



# ON-SITE

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## Workers' compensation insurance

# Experience rating modifiers make all the difference

**T**here's an old saying about workers' compensation insurance: You can't live with it; you can't work without it. Of course, you *have* to live with your workers' comp premiums — whether they're unwieldy or relatively reasonable. One way to get that dollar figure in the latter category is to know how the insurer calculates it.

Among the primary formulas that determine every construction company's premiums is the experience rating modifier (ERM). Knowing even just a little about where it comes from and what it does can help you better control your insurance costs.

### History lesson

"Experience" is the operative word in an ERM. Insurers use this complex calculation to adjust workers' comp premiums based on the subject company's recent *history* of claimed losses.

The objective of an ERM is to determine whether your loss history is above or below industry norms. If your construction company has submitted more claims than a similar business has, its premiums will go up. Likewise, if you've reduced claims to

a below-average number, you should pay less. An ERM rate of 1.0 is industry average — the further below, the better; the further above, watch out.

### Number crunching

So how do insurers crunch the numbers that create an ERM? As mentioned before, it's complicated. But let's take a simplified look.

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Typically, an insurance company starts with a base premium that divides a company's payroll in each job classification by 100 and then divides again by a class rate. Job classifications and class rates are issued by the National Council on Compensation Insurance (NCCI) to reflect risk across various job types. For example, a welder on a job site will generate a much higher risk factor than the receptionist greeting visitors in the front office.

The insurer then compares past claims history to those of similar companies. Generally, it will review the three full years ending one year before the expiration of the existing policy. When the data has been processed, the insurer will multiply the result (your ERM) against its stated premium rate to determine the actual premium, less any discounts or credits.

Important note: The NCCI occasionally performs Experience Rating Plan methodology reviews that



drive changes to insurers' ERM formulas. Ask your financial advisor or insurance agent for the latest details.

### Administrative steps

Perhaps the most important point about the ERM process is that the calculation weighs *frequency* of losses more heavily than *severity*. So you'll be penalized more by multiple, repetitive claims than by just one or two big ones.

So look for specific ways to submit fewer workers' comp claims. This is where a strong focus on safety comes into play. Formalize your efforts to reduce or eliminate accidents through a company safety program. Also, take a "no exceptions" approach to workers following rules.

Beyond that, there are administrative steps you can take to address your ERM rating. First, at least once a year, ask an insurance agent to re-evaluate your classification codes. Misclassified employees could be driving up costs. Or he or she might be able to move some staff members into lower rated classes, which could reduce your premiums.

Something else to do annually: Sit down with your agent and, with your financial advisor's input, audit your workers' comp policy. As noted, misclassified employees might be a problem, but so could:

- Misclassified operations,
- Payroll allocated to wrong projects or states, and
- Data-entry errors regarding claim values.

In addition, review open claims and see whether you may be able to reduce or even eliminate one or more of the outstanding amounts.

Another often cost-effective strategy to consider is setting up an agreement with your insurer to pay small medical-only claims (usually defined as those of \$5,000 or less) out of pocket. In exchange for doing so, the insurer should agree to leave these claims out of your construction

## A tale of two contractors

Here's a simplified example of how substantially an experience rating modifier (ERM) can affect a construction company's cash flow. Contractor X and Contractor Y both run comparably sized construction companies that operate in the same market and perform similar services. They also both have a "before modification" workers' compensation premium of \$27,000.

Contractor X, however, has an ERM rating of 0.50. Meanwhile, Contractor Y's rating is 1.75. So X's adjusted bill comes to \$13,500 ( $0.50 \times \$27,000$ ), while Y's is \$47,250 ( $1.75 \times \$27,000$ ). That's a \$33,750 difference! This money represents cash flow that X can use for paying invoices, keeping up with payroll, and dealing with permits and fees. It's a competitive advantage.



company's ERM calculation — thereby reducing loss frequency.

The primary risks of such a deal? You might not have the cash flow to pay the claims when they come up. Or you could run out of money if hit by a flurry of claims. So be sure to factor in these dangers before striking a bargain with the insurer.

### Not a whim

Your workers' comp premiums may seem to rise and fall at the insurers' whim. But know that there are many factors behind these fluctuations — one of which is ERM. By taking proactive measures to better understand and moderate it, you'll stand a better chance of paying lower premiums. ☒

# Prevailing wages remain a sticking point on public jobs

**T**ime flies when you're working hard. About four years ago, the American Recovery and Reinvestment Act was signed into law and the construction industry stood poised to reap the benefits of a surge in public sector projects.

Nowadays, spending on government jobs seems to have moderated a bit. According to a U.S. Census Bureau announcement in February of this year, public construction spending sat at about \$272 billion — down from about \$276 billion in February 2012.

Still, the work is out there for contractors with the skill and service sets to suit the projects available. If you're prepared to throw your hard hat in the ring, bear in mind that among the biggest sticking points in taking on a public job is complying with prevailing wage requirements.

## Legal stipulations

Most federal projects are subject to the Davis-Bacon Act, which requires federal contractors to pay a “prevailing wage.” That is, Davis-Bacon — along with its state counterparts — requires you to pay wages on a public project that are comparable to wages for similar work in the same geographic area.



What's more, a majority of states impose similar requirements on state-funded projects. If a project is financed by both federal and state funds, the higher wage usually applies.

*Prevailing wages may vary among different classifications, so it's critical to get them right.*

## Worker classification

On federal projects, the U.S. Department of Labor (DOL) sets prevailing wage rates. On state projects, the equivalent state agency sets the rates. One of the biggest challenges for contractors bidding on public projects is worker classification. Prevailing wages may vary among different classifications, so it's critical to get them right.

Complicating matters further, the DOL and state agencies may restrict the types of work that can be performed by workers in certain classifications. For example, a worker classified as a laborer may not be permitted to perform tasks traditionally associated with members of a particular trade or craft, such as plumbers or electricians.

## Payout options

Generally, prevailing wage rates consist of a base rate paid in cash and a fringe benefit amount. Contractors have the option of paying fringe benefits in cash or applying fringe benefit credits for contributions to “bona fide” benefit plans, such as health and life insurance, long-term disability plans, retirement plans, and vacation days or other paid time off.

Computing fringe benefit credits is complex, so you might be tempted to simply pay the fringe benefit amount in cash. But satisfying the fringe benefit obligation using bona fide benefit plans can be more cost-effective. Moreover, cash wages are subject to Social Security, Medicare and other payroll taxes, while contributions to benefit plans are generally exempt from these taxes.

Your advisors can help you determine which approach would be better for your bottom line in light of your existing compensation and benefit programs.

### Administrative duties

Compliance with prevailing wage laws demands timely, accurate record-keeping. You'll need to submit certified payroll reports periodically and keep accurate internal payroll records on file. It's particularly important that you document the classification of workers and the tasks they perform.

In addition, general contractors and upper-tier subcontractors are responsible for prevailing wage violations by lower-tier subcontractors. So

it's important to gather records from these subcontractors to ensure they're in compliance.

### Risk management

The penalties for prevailing wage violations can be severe. Under the Davis-Bacon Act, for example, they may include fines, contract termination or even "debarment" from future federal contracts for up to three years. And that's not all — contract payments may be withheld to cover the violator's liabilities for unpaid wages and certain other damages.

Contractors or subcontractors that falsify payroll records or demand kickbacks of wages are subject to civil and even criminal prosecution.

### Contentious issue

Prevailing wage laws remain a contentious issue. As of this writing, multiple states are debating whether they should stay on the books. One in particular, Kansas, has already banned local governments from requiring private employers to pay prevailing rates. The bottom line: If your construction company decides to bid on a public job, be sure to strongly consider this issue. ☒

## Job site safety and Heinrich's Law

**A**mong the most obvious inhibitors of profitability for construction companies is job site safety. Consider the following example suggested by the Electronic Library of Construction Safety and Health: A contractor with a 3% profit goal who suffers a \$50,000 loss because of an accident must boost sales by more than \$1.6 million to counteract the shortfall.

If only there were a crystal ball you could use to foresee a catastrophe and then take steps to prevent it. There isn't. But one long-time safety concept, Heinrich's Law, may offer you a glimpse

into the future — or at least provide some food for thought.

### The gathering clouds

H. W. Heinrich was Assistant Superintendent of the Engineering and Inspection Division of Travelers Insurance Company during the 1920s and 1930s. In 1931, he published *Industrial Accident Prevention: A Scientific Approach*. The book brought us Heinrich's Law, which states that, for every 300 injury-free accidents, there are 29 minor-injury accidents and one major-injury accident.



To be clear, this 300:29:1 ratio is far from being set in stone. It's based on research from decades ago for which no reviewable papers exist. Several books have been written challenging Heinrich's Law, and workplace (and construction job site) safety has grown in leaps and bounds since 1931.

Yet the enduring lesson of Heinrich's Law persists. That is, if your construction company experiences a rash of "minor" accidents, don't assume the weather has cleared. Those incidents could be the gathering clouds of a much greater storm.

### What you can do

Sometimes contractors actually grow *overconfident* after enduring a series of relatively unremarkable safety-related occurrences. One might say: "Yeah, we had a couple of scaffolds fall apart, but no one was hurt. We're good." Or: "There was a fender-bender, and a few of the guys were a little banged up. But no one had to be hospitalized."

Workers escaping serious harm is a good thing. But, as Heinrich's Law indicates, as the number of these incidents builds, you may not be managing

job site safety so much as suffering a slow erosion of it.

So what can you do? For starters, document every safety-related incident with no exceptions. And don't just document them — *track* them. Look for patterns and any sudden upswings in the number and severity of accidents. Over several years, you might be able to develop your own approximation of Heinrich's Law. The railroad system in the United Kingdom, for instance, purportedly uses a 12:1.5:1 ratio.

Second, get every employee involved. Data is important, but it's human beings who will make the difference. Establish a formal safety program that includes:

- Ongoing training,
- Prejob safety meetings,
- Regular project updates, and
- Clear procedures for preventing, reporting and responding to accidents.

Require every worker on staff, from project manager to laborer, to sign off on the program and follow the rules.

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### Out of harm's way

Heinrich's Law may not be perfect, but it should get you thinking about your recent history of job site accidents. A strong safety record can mean the difference between a profitable year and a losing one. Most important, safer job sites greatly improve your chances of keeping employees out of harm's way. ☒

# The Contractor's Corner

## Could EDI ease our paperwork problems?

*Let me put this simply: I'm sick of paperwork. For every job, I find myself shuffling through tons of bills, checking multipaged paper invoices, scanning documents into my computer, stuffing hard copies into envelopes, e-mailing scanned files to suppliers' account reps and then entering the data into my accounting system. Is there an easier way that won't cost me an arm and a leg?*

There might be. Many paperwork-intensive businesses — which certainly includes construction companies — are finding electronic data interchange (EDI) a great way to save trees and speed processes.

### Speed it up

As its name indicates, EDI is the electronic exchange of documents in a standard format between two businesses. Generally, these arrangements are established between a contractor and a supplier, though you could use EDI with a regular customer who has, for instance, contracted with you for maintenance services.

By replacing those reams of papers you mentioned with computer files transmitted instantly via an EDI system, you may be able to:

- Speed processing of invoices and supply orders,
- Reduce the inconveniences and conflicts caused by errors,
- Save money in lower labor costs and fewer mistakes, and
- Solidify partnerships with vendors.

Obviously, this technology eliminates the need for traditional postal mail and faxes for invoicing and purchasing processes. But what about e-mail?

Isn't that an essentially free means of electronically exchanging documents?

Well, yes; but using e-mails to send and receive documents still involves scanned *hard copies*. The paperwork still applies. EDI allows you to generate, send, receive and process documents from one compatible system to another via a standardized, engineered software platform. And a fully integrated system allows you to channel document-related information directly to your accounting system, eliminating data entry.



### Consider compatibility

So what's the downside to EDI? You may have noticed the word "compatible" in that preceding paragraph. Therein lies the rub.

For EDI to work, both you and the other party generally must use the same technology provider. If several of your key suppliers use different EDI systems, you'd theoretically have to implement separate systems yourself to communicate with them. Thereby, your costs would incrementally increase with each additional partner.

This problem often puts smaller construction businesses, or even midsize ones on tight budgets, out of the running for this technology.

### Make the call

Don't let the compatibility issue scare you away from EDI entirely. If you have one key supplier, the benefits of implementing a system may outweigh the costs. Your financial and technology advisors can help you make the call. ☒