



Best Practices for Insurance Audit Preparation

**the
bunker**
INSURANCE & RISK MANAGEMENT

Successful Audits are Set Up When the Policy is Written

Believe it or not, the most successful and painless insurance audits are a result of properly setting up the policy. Interestingly, there is not a lot of guess-work in the insurance world. Class codes and their corresponding descriptions are readily available to agents for all lines of coverage. If the agent isn't sure how to access this information, they are always able to rely on their underwriter to provide the appropriate guidance. The bullet points below represent the activities that should be taken prior to binding an insurance policy in an effort to assure a "surprise-free" audit.

- Verify the class codes are correct. For workers' compensation policies, validate the class code in the SCOPES manual and discuss any possible discrepancies with the client.
- If there are questions, schedule a visit with the underwriter or company auditor to visit the client prior to binding the policy.
- Review the information that is included in workers' comp wages with the client.
- Request that the policy be written on a monthly self-audit basis or pay as you go with the payroll provider.

By following the above steps, an insured and their agent have the ability to control the pain level of the audit process. While audits will always be necessary, they don't have to be a pain and they don't have to contain surprises. It does not cost any money or extra time to make sure things are right before the policy begins.

If You Have Questions, ASK!

No one wants to get your insurance policy written correctly more than your underwriter. It is imperative that the underwriter has a good understanding of the risk your business and all of its exposures. If you are not comfortable talking to your underwriter directly, use your agent as a liason. A good agent understands how to communicate with an underwriter so that you get the best results.

Schedule a Visit

The absolute best to to make sure that an insurance company understands your business is to have them visit you. A physical visit to your business assures that the carrier understands the intricacies of your operations and leaves nothing to interpretation. If you don't think that an agent can accurately represent what you do on paper applications, a visit from the underwriter and/or company auditor is a must. There are several benefits to having an auditor review your class codes and exposure:

- Company buy-in on the front end removes audit issues on the back end. By addressing everything with an auditor in person, there is no room for interpretation at the end of the policy period.
- An auditor can oftentimes offer you a creative solution to addressing a class code discrepancy. Not only will this avoid confusion at audit, it could possibly save you money on your premium.
- Including your agent in the visit will make sure that nothing is lost in translation.

The relationship between the insured and the carrier should not be contentious. You are paying a lot of money in premium to have access to the insurance carrier's resources. USE THEM!

What is Included in Workers Compensation Payroll?

It is important to understand exactly what is considered "payroll" for workers' compensation purposes. Once a policy is set up correctly, this can be one of the single largest areas for an audit resulting in additional premium owed to the insurance company.

- Wages or salaries, including retroactive wages. (Check with your insurance company auditor to have them provide state caps on individual weekly wage) Not capping individual wages is a common cause for over-reporting
- Commissions and draws against commissions
- Bonuses including stock bonus plans
- Extra pay for overtime work, with exception
- Pay for holidays, vacations, or periods of sickness
- Payments by an employer of amounts required by law to be paid by employees to statutory insurance or pension plans (like Federal Social Security)
- Payments to employees on any basis other than time worked, such as piecework, profit sharing, or incentive plans
- Payments or allowance for hand tools or power tools used by hand and used in their work or operations for the employer
- The rental value of an apartment or house provided for an employee
- The value of lodging, other than apartment or house, received by employees as part of their pay
- The value of meals received by employees as part of their pay
- The value of store certificates, merchandise, credits, or any other substitute for money received by employees as part of their pay
- Payments for salary reduction, employee savings plan, retirement, or cafeteria plans that are made through employee-authorized salary reduction from the employee's gross pay
- Annuity plans
- Expense reimbursements to employees to the extent that employers' records do not substantiate that the expense was incurred as a valid business expense (Note: when it can be verified that the employee was away from home overnight on the business of the employer, but the employer did not maintain verifiable receipts, a reasonable expense allowance, limited to \$30 day, is permitted)
- Payment for filming of commercials, excluding subsequent residuals

What is Excluded in Workers Compensation Payroll?

It is important to understand exactly what is considered "payroll" for workers' compensation purposes. Once a policy is set up correctly, this can be one of the single largest areas for an audit resulting in additional premium owed to the insurance company.

- Tips and other gratuities received by employees
- Payments by an employer: (1) to group insurance or pension plans and (2) into third-party pension trusts for the Davis-Bacon Actor or similar wage law (pension trust must be qualified under IRC Sections 401(a) and 501(a))
- The value of special rewards for individual invention or discovery
- Dismissal or severance payments, except for time worked or accrued vacation
- Payments for active military duty
- Employee discounts on goods purchased from employer
- Expense reimbursements to employees to extend an employer's records substantiate the expense was a valid business expense (Note: reimbursed expenses and flat expense allowances, except for hand or power tools, may be excluded from the audit if all three of the following conditions are met: (1) the reimbursed expenses were incurred upon the business of the employer, (2) the amount of each employee's expense payments is shown separately in the record of the employer, and (3) the amount of each expense reimbursement approximates the actual expenses incurred by the employee)
- Dinner money for late work
- Work uniform allowances
- Sick pay to an employee by a third party such as an insured's group insurance carrier that is paying disability income benefits
- Employer-provided perks such as:
 - (1) use of an automobile,
 - (2) an airplane flight,
 - (3) an incentive vacation (e.g. contest winner),
 - (4) a discount on property or services,
 - (5) club memberships,
 - (6) tickets to entertainment events
- Employer contributions to salary reduction, employee savings plans, retirements, or cafeteria plans (IRC 125) - contributions made by the employer that are determined by the amount contributed by the employee

Now that you have an understanding of what needs to happen before the policy is set up and exactly what is and is not included in Workers Compensation payrolls, there are some things you can do during the year to assure you stay on track.

Create a spreadsheet by line of coverage for those insurance policies that are subject to audit. In the spreadsheet, you will want to create the formulas that will calculate your premium owed in real time. The Bunker provides our clients with an excel sheet that they can use in real time.

Simply, you want to be able to type in sales or payroll, have the spreadsheet multiply that exposure by the rate and spit out exactly how much premium you have "used up". Not only does this help you with audit, it is a great way for you to see how much a specific project will cost prior to entering a bid.

In addition, you should periodically review your payroll files to assure that each employee is correctly listed in the appropriate class code.

Create a Formal Subcontractor Agreement

By creating a formal subcontractor agreement, you are doing more than just helping your cause at audit time. A properly written subcontractor agreement is an excellent way to transfer risk from your company's insurance policies to the policies of a properly insured subcontractor.

Your subcontract agreement should require you to be named an additional insured on all subcontractor policies. In addition, you need to be sure that the limits of liability are at least the same as your own limits of liability when setting up your agreement. It is not uncommon to request a Waiver of Subrogation from your subcontractors.

Other considerations include, but are not limited to language that addresses: breach, warranty, remedy, severability, alternative dispute resolution and hold harmless.

We will save any further discussion about subcontractor agreements to another day.

Prepare the Required Documents Ahead of Time

Auditors are typically very organized people. They definitely do not like to have to organize your data because you were too lazy to do it. Make sure that you take the time necessary to get your reports and data organized in an easy to read format prior to the auditor's arrival.

While the type of documents required for an audit will vary by policy type, below is a pretty good list of what an auditor might ask you to gather when preparing for your audit.

- Payroll records (payroll summaries, registers or journals)
- Federal or State Quarterly Tax Reports (Fed 941 or State Unemployment Income)
- Subcontractor expense records
- Subcontractor certificates of insurance for those subs used during the audit period
- Cost for leased, temporary or casual/contract labor (names & amounts paid)

Preparing for an audit can seem like a daunting task. Usually that's because you have not been given good advice on how to prepare. By setting up the policy right in the beginning, reviewing exposures as frequently as needed and keeping your information in an organized, easy-to-read format, the days of painful audits will be long gone. In fact, you just might look forward to seeing that auditor every year and hearing them tell you what a great job you have done to make their life easier.

ABOUT THE AUTHOR



Ciara Gravier - Founder & CEO

Ciara has nearly twenty years of experience in the insurance industry. She's helped her family start and sell two prior agencies and now Ciara is the Founder & CEO of The Bunker Insurance & Risk Management, where they focus on middle market commercial insurance. She holds several designations, including the CIC, CRM, and CCIC. Ciara sits on the local board of insurance agents, the Broward chapter of LAAIA, as a director for the second year in a row.

Ciara's specific specialties include: Workers' Compensation Experience Modification Factor Analysis and Analytics and structuring and negotiating risk financing structures for organizations of all sizes. Ciara is often tapped to lead educational seminars and be an ad-hoc board member in various technology incubators/accelerators throughout the Southeast.

The Bunker Insurance & Risk Management is a unique firm that leverages technology and out of the box thinking to serve clients throughout the state of Florida. Because of our deep roots in client service and our ability to build mutually beneficial partnerships, The Bunker stands to be one of the fastest growing firms in the Southeast over the next several years.