



Pennsylvania Compensation Rating Bureau

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November 12, 2014

PCRB CIRCULAR NO. 1634

To All Members of the PCRB:

Re: **TEST AUDIT PROGRAM - REVISED TEXT**

This circular is the companion to PCRB Circular No. 1633 which presents the revisions to the Test Audit Program, effective January 1, 2015, in legislative style.

TEST AUDIT PROGRAM – ORIGINALLY EFFECTIVE MAY 1, 1982 – REVISED JANUARY 1, 2015

I: PURPOSE

The purposes of the Test Audit Program are as follows:

- A. To monitor the accuracy and consistency of PCRB'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 PCRB 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 PCRB.
- 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 randomly 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 PCRB 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.

| Test Audit Selection Date | Policy Expiration Dates | Carrier Notice Date | Test Audit Selection Date | Policy Expiration Dates | Carrier Notice Date |
|---------------------------|-------------------------|---------------------|---------------------------|-------------------------|---------------------|
| Jan 1 | Sep 1 - 30 | Feb 1 | Jul 1 | Mar 1 - 31 | Aug 1 |
| Feb 1 | Oct 1 - 31 | Mar 1 | Aug 1 | Apr 1 - 30 | Sep 1 |
| Mar 1 | Nov 1 - 30 | Apr 1 | Sep 1 | May 1 - 31 | Oct 1 |
| Apr 1 | Dec 1 - 31 | May 1 | Oct 1 | Jun 1 - 30 | Nov 1 |
| May 1 | Jan 1 - 30 | Jun 1 | Nov 1 | Jul 1 - 31 | Dec 1 |
| Jun 1 | Feb 1 - 28 | Jul 1 | Dec 1 | Aug 1 - 31 | 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 (except assigned risk policies). If it is determined that a selected policy has both Pennsylvania and Delaware exposure, a separate test audit will be performed in each state and the results will be included separately in the carrier's test audit quarterly statistics.
- E. The following types of risks will not be subject to test audit:
 1. A risk in which a test audit has been completed within the last five years.
 2. A risk in which the selected policy has been cancelled flat or cancelled mid-term.
 3. A risk in which the central mailing address is out of state.
 4. A risk with a total Pennsylvania or Delaware premium of \$500,000 or more on the most recent available unit report.
 5. A risk that is a temporary staffing contractor and/or PEO.
 6. A risk which is part of a wrap-up and/or OCIP.
- 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 PCRB
 2. Number of policies as indicated on the latest available risk data base policy report by carrier from the PCRB

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, cannot be honored.

III: TEST AUDIT ONLINE

Test Audit Online is the PCRB's website application dedicated to the Test Audit Program. Information regarding the Test Audit Program, including policy selection lists and electronic response notifications and forms, as well as carrier performance statistics, will be posted to the PCRB's secured Test Audit Online application. Carrier access to Test Audit Online is managed by the carrier through a carrier-designated Carrier Group Administrator (CGA). PCRB test audit staff can not authorize access to Test Audit Online. Carriers may provide access to Test Audit Online to

anyone in their organization but only those designated to be PCRB test audit contacts will be e-mailed posting notices. These notices will be e-mailed once to all designated primary and secondary contacts. Information regarding how to navigate Test Audit Online is available in various User Guides found on Test Audit Online.

IV: DISPOSITION OF TEST AUDITS

- A. Via Test Audit Online the PCRB will provide notice to the carrier 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 PCRB 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 VII, Test Audit Standards, the carrier contact(s) will be notified by email 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 VII, Test Audit Standards, the carrier contact(s) will be notified via email that a reportable difference has been found. Such notice will be posted to the Test Audit Online application with copies of the PCRB's test audit work papers, an explanation of the source(s) for the difference, and the effect of such difference on premium for the risk.
- B. Reportable differences will be considered confirmed if the carrier chooses to agree with the test audit difference via the Test Audit Online difference response application 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 V: G. and V: H. or within an extension of time established in accordance with Section V: J.
 2. The carrier does not file a timely appeal to the Audit Committee of a reportable difference subsequent to the PCRB 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 PCRB 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 PCRB's Statistical Plan Fine Program.

2. Additional Premiums

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

- a. 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 PCRB 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. See Section VII- E for more information regarding timing standards to submit classification changes.

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 PCRB, 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 PCRB.

V: PROCEDURES FOR EXCHANGE OF INFORMATION ON TEST AUDITED RISKS

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

- A. For all test audit selection notices and compatible/difference correspondence the carrier must designate one primary contact. The carrier can have up to three additional contacts eligible to receive notification emails.
- B. For all quarterly statistics postings the carrier must designate one primary contact. This contact may be the same as the primary contact for test audit selection notices and compatible/difference correspondence; however, carriers may not designate any additional contacts for quarterly statistical information.
- C. **ALL RESPONSES TO THE PCRB PERTAINING TO TEST AUDITED POLICIES MUST BE SUBMITTED VIA TEST AUDIT ONLINE. ANY RESPONSE NOT SUBMITTED VIA TEST AUDIT ONLINE (i.e., SENT USPS, FAX, OVERNIGHT SERVICE OR SEPARATE EMAIL) WILL BE SUBJECT TO A \$100 PROCESSING FEE FOR EACH SUBMISSION.**

- D. Each month a list of policies selected for test audit will be posted to Test Audit Online. The designated contact for each participating carrier group will be notified via email regarding the posting. The list will include the named insured, policy number and policy effective date for each selected policy. Policy selection notification is predicated on the PCRB's membership records (carrier group composition) at the time of selection. The designated contact(s) for each carrier group is responsible for facilitating the proper response (see below) for all carriers listed under that carrier group according to PCRB membership records. Requests to redirect notices or mitigate a failure to respond based on a lack of carrier affiliation cannot be recognized if not supported by official PCRB membership records.
- E. Within ten business days from the date of posting of any month's selection list, the following audit materials must be received by the PCRB from the carrier via Test Audit Online. 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 PCRB with respect to the selected risks must be included. The carrier must also choose the type of audit completed for each test audit selection from the drop down box on the Test Audit Online screen. 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 PCRB assigning the type of audit based on its best judgment. Once assigned, the PCRB cannot revise audit type assignments when this information is not initially provided by the carrier.

The PCRB requires copies of 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 PCRB 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 PCRB 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 PCRB 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 choose that selection from the drop down box on the Test Audit Online screen.

Failure to provide the above cited information will result in the PCRB's use of the unit statistical report for purposes of comparison to the PCRB's test audit. Reportable differences found on risks for which the requested data is not timely received in the PCRB and for which unit statistical data is used for purposes of comparison to the PCRB'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 PCRB 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 PCRB in determining appropriate disposition of those test audits under Section IV of this program. If the PCRB 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 the test audit selection is posted to Test Audit Online, the PCRB will establish a future date which will be designated as the "Final Response Date." This Final Response Date will be ten business days after carrier notification.

Each calendar month the PCRB will establish the number of test audits for each carrier with Final Response Dates falling within that month. The PCRB will then determine how many of the test audits with Final Response Dates falling in the month did NOT have an acceptable response to the request(s) for carrier audit worksheets and premium invoice received by the PCRB 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 PCRB, 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 PCRB on or before their respective Final Response Dates will be designated as "Failed Requests." 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.

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.

- F. The PCRB must complete its test audit assignment within seven 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.
- G. The PCRB will email the carrier's designated contact(s) of a reportable difference posted to Test Audit Online, 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 PCRB's original notice. This notice will be accompanied by copies of the PCRB's test audit work papers and will advise the carrier that response via Test Audit Online to the PCRB, either accepting the difference or setting forth all information which the carrier wishes the PCRB to consider towards making the audit compatible, must be received in the PCRB within 45 days of the date of the PCRB'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.

- H. A carrier may request a single extension of time for their response to the initial test audit difference notification from the PCRB. Such requests must be made via the Test Audit Online difference response form no later than **45** days from the date of the PCRB's notice of a difference. The extension will establish a date **75** days from the date of the PCRB's notice of a difference by which the carrier's final response must be received by the PCRB. No extensions may be granted for worksheet submissions or subsequent correspondence between the carrier and the PCRB after the initial test audit difference notification.
- I. This date will be binding on the carrier. If a response is not received by the PCRB by the specified date, the test audit in question will become a reportable difference without further appeal rights for the carrier. The PCRB will acknowledge receipt of all requests for extensions of time and responses to notice of test audit differences via email to the carrier's designated contact(s). It is the responsibility of the carrier to notify the PCRB by telephone in any case where this acknowledgment is not received by the carrier within two calendar days of the date of the carrier's response or request for extension. Failure to so notify the PCRB will forfeit the carrier's rights to an extension of time and/or further appeal of the difference on the test audit in question.
- J. The PCRB 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 PCRB 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 PCRB 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 PCRB'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 PCRB will prepare and post to Test Audit Online a summary statistical report of the carrier's test audit results for the last quarter and the most recent available four consecutive quarters. Once a carrier's test audit statistical results are posted they are final.

VI: APPEALS PROCEDURES

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

VII: 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 VIII.
- D. When factual differences arise between the carrier's audit and the PCRB'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 PCRB test audits, respectively, the PCRB 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 PCRB prior to the notice to the carrier of test audit selection by the PCRB (see Section II. C.). The carrier's request must be submitted to the PCRB's Classification Department. If such a request is not received prior to the notice to the carrier of test audit selection by the PCRB, any difference attributable to the unauthorized classifications must be included in the PCRB'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 separate and distinct attempts (i.e. separate dates), to gain access to the insured's records and has documented those efforts in its submission of information to the PCRB, the test audit selection may be eligible for rescission. The documentation must be submitted at the time of the carrier's response to the PCRB's request for audit worksheets.

The documentation of unsuccessful attempts should include all of the following information:

- The name and title of the person contacted
- The date of each contact attempt (must be three separate dates)
- Specify whether the attempts were made by mail (USPS), e-mail or telephone
- If the attempted contact was by telephone, the telephone number used
- If contact was by e-mail, a copy of the e-mail which must include the date, time and e-mail address of the person contacted
- Any and all supporting information including, but not be limited to, copies of progress reports.

Upon receipt and review of the documentation submitted, the test audit will be evaluated for rescission if the criteria described above have all 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 values¹
7. Volunteer Ambulance Corps. – stipends paid to members
8. Per Diems

Test audits found compatible but for differences attributable to the above Items 1 through 8 shall be completed by the PCRB, 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 VII, 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. Those qualifying carriers who wish to exercise this option must do so within ten working days from the date the quarterly statistics are posted to Test Audit Online. The decision to withdraw must be submitted in writing and sent via email to the PCRB's Test Audit Department for review and approval.

EXCEPTIONS:

- o Carriers in the action plan review process
 - o Carriers who have unresolved and disputed differences which would, if retained as differences, materially impact qualification
- 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.

VIII: INCENTIVE PROGRAM

As a means of encouraging participating carriers to meet or exceed established standards, incentive charges will be assessed by the PCRB 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 VII, 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.

¹ A difference will be applied if the carrier rating value is used incorrectly in the calculation of premium.

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 | \$350 |
| 20.0 - 21.9 | \$ 50 | 34.0 - 35.9 | \$400 |
| 22.0 - 23.9 | \$100 | 36.0 - 37.9 | \$450 |
| 24.0 - 25.9 | \$150 | 38.0 - 39.9 | \$500 |
| 26.0 - 27.9 | \$200 | 40.0 - 43.9 | \$550 |
| 28.0 - 29.9 | \$250 | 44.0 - 47.9 | \$600 |
| 30.0 - 31.9 | \$300 | 48.0 & Over | \$650 |

| 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 \$150. The total number of differences is 13, so the base incentive charge applicable for this carrier based on these four quarters' experience is $\$150 \times 13 = \$1,950$.

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 2006 | 25% | \$150 | N/A | \$150 |
| 3rd Q 2006 | 25% | \$150 | N/A | \$150 |
| 4th Q 2006 | 25% | \$150 | N/A | \$150 |
| 1st Q 2007 | 25% | \$150 | N/A | \$150 |
| 2nd Q 2007 | 25% | \$150 | 1.25 | \$187 |
| 3rd Q 2007 | 25% | \$150 | 1.50 | \$225 |
| 4th Q 2007 | 25% | \$150 | 1.75 | \$262 |
| 1st Q 2008 | 25% | \$150 | 2.00 | \$300 |
| 2nd Q 2008 | 25% | \$150 | 2.25 | \$337 |
| 3rd Q 2008 | 25% | \$150 | 2.50 | \$375 |
| 4th Q 2008 | 25% | \$150 | 2.75 | \$412 |
| 1st Q 2009 | 25% | \$150 | 3.00 | \$450 |

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 2006 | 21.9% | \$ 50 | N/A | \$ 50 |
| 3rd Q 2006 | 23.6% | \$100 | N/A | \$100 |
| 4th Q 2006 | 28.1% | \$250 | N/A | \$250 |
| 1st Q 2007 | 25.7% | \$150 | N/A | \$150 |
| 2nd Q 2007 | 25.4% | \$150 | 1.25 | \$187 |
| 3rd Q 2007 | 23.3% | \$100 | 1.50 | \$150 |
| 4th Q 2007 | 20.3% | \$ 50 | 1.75 | \$87 |
| 1st Q 2008 | 22.9% | \$100 | 2.00 | \$200 |
| 2nd Q 2008 | 27.3% | \$200 | 2.25 | \$450 |
| 3rd Q 2008 | 22.7% | \$100 | 2.50 | \$250 |
| 4th Q 2008 | 30.2% | \$300 | 2.75 | \$825 |
| 1st Q 2009 | 28.5% | \$250 | 3.00 | \$750 |

IX: ACTION PLANS

Any carrier with a difference ratio of 25 percent or above for a four consecutive quarter measurement period (minimum 30 audits) and a difference ratio of 25 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.

PCRB staff will review the action plan to ascertain the feasibility and appropriateness of the measures listed. Based on this review, PCRB staff will then consult with the PCRB Audit Committee (Committee), as necessary, to determine whether an appearance before the Committee by an officer of the carrier will be required. 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. In no case will a carrier be required to submit more than one action plan in any 12-month period of review.

The primary goal of the action plan process is the achievement and subsequent maintenance of the program standard of a less-than-20-percent difference ratio. The action plan review process consists of two stages, including a final assessment.

First Stage, Quarters 1 - 8. At the conclusion of each quarter during this stage of the action plan process, the carrier will be notified via e-mail as to the results of their performance. Standard results during this stage are defined as a less-than-20-percent difference ratio for either the most recently completed quarter or cumulatively for the most recent available four quarters.

Quarter 4. Carriers with substandard results at the end of Quarter 4 may be required to appear before the Committee to report on the status of their action plan, discuss reasons for its failure to date and describe additional efforts to be applied in the continuing attempt to remedy the carrier's substandard test audit performance.

Quarter 8. Carriers with substandard results at this point will be required to appear before the Committee, irrespective of whether or not the carrier met with the Committee based on their results at the end of Quarter 4.

Second Stage, Quarters 9 – 16. Quarterly communications with the carrier related to its action plan status will be discontinued. An action plan surcharge will be applied to carriers not meeting the four quarter cumulative standard of a less-than-20-percent difference ratio. Under this surcharge the applicable fines will be double the amounts otherwise determined under provisions of the Test Audit Program.

Quarter 12. Carriers with substandard results at this point will be required to appear before the Committee. The Committee will report in writing to the PCRB Governing Board the results of their meeting with the substandard carrier following the conclusion of Quarter 12. That report will serve notice to the Governing Board for future reference as needed (see Final Assessment below).

Final Assessment, Quarter 16.

If the carrier has achieved standard results (a less-than-20-percent four quarter difference ratio) at the end of Quarter 16 OR standard results for Quarters 9 -16 in total, the carrier will have successfully completed the action plan review process. In such cases the action plan surcharge fines cease to apply. A grace period of 8 quarters would begin during which the carrier would not be eligible for action plan review. If the carrier has substandard results at the end of Quarter 16 (a 20-percent or greater four quarter difference ratio) AND substandard cumulative results for Quarters 9 – 16 (a 20-percent or greater eight quarter difference ratio), a new, updated action plan would be required to be prepared for personal presentation to the Governing Board by a representative of senior management from the carrier. The Governing Board will then determine the parameters of the next phase(s) of the action plan review process for the carrier, including the imposition of additional disciplinary measures based on consideration of the carrier's updated action plan and recommendations of the Committee and PCRB staff.

X: SPECIAL AUDITS

- A. At the initiative of PCRB management selected employers may be audited by PCRB staff for purposes of information gathering and research or to resolve disputes between insureds and their carrier. Regarding the latter, the PCRB will only conduct these reviews at the request of the employer or the employer's representative. Carriers are reminded that the PCRB will usually not intervene on their behalf in cases in which questions or complaints arise concerning classification assignment of individual employees.

Such circumstances are relatively common, and it is incumbent on carriers 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 PCRB intervention.

- B. The results of audits specifically requested by PCRB 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.

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 PCRB's request for audit worksheets, the carrier must so advise the PCRB in writing. This information must be returned to the PCRB with the related audit information within ten business days of the notice of selection for test audit.

XII: TEST AUDIT BULLETINS

The PCRB will utilize Test Audit Bulletins as a means of disseminating educational information regarding the Test Audit Program to its members. These bulletins can be found on the PCRB website in the Test Audit section. 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 PCRB staff which appear to be of interest and illustrate applications of various audit procedures or Manual rules.
- C. Communications from the Audit Committee to PCRB members, as directed by the Committee.
- D. Other items of an educational or informational nature pertaining to the Test Audit Program.

Any questions regarding the PCRB's Test Audit Program should be directed to the attention of Christina Yost or Vincent Dean at the following address and telephone numbers:

Pennsylvania Compensation Rating Bureau
Field Operations Department
United Plaza Building – Suite 1500
30 South 17th Street
Philadelphia, PA 19103-4007

(215) 320-4552 or cyost@pcrb.com (Yost)
(215) 320-4490 or vdean@pcrb.com (Dean)

Timothy L. Wisecarver
President

jf
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

| <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.

PENNSYLVANIA COMPENSATION RATING BUREAU

TEST AUDIT PROGRAM APPEALS PROCEDURE

1. When the PCRB 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 PCRB's original notice. This notice will be accompanied by copies of the PCRB's test audit work papers and will advise the carrier that a written response to the PCRB, either accepting the difference or setting forth all information which the carrier wishes the PCRB to consider towards making the audit compatible, must be received in the PCRB within 45 days of the date of the PCRB'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 the initial test audit difference notification from the PCRB. Such requests must be in writing, must be received by the PCRB not later than 45 days from the date of the PCRB's notice of a difference. The extension will establish a date 75 days from the date of the PCRB's notice of a difference by which the carrier's final response must be received by the PCRB. No extensions may be granted for worksheet submissions or subsequent correspondence between the carrier and the PCRB after the initial test audit difference notification. This date will be binding on the carrier. If a response is not received at the PCRB by the specified date, the test audit in question will become a reportable difference without further appeal rights for the carrier.
3. The PCRB 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(s). It is the responsibility of the carrier to notify the PCRB 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 PCRB 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 45 days after the date of the PCRB's notice of a difference in order to provide adequate time for correspondence between the PCRB and the carriers.
5. The PCRB 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 PCRB does not so respond, the test audit in question shall be considered as compatible for purposes of the Test Audit Incentive Program.
6. If, after receipt of the PCRB's final decision, a carrier is aggrieved by the PCRB'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 PCRB within 30 days of the date on the PCRB'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 Committee and to the appealing carrier.
8. Detail information of each test audit to be appealed before the Audit Committee will be provided by the PCRB 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 PCRB in regard to each appeal and will hear testimony from both the carrier and PCRB staff at the appeals hearing. As a part of hearing such testimony, the Committee may ask questions of the carrier and staff as needed for purposes of understanding the test audit in question. After receiving testimony, the 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 PCRB staff chairing the meeting and PCRB legal counsel. The Chairperson shall preside over the executive session for procedural purposes and shall maintain a record of the discussion. PCRB legal counsel shall advise the Committee with respect to antitrust matters. The decision of the Committee shall be communicated to the appellant in writing by the PCRB within 30 days of the appeal hearing.

11. Decisions of the Audit Committee will be final and binding on both the carrier and the PCRB.
12. Summary discussions of each test audit appeal taken before the Audit Committee will be prepared by PCRB staff and published 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. 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 specifically agree to such publication of information as a condition for hearing of the appeal.