer in May 2005. He was appointed interim President and Chief Executive Officer in January 2011 upon the death of William W. Sherertz. Effective February 17, 2011, Mr. Elich was elected to serve on the Board of Directors and was made President and Chief Executive Officer. From 1995 to 2001, Mr. Elich served as Executive Vice President and Chief Operating Officer of Skills Resource Training Center, a staffing services company with offices in Oregon, Washington and Idaho that we acquired effective January 1, 2004.

James D. Miller joined the Company in January 1994 as Controller. He was promoted to Vice President-Finance, Treasurer and Secretary, and Chief Financial Officer effective June 1, 2008. From 1991 to 1994, he was the Corporate Accounting Manager for Christensen Motor Yacht Corporation. Mr. Miller, a certified public accountant on inactive status, was employed by Price Waterhouse LLP, now known as PricewaterhouseCoopers LLP, from 1987 to 1991.

Gregory R. Vaughn joined the Company in July 1997 as Operations Manager. Mr. Vaughn was appointed Vice President in January 1998. Prior to joining Barrett, Mr. Vaughn was Chief Executive Officer of Insource America, Inc., a privately-held human resource management company headquartered in Portland, Oregon, for approximately one year. Mr. Vaughn has also held senior management positions with Sundial Time Systems, Inc. and Continental Information Systems, Inc. Previously, Mr. Vaughn was employed as a technology consultant by Price Waterhouse LLP, now known as PricewaterhouseCoopers LLP.

**Table of Contents****PART II****Item 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock (the "Common Stock") trades on the Global Select Market segment of The Nasdaq Stock Market under the symbol "BBSI". At February 28, 2011, there were 35 stockholders of record and approximately 2,460 beneficial owners of the Common Stock.

The following table presents the high and low sales prices of the Common Stock and cash dividends paid for each quarterly period during the last two fiscal years, as reported by The Nasdaq Stock Market. Any future determination as to the payment of dividends will be made at the discretion of the Board and will depend upon the Company's operating results, financial condition, capital requirements, general business conditions and such other factors as the Board deems relevant.

	High	Low	Cash Dividends Declared
<u>2009</u>			
First Quarter	\$ 12.00	\$ 7.92	\$ 0.08
Second Quarter	11.69	9.31	0.08
Third Quarter	11.30	9.47	0.08
Fourth Quarter	12.60	10.07	0.08
<u>2010</u>			
First Quarter	\$ 14.50	\$ 11.15	\$ 0.08
Second Quarter	16.00	12.18	0.08
Third Quarter	15.60	12.25	0.08
Fourth Quarter	17.14	14.36	0.09

In November 2006, the Board adopted a stock repurchase program and authorized the repurchase of up to 500,000 shares of the Company's stock from time to time in open market purchases. In November 2007, the Board approved an increase in the authorized shares to be repurchased up to 1.0 million shares. In October 2008, the Board approved a second increase in the authorized shares to be repurchased up to 3.0 million shares. The following table summarizes information related to stock repurchases during the quarter ended December 31, 2010.

Month	Shares Repurchased	Average Price Per Share	Total Number of Shares Repurchased as Part of Publicly Announced Plan	Maximum Number of Shares that May Yet Be Repurchased Under the Plan
October	-	\$ -	-	1,547,600
November	-	-	-	1,547,600
December	-	-	-	1,547,600
Total	-	-	-	-

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The following graph shows the cumulative total return at the dates indicated for the period from December 31, 2005, until December 31, 2010, for our Common Stock, The Nasdaq Composite Index, and a group of the Company's current peers in the staffing industry (the 2010 Peer Group). The 2010 Peer Group is comprised of five companies included in the peer group used to prepare the performance graph included in the Company's Form 10-K for the year ended December 31, 2009.

The stock performance graph has been prepared assuming that \$100 was invested on December 31, 2005, in our Common Stock, The Nasdaq Composite Index, and the 2010 Peer Group, and that dividends are reinvested. In accordance with the SEC's disclosure rules, the stockholder return for each company in the 2010 Peer Group indices has been weighted on the basis of market capitalization as of the beginning of each annual period shown. The stock price performance reflected in the graph may not be indicative of future price performance.

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	<b>12/05</b>	<b>12/06</b>	<b>12/07</b>	<b>12/08</b>	<b>12/09</b>	<b>12/10</b>
Barrett Business Services, Inc.	100.00	93.99	73.25	45.42	52.86	68.55
NASDAQ Composite	100.00	111.74	124.67	73.77	107.12	125.93
Peer Group	100.00	119.61	89.44	62.18	86.10	103.19
Members of Peer Group:						
Administaff Inc						
CDI Corp.						
Kelly Services Inc						
Manpower Inc						
Robert Half International Inc						

**Table of Contents****Item 6. SELECTED FINANCIAL DATA**

The following selected financial data should be read in conjunction with the Company's financial statements and the accompanying notes listed in Item 15 of this report. The Company's financial statements for the years ended December 31, 2009, 2008, 2007 and 2006 have been restated from amounts previously presented. See Note 2 to the Consolidated Financial Statements included in Item 15 of this report.

	Year Ended December 31,				
	2010	2009	2008	2007	2006
	As Restated, See Note 2 of Notes to Financial Statements				
<b>(In thousands, except per share data)</b>					
Statement of operations:					
Revenues:					
Staffing services	\$125,738	\$116,155	\$154,565	\$147,221	\$123,500
Professional employer service fees	147,385	120,305	125,903	141,992	135,684
<b>Total</b>	<b>273,123</b>	<b>236,460</b>	<b>280,468</b>	<b>289,213</b>	<b>259,184</b>
Cost of revenues:					
Direct payroll costs	95,439	87,679	114,440	113,450	92,676
Payroll taxes and benefits	96,660	82,077	85,531	87,822	83,756
Workers' compensation	36,284	39,765	31,166	29,835	27,472
<b>Total</b>	<b>228,383</b>	<b>209,521</b>	<b>231,137</b>	<b>231,107</b>	<b>203,904</b>
Gross margin	44,740	26,939	49,331	58,106	55,280
Selling, general and administrative expenses	35,429	33,481	36,654	34,688	31,604
Depreciation and amortization	1,395	1,641	1,536	1,387	1,306
Income (loss) from operations	7,916	(8,183)	11,141	22,031	22,370
Loss on impairment of investments	-	-	(3,483)	-	-
Other income:					
Investment income, net	849	1,003	2,080	3,183	2,869
Other, net	1,162	637	(26)	(100)	(22)
<b>Total</b>	<b>2,011</b>	<b>1,640</b>	<b>2,054</b>	<b>3,083</b>	<b>2,847</b>
Income (loss) before income taxes	9,927	(6,543)	9,712	25,114	25,217
Provision for (benefit from) income taxes	2,574	(2,598)	3,750	8,953	9,046
Net income (loss)	\$ 7,353	\$ (3,945)	\$ 5,962	\$ 16,161	\$ 16,171
Basic earnings (loss) per share	\$ .71	\$ (.38)	\$ .55	\$ 1.44	\$ 1.44
Weighted average number of basic shares outstanding	10,333	10,452	10,861	11,247	11,194
Diluted earnings (loss) per share	\$ .71	\$ (.38)	\$ .53	\$ 1.39	\$ 1.39
Weighted average number of diluted shares outstanding	10,372	10,452	11,120	11,654	11,671
Cash dividends per common share	\$ .33	\$ .32	\$ .32	\$ .29	\$ .07

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Selected balance sheet data:

Cash and marketable securities	\$ 61,356	\$ 57,910	\$ 60,609	\$ 64,913	\$ 73,439
Working capital	44,563	45,301	51,370	52,740	57,942
Total assets	187,884	174,616	172,764	175,466	165,529
Long-term debt, net of current portion	-	-	-	-	-
Stockholders' equity	95,365	94,932	104,604	108,031	98,628

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

**Overview**

We provide human resource management services, comprised principally of staffing services and PEO services. We generate staffing services revenues primarily from short-term staffing, contract staffing, on-site management and direct placement services. Our PEO service fees are generated from contractual agreements with our PEO clients under which we become a co-employer of our client's workforce with responsibility for some or all of the client's human resource functions. We recognize revenues from our staffing services for all amounts invoiced, including direct payroll, employer payroll-related taxes, workers' compensation coverage and a service fee (equivalent to a mark-up percentage). PEO service fee revenues are recognized on a net basis in accordance with current accounting guidance for revenue recognition and principal/agent considerations. Consequently, our PEO service fee revenues represent the gross margin generated from our PEO services after deducting the amounts invoiced to PEO customers for direct payroll expenses such as salaries, wages, health insurance and employee out-of-pocket expenses incurred incidental to employment. These amounts are also excluded from cost of revenues. PEO service fees also include amounts invoiced to our clients for employer payroll-related taxes and workers' compensation coverage.

Through centralized operations at our headquarters in Vancouver, Washington, we prepare invoices weekly for our staffing services customers and following the end of each payroll processing cycle for PEO clients. We invoice our customers and clients as each payroll is processed. Payment terms for staffing customers are generally 30 days, while PEO clients' invoices are generally due on the invoice date.

Our business is concentrated in California and Oregon and we expect to continue to derive a majority of our revenues from these markets in the future. Revenues generated in our California and Oregon offices accounted for 69% of our total net revenues in 2010, 67% in 2009 and 65% in 2008. Consequently, any weakness in economic conditions or changes in the regulatory environments in these regions could have a material adverse effect on our financial results.

We offer cash safety incentives to certain PEO clients for maintaining safe-work practices in order to minimize workplace injuries. The cash 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 expense is also netted against PEO revenues on our statements of operations.

Our cost of revenues is comprised of direct payroll costs for staffing services, employer payroll-related taxes and employee benefits and workers compensation. 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

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paid by the customer. Workers' compensation expense consists primarily of the costs associated with our self-insured workers' compensation program, such as claims reserves, claims administration fees, legal fees, state administrative agency fees and excess insurance costs for catastrophic injuries. We also maintain separate workers' compensation insurance policies for employees working in states where we are not self-insured.

The largest portion of workers' compensation expense is the cost of workplace injury claims. When an injury occurs and is reported to us, our respective independent TPA or our internal claims management personnel analyze the details of the injury and develop a case reserve, which becomes the estimate of the cost of the claim based on similar injuries and their professional judgment. We then record or accrue an expense and a corresponding liability based upon our estimate of the ultimate claim cost. As cash payments are made by our TPA against specific case reserves, the accrued liability is reduced by the corresponding payment amount. The TPA and our in-house claims administrators also review existing injury claims on an on-going basis and adjust the case reserves as new or additional information for each claim becomes available. Our reserve includes a provision for both future anticipated increases in costs ( adverse loss development ) of the claims reserves for open claims and for claims incurred but not reported related to prior and current periods. This provision of the reserve is based upon an actuarial estimate provided by our third-party actuary. We believe our operational policies and internal claims reporting system help to limit the occurrence of unreported incurred claims.

Selling, general and administrative expenses represent both branch office and corporate-level operating expenses. Branch operating expenses consist primarily of branch office staff payroll and personnel related costs, advertising, rent, office supplies, professional and legal fees and branch incentive compensation. Corporate-level operating expenses consist primarily of executive and office staff payroll and personnel related costs, professional and legal fees, travel, occupancy costs, information systems costs and executive and corporate staff incentive compensation.

Depreciation and amortization represents depreciation of property and equipment and amortization of intangible assets consisting of the amortization of software costs, covenants not to compete, and if material, customer related intangibles. Property and equipment are depreciated using the straight-line method over their estimated useful lives, which generally range from two to 39 years. Intangible assets are amortized using the straight-line method over their estimated useful lives, which range from two to ten years.

## **Critical Accounting Policies**

We have identified the following policies as critical to our business and the understanding of our results of operations. For a detailed discussion of the application of these and other accounting policies, see Note 1 to the audited consolidated financial statements included in Item 15 of this Report. Note that the preparation of this Annual Report on Form 10-K requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. 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



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judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Self-Insured Workers Compensation Reserves. We are self-insured for workers compensation coverage in a majority of our employee work sites in Oregon, California, Maryland, Delaware and Colorado and for staffing services and management employees only in Washington. The estimated liability for unsettled workers compensation claims represents our best estimate, which includes an evaluation of information provided by our internal claims adjusters and our third-party claims administrators, coupled with management's use of a third-party actuary. These elements serve as the basis for our overall estimate for workers compensation claims liabilities, which include more specifically the following components: case reserve estimates for reported losses, plus additional amounts for estimated future development of reported claims and incurred but not reported claims (together IBNR). Our estimates also include amounts for unallocated loss adjustment expenses, including legal costs. These estimates are continually reviewed and adjustments to liabilities are reflected in current operating results as they become known. We believe that the amounts recorded for our estimated liabilities are reasonable and objective and are based upon facts and other trends associated with the Company's historical universe of claims data. Nevertheless, it is possible that adjustments to such estimates may be required in future periods if the development of claim costs varies materially from our estimates and such adjustments, if necessary, could be material to results of operations.

Safety Incentives Liability. Our accrued safety incentives represent cash incentives paid to certain PEO client companies for maintaining safe-work practices in order to minimize 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 liability is estimated and accrued each month based upon the expected payout as determined by historical incentive payment trends.

Allowance for Doubtful Accounts. We are required to make estimates of the collectibility of accounts receivables. Management analyzes historical bad debts, customer concentrations, customer creditworthiness, current economic trends and changes in the customers' payment tendencies 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.

Goodwill. We assess the recoverability of goodwill annually and whenever events or changes in circumstances indicate that the carrying value might be impaired. Factors that are considered include significant underperformance relative to expected historical or projected future operating results, significant negative industry trends and significant change in the manner of use of the acquired assets. Management's current assessment of the carrying value of goodwill indicates there was no impairment as of December 31, 2010. If these estimates or their related assumptions change in the future, we may be required to record impairment charges for these assets whenever events or circumstances occur indicating that goodwill might be impaired.

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**Investments in Marketable Securities.** We consider available evidence in evaluating potential impairment of our investments, including the duration and extent to which fair value is less than cost and our ability and intent to hold the investment. Investments in securities classified as trading are reported at fair value, with unrealized gains or losses reported in other income in our consolidated statements of operations. Investments in securities classified as available-for-sale are reported at fair value, with unrealized gains or losses reported net of tax in other comprehensive income (loss) in stockholders' equity. In the event a loss on our available-for-sale investments is determined to be other-than-temporary, the loss will be recognized in our statement of operations. Investments in securities classified as held-to-maturity are reported at amortized cost.

**Income Taxes.** Our income taxes are accounted for using an asset and liability approach. This requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial statement and tax basis of assets and liabilities at the applicable tax rates. The determination of our provision for income taxes requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. Significant judgment is required in assessing the timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions. The impact of uncertain tax positions would be recorded in our financial statements only after determining a more-likely-than-not probability that the uncertain tax positions would withstand challenge, if any, from taxing authorities. We assess the realization of the deferred income tax assets as significant changes in circumstances may require adjustments during future periods. The amount of the deferred income tax assets actually realized could vary, if there are differences in the timing or amount of future reversals of existing deferred income tax assets or changes in the actual amounts of future taxable income as compared to operating forecasts. If our operating forecast is determined to no longer be reliable due to uncertain market conditions, our long-term forecast may require reassessment. As a result, in the future, a valuation allowance may be required to be established for all or a portion of the deferred income tax assets. Such a valuation allowance could have a significant effect on our future results of operations and financial position.

## **Recent Accounting Pronouncements**

For a discussion of recent accounting pronouncements and their potential effect on the Company's results of operations and financial condition, refer to Note 1 in the Notes to the Consolidated Financial Statements beginning at page F-6 of this Annual Report on Form 10-K.

## **Forward-Looking Information**

Statements in this Item or in Items 1 and 1A of this Report which are not historical in nature, including discussion of economic conditions in the Company's market areas and effect on revenue levels, the potential for and effect of past and future acquisitions, the effect of changes in the Company's mix of services on gross margin, the adequacy of the Company's workers' compensation reserves and allowance for doubtful accounts, the effect of the Company's formation and operation of two wholly owned fully licensed captive insurance subsidiaries and becoming self-insured for certain business risks, the financial viability of the Company's excess insurance carrier, the effectiveness of the Company's management information systems, payment of future dividends and the availability of financing and working

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capital to meet the Company's funding requirements, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such 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 difficulties associated with integrating acquired businesses and clients into the Company's operations, the Company's ability to retain current customers, economic trends in the Company's service areas, material deviations from expected future workers' compensation claims experience, the effect of changes in the workers' compensation regulatory environment in one or more of the Company's primary markets, collectibility of accounts receivable, the carrying values of deferred income tax assets and goodwill, which may be affected by the Company's future operating results, the availability of capital or letters of credit necessary to meet state-mandated surety deposit requirements for maintaining the Company's status as a qualified self-insured employer for workers' compensation coverage, and the use of \$61.4 million in cash and marketable securities, among others. The Company disclaims any obligation to update any such factors or to publicly announce the result of any revisions to any of the forward-looking statements contained herein to reflect future events or developments.

## **Results of Operations**

During the 2010 year-end financial close process, the Company discovered an error related to legal expenses incurred for the administration of workers' compensation claims by the Company's captive insurance subsidiary and determined that the Consolidated Financial Statements for all periods beginning January 1, 2007 should be restated. The Company's historical accounting method for legal expenses incurred for claims administration had been to recognize the expenses in the period incurred. The error generally resulted in an understatement of workers' compensation expense, recorded as a component of cost of revenues, and an overstatement of the income tax provision in the consolidated statements of operations for prior periods beginning January 1, 2007. The recorded balances for workers' compensation claims liabilities and deferred tax assets were also understated.

The Company has also determined to make a conforming change to its accounting method for legal expenses incurred for the administration of workers' compensation claims that arose prior to the formation of our first captive insurance subsidiary, Associated Insurance Company for Excess (AICE), on January 1, 2007. Management believes this change is preferable as the Company's and its subsidiaries' financial statement presentation will be consistent and reflect the true ultimate cost to settle our workers' compensation claims.

As further discussed in Note 2 of our Consolidated Financial Statements in Item 15, we evaluated the effects of these errors and the conforming change in accounting method on prior period consolidated financial statements, in accordance with applicable SEC guidance, and have restated our consolidated financial statements as of and for the years ended December 31, 2009 and 2008, which restated periods are discussed below.

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The following table sets forth the percentages of total revenues represented by selected items in the Company's Statements of Operations for the years ended December 31, 2010, 2009 and 2008, included in Item 15 of this report. References to the Notes to Financial Statements appearing below are to the notes to the Company's financial statements included in Item 15 of this report.

	<b>Percentage of Total Net Revenues</b>		
	<b>Year Ended December 31,</b>		
	<b>As Restated, See Note 2 of</b>		
	<b>Notes to Financial Statements</b>		
	<b>2010</b>	<b>2009</b>	<b>2008</b>
<b>Revenues:</b>			
Staffing services	46.0%	49.1%	55.1%
Professional employer service fees	54.0	50.9	44.9
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Cost of revenues:</b>			
Direct payroll costs	34.9	37.1	40.8
Payroll taxes and benefits	35.4	34.7	30.5
Workers' compensation	13.3	16.8	11.1
<b>Total</b>	<b>83.6</b>	<b>88.6</b>	<b>82.4</b>
Gross margin	16.4	11.4	17.6
Selling, general and administrative expenses	13.0	14.2	13.1
Depreciation and amortization	0.5	0.7	0.5
<b>Income (loss) from operations</b>	<b>2.9</b>	<b>(3.5)</b>	<b>4.0</b>
Loss on impairment of investments	-	-	(1.2)
<b>Other income</b>	<b>0.7</b>	<b>0.7</b>	<b>0.7</b>
Pretax income (loss)	3.6	(2.8)	3.5
Provision for (benefit from) income taxes	0.9	(1.1)	1.4
<b>Net income (loss)</b>	<b>2.7%</b>	<b>(1.7)%</b>	<b>2.1%</b>

We report PEO revenues on a net basis because we are not the primary obligor for the services provided by our PEO clients to their customers pursuant to our PEO contracts. We present for comparison purposes the gross revenues and cost of revenues information for the years ended December 31, 2010 and 2009 set forth in the table below. Although not in accordance with generally accepted accounting principles in the United States (GAAP), management believes this information is more informative as to the level of our business activity and more illustrative of how we manage our operations, including the preparation of our internal operating forecasts, because it presents our PEO services on a basis comparable to our staffing services.

The presentation of revenues on a net basis and the relative contributions of staffing and PEO revenues can create volatility in our gross margin percentage. The general impact of fluctuations in our revenue mix is described below.

A relative increase in staffing revenues will typically result in a lower gross margin percentage. Staffing revenues are presented at gross with the related direct costs reported in cost of sales. While staffing relationships typically have higher margins than PEO relationships, an increase in staffing revenues and related costs presented at gross dilutes the impact of the net PEO revenue on gross margin percentage.



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A relative increase in PEO revenue will result in higher gross margin percentage. Improvement in gross margin percentage occurs because incremental PEO revenue dollars are reported as revenue net of all related direct costs.

(in thousands)	Year Ended December 31,	
	2010	2009
<b>Revenues:</b>		
Staffing services	\$ 125,738	\$ 116,155
Professional employer services	1,111,052	903,731
Total revenues	1,236,790	1,019,886
<b>Cost of revenues:</b>		
Direct payroll costs	1,053,748	866,167
Payroll taxes and benefits	96,661	82,077
Workers compensation	41,641	44,703
Total cost of revenues	1,192,050	992,947
Gross margin	\$ 44,740	\$ 26,939

A reconciliation of non-GAAP gross revenues to net revenues is as follows for the years ended December 31, 2010 and 2009 (in thousands):

	Gross Revenue Reporting Method		Reclassification		Net Revenue Reporting Method	
	2010	2009	2010	2009	2010	2009
<b>Revenues:</b>						
Staffing services	\$ 125,738	\$ 116,155	\$ -	\$ -	\$ 125,738	\$ 116,155
Professional employer services	1,111,052	903,731	(963,667)	(783,426)	147,385	120,305
Total revenues	\$ 1,236,790	\$ 1,019,886	\$ (963,667)	\$ (783,426)	\$ 273,123	\$ 236,460
<b>Cost of revenues:</b>						
	\$ 1,192,050	\$ 992,947	\$ (963,667)	\$ (783,426)	\$ 228,383	\$ 209,521

The amount of the reclassification is comprised of direct payroll costs and safety incentives attributable to our PEO client companies.

**Years Ended December 31, 2010 and 2009**

Net income for 2010 amounted to \$7.4 million, an improvement of \$11.3 million over a net loss of \$3.9 million for 2009. The increase for 2010 was primarily due to a 15.5% increase in revenues and the recognition of an expense of \$11.8 million related to the change in estimate of the workers compensation reserve during 2009. Diluted income per share for 2010 was \$.71 compared to a diluted loss per share of \$.38 for 2009.

Revenues for 2010 totaled \$273.1 million, an increase of approximately \$36.7 million or 15.5%, which reflects an increase in both the Company's PEO service fee revenue and staffing service revenue. PEO service fee revenue increased approximately \$27.1 million or 22.5% over 2009 primarily due to growth in new customers as PEO business from new customers during 2010 exceeded our lost PEO business from former customers. PEO

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revenue from continuing customers reflected a small increase on a year-over-year basis. Staffing service revenue increased approximately \$9.6 million or 8.3% over 2009 primarily due to an increase in demand for our staffing services from existing customers in our northwest and intermountain markets. During 2010, the Company served approximately 1,820 PEO clients, which compares to approximately 1,620 PEO clients during 2009. During 2010, the Company served approximately 1,750 staffing service customers, which compares to 1,800 during 2009. The decline in economic activity and associated reductions in employment levels in the Company's market areas in late 2008 and 2009 continue to impact our existing client base, resulting in ongoing pressure on demand for the Company's staffing services.

Gross margin for 2010 totaled approximately \$44.7 million, which represented an increase of \$17.8 million or 66.1% over 2009, primarily due to a 15.5% increase in revenues, the inclusion of the \$11.8 million additional workers' compensation expense adjustment in 2009, and a decline in direct payroll costs, as a percentage of revenues. The gross margin percent increased from 11.4% of revenues for 2009 to 16.4% for 2010. Workers' compensation expense, as a percent of revenues, decreased from 16.8% in 2009 to 13.3% in 2010. Workers' compensation expense for 2010 totaled \$36.3 million, which compares to \$39.8 million for 2009. This decrease was primarily due to the \$11.8 million additional workers' compensation expense adjustment recognized in 2009. The decrease in direct payroll costs, as a percentage of revenues, from 37.1% for 2009 to 34.9% for 2010 reflects the moderate shift in the overall mix of services from staffing services to PEO services in the Company's customer base and the effect of each customer's unique mark-up percent. The increase in payroll taxes and benefits, as a percentage of revenues, from 34.7% for 2009 to 35.4% for 2010, was principally due to higher statutory state unemployment tax rates in various states in which the Company operates in 2010 as compared to 2009 and to a relative shift in business mix to PEO services, as to which payroll taxes and benefits are presented at gross cost while the related direct payroll costs are netted against PEO services revenue. We expect gross margin as a percentage of total revenues to continue to be influenced by fluctuations in the mix between staffing and PEO services, as well as changes to our estimates for workers' compensation claims liabilities, if necessary.

Selling, general and administrative (SG&A) expenses consist of compensation and other expenses relating to the operation of our headquarters and our branch offices and the marketing of our services. SG&A expenses for 2010 amounted to approximately \$35.4 million, an increase of \$1.9 million or 5.8% over 2009. The increase in dollars over 2009 was primarily attributable to higher profit sharing due to improved profitability and to an increased level of business activity. SG&A expenses, as a percentage of revenues, decreased from 14.2% in 2009 to 13.0% in 2010.

Other income for 2010 was \$2.0 million compared to other income of \$1.6 million for 2009. The increase in other income for 2010 was primarily attributable to increased gains on the sales of certain marketable securities as compared to 2009.

Our effective income tax rate for 2010 was 25.9%, as compared to (39.7%) for 2009. The provision for income taxes included higher current year employment tax credits for 2010, a benefit of \$434,000 primarily from a reduction to a deferred tax asset allowance as sales of certain marketable securities during 2010 allowed the Company to apply current year capital losses to 2009 capital gains and to benefit from additional prior year employment tax credits resulting from the Company amending its 2008 federal tax return.

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At December 31, 2010, we had deferred income tax assets of \$6.1 million, which consist of temporary differences between taxable income for financial accounting and tax purposes, which will reduce taxable income in future years. We assess the realization of the deferred income tax assets as significant changes in circumstances may require adjustments during future periods. Although realization is not assured, management has concluded that it is more likely than not that the remaining deferred income tax assets will be realized, principally based upon projected taxable income for the next two years. The amount of the deferred income tax assets actually realized could vary, if there are differences in the timing or amount of future reversals of existing deferred income tax assets or changes in the actual amounts of future taxable income as compared to operating forecasts. If our operating forecast is determined to no longer be reliable due to uncertain market conditions, our long-term forecast may require reassessment. As a result, in the future, a valuation allowance may be required to be established for all or a portion of the deferred income tax assets. Such a valuation allowance could have a significant effect on our future results of operations and financial position.

**Years Ended December 31, 2009 and 2008**

Net loss for 2009 amounted to \$3.9 million, a decline of \$9.9 million from net income of \$6.0 million for 2008. The decline for 2009 was primarily due to lower revenues and lower gross margin dollars principally due to an \$11.8 million increase in workers' compensation expense resulting from the Company's change in estimate of its workers' compensation reserves during the second quarter of 2009. Diluted loss per share for 2009 was \$.38 compared to a diluted earnings per share of \$.53 for 2008.

Revenues for 2009 totaled \$236.5 million, a decrease of approximately \$44.0 million or 15.7%, which reflects a decline in both the Company's staffing service revenue and PEO service fee revenue. Staffing service revenue decreased approximately \$38.4 million or 24.9% from 2008 primarily due to a significant decline in demand for our staffing services from existing customers in the majority of our markets. PEO service fee revenue decreased approximately \$5.6 million or 4.4% from 2008 primarily due to a decline in business as a result of decreased hours worked at our existing PEO customer worksites, partially offset by the net effect of the addition of new customers. During 2009, the Company served approximately 1,800 staffing service customers, which compares to 2,300 during 2008. During 2009, the Company served approximately 1,620 PEO clients, which compares to approximately 1,415 PEO clients during 2008. Offsetting the increase in the number of PEO clients served in 2009 was a decline in the average number of PEO employees and worker hours per client.

Gross margin for 2009 totaled approximately \$26.9 million, which represented a decrease of \$22.4 million or 45.4% from 2008, primarily due to the \$11.8 million additional workers' compensation expense adjustment, a 15.7% decline in revenues and higher payroll taxes and benefits as a percentage of revenues. The gross margin percent decreased from 17.6% of revenues for 2008 to 11.4% for 2009. Workers' compensation expense, as a percent of revenues, increased from 11.1% in 2008 to 16.8% in 2009. Workers' compensation expense for 2009 totaled \$39.8 million, which compares to \$31.2 million for 2008. This increase was primarily due to the \$11.8 million additional workers' compensation expense adjustment. The increase in payroll taxes and benefits, as a percentage of revenues, from 30.5% for 2008 to 34.7% for 2009, was principally due to higher statutory state unemployment



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tax rates in various states in which the Company operates in 2009 as compared to 2008 and to an increase in business mix of PEO services where payroll taxes and benefits are presented at gross cost whereas the related direct payroll costs are netted against PEO services revenue. The decrease in direct payroll costs, as a percentage of revenues, from 40.8% for 2008 to 37.1% for 2009 reflects the moderate shift in the overall mix of services from staffing services to PEO services in the Company's customer base and the effect of each customer's unique mark-up percent.

During the second quarter of 2009, the Company engaged a new actuary to review its workers' compensation liabilities. While the Company historically obtained an actuarial study, management determined the study was not the best estimate of the workers' compensation liability. Based upon discussions with the new actuary and a thorough review of the Company's reserving process and consideration of recent developments, management determined the actuarial estimate as of June 30, 2009 was the best estimate of the ultimate cost to settle open claims. Our primary considerations included the significant erosion in the economy, the increasing complexity and uncertainty surrounding healthcare costs, unexpected development in open claims and growth in our business. The change in estimate resulted in the Company increasing its workers' compensation claims liabilities by approximately \$11.8 million at June 30, 2009.

SG&A expenses for 2009 amounted to approximately \$33.5 million, a decrease of \$3.2 million or 8.7% from 2008. SG&A expenses, as a percentage of revenues, increased from 13.1% in 2008 to 14.2% in 2009. The decrease in dollars from 2008 was primarily attributable to lower profit sharing and an overall reduction in variable operating expenses due to the decline in business activity and profitability.

During 2008, the Company recorded a non-cash, other-than-temporary impairment charge of approximately \$3.5 million relating to its investment in four closed-end bond funds. The impairment charge assumed no income tax benefit given the uncertainty of the Company's ability to generate future taxable investment gains required to utilize these investment losses.

Other income for 2009 was \$1.6 million compared to other income of \$2.1 million for 2008. The decline in other income for 2009 was primarily attributable to decreased investment income earned on the Company's cash and investments due to a decline in investment yields, partially offset by a gain on the sale of certain corporate bonds of \$572,000.

Our effective income tax rate for 2009 was (39.7%), as compared to 38.6% for 2008. The effective rate for 2009 was primarily attributable to the Company's loss before income taxes coupled with higher federal and state tax credits.

## **Fluctuations in Quarterly Operating Results**

We have historically experienced significant fluctuations in our quarterly operating results 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 and the effect of acquisitions. Payroll taxes, as a component of cost of revenues, generally

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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 affected 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, 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 position of \$30.9 million at December 31, 2010, decreased by \$5.7 million from December 31, 2009, which compares to a decrease of \$5.5 million for the year ended December 31, 2009. The decrease in cash at December 31, 2010, as compared to December 31, 2009, was primarily due to net purchases of marketable securities of \$12.1 million, an increase in accounts receivable of \$4.5 million, payment of cash dividends of \$3.4 million and the Company's repurchase of its common stock of \$3.4 million, partially offset by net income of \$7.4 million and an increase in accrued payroll, payroll taxes and benefits of \$7.3 million and a decrease in income taxes receivable of \$3.8 million. The decrease in cash at December 31, 2009 was primarily due to net loss of \$3.9 million, payment of cash dividends of \$3.4 million, the Company's repurchase of its common stock of \$3.0 million and an increase of \$4.3 million in income taxes receivable, partially offset by a \$11.6 million increase in workers' compensation claims liabilities.

Net cash provided by operating activities for 2010 amounted to \$17.9 million, as compared to net cash provided by operating activities of \$3.0 million for 2009. For 2010, cash flow was primarily provided by net income of \$7.4 million, an increase of \$7.3 million in accrued payroll, payroll taxes and related benefits, and a decrease in income taxes receivable of \$3.8 million, partially offset by an increase in accounts receivable of \$4.5 million.

Net cash used in investing activities totaled \$16.9 million for 2010, compared to net cash used in investing activities of \$2.7 million for 2009. For 2010, the cash from investing activities was principally used in purchases of \$35.2 million of marketable securities and net purchases of \$2.8 million of restricted marketable securities, offset in part by proceeds from sales and maturities of marketable securities of \$23.1 million. The Company presently has no material long-term capital commitments.

The Company's investment policy regarding its marketable securities focuses on the preservation of principal and the maintenance of a high degree of liquidity. The investment policy requires credit ratings of its investments to be rated BBB-/Baa3, or better.

Net cash used in financing activities for 2010 was \$6.8 million compared to net cash used in financing activities of \$5.9 million for 2010. For 2010, the principal uses of cash for financing activities were for the Company's cash dividends of \$3.4 million paid to holders of the Company's common stock and the Company's repurchase of 267,000 shares of its common stock for \$3.4 million.

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The Company's business strategy continues to focus on growth through the expansion of operations at existing offices, together with the selective acquisition of additional personnel-related business, both in its existing markets and other strategic geographic markets. The Company periodically evaluates proposals for various acquisition opportunities, but there can be no assurance that any additional transactions will be consummated.

The Company is a party to a Standby Letter of Credit Agreement dated as of June 30, 2009 (the "Credit Agreement") with its principal bank. The Credit Agreement provides for standby letters of credit as to which there were \$6.7 million outstanding at December 31, 2010 in connection with various surety deposit requirements for workers' compensation purposes.

Pursuant to the Credit Agreement, the Company is required to maintain compliance with the following covenants: (1) to maintain net income after taxes not less than \$1.00 (one dollar) on an annual basis, determined as of each fiscal year end; (2) to maintain liquid assets (defined as unencumbered cash, cash equivalents, and publicly traded and quoted marketable securities) having an aggregate fair market value at all times not less than \$10.0 million, determined as of the end of each fiscal quarter; and (3) to not borrow or permit to exist indebtedness (other than from or to the bank), or mortgage, pledge, grant, or permit to exist a security interest in, or a lien upon, all or any portion of the Company's assets now owned or hereafter acquired, except for purchase money indebtedness (and related security interests) which does not at any time exceed \$500,000. The Company was in compliance with all covenants at December 31, 2010.

The Company is self-insured for certain business insurance risks such as general liability, errors and omissions and umbrella coverage. It is the Company's determination that the risk of loss for such coverage is remote. Management may explore in the future more cost effective vehicles to provide higher limits of coverage, as well as coverages provided by the Company's captive insurance companies.

The Company maintains a Board authorized stock repurchase program to repurchase common shares from time to time in open market purchases. During November 2007, the Board approved an increase in the total number of shares to be repurchased under the program up to a total of 1.0 million common shares, up from the initial authorization of 500,000 shares. In October 2008, the Board approved a second increase in the authorized shares to be repurchased up to 3.0 million shares. The repurchase program currently permits approximately 1.5 million of additional shares to be repurchased as of December 31, 2010. Management anticipates that the capital necessary to execute this program will be provided by existing cash balances and other available resources.

Management expects that current liquid assets, coupled with the funds anticipated to be generated from operations, will be sufficient in the aggregate to fund the Company's working capital needs for the next twelve months.

**Table of Contents****Contractual Obligations**

The Company's contractual obligations as of December 31, 2010, including commitments for future payments under non-cancelable lease arrangements and long-term workers' compensation liabilities and other long-term liabilities, are summarized below:

(in thousands)	Total	Payments Due by Period			
		Less than 1 year	1 - 3 years	4 - 5 years	After 5 years
Operating leases	\$ 5,544	\$ 2,346	\$ 2,314	\$ 795	\$ 89
Long-term workers' compensation claims liabilities for catastrophic injuries	745	71	146	147	381
Other long-term liabilities	500	-	-	500	-
Total contractual cash obligations	\$ 6,789	\$ 2,417	\$ 2,460	\$ 1,442	\$ 470

**Inflation**

Inflation generally has not been a significant factor in the Company's operations during