

Planning for a Workers Compensation Audit

At the end of virtually every workers compensation policy period, there will be an audit. For smaller firms, insurers may just send your firm a worksheet and ask you to complete and return it. But for larger firms, the audit generally means an auditor comes to your premises and asks to see the books. That audit can go smoothly and to everyone's satisfaction, or the process and the results can lead to a disagreement that can take months to resolve. As with many of life's tasks, the six Ps apply here: Proper Prior Planning Prevents Poor Performance. The time to start planning for a workers compensation audit is at the beginning of the policy period, not the end.

Authority to Audit

The workers compensation policy gives the insurer the right to inspect your records. The following is part of the standard policy:

You will let us examine and audit all your records that relate to this policy. These records include ledgers, journals, registers, vouchers, contracts, tax reports, payroll and disbursement records, and programs for storing and retrieving data. We may conduct the audits during regular business hours during the policy period and within three years after the policy period ends.

The insurer generally will audit your policy within a few months of policy expiration, but it is important to remember the insurer has a three-year window of opportunity to look at your records.

Premium Basis

The most common basis for calculating workers compensation premium is remuneration—generally, payroll. But remuneration is not limited to payroll. It can include a number of equivalents. The following is a partial list of other items included:

- bonuses;
- commissions;
- pay for holidays;
- sick pay;
- vacation pay;
- profit sharing;
- allowances for hand tools;
- value of lodging when provided by employer;

- value of meals provided by employer; and
- expense records when there are no receipts.

Independent Contractors

Perhaps the most frequent point of contention in workers compensation audits arises when the insurer includes the cost of independent contractors as payroll. The reason for this is that the standard policy defines the premium basis as including:

...all other persons engaged in work that could make us liable under...this policy. If you do not have payroll records for these persons, the contract price for their services and materials may be used as the premium basis.

Every state has statutory and/or case law that may impose responsibility for injuries to uninsured independent contractors/subcontractors on the firm for which they are working. Since the insurer may be liable for claims, it is also entitled to premium. But the policy goes on to say that this condition:

...will not apply if you give us proof that the employers of these persons lawfully secured their workers compensation obligations.

The easiest way to prove your independent contractors/subcontractors have secured those obligations is with a certificate of insurance. It is much easier to gather these certificates of insurance over the course of the policy year than it is to try to obtain all of them after the policy year is over.

Executive Officers' Payroll

Executive officers are subject to a payroll limitation under states' workers compensation laws—a maximum amount of payroll that will be included in your firm's workers compensation audit. (There is also a minimum amount that would apply to executive officers who work, for example, for a nominal \$1 per year.) The maximum amounts range from as low as \$150 per week in Texas to as high as \$5,900 per week in the District of Columbia.

Some firms with highly paid professional staffs would understandably like to classify all professionals as officers. But the definition of executive officers is generally limited to those people occupying executive positions listed in the firm's bylaws, articles of incorporation, and/or similar documents. If your firm pays some nonexecutive employees more than the maximum workers compensation executive pay in a given state, it will have to pay premium on the entire payroll for those individuals.

In preparation for your audit, you should isolate executive payroll from other payroll, listing it separately along with the executive titles for those individuals.

Payroll by Classification Code

Your firm's workers compensation policy includes a variety of payroll classifications, each of which also has a code. For example, "Clerical Office Employees" is code 8810 in most states. Your payroll records should include the workers compensation code for each employee. That will save you from having to translate your own payroll language for the auditor.

Treatment of Overtime Pay

Most firms pay a surcharge for work beyond 40 hours per week, generally calculated as a multiple of regular pay. For example, someone who earns \$20 per hour

may be entitled to "time and a half," or \$30, for hours 41 through 60; "double time," or \$40, for hours 61 and beyond.

While the basic pay for those extra hours is part of the auditable payroll, most states allow firms to exclude any surcharge from the audit. Thus, you should keep track of overtime surcharges, listing them separately and labeling them clearly in your payroll records.

The Audit

Once you make an appointment with the auditor, the following steps should facilitate and expedite the process:

- Decide who will work with the auditor. This should be someone familiar with your firm's payroll records and methodology.
- Gather all of the records you may need. These might include payroll ledgers, general ledgers, sales journals, Social Security reports, state and/or federal income tax filings, and similar information. And do not forget those certificates of insurance.
- Ask the auditor to perform the audit at your premises. That way, any additional information needed will be readily accessible.
- Participate in the process. Ask questions if there are things you do not understand.
- Ask for a copy of the auditor's worksheets before she/he leaves your premises.
- When you later receive your audit from your insurer or your broker, be sure to check it against the worksheets. If there are any discrepancies, contact your insurance broker and/or your insurer for an explanation.

The proper prior planning you have done throughout the policy year should prevent any poor performance—and protracted battles—at audit time.