Navigating your First (or Next) Insurance Premium Audit

One of the primary ways to address risk on any construction project is to purchase insurance products to cover the financial fall-out that occurs when a particular insured risk materializes into an injury, property damage, etc. The familiar insurance products include general liability insurance, worker's compensation insurance, and others. Insured risks are "priced" in the form of policy premiums, which the insured party pays to its insurers in exchange for an agreed amount of insurance coverage. Because the costs for addressing these insured risks are essentially liquidated, the insured party is better equipped to manage its finances and provide accurate pricing for its work.

A party's responsible financial management and accurate work pricing can all be sent into a tailspin, however, as a result of a material after-the-fact change in a party's insurance costs. How can this happen? Welcome to the world of insurance premium audits.

If you look closely, most insurance policies define the premium paid in exchange for the insurance coverage provided (typically listed on a declarations page) as an advance premium, an estimated premium, a deposit premium, a premium subject to verification, or a premium subject to audit. Often a policy year for a particular insurance policy comes and goes with the insured party simply paying the premium stated in the policy's declarations page. Other times, however, the insurer exercises its contractual audit rights which may result in the insured party receiving a much-higher-than-anticipated insurance bill.

This is purely anecdotal, but the audit followed by a large invoice from the insurer seems to be the subject of more and more client calls as of late. What if you are next on the insurance premium audit chopping block? Here are some questions, answers, and tips that may help you navigate your first (or next) insurance premium audit.

Why is the insurance company allowed to conduct a premium audit?
All insurance policies are contracts – agreements between the insurer and the insured party. Most insurance policies include provisions specifically authorizing the insurer to examine and audit the insured party's records that may relate to the insurance provided under the policy. Often the insurer's contractual audit rights may extend for two to three years (or more) after the end of the stated policy period.

If an insurer contacts you to schedule an audit, you should request clear answers regarding the specific policy the insurer seeks to audit and the policy year that is the subject of the audit. Next, check the terms of the policy for language authorizing the audit. If the policy does not authorize an audit or if the insurer is attempting to conduct the audit beyond the time allowed by the policy's terms, then you will likely be justified in refusing to participate in the audit. Absent those circumstances (which are unlikely), you are contractually required to participate in the audit pursuant to the policy's terms.

Your insurance agent can be a valuable resource in connection with an audit. We recommend you reach out to your agent once an audit is initiated.

If an audit is initiated, am I required to provide information and cooperate in the process?
An insured party's contractual obligations with regard to retention of relevant records and auditing of those records is typically broad. An insurance policy may require the insured party to retain all records and information that may be necessary to compute the premium owed under the policy and allow the insurer to inspect and audit those records. These can include ledgers, journals, contracts, payroll, etc.

Assuming the premium audit is authorized by the insurance policy, the insured party's failure to provide information and/or cooperate in the audit will likely constitute a breach of contract.

What happens after the audit?
Sometime after the audit, the insurer will usually issue some type of audit report along with a statement or invoice seeking payment of additional premiums from the insured. Indeed, it is rare (perhaps it has never occurred) where the insurer proceeds with an audit and determines the insured party has over-paid for insurance.

Can I challenge the results of the audit?
An insured party can certainly push back on the results of the insurer's audit.

If an insured party intends to challenge the insurer's audit, the report deserves scrutiny. Oftentimes, insurers hire a third party to conduct these audits and many times the reports raise more questions than provide answers. Review the audit report and ask the insurer to answer any questions you may have, putting both questions and answers in writing. Sometimes answering questions about a defective audit report can result in the insurer backing off or reducing its request for additional premiums.

Look closely at how the audit report classifies the risk associated with the additional premiums sought. Typically, some risks are priced differently when it comes to insurance. A common theme in recent insurance audits is the "lumping together" of risks into the highest rate classification possible. Perhaps there is some additional premium owed, but the amount owed may decrease significantly if the appropriate classification (and corresponding price) is applied to the exposure. Parsing out rate classification issues may take some grunt work, but it may also pay significant dividends by reducing the additional premium due.

What if I push back on the insurance audit, but the insurer won't budge?
Call us.

For more information, please contact Billy Davis.

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