Understanding and managing a General Liability premium audit

Guest editorial
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Many work truck industry companies have General Liability policies that are auditable on an annual basis. And most of them dread the audit — both the process itself and the impending outcome of additional premium due. So, let's review the audit purpose and process, and how to possibly avoid an unwanted and unexpected bill from your insurer at the end of it all.

The purpose of an audit is for the insurer to collect premiums commensurate to your operation's exposure. Not unlike a Workers Compensation audit, the General Liability audit is a mechanism to show your actual exposure for the policy term. General Liability policies are written in the beginning of the policy term with an estimate (from you) of either your sales (used most commonly, and the example given in this article) or payroll, depending on how operations are classified.

Of course, there is no way to know exactly what sales or payrolls will be for the upcoming year. For example, as an upfitter, you likely sit with your agent at renewal time and predict gross sales for the next year. The policy is rated and written based on those estimated gross sales. Then, at the end of the year, the insurer will inquire as to what your actual sales were for the term. If they were higher than estimated, you'll receive a bill for additional premium. Conversely, if sales were lower, you'll you get a return premium. (Note, not all insurers return premium when the latter occurs — some are auditable upward only. This is a good question to ask your agent before signing up with a particular insurer.)

The audit process typically takes one of two forms. One is the written audit, during which the insurer sends a form to complete with your actual sales and return to the insurer, who then calculates the total and informs you of the outcome. The more common way is an in-person audit (though these have been less frequent during COVID). With this type of audit, an auditor comes to your facility, sits with you to review your books, and completes the audit form based on the findings. The auditor then submits the form to the insurer for calculation, and you are informed of the outcome. When you receive the final audit, after all calculations are made, you should end up with a form outlining what you actually paid and what you should have paid. In a perfect world, this would result in a credit back to you each year. Unfortunately, it usually ends with a bill for additional premium because most companies give conservative estimates at the beginning of the policy term.

The following tips can help you avoid being caught off-guard by a large additional premium.

1. Meet with your agent and discuss estimated gross sales for the coming year at every renewal. The more you're involved in the process, the more control you'll have over the outcome. Your sales estimates should be as accurate as possible to avoid additional premium due.

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2. Understand what information the insurer wants. Using the upfitter example again, auditable sales are always based on gross revenue. This means you can't deduct chassis cost from your sales figure. By doing so, you're essentially deducting cost of goods sold and therefore providing the insurer with gross profit, not gross revenue. This will be caught at audit, and the additional premium generated by such a mistake can be substantial.
3. Stay in contact with your agent through the year if sales swing drastically in either direction. Your agent should be able to go to the insurer during the policy term and amend estimated sales to your revised forecast. This can help avoid a big bill at the end of the policy term by breaking up additional premium in small amounts over your monthly installments. But most importantly, if you're estimating much higher sales than originally predicted, your rate/$1,000 could actually decrease. Many policy rates lower as sales rise. So, by accurately amending sales to a higher figure, your agent can often negotiate a lower rate for you. Then, even if you're still audited at the end of the year and receive an additional premium, the rate by which it's calculated is decreased — resulting in a lower audit bill than if your agent had not negotiated down the rate.

Ultimately, the audit process is inevitable — but it doesn't have to be as painful as you think. Talk with your agent, learn the process and gain more control over the outcome.