



Pennsylvania Compensation Rating Bureau

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PENNSYLVANIA TEST AUDIT PROGRAM **BULLETIN # 91**

TEST AUDIT APPEAL DECISION

Per Bureau Circular No. 1479, the results of an insurance carrier appeal to the Audit Committee are presented to the membership for their information.

The carrier was appealing a test audit difference related to the insured for the policy period of December 3, 2002 to December 3, 2003. The insured operated an establishment serving prepared foods and alcoholic beverages by the drink with a seating capacity of over 200 patrons. The facility consisted of a downstairs bar and patio with the main dining room on the second floor, complete with a separate bar area. The insured also featured a disc jockey on weekends. During the test audit interview, the insured stated that the sale of alcoholic beverages by the drink represented 60 percent of its overall sales, with the sale of prepared food accounting for the remaining 40 percent of overall sales. Based on this information, the Bureau notified the carrier that the test audit had developed information leading to the authorization of Code 899, Bar or Tavern, and the deletion of Code 975, Restaurants, N.O.C.

The carrier responded to the test audit difference, stating that their auditor had reviewed the duties of each employee and then based their classification assignment on the information about such job duties as provided by their audit contact, the corporate president. The carrier had also questioned the audit contact regarding the basic classification for the business, since the trade name of the business was a "tavern." The carrier auditor had explained to the contact that, if 50 percent or more of the total revenue were derived from the sale of alcohol by the drink, then Code 899 would apply. The contact had responded by asserting that the receipts for alcoholic beverages were more than 50 percent of the total sales. Reportedly, because the carrier was not also provided with a more specific and accurate breakdown of revenue by source, the carrier auditor had not pursued a classification change.

Bureau staff had responded to the carrier's dispute of the test audit difference by advising the carrier that the test audit would not be revised because it appeared that the carrier's documentation was consistent with the finding that the insured was improperly classified. Bureau staff also explained in that regard that, while verification of specific and detailed sales figures was preferable, such measures were not mandatory in order to invoke a classification change. As a further accommodation to the carrier, Bureau staff had contacted the insured and requested the total sales figures for Calendar Year 2003. The insured's bookkeeper had provided those sales figures in writing as requested, and the information thus submitted was consistent with the test audit decision to revise the insured's classification to Code 899.

This information was subsequently provided to the carrier, and the carrier was advised the test audit difference would stand as presented. The sales figures most recently provided contained the following percentage breakdown:

- Food 45 percent of sales
- Liquor 55 percent of sales

A representative from the carrier and the independent auditing firm that had completed the original audit attended the Audit Committee meeting to present the carrier's appeal. During their presentation, the appellants focused on two areas:

- The verification of sales figures attempted or accomplished by each party
- The classification procedure generally applicable to businesses similar in operation to the risk in question

The carrier representative noted there had been various interim changes to the substance and presentation of sales figures by the insured, starting with a verbal representation that 60 percent of sales were attributable to alcohol and 40 percent were attributable to food, with that description later being revised to 55 percent of sales being from alcohol and 45 percent from food upon the Bureau's follow-up inquiry. The carrier representative questioned whether the insured may have developed these percentages in order to justify and retain assignment of the lower-rated classification of Code 899. The carrier representative went on to describe the insured as a "high-end, white tablecloth restaurant" and provided the Committee with an employee breakdown, noting that a majority of employees worked in the food preparation and serving areas of the operation. The carrier representative asserted that the proper classification of this type of operation should be determined by focusing on the number of employees engaged in food preparation versus the number of employees engaged in the serving of alcoholic beverages. Bureau staff pointed out that, even though it appeared that the majority of employees are involved in various aspects of the food service operation; most employees would presumably support both the food and beverage operation. Examples offered in this respect included wait staff taking and delivering beverage orders, cashiers processing payments and dishwashers handling service items related to both food and beverage products.

The carrier representatives stated that, since the criteria for classifying this type of operation is currently based on sales, it should be mandatory to have revenue figures that would serve as a basis for changing classifications verified by doing a sales audit. After a short discussion, it was determined that conducting sales audits was generally not practical nor necessary, given that workers compensation audits are based predominantly on payrolls, and the insured will not normally have sales records available as part of the workers compensation audit process.

The carrier representatives questioned Bureau staff about the origins of Code 899. It was explained by staff that Code 899, as approved by the Pennsylvania Insurance Department, had been authorized after the Bureau conducted a comprehensive study of Pennsylvania restaurants. That study had included restaurants serving alcohol, as well as those with no alcohol sales. It was also noted by staff that the matter at-hand was the first appeal involving Code 899 and its assignment criteria since the classification was established.

In executive session, the Committee reviewed the facts presented. After some discussion relative to the verification process for confirming the business percentage breakdowns between

alcohol sales versus food/meal sales, it was concluded that the Pennsylvania Manual was unequivocal regarding the methodology for the classification of these types of businesses. Specifically, the Manual clearly states that retail establishments principally engaged in the sale of alcoholic beverages by the drink are assignable to Code 899 (where "principally engaged" means more than 50 percent of the establishment's gross receipts). The insured's business percentage breakdown of 55 percent alcohol sales and 45 percent food sales could lead to no other conclusion than the assignment of Code 899.

After some further discussion, upon motion made and duly seconded, the Audit Committee voted to sustain the Bureau's test audit and deny the carrier's appeal.