

## PAYROLL AUDITING

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Payroll auditing by salaried employees was inaugurated about twenty-five years ago and was not accepted without protest from both policyholders and agents. In some instances the auditor was looked upon with suspicion until it was evident the premium would not be inflated by inclusion of payrolls to which we were not lawfully entitled. Time passed, and where the auditor was once coolly tolerated he is generally welcomed today. This change of attitude is the result of wholesome respect and admiration for the auditor's knowledge of the coverage each policy affords, and his familiarity with bureau and manual rules which permits the correct classifying of whatever operations may be undertaken.

Auditing is the examination and authentication of accounts so necessarily the work can only be intrusted to experienced accountants if justice is to be done both insurer and insured. Therefore, only experienced accountants are employed who undergo an intensive insurance course in our training school, where a study is made of the various insurance contracts, manual rules, classifications and their interpretation. After leaving the school, further training of a practical nature is received by accompanying a veteran payroll auditor until such time as is possible to intelligently and correctly adjust the premium of the average risk without danger of either undercharge or overcharge.

It is not expected that anyone can be acquainted with the many operations in every line of business, resulting in a few of our auditors specializing. This is particularly true in the larger cities where these specialists devote their entire time to certain industries, such as stevedoring, vessel and maritime work; the building trades; subway construction; and certain complicated manufacturing risks.

The training of men is of the utmost and vital importance to your work, and, while it is said that "figures cannot lie", rates

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surely may become distorted and not reflect the proper exposure if payrolls are not properly segregated and classified.

The importance of payroll auditing is being recognized more and more each year. The responsibilities greatly increase. Judgment and initiative are important factors, but there are certain fundamentals adhered to which assist us to establish the total amount of premium earned.

We insist upon verification of wage expenditure shown in all books of original entry whenever supporting records are maintained. It is essential to every business that some sort of a record be kept disclosing the amount of wages paid, not solely for insurance purposes, but primarily for the benefit of the owner or owners. The majority of concerns also have records such as check stubs, canceled checks, cash book, ledger, a copy of their income tax report or other special records which fit the needs of their particular type of work or business.

The average mercantile or manufacturing adjustment results in few complications as the records are usually satisfactory and it is infrequent when such risks have numerous operating classifications to cause concern in the distribution of payrolls.

Contracting risks present more problems than all the other groups combined, and I refer particularly to the general contractor engaged in construction operations. Fortunately the larger ones through necessity must keep an elaborate set of records which not only show the amount of payroll expended but also disclose the wage cost for the various operations and jobs undertaken. Furthermore, documentary proof, such as contracts with those for whom the work is performed, is generally available, which permits checking to determine if all payrolls were obtained and properly classified.

Of course, there are many risks that have no records of any description, especially where the business is owned and operated by an individual. Partnerships and corporations are not exceptions but generally they maintain some record, as an accounting is expected when more than one person has money invested in an enterprise. There is little to worry about if the nature of the business is either mercantile or manufacturing, as ordinarily the payroll will not fluctuate to any great extent and it is simple to count the employees and determine their remuneration. With contractors the situation becomes more complicated and many

times the premium adjustment is anything but satisfactory. Inspection reports and claim files play an important part in such cases. If it is possible to make an estimate of the payroll expenditure of the completed work, an inspection is made for that purpose for comparison with the verbal statement of payrolls given.

The information and data obtained by our Inspection and Engineering Division is of much value to our work. That division furnishes the auditors with copies of inspection reports of all contracting risks which indicate the locations or addresses of work under construction, the number of employees engaged on each project and the operations to which they are assigned. Copies of schedule rating reports are carefully reviewed at time of audit, which greatly eliminates the possibility of misclassification or failure to overlook payroll of certain departments or subdivisions. We are constantly being furnished with information by our inspectors to be on the alert for certain payrolls, which has resulted in the collection of considerable premium which might otherwise have been missed.

Our Claim Division furnishes us with a copy of each accident report which gives the injured's name; when, how and where the accident occurred, and any other facts that are of interest. Whenever an accident is assigned to a classification which is not shown in the policy, we are immediately advised by separate memorandum and results many times in a tentative audit to determine the volume of payroll being expended for that classification. We are also informed of any accidents suffered by sub-contractors' employees and in such cases we likewise make tentative audits to satisfy ourselves these payrolls will be available for premium charge at expiration of policy.

Our credit unit also plays an important part in assisting us to salvage considerable premium which otherwise might be lost. We are informed of risks that are not healthy financially, and here too a tentative audit is made to learn if the advance premium is adequate. These risks are audited as soon after expiration as possible to facilitate premium collection. These special credit reports disclose the annual volume of business, so by analyzing them it is possible to gauge the adequacy of the payrolls obtained at time of audit.

Intelligent and sympathetic underwriting saves our division

many dollars and conserves much of the auditors' time. For example, if an address of a risk is incorrect, a fruitless call is made, resulting in waste time—and waste time means waste dollars. If the operations are incorrectly classified, the burden falls on the auditor to properly classify the risk, which also takes time, and if the rates to be used are greater than those shown in the policy, dissatisfaction arises and frequently results in loss of profitable business, but such occurrences must be expected as the average agent who submits an application is not an underwriter. If the locations for which insurance is provided are not fully disclosed, there is a possibility of overlooking payroll and that means loss of premium. While we benefit greatly from the cooperation rendered by the Underwriting Division, they too profit by information gleaned by the auditors. Whenever a renewal policy is issued, the underwriter reviews the previous premium adjustment report to determine the active classifications and the earned premium, a similar amount which ordinarily can be used as the advance premium for the renewal policy. When it is learned at time of audit that a change of ownership has occurred, the underwriters are automatically advised so current insurance may be endorsed. The same procedure applies when additional classifications or a change in classification results from the facts obtained at time of adjustment. If the earned premium developed is considerably in excess of the advance, this information also is relayed to the Underwriting Division, which results in an increase in the advance premium under the current policy. The Service Divisions are believers in disseminating all information that may help another, and by closest cooperation many thousands of dollars of premium have been collected without strenuous effort.

Experience has taught us that certain lines of business should not be insured until an audit investigation is made to determine if satisfactory records are kept which will assure us of receiving all premium to which we may be entitled. Several hundred such audit investigations are made each year and result in the company rejecting many applications as undesirable business.

There are several inspector-auditors assigned to the New York City payroll audit unit whose duties are to observe new buildings under construction and report the names of all contractors working on such buildings when insured by us. They also make

estimates of work undertaken by those who have not kept a record of payroll expenditure, and investigate policyholders who we believe are manipulating payrolls to defraud us of premium.

It is not infrequent to find a policyholder who is dishonest, and unfortunately some are inclined to distort facts so the auditors will apply certain payrolls to lower-rated classifications, which rate these payrolls are not privileged to enjoy. It is almost an every-day occurrence for an auditor to be offered a bribe to fix his report so that it will greatly reduce, if not entirely wipe out, the additional premium. An hour would not be sufficient time to acquaint you with the methods pursued to defraud us of premium—however, the most frequently used methods are to maintain more than one set of books or manipulate one set by making false entries to confuse the auditor. It is not unusual to find a risk where three sets of books are kept, one for insurance companies, another for the government and a third for the assureds themselves. The keeping of fraudulent records is not prevalent in any particular line of business, as someone in practically every line of endeavor has been caught at one time or another withholding his true payroll expenditure. Many give us the excuse that it is necessary to meet competition; others offer no reason, as their reputation is not worth the few dollars they expect to gain. After being caught, some break down and weep while others are as indifferent as a frog on a rainy night.

For the preceding nine months of this year, we have unearthed about 150 policyholders who attempted to defraud us of approximately \$150,000 in premium, an average of \$1,000 per risk. It would appear from these figures that only the larger risk is engaged in this nefarious work, which is not the fact, as many of the 150 cases were of the small risk or small premium type, which has taught us to be as painstaking in auditing a small risk as a large one, and frequently what appears to be a small risk develops into one of fairly good size by reason of audit. Small risks can be divided into two classes—first, those with an advance premium in excess of the minimum premium, which we audit each year even though the risk has been carried for many years. The second class are those whose advance premium is the same as the minimum premium and, if this group discloses any construction or manufacturing classifications, we always make an audit each

year. Store risks are treated as follows: An audit is always made at expiration of the first year's policy and, if the actual earned premium is less than the minimum premium, we may forego subsequent audits, but before definitely passing a risk for any year of its cover without an audit, all home office records are scrutinized and the auditor is given a list of such cases with instructions to check our decision by reviewing the branch office proposal, as such review will give him an opportunity to observe coverage, premium involved and location of risk, and, if there are any cases where in his opinion an adjustment should be made, he proceeds to do so. When in doubt as to the advisability of audit, the case is discussed with the agent or broker, thereby using every precaution to avoid passing as "no adjustment" any case which would deprive the company of additional premium.

Ordinarily, the auditor is the last man to call on the policyholder, and the information he obtains regarding the risk is very valuable. A properly trained auditor can assume a great deal of responsibility and, if you are not permitting your auditors to assume the responsibility which is rightfully theirs, you are smothering the initiative of a very important service division of your organization.