business issues

MODIFICATION MATTERS

Applying the correct experience modification rates for employees can help keep insurance premiums at the correct level.

BY DUKE MILLS

A SIMPLE MISUNDERSTANDING—OR misclassification—can lead to big costs.

A handful of errors in experience modifications, employee classifications and missed credits or discounts can cost steel contractors tens of thousands of dollars a year. Finding and fixing these mistakes enable companies to recoup past costs and reduce future premiums.

These costs can be quite significant. In fact, one Florida-based steel fabrication and erection company reduced its annual premium by $262,400 by identifying and correcting the experience modification rate, properly classifying employees and reducing overstated claim reserves. And one cell tower contractor reduced a $650,000 audit charge to $250,000 just by correcting employee misclassifications.

Experience Mod Mistakes

One error-prone area is the experience modification rate, also called experience modifier or just the "mod." The lower the mod, the lower the workers' compensation premium will be—and a few points can make a big difference. An experience mod of 1.2 could make your comp premiums 20% higher than for a contractor with a mod of 1.0. Perhaps more importantly, a high mod rate can disqualify contractors from bidding on certain projects.

The number of experience mod mistakes results from an inherent flaw in the system: "too many cooks in the kitchen." Bookkeepers and accountants gather information for work comp auditors who report payroll to insurance companies. Claim departments report paid and reserved claims, and wrap-up administrators file similar data. All this reporting—combined with multiple state filings, mergers and acquisitions and the misappropriation of injury codes—creates a perfect recipe for mod mistakes.

To determine your experience mod, your company's past claims history is compared to similar firms in your industry and in your state. You'd have to be a math major to understand the complexity of experience mod calculations, so let's just say there is a super-complicated formula that looks at the ratio between expected losses in your industry and what your construction company actually had. It also considers the frequency and severity of your firm's losses. Running your numbers through the formula produces your experience mod. This is multiplied by the manual premium rate to determine your actual modified premium.

The experience mod number means everything. Be aware, 1.0 is just average; you want to know the lowest possible experience mod your company can attain. As an example, if the lowest possible experience mod could be a 0.70 and your company is a 1.2, you're paying 50% more in work comp premiums. There are myriad ways for contractors to reduce their mod, but that calls for a whole other article, so let's focus on mistakes that inflate the experience mod, such as claim reserves.

The date used when the insurance company files the data with the rating bureau, which is usually the National Council on Compensation Insurance (NCCI), is critical. It's commonly called the valuation date. Let's say your work comp insurance renews on Jan. 1, 2014. Six months prior, in June 2013, the insurance carrier will forward three prior years of payroll per employee classification and injury claims data to NCCI. This data includes not only what has been paid out, but what is still reserved for payment on any open claims.

So if you have an open claim and $50,000 has been paid with $50,000 reserved, the carrier submits $100,000. However, if the employee recovers and returns to work and the claim closes after the data was filed in June, the carrier doesn't necessarily go back and change the data to reduce the total payout to less than $100,000.

Reserved claims require constant vigilance; the carriers are not required to adjust or remove claim reserves in what we would consider a timely fashion. So the contractor must make this a priority.

Erroneous Employee Classifications

The most common mistakes occur in the employee classifications that determine the rate that is multiplied by payroll to determine the premium. Typically employers assign the classifications and the insurance company's auditor has the right to change them. Either party can make mistakes or—as in this real-life example—an innocent conversation between a company controller and insurance company auditor can prompt an expensive reclassification change.

The vice president of the cell tower construction company went into the steel fabrication shop to watch a demonstration of a newly purchased hydraulic punching machine. While leaning against a work table he cut his hand on a

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piece of sheet metal. When reviewing the claim (yes, auditors are comparing description of employee accident to the employer's classification of the employee), the auditor noted the vice president was classified as clerical and asked how often he went into the shop. When the answer was "I'm not sure," the auditor changed the vice president's class code to welder—one of the highest rated codes—and the company suddenly owed $15,000. (This occurred despite the fact that the employee's $137,000-a-year salary was clearly higher than a typical welder's pay rate and he wore a sports coat to work every day as opposed to a welder's mask.)

This scenario has played out in numerous structural steel fabrication and erection companies, usually with more subtle annual changes that gradually increase premium over the years.

In the Florida fabrication shop scenario, much of the work was miscellaneous light-gauge, yet the insurance company classified all employees as "iron-steel" fabricators. National Risk Services, a third-party auditor, was hired to review job classifications and scope of work. When its report went to NCCI, both the rating bureau and the workers' comp carrier agreed that the positions were misclassified. Reclassifying employees into the lower-rated classifications produced a $72,000 refund for this single misclassification incident and reduced future premiums by 50%.

In the case of the $650,000 audit, improper classifications for employees working on cell phone towers accounted for $400,000 in overcharges. There are multiple classifications for steel erectors, with the highest one for the workers who actually build the towers. Codes for repairing towers, running wire on existing towers, adding antennas and laying sheet metal are much, much lower. The insurance company's auditor had applied the highest steel erection code across the board to all workers regardless of duties performed. After a third party examined the workers' actual duties and correctly classified the jobs, the final audit bill was $250,000.

Missed Credits and Discounts

Depending on the state, most insurance companies provide discounts and credits for various initiatives, like having drug-free workplaces or safety programs. However, these programs need to be certified each year and if the insurance agent misses the deadline for filing all the notarized forms for certification, the contractor can lose premium credits.

In addition, some carriers refund partial premiums called "safety dividends" to employers who have good claims experience and these refunds can range from 5% to 50% of the premium. Some insurance companies will do it automatically, but don't count on it.

The possibility for errors increases when contractors work on a construction wrap-up project because of the multiple audits, missing or incorrect data on experience mod worksheets and misaligned incentives with the wrap up administrator. As a case in point, a wrap-up administrator was aware of a series of clerical errors made by the steel subcontractor, the general contractor and the administrator itself, but still withheld $52,000 from the steel subcontractor's final payment. Had the sub not protested and found and fixed the mistakes, that money would be gone.

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Preparing for an Audit

The stakes are high in an insurance audit, and it pays to prepare. If a contractor has been with the same carrier and auditor for several years, the audit may not hold many surprises. Problems arise when you change insurance companies or are assigned a new auditor; then you should prepare as if this were an IRS audit.

You need to anticipate questions and prepare thorough and accurate answers without volunteering any unnecessary information. You don't want any "I don't know" answers. Produce clear delineations of duties and backup for classifications—and ascertain the status of outstanding and closed claims.

Have your insurance agent or another business advisor take you through a 15-minute trial audit. This will turn up possible problems like missing certificates from subcontractors, excluded payroll, separation of construction wrap-up payroll from non-wrap-up payroll and confirmation that all employees are correctly classified.

Bring your agent to the audit. You wouldn't have an IRS audit without your CPA present, and you shouldn't have an insurance audit without your agent or other insurance professional on hand. Be sure to provide accurate job descriptions to back up your classifications. If auditors cannot determine where the employees should be classified, they will put them in the highest-rated class codes.

Before the auditor leaves, ask for a copy of the audit, the auditor's notes and any changes made by the auditor. Review this while everything is fresh. This is your opportunity to challenge any changes that create higher premiums.

Put Your Agent to Work

Don't wait for your renewal or an audit to engage your insurance agent. Have quarterly meetings to discuss current projects and upcoming bids. By understanding what employees will be doing based on the scope of the project, a good agent can often uncover new classifications to keep premiums lower. Reviewing current projects keeps the agent aware of time lines for applying for credits or discounts and reminds you to report reduced claims costs to the rating bureau during that critical six-month period.

Two things keep companies from doing a detailed analysis of the workers' compensation program. One is that employers believe their agents are taking care of it, and the other is that they are time-bankrupt. The role of an independent work comp analysis is similar to having a CPA firm that reviews or audits your company financials, making sure everything is correct.

If time is the issue, find a workers' compensation premium recovery expert in your state and authorize your insurance company to share audits and other records with that expert. Many work on a contingency basis, keeping part of the money they recover. You may have nothing to lose and much to save. MSC