R.C. 2012

To the Members of the Board

Re: New York Carrier Test Audit Performance Program

This is to inform you that the Governing Committee of the New York Compensation Insurance Rating Board (Rating Board) has approved the New York Carrier Test Audit Performance Program to become effective on January 1, 2003. This program will measure carrier performance following a test audit performed by a Rating Board Auditor.

Currently, the Rating Board compares its test audit results to the carrier’s final premium billing and any difference within a predefined range is considered an error. The carrier is then required to rebill its insured for the proper premium. The Rating Board reviews a carrier’s audit performance on an annual basis and distributes, to each carrier, its audit performance results. A detailed description of the current Premium Verification Program is attached as Exhibit I.

A review of carrier test audit performance in New York revealed an overall error ratio significantly higher than the error ratios of carriers in other jurisdictions. After a comprehensive review of Programs followed in other states a new program that establishes a maximum test audit error ratio of 25% and possible penalties for ratios that exceed that amount was adopted in New York.

The details of the New York Carrier Test Audit Performance Program, to become effective January 1, 2003, is included under Exhibit II of this bulletin. This Program is designed to be administered by an Audit Review Committee of the Board in conjunction with the Rating Board staff.

If there are any questions concerning this program, please contact Mr. Richard Kaefer, Chief Auditor at extension 157.

Very truly yours,

Monte Almer

President

CD:tg
Encl.
PREMIUM VERIFICATION PROGRAM

History

The purpose of the Test Audit Program is to monitor the accuracy of the audits of the Rating Board’s member carriers and to verify that classifications, rates, rating plans and other rating factors are accurately applied and to further ensure that the rules contained in the New York Workers Compensation and Employers Liability Insurance Manual have been applied correctly.

It came to the attention of the New York State Insurance Department, in the 1930’s, that the insurance carriers writing workers compensation insurance coverage were deliberately misclassifying businesses by assigning a classification code(s) that would produce a lower rate and resultant lower premium. The Department perceived this practice as a form of corruption and met with the Rating Board staff, informing the staff that they (the Department) would institute a program or procedures that would reduce the potential for this practice to occur in the future.

The staff met with its member carriers to discuss the Department’s intentions. Since it was not all carriers who were deliberately assigning incorrect classifications, the industry asked that the Department allow them to monitor their own activities. The Department agreed and the Test Audit Program, which was to be administered by the Rating Board, was developed. New York was the first state to implement a Test Audit Program.

It was concluded, at that time, the three bases of premium determination should be audited – physical audit, payroll statement and payroll estimate. It was the intent of the Program to include every industry in the audit selection process as well as a mix of payroll sizes. That criteria still applies today.

At the onset of the program, approximately 20% of experience rated risks and 80% of non-experienced rated risks were audited since the Insurance Department believed the smaller risks needed more protection. Their theory was that a larger risk’s insurance agent, broker or consultant protected their interests. Over the years, because of wage increases with no significant increase in the eligibility level for experience rating, the pool of eligible non-experience rated risks has diminished and the Rating Board now audits approximately 65% to 70% of the experience rated risks.

Following is an explanation of the Premium Verification Program and then an outline of the procedures to be administered as part of the New York Carrier Test Audit Performance Program to improve the audit performance standards of member carriers.

Selection

On a monthly basis, policies are selected for test audit on a random basis. Excluded from the selection process are policies written for Per Capita codes and policies written for risks such as taxicabs where verifiable payroll records are not maintained. Test audits are performed after a carrier has performed its own audit, therefore, the selection process begins four (4) to five (5) months after the policy expires. Currently, the composition, by industry, for the selection list consists of:

25% – Manufacturing Risks
15% – Contracting Risk
60% – All Other

With the implementation of the Payroll Limitation Program, the Contracting and All Other Risks categories will be adjusted in 2003 so that more emphasis can be put on test audits for employers subject to the New York Construction Employment Payroll Limitation Program.

Payroll parameters have also been established for the selection process and have been adjusted over the years. Currently, policies with payroll amounts greater than $50,000, but less than $1,000,000 are selected for audit. The average payroll for policies in the Premium Verification Program has been around $300,000 for the past several years. Policies with lower payroll amounts
continue to be the focus of the Program, if they are available, as this allows the Rating Board to audit the policies of smaller insureds to ensure that they have been charged proper premiums.

**Quota**

A predetermined quota is established for each carrier and is based upon two factors. The quota is proportional to the number of policies written by the carrier to the total number of policies written in the State; and, the proportion of premium writings for each carrier to the total premium generated statewide.

A carriers’ quota is reviewed and adjusted based upon four (4) year audit results. The quota for a carrier increases if the carrier’s performance is consistently worse than the industry as a whole and decreases if its audit performance is consistently better than the industry.

A carrier may be part of a larger group. The current selection process does not put any weight on the carrier group in establishing a quota. Other jurisdictions, however, measure the individual carrier’s performance and the group’s performance as a whole. One of the conditions of the new program is to measure the audit performance for individual carriers and the performance of a carrier group as well.

**Preliminary Steps**

Each carrier is notified of the insureds selected for audit on a monthly basis. Prior to the Rating Board audit, the carrier is required to forward a copy of its final premium billing for each policy selected. If the carrier has performed a physical audit, then a copy of the carrier’s detail sheets must also be forwarded to the Rating Board.

The carrier’s detail sheets, however, are not sent to the auditor. The auditor performs an unbiased audit based upon his/her audit findings. The detail sheets are used by the office staff, first in identifying discrepancies and, then, as an added tool when the office reviews both the carrier’s audit and the audit submitted by the Rating Board auditor. Each insured is also notified that a Rating Board audit is forthcoming.

It is important to adhere to the timeframes established for the test audit program so that insureds are charged properly for the insurance coverage within a reasonable time period. Problems have been encountered, over the years, when carriers do not comply with Rating Board requests for final premium billings and audit detail sheets.

Carriers are required to provide any information requested by the Rating Board within sixty (60) days. If the information is not provided, that carrier is considered to be in violation of Rating Board rules and procedures and will be assessed fines for non-compliance.

A new procedure was established in recent years whereby the Rating Board will conduct the audit without a copy of the carrier’s final billing. Under this situation, Rating Board audit results are compared to the carrier’s estimated premium determined at time of policy issuance. This, however, typically results in audit differences between the Rating Board audit and the policy estimates and increases the risk of the carrier audit being considered incorrect. The carrier is then charged with an error against its performance record that could have an effect on the carrier’s overall error ratio. **To ensure that Rating Board audits are not compared to carrier policy estimates, it is imperative the carriers comply with requests for their final premium billings. This will minimize the potential for audit results to be considered an error.**

Approximately 2,000 audits are conducted each year by the Rating Board’s nine auditors. While this number may seem low, the Rating Board audit entails additional steps that a carrier does not perform during its audit process. As part of the Rating Board audit, the auditor compares the premium developed under the carrier’s audit to the premium developed under the Rating Board audit and analyzes each difference in detail.
Premium Differences

Not all of the differences between a Rating Board audit and a carrier audit are considered errors. A tolerance has been built into the Premium Verification Program whereby a premium difference of more than plus or minus $400 is considered an error and requires rebilling the insured.

If an audit results in a premium difference of less than plus or minus $150, it is not considered an error and a rebill is not required.

If a premium difference falls between $150 and $400, another step is followed to determine whether or not the premium difference is rebillable. If 5% of the carrier premium is greater than the premium difference, the audit difference is considered non-rebillable. If 5% of the carrier premium is less than the premium difference, then the audit difference is rebillable regardless of whether it is for a return or for an additional premium.

Upon completion of an audit, the carrier is notified of the Board’s audit findings. The carrier must, within sixty (60) days, either send a copy of its revised billing or inform the Rating Board that they do not agree with the audit results. If a carrier fails to respond within the sixty (60) day period, it is concluded that the carrier is in agreement with the audit findings. This will result in the audit file being closed. However, if a rebill is not received, fines will be imposed upon the carrier for non-compliance of a Rating Board criticism. If the carrier disputes the audit findings within the sixty (60) day period, additional time may be provided to resolve the dispute and fines are not assessed at this time.

Performance Results

The performance of member carriers under the Program is measured on an annual basis. All member carriers are furnished with quarterly and annual reports that show the individual carrier’s performance results. An accompanying cover sheet provides an explanation of the Industry Group, Audit Type and Cause of Difference categories.

These reports, when used in conjunction with the actual audit results that were previously sent to the carrier, should help the carrier identify where underwriting and auditing problems may exist within their company. The cause of difference is contained in the report and should also be an additional tool for the carrier in identifying and correcting the problem areas.

The cover sheet attached to the quarterly and annual performance reports indicates whether or not the Rating Board audits were compared to physical audits, payroll statements or policy estimates. For purposes of the Test Audit Program, any rebillable audit difference is considered an error regardless of whether the Rating Board audit was compared to physical audit or to policy estimates. It is assumed that the carrier had not conducted an audit if it did not provide a copy of their detail sheets and that the insured was charged an improper premium. The carrier is then required to rebill the insured based upon the Rating Board audit results unless that carrier can prove the Board audit is incorrect.
NEW YORK TEST AUDIT CARRIER PERFORMANCE PROGRAM
Effective January 1, 2003

The purpose of the New York Carrier Test Audit Performance Program (Program) is to:

- Verify that Rating Board member carriers accurately and consistently apply classifications, rates, rating plans and other rating factors.
- Ensure that statistical data is accurately reported to the Rating Board on policies affected by the Program.
- Establish a standard of performance for carriers to achieve following a Rating Board audit.
- Establish a procedure for the Rating Board to work with member carriers who exceed the minimum performance standard.
- Provide incentives for carriers who exceed the minimum standard to improve their audit proficiency.

HOW THE PROGRAM WORKS

POLICY SELECTION

- A predetermined quota for policies to be audited is established for each carrier group based upon:
  1. The number of policies written by the group proportional to the total number of policies written in New York State;
  2. The carrier group’s premium writings proportional to the total premium generated statewide.

  **Note:** The quota standards will also apply to each carrier within the group.

- The quota is reviewed and adjusted based upon the carrier/carrier group’s four-year audit results.

  The quota will increase for the carrier or carrier group if the audit performance is consistently worse that the industry as a whole and decrease if the audit performance is consistently better than the industry.

- The selection process includes:
  1. Physical audits;
  2. Payroll statements;
  3. Payroll estimates.

- No policy will be audited more than once in a five-year period.

- Policies selected will be determined based upon the following industry groups:
  
  25% Manufacturing Risks
  20% Contracting Risks
  55% All Other

  Excluded from this selection process will be policies written on a Per Capita basis and other types of risks where verifiable payroll records are not maintained.

- The selection process includes policies with payroll amounts greater than $50,000, but less than $1,000,000.
• Carriers are notified on a monthly basis which insureds are selected for audit.

• Within sixty (60) days of notification, a carrier is required to:
  1. Forward a copy of its final premium billing for each policy selected for audit;
  2. Forward a copy of its detail sheets if a physical audit was performed by the carrier.

*Note:* A carrier’s failure to comply with these requests will result in a carrier being assessed fines for non-compliance of Rating Board rules and procedures.

**AUDIT DIFFERENCES**

When an audit is completed, the audit file for a particular policy –

• Will be closed if the premium difference between the carrier audit and the Rating Board audit is less than plus or minus $150.

• Will be considered in error if the premium difference is more than plus or minus $400. The carrier is informed that a rebill is required if the premium difference falls between $150 and $400 and is subject to the following:
  1. The audit difference is considered non-billable if 5% of the carrier premium is greater than the premium difference;
  2. The audit difference is rebillable if 5% of the carrier premium is less than the premium difference.

The carrier has sixty (60) days to either submit a revised billing or inform the Rating Board that it does not agree with the audit results.

Failure to respond within the sixty (60) day period will result in a carrier being assessed fines for non-compliance of a Rating Board rule or procedure.

• A revised Unit Statistical Report is required to be submitted to conform to the revised and final premium billing.

• A Rating Board audit can differ from a carrier audit, but not require a revised billing because the audit difference is within the established tolerance levels. However, the Rating Board audit can result in a classification change. In this instance:
  1. The carrier will be informed that a change in classification is required and that an endorsement is to be submitted to the Rating Board;
  2. A revised Unit Statistical Report is required to reflect the change in classification.

The carrier has sixty (60) days to either submit a revised billing or inform the Rating Board that it does not agree with the audit results.

Failure to respond within the sixty (60) day period will result in a carrier being assessed fines for non-compliance of a Rating Board rule or procedure.

**COMPLIANCE WITH THE PROGRAM**

Carrier and carrier group test audit performance will be reviewed quarterly. The performance evaluation will be based upon four consecutive calendar quarters. A carrier or carrier group that exceeds the minimum test audit performance standard, as shown below, is considered to be subject to the procedures of the Program.
• A carrier or carrier group has met the minimum test audit performance standard if not more than 25% of all policies test audited in the review period have developed reportable premium differences.

• A carrier who has achieved a performance standard of less than 15% of all policies test audited in the review period will be exempt from the Program for eight consecutive calendar quarters.

The exclusion of carriers who have consistently performed better than the minimum standard will allow the Rating Board to perform more audits on those carriers who have exceeded the minimum standard. Following the eight consecutive calendar quarter exclusion, the exempt carrier will again become subject to review.

ADMINISTRATION OF THE PROGRAM

The Rating Board will administer the New York Carrier Test Audit Performance Program. An Audit Review Committee, consisting of three member carriers, has been established by the Governing Committee and is empowered to discuss a carrier’s test audit results, audit program and any remedial measures the carrier has implemented or proposes to implement to improve its audit proficiency. As part of the Program, the Rating Board will:

• Notify the carriers, on a monthly basis, which policies are subject to the Test Audit Program.

• Report individual audit results, quarterly reports and annual reports to the carrier. These reports include the reason for the difference between the carrier audit and the Rating Board audit as a tool for the carrier in identifying the area(s) that need improvement within their auditing procedures.

• If the test audit performance of a carrier or carrier group has exceeded the minimum test audit standard for four consecutive calendar quarters, the following steps are followed:

  1. The carrier is required to meet with the Rating Board Chief Auditor and the Vice President of Classification and Audit to discuss its audit proficiency. At this meeting, the carrier is to provide a detailed explanation of any remedial measures it has implemented or proposes to implement in the future to improve its audit proficiency.

     Since the Rating Board has previously provided the carrier with the cause of difference between the two audits, the carrier should be prepared to discuss its plans for improvement.

  2. Any carrier required to meet with the Rating Board staff will be informed, at the meeting, that continued failure to meet the minimum standard will result in additional policies added to the carrier quota and the carrier will be charged $1,000 for each additional test audit performed beyond their established quota.

  3. Following the meeting with the Rating Board staff, the carrier’s performance will be measured again after three consecutive calendar quarters. If the carrier has failed to achieve the minimum standard, an officer of the carrier will be required to meet with the Audit Review Committee to present the carrier’s plan to achieve audit proficiency within the established standard.

     The Audit Review Committee will establish the number of additional audits that will be test audited for the next two quarters and inform the carrier that $1,000 per audit will be charged to offset the cost of conducting the number of additional audits that exceed the carrier’s normal quota. The number of audits may not exceed twice the carrier’s normal quota.

  4. Any carrier who fails to achieve the minimum standard following the two additional quarters will be reported to the Governing Committee for further action. An officer of the carrier will then meet with the Governing Committee to explain why its plan to improve audit proficiency has failed. The Committee may then impose additional fines on the carrier and/or report the carrier to the Superintendent of Insurance.
Since the carrier will not be present when the Governing Committee discusses what further action, if any, should be taken, the President will inform the carrier the actions taken by the Governing Committee.

- Special audits performed by the Rating Board that fall outside the parameters of the Test Audit Program will not be included in the carrier’s overall audit performance rating.