

Physical Audit FAQ



Premium Audit wants to make our physical audit process as transparent and easy to understand as possible. Towards that goal, Liberty Mutual has developed these frequently asked questions to assist you with preparation for that process.

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General Audit Information

What is the purpose of a premium audit?

- The purpose is to determine actual exposures and classes of operation for the coverage we've provided for the applicable audit period. A premium audit protects both Liberty Mutual and our customers.. Our auditors undertake this review of your company's books and records to determine the correct exposure for the audit period and ensures the proper premium is collected for your policy.
- In addition, audit information is filed as part of unit statistical data reporting which determines your experience modification and is used in establishing appropriate premium rates for each state.

How is an audit performed?

- An auditor will come to your business location to review the payroll, sales and/or other records that were requested. During this process, it is important to have someone familiar with your overall operations present to answer questions and provide a tour of the business location. When the auditor has completed his/her review, an exit interview will be conducted where the auditor will explain the findings from the audit.

Can I provide records in advance of the audit appointment securely?

- Yes, receiving the records in advance makes the audit appointment more efficient and effective. We use ShareFile to securely receive records. You can request your auditor provide you with a link to a ShareFile folder where you can drag and drop your records if a link has not already been provided to you.

How do I find out who the auditor is on a particular account?

- Auditors have physical territories based on zip code. You can contact our audit support team at (888)224-9246 Monday through Friday 8:00 a.m. to 8:00 p.m. EST or send an email to premiumauditservices@libertymutual.com.

Will Liberty Mutual Insurance allow the agent/broker to be present at the audit appointment?

- Yes, agents/brokers are welcome to be present during the audit process.

Why are records being requested on a policy that was already audited?

- There are various reasons that an audited policy may require an additional records review. The reasons include verification of information that was previously completed via mail form, revising an audit that was previously estimated or to determine the accuracy of the final exposures and premium. Per Section 5 G of your workers compensation policy and Section IV.5 of your general liability policy, Liberty Mutual Insurance has the right to go back three consecutive years to perform re-audits or verification audits.

Why does an audit need to be completed on a policy when the premium is already paid?

- Workers compensation and general liability policies are issued based on variable exposures such as payroll, total cost and sales that are generated during the policy period. The policy premium is initially based on estimated exposures for the policy period which you supply to us prior to the policy taking effect. While you provide a good faith estimate, it is rare that the actual totals will not vary from your initial estimates. When the policy expires, per Section 5 G of the workers compensation policy and Section IV.5 of the general liability policy, Liberty Mutual Insurance conducts an audit to determine what the actual exposures were during the policy period. The actual exposures are used to develop the Final Earned Premium for the policy. This process ensures that the exposures and classifications are accurate.
- The information is filed as part of unit statistical data reporting which determines your experience modification and is used in establishing appropriate premium rates for each state.

Why is it important to complete an audit promptly after expiration?

- The auditor is trying to best serve you by contacting you close to the policy expiration date to set up an audit appointment. The earlier the audit is completed, the earlier we can provide you with the accurate final earned premium. Accurate data filed in a timely manner for workers compensation policies will provide you with the most accurate rate for your experience and exposure.
- There are state rules that require unit statistical data reporting to be completed within certain time guidelines to meet statutory requirements.

Will Liberty Mutual Insurance mail or securely e-mail audit worksheets to the agent /broker?

- Yes, if we have written approval from the policyholder.

Why have I not received my bill for the audit completed on a retrospective policy

- All retrospective policies are subject to an annual retrospective adjustment at an established date after policy inception. For example, the audit is completed right after policy expiration to meet state statutory requirements, but the first adjustment will not be completed until 18 months after policy inception.

What is an Account Service Review and its benefits?

- An Account Service Review is conducted on new accounts with auditable premium of \$500K or greater to explain the audit process and promote availability throughout the audit period. This is completed within 90 days of the policy effective date and provides these benefits:
 - Allows you to become familiar with our audit process
 - Advise on report enhancements to maximize exclusions and reduce preparation time for the audit contact
 - Proactively addresses your concerns that could be discovered during the final audit
 - Allows you to collaborate on the plan for an efficient audit including assistance with reports
 - Assist with policy exposure projections
 - Review operations to confirm consistency with policy classifications

Who should I contact to discuss a possible error on my audit?

- Your auditor is available to answer any of your audit related questions and can revise the audit findings if an audit is inaccurate. Also visit: www.business.libertymutualgroup.com/business-insurance/account-self-service/premium-audit to get a copy of our dispute form to fill out and submit to premiumauditservices@libertymutual.com or call us at (888) 224-9246.

Required Records

What records are reviewed for an audit of a policy rated on a payroll basis versus sales basis?

- For policies rated on a **payroll basis**, such as workers compensation and some general liability policies, we'll review payroll journals and state and federal quarterly payroll tax returns, as well as a profit and loss statement, general ledger, subcontractor payments, and any certificates of insurance for subcontractors paid during the policy period. Additional or alternative records may be requested on a case by case basis in order to complete an accurate audit.
- For policies rated on a **sales basis**, we'll review sales journals, income statement, annual federal tax return and/or a general ledger. Additional or alternative records may be requested on a case by case basis in order to complete an accurate audit.

Why is so much documentation required?

- The documentation ensures that we review all the records needed to perform a comprehensive, quality audit in accordance with NCCI and state specific guidelines. Basis of premium varies by policy, so there are a wide variety of records that auditors use to determine the correct exposures. Your auditor will request documentation needed to apply all payroll and sales exclusions that are allowed following manual rules. Providing records that allow for these exclusions will reduce your exposures.

Why is payroll information requested when the policy is based on sales (typically a general liability policy)?

- With a composite rated policy, the standard exposure details can also be required in order to provide the background for the development of the composite rate. For example, some general liability policies are rated based on sales, but the composite rate is based on payroll (a standard policy would be based on payroll). To develop the composite rate, we need to obtain all the necessary information as if the policy was standard rated. We provide this information to our Actuarial Department, which uses it to develop the composite rate. The payroll information is not used to calculate the audit premium.

Why are additional documents required to verify prepared summaries?

- Prepared summaries need to be tested against a primary source to determine their accuracy.

What is the difference between a Remote Audit and a Mail Audit? Why are more records required?

- A physical audit may be completed remotely, when possible, for the policyholder's convenience. Remote audits require all the same information be provided to the auditor electronically and the audit is completed just as if there had been an in-person audit appointment. A mail audit is performed using a signed form completed by the policyholder.

Audit Exposure

Why are bonuses, vacation, sick and holiday pay included on payroll audits?

- These types of payments are part of the employee's remuneration per NCCI Basic Manual Rule B.1.c and per several independent state bureaus which define bonuses, vacation, sick and holiday pay as includable remuneration. There are exceptions to this rule in certain states. Your auditor will ensure that all the state specific deductions are applied when performing your audit.

Why are sales discounts and inter-company sales not excluded from gross sales on the general liability audit?

- Per the ISO Commercial Lines Manual definition of gross sales:
 - **Discounts**, whether cash or trade, do not change the liability arising from the sale and should be included. **Cash discounts** are normally a percentage discount given when a client pays their bill within a specific period of time. **Trade discounts** are usually given to clients who purchase a certain quantity of merchandise.
 - **Inter-company sales** - Each company insured on a policy is considered a separate legal entity and is insured separately. As separate companies, the entities can bring suits against each other. Our policy must respond to all suits, even suits from one named insured against another named insured. For this reason, sales from one company to another are normally considered sales for the purposes of calculating the premium basis. However, you may elect to exclude coverage for these intercompany suits if you meet certain parameters. Contact your agent or underwriter for further information on an intercompany sales exclusion.

What are foreign sales?

- Foreign sales are defined as sales of goods that are manufactured and sold outside of the coverage territory (US (including its territories and possessions), Puerto Rico, and Canada) as detailed in Section V of the general liability policy. Liability coverage only extends to those sales that are generated in the coverage territory. In order for sales to be excluded as foreign sales, the products must be manufactured outside of the coverage territory and sold directly to clients outside of the coverage territory. If the products are manufactured within the coverage territory, brought within the coverage territory for distribution, or sold to customers within the coverage territory they are no longer considered foreign sales and will be included in gross sales for audit purposes.

Why are liquor sales being billed on both the general liability policy and the liquor liability policy? Is that a double charge?

- No. General liability and liquor liability are separate and distinct coverages. The general liability policy covers exposures inherent within the operation only, such as slip and falls and the exposure of someone claiming sickness or injury from the consumption of all products sold, including alcoholic beverages. Liquor liability provides protection for the insured should they be brought into a lawsuit arising from the sale of alcoholic beverages.

Classification of Exposure

What is the definition of “Clerical Office Employee”?

- Per the NCCI Scopes Manual definition (Rule 1-B-2-a), the duties of a clerical office employee include creating or maintaining financial or other employer records, handling correspondence, computer composition, technical drafting and telephone duties, including sales by phone. A clerical office is a work area physically separated by floors, walls, partitions, counters or other barriers and distinct from all other work areas and hazards found on the employer’s premises. Independent state bureaus also provide the definition of a clerical employee in their state manuals. Most clerical employees are defined in a similar fashion to NCCI.
- An employee who has clerical duties but is also exposed to the hazards of the business would not be considered a clerical employee. A few examples would be a manager who has a desk on the manufacturing floor, a clerical employee who works in a store to cover breaks or lunches, an office employee who does shipping and receiving work.

What is the definition of “Outside Sales Employee”?

- NCCI Scopes Manual (Rule 1-B-2-b) defines salespeople as employees engaged in sales duties away from the employer’s premises. This classification is not available for employees who deliver merchandise. Independent state bureaus also provide the definition of an outside sales employee in their state manuals.

How are miscellaneous employees (maintenance, shipping & receiving clerks, etc.) classified?

- NCCI Basic Manual Rule 1-E states miscellaneous employees must be assigned to the governing classification, which is the classification, other than standard exception classifications, with the most payroll exposure. For WC purposes, we classify the business operations, not the individual employee duties. Independent state bureaus have similar wording and classification procedures for miscellaneous employees.

May the payroll for employees with multiple duties be split between class codes?

Construction classifications are handled differently than other industries. Contact your auditor for specific questions.

- Some employees may perform duties directly related to more than one properly assigned classification. According to NCCI basic manual Rule 2-G, the payroll for such employees may be divided among the properly assigned classifications provided that:
 - The classifications can be properly assigned to the employer according to the rules of the classification system, and the employer maintains proper payroll records, which show the actual payroll by classification for that individual employee (hourly breakdowns, timecards, etc.).
 - Records must reflect actual time spent working within each job classification and an average hourly wage comparable to the wage rates for such employees within the employer’s industry.
 - Estimated or percentage allocation of payroll is not permitted.
- If payroll records do not show the actual payroll applicable to each classification, the entire payroll of the individual employee must be assigned to the highest rated classification that represents any part of his or her work.
- Note that payroll cannot be split between a clerical or sales class code and a Basic Classification. All payroll exposure will be included in the higher rated class code due to the Interchange of Labor rule.
- Independent state bureaus have similar wording and classification procedures.

Who is an executive officer?

- NCCI basic manual Rule 2-E-1 defines executive officers of a corporation or unincorporated association as the President, Vice President, Secretary, Treasurer or any other officer appointed in accordance with the charter, resolutions, meeting minutes or bylaws of such entity. Independent state bureaus also provide the definition of a corporate officer in their state manuals.

Subcontractors

Note: Subcontractor handling may vary from state to state.

Why are 1099s, General Ledger, Income Statement or Cash Disbursements records required?

- These records are used to verify any off-payroll exposures. In most states, workers compensation laws stipulate that a contractor is responsible for the payment of compensation benefits to employees of its uninsured subcontractors. You must furnish satisfactory evidence that the subcontractor has workers compensation insurance in force, covering the work performed for the insured during the policy period.
- For general liability, uninsured or under-insured subcontractors are treated as employees and will be included under the appropriate payroll classification. Your policy will define what is adequately insured.
- For general liability, adequately insured subcontractors are included in the exposure under one of the ten Contractors – Subcontracted Work classifications. Even if the subcontractor has adequate insurance the mere fact that you used a subcontractor creates an additional exposure known as vicarious liability. The basis of premium for this exposure is total cost. Total cost is defined as labor, materials and equipment. We need to obtain the total amount paid to the subcontractor, the total they billed you for materials and the total value of any materials or equipment that you supplied to the contractor for their use in completing the work.

Why would questions about independent contractors be part of the workers' compensation audit?

- The auditor will ask a series of questions about the method and frequency of payment(s), the relative nature of the work and the amount of direction and control to determine if the subcontractor is in fact independent. If the subcontractor is not deemed independent based on the responses; the contractor will be included in the audit as an uninsured subcontractor. Many states have additional rules regarding independent contractors. The auditor will follow these rules when determining if a contractor will be included in the exposure.

If the state does not require a sole proprietor, partner or member to carry workers compensation coverage, why do they have to be covered under the Liberty Mutual Insurance policy?

- If the subcontractor has no employees, some states do not require workers compensation coverage. However, the auditor needs to determine if an employer-employee relationship exists between the insured and subcontractor. If an employer-employee relationship exists, Liberty Mutual Insurance may be liable for any claims the individual may file. Each state has different requirements to determine independent status. A general liability insurance certificate does not replace workers compensation coverage.

Why is a Certificate of Insurance (COI) for a subcontractor needed if the sub was paid less than the 1099 minimum (\$600)?

- Proof of coverage is required for all subcontractors regardless of the amount of payment. The \$600 IRS limit does not apply to the calculation of workers compensation or general liability premium.

For a contracting company who requires all subcontractors to sign a document stating they are not employees, why are Certificates of Insurance still required?

- The document does not waive the right of the subcontractor to file a claim. Therefore, without a valid Certificate of Insurance, the exposures are included for premium calculation purposes.

Why is a subcontractor included on my workers' compensation audit when a general liability Certificate of Insurance was provided?

- A general liability insurance certificate does not provide workers compensation coverage. General liability coverage is just one factor that can be taken into consideration when determining independence.

Commercial Auto Policy Audits

Why are purchase and disposal dates requested for the covered autos?

- Some auto policies are composite rated based on the number of vehicles. The premium base uses the actual number of days that each vehicle is covered during the policy period. Vehicles that are bought and sold during the policy period will be pro-rated for the actual number of days insured. Often, we use actual number of days each vehicle was active to determine the exposure if there are less than 25 vehicles or a change during the policy period of more than 20%. See your composite rate endorsement for more details.

Why are additional records needed to verify the fleet list?

- Depending on the rating of the policy, Liberty Mutual Insurance may be liable for additional vehicles that you have or operate. As a result, auditing is required to verify and obtain information regarding all your vehicles. Examples of the type of records we may need to review are maintenance records, lease invoices, or registrations.

Why are idle vehicles included?

- There is an endorsement available to allow for the exclusion of idle vehicles. The vehicles must be idle for a period of 30 days or greater to qualify for the exclusion. If idle vehicles are not specifically endorsed off the policy, they are included for premium calculation purposes. Leased vehicles may not be eligible for the exclusion based on insurance requirements outlined in the lease agreement.