

# Audit

## The Dreaded “A” Word

by Amy DeJong

*The annual workers’ compensation audit may not be as feared as its IRS counterpart, but it probably wouldn’t qualify as a yearly highlight.*

“Get it done and move on” is the approach most companies take when preparing for a workers’ compensation (work comp) audit. However, simply turning over a stack of documents to the auditor without preparation might be a costly mistake that could result in unnecessary charges. There is often great benefit in doing your homework before the auditor arrives.

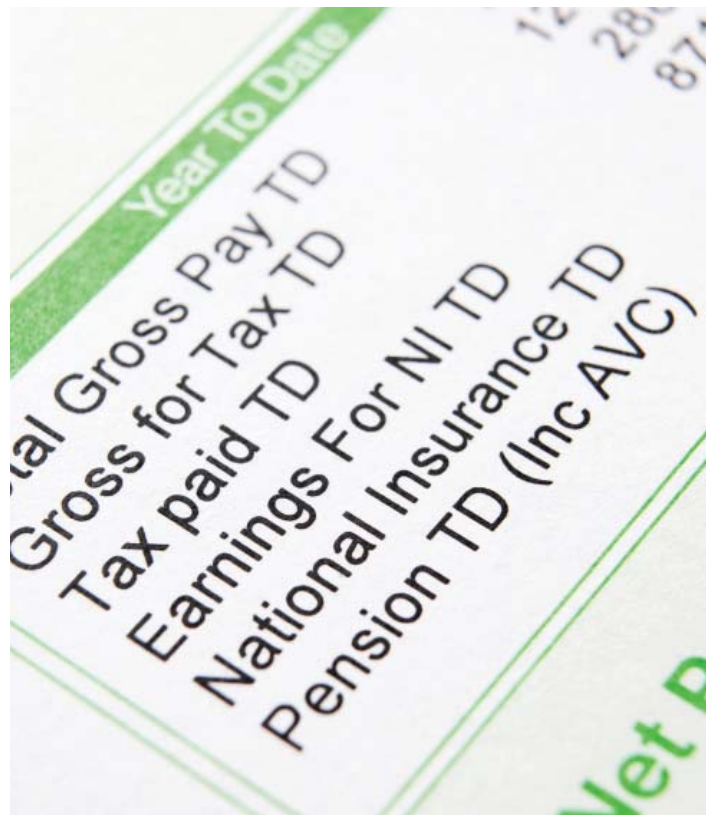
### The audit process

Work comp premium is basically calculated by multiplying payroll by the rate for a specific job classification. An estimate of a coming 12-month payroll is made at the beginning of the policy period to determine a “deposit premium.” It should be noted that the estimated payroll rarely matches the exact payroll outlay at the end of the policy period. Therefore, the audit is designed to reconcile the original estimate to the actual payroll. The difference can result in either an additional premium due or a refund.

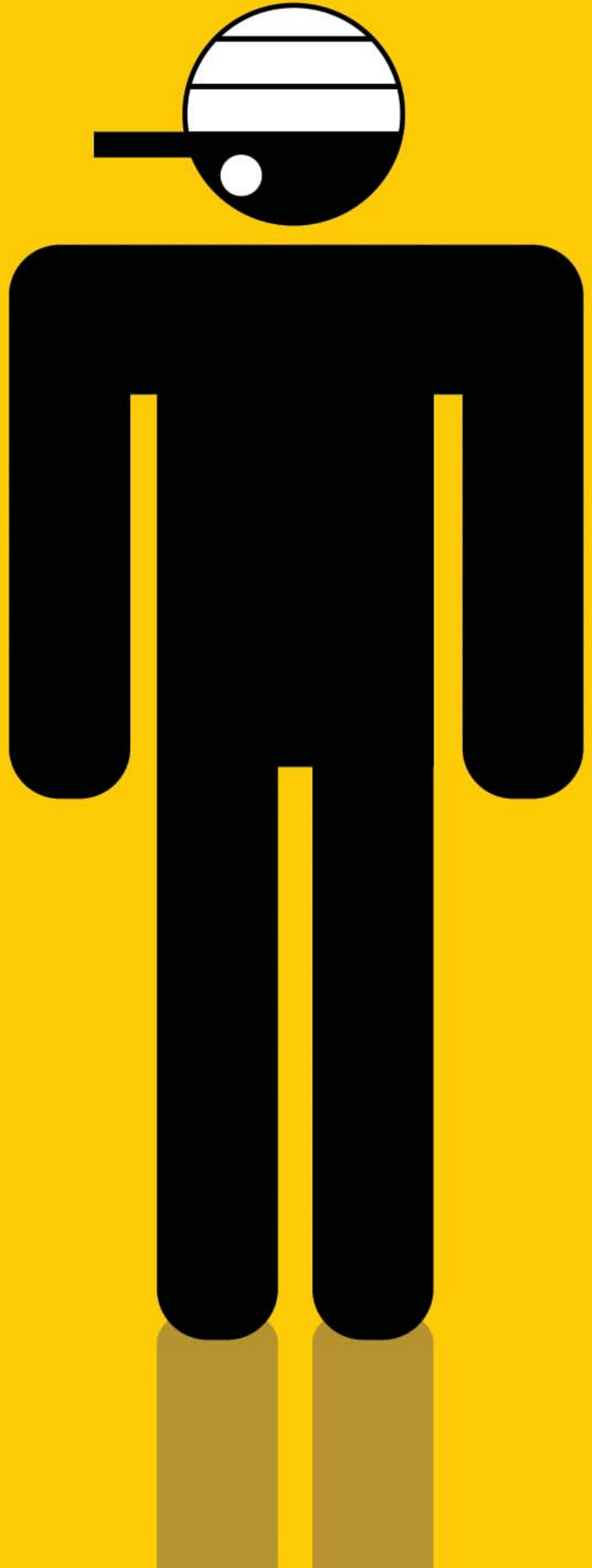
Potential overcharges can occur if the auditor is allowed to be the sole interpreter of the rules. A typical audit begins by placing your entire payroll into the highest-rated code; the auditor then “backs out” the exceptions. How can you take control of the process? The following tips may help you avoid paying more than you should:

### Classify, classify, classify

Correct classification is the greatest single factor in the work comp premium calculation. It is in your best interest to be aware of positions within your organization that qualify for a lower-rated code. The insurance underwriter who programs classifications may not know your business well enough to look for specific job classifications. The auditor may not always catch a mistake in your favor, either.



The National Council on Compensation Insurance (NCCI) is the governing authority for classifications, and the Scopes® manual is the rule book. The saying “it pays to know the law” is applicable in this case, as well. Work closely with your advisors to make sure you are coded correctly, especially regarding any unique or “hybrid” positions within your company. This can make a big difference at audit time.



## Getting prepared

Your understanding of the way in which a work comp premium is derived can help you complete the following tasks before the auditor arrives:

- Utilizing a spreadsheet or payroll system report to pull payrolls per employee for the policy year by work class code, including separate detail on overtime
- Reviewing the work comp classification for accuracy
- Adjusting the payroll for excluded remuneration (wages) (see details below)
- Preparing a summary of the results
- Consolidating the payroll verification records (941, 940, W-3, Unemployment Tax Reports, etc.)
- Preparing copies of the subcontractor certificates of insurance, showing proof that they are covered by their own work comp programs

This advance preparation can save time for you and the auditor, as well as create an audit that may be favorable to your situation. In addition, being forthcoming with the data creates a defensible position. You might not always win, but you will be in the best position to defend your case.

## Work comp payroll inclusions and exclusions<sup>1</sup>

Under the NCCI, remuneration *includes* the following components:

- Payroll, both salary and hourly
- Commissions
- Bonuses
- Overtime pay (less the premium portion)
- Holiday, vacation and sick pay
- Contributions required by law to statutory insurance or pension plans, which would be paid by the employee
- Incentive plans and profit sharing plans
- Payments made to employees for employee-supplied hand and power tools
- Rental value of housing provided to employees
- Value of meals or lodging provided by employers
- Payments for employee savings plans, retirement or cafeteria plans that are made through salary reductions from employees' gross pay or through annuity plans
- Davis-Bacon or similar wage laws (contractors paying prevailing wages who are able to deduct from workers'

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compensation payroll to determine premiums made to health and pension plans for contracted workers)

- Expense reimbursements to employees that were not verifiable expenses

The following components are *excluded*:

- Tips and gratuities received by employees
- Payments made by employers for group insurance plans
- Values of special awards paid for inventions and/or discoveries
- Dismissal or severance pay (except for time worked or accrued vacation pay)
- Value of employer-provided aircrafts, automobiles, aircraft flights (free or discounted) or incentive vacations given to contest-winning employees
- Employer-provided discounts on properties, services or tickets to entertainment events
- Payments to military reservists called to active duty status
- Work uniform allowances
- Sick pay (if not from a non-related third party)

## Overtime pay

Under NCCI rules, the only pay that can be adjusted to be considered normal salary or hourly pay is overtime, either time-and-a-half or double time. Most states comply with the NCCI overtime rule; however, Pennsylvania and Delaware do not allow overtime premium portions to be removed from payroll calculations.

Overall, a work comp premium begins with an estimate. Once the policy expires, the insurance company determines the actual premium through remuneration. To avoid mistakes during the audit process, remember to request a copy of the auditor's notes. This serves as an explanation of how the auditor determined remuneration and how values were placed in various classifications. Knowing the rules and doing your homework can pay dividends.

<sup>1</sup> Information from SilverSource, SilverStone Group's proprietary online resource for risk management problem solving. SilverStone Group clients should contact your account manager for access to SilverSource.