



Frankly speaking, your  
annual audit doesn't have  
to be as confusing  
as it sounds.

Our Premium Audit Guide is here to help.



# Table of Contents

Introduction	2
Types of Audits	3
Workers' Compensation	11
General Liability	17
Frequently Asked Questions	23

Owning a business is a labor of love. But frankly, your insurance shouldn't create more work for you. That's why the experts at Frankenmuth Insurance are determined to help you make sense of your insurance, so you only need to worry about doing the work you love.

# Introduction

We make it our business to help protect your business, making the coverage you need affordable and accessible, with minimal headaches. But not all policies are created equal. Certain commercial insurance policies require an audit before appropriate premiums can be assigned, including workers' compensation, general liability and/or commercial auto policies. These annual audits involve examination of the policyholder's records that may include payroll, sales and subcontracting costs. Frankenmuth Insurance auditors are trained to observe your operation and determine the classifications that best reflect potential exposures or risks involved in insuring your business and making sure you have the right coverage to protect your assets.

To make the process easier, we have created this manual providing important and useful information about auditable policies. It will:

- Outline the audit process and explain why it is necessary
- Provide easy-to-follow steps to make your audit smooth and efficient
- Serve as a handy reference for questions

Of course, we encourage you to contact our team should you require clarification on any issue. Important numbers for customer service are: **(989) 652-6121** or **(800) 234-1133**, ext. 4013.

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## Service Goal

To better serve you, we strive to have policy audits completed within 90 days of the policy expiration. Proper preparation, as described in this document, will make the audit process swift and efficient.

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## Agent Responsibilities

The Frankenmuth Insurance team believes understanding your insurance should not be hard work for you. Our agents are proactive partners who can assist you in making sense of your auditable policy. Your agent will explain the purpose of the audit and the type of audit required and will attach form [FM-626 – Your Policy Premium Is Subject to Adjustment by Audit](#) to your policy. She/He is your first source for information regarding what to expect from your audit.

# Types of Audits

Upon expiration, policies requiring an audit (performed by a Frankenmuth Insurance auditor or a third-party service) will be identified. The policyholder's audit may be conducted in one of three ways, which will be determined based on policy criteria. You will receive a call to schedule the audit, and/or a predetermined scheduling letter indicating the type of audit to be performed. To help you understand what to expect, we describe the three audit types below.

A **physical audit** involves a Frankenmuth Insurance representative conducting the audit at the insured policyholder's place of business or accountant's office, wherever your records are kept.

A **telephone audit** involves a conference call between a Frankenmuth Insurance representative and the insured policyholder, or the policyholder's accountant.

A **mail/online audit** involves the assignment of a username and password to the insured policyholder, which will be communicated by letter. Information can be entered on the website identified in the letter and, once complete, submitted to Frankenmuth Insurance for review and processing. Not a fan of online applications? If you prefer, you may call **(800) 234-1133**, ext. 4013 to request a hard copy form. The form is mailed directly to you, the policyholder, for completion.

# Records Required for Audit

As the policyholder, you will be asked to provide certain business records that will allow Frankenmuth Insurance to calculate the actual earned premium during the policy period. These may include:

**State and Federal Tax Reports** – These reports include 940, 941, 1065, 1120, 1040-C and more. These tax documents help the auditor by:

- Verifying payroll figures obtained from detailed earnings records balanced to the tax reports
- Ensuring amounts paid to corporate officers are not included beyond the maximum limitations established for the policy period
- Ensuring the insured policyholder is not charged a premium on excluded spouses and children
- Identifying and allowing excludable tips to be deducted from gross payroll
- Identifying and allowing the appropriate amount of payroll for policyholders involved in third-party sick pay to be deducted from gross payroll

**Payroll Records** – Summarized payroll records assist the auditor with assigning payroll to proper risk classifications.

**General Ledger** – The ledger is another source that helps the auditor verify wages and payments to contract labor.

**Cash Disbursement Journal** – A cash disbursement journal verifies payments made to individual employees and subcontractors.

**Check Register** – The check register verifies names of subcontractors and the amounts they were paid.

**Profit and Loss Statements** – These statements contain data on subcontract labor for the audit period. This statement can speed up the audit process by saving the auditor time checking other documents for subcontract labor that does not exist.

# Inclusion and Exclusion of Payments Made

Your Frankenmuth Insurance auditor will carefully review your business records to identify certain payable items (also called remuneration) that may be excludable. The auditor works to determine two things related to remuneration:

- How much you paid to employees and uninsured subcontractors in wages or other forms of remuneration
- The classification of work performed by employees and uninsured subcontractors

The chart below displays what remuneration or payments must be included when calculating the insured policyholder's actual earned premium.

Included Remuneration		
1. Wages or salaries, including those that are retroactive	6. Payment by an employer of amounts otherwise required by law to be paid by the employee's statutory insurance or pension plans such as Federal Social Security Act	11. The value of meals received by employees as part of their pay, as shown in the policyholder's records
2. Total cash received by employees for commissions and draws against commissions	7. Payments to employees on any basis other than time worked, such as piecework, profit sharing or incentive plans	12. The value of store certificates, merchandise, credits or any other substitute for money received by employees as part of their pay
3. Bonuses, including stock bonus plans	8. Payments or allowances for hand or power tools used and provided by employees in their work for the policyholder	13. Payments for salary reduction, retirement or cafeteria plans (IRC 125), which are made through deductions from the employee's gross pay
4. Extra pay for overtime work (except as listed on page 11 in this booklet)	9. The rental value of an apartment or house provided for an employee based on comparable accommodations	14. Davis-Bacon wages paid to employees or placed by an employer into third-party pension trusts
5. Pay for holidays, vacations or periods of sickness	10. The value of lodging, other than an apartment or house, received by employees as part of their pay as shown in the policyholder's records	

The chart below displays what remuneration or payments may be excluded when calculating the insured policyholder's actual earned premium.

Excluded Remuneration		
1. Tips and other gratuities received by employees	3. The value of special rewards for individual invention or discovery	6. Sick pay paid to an employee by a third policy, such as by a policyholder's group insurance carrier, which is payment of disability income benefits to a disabled employee
2. Payments by an employer to group insurance or group pension plans for employees other than payments covered by the chart above	4. Dismissal or severance payments, except for time worked or accrued vacation	7. Payments for active military duty
	5. Work uniform allowances	

# Audit Verification

Many forms, most completed as part of your year-end income tax calculations, may be used to verify the payroll on an account. Below is a summary of federal forms that your Frankenmuth Insurance auditor may ask to see.

Individual state forms will vary.

Federal Forms			
Entity	Form #	Form Name	Verifies
Sole Proprietorship	Schedule C (Form 1040)	Profit or Loss from Business (Sole Proprietorship)	<ul style="list-style-type: none"> <li>Gross receipts or sales (line 1)</li> <li>Wages (line 26)</li> <li>Other expenses (line 27 detail from line 28 on page 2) Picking up and causal labor, misc. labor, or subcontractor expenses</li> <li>Cost of labor (line 37)</li> </ul>
Partnership	1065	U.S. Return of Partnership Income	<ul style="list-style-type: none"> <li>Gross receipts or sales (line 1a)</li> <li>Salaries and wages (line 9)</li> <li>Other deductions (line 20) A separate schedule should be attached with an itemized listing of deductions. The list identifies any subcontractors, misc. labor or casual labor exposures.</li> <li>Cost of labor (schedule A, line 3) Attach itemized list.</li> <li>Other costs (schedule A line 5) Attach itemized list.</li> </ul>
Corporation	1120	U.S. Corporation Income Tax Return	<ul style="list-style-type: none"> <li>Gross receipts or sales (line 1a)</li> <li>Compensation of officers (line 12)</li> <li>Salaries and wages (line 13)</li> <li>Other deductions (line 26) A separate schedule should be attached with an itemized listing of deductions. The list identifies any subcontractors, misc. labor or casual labor exposures.</li> <li>Cost of labor (schedule A, line 3) Attach itemized list.</li> <li>Other costs (schedule A, line 5) Attach itemized list.</li> </ul>



S-Corporation	1120S	U.S. Income Tax Return for an S-Corporation	<ul style="list-style-type: none"> <li>Gross receipts or sales (line 1a)</li> <li>Compensation of officers (line 7)</li> <li>Salaries and wages (line 8)</li> <li>Other deductions (line 19)</li> </ul> <p>A separate schedule should be attached with an itemized listing of deductions. The list identifies any subcontractors, misc. labor or casual labor exposures.</p> <ul style="list-style-type: none"> <li>Cost of labor (schedule A, line 3) Attach itemized list.</li> <li>Other costs (schedule A, line 5) Attach itemized list.</li> </ul>
All	940	Employer's Annual Federal Unemployment Tax Return (FUTA)	Total amount paid in wages (part 1, line 3)
All	941	Employer's Quarterly Federal Tax Return	<ul style="list-style-type: none"> <li>Total quarterly wages paid (line 5c)</li> <li>Number of employees for quarter (line 1)</li> </ul>
All	W-2	Wage and Tax Statement (Employee)	Total wages, tips and other compensation for an employee
All	W-3	Wage and Tax Statement (Employer)	Total wages, tips and other compensation paid to all employees
All	1099-MISC	Misc. Income	Documents casual labor
All	UC-1017	Wage Detail Report	<ul style="list-style-type: none"> <li>Individual employee payroll by quarter</li> <li>Total wages paid for quarter</li> </ul>

## Incomplete Audits

Because our mission is to serve our policyholders, your Frankenmuth Insurance auditor will make every effort to work with you to make the audit process as painless as possible. However, in the rare circumstance that an insured policyholder is uncooperative, or Frankenmuth Insurance auditors are unable to complete the audit for reasons beyond our control, the policy may not be renewed at the underwriter's discretion. Some states allow for a noncompliance charge to be assessed to the insured policyholder, which can total up to three times the estimated premium.

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## Current Term Endorsement Due to Audit Results

When an audit identifies exposure changes (increased risks) on an expiring policy, premiums will increase. Frankenmuth Insurance will notify the policyholder of our intent to increase the current policy's premium base. At that time, you will have 20 days to dispute the adjustment. Please respond directly to the Premium Audit Department in writing or by email ([claudit@fmins.com](mailto:claudit@fmins.com)), and include documentation to support not increasing exposures on the current term. We will review your request and document your file accordingly.

# Audit Disputes

While Frankenmuth Insurance works hard to keep our policyholders happy, we understand that, at times, an audit dispute is merited. To make this process easier for policyholders and/or agents, we offer the following guidelines:

**Agency Billed** – Accounts may be disputed up to 45 days after the end of the month in which the account is billed.

**Company Billed** – Accounts may be disputed up to 30 days after the final Premium Audit Notice (not the bill) is received by the agency.

Once in a dispute, you will have two weeks to send in the formal revision information using the following procedures:

1. Determine the exact discrepancy in the audit. Document the discrepancy by outlining the situation with a memo and provide it to the Premium Audit Department within the time frame noted above. Be specific as to what area is in dispute and, if possible, include the revised information.
2. If the policyholder is questioning overtime, include a summary of the overtime, broken down by employee or department. The policyholder should also be specific about whether the overtime represents the entire time and a half or is strictly the “premium” or “halftime.”
3. If the insured policyholder is disputing the classification of a worker, provide a complete and detailed job description for that worker. Also include the amounts paid to that worker during the audit period.
4. If the insured policyholder is disputing payments to outside labor, send copies of the certificates of workers’ compensation insurance or signed statements of sole proprietor status.
5. Pay all premiums not in dispute. For example, if the audit generates an additional amount due of \$5,000 and of that amount, \$1,000 is in dispute, the policyholder should submit the \$4,000 not in dispute to the Frankenmuth Insurance Billing Department by the due date on the invoice. All of the current term premium should also be paid.
6. Make sure you include the policy number on all correspondence sent to Frankenmuth Insurance.
7. If placed in dispute and necessary information listed above is not received within the two-week time frame, Frankenmuth Insurance will release the billing and continue with collection of the premium.

# Workers' Compensation

Your policy with Frankenmuth Insurance is based on an estimated premium. An audit of your business records is required to calculate your actual earned premium for the policy period. Part V of your Frankenmuth Insurance workers' compensation policy states the role of the insured policyholder and the reason for the audit. Among the responsibilities of the policyholder are:

- The policyholder will maintain and provide as requested all business records needed by Frankenmuth Insurance to calculate the policy premium.
- The policyholder will allow the assigned Frankenmuth Insurance representative to examine and audit all records related to this policy. These records include ledgers, journals, registers, vouchers, contracts, tax reports, payroll and disbursements records, and programs for storing and retrieving data.

Audits may be conducted during regular business hours during the policy period and within three years after the policy period ends. Information developed by an audit will be used to determine the final premium.

Please refer to your policy for more information.

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## Employee Classification

Frankenmuth Insurance will determine the classification of employees based upon the definition of class code(s) and the job duties or services performed by employees on behalf of the insured policyholder. Classification codes on the policy are reviewed to ensure they properly reflect your business operation. Then, the appropriate payroll amount is reported for each applicable class code.

# No-Payroll Division Classifications

Some types of employee wages are not available for division of payroll. These include:

- Clerical/Drafting – 8810
- Outside Sales – 8742
- Drivers NOC – 7380
- Executive Supervisors – 5606

Certain class code(s) do not allow incidental or supportive job duties to be separately classed. For example, Code 5645 Carpentry-Dwell includes helpers, cleanup personnel and other miscellaneous employees at the jobsite.

In some cases, an insured policyholder has an employee who divides time between store and driving duties. When this happens, exposure can be allocated to the highest-rated classification to which the employee is exposed. An exception is if an employee's duties changed during an audit term and proper records are kept identifying the change. In this case, the payroll can be allocated to the classification applicable to each period.

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## Interchange of Labor

Some businesses have employees who perform a variety of duties. This is referred to as an interchange of labor. The wages of such employees may be allocated to different classifications if the allocation is:

- Shown separately in the insured policyholder's original entry records
- Based on actual payroll incurred in each operation
- Not based on an estimate or percentage

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## Prevailing Wage

Often, a wage paid to an employee working on a government contract is higher than a typical wage. This is called prevailing wage. For example, a nonunion worker may be paid \$10 per hour on a typical contract. The same worker may be paid the union wage of \$18 per hour when working on a government contract. It is the insured policyholder's responsibility to pay the prevailing wage and any additional benefits required by the government to the employee, and to include these wages and benefits in the payroll if they are shown on the W-2 or 941.

# Overtime

Overtime is the hours worked for which there is an increase in the rate of pay and can include daily or weekly work beyond the typical hours worked (for example, more than eight hours per day or 40 hours per week). Overtime can also include weekend and holiday work.

The extra payroll for overtime will be excluded from the payroll on which the policy premium is calculated under the following conditions:

- Records show the total pay earned for overtime (regular pay plus overtime pay) in one combined amount. In this case, one-third of the total pay shall be excluded.
- The total pay for overtime paid as double time is recorded separately. In this case, one-half of the total pay for double time shall be excluded.
- Records show separately the extra pay earned for overtime, so the entire extra pay shall be excluded.

The chart below shows an example of how excludable overtime pay is calculated, depending upon how the insured policyholder's records are displayed. The example assumes an hourly wage of \$1.00/hour, time-and-a-half pay of \$1.50/hour and double time pay at \$2.00/hour.

Regular	Time and a Half	Double	Total Pay	Excluded Overtime
\$40	\$7.50	\$2	\$49.50	\$3.50
\$46	\$2.50	\$1	\$49.50	\$1.50

# Subcontractor Information

Subcontractors are individuals or businesses contracted to perform all or a portion of a job undertaken by the insured policyholder. Costs for subcontractors are included or excluded from premium calculations based on their classification. There are two types of subcontractors:

- **Uninsured Subcontractors** – A subcontractor without insurance is charged based upon the type of work performed. Generally, the total amount paid to the subcontractor is used to calculate audit exposure. However, if records show a separation for labor and materials, then the material cost is excluded, and only the amount for labor is assessed.
- **Insured Subcontractors** – An insured subcontractor is excluded from the workers' compensation audit. The insured policyholder will need to provide a certificate of insurance as proof of coverage. If applicable, a state exclusion or independent contractor statement form may be submitted.

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## Certificates of Workers' Compensation Insurance

To prove that a subcontractor has its own workers' compensation insurance coverage and is therefore eligible to be excluded from your policy, the auditor will require that a valid certificate of insurance be provided. To be valid, the certificate(s) must cover at least six months of the audit period or the date of the service.

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## State Exclusions/Exemptions

The Workers' Compensation Act allows exemption for some employees, officers, partners or members. A certificate must be provided to your auditor to prove these exclusions. Please consult with your agent or contact our Premium Audit Department for more information.

# Independent Contractor Statement

Payments made to independent contractors may be excluded from your premium calculation, but only if certain standards are met. Generally, a person cannot be considered an independent contractor based on an agreement between the policyholder and that individual. An independent contractor must maintain a separate business and render independent services to the public. If this individual is directed and controlled by the insured policyholder, she/he is probably an employee and not an independent contractor.

Each independent contractor is required to complete the Independent Contractor Statement/FM-901. This form is provided with every new and renewal policy or can be provided by the Premium Audit Department. The form assists an auditor in determining whether an independent contractor is an employee or a true independent contractor not subject to workers' compensation coverage. Since many factors affect status, the auditor will look for reasonable proof prior to excluding the independent contractor from premium calculations.

Independent contractor statement forms must be reviewed and completed each year as the status of subcontractors often changes. It is very important that this form is completed by the contractor at the time of hire by the insured policyholder. After work by the subcontractor is completed, it can be extremely difficult for the insured policyholder to obtain the required information.

The signed statement may be sent via email or mail (see below) to Frankenmuth Insurance's Premium Audit Department for immediate review.

**[claudit@fmins.com](mailto:claudit@fmins.com)    One Mutual Avenue, Frankenmuth, MI 48787**



# Special Rules of Workers' Compensation

To help our customers better understand workers' compensation, we have listed and described some of the most common workers' compensation rules below.

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## Records from Subcontractors Who Use Employee Leasing Companies

Leasing workers from an employee leasing company is a growing employment trend. In this arrangement, the leasing company (Business A) hires the employees of another business (Business B). Business B then leases some, or all, of the employees back from Business A.

If an insured policyholder hires a subcontractor (Business B) who leases its employees from a leasing company (Business A), this subcontractor may provide the insured policyholder with a certificate of workers' compensation insurance, naming the leasing company (Business A) as the "named insured." However, when performing the work for the insured policyholder, Business B may utilize additional employees who are not covered under its leasing arrangement.

To help eliminate premium charges and confusion concerning leased workers, the insured policyholder should require an additional certificate of workers' compensation insurance, stating that the subcontractor (Business B) does not have any other employees, casual laborers or subcontractors with employees, except for the leased workers. In the absence of this certificate or signed statement, premium charges for this subcontractor (Business B) will be included unless auditors are given access to the subcontractor's (Business B's) books to determine if additional exposure exists. The subcontractor's (Business B's) books must be available at the insured policyholder's location at the same time the audit is completed.

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## Vehicles Under Contract

Specific guidelines govern the inclusion or exclusion of drivers of vehicles under contract. Generally, these guidelines are as follows:

- If the owner of the vehicle has not furnished evidence of workers' compensation coverage for his/her drivers, the total payroll of all drivers will be added to the insured policyholder's payroll for inclusion in premium calculations.
- If that payroll is not available, the payroll will be calculated at one-third of the total contract price for the vehicles.
- If the owner of a vehicle under contract is also a driver and does not furnish evidence of workers' compensation coverage, one-third of the contract price for the vehicle will be included in the insured policyholder's total payroll for inclusion in premium calculations.

# General Liability

As you have learned through this document, your policy with Frankenmuth Insurance is based on an estimated premium. To calculate the actual earned premium for the policy period, an audit of your records is required. The liability can be based on gross sales, payroll, total cost, admissions, each (meaning each unit of exposure) or number of employees. Descriptions of these bases of premium follow.

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## Bases of Premium

**Gross Sales** – This is the gross amount charged by the named insured policyholder, all concessionaires, other entities trading under the insured policyholder’s name for goods or products sold or distributed, operations performed during the policy period, rentals, and dues or fees.

- **Inclusions** – Foreign exchange discounts, freight allowance to customers, total sales of consigned goods and warehouse receipts, trade or cash discounts, bad debts, and repossession of items sold on installments (amount collected)
- **Exclusions** – Sales or excite taxes that are collected and submitted to a governmental division, credits for repossessed merchandise and products returned (allowances for damaged and spoiled goods), finance charges for items sold on installments, freight charges on sales if freight is charged as a separate item on customer’s invoice, and royalty income from patent rights or copyrights that are not product sales

**Payroll** – Inclusions and exclusions for payroll were listed previously in this document (page 5). However, liability for payroll follows the same rules as the workers’ compensation liabilities with a few exceptions, which will be covered later in this section.

**Total Cost** – The cost of all work let or sublet relative to each specific project is the total cost. This includes the cost of all labor, materials, and equipment used or delivered for use in the execution of the work, along with all fees, bonuses, or commissions made, paid, or due. Regardless of who furnishes the materials and/or equipment for use by the subcontractors, these costs are included in the calculation of total cost.

**Each** – This involves units of exposure. The quantity of each unit of exposure is indicated in the classification footnotes, such as “per person.”

**Admissions** – The total number of people admitted to an event or to events conducted on the premises, whether on paid admissions, ticketed, complimentary tickets or passes are referred to as admissions.

# Officers

The treatment of officers depends on the bases of premium. Those types follow.

- **Sales-Based** – The gross sales covers the risk.
  - **Payroll-Based** – Active officers are included at a flat officer amount.
  - **Number of Employees** – Owners/officers/partners/members are included as full time if they are active in the business, regardless of the time worked and their job duties. Officers/owners/partners/members doing clerical or outside sales are included.
  - **Garage Liability - Hazard I** – Active owners/officers/partners/members are included at rating factor 1.00.
  - **Garage Liability - Hazard II** – All active owners/officers/partners/members are included at a fixed amount of \$100 per week. They are excluded if they are inactive or 100% clerical or managerial. Strictly clerical or managerial means they do not do any work in the shop area. All their work is done in an office.
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## Employee Classification

Your auditor will determine the classification of employees based on the definition of class code(s) and job duties or services performed. Classification codes on the policy are reviewed to ensure they properly reflect the insured policyholder's business operation. Then, the appropriate payroll amount is reported for each applicable class code.

# Excluded Employee Payroll

In some cases, payroll for employees performing specific functions or working in prescribed environments is excluded. Among the exclusions are:

- Payroll of clerical office employees who work in an area physically separated by walls, floors, or partitions, from all other work areas and whose duties are strictly limited to keeping the insured policyholder's books or records or conducting correspondence, including any other employees engaged in clerical work in the same area.
  - Exceptions – Certain classifications include the payroll of outside salespersons, collectors, messengers and clerical employees.
- Payroll of salespersons, collectors or messengers who work principally away from the insured policyholder's premises. This term does not apply to any employee whose duties include the delivery of any merchandise handled, treated or sold.
- Payroll of drivers and their helpers, if their principal duties are to work on or in connections with automobiles.
- Payroll of draftsmen, if their duties are limited to office work only and who are engaged strictly as draftsmen in such a manner that they are not exposed to the operative hazards of the business.
  - Exceptions – Payroll of draftsmen shall be assigned to the classification 91805-Draftsmen if the draftsmen are employed by the insured policyholder in the business of providing engineering or architectural drawing services to others based on customer specifications; or are employed by contractors for drafting plans and designs for specific jobs. This classification does not apply to manufacturing operations that have draftsmen or drafting departments.

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## Prevailing Wage

Often, a wage paid to an employee working on a government contract is higher than a typical wage. This is called prevailing wage. For example, a nonunion worker may be paid \$10 per hour on a typical contract. The same worker may be paid the union wage of \$18 per hour when working on a government contract. It is the insured policyholder's responsibility to pay the prevailing wage and any additional benefits required by the government to the employee, and to include these wages and benefits in the payroll if they are shown on the W-2 or 941.

## Leased Employees

The payroll of leased workers furnished to the insured policyholder by a labor leasing firm is included. The premium on such payroll shall be based on the classifications and rates that would have applied if the leased workers had been the direct employees of the named insured policyholder. If payroll is unavailable, 100% of the total cost of the contract for leased workers will be used. The premium shall be charged on that amount as payroll.

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## Temporary Employees

Fees paid to employment agencies for temporary personnel provided to the insured policyholder are included.

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## Drivers of Automobiles and Their Helpers

The payroll of drivers and their helpers should not be included when developing payroll for classifications such as 99793 Truckers and 95233 Garbage, Ash or Refuse Collecting. The payroll of such employees is an exposure normally provided by an automobile insurance policy. Do not confuse drivers of automobiles and their helpers with that of mobile equipment operators and their helpers. Mobile equipment operators are included in the premium charge. See Mobile Equipment Operators on page 21.

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## Subcontractor Information

As defined previously, a subcontractor is an individual or business contracted to perform all or a portion of a job undertaken by the insured policyholder. There are two kinds of subcontractors:

- **Uninsured Subcontractors** – A subcontractor without insurance is charged based upon the type of work performed. Generally, uninsured subcontractors are charged at total cost, unless their records clearly show a separation of labor and materials. When separated, the material cost is excluded and the amount of labor is charged. Once proof of insurance is provided, the total cost of material and labor is included in the insured policyholder sub code.
- **Insured Subcontractors** – An insured subcontractor will provide a valid certificate of liability insurance covering the audit period. This allows the auditor to include the total cost paid to the subcontractor in the applicable insured contractor classification. Coverage protects the insured policyholder from vicarious liability arising from torts, negligent hiring of incompetent subcontractors, or when the subcontractor does not have adequate coverage limits.

# Certificates of Liability Insurance

As the insured policyholder, you will need to provide these certificates as proof that subcontractors have their own liability insurance coverage. You may need certificates for two different years to cover the entire audit period. Frankenmuth Insurance advises you to obtain these certificates prior to work being performed, as it can be difficult to obtain these certificates once work by the subcontractor has been completed.

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# Mobile Equipment Operators

The payroll of mobile equipment operators and their helpers, regardless of designation or licensure to operate automobiles, is included in premium calculations. If the operators and their helpers are provided to the insured policyholder, along with the equipment hired under contract and their actual payroll is not known, one-third of the total amount paid out by the insured policyholder for the hire of the equipment will be used.

# Special Rules of General Liability

To help our customers better understand general liability, we have listed and described some of the most common rules below.

**Intra-Company vs. Inter-Company Sales** – Sales made between several locations within one company/corporation/legal entity are called intra-company sales. For example, Business A may sell productions to Business B or vice versa. There is no exposure to the public, and as a result, no charge is made on the audit.

Inter-Company Sales occur between more than one company/corporation/legal entity. For example, the named insured policyholder could be BOTH Business A and Business B. These businesses are separate legal entities that can sell products and services to each other, and that may sue each other despite being on the same policy. Therefore, the premium charge is based on all sales generated by each named insured policyholder, including the intercompany transactions. If the policy is written with form [CG-2141 – Exclusion – Intercompany Products Suits](#), the portion of the gross sales representing the intercompany transactions should be excluded from the products' premium base. The premises/operations base is not affected by this endorsement.

**Mercantile Risks** – Mercantile risks follow a special classification inclusion in which installation, servicing or repair of merchandise sold or distributed by the risk company shall not be separately classified and rated. It does not matter if the installation work is done by employees, adequately insured policyholder subcontractors or inadequately insured policyholder subcontractors. Unless the classification specifically states installation is to be separately rated, the special inclusion rule should be applied.

**Manufacturing Risks** – Manufacturing risks follow a special classification inclusion in which installation, servicing, or repair of the named insured policyholder's products shall not be separately classified and rated. It does not matter if the installation work is done by employees, adequately insured subcontractors or inadequately insured subcontractors. Unless the classification specifically states installation is to be separately rated, the special inclusion rule should be applied.

# Frequently Asked Questions

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## When can Independent Contractor Statement (ICS) forms be used?

ICS forms are used only by sole proprietors with no employees. The form helps the auditor to determine independent contractor status for workers' compensation purposes and is not applicable for general liability audits. All subcontractors must have general liability coverage to be listed as an insured subcontractor on the audit.

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## Why am I being charged for a subcontractor when they have sent in an ICS?

There can be many reasons for this charge, among them:

- The form may be old. Information provided on the form should be current and must apply to the audit term.
- The entity may not be a sole proprietor.
- The subcontractor may have hired additional help.
- Clients may not be listed or phone numbers may not be provided.
- The certificate of insurance may show a different entity than the sole proprietor indicated on the form.
- The ICS form may not be complete (e.g., signature, date, etc.).
- If the audit is a general liability audit, the ICS form is not applicable. All subcontractors must have general liability coverage to be listed as an insured subcontractor on the audit.
- Independent contractor status may be incorrect. The method of payment (1099 vs. W-2) alone does not determine independent contractor status. An independent contractor must operate a business offering services to the public or other businesses, and must not be dependent on one client alone for income. A subcontractor working only for the insured policyholder is considered a statutory employee.



## All the subcontractors are insured. Why is their exposure charged on the general liability audit?

Although the subcontractor provides his/her own general liability insurance, the insured subcontractor classification is additional coverage made available to the insured on a commercial policy. It protects the insured policyholder from “vicarious liability,” which may arise out of acts performed by the subcontractor such as the following:

- Torts committed by the subcontractor
  - Negligent hiring of incompetent subcontractors
  - Subcontractors that do not have adequate coverage limits
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## Why is the Premium Audit Notice showing estimated premium when the estimated exposure is zero?

We realize this can be confusing. However, typically, this is the result of a policy with a midterm change. If the estimated exposure for a classification is reduced to zero midterm, the premium notice will show zero estimated exposure. The estimated premium will be the actual amount collected for that classification while it was in place on the policy with exposure. Midterm changes are prorated for the time they are effective.

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## What is the change in premium for the revision? The Premium Audit Notice is confusing.

The Premium Audit Notice for a revision shows the additional or returned premium from the original estimated premium, not from the prior audit notice. The figures are always calculated against the original estimates from the policy.

## My employee is clerical. Why is he or she not classified as clerical?

Clerical duties exclude any worker exposed to the operative hazards of the business. Clerical employees must be exclusively engaged in bookkeeping, record-keeping, correspondence, or other office work where books and other records are kept and such business is conducted. This classification applies only to employees who work in areas physically separated from other operations by structural partitions and in which only clerically defined employees work. If such an employee has any other duty, the total payroll of that employee shall be assigned to the highest-rated classification of operations to which the employee is exposed.

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## My employees perform duties that may fall within more than one class code. The auditor was provided a percentage split of their payroll. Why didn't the auditor split the payroll of the employees between the applicable classifications?

The insured policyholder's records should provide a breakdown of wages per classification/duties to split payroll between codes. However, per ISO rules, payroll cannot be split between applicable classifications based on a percentage breakdown. If the insured's policy records do not show a breakdown in wages per the classification/duties performed during the policy period, then the exposure must go to the highest-rated classification to which the employee has exposure.

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## Some employees perform interior carpentry only. Why were they included with the rough carpentry exposure in code 91340 instead of interior carpentry code 91341?

Per ISO rules, class 91341 does not apply to contractors engaged in any other carpentry operations at the same job or location. Though the insured policyholder may keep a breakdown in his or her records, Frankenmuth Insurance auditors must place all the carpentry exposure in 91340.

## We hired a subcontractor who has no employees but is a corporation. Can an ICS be used to remove the cost of the subcontractor from the audit?

No. A corporate officer is considered an employee of a corporation. All employers regularly employing one or more employees must carry workers' compensation coverage. Please note individual state rules vary regarding who is required to carry and is covered by the Workers' Compensation Act of that state.

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## Why can't I exclude my family members from workers' compensation?

The treatment of family members will differ depending on the entity status of the insured policyholder (i.e., Partnership, LLC or Corporation) and the state in which the business operates. Seek additional information from your insurance agent or contact our Premium Audit Department for state-specific rules.