

# Premium Audit Guide



## What is a premium audit?

The purpose of a premium audit is to verify information necessary to calculate an insured's final premium for a specific policy term. When a policy is initially issued or renewed, the premium for the policy term is estimated based on anticipated exposure (usually payroll or sales) multiplied by a rate factor. The premium audit process involves an examination of the customer's records to establish the actual exposure and to make sure the correct classification codes and rates are used in determining the final premium. Because the original premium was an estimate, the audit may result in a change of premium and/or classifications for the business.

Typically, information from the audit will generate either a bill or a refund. In addition, the premium audit can provide customers with useful information about business operations.

A premium audit may be done after the policy term expires or after the policy is cancelled.

## Types of audits

### Field Audit

A field audit is an on-site review of the business records and possible inspection of business location(s) by a State Fund Auditor or a designated premium audit vendor.

### In-House (Telephone/Mail-in) Audit

The customer may be asked to complete an audit by, telephone, fax, email, or mail. Supporting records, such as payroll records and copies of the business' quarterly tax reports, will be required.

## Information requested at time of audit

Below are examples of the information an auditor may request at the time of an audit. Additional information may be required depending on each business' specific issues.

### General information

- Description of company operations
- Officers/owners names, titles, and percentage of shares/ownership
- Employee names, titles, and job duties
- Number of employees at each location

### Payroll information

- Gross pay, including bonuses, commissions, holiday pay, sick pay, vacation pay, and all pretax amounts
- Pretax/Section 125 amounts, 401K
- Overtime pay shown separately

*Please refer to the Premium Audit Checklist for the types of records to be made available for the audit.*

### Subcontractor information

- Name of Subcontractor
- Contractors State License Number (where applicable)
- Business License, Public Utilities Commission (PUC) License/Permit (where applicable)
- Certificate of Insurance covering the time period the services were provided
- Copies of project contracts and invoices

### Tax information to verify payroll/sales records

- Forms 940, 941, 1096, 1099, W-2, W-3
- Income tax return
- State unemployment insurance (SUI) quarterly returns (DE-9/DE-9C)

### Sales

- Profit and loss statement
- General ledger

### Additional information typically requested for restaurants

- Tips shown separately
- Number of free meals given to employees
- Live entertainment

## Payroll as a premium basis

Payroll is the basis most often relied on for calculation of premium for Workers' Compensation insurance.

Payroll includes, but is not limited to: hourly and salaried payroll, bonuses, holiday pay, sick pay, vacation pay, commissions, piece work, market value of gifts, and profit sharing. Also included in the payroll premium base are: meals and housing for employees, allowances for hand tools, expense allowances not based on receipts, and amounts used to reduce taxable wages such as cafeteria plans and deferred compensation plans.

Payroll does not include tips, overtime excess, severance pay, expense reimbursements based on receipts, third-party sick pay, salary reductions to fund the welfare or fringe-benefit portions of Section 125 cafeteria plan, personal use of a company auto and certain company perks (such as incentive vacations, club memberships or tickets to entertainment events). Employer contributory payments, including group

insurance, stock purchase plans and qualified retirement plans are not subject to premium computation. Likewise, the exercise of stock options and withdrawals from deferred compensation plans are not subject to premium.

## Subcontractors

Contractors must obtain Workers' Compensation certificates of insurance from all subcontractors retained as well as verification of a valid license (where license is required). If a certificate of insurance from a subcontractor is not provided and does not have a valid license, the subcontractor may be considered an employee for premium audit purposes, and a corresponding premium will be charged. Uninsured subcontractors covered under the policy are classified on the basis of the classifications that would apply if the work were performed by employees. The premium for uninsured subcontractors can be substantial, and proof of insurance and a valid license should be obtained and verified from subcontractors prior to using their services.

## Construction Classifications

Some construction classifications are dual-wage classifications. The employee's base hourly wage rate determines which class code applies. These wage rates are subject to verification at the time of the audit through a valid source such as time cards, personnel records, and employee earnings records. Original time cards must clearly show start, stop and break times, hours worked, job duties and wage rates.

The policy might allow a split of an employee's wages between different types of construction jobs by keeping accurate time cards. With this breakdown, the use of more than one class code may be allowed. This would also apply if the employees are paid by piece work or salary, records of start and stop times and number of hours worked are needed to qualify for the lower-rated dual-wage class code.

Without this breakdown, WCIRB Manual rules require all wages be included in the highest-rated class that applies to any portion of the employee's work. The auditor will not track payroll by class from time cards. A monthly payroll by class must be provided at time of audit.

Payroll may not be divided by means of percentages, averages, estimates, or any basis other than specific time records.

## Physical Inspection for Roofing

Legislation (IC 11665) requires an annual audit with all contractors holding a C-39 license. This also includes an in-person visit to the contractor's place of business. If the payroll audit is conducted at an accountant's or bookkeeper's office, the auditor will also need to conduct a physical inspection of the work location listed on the policy or yard/warehouse where equipment and tools are stored.

## Premium Audit Disputes

The role of the auditor is to review the results of the audit against the estimated totals. The audit is only the initial step in determining premium. Auditors do not have the information or payment history available to confirm whether there will be "additional" or "return" premium.

### Dispute Resolution Process:

1. If an audit is believed to be incorrect, a written statement detailing the specific information claimed to be inaccurate should be submitted.
2. Disputes should be emailed to [ADispute@scif.com](mailto:ADispute@scif.com)
3. Any claim of inaccurate audit information must be supported by a detailed explanation of what is believed to be incorrect and what the correction should be.
4. Copies of original financial and/or other records that support the discrepancy must cover all disputed information. Spreadsheets outlining the disputed information may be included but would not be considered proper legal proof.
5. All information relayed above should be received within 10 calendar days. If it's not received within 10 calendar days, we will consider the matter closed.
6. Non-written or non-specific claims of dispute are not considered an official audit dispute. If the dispute notice is not supported or vague, the audit will be reviewed for accuracy based on the information contained in the audit but will not qualify for a billing hold.

### Examples of Common Audit Issues:

**Officer exclusions:** Officers of corporations are automatically included for Workers Compensation insurance coverage unless eligible for exclusion and an endorsement is on file to exclude them from coverage.

**Subcontractors & Independent Contractors:** Most states require the employer to provide Workers' Compensation insurance coverage for uninsured contractors and subcontractors hired. To avoid being charged premium for these contractors, the insured must provide proof of a valid Workers' Compensation insurance policy issued to the contractor or proof of their exemption from state law. If a license is required, a valid license for the subcontractor must also be provided at time of audit.

**Standard Exception Classification Code 8810:**

Clerical – The duties of clerical office employees must be limited to general office work and located in an area that is physically separated from all other work areas and operations of the business. No payroll division is allowed between clerical and any other classification. Any classification that contains phraseology specifically including clerical employees will prevent assignment of the 8810 classification.

**Standard Exception Classification Code 8742:**

Salesperson Outside – The duties of outside sales employees must be limited to solicitation, collection activities, or meeting

with clients outside the office. The balance of their time can be spent in the office performing clerical duties. No payroll division is allowed between outside salesperson and any other classification. If they have duties of any other nature, they will be classified accordingly and would not qualify for classification 8742.

## Frequently Asked Questions

### What happens if an insured does not comply with a Premium Audit?

If the insured fails to comply with a Premium Audit, State Fund may cancel the current policy, and may have a negative impact on experience modification. State Fund may also estimate, if any, an insured's final audit premium which may result in additional premium due.

### If a customer works alone, has no employees and no payroll records, is the audit still necessary?

Yes. The auditor will need documentation to verify that information and may also look at disbursement records, bank statements, cancelled checks, or income tax returns. The auditor will also review information relative to any independent contractors used during the policy period.

### What if I pay my employees in cash?

If you pay your employees in cash instead of payroll checks, a log of the cash payments, the hours worked, the dates paid, the amounts paid, and the first and last name of each employee must be kept. Otherwise, all cash withdrawals on your check register may be included for computing workers' compensation premium.

### Are payments reported on 1099's subject to premium?

Payments to uninsured and/or unlicensed workers reported on 1099's may be subject to premium and included in the audit as payroll. Determination is made on a case-by-case basis. The auditor may require additional information to assist in that determination.

For the trucking industry, please provide the following additional information for drivers not on regular payroll to the auditor:

- List of payments made to drivers
- USDOT / MCP for drivers
- DMV Registration for ALL drivers paid/CAB Card
- Verification of number of trucks owned by insured
- Lease agreement for drivers

### Is an audit still required when a policy has been cancelled?

Yes. The purpose of the audit is to verify actual payroll to use in the final calculation of premium during the time the policy was in force.

### How are owners classified in an audit?

Owners, officers, partners, and manager/members may be able to elect exclusion under the policy depending on the type of entity insured. If owners, officers, partners, and members are covered under the policy, their wages will be included at either a fixed amount or an actual amount (subject to a minimum and maximum). Owners are classified according to their actual duties. A description of each person's duties must be provided.

### What is overtime excess, and how do I report it?

The portion of an employee's overtime wage that is over and above the regular rate of pay is called overtime excess. This portion includes increased pay for time worked on holidays, Saturdays, or Sundays, or the number of hours worked in any week or day beyond the standard for the industry. Overtime excess does not include extra pay for swing or graveyard shifts, for working certain hours on the clock, for incentive, or for bonus pay figured on volume without regards to hours worked. The auditor will verify the employee(s) hours worked and hourly rate.

An easy way to calculate the overtime excess for the time and a half is to divide the gross overtime by 3. For overtime excess paid at double time, divide the gross overtime by 2.

*Example: If your employee's hourly wage is \$10 and the overtime rate of pay is \$15 (time and a half), the overtime excess is \$5. In this example, you pay premium on \$10 (\$15 divided by 3=\$5).*

### Are payments made to family members subject to premium?

Yes, as employees, family members are entitled to Workers' Compensation benefits. Special rules apply to family members living in the main household while working on a family-owned farm.

### Could there be special audit requirements for some State Fund policyholders?

Some policies, such as those in Collective Bargaining group programs, temporary help agencies, U.S. L&H, farm labor contractors, and Professional Employee Organizations, have statutory requirements that may change the way the audit is completed. Some policies will require payroll segregated by client. Others will require payroll segregated by union and non-union. Your auditor will inform you of any special requirements in the appointment letter sent to you in advance of the audit date.

## What gives the company the right to audit books and records?

The State Fund policy contract allows the company to examine and audit records that relate to the policy. Customers receive additional notification about premium audits through various inserts and letters, both when the policy is originally written and at renewal.

## What information do I need if I have a Waiver of Subrogation endorsement on my policy?

Endorsement 2570 waives State Fund's right to a third party settlement if injuries occur for your employees at any of that client's jobsites. An additional fee is assessed on the premium generated for all work performed for that client. A breakdown of payroll by employee and classification code for all work performed for the waived client's operations, must be provided to the auditor.

## What happens after the audit is completed?

The insured may ask for a copy of the audit upon completion. Once complete, the audit is sent for review and final billing. We will send a final statement with the payroll exposures gathered from the audit and premium calculated.

## I need an audit to obtain new coverage.

To aid in satisfying this requirement, State Compensation Insurance Fund offers employers audits by fax, email, regular mail, or at your location (based on available records). Please follow these steps:

1. Determine the policy period(s) needing an audit and prepare the payroll records and information that correspond to that time frame. Quarterly tax reports are needed for the audit; use the table below to determine what months are included in each quarter.

| Quarter | Months                      |
|---------|-----------------------------|
| Q1      | January, February, March    |
| Q2      | April, May, June            |
| Q3      | July, August, September     |
| Q4      | October, November, December |

2. For example, if your policy period is February 15, 2015 to February 15, 2016, aside from the payroll records, you will also need to provide tax quarterlies for first, second, third, and fourth quarters of 2015 and first quarter of 2016.

3. Prepare the following payroll records and information, based on check dates within the policy period, which are **required** to complete the audit:

- Payroll records (registers, journals, earnings cards, etc.)
- Payroll, overtime and Section 125 Cafeteria Plan (if any) must be summarized by month, quarter, or policy period for each Classification Code
- State tax reports (EDD: DE9 and DE-9C)
- Payroll records associated with Waiver of Subrogation and/or Owner Controlled Insurance Policy (OCIP), if endorsed on your policy

The following records **may be required** to complete the audit and must be sent to the auditor when requested:

- Federal tax reports & schedules (941s/940; 1099s/1096; W2s/W3; Schedule C, K, E, F, etc.)
- Check register & cash disbursements journal
- General Ledger

For **all Construction policies**, we require these **additional records**:

- Employee time cards with daily start/stop times, necessary to validate the use of a high wage classification.
- If Independent Contractors and/or Subcontractors were used, provide Contractors State License Board (CSLB) number with expiration date for all contractors. If there is no CSLB number, provide the name, amount paid, date, and work performed. (You may check licenses at [www.cslb.ca.gov](http://www.cslb.ca.gov)).

4. Send the information to [RAudit@scif.com](mailto:RAudit@scif.com). You can also fax the information to: (916) 567-4882 or mail to P.O. Box 8192, Pleasanton, CA 94588.

5. In sending this information by email or fax, please use the format shown in this example on the subject line:

**Subject: Rewrite, Your Policy Name, Your Policy Number**

Once we receive the payroll information, it will be assigned to an auditor to complete the audit. You may be contacted by the assigned auditor if additional information is needed. The audit will be processed to generate a final premium statement. Any outstanding premium must be paid before your application is accepted.

## How can I get a copy of the audit documents?

You may view an electronic copy of the completed audit and audit justification form via State Fund Online, or request a copy from State Fund. Your customer service agent, underwriter, and auditor can all assist you. You can also contact your broker.

## Helpful Hints

- Have the proper person available during a physical audit to provide records and answer the auditor's questions.
- Properly summarize overtime paid to individual employees and organize it by type of job.
- Construction companies should keep track of time and payroll for different types of work. Dual-wage classifications (a classification that requires the regular hourly wage to equal or exceed a specified amount) require timecard verification.
- Obtain Workers' Compensation certificates of insurance for subcontractors or independent contractors.
- Identify individuals who perform specific job functions (clerical duties, outside sales, or drivers).
- Keep a record of tips for restaurant employees.
- Large payroll changes should be reported to your broker or underwriter as they occur. Estimated payroll can be changed during the policy period and any additional premium may be spread over several installments. Reporting changes will keep the policy in line with the actual payroll figures and avoid large differences at time of audit.
- Changes to ownership, corporate titles, or stock, could affect your policy premium and should be reported immediately.

## Premium Audit Checklist

To assist in gathering the necessary records for a premium audit, please refer to the checklist below.

- Payroll Records (Journals, Registers)
- Employee Earnings Records
- Payroll Breakdowns (Overtime/Class)
- Hours Worked and Hourly Rate
- State Quarterly Tax Return (DE9/DE9C)
- Forms 940 and 941
- Forms W-2 and W-3
- Forms 1096 and 1099
- Federal Income Tax Return
- List of Officers & Clerical Employees
- Time cards showing start and stop times for Construction Policies
- Certificates of Insurance for Subcontractors
- Certified Payrolls on OCIP/CCIP Jobs
- General Ledger and Check Register
- Bank Statements with Cancelled Checks
- Profit & Loss Statement
- Cash Disbursements
- Sales Journal/Cash Receipts
- Job Cost Records, Contracts, & Invoices
- Gross Receipts/Materials

## Contact Info:

Always include Policy Number and Policy Name  
in all correspondence:

### Premium Audit Dispute

ADispute@scif.com (916) 924-4765

### Premium Audit Rewrite

RAudit@scif.com (916) 567-4882

### Telephone (Mail-in)

AgileAudit@scif.com (323) 526-2151

### All other Premium Audit Requests

PremiumAudit@scif.com (916) 567-4881

### Mailing Address:

P.O. Box 8192, Pleasanton, CA 94588



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