Your Guide to Preparing for an Insurance Company Audit

B.F. SAUL INSURANCE

Expert Advisory. Claims Advocacy.

Insurance policies such as general liability (GL) and workers' compensation are auditable each year by your insurance company.

Though the audit process is relatively straightforward, if you don't comply with the audit or plan for it properly, the process could become difficult and you could face costly consequences.

Whether you're new to purchasing GL and workers' compensation insurance or you've been buying these coverages for years, this guide will help you avoid problems at audit time. It reviews what to expect of the insurance audit process, the types of information you're required to provide, missteps that can cause audit problems, the potential results of an audit, and how to prepare effectively. The guide also covers the most Frequently Asked Questions about insurance carrier audits.

The Purpose of an Insurance Audit

The data collected during the audit allows the insurer to properly determine your premium, deter and detect fraud, and meet regulatory requirements. Rating organizations also use the data collected at the audit to develop loss costs and experience modifiers.

For coverages like GL and workers' compensation, your premium is based on the exposure estimates you provide to the insurance company prior to the beginning of the policy period. For GL, you will provide estimates of your sales, payroll, costs, or other units of measurement depending on your class of business. For workers' compensation, the insurer will require an estimate of your annual gross payroll.

The insurance company uses your estimates to assess the level of risk and determine the premium. However, your circumstances could change over the 12-month policy period. You could win a large contract you weren't expecting or hire more employees than you anticipated to handle a surge in growth. You could also finish a project earlier than anticipated or lose a contract unexpectedly.

As your dynamic business evolves, so will your exposure, especially for GL and workers' compensation. That's why insurers conduct annual premium audits for these policies.

At the end of the policy period, they compare your initial estimates to your actual experience for the previous 12 months. If your estimates were higher than your actual figures, the insurer will refund you the difference in premium. If your estimates wer lower than your actual exposure, they'll charge you the difference.

Let's say you apply for GL insurance with a new carrier and estimate your revenues for the policy period will be $15 million. Three months later your company wins a major contract that brings in an additional $3 million, which you hadn't anticipated. When the insurer audits your GL policy, they'll see that your actual revenue for the period was $18 million, which means they have been carrying more risk than expected. They'll recalculate your premium based on your actual revenue and charge you the difference between what you paid vs what you should have paid.

WHAT TO EXPECT OF THE Insurance Audit Process

Though the term "audit" can sound intimidating, the process is straightforward and shouldn't cause concern.

All workers' compensation policies are auditable annually, while some GL policies are auditable depending on the insurance company, the class of business, your state, and other factors. Regardless, the audit should never come as a surprise since the insurer will always disclose upfront whether your policy is auditable. When you purchase a new GL policy or renew an existing policy, ask your independent insurance advisor whether it is auditable. If so, the premium audit will occur annually, no matter how long you stay with the same insurer.

The timing of an insurance audit can vary slightly by company, but most follow this cadence:

- A couple of weeks before the policy period ends, the insurer notifies you that they are auditing the policy. You receive a detailed list of information and documentation to provide.
- Most insurers give you 60 to 90 days from the end of the policy period to provide the requested data.
- In most cases, the insurer provides the audit findings a few weeks after receiving your information. For large companies or especially complex policies, it might take much longer to receive the results.

REMOTE VS PHYSICAL
Insurance Premium Audits

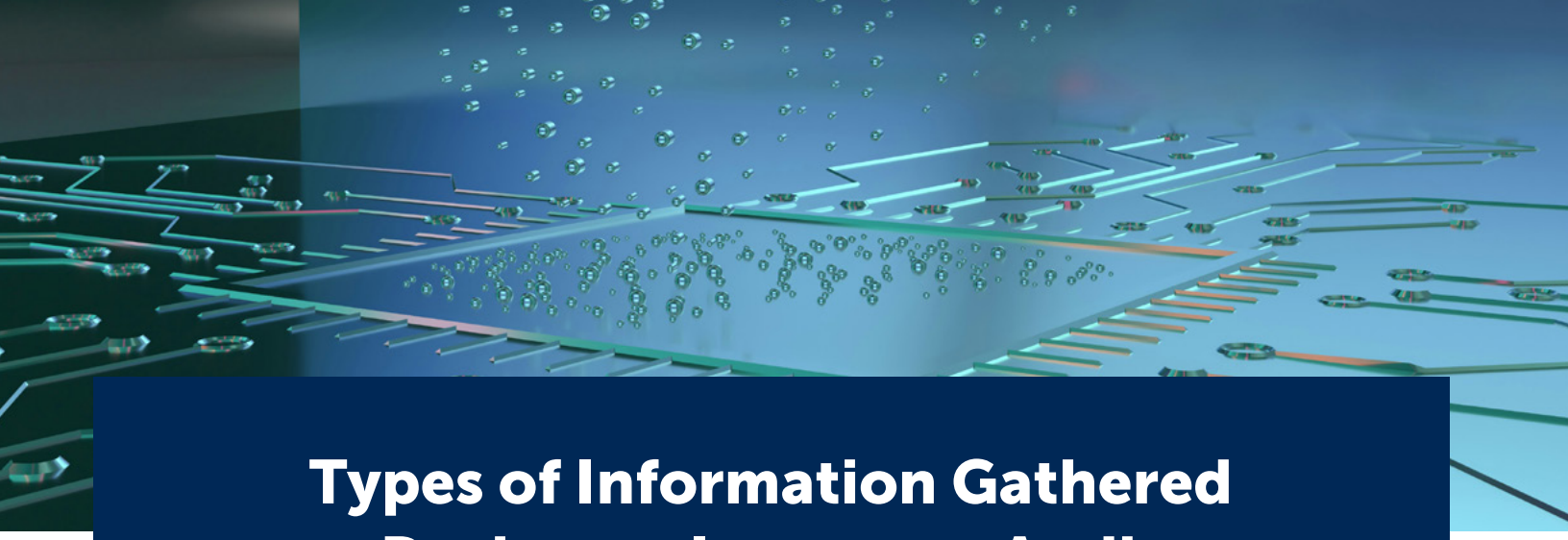
These days, many audits are done remotely. The insurance company sends you a list of audit requirements and you send back the required information. However, in some cases the insurer conducts the audit in person at your facility. The in-person audit date will be scheduled ahead of time and you'll have plenty of notice.

Though the specifics vary by state and insurer, the decision to conduct the audit in person is based on the premium size, along with your claim history and risk rating. Some insurance companies also conduct a physical audit if your worker classification codes recently changed or are potentially problematic.

For example, the National Council on Compensation Insurance (NCCI) recently made worker classification changes that could impact businesses in states that follow the NCCI guidelines.

The only difference between a remote audit and a physical audit is how you provide the requested information.

Instead of submitting your documentation via the mail or electronically, you provide it to the auditor in person, in real time. The individual in your organization who is responsible for handling insurance audits (typically the CFO, Controller, or HR representative) will need to be prepared to attend the audit, answer questions, and provide any requested documents.



Types of Information Gathered During an Insurance Audit

The type of information the insurer requests will vary slightly based on the type of policy involved and your industry. Generally, they ask for information and documentation such as the following:

- General ledger
- Sales records
- Total payroll for the previous policy period (for workers' compensation policies)
- W-2 & 1099 forms for all employees and contractors
- 941 forms for the policy period
- Federal tax returns
- Cash expense reports
- Job duties and employee classification codes
- Description of company services
- Certificates of insurance for all contractors and subcontractors

The last item often poses problems during the audit process. Many businesses don't realize they should require contractors and subcontractors to carry their own liability and workers' compensation coverage and should keep the certificate of insurance on file. In the absence of such proof, in most states the insurer can require you to cover the contractor under your own policies. If the audit determines you're using uninsured contractors and you didn't include them in your forecasts, the insurer will adjust your premium accordingly.

Properly insuring contractors is complicated by the fact that the criteria for classifying an individual as an employee vs a contractor vary by state. An independent insurance advisor can provide guidance on the laws in any state you do business in and help ensure you're classifying workers correctly in all jurisdictions.

The insurance audit will also assess whether you have classified all your employees correctly, since different types of work present different levels of exposure. For example, if you run a construction company that does roofing work and you classify most of your employees as "clerical," that is likely to raise a red flag during the audit.

Missteps That Can Trigger Audit Problems

How you operate your business during the policy period has insurance implications, and it can affect whether you encounter issues at audit time. This is especially true for workers' compensation policies.

The insurance carrier writes your workers' compensation policy based on certain assumptions about your business, including the nature of your work and the classification codes of your workers. If either of those factors changes, so will your exposure. For instance, if your government contracting business provides IT staffing services, and you decide to branch out into healthcare staffing, you're now doing work that carries a different risk than the insurer expected. Your risks also could change if you expand your operation into additional states or agree to a customer's request to perform work that is outside your normal area of expertise.

When changes like these surface during the audit, the insurer recalculates the premium and charges you the difference, which could be significant. Some companies have seen their workers' compensation or general liability premiums increased tenfold just by expanding into new services that carry higher risk.

Possible Results of an Insurance Audit

When an audit uncovers that you underpaid for the previous policy period, the insurer bills you for the difference between what you paid and what you should have paid. Typically the bill is due in full and on receipt, which usually means within seven to 10 days. Some insurers allow you to make payments over several months, but that's not always the case. To avoid these unwelcome surprises, it's essential to provide accurate estimates upfront and inform the insurer if something substantive changes in your business during the policy period.

There are some exceptions when a large audit finding is expected and intentional. Businesses with inconsistent cash flow might choose to preserve their cash by underestimating sales or payroll to obtain a lower premium; then they pay the difference after the audit. In this case, it's important to monitor how the business is tracking and ensure you have sufficient cash to cover any underpayment post-audit.

While an audit can result in your company owing additional premium, if the amount you paid is more than the resulting audit premium then the insurer will issue a returned premium. They typically send you a check for the returned premium immediately after the audit is complete, but in some cases they issue a premium credit if you have a premium balance on your current term.

TIPS FOR PREPARING FOR AN
Insurance Premium Audit

Best practices like the following will help you prepare for an insurance audit and avoid surprises at the conclusion.

Know your policy.

Be aware of which policies are auditable and what the insurer will expect to review at audit time. Review the exposures which the insurer originally used in rating your policy.

Mark your calendar.

The insurance audit tends to happen soon after you've finished the policy renewal process, making for a hectic and potentially overwhelming time. Note the date that your policy period ends, so you know when you'll need to start gathering information.

Don't overlook the audit request.

If you don't respond to the insurer's request for information, they can issue an estimated audit. In many states, the insurer can also assess a non-compliance surcharge. The allowable surcharges vary by state, but can be especially high for workers' compensation policies, running as high as double the premium. The insurer could also cancel your policy for not complying with the audit. And once you've had a policy canceled, it's more difficult to obtain coverage from another insurer.

Maintain good records year-round.

The better your recordkeeping, the less time you'll spend preparing for the audit. Make sure your financial statements, payroll records, and tax-related documents are complete and up to date.

Review the audit requirements carefully.

In most cases, you'll already have the necessary financial and tax documents on file. But the insurer might ask for other information, such as a description of your services or the names of all officers and owners. Review their detailed list of requirements and be sure you provide everything they request.

Check for certificates of insurance.

It's best to ask for a certificate of insurance when you first hire a contractor or subcontractor. If you don't do this as a matter of course, begin gathering these documents well ahead of audit time.

If you believe that the audit findings are inaccurate, you'll have a limited time to open a dispute. *So it's important to review the findings upon receipt and contact your insurance advisor to discuss them and determine the best next steps.*

How Your Independent Insurance Advisor Can Help

Experienced independent insurance advisors like B. F. Saul Insurance are well-versed in the insurance premium audit process and can help you avoid the pitfalls that result in unpleasant surprises.

The B. F. Saul team can guide you on how to prepare for the audit, point out potential gaps in information or problems with your recordkeeping, and talk with you periodically about how your business is changing and whether that could impact the audit findings. For companies with large GL or workers' compensation exposures, we can conduct a quarterly test audit to see how your business is tracking and determine whether you should budget for a potentially large underpayment bill.

We can also review the audit findings, recommend whether to dispute them, and guide you through the dispute process smoothly.

Contact B. F. Saul Insurance to learn how we can help you navigate insurance company audits effectively.

FREQUENTLY ASKED QUESTIONS
About Insurance Premium Audits

Q. Why am I required to have an insurance premium audit?

A. For coverages like general liability and workers' compensation, the insurer assesses the level of risk and determines your premium based on estimates you provide prior to the start of the policy period. But over a 12-month timeframe, your business can change in ways that change your risk. At the end of the policy period, the insurer conducts a premium audit to compare your initial estimates to your actual experience. If your estimates were lower than your actual exposures, the insurance company will charge you the difference. If your estimates were higher than your actual exposures, they will return the difference in premium to you.

Q. What does the audit process involve?

A. As you near the end of the policy period, the insurer provides a detailed list of information and documentation you need to provide. In most cases, you'll have 60 to 90 days to respond. The insurer typically provides the audit results a couple of weeks after receipt of your information, though it could take longer for large companies or complex policies.

Q. Will the insurer conduct the audit in person?

A. In most cases, you'll submit the required information by mail or electronically. However, sometimes the insurer will need to conduct the audit in person at your facility. Factors such as your domiciled state, premium amount, claims history, and the nature of your classification codes tend to drive the decision to conduct an on-site audit.

Q. What type of information will I need to provide?

A. Most insurers request your general ledger, employee W-2s, 1099s, and certificates of insurance for all contractors and subcontractors, 941 forms for the policy period, federal tax returns, and cash expense reports. You should also be ready to discuss job descriptions and employee classifications and provide descriptions of the services you provide.

Q. What are the potential results of an audit?

A. The audit could determine that you underpaid the premium for the previous policy period. In that case, the insurer will bill you for the difference. The bill is usually due in full and on receipt, though some insurers allow you to make payments over several months. The audit could also determine you were overcharged for the previous policy term. In this case, the insurance company will return the overpayment to you via a refund check or a premium credit.

Q. Why does the insurer ask if we use contractors or subcontractors?

A. Insurance companies expect that your contractors and subcontractors carry their own liability and workers' compensation coverage. Otherwise, you need to cover them under your own policies. If the audit determines you're using uninsured contractors that were not included in your estimated figures, the insurer will adjust your premium accordingly.

Q. Why was our company charged an audit noncompliance fee?

A. In many states, if you fail to respond to an audit you'll incur a penalty for noncompliance. The penalty is usually a percentage of the premium, and for workers' compensation policies it can be substantial.

Q. How can an insurance advisor help me with an audit?

A. An experienced independent insurance advisor can help you prepare for the audit and identify any gaps in the requested information or problems with your recordkeeping. They can talk with you throughout the policy period to determine if your business is changing in ways that could affect the audit. If you have a large GL or workers' compensation exposure, your advisor should offer to conduct a quarterly test audit to help you avoid an unnecessary surprise when the annual audit is conducted. They can also review the audit findings, provide guidance on whether to file a dispute, and help you navigate the dispute process.

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