

# SPECIAL REPORT

## PAYROLL AUDIT INFORMATION AND PROCEDURES

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This Special Report was written by Daniel P. Hale, J.D., CPCU, ARM, CRM, LIC, AIC, AIS, API of Marsh & McLennan Agency LLC. Mr. Dan Hale can be contacted at 734-525-2429 or [dhale@mma-mi.com](mailto:dhale@mma-mi.com). More Special Reports are available at [www.mma-mi.com](http://www.mma-mi.com).

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After the expiration of your policy, your insurance carrier will conduct a payroll audit to determine the final premium for your Workers' Compensation and general liability policies. Because the amount of premium you pay is based upon the audit, the organization and accuracy of your records is extremely important.

Payroll audits are conducted in one of two ways. You will either receive a Mail-In Final Audit Worksheet to complete, or you will be notified by postcard that a physical audit of your records will be conducted. Your bookkeeper should also be available so the auditor's questions may be answered quickly and accurately.

### **PREPARING FOR A PAYROLL AUDIT**

The key to a smooth audit is preparation. The following information should be on hand when the auditor arrives (or available to complete the Final Audit Mail-In Worksheet):

- 1. Payroll records for the audit period** - Your worker's compensation premium is computed on the basis of the total compensation for your employees and employees of any uninsured subcontractors during the policy term. Compensation includes all regular pay in addition to items such as bonuses, vacation, sick leave, etc. Overtime is charged at the straight rate only, but your records *must* show the extra pay for this time separate from the straight rate payments by employee and by classification. Payroll records for the audit period must be complete and should be summarized by month or quarter.

2. **Quarterly tax reports** - Federal Form 941 and State Form MESC 1017 for the audit period.
3. **Other** - Business check register, general ledger, disbursement journal, payroll summary, and records of payment to subcontractors for the audit period.

## **SUBCONTRACTOR INFORMATION**

The Workers' Compensation Act provides that a contractor is responsible for the payment of compensation benefits to the employees of its uninsured subcontractors. To avoid paying premium for subcontractors, you must produce adequate documentation to verify that they were insured or excluded from coverage. Following are acceptable forms of proof:

- **Certificates of Insurance** - All subcontractors should be required to provide you with Certificates of Insurance. Please retain them for the annual premium audit. Certificates must show that Workers' Compensation coverage was in effect during the period in which checks were issued to the subcontractor. If certificates are not available when the audit is performed, the auditor will provide you with a list of certificates you need to submit within a specified period of time, generally 15 days.
- **BWC 337, Notice of Exclusion Form** - The subcontractor may obtain the BWC 337 form from the Michigan Workers' Compensation Agency. The form must be approved and stamped by the WCA. Note that this form is effective only from the date it was approved by the WCA.
- **Independent Contractor Statement** - May be utilized by sole proprietors with no employees. This form may be obtained from Cambridge. All items on the form must be completed, signed by the subcontractor, and supporting documentation attached. The insurance carrier may, at its discretion, require additional documentation to support that the subcontractor is a sole proprietor, not an employee.

**Material and labor payment documentation for uninsured subcontractors** - Your records should show a breakdown between labor

and materials. If they do not you will be charged premium for the entire contract amount.

## **WORKERS WHO MAY BE EXCLUDED FROM COVERAGE**

Although Cambridge does not recommend this, the Workers' Compensation Act allows for the exclusion of certain executive officers, member-managers of limited liability companies, partners, or eligible family members working for a sole proprietor. To exclude eligible individuals you must file an exclusion endorsement with the insurance carrier at the beginning of the policy term. Exclusion endorsements are only valid from the date they are filed with the company and may not be backdated.

If an eligible individual is excluded from Workers' Compensation, a coverage gap could exist because health insurance carriers typically excluded work-related injuries.

## **MINIMUM AND MAXIMUM PAYROLLS FOR CERTAIN EMPLOYEES**

- **Corporations and Limited Liability Companies** - Each insurance carrier is filed for their own minimum and maximums, but as a guideline, as of January 1, 2011 the compensation for each covered corporate officer or member-manager, will be included subject to a minimum of approximately \$21,000 and a maximum of \$88,000.
- **Partnerships** - Partners will be included at a fixed amount, which varies by carrier.
- **Sole Proprietors** - Payroll will not be included for a sole proprietor. However, if the spouse or a family member of the sole proprietor works in the business their compensation will be included.

NOTE: Premium will not be charged for any excluded person.

## **DIVISION OF PAYROLL BETWEEN CLASSIFICATIONS**

If an employee works within two or more classification codes, the pay for that employee may be divided between the codes. To qualify for a division of payroll your records must reflect the actual earnings in each code. An estimate and/or percentage allocation between classifications is not

acceptable. Where your records are not complete, the entire payroll of an employee will be assigned to the highest rated classification applicable.

NOTE: There are some special classifications where division of payroll is not allowed. Your auditor will be able to provide this information.

## **FAILURE TO COMPLY**

If you do not comply with the audit or do not provide the records needed to complete the audit, the company will estimate the payroll and bill you accordingly. Most companies, if forced to produce an estimated audit, will use payroll figures of up to 25% higher than those on the policy. They may also elect to terminate coverage for failure to comply with the audit.

## **REVISION OF AN AUDIT**

If you believe there are errors or you have any questions regarding your audit, please contact our office immediately so an audit correction can be requested. There is a very limited time to dispute an audit.

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