

PREMIUM AUDIT GUIDE

CONTENTS

I.	PREMIUM ADJUSTMENT BY AUDIT	2
II.	REMUNERATION INCLUSIONS AND EXCLUSIONS	2
III.	TYPE OF LABOR HIRED	3
IV.	WORKERS' COMPENSATION	4
V.	GENERAL LIABILITY	5
VI.	TEMPORARY LABOR INFORMATION FOR GENERAL LIABILITY	7
VII.	AUTO SERVICE (BOP) PROGRAM	7
VIII.	INCOMPLETE AUDITS	7
IX.	CURRENT TERM ENDORSEMENT DUE TO AUDIT RESULTS	7
X.	FREQUENTLY ASKED QUESTIONS	8

PREMIUM AUDIT GUIDE

I. PREMIUM ADJUSTMENT BY AUDIT

Our company's role is to provide your business with quality insurance protection at a fair price. Audits ensure you will only pay premium for your actual business operation exposure to loss. Your initial deposit premium is based on your best estimate of the rating base (payroll, sales, total cost, etc.) for the policy term. At the end of your policy term, we perform an audit to determine the final premium by comparing your estimated exposure to your actual business exposures during the policy term.

II. REMUNERATION INCLUSIONS AND EXCLUSIONS

An auditor reviews business records for the audit period to determine two things:

1. How much the employer paid to employees and temporary laborers in wages or other **remuneration**.
2. The **type** of work performed by employees and temporary laborers for correct classification.

The charts below display what remuneration must be included (or can be excluded) when the auditor computes the actual exposure. **These are general rules and each state may have exceptions. For more specific rules governing your particular state please refer to your agent.**

Included Remuneration		
<ol style="list-style-type: none"> 1. Wages or salaries, including those that are retroactive. 2. Total cash received by employees for commissions and draws against commissions. 3. Bonuses, including stock bonus plans. 4. Extra pay for overtime work. 5. Pay for holidays, vacations, or periods of sickness. 6. Payment by an employer of amounts otherwise required by law to be paid by the employee's statutory insurance or pension plans such as Federal Social Security Act. 7. Payments to employees on any basis other than time worked such as piecework, profit sharing, or incentive plans. 	<ol style="list-style-type: none"> 8. The rental value of an apartment or house provided for an employee based on comparable accommodations. 9. The value of lodging, other than an apartment or house, received by employees as part of their pay as shown in the policyholder's records. 10. The value of meals received by employees as part of their pay as shown in the policyholder's records. 11. The value of store certificates, merchandise, credits, or any other substitute for money received by employees as part of their pay. 12. Payments for salary reduction, retirement, or cafeteria plans (IRC 125), which are made through deductions from the employee's gross pay. 	<ol style="list-style-type: none"> 13. Davis-Bacon wages paid to employees or placed by an employer into third-party pension trusts. 14. The value of Automobile Allowance received as part of pay as shown in the records. 15. Prevailing Wage - Prevailing wage is the wage paid to an employee for a government contract, which pays a higher wage than is normally paid to the employee. The insured must pay the prevailing wage to the employee and any of the extra benefits that the government requires. All of the wages and the benefits are included in the payroll if they are shown on the W-2 or 941.

PREMIUM AUDIT GUIDE

Excluded Remuneration		
<p>1. Tips and other gratuities received by employees.</p> <p>2. Payments by an employer to group insurance or group pension plans for employees other than payments covered by items 6 and 13 above.</p>	<p>3. The value of special rewards for individual invention or discovery.</p> <p>4. Dismissal or severance payments except for time worked or accrued vacation.</p> <p>5. Work uniform allowances.</p> <p>6. Payments for active military duty.</p>	<p>7. Sick pay paid to an employee by third party, such as by a policyholder's group insurance carrier, which is payment of disability income benefits to a disabled employee.</p> <p>8. Expense Reimbursement to Employees substantiated in the Employer's Records (cell phones, mileage)</p>

III. TYPE OF LABOR HIRED

The auditor will review your payroll and general ledger to determine the exposure for the audit period. Depending on the employer/employee relationship and payment process, the type of labor you hire will be reviewed and defined as follows:

1. **Employee Labor = FICA** (FICA = Federal Insurance Contributions Act tax) A full or part time individual performing service in the course of the trade, business, profession or occupation hired and paid directly by an insured. Employees are issued a W2 at the end of the calendar year which is verifiable to Federal and/or State tax forms. Mandated taxes for unemployment, social security, etc. are deducted from their pay. These employees may or may not receive additional benefits from their employer.
2. **Statutory Employee Labor** A full or part time individual performing service in the course of the trade, business, profession or occupation hired and paid directly by an insured. Does NOT work for others and is paid via check or cash (1099).
3. **Leased Labor -** A full or part time individual performing service in the course of the trade, business, profession or occupation to perform work for an insured. These individuals are hired through a leasing company. The insured generally does not provide benefits and pays a fee to the leasing company. Generally, Workers' Compensation exposure is covered by the leasing company certificate, but General Liability is included on your policy.
4. **Temporary Labor = Non-Fica/Subcontractors/1099 Labor**
A full or part-time laborer who is paid via check or cash and was hired to perform part or an entire job for an insured. The individual must carry valid General Liability and/or Workers' Compensation coverage or prove he or she is an independent contractor.

Independent Contractor

A type of subcontractor. An independent contractor is a person or business which provides goods or services to another entity under terms specified in a contract. Unlike an employee, an independent contractor does not work regularly for one company and may have limited amount of hired workers (state rules). He or she is NOT required to carry WC coverage, but should carry an exemption certificate (state rules) and GL coverage. It is the responsibility of the general contractor to provide reasonable proof to his or her

PREMIUM AUDIT GUIDE

insurance company the independent contractor is as sole proprietorship with no employees. For Workers' Compensation, we request the completion of the Independent Contractor Statement FM-901 as the method of proof. This form is enclosed in your policy declaration.

Independent Contractor Statements must be reviewed and completed each year since the status of subcontractors often changes. It is very important that the subcontractors who are independent contractors complete this form at the time they are hired. It can be very difficult to obtain this information when the subcontractor no longer works for your company.

5. Casual Labor

Employment that is casual and not in the usual course of trade, business, profession or occupation of the employer. It is characterized as irregular, unpredictable, sporadic and brief in nature.

IV. WORKERS' COMPENSATION

The company's policy is based on an **estimated exposure**. In order to obtain and verify the information necessary to compute the **actual exposure** for the policy period, an audit of the company's records is required.

OFFICERS

Business officers and owners are subject to special minimum and maximums that differ by state. Please be sure to inform your agent if the officers have changed during the policy period. This could influence the total exposure reported for each class code. An exclusion form is effective beginning with the current term in which it is signed; it is not retroactive. Contact your agent if an election to be excluded or included is desired.

EMPLOYEE CLASSIFICATION

A determination is made regarding the classification of employees based upon the definition of class code (s) and the job duties or services performed by employees on behalf of the company. The class codes are reviewed to ensure they reflect the company's business operation. The appropriate payroll amount is then reported for each applicable class code (s).

NO-PAYROLL DIVISION (NPD) CLASSIFICATIONS

The wages of certain types of employees are not available for division of payroll between codes. These are known as no payroll division (NPD) codes. The state of employment and type of work performed determine if exposure can be divided. Some of the codes not available for division are clerical/drafting and outside sales.

INTERCHANGE OF LABOR

Your business may have employees who perform a variety of duties for the company. This is referred to as an interchange of labor. The wages of such employees may be allocated to different classifications, permitting the codes do not qualify for non-payroll division, if the allocation is:

- ◆ Shown separately in the insured's original entry records.
- ◆ Based on actual payroll incurred in each operation.
- ◆ Not based on an estimate or percentage.

PREMIUM AUDIT GUIDE

OVERTIME

In most states, the amount paid in excess of straight time pay can be deducted, if the excess can be verified in the company's records. The company must maintain records to show overtime pay separately by employees and summarized by classification of work by state.

Definition-Overtime means those hours worked for which there is an increase in the rate of pay:

- a. For work in any day or in any week in excess of the number of hours normally worked, or
- b. For hours worked in excess of 8 hours in any day or 40 hours in any week, or
- c. Doesn't apply to 2nd or 3rd shift premiums.

V. GENERAL LIABILITY

The company's policy is based on an **estimated exposure**. In order to obtain and verify the information necessary to compute **actual exposure** for the policy period, an audit of the company's records are required. The liability can be based on gross sales, payroll, total cost, each, admissions, or number of employees.

- **Gross Sales** is the gross amount charged by the business, concessionaires of the business, or by others trading under the business's name for all goods or products sold or distributed, operations performed during the policy period, rentals, and dues or fees.

Inclusions: Foreign exchange discounts, freight allowance to customers, total sales of consigned goods and warehouse receipts, trade or cash discounts, bad debts, and repossession of items sold on installments (amount actually collected).

Exclusions: Sales or excise taxes which are collected and submitted to a governmental division, credits for repossessed merchandise and products returned (allowances for damaged and spoiled goods), finance charges for items sold on installments, freight charges on sales if freight is charged as a separate item on customers invoice, and royalty income from patent rights or copyrights which are not product sales.

Intern Company Vs Inter-Company Sales

Intra-company sales are sales made between several locations within ONE company/corporation/legal entity. For example, location one may sell products to location two or vice versa. There is no exposure to the public and the company themselves. No charge is made on the audit as only sales to the public are considered chargeable exposure.

Inter-company sales are sales between more than one company/corporation/legal entity. For example, the named insured could be ABC Corp & XYZ Corp. ABC Corp could sell products to XYZ Corp. These are two legal entities and they could sue each other even though they are both on the same policy. This exposure should be picked up on the audit; however, there is exclusion for this type of coverage. See your agent regarding this form.

PREMIUM AUDIT GUIDE

- **Payroll** inclusion and exclusion are listed in the chart under II. Remuneration Inclusions and Exclusions. The liability follows the same rules as the Workers' Compensation with a few exceptions.
- **Total Cost** is the cost of all work let or sublet in connection with each specific project including the cost of all labor, materials, and equipment furnished, used or delivered for use in the execution of the work and all fees, bonuses, or commissions made, paid or due.
- **Each** The basis of this premium is per person. The company's documentation should include all individuals actively employed during the policy term. Hire and termination dates may be required.
- **Admissions** is the total number of people admitted to the event or to events conducted on the premises whether on paid admissions, tickets, complimentary tickets, or passes.

OFFICERS

Officer treatment on General Liability depends on the basis of premium or policy coverage. Please be sure to inform your agent if the officers have changed during the policy period. This could influence the total exposure reported for each class code. Below is a summary of officer treatment by basis of premium.

Sales Based- The gross sales covers the risk.

Payroll Based – Active officers are included at a flat officer amount or subject to special minimum and maximums that differ by state and entity type.

Number of Employees (Auto Service BOP Program) – Owners/officers/partners/members are generally included as full time if they are active in the business, regardless of the time worked and their job duties. Officers/owners/partners/members doing clerical sales are included.

Artisan BOP – All active owners/officers/members/partners included regardless of job duties.

Garage Liability-Hazard I – Active owners/officers/partners are included at rating factor of 1.00.

Garage Liability- Hazard II – All active owners/officers/partners are included at a fixed amount of \$100 per week. They are excluded if they are inactive, 100% clerical or managerial.

EMPLOYEE CLASSIFICATION

The classification of employees is based upon the definition of each class code (s) and the job duties or services performed by employees. The appropriate payroll amount is reported for each applicable class code (s).

LEASED EMPLOYEES

The payroll of leased workers furnished to the company by a labor leasing firm is included in the General Liability exposure. The exposure is applied as if the leased workers had been the direct employees of the company. If payroll is unavailable, 100% of the total cost of the contract for leased workers will be used as the payroll of leased workers.

PREMIUM AUDIT GUIDE

VI. TEMPORARY LABOR INFORMATION FOR GENERAL LIABILITY

UNINSURED TEMPORARY LABOR – A laborer without insurance is charged based on the type of work performed. Uninsured subcontractors are charged at total cost unless the records clearly show a separation for labor and materials.

INSURED TEMPORARY LABOR - A valid Certificate of Liability Insurance covering the audit period allows the total cost paid to the temporary laborer to be included in the insured subcontractor code. Coverage protects the insured from vicarious liability out of the torts, negligent hiring or incompetent subcontractors, or when the subcontractor does not have adequate coverage limits.

CERTIFICATES OF LIABILITY INSURANCE – These certificates prove subcontractors have their own liability insurance coverage. The insured may need a subcontractor's certificate for two different years to cover the entire audit period.

VII. AUTO SERVICE (BOP) PROGRAM

Most Auto Service programs are based on the number of equivalent full time employees. Car Wash operations are based on sales.

Officer Inclusion

Executive officers, sole proprietors, or partners are included at 1.0 no matter the duties performed or time worked (if active in business). Even if the owner/officer is doing strictly clerical, they are included in the audit at 1.0.

Clerical Employees

Clerical employees are not included in the audit unless they operate a vehicle as part of their job responsibilities. Clerical employees must be in a physically separate area away from the rest of the operations with duties consisting only of keeping the books for the insured.

VIII. INCOMPLETE AUDITS

The premium audit is a policy provision. If the audit is not completed the policy may be non-renewed.

IX. CURRENT TERM ENDORSEMENT DUE TO AUDIT RESULTS

If the exposure on the expiring policy increases significantly as a result of audit, we notify the agent and your company of our intent to increase the current policy's premium base. We provide a window of **20 days** to dispute the adjustment or request no endorsement. Please contact your agency to discuss the exposures on your current term policy.

PREMIUM AUDIT GUIDE

X. FREQUENTLY ASKED QUESTIONS

1. What kinds of records are needed by the auditor?

The necessary records will vary depending on the type of coverage (s) that is provided. In most cases the following type of records should be provided:

Payroll Records:

- ◆ Payroll Journal and Summary
- ◆ Check Book
- ◆ Federal Tax Reports-941's which cover the audit period
- ◆ State Unemployment Reports and Individual Earnings Records
- ◆ All Overtime Payments shown by individual employee

Employee Records:

- ◆ Include a detailed explanation of the job duties of each employee
- ◆ Include the Number of Full Time/Part Time/Seasonal Employees
- ◆ Hours, Hourly Rate, Days, or Weeks Worked Annually

Cash Disbursement Journals (or checkbook) showing:

- ◆ Payments to Temporary Labor
- ◆ Materials
- ◆ Casual/Contract Labor

Certificates of Insurance

- ◆ For All Subcontractors
- ◆ For All Independent Contractors

2. If I hire temporary labor what do I need to do?

Inform your agent so they can provide you with the information to request from the person you hired. Examples include Certificates of Insurance coverage or Independent Contractor's Statement for the hired labor.

3. What additional information may be required of a contractor?

You will be required to provide certificates of insurance for your subcontractors. Make sure the certificates are current for each of the subcontractors paid during the audit period. Without proof of insurance, they could be considered your employees, resulting in increased exposures.

4. Why is there still a premium charge on liability when the subcontractor provided their own insurance?

Although the subcontractor provides their own General Liability insurance, the insured subcontractor classification protects the insured from "vicarious liability" which may arise out of acts performed by the subcontractor such as the following: (a) the torts of the subcontractor, (b) the negligent hiring of incompetent subcontractors, and/or; the subcontractor that does not have adequate coverage limits. Therefore, a charge is developed for this exposure.

PREMIUM AUDIT GUIDE

5. When can an ICS—Independent Contractor Statement forms be used?

An ICS form is a tool for determination of independent contractor status on Workers' Compensation policies. The form can be submitted by sole proprietors with no employees (or as dictated by state law).

These ICS forms are not applicable for General Liability audits. For General Liability purposes, all subcontractors must have General Liability coverage in order to be listed as an insured subcontractor on the audit.

6. What happens after I provide the information requested?

The exposure for your operation is reviewed and inputted into a computer system. A summary of the exposure is then reviewed and premium computations are developed from the exposure presented.

7. Do I have to provide the information requested?

Yes, it is one of the terms of the insurance contract and is a standard practice of the insurance industry. If you do not provide, you risk non-renewal of your policy. Always speak to your agency when making decisions to not provide information.

8. What is the best method to organize my payroll records?

In order to collect the specific payroll information needed to conduct an accurate premium audit, your payroll records should be organized as follows:

- Policy term. Present records that reflect the payroll or sales for the policy term-beginning with the effective date of your policy.
- Classification. List each type of job separately, i.e. sales, clerical, etc.

In some circumstances a single employee's payroll may be divided over different class codes unless the employee works in a clerical or sales position. There are different state exceptions. Proper records must be kept in dollar amounts, percentages are not allowed. Without adequate records, the entire payroll for the employee must be placed in the higher rated classification and payroll separation cannot be used. This method requires additional record-keeping but is advantageous, as all payrolls are not charged to the higher classification.

Overtime- Overtime paid to employees during the policy term. If you maintain overtime detail you may be able to take advantage of the available credits and reduce your audit premium due.

Credits are available on the audit for pay types such as premium overtime, tips, severance pay and third party sick pay; however your records must provide a summary of these wage types by employee, department, and class code to allow credit on the audit.

9. How is the premium rate determined for the class codes?

Most basic classification codes used are categorized by job functions and assigned based on the overall nature of the business and not on a separate occupation or operation of individual employees. For example, the construction or erection business classification would be Carpentry.

PREMIUM AUDIT GUIDE

Most Workers' Compensation policy premium is based on payroll. The rates are developed by either the National Council of Compensation (NCCI) or a state's own rule and rate-making bureau. The NCCI's primary functions are the preparation and administration of rates, and classification systems for Workers' Compensation insurance in thirty-two states while providing similar assistance in half of the remaining states.

The General Liability policy premium maybe based on gross sales, payroll, total cost and the rate developed for each class code is provided by the Insurance Services Offices (ISO). This is a nationwide organization that functions as an advisory and rating organization for non-compensation insurance coverage such as commercial General Liability.

10. Who is an officer?

Just because they have the title(Secretary/Controller) does not mean they are treated as officers. Your Articles of Incorporation should list these individuals.

11. Can I contact Frankenmuth Insurance to schedule my audit?

Yes. You may call 1-800-234-1133 ext 2586 or E-Mail claudit@fmins.com

12. What should I do if I do not agree with the results of the Final Audit?

Your agency should be contacted to inform them of your concerns. You can also provide a written dispute and submit either via e-mail at CLAudit@fmins.com

Or mail to: Frankenmuth Insurance
Attn Audit Team
One Mutual Avenue
Frankenmuth, MI 48787-0001

Or Fax to: 989-652-2105

13. What information do I need to include in the dispute letter?

We will need an e-mail or memo stating the following:

- The name of your business
- Your Frankenmuth Insurance policy number
- A written description detailing what you are disputing.
The more information you can provide, the less likely we will need to contact you or your agency for additional information. Simply stating "I do not agree with my audit premium bill" or "An error has been made in my premium audit billing" without elaborating on the reasons for your disagreement is not considered a valid dispute.
- Best time of day/week to contact you and phone number.