

PREMIUM AUDIT EXPLANATION

WHAT IS IT?

Simply defined, it is “the examination of an insured’s operations, records, and books of account to determine the actual exposures and applicable premiums for the coverages provided.”

WHY THE PREMIUM AUDIT?

A premium audit, whether by mail or on site is a necessary function of casualty insurance. Premiums for casualty insurance, in particular General Liability and Workers’ Compensation, are based on such variables as sales, receipts, costs or payrolls.

Given these variables, it is seldom possible to determine the final premium at the time the policy is issued; therefore, the actual “earned” premium is computed at the end of the policy term upon completion of an audit.

Authority for the company to conduct an audit of the insured’s financial records and books, and then to compute the appropriate premium, is contained as a condition of the policy.

RECORDS

To be certain the premiums fairly represent the exposures, the insured must maintain accurate records. If the estimated premium charged at policy issuance was too high, we will return the excess. If it was too low, the insured will owe additional premium to the company. It should be noted that in some cases minimum premiums will apply.

It is imperative that the insureds maintain their financial records in sufficient detail to facilitate the completion of the audits. Since the basis of premium will vary with the type of coverages, the insured’s financial and operations records must be available to the premium auditor for review.

Depending on the coverage provided, the premium auditor will be able to secure the necessary data from the following types of records:

- General Ledger
- Payroll Journal
- Individual Earnings Cards or Ledger
- Cash Receipts Journal
- Accounts Receivable Journal
- Accounts Payable Journal
- Quarterly Wage Reports
- Financial Statements
- Cash Disbursements
- Sales Records
- Certificates of Insurance

In some businesses, employees can be used in more than one job classification. These employees' payroll and resultant premium will be based on the most hazardous work performed. For construction and erection business, the salary of employees may be assigned to the different types of work performed, but only when the payroll records show how much time and salary is charged to each type of work. When such payroll breakdown is not kept, all payroll will be assigned to the highest rated class.

PAYROLL REMUNERATION

As previously stated, many of the premiums for casualty insurance are based on payroll. This can be simply defined as the "the total remuneration for services performed by an employee". Remuneration may be money paid direct, as listed below:

- Wages
- Bonuses
- Commissions
- Incentive Pay
- Overtime Pay
- Payment for Piece Work
- Holiday or Vacation Pay and Tips are subject to special rules for many states.
- Sick Pay or substitutes for money such as:
Board or Lodging, Store Certificates or Merchandise.

EXECUTIVE OFFICER OR PARTNERS

Earnings of executive officers or partners, when covered by the policy, are assigned to the job classification in which they are primarily engaged. All executive earnings are subject to a minimum and maximum as approved by each state. Premiums for executive officers will be for at least the minimum, even though the payroll records indicate less than the minimum. The inclusion of officers and partners, in some states, is dependant on an election and the attachment of the appropriate endorsement.

COVERAGE AUDITED:

GENERAL LIABILITY

Premises/Operations and Products/Completed Operations

Manufacturing and processing as well as mercantile classifications are rated on a "gross sales" basis.

Contracting and service risks are rated on a "payroll" basis.

The same premium basis must apply to each classification for both premises operations and products.

Overtime pay may be excluded from payroll on which premium is computed, provided records are maintained to show overtime pay separately by employee and in summary by classification.

WORKERS' COMPENSATION

The gross payroll is used to figure the premiums for each classification.

Overtime pay may be excluded from payroll on which premium is computed, provided records are maintained to show overtime pay separately by employee and in summary by classification.

INDEPENDENT CONTRACTORS/SUBCONTRACTORS

Most states require that an employer provide coverage for the employees of a subcontractor, in the event the subcontractor has not obtained a Workers' Compensation Policy. Contracts between the contractor and subcontractor will not alter this determination.

Independent contractors or subcontractors work for another, as does an employee, but the independent contractor is not subject to detailed supervision by the principal. In a relationship between an independent contractor and a principal, the principal has general control over the results of the work but not over the details by which the work is accomplished.

CERTIFICATES OF INSURANCE

Certificates of Insurance from the subcontractor/independent contractor verify that coverage was in effect for the subcontractor. Insurance Carriers typically require that all certificates for independent/subcontractors indicate coverage in force during job period and that the Premises Operations and Products Completed Operations limits for the independent/subcontractor be at least the lower of: 1) limits equal to the limits carried by our insured; or 2) \$1,000,000 each Occurrence / \$2,000,000 Aggregate.

It is extremely important that appropriate certificates of insurance from each subcontractor be secured and on file, **NOT REQUESTED AFTER AUDITOR ARRIVES**. Auditors will ask to review this certificate at the time of audit. Failure to obtain the certificates will require the inclusion of the payroll for the uninsured or inadequately insured subcontractor at the appropriate classifications for the jobs being done by the independent/subcontractor and could increase the premium substantially.

The basis of premium for adequately insured subcontractors is **TOTAL COST**. Total cost is defined as "the total cost of all work let or sublet in connection with each specific project including: 1) the cost of all labor; materials and equipment furnished, used or delivered for use in the execution of the work; and 2) all fees, bonuses or commissions made, paid or due.

The "cost" of all such items must be included whether furnished by the owner, the general contractor or any subcontractors. **THUS, IF THE GENERAL CONTRACTOR SHOULD FURNISH PART OF THE MATERIALS IN A SUBLET PROJECT, THE COST THEREOF MUST BE ADDED TO THE AMOUNTS PAID TO THE CONTRACTOR TO ARRIVE AT THE TOTAL COST OF THE WORK.**

GENERAL AUDIT DEFINITIONS:

Corporate Officer, Partners, Individual Owners:

Do not include payroll of those whose duties are clerical only or who have no active role in the business.

Remuneration:

Means entire compensation for services rendered by an employee - base pay prior to deductions for taxes, social security, etc. It includes tips and the value of board and lodging. Include the payroll of lease workers furnished to you by a labor leasing firm.

Do not include as remuneration - Employer contributions to employee group insurance and pension plans. Special rewards for invention or discovery, overtime above regular pay rate, payroll of drivers.

Total Cost:

Means cost of all work let or sublet in connection with any job or project including all labor, materials and equipment used or delivered for use whether paid by you, a client, or a bank.

Receipts or Sales:

Means gross amount of money paid for goods or products sold, operations performed, rentals, or dues and fees.

These condensed definitions are intended to assist you with general definitions. Review your policy for a better understanding of the rating basis.