



Pennsylvania Compensation Rating Bureau

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June 27, 2007

BUREAU CIRCULAR NO. 1531

To All Members of the Bureau:

Re: **TEST AUDIT PROGRAM - EFFECTIVE MAY 1, 1982 - REVISED OCTOBER 1, 2007**
(LEGISLATIVE STYLE REVISION)

By virtue of a series of actions by the Bureau's Audit Committee, the Test Audit Program has been revised in several respects. The remainder of this circular is a complete presentation of the revised Test Audit Program effective October 1, 2007 printed in "legislative style" to highlight changes from the previous program. Generally, new language is underlined, while deleted language is shown with strikethroughs. An exception to this convention applies to section titles, which are bolded and underlined in both the previous and newly-approved programs for purposes of editorial distinction and clarity but have not changed with the most recent program revisions.

A companion Bureau circular, No. 1532, presents the complete text of the revised Test Audit Program effective October 1, 2007 without highlighting the changes in legislative style.

TEST AUDIT PROGRAM – EFFECTIVE OCTOBER 1, 2007

I: PURPOSE

The purposes of the Test Audit Program are as follow:

- A. To monitor the accuracy and consistency of the Bureau's member carriers' premium audits, verifying that the classifications (including governing classifications, standard exceptions and classification of individuals, partners and officers), rating values, experience modifications and related rules applied on audit are correct.
- B. To assure that statistical data reported to the Bureau is consistent with the business operations of insured risks and all provisions of the Manual of Rules, Classifications and Rating Values.
- C. To serve as an educational resource for member carriers in matters related to the discipline of premium audit.
- D. To establish quantitative standards of performance for auditing and reporting of data to the Bureau.
- E. To maintain incentives for member carriers to meet or exceed established quantitative performance standards.

II: RISK SELECTION FOR TEST AUDIT PROGRAM

The Test Audit Program is administered and applied on a carrier group basis. The term “carrier” as used throughout the Test Audit Program means “carrier group.”

All carriers participating in the Test Audit Program will have risks selected for test audits on a monthly basis. The criteria for these selections are set forth below:

- A. Policies selected will be subject to a minimum annual policy premium of \$2,500. This premium will be determined for selection purposes from the most recent available unit report on file with the Bureau for the risks being selected for test audit.
- B. Selections will include but not be limited to physical, voluntary (including telephone) and waived (estimated) audits.
- C. Each month policies will be selected for test audit purposes based on the following chart. ~~Policies selected shall have inception dates falling in the calendar month ending two months prior to the current month.~~

Test Audit Selection Date	Policy Expiration Dates	Carrier Notice Date	Test Audit Selection Date	Policy Expiration Dates	Carrier Notice Date
Jan 1	Oct 1 - 31	Feb 1	Jul 1	Apr 1 - 30	Aug 1
Feb 1	Nov 1 – 30	Mar 1	Aug 1	May 1 - 31	Sep 1
Mar 1	Dec 1 - 31	Apr 1	Sep 1	Jun 1 - 30	Oct 1
Apr 1	Jan 1 - 30	May 1	Oct 1	Jul 1 - 31	Nov 1
May 1	Feb 1 – 28	Jun 1	Nov 1	Aug 1 - 31	Dec 1
Jun 1	Mar 1 - 31	Jul 1	Dec 1	Sep 1 - 30	Jan 1

- D. As the State of Delaware has insufficient data to support an independent Test Audit Program, Delaware risks will be included in the selection and processing under the Pennsylvania Test Audit Program.
- E. No risk in which a test audit has been completed will be test audited as a part of the random selection and/or incentive programs more than once in any five-year period.
- F. The number of risks selected for each participating carrier shall not exceed 16 policies per month and will be determined based on two factors as set forth below:
 - 1. Annual premium volume as indicated for the latest available calendar year reporting to the Bureau
 - 2. Number of policies as indicated on the latest available risk data base policy report by carrier from the Bureau

The contributions of each of these criteria to the total risk selection by month are shown in Exhibit I attached. Requests to increase or decrease the number of risks selected, separate from the specified criteria indicated above, will not be honored.

III: DISPOSITION OF TEST AUDITS

- A. The Bureau will provide notice to the carrier in writing of the disposition of each policy selected for test audit as follows:

1. In those instances where a test audit was not performed and the selection was rescinded, the Bureau will so advise the carrier and will provide the reason(s) for rescinding the audit.
 2. For test audits which do not develop a reportable difference as defined under Section VI, Test Audit Standards, the carrier contact will be notified of the name of the insured, the policy number and the fact that the test audit was closed without change from the original audit.
 3. For test audits which do develop a reportable difference as defined under Section VI, Test Audit Standards, the carrier contact will be notified that a reportable difference has been found. Such notice will be accompanied by copies of the Bureau's test audit workpapers, an explanation of the source(s) for the difference, a difference response form and the effect of such difference on premium for the risk.
- B. Reportable differences will be considered confirmed if the carrier provides written agreement with the difference to the Bureau in response to receipt of the notice of difference or if any of the following events occur:
1. The carrier fails to respond to the notice of difference, either within the time frames set forth in Sections IV: F. and IV: I. or within an extension of time established in accordance with Section IV: G.
 2. The carrier does not file a timely appeal to the Audit Committee of a reportable difference subsequent to the Bureau affirming the test audit as a difference in reply to a carrier's response contesting the difference.
 3. The Audit Committee renders a decision sustaining the test audit as a reportable difference that is not further appealed on a timely basis by the carrier to the Classification & Rating Committee or the Governing Board.
 4. The Classification & Rating Committee or the Governing Board renders a decision sustaining the test audit as a reportable difference upon appeal from a decision of the Audit Committee

After confirmation as defined above, each reportable difference will be subject to the following final disposition:

1. Return Premiums

If results of the test audit produce a return premium to the risk, the carrier is required to:

- a. Prepare a revised premium adjustment statement returning the appropriate premiums to the risk.
- b. Prepare a revised unit statistical report reflecting the results of the test audit and forward that unit statistical report to the Bureau within 60 days [or the normal due date of the original unit, whichever is later](#). Failure to submit the required correction report within the specified time frame will result in the inclusion of the file in the Bureau's Statistical Plan Fine Program.

2. Additional Premiums

If results of the test audit produce an additional premium, the carrier:

- a. ~~May not~~ is not permitted to bill the additional premium on the test audited policy. For the outstanding policy, changes in authorized classifications shall be deferred until the next renewal, effective at least 60 days after notice has been given to the employer. Issues of allocation or adequacy of payrolls between or within authorized classifications for the outstanding policy shall be governed by applicable Manual rules.
- b. Will not be required to prepare a revised statistical report reflecting the results of the test audit. The correction of statistical data relative to test audits resulting in additional premium will be internally processed by Bureau staff.

3. Classification Changes

If a test audit results in a classification change which is being postponed due to adverse premium impact, the carrier will still be cited for a difference on that test audit if the magnitude of the change would qualify as a reportable difference but for such postponement.

C. Revised Unit Statistical Reports for Test Audits Not Producing Reportable Differences

If a claim or claims have been discovered by test audit to have been misclassified or if, in the sole opinion of the Bureau, a significant amount of payroll should be reclassified to conform to a test audit, even though the resulting premium difference does not exceed reportable standards under the Test Audit Program, the carrier will be required to prepare a revised unit statistical report reflecting the results of the test audit and submit that unit statistical report to the Bureau.

IV: PROCEDURES FOR EXCHANGE OF INFORMATION ON TEST AUDITED RISKS

It is imperative for the effective operation of the Test Audit Program that the Bureau and participating carriers recognize and adhere to established time frames and procedures for communication. The following procedure will apply:

- A. Each carrier shall designate one individual to serve as their contact for the Bureau for purposes of the Test Audit Program and one or two individual(s) to whom quarterly statistical reports for the Test Audit Program are to be directed. These contacts may be the same or different person at the option of the carrier. These designations shall be delivered in writing on an annual basis (including e-mail address) and must be revised by the carrier in writing in a timely manner upon any changes desired for purposes of ongoing communication and correspondence.
- B. All correspondence to the Bureau pertaining to the Test Audit Program must be directed to the following address:

ATTENTION: Test Audit Reviewer
Field Operations Department
Pennsylvania Compensation Rating Bureau
~~The Widener Building – 6th Floor~~ United Plaza Building – Suite 1500
~~One South Penn Square~~ 30 South 17th Street
Philadelphia, PA 19107-3577 3-4007

The Bureau cannot guarantee and will not be responsible for the routing, handling of and timeliness of responses to any test audit correspondence not so addressed. In the event that correspondence pertaining to the Test Audit Program is to be directed to the attention of any individual member of the Bureau staff, their name shall be shown as an additional line at the top of the above address.

- C. Each month a listing of risks selected for test audit will be sent by the Bureau to the designated contact at each participating carrier. This listing will include the carrier name, name insured, policy number and policy dates for each selected risk.
- D. Within 45 days from the date of mailing of any month's selection list, the following audit materials must be received by the Bureau from the carrier. A second request will be sent after 45 days on items not received. No additional requests will be sent.
 - 1. For each risk physically audited by the carrier a non-returnable copy of the auditor's original worksheets, premium invoice, copy of any classification change request and all other pertinent information which the carrier wishes to present to the Bureau with respect to the selected risks must be included. The carrier must also include the type of audit completed for each test audit selection. The types of audits include: carrier physical (CP), independent physical (IP), voluntary (V) and estimated/waived (E or W). Failure to provide this information will result in the Bureau assigning the type of audit based on its best judgment. Once assigned, the Bureau can not revise audit type assignments when this information is not initially provided by the carrier.

The Bureau requires original carrier audits for test audit comparison purposes and does not accept revised audits initiated after the test audit notification date. Absent this policy, some carrier procedures could apply uniquely and selectively to policies/audits selected for test audit. Such circumstances would be contrary to the purposes of the Test Audit Program, i.e., the Test Audit Program operates on the premise that the policies/audits selected at random will be representative of a carrier's normal processing procedures, thus providing an unbiased sample of the quality of each carrier's collective data reported to the Bureau for statistical purposes. Allowing revisitation and possible revision of policies/audits after those policies/audits were known to have been selected as test audits would invalidate this key assumption of the program. The Test Audit Program assumes that, by the time a test audit selection list is provided to the carrier, the auditing (including review) and billing processes for those policies will have been completed. While any review and analysis done in the normal course of business prior to the notification of test audit selection is obviously appropriate and acceptable, any review and/or "re-working" of audits or the changing of a self-audit to a physical audit after a policy has been designated as a test audit selection is clearly problematic. In the absence of specific written documentation that a revised audit was precipitated by factors and events independent of the test audit designation and preceding the test audit notification date, the Bureau will not accept revised audits for test audit comparison purposes.

- 2. For each risk not physically audited by the carrier, a non-returnable copy of the employer's payroll statement, premium invoice and all other pertinent information which the carrier wishes to present to the Bureau with respect to the selected risks must be included.
- 3. A current loss run/list for the same policy period of the test audit must be provided. This list must include the claim number, date of claim, claimant's name, incurred loss amount and classification assigned for each claim. In the event there are no reported losses, the carrier must so advise the Bureau in writing.

Failure to provide the above cited information will result in the Bureau's use of the unit statistical report for purposes of comparison to the Bureau's test audit. Reportable difference found on risks for which the requested data is not timely received in the Bureau and for which unit statistical data is used for purposes of comparison to the Bureau's test audit as a result will be automatically included as differences on the carrier's quarterly reports, and those quarterly results shall not be subject to revision based on subsequent review by the Bureau or decisions on appeal to the Audit Committee, Classification & Rating Committee and/or Governing Board. However, carrier responses to differences based on unit statistical reports will be required and will be considered by the Bureau in determining appropriate disposition of those test audits under Section III of this program. If the Bureau does not receive the carrier worksheets and billing notice or the unit statistical report within 24 months of the effective date of the policy, the estimated unit statistical report will be used for comparison purposes

At the time a test audit is assigned and a first request for carrier audit worksheets and premium invoice is sent, the Bureau will establish a future date which will be designated as the "Final Response Date." This Final Response Date will be 30 days after the normal issuance of a second request for carrier documentation (see above) or 75 days after the original request.

For each calendar quarter the Bureau will establish the number of test audits for each carrier with Final Response Dates falling within that quarter. The Bureau will then determine how many of the test audits with Final Response Dates falling in the quarter did NOT have an acceptable response to the request(s) for carrier audit worksheets and premium invoice received by the Bureau as of their respective Final Response Dates.

NOTE: An acceptable response must provide a non-returnable copy of the auditor's worksheets and premium invoice (in the case of a physical audit) OR a non-returnable copy of the employer's payroll statement and premium invoice (in the case of a risk not physically audited) to the Bureau, as well as the applicable loss run OR the written acknowledgement that there were no losses.

Those test audits for which an acceptable response to the request(s) for carrier audit worksheets and premium invoice and loss run is not received by the Bureau on or before their respective Final Response Dates will be designated as "Failed Requests." ~~(EXCEPTION: Failure to submit loss runs as defined above OR the written acknowledgement that there were no losses will not be designated as a failed request until October 1, 2005.)~~ Incentive charges in the amount of \$1,000 will be assessed per Failed Request for each carrier, regardless of whether or not the carrier is otherwise subject to incentive charges under the performance standards of the Test Audit Program, subject to the following limitations:

- The first Failed Request recorded in each quarter shall not be subject to an incentive charge. This exclusion is provided in recognition of the possibility that an isolated problem in delivery not attributable to the carrier of record might otherwise cause an incentive charge.
- If a carrier has more than ten Final Response Dates in a given quarter, incentive charges shall apply only to those Failed Requests representing in excess of ten percent of the total number of Final Response Dates, rounded to the nearest whole number. This exclusion is provided in recognition of the possibility that isolated problems in delivery not attributable to the carrier of record might otherwise cause incentive charges.

The above limitations on incentive charges for Failed Requests are the sole and exclusive means by which such incentive charges will be adjusted for problems in delivery. Audits which have been rescinded prior to the final response date will not be subject to the incentive charge. However, audits rescinded for whatever reason after the final date established for receipt of an acceptable response by the carrier will be subject to the incentive charge.

- E. The Bureau must complete its test audit assignment within six months of policy expiration. Completion of the test audit assignment as used in this section shall not include the review and notice of results to the carrier. Any test audit not so completed shall be rescinded.
- F. The Bureau will give notice in writing to the carrier's designated contact of a reportable difference, identifying all known bases for such difference. Differences for the test audit to which such notice applies shall be limited to those bases identified in the Bureau's original notice. This notice will be accompanied by copies of the Bureau's test audit workpapers and will advise the carrier that a written response to the Bureau, either accepting the difference or setting forth all information which the carrier wishes the Bureau to consider towards making the audit compatible, must be received in the Bureau within 45 days of the date of the Bureau's notice of a difference. If such a response is not received, the test audit in question will become a reportable difference without further appeal rights for the carrier.
- G. A carrier may request a single extension of time for their response to any specific test audit difference. Such requests must be in writing and must be received by the Bureau not later than **45** days from the date of the Bureau's notice of a difference. The extension will establish a date **75** days from the date of the Bureau's notice of a difference by which the carrier's final response must be received by the Bureau.

This date will be binding on the carrier. If a response is not received in the Bureau by the specified date, the test audit in question will become a reportable difference without further appeal rights for the carrier.
- H. The Bureau will acknowledge receipt of all requests for extensions of time and responses to notice of test audit differences in writing to the carrier's designated contact. It is the responsibility of the carrier to notify the Bureau by telephone in any case where this acknowledgment is not received by the carrier within ten calendar days of the date of the carrier's response or request for extension. Failure to so notify the Bureau will forfeit the carrier's rights to an extension of time and/or further appeal of the difference on the test audit in question.
- I. In no event will results of test audits be entered into the carrier's quarterly test audit reports sooner than 55 days after the date of the Bureau's notice of a reportable difference in order to provide adequate time for correspondence between the Bureau and the carriers.
- J. The Bureau must reply to all responses from carriers which present information in support of the carrier's original audit within 55 days of receipt of the response. If the Bureau does not so respond, the test audit in question shall be considered as compatible for purposes of the Test Audit Incentive Program. In the event that a timely reply from the Bureau indicates that a reportable difference remains, the reply must include a copy of the Test Audit Program Appeals Procedure attached.
- K. A carrier aggrieved by a reportable difference remaining after the Bureau's reply may request an appeal before the Audit Committee. Requests for appeals must be submitted in conformance with applicable procedures published for the Test Audit Program.
- L. After the close of each calendar quarter, the Bureau will prepare and distribute a summary statistical report of the carrier's test audit results for the last quarter and the most recent available four consecutive quarters to the individual designated by each carrier to receive that information.

V: APPEALS PROCEDURES

The Test Audit Program will provide for carrier appeals of Bureau findings in qualifying cases as defined in and subject to the Appeals Procedures as set forth in Exhibit II attached.

VI: TEST AUDIT STANDARDS

The Test Audit Program recognizes performance standards applicable to individual test audits and to overall results for each participating carrier, as follows:

- A. **Reportable Difference:** A test audit which produces a difference in premium when compared to the carrier's audit for the risk and policy period in question shall be defined as a "reportable difference" if BOTH of the following two measures of the difference are met:
1. The difference in premiums is greater than \$500.
 2. The difference in premiums expressed as a percent of the carrier's earned premium is greater than 2.0 percent.
- B. **Program Standards:** If a carrier's reportable differences expressed as a percentage of total test audits completed is below 20.0 percent, the carrier will have met program standards. If the carrier's reportable differences expressed as a percentage of total test audits completed is 20.0 percent or higher, the carrier will have exceeded program standards.
- C. Carriers exceeding program standards for any four consecutive calendar quarters in the aggregate shall be subject to the payment of an incentive charge for that four-quarter period as set forth in Section VII.
- D. When factual differences arise between the carrier's audit and the Bureau's test audit, those facts supported by a preponderance of the available credible evidence shall be used for purposes of test audit. Signed statements from insureds pertaining to corporate officers' duties may be considered but shall not be determinative as to the duties or classification of those corporate officers. In the event that specific contradictory facts are equally supported by information in the carrier and the Bureau test audits, respectively, the Bureau shall either obtain additional credible information to resolve the discrepancy or shall accept the carrier's facts for purposes of the test audit.
- E. In cases where a carrier auditor identifies the need for a new classification(s) for a risk a written request from the carrier for authorization thereof must be received by the Bureau prior to the ~~review of the carrier audit and Bureau test audit by Field Operations staff~~ [notice to the carrier of test audit selection by the Bureau \(see Section II. C.\)](#). The carrier's request must be submitted to the Bureau's Classification Department. If such a request is not received prior to the ~~review of the carrier audit and Bureau test audit~~ [notice to the carrier of test audit selection by the Bureau](#), any difference attributable to the unauthorized classifications must be included in the Bureau's determination of any reportable difference on the policy in question.
- F. In cases where a carrier has been unable, after a minimum of three attempts, to gain access to the insured's records and has documented those efforts in its submission of information to the Bureau, any test audit completed by the Bureau will be processed on an information-only basis. The documentation must include the dates of the attempts, the name of the person contacted and whether the attempts were made by mail or telephone. If available, all supporting evidence must be submitted with the documentation, which may include but not be limited to copies of progress reports. Upon receipt and review of the documentation submitted, the test audit will be rescinded if the standards described herein have been met.

- G. For purposes of the Test Audit Program any test audit processed on an “information-only” basis shall not be entered into the carrier’s quarterly results regardless of whether findings of the test audit review would otherwise indicate a compatible audit or a reportable difference.
- H. Differences attributable to the following items shall not be included in the determination of reportable differences for the Test Audit Program:
 - 1. Extraterritoriality
 - 2. Independent contractors
 - 3. Owner-operators
 - 4. Claims history review
 - 5. Outworkers/homeworkers
 - 6. Credits or debits based on carrier values
 - 7. Volunteer Ambulance Corps. - stipends paid to members

Test audits found compatible but for differences attributable to the above Items 1 through 7 shall be completed by the Bureau, with the above items presented to the carrier on an information-only basis. Such test audits shall be counted as compatible for purposes of the Test Audit Incentive Program.

- I. Carriers with 25 or more test audits having less than 10.0 percent of their test-audited policies developing reportable differences as defined in Section VI, Test Audit Standards, for a period of four consecutive quarters in the aggregate may be excused (at the option of the carrier) from participation in the Test Audit Program for the ensuing four consecutive calendar quarters. [\(EXCEPTION: Carriers in the action plan review process may not opt out.\)](#) Those qualifying carriers who wish to exercise this option must do so within ten working days from the date on the letter notifying them of their quarterly results. The decision to withdraw must be confirmed in writing in the form of a letter mailed or faxed to the Bureau or a telephone call. E-mail confirmation is also acceptable. If notice is given by telephone call, such telephone call must be confirmed by a subsequent letter received by the Bureau not later than ten days after the date of the telephone call.
- J. [Test audits are completed using the pay date rather than the week-ending date because this method conforms to IRS standards and policy language. Carriers are allowed a 16-day variance from the policy period.](#)

VII: **INCENTIVE PROGRAM**

As a means of encouraging participating carriers to meet or exceed established standards, incentive charges will be assessed by the Bureau in accordance with the following procedures:

- A. Carriers having 25 or more test audits completed in any four consecutive calendar quarters and whose reportable difference percentage over those four consecutive calendar quarters in the aggregate exceeds program standards as defined in Section VI, Test Audit Standards, will be subject to payment of an incentive charge based on that four-quarter period.
- B. The amount of incentive charges required shall be a function of the difference percentage, the number of differences found for the carrier over each four consecutive calendar quarters in question, and the number of consecutive four-quarter periods in which a carrier has incurred difference percentages in excess of the minimum standard of less than 20.0 percent.

Base incentive charges will be assessed per difference in accordance with the following schedule:

Difference Percentage	Base Incentive Charge per Difference	Difference Percentage	Base Incentive Charge per Difference
Below 20.0	\$ 0	32.0 - 33.9	\$113
20.0 - 21.9	\$ 23	34.0 - 35.9	\$125
22.0 - 23.9	\$ 43	36.0 - 37.9	\$135
24.0 - 25.9	\$ 60	38.0 - 39.9	\$144
26.0 - 27.9	\$ 74	40.0 - 43.9	\$148
28.0 - 29.9	\$ 86	44.0 - 47.9	\$149
30.0 - 31.9	\$100	48.0 & Over	\$150

EXAMPLE: Assume the following carrier experience in the Test Audit Program over four successive quarters:

Quarter	1	2	3	4	Total
Number of Test Audits	12	16	11	13	52
Number of Differences	4	3	3	3	13

The carrier has more than 25 test audits done in the four-quarter period and so is subject to the incentive program. The difference ratio for the four quarters in total is $13/52 = 0.25$, in excess of the program standard which requires a difference ratio below 20.0 percent. From the table above the base incentive charge per difference at this level is \$60. The total number of differences is 13, so the base incentive charge applicable for this carrier based on these four quarters' experience is $\$60 \times 13 = \780 .

Carriers failing to meet the minimum standard of a below 20 percent difference ratio will be subject to a graded schedule of surcharges to otherwise applicable base incentive charges. The surcharge schedule is set forth below:

No. of Consecutive Four-Quarter Periods with Difference Ratios in Excess of Program Standards	Surcharge Factor	No. of Consecutive Four-Quarter Periods with Difference Ratios in Excess of Program Standards	Surcharge Factor
5	1.25	9	2.25
6	1.50	10	2.50
7	1.75	11	2.75
8	2.00	12 or more	3.00

If at any point a carrier meets or exceeds the four-quarter difference standard of less than 20 percent, the surcharge would become inoperative. Surcharges would not then be applied again unless and until the carrier fails to meet program standards for five subsequent consecutive four-quarter reporting periods.

EXAMPLE: To facilitate a basic understanding of this surcharge procedure, a static carrier experience of a 25 percent difference ratio in the Test Audit Program over 12 successive four-quarter reporting periods is illustrated. Such experience would invoke surcharges to basic incentive charges as shown:

Quarter	Four-Quarter Difference Ratio	Basic Charge Per Difference	Surcharge Factor	Total Charge Per Difference
2nd Q 2001	25%	\$60	N/A	\$ 60
3rd Q 2001	25%	\$60	N/A	\$ 60
4th Q 2001	25%	\$60	N/A	\$ 60
1st Q 2002	25%	\$60	N/A	\$ 60
2nd Q 2002	25%	\$60	1.25	\$ 75
3rd Q 2002	25%	\$60	1.50	\$ 90
4th Q 2002	25%	\$60	1.75	\$105
1st Q 2003	25%	\$60	2.00	\$120
2nd Q 2003	25%	\$60	2.25	\$135
3rd Q 2003	25%	\$60	2.50	\$150
4th Q 2003	25%	\$60	2.75	\$165
1st Q 2004	25%	\$60	3.00	\$180

EXAMPLE: The following is a more varied and, therefore, more realistic portrayal of a carrier's experience in the Test Audit Program over 12 successive four-quarter reporting periods. Illustrated below are the surcharges to basic incentive charges this carrier would have to pay given its experience as indicated:

Quarter	Four-Quarter Difference Ratio	Basic Charge Per Difference	Surcharge Factor	Total Charge Per Difference
2nd Q 2001	21.9%	\$ 23	N/A	\$ 23
3rd Q 2001	23.6%	\$ 43	N/A	\$ 43
4th Q 2001	28.1%	\$ 86	N/A	\$ 86
1st Q 2002	25.7%	\$ 60	N/A	\$ 60
2nd Q 2002	25.4%	\$ 60	1.25	\$ 75
3rd Q 2002	23.3%	\$ 43	1.50	\$ 64
4th Q 2002	20.3%	\$ 23	1.75	\$ 40
1st Q 2003	22.9%	\$ 43	2.00	\$ 86
2nd Q 2003	27.3%	\$ 74	2.25	\$166
3rd Q 2003	22.7%	\$ 43	2.50	\$107
4th Q 2003	30.2%	\$100	2.75	\$275
1st Q 2004	28.5%	\$ 86	3.00	\$258

VIII: ACTION PLANS

Any carrier that attains a difference ratio of 25 percent or above for a four consecutive quarter measurement period (minimum 25 audits) and a difference ratio of 20 percent or above for the most recent quarter will be required to submit an action plan, detailing in writing measures it will be taking to bring the carrier in compliance with the less than 20 percent difference standard of the Test Audit Program. This plan must include a comprehensive analysis of the problems the carrier understands to be the basis for its substandard test audit performance, as well as the specific steps the carrier will be taking to remedy these problems. In addition, to facilitate a mutual evaluation of progress towards compliance, the action plan must establish interim target difference ratios for each of four consecutive quarters

subsequent to the approval of the action plan by the Bureau, such that the Test Audit Program standard of a less than 20 percent difference ratio is reached not later than the last quarter of that period. The action plan must further state the intention that performance in compliance with the less than 20 percent difference standard of the Test Audit Program will be maintained over an additional period of four consecutive calendar quarters immediately following the period to which the carriers' interim target difference ratios will apply. The four consecutive quarters subsequent to the approval of a carrier action plan by the Bureau is considered the "first state" of the action plan review process. The four additional consecutive calendar quarters immediately following the first stage is considered the "second stage" of the action plan review process.

Bureau staff will review the action plan to ascertain the feasibility and appropriateness of the measures listed. Based on this review, Bureau staff will then consult with the Audit Committee, as necessary, to determine whether an appearance before the Committee by an officer of the carrier will be required, as authorized by Section VIII IX of the Pennsylvania Test Audit Program. Once a carrier is notified that an action plan is required, it will not be subject to subsequent requests for an action plan while the monitoring process takes place. Each quarter during the action plan measurement period the carrier will be notified as to the results of their performance, as compared to the targeted results contained in their action plan. ~~At the end of the four-quarter action plan measuring period, the carrier will be apprised of the final results of the action plan process.~~ Should the results for the first stage of the action plan review process fail to achieve the target level(s) specified in that plan, the carrier may be required to appear before the Audit Committee to report on the status of the action plan, discuss reasons for the failure to meet target performance levels and describe additional efforts to be applied in the continuing attempt to remedy the substandard test audit performance. However, in no case will a carrier be required to submit more than one action plan in any 12-month period of review.

If results for the first stage of the action plan review process achieve or are better than the target level(s) specified in the carrier's action plan, the carrier will continue to be notified as to the results of their performance through the second stage of the action plan review process. At the end of this second four-quarter action plan evaluation period the carrier will be apprised of the final results of the action plan process. Where those results achieve or exceed Test Audit Program standards, the carrier will not be subject to action plan qualification scrutiny for at least a period of four subsequent quarters, regardless of difference ratios arising during that period of time. Should the carrier fail to achieve or exceed Test Audit Program standards in the second stage as described above, the carrier may be required to appear before the Audit Committee to report on the status of their action plans, discuss reasons for the failure to sustain acceptable performance levels and describe additional efforts to be applied in the continuing attempt to remedy the occurrence of substandard test audit performance.

IX: CARRIER CONSULTATIONS WITH AUDIT COMMITTEE

- A. After the close of each calendar quarter, the Bureau will distribute to the Audit Committee detailed results by carrier for the most recent quarter and the four quarters to date. Upon specific request by the Audit Committee, the Bureau will also provide the Audit Committee with additional available information pertaining to the Test Audit Program.
- B. After review of reported results of the Test Audit Program, the Audit Committee may require any carrier(s) to appear individually before the Audit Committee to discuss the carrier's audit program, test audit results and work plans to improve future performance in the Test Audit Program. Such requests may not be made more frequently than once every nine months.
- C. If in the opinion of the Audit Committee a carrier is not demonstrating sufficient progress toward achieving compliance with Test Audit Program standards after two or more meetings with the Audit Committee as provided in Section B, the Audit Committee may request that the carrier be required to meet with the Bureau's Governing Board to discuss the status of the carrier's audit program and test audit results. Such requests from the Audit Committee shall be referred to the Governing Board for action as they may deem appropriate.

X: SPECIAL TEST AUDITS

- A. At the initiative of Bureau management selected risks may be test-audited by Bureau staff for purposes of information gathering and research or to resolve disputes between insureds and their carrier. Carriers are reminded that the Bureau will not provide these services in every case in which questions or complaints arise concerning classification assignment of individual employees. Such circumstances are relatively common, and it is incumbent on insurers to apply the classification plan and explain that application to their insureds. The great majority of insureds' concerns in this area should be resolvable without Bureau intervention.
- B. The results of all test audits specifically requested by Bureau management for purposes other than the random sampling of carrier audits done under the Test Audit Program shall not be included in any portions or aspects of the Test Audit Program, including specifically the quarterly results of participating carriers and the Incentive Program.

XI: CLAIMS HISTORY REVIEW

For each test audit assignment a current loss run/list for the same policy period must also be provided. This list must include the following information for each claim: claim number, date of claim, claimant's name, incurred loss amount and the classification being assigned. In the event that a policy selected for test audit assignment has no reported losses when the carrier responds to the Bureau's request for audit workpapers, the carrier must so advise the Bureau in writing. This information must be returned to the Bureau with the related audit information within 45 days of the mailing of the notice of selection for test audit.

XII: TEST AUDIT BULLETINS

The Bureau will utilize Test Audit Bulletins as a means of disseminating educational information regarding the Test Audit Program to its members. Subject matter to be published in Test Audit Bulletins includes the following:

- A. Summaries of test audit appeal cases heard before the Audit Committee. These summaries will present on an anonymous basis the facts and circumstances underlying each appeal, the decision of the Audit Committee and a synopsis of the Committee's reasoning in arriving at each decision.
- B. General descriptions of actual cases or questions encountered by Bureau staff which appear to be of interest and illustrate applications of various audit procedures or Manual rules.
- C. Communications from the Audit Committee to Bureau members as directed by the Audit Committee.
- D. Other items of an educational or informational nature pertaining to the Test Audit Program.

Any questions regarding the Bureau's Test Audit Program should be directed to the attention of Linda Isard or Vincent Dean at the following address and telephone number:

Pennsylvania Compensation Rating Bureau
Field Operations Department
~~Widener Building – 6th Floor~~ [United Plaza Building – Suite 1500](#)
~~One South Penn Square~~ [30 South 17th Street](#)
Philadelphia, PA 19107-3577 [3-4007](#)

(215) 568-2371 Extension 4496 or lisard@pcrb.com (Isard)
Extension 4490 or vdean@pcrb.com (Dean)

Timothy L. Wisecarver
President

kg
DCirc
Attachments

Remember to visit our web site at www.pcrb.com for more information about this and other topics.

BASIS FOR SELECTION OF RISKS

BY PREMIUM VOLUME WRITTEN BY CARRIER

<u>Volume of Premium</u>		<u>Number of Risks To Be Selected Monthly</u>
0	- 100,000	0
100,001	- 1,000,000	1
1,000,001	- 2,000,000	2
2,000,001	- 6,000,000	3
6,000,001	- 12,000,000	4
12,000,001	- 25,000,000	5
25,000,001	- 50,000,000	6
50,000,001	- and Over	8

BY NUMBER OF POLICIES WRITTEN BY CARRIER GROUP

<u>Volume of Policies</u>		<u>Number of Risks To Be Selected Monthly</u>
0	- 120	0
120	- 500	1
501	- 1,000	2
1,001	- 3,000	3
3,001	- 4,500	4
4,501	- 6,000	5
6,001	- 7,500	6
7,501	- and Over	8

The total number of risks to be selected for each carrier shall be determined both by premium volume and by number of policies.

Conditions may warrant a reduction in the number of test audits each month or a variation of this selection method. The Bureau will be responsible for ensuring that a representative number of test audits are conducted on all carriers throughout the year.

PENNSYLVANIA COMPENSATION RATING BUREAU
TEST AUDIT PROGRAM APPEALS PROCEDURE

1. When the Bureau finds a reportable difference on a test audit, the carrier will be notified in writing that such difference has been identified and the basis or bases for the difference. Differences for the test audit to which such notice applies shall be limited to those bases identified in the Bureau's original notice. This notice will be accompanied by copies of the Bureau's test audit workpapers and will advise the carrier that a written response to the Bureau, either accepting the difference or setting forth all information which the carrier wishes the Bureau to consider towards making the audit compatible, must be received in the Bureau within 45 days of the date of the Bureau's notice of a difference. If such a response is not received, the test audit in question will become a reportable difference without further appeal rights for the carrier.
2. A carrier may request a single extension of time for their response to any specific test audit difference. Such requests must be in writing, must be received by the Bureau not later than 45 days from the date of the Bureau's notice of a difference. The extension will establish a date 75 days from the date of the Bureau's notice of a difference by which the carrier's final response must be received by the Bureau. This date will be binding on the carrier. If a response is not received at the Bureau by the specified date, the test audit in question will become a reportable difference without further appeal rights for the carrier.
3. The Bureau will acknowledge receipt of all requests for extensions of time and responses to notice of test audit differences in writing to the carrier's designated contact. It is the responsibility of the carrier to notify the Bureau by telephone in any case where this acknowledgment is not received by the carrier within ten calendar days of the date of the carrier's response or request for extension. Failure to so notify the Bureau will forfeit the carrier's rights to an extension of time and/or further appeal of the difference on the test audit in question.
4. In no event will results of test audits be entered into the carrier's quarterly test audit reports sooner than 55 days after the date of the Bureau's notice of a difference in order to provide adequate time for correspondence between the Bureau and the carriers.
5. The Bureau must reply to all responses from carriers which present information in support of the carrier's original audit within 55 days of receipt of the response. If the Bureau does not so respond, the test audit in question shall be considered as compatible for purposes of the Test Audit Incentive Program. In the event that a timely reply from the Bureau indicates that a reportable difference remains, the reply must include a copy of the Test Audit Program Appeals Procedure attached.
6. If, after receipt of the Bureau's reply, a carrier is aggrieved by the Bureau's position, the carrier may request an appeal of the difference before the Audit Committee. This request must be in writing, must be received in the Bureau within 30 days of the date on the Bureau's reply correspondence and must clearly state all bases for the appeal. Results of test audits on which timely appeals are made will not be entered into the carrier's quarterly test audit reports until the appeal is decided.
7. Test audit appeals will be heard at the next scheduled Audit Committee meeting which allows at least 30 days advance notice to be given to the Audit Committee and to the appealing carrier. Regularly scheduled meetings of the Audit Committee will be held in the months of April, August and December, with the Audit Committee retaining the option to cancel any specific meeting if no business would come before the Committee at such a meeting.

8. Detail information of each test audit to be appealed before the Audit Committee will be provided by the Bureau to the Committee prior to the meeting date at which the appeal will be heard.
9. If a test audit appeal is presented by a carrier also represented on the Audit Committee, that member of the Committee may not participate in the Committee's discussion or vote on the appeal.
10. The Audit Committee will review all materials presented by the carrier and the Bureau in regard to each appeal and will hear testimony from both the carrier and Bureau staff at the appeals hearing. As a part of hearing such testimony, the Audit Committee may ask questions of the carrier and the Bureau staff as needed for purposes of understanding the test audit in question. After receiving testimony, the Audit Committee shall convene in Executive Session to discuss the appeal and shall reach a decision by majority vote of those members present and eligible to vote. If a vote on an appeal results in a tie, then the carrier prevails in its appeal.

Attendance at the Executive Session shall be limited to members of the Audit Committee, the one member of Bureau staff chairing the meeting and Bureau legal counsel. The Chairperson shall preside over the Executive Session for procedural purposes and shall maintain a record of the discussion. Bureau legal counsel shall advise the Audit Committee with respect to antitrust matters. The decision of the Audit Committee shall be communicated to the appellant in writing by the Bureau within 30 days of the appeal hearing.

11. Each decision of the Audit Committee will include a determination as to whether the appeal in question turns primarily upon a) matters of interpretation and application of the Pennsylvania Manual of Rules, Classifications and Rates to a set of generally agreed to facts, or b) disputed facts or other issues of administration of the Test Audit Program. This portion of each decision of the Audit Committee will be final.

Further appeals of test audits of the type described in point a) must be directed to the Classification & Rating Committee, and further appeals of test audits of the type described in point b) must be directed to the Governing Board. In the event that a test audit appeal involves issues of both type a) and type b) and reportable differences would arise from both the type a) and type b) issues considered separately, any further appeal must be directed to the Governing Board.

12. At the option of the carrier, a further appeal from an adverse decision of the Audit Committee may be taken. The carrier must give written notice to the Bureau that such further appeal is desired, with such notice received by the Bureau within 30 days of the mailing of the written decision of the Audit Committee. Such further appeals will be directed as set forth in Section 10 of these procedures and will be governed by procedures adopted for that purpose by either the Classification & Rating Committee or the Governing Board, as the case may be.
13. Decisions of the Classification & Rating Committee and Governing Board regarding further test audit appeals will be final and binding on both the carrier and the Bureau.
14. Summary discussions of each test audit appeal taken before the Audit Committee, Classification & Rating Committee and Governing Board will be prepared by Bureau staff and approved by the body hearing the appeal in question. Upon receiving such approval, these summaries will be published and distributed by the Bureau as Test Audit Bulletins. This publication is intended to advise all carriers of the nature of test audit appeal decisions as a further guide in improving audit and data reporting procedures and to minimize the need for duplicative appeals proceedings before the Audit Committee, Classification & Rating Committee and Governing Board. The actual identity of appellants and insureds will not be disclosed in these summary descriptions of test audit appeals cases. Carriers taking appeals to the Audit Committee, Classification & Rating Committee or Governing Board specifically agree to such publication of information as a condition for hearing of the appeal.