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Big Money Workers' Comp Payroll Deductions Employers Most Often Miss



The total cost of workers' compensation includes the cost of premium plus claim costs (in a loss sensitive plan.) The oversimplified basic formula for calculating the total cost of workers' compensation is:

$$\begin{aligned} & \text{Payroll} \times \text{Rate} \times \text{Experience} \\ & \text{Modification Factor} \times \\ & \text{Adjustments} \\ & = \text{Premium} \\ & + \text{Claim Costs} \\ & \text{(in a loss-sensitive plan)} \\ & = \text{Total Cost of Workers' Compensation} \end{aligned}$$

Review the basic formula for calculating the total cost of workers' compensation:

- The items marked in **RED** (above) are those items which are impacted by injury management best practices.
- The items marked in **RED ITALICS** (above) including Payroll and Rate are those items impacted by a specific set of classification rules.

Organizations often make the common error of not properly understanding or applying classification rules which results in unnecessary and artificially inflated workers' compensation premiums.

One of the biggest mistakes many employers make is failing to take allowed payroll deductions.

Deductions vary from state to state. However, the big three are:

- 1 **Overtime (premium portion, or the amount greater than standard time).**
- 2 **Double Time (premium portion, or the amount greater than standard time).**
- 3 **Severance Pay.**

What does premium portion mean?

Premium portion of overtime and double time is any amount of pay greater than the employees' standard rate. (Example: Standard rate = \$10 / hour; Time-and-a-half = \$15 / hour; Premium portion = \$5 / hour or the amount of pay greater than the employees' standard rate.)

Why is only the premium portion excluded?

At a high level, the amount of premium an insurance company charges should accurately reflect the risk of the organization. The amount of payroll is an indicator of the organizations level of exposure to injury. Any extra hours an employee works will incrementally increase the risk of injury at a standard rate. Including 1.5 - 2.0x an employee's rate of pay for these extra hours is an inaccurate assessment of risk and will artificially inflate the employer's premium.

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Overtime & Double Time — Example

Jeff Thompson makes \$10 per hour as his standard rate. This pay period Jeff worked 40 hours Monday – Friday, 8 hours on Saturday, and 5 hours on Sunday.

- 8 hours on Saturday is paid at time and a half, or \$15 per hour.
- 5 hours on Sunday is paid at double time, or \$20 per hour.

Following the deduction rules of excluding the premium portion of overtime and double time, Jeff's included and excluded payroll figures are as follows:

Jeff's Total Payroll: \$610

INCLUDED:

- 40 hours of Standard Time x \$10 / hour. 40 hrs x \$10/hour = \$400
- Standard portion of 8 hours of 'time and a half'. 8 hrs x \$10/hour = \$80
- Standard portion of 5 hours of 'double-time'. 5 hrs x \$10/hour = \$50

Total Payroll INCLUDED: \$530

EXCLUDED:

- Premium portion of 8 hours of 'time and a half', or \$15/hour - \$10/hour = \$5/hour premium portion. 8 hrs x \$5/hour = \$30
- Premium portion of 5 hours of 'double-time', or \$20/hour - \$10/hour = \$10/hour premium portion. 5 hrs x \$10/hour = \$50

Total Payroll EXCLUDED: \$80

Following the deduction rules, 15% of Jeff's payroll is excluded from the workers' comp premium calculation.

One of the biggest mistakes many employers make is failing to take allowed payroll deductions.



Severance Pay

Severance pay, or the amount paid to an employee upon dismissal from a company, is entirely deductible to the extent it does not include pay for time worked or accrued vacation.

Key Philosophical Shift

A key philosophical shift that often needs to occur is to look at the premium auditor as a partner rather than an adversary. The premium auditor is trained and knowledgeable regarding specific rules which apply to your state; you simply need to ASK QUESTIONS.



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