

Commercial Insurance Update

Topics Affecting Buyers of Commercial Insurance

MSP C 04/2004 – “Your Workers Compensation Final Audit”

April, 2004

Your Workers Compensation Final Audit

By Jeffrey W. Cavnac, CPCU, RPLU

The ultimate cost of your workers compensation program is determined by a number of factors, not the least of which is your final audit.

The workers compensation audit process can be confusing, complex and, if done incorrectly, expensive. It doesn't help that the audit process is set up so that most errors benefit the insurance company.

The company may simply ask you to send the information needed to perform the audit, or may choose to conduct a physical audit in your office. In either case the auditor will probably want to see your State quarterly wage and withholding reports (DE-6s), payroll journals, and any previously filed payroll reports for the period being audited. Occasionally, other records that relate to your workers compensation policy may be requested as well.

Regardless of what records are requested, it is imperative that the payroll is placed in the appropriate classifications and that any rules that could work to your advantage are employed.

Your premium is based on gross payroll, not net payroll. Gross payroll includes salaries, commissions, bonuses, vacation and holiday pay, sick pay, overtime payments (which can subsequently be deducted), the value of gifts, all substitutes for money earned or paid during the policy period, including meals and lodging in lieu of wages, automobile allowances, and any amount by which an employee's salary is reduced to fund a pension or deferred compensation plan.

If you subcontract work, you will be asked to supply basic information about the subcontractors, and verification that they have appropriate insurance. Recognize that if they do not carry the appropriate

insurance, you will be charged premium based on their exposures.

Some payroll classifications allow you to split an employee's payroll among various class codes (recognize that many, including clerical, do not allow this). In order to take advantage of such a split, proper payroll records must be kept that specifically identify time worked in each classification.

Following are additional tips that you should be aware of during the course of the audit process:

1. **Appropriate Classifications** – Don't overlook clerical and sales classifications. In addition, if you have several classifications on your policy with various rates, make sure you understand the differ-

(Continued on page 2)

In this issue...

Your Workers Compensation Final Audit	1-3
Premium for Uninsured Contractors	4

Published by

Cavnac & Associates

INSURANCE BROKERS

License No. OA99520

1230 Columbia Street, Suite 850
San Diego, CA 92101-3547

- ◇ **Phone** 619-234-6848
- ◇ **Fax** 619-234-8601
- ◇ **Web Site** www.cavnac.com

(Continued from page 1)

ences so you can classify your employees in the most favorable category.

2. **Executive Officers and Partners** – Executive Officers and Partners are capped for payroll purposes. For 2004, the maximum amount that an executive officer or partner can be charged is \$81,900. If you have elected to exclude executive officers or partners, make certain that their payroll is *not* included in the audit.

3. **Overtime** – You are not required to pay workers compensation premium on the overtime portion of a wage. In other words, if somebody who normally makes \$10 an hour works an hour of overtime and is paid \$15, you would pay premium on the \$10 but not the extra \$5.

It is important that your payroll records be maintained to show the regular rate of pay, the overtime earnings by employee, and a summary by type of operation performed so that the auditor can give you credit for overtime excess.

4. **Severance** – If you have paid severance to anyone in the past year, you can deduct this from your audit. You are not required to pay workers compensation premium on severance pay.

5. **Payments to Inactive Employees** – Payments to inactive employees are not counted when calculating your workers compensation premium.

6. **Third Party Sick Pay** – Were there any employees hurt on the job that received disability payments (short or long term) from a disability carrier or provider? If this third party sick pay was included in the employee's W-2 and/or payroll register, you can deduct it.

7. **Travel Expense Offset** – Did any employees receive additional funds to offset travel expenses? This is not chargeable as payroll.

8. **Form 1099** – If anyone was paid by Form 1099 through your payroll, was this amount deducted for workers compensation purposes?

9. **Uniform Allowance** – Was anything added to individuals' payrolls to compensate for required work clothes or safety equipment? If so, this can be deducted.

10. **Any Other Additions or Exclusions** – Other than base pay, bonuses and commissions, were there any other additions or exclusions to payroll?

11. **Owner-Controlled Insurance Programs ("Wrap-Up" Policies)** – Were you involved in any owner-controlled insurance programs ("wrap ups") that extended to workers compensation? If so, you can deduct this payroll from your audit.

Preparing Your Audit Package

How can you prepare for your audit and make certain that you aren't overcharged? The key is to develop an "overcharge-proof" audit package.

1. **Classification** – Use a spreadsheet to place each employee into the correct classification (see Exhibit A). If you have any question as to where to classify a specific employee, call us.

2. **Remuneration** – Adjust for excluded remuneration

a. Exempted or excess corporate officers' payroll

b. Delete the overtime portion of any payroll

3. **Summary Statement** – Total payrolls for all classifications and prepare a Summary Statement.

4. **Subcontractors** – If you employed any subcontractors, compile the appropriate Certificates of Insurance.

5. **Uninsured Contractors** – Confirm that any uninsured contractors are placed in the appropriate classification.

The Auditor Arrives!

1. **Treat the Auditor as a Welcome Guest** – Assign a knowledgeable and friendly person to work with the auditor. Treat the auditor as a welcome guest (they're not used to this).

2. **Audit Package** – Present the auditor with your Audit Package

3. **Volunteer Nothing** – Answer the auditor's questions, but offer no gratuitous information.

4. **Premises Tour** – Provide the auditor with a tour if he/she wants one, but don't allow him/her to roam freely and unaccompanied around the work place.

(Continued on page 3)

(Continued from page 2)

If done correctly, the audit process will result in an appropriate premium charge. If done incorrectly, it can result in dramatic overcharges. The key to making certain your audit is done properly is to prepare an “overcharge proof” audit package.

In addition, don't hesitate to contact Cavnac & Associates with any questions that you might have. In general, the insurance company auditors do an excellent job and our involvement is minimal, but if at anytime you have questions or if you disagree with the auditor, let us know. It is our job to make certain that the audit performed fairly and reasonably.✧

Disclaimer: This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.

Premium for Uninsured Subcontractors

Article Courtesy of WorkComp Advisors

If you subcontract work, you will be responsible for providing the subcontractor with workers compensation insurance unless you can furnish satisfactory evidence that the subcontractor had workers compensation insurance in force covering the work performed for the contractor.

For each subcontractor **for which such evidence is not furnished**, additional premium shall be charged on the policy that insured the contractor as follows:

1. The contractor shall provide a complete payroll record of the employees of each uninsured subcontractor. Premium on such payroll shall be based on the classifications that would have applied if the employees of the subcontractor had been employees of the contractor.
2. If the contractor does not supply the payroll records of its subcontractor, the full subcontract price of the work performed during the policy period by the subcontractor shall be established as the payroll of the subcontractor's employees. The additional premium shall be charged on that amount as payroll.

In contracts for:

- a. Mobile equipment with operators (such as but not limited to earth movers, graders, bulldozers, or log skidders), the payroll shall not be less than 33-1/3% of the subcontract price.

- b. Labor and material, the payroll shall not be less than 50% of the subcontract price.
- c. Labor only, the payroll shall be established as not less than 90% of the subcontract price.

If vehicles with drivers, chauffeurs, or helpers are engaged under contract and the owner of such vehicles has not furnished evidence that the workers compensation obligation has been insured, the total payroll of such drivers, chauffeurs, or helpers shall be included as payroll of the insured employer that contracted for such vehicles.

Whenever you subcontract work, it is imperative that you require evidence (Certificates of Insurance) of workers compensation insurance and have those certificates available for the auditor's review.✧

Cavnac & Associates

INSURANCE BROKERS



www.cavnac.com