

Good Workers' Comp Records Can Save Big Bucks

by Shawn McCadden, CR/CLC

Before I had my own remodeling business, I worked for someone else. Every year, when my boss's workers' comp audit came around, he would be in a bad mood before the audit and an even worse mood afterward because he always ended up owing more money. He reminded me of that whenever I asked for a raise, complaining about how much more it cost than he had anticipated.

When I started my company, I was determined not to repeat that pattern. So I would know what to charge before I sold my first project, I put together a budget to predict what it would cost to get the business up and running. Because I planned to have employees, workers' compensation insurance would be one of the costs.

How Premiums Are Determined

My insurance agent explained that, for the most part, my costs would be

based on the total payroll for the employees insured. I should be able to watch the payroll and predict the total cost. This would allow me to carry the true cost of labor in my estimates and know in advance whether I would owe money or get a refund at audit time.

The yearly premium for workers' comp is based on the estimated payroll for the year (see Figure 1). In most states, business owners can negotiate the payment schedule with their insurance carrier. Insurance companies typically require a substantial down payment and bill the remainder monthly or quarterly. At the end of the year the insurance company will audit your books to determine whether your estimate was high or low. If it was low, you will owe an additional amount for the excess hours. If it was high, you should get some money back — as long as you have the records to prove it.

The lion's share of my premium is based on payroll, but the policy also includes miscellaneous fees, like taxes, surcharges, service charges, and state assessments. Some are fixed charges, while others are based on total premium or yearly sales volume. The amounts vary from state to state; the examples described in this article are for Massachusetts.

Classifications and Rates

Some jobs are more dangerous than others, which is why insurance companies charge different amounts for different positions. Each job position is given a classification rate. Your office manager will get a low rate, while field employees such as carpenters will get a high rate. My carpenters fall under code 5645, "Carpentry, detached one- or two-family dwellings." Their rate is \$9.93 per \$100 of payroll.

Calculating Expected Annual Comp Premiums

Classification	Description	Rate/\$100	Discounted Rate	Employee	Estimated Annual Payroll	Subtotal	Estimated Annual Premium
5606	Contractor — executive supervisor or const. superintendent	2.46%	1.87%	Super 1	\$60,000		
				Super 2	\$50,000	\$110,000	\$2,057
5645	Carpentry — detached one- or two-family dwellings	9.93%	7.55%	Carpenter 1	\$50,000		
				Carpenter 2	\$45,000		
				Carpenter 3	\$40,000		
				Carpenter 4	\$40,000		
				Carpenter 5	\$35,000		
				Carpenter 6	\$25,000	\$235,000	\$17,743
8742	Salespeople	0.27%	0.21%	Salesperson 1	\$70,000		
				Salesperson 2	\$65,000	\$135,000	\$284
8810	Clerical office employees	0.17%	0.13%	Office staff 1	\$40,000		
				Office staff 2	\$25,000	\$65,000	\$85
Total Annual Premium							\$20,169

Figure 1. The author uses a spreadsheet to accurately predict his annual workers' comp premiums. Rates are applied as a percentage of total payroll for each job classification.

The total payroll for all employees doing a particular job is called the *exposure* for that classification. You can calculate your insurance cost (premium) by multiplying the exposure (total payroll) by the rate for that classification. For example, if my carpentry payroll is \$10,000, the premium for carpentry would be \$993 (\$10,000 x .0993).

The total premium is determined by adding the premiums for each job classification. As you can see from the rates in Figure 1, you can save a lot of money by putting employees in the lowest correct job classification.

Discounts

My premium includes the following three discounts, which give me another way to save (Figure 2). These discounts apply only to exposure costs, not to miscellaneous fixed fees.

Experience modification factor. The modification rate depends on the company's safety record. If your record is good, you get a discount; if not, your premium will rise. My company has very few comp claims, so we enjoy a .85 modification factor. That means we pay only 85% of the standard premium; in other words, we get a 15% discount. If your rate is higher than 1, you're paying a penalty.

Premium discount. This is set by the state. Its premise is that it costs the insurance company the same amount of overhead to write and manage a small policy as it does to write and manage a big one. I have a relatively high premium, so I get a discount.

SMP credit. This is a discretionary discount given by the insurance carrier.

Auditing the Auditor

Workers' comp is expensive to begin with, but it can be even worse if you take the insurance company's word for what you owe. I've been through 14 years of audits, and there have been very few when the auditor didn't make a math error, put an

Applying Discounts to the Experience Rating

Experience Modification Factor	85%
Premium Discount	2.8%
SMP Credit	8%
Final Discounted Rate	76%

$$= .85(1-.028)(1-.08)$$

Figure 2. Companies with a good safety record receive a favorable experience modification factor. The author's experience rating is .85, which means he gets a 15% discount off published rates for all labor classifications. After applying additional credits, his final discounted rate is 76% of the book rate for any job class.

employee in the wrong classification, or put every employee in the most expensive classification.

Early on, I created a spreadsheet to predict and track my actual workers' comp exposure (Figure 3, next page). It has saved me countless hours of frustration and unjustified expense. Every year I send a copy to my insurance agent. As a result, he now gives me the benefit of the doubt when there's a discrepancy and tells the insurance carrier to correct its audit. My agent told me that nine out of ten businesses do not review their insurance audits closely and are most likely overpaying.

If you want to check your audit, you need to understand how your policy works. Terms and coverage vary from state to state. In Massachusetts, an employee can be assigned to only one classification, usually the most expensive one that he or she works in. In other states, employers are allowed to break out the hours employees spend on tasks that fall into different classifications. This can save a lot of money if the classifications have very different rates.

When my company was small, it was easy to do my own audit. There were only two classifications, and the payroll was not as big as it is today. It's more complicated now, but it's been worth it — particularly the year the insurance company said I owed an additional \$10,000. I figured the insurance company owed *me* about \$1,500, but the agent wouldn't believe it. That's when I

created the spreadsheet. Once he saw it, he conceded that I was right.

Since then, I always do my own audit before the insurance company does it. When the auditor shows up, I give him my audit and supporting documents from the insurance company. We go over the figures together, and I insist that he point out anything he takes issue with before he leaves my office. It's much easier to sort things out in person — it saves me from spending hours on hold or having to re-explain the situation to a different auditor later on.

Tracking Comp Premiums

Keeping good records allows me to check my financial status periodically and make necessary adjustments. Doing regular workers' comp "self-audits" has been very helpful. If I find that I will owe additional premiums at the end of the policy period, I have time to accumulate cash for what might otherwise have been an unexpected bill. I also have time to pass that cost on to clients, since unexpected payments typically end up coming out of profit.

If my self-audits indicate that I've actually overpaid my premiums, I have time to gather the necessary records to prove my case to the insurance company auditor.

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Monitoring Comp Premiums Through the Year

Classification	Discounted Rate	Job	Estimated Annual Payroll	Actual Payroll Through 6/30	Reprojected Annual Payroll	Estimated Premium	Reprojected Premium	Difference
5606	1.87%	Supers	\$110,000	\$52,000	\$104,000	\$2,057	\$1,945	
5645	7.55%	Carpenters	\$235,000	\$106,000	\$212,000	\$17,743	\$16,006	
8742	0.21%	Sales	\$135,000	\$73,000	\$144,000	\$284	\$302	
8810	0.13%	Office	\$65,000	\$36,000	\$72,000	\$85	\$94	
						\$20,169	\$18,347	\$1,822

Figure 3. Comparing budgeted payroll hours, or exposure, with actual hours allows the author to predict whether he will owe additional premiums or can expect a year-end refund, as in this example.

Make Subs Part of the Team

by Fred Seifert

In my work as a custom home builder, every day comes with its share of problems. Running from job to job to put out fires can be a full day's work in itself. The last thing I need is trouble with my subcontractors. So I've learned to apply a few simple rules, based on the notion that subcontractors are part of my team. It sounds simplistic, but it works. And though we've all heard it before, it still surprises me how often the team approach is ignored.

A team that works together stands a better chance of producing a successful project and satisfying the homeowner, which benefits everyone.

Hire the best subs. I want subs on my jobs who are as interested in the success of their businesses as I am in mine. In large part, our jobs are only as good as our subcontractors, so I try to make sure they're serious about what they do. How many times have you told a homeowner that a sub will start on Tuesday only to have no one show up? This makes a bad impression on the homeowner and delays the work of other subs.

Put the right people in the right places. Would you have a 300-pound

offensive lineman go down the field for a long bomb? Of course not, so why would you let your mason do your flashing? I try to pay attention to every subcontractor's strengths and weaknesses and put them in a position to succeed.

Keep every sub apprised of the job's progress. Is it fair to tell the painter one week in advance that the inside of the Miller house is ready for paint and the carpets will be installed in two weeks? Even if the painter could pull it off, you'd probably get a sloppy job, and the painter would be annoyed. Subs have every right to be kept abreast of the project's progress so that they can arrange their schedules accordingly.

Motivate subs. The project may have our company sign out front, but the subs need to be just as enthusiastic about it as we are. This is often as simple as paying a compliment. I let our subs know that we value the good work they're doing, and that because of it "we" just landed another job.

Communicate your company's job policies. We have certain guidelines for behavior on our job sites, and we want our subs and their employees to

follow them. I make sure they all understand what's expected. For example, we make it clear that it's unacceptable for them to discuss matters like pricing and scheduling conflicts directly with the customer. They often have no idea of the misunderstandings they can cause.

Treat subs the way you like to be treated. Although I may be the "boss" on the job, we are all professionals working toward a common goal. Some of my subs tell me about "big time" builders who don't even bother to say hello. It's important to always convey a feeling of inclusion, that this is a team project that can't be done well without great subs.

Fred Seifert and his brother John operate Seifert Construction in Mattituck, N.Y.

Use the 80/20 Rule to Improve Efficiency

by Judith Miller

Contractors suffer a deluge of information, much of it valuable and some of it vital, all of which must be sorted through to run a successful company.

When your company is just starting out, you barely have a moment to step back and analyze. You're constantly juggling your time — time on the job producing the work, time in the office pricing the work and billing for it, and time with new clients lining up the next project. As your company matures, you begin to oversee the efforts of others who perform the tasks you used to do. Hopefully, this frees up time for you to step back and look at the big picture.

Unfortunately, that is not usually the case. Peter Feinmann, of Feinmann Remodeling in Boston, once told me that he was surprised to find that as his company grew and he began to delegate, he had even less time to focus on strategy and growth. His days were increasingly spent helping other people deal with the requirements and problems of their own jobs.

As your company grows, so does the volume of information, as well as its complexity. Finding a way to determine what's important can overwhelm even the most organized contractor.

Enter a Cliché

The old adage "Separate the wheat from the chaff" describes the process of determining what information is essential and what is nonessential. In business lingo, this is sometimes referred to as the 80/20 rule. It states that 80% of the value derives from 20% of the effort, and that that relationship holds across everything you do. Although you may quibble about the exact ratio, you can use this simple principle to focus on the "vital few" — those people, activities, and

job types that make the greatest impact on your business — rather than squandering precious time on the "meaningless many."

For example, this means that 80% of your job referrals come from 20% of your clients, and that 20% of your jobs produce 80% of the profits. Conversely, 20% of your jobs also produce 80% of the losses. When applied to employees, the rule predicts that 20% of your employees are responsible for 80% of job success and client satisfaction. A different 20%, theoretically, are responsible for bad morale and missed deadlines.

Putting the Rule to Work

The challenge is to see the patterns in all the information coming your way, then to determine which 20% provides the 80% value.

In *Managing the Small Construction Business* (jlcbooks.com), remodeling contractor John Sylvestre describes how his company's time card evolved from having over 70 item codes to having just 10. The card with 70 codes took field staff far more time than it was worth to fill out, and the extra level of detail wasn't really useful back in the office. Applying the 80/20 rule to time tracking, Sylvestre determined that only 10 cost codes could give him the vital information he needed for job pricing.

Look at Labor

In all the remodeling companies I've worked with over the years — mostly companies that sub out everything but carpentry and job supervision — labor management provides the 20% when it comes to controlling costs. And only a few labor categories consistently run over budget: supervision, setting up and taking down the job, material handling, trim carpentry, and punch list.

As an example, owners of a busy

kitchen and bath remodeling company I worked with noticed they were chewing up valuable time at the beginning and end of every job, as well as setting up and cleaning the site daily. Focusing on those two areas, they developed a mobilize-demobilize checklist, on both a per job and a weekly basis, which listed every task and every piece of required equipment. By following the checklists, they reduced their typical job setup time from most of one day to half a day. Daily setup and takedown were reduced from 1 hour (30 minutes morning and afternoon) to 30 minutes total. Multiplied through the year, that reduction gave them back more than three weeks of billable production time.

Where to Start

Although you juggle many balls simultaneously, the big picture looks the same for every contractor, in every state, at every stage of growth: Your three goals are to satisfy clients, to have satisfied employees, and to make a profit.

To put the 80/20 rule to work, dig more deeply into whichever area currently distresses you most. Even though the three areas function together, choosing one on which to focus can help you to achieve the most good most quickly. You will be able to focus on the others in turn after resolving the first.

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