Guide to Understanding the Premium Audit Process

An accurate audit is a benefit to you and your business.

Why Are You Audited?

Because the premiums charged for some of your coverages are based on how much business you do during the policy period. The insurance company charges an estimated premium at the beginning of the period based on the prior year's activity, or from an annual estimate that you provide (payroll, number of employees, amount paid to subs that have their own insurance, and receipts). At the end of the policy period, the company audits the actual numbers in these categories, and either credits premium back to you, or charges additional premium. This is based on how much the audit compared to the estimated figures.

Think of your policies as being elastic as they stretch and shrink to meet your needs and activity. It's actually a very good system, and you wouldn't want it any other way! The audit process lets you go about your business during the course of the year with no worries about reporting every job and every employee change. You should, however, contact your agent regarding jobs with unique insurance requirements, or out of state work.

Will You Be Audited?

The most commonly audited policies are workers compensation (payroll), general liability (payroll, number of employees, receipts, or cost), and business auto (number and type of vehicles). The policy indicates whether it is auditable or not. If your premium is based on any of the variables mentioned above, it is likely subject to audit. The company may not audit your account each policy period, but it reserves the right to do so.

How Will You Be Audited?

Audits are conducted three ways:

- Through the mail, via a form the company sends you. You complete and return it to them.
- Over the phone, with you providing the company with your information.
- By a physical audit, where an auditor visits you, your designee, or accountant to personally review your records.

If a phone or physical audit is necessary, you will be contacted in advance to arrange for a convenient time.

Overtime

In most states, the amount paid in excess of straight time pay can be deducted if the excess can be verified in your records. You must maintain your records to show overtime pay separately by employee and in summary by classification of work.

Division Of Payroll

Division of an individual employee's payroll to more than one classification is not allowed. The one exception is for construction or erection operations. The payroll of these employees may be allocated to each type of work performed if proper records are kept.

Your records must show the number of hours and amount of payroll for each type of work. <u>If you do not keep such a breakdown, the full salary will be charged to the highest rated classification</u>.

Reclassification

Can an auditor do this? **Absolutely!!!** Auditors are trained to ask the right questions. If they can legitimately and fairly get more premium dollars for the insurance company, you better believe they're going to do it. If an auditor determines that an employee is misclassified, they can change it all the way back to the beginning of the policy period, and you will owe the difference.

An extreme example is someone classified at policy issuance as clerical, but the auditor determines that this employee is spending most of his time roofing. The rate per $100 for Clerical is around $.30 as compared to about $30.00 for Roofing. Just imagine what your audit bill would look like with this reclassification: $100,000 of payroll at $.30 per $100 = $300 vs. $100,000 at $30.00 = $30,000. <u>You would owe $27,700 in premium just from this one reclassification</u>!

Reclassification can be very dangerous to your bottom line!

Subcontractors

Under the Illinois <u>Workers Compensation</u> law, you will be held responsible when an uninsured subcontractor's employee is injured on your job. This also applies if the <u>owner</u> of the subcontracting business is hurt on your job, and he isn't covered for work. comp. under the policy he bought for his employees (happens all the time), or just doesn't have a policy at all.

To protect yourself, be sure to secure a Certificate of Insurance from each subcontractor you use, and make sure the owner is covered under his/her own policy. **If such evidence of insurance is not available at the time of audit, you will be charged for the subcontractor's payroll based on the type of work he does.**

For example, you used an uninsured plumber for many jobs throughout the year. The total you paid him was $40,000. If the Plumbing rate is around $10.00 per $100, your insurance company will now charge you for an additional $4,000. I don't know anybody that would be happy with that. Even the insurance company wouldn't be pleased. Yeah, they just dug up some more money, but they don't like it when their contractors hire uninsured subs. Imagine paying $4,000 for an audit, and being threatened with cancellation to boot.

For <u>General Liability</u>, it is also necessary to secure a Certificate of Insurance from each subcontractor you hire. Without a certificate, the company will classify these subs and their employees as <u>your employees</u>, and charge you based on the type of work they do. Some companies aren't satisfied with just a certificate proving the sub had general liability. If a subcontractor doesn't carry a liability limit equal to or greater than yours, you'll still be charged for the sub and his employees.

Not having certificates of insurance for your subs <u>is</u> very dangerous to your bottom line!

What Information Will I Need To Provide?

The records needed will vary, depending on the type of coverage you have. In most cases, the premium auditor will be able to obtain the necessary audit data from two or more of the following records:

- Journals
- Tax Reports
- Vehicle Titles, Registrations or Ownership Tax
- Ledgers
- Individual Earning Cards

CAUTION: Have your payroll tax returns ready. What you don't want is the auditor winging it through your checkbook. Everything is open to interpretation, and you could have an auditor taking payments to a lumberyard, and calling it payroll.

Remuneration

Remuneration means money or substitutes for money and includes:

$ Wages

$ Commissions

$ Bonuses

$ Overtime Pay

$ Holiday Pay

$ Vacation Pay

$ Sick Pay

$ Payment for Piece Work

$ Profit Sharing Plans

$ Salary Reduction Retirement or Savings Plans

$ Tool Allowances

$ Value of Board, Lodging

$ Store Certificates

$ Meals

$ Merchandise or Store Certificates

$ Other Money Substitutes

Maintaining your payroll records in accordance with the above guidelines may reduce your insurance costs.

Final Notes

- If you owe an insurance company money from an audit on last year's policy, there's a good chance they're going to increase this year's policy estimates (payroll, receipts, etc.) accordingly. That's actually something you should want. I don't know any business owners that like big audit balance surprises. When you get an audit balance, the company wants payment now! No breaking it up into convenient installments.

  By using more accurate estimates, you can

  - spread your payments over the policy year
  - budget for your real insurance expenses
  - avoid nasty surprises

- If there is a large additional amount owed because you had a huge "once in a blue moon" job, tell the auditor to pass that on to the underwriter so you can avoid the current year's policy being unnecessarily increased.

- Know the rules so that you're not surprised by audit results, and so you can prevent an auditor from making a costly mistake or interpretation.

- Place your insurance with an independent agent that is not employed by the very company that is auditing your books. Plus, don't settle for just any agent. Your agent should really know his stuff.

- There may come a time when you think your audit outcome is wrong or unfair. Your agent should know how to stop the billing for this audit dead in its tracks and force a resolution.