



Pennsylvania Compensation Rating Bureau

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PENNSYLVANIA TEST AUDIT PROGRAM **BULLETIN # 88**

TEST AUDIT APPEAL DECISION

Per Bureau Circular No. 1479, the results of an insurance carrier appeal to the Audit Committee are presented to the membership for their information.

The carrier was appealing a test audit difference related to an insured for the policy period of October 2, 2002 to October 2, 2003. The insured operated an apartment complex with 108 units. After the test audit had been completed and the comparison to the carrier's audit had been made, it was determined that there were three sources of differences between the test audit and the carrier as set forth below:

- The test audit assigned the payroll of an employee of the insured to Code 880, Apartment House or Condominium Complex Operation, as he was a maintenance employee engaged in the repair and general maintenance of the apartment complex. The carrier audit did not include this employee.
- The carrier included \$9,000 for apartment rental value, while the test audit contained the statement that none of the employees received an apartment.
- The carrier used an unauthorized experience modification factor.

Subsequent to receiving the test audit difference notification, the carrier had determined by consultation with its independent audit company that the insured had not informed its auditor of the fact that the individual was an employee of the insured. The insured apparently reported the payroll of at least two other entities under the same taxpayer identification number as applied to the carrier's insured, and an unrelated carrier group(s) reportedly insured the other entities' employees. The carrier representative expressed the view that their company should not be cited for what it termed an error of omission on the part of the insured. The carrier representative included a signed letter from the insured which acknowledged that they had omitted that individual as an employee of the insured in materials provided to the carrier's auditor. The carrier representative believed that their auditing firm had followed standard auditing procedures and had no practical alternative to relying on the material submission of facts by the informant.

The carrier noted that the insured had further acknowledged that another employee's remuneration should have included the \$9,000 value attributable to lodging provided as part of her compensation and that the Bureau's test audit was in error for not including this value.

The carrier included a copy of an experience rating calculation sheet provided by the Bureau that produced the experience modification factor that the carrier had utilized on their audit invoice.

In response to the carrier's letter disagreeing with the test audit difference for the above-described reasons, the Bureau's test audit had been revised to include the value of lodging for one of the insured's employees and to recalculate the test audit premium using the experience modification factor that the carrier had used.

These revisions notwithstanding, the difference remaining due to the carrier's exclusion of the insured's maintenance employee was of a sufficient magnitude that the test audit continued to be non-compatible.

The written appeal to the Bureau focused on the carrier's auditor not being properly informed by the insured of the fact that the maintenance employee was covered by the carrier's policy. At the meeting, the carrier representative asserted to the Committee that one of the primary purposes of the Test Audit Program was to provide an educational resource to the member carriers. The carrier representative believed that the test audit difference in question did not provide any educational value but rather was the subjective result of the insured having failed to provide the carrier with correct information regarding the identity of covered employees. The carrier representative then introduced the manager of the independent auditing firm that had completed the carrier premium audit.

The audit firm manager stated that their auditor could not obtain any alternative reference point to ascertain whether all the employees covered by the carrier's policy had been appropriately noted by the insured. The quarterly tax return records given to the independent auditor had been highlighted by the insured, purportedly to identify the employees who worked for that particular apartment complex. The carrier representative stated that neither the independent auditor nor the Bureau's test auditor could accurately identify which employees worked for the entity insured by the carrier. It was claimed that both auditors had to rely on the veracity of the insured's informant to correctly identify the employees. The carrier representative opined that the insurance carrier should not be held responsible for errors of omission made by the insured.

Bureau staff commented that carriers frequently claimed that test audit errors resulted from the omission of certain facts by insureds and questioned the precedential implications of revising this test audit difference to compatibility based on the claim that the insured had made a willful or inadvertent omission of fact in interacting with the independent auditor.

The independent audit firm manager stated that information developed after their original audit indicated that the insured owned another apartment complex located at a separate address. This additional entity had employees included on the insured's quarterly payroll tax returns. The carrier representative suggested that the error made on the Bureau's test audit regarding the lodging value illustrated that the test audit had also been subject to errors of omission made by the insured's informant.

Bureau staff pointed out that the test audit worksheets had been revised to include the value of the lodging for the named employee in consideration of the carrier's response to the original test audit difference, eliminating that factor as the basis for any test audit difference.

Staff expressed its view that the Test Audit Program was not a competition between the Bureau and the carrier over which party produced the better audit and that the occurrence of an error(s) in a Bureau test audit did not serve as the basis for dispensation against carrier errors in developing reportable differences under the program. The primary purpose of the Test Audit Program was described as monitoring the accuracy of the Bureau member's audits and statistical reports. Staff noted that the test audit in question was now considered to be correct by both staff and the carrier as far as payroll allocations of employees and total payroll developed.

The maintenance employee had been identified by the Bureau as an employee of the insured in the course of their audit by reviewing employee records that not only identified employees by department but also showed the location at which each employee worked. This information had been found upon review of the insured's payroll registers, which also contained a master listing of employees with year-to-date earnings.

Staff stated that the employee had also been identified in the test audit as an employee of the insured because the informant had highlighted his name on the quarterly payroll tax return.

In executive session, the Committee reviewed the appeal and noted the following:

- The dispute centered on the inclusion of one employee by the Bureau that the carrier had missed in their audit, resulting in a reportable difference. Other errors made or adjustments performed by the Bureau in the test audit were deemed to be irrelevant to the appeal at hand.
- The carrier's material reliance on verbal information provided by the informant was characterized as a mistake.
- Documentation apparently had existed which would have supported the inclusion of the disputed employee in the carrier audit, provided a more thorough investigation of the records had been performed.

After some further discussion, upon motion made and duly seconded, the Audit Committee voted to sustain the Bureau's test audit and deny the carrier's appeal.