



# UNDERSTANDING THE RELEVANCE OF PREMIUM AUDIT AND ENHANCING AUDIT ACCURACY

## Abstract

A premium audit is a vital function in commercial insurance that ensures policy premiums accurately reflect actual exposures such as payroll, sales, and operations. This PoV highlights the importance of premium audits in supporting regulatory compliance, underwriting discipline, loss ratio improvement, and fraud detection. It examines common causes of audit errors, including misclassification, inaccurate data, operational changes, and stakeholder misalignment, and emphasizes the role of clear communication among insureds, agents, underwriters, and auditors. The paper also reviews audit types, adjustable versus flat-rate policies, and the impact of minimum and deposit premiums. Finally, it demonstrates how automation, analytics, and AI are transforming premium audit into a strategic tool that improves accuracy, efficiency, transparency, and insurer profitability.



## Understanding premium audit

Premium audit is an essential part of the insurance premium determination process. It validates the actual exposure, such as payroll, sales, number of employees, events or operations, after the policy period ends, ensuring that the insured pays premium that matches their real risk.

Premium audits are performed on adjustable policies immediately after the policy expires. Some lines of business (like inland marine, WC or general liability) are audited monthly or quarterly based on exposure.

Premium audits also play a vital role in maintaining transparency and trust between insurers and policyholders. They help ensure that coverage is priced reasonably and that both parties are aligned on exposure and risk. As such, audits are not just a financial exercise, they are a strategic tool for risk management, regulatory alignment, and operational integrity. From a regulatory and operational standpoint, premium audits are essential for maintaining compliance with state insurance departments and

industry rating bureaus. Accurate audit data ensures proper classification of exposures and supports the integrity of statistical reporting. When audits are incomplete or inaccurate, they can distort the insurer's cash flow due to under- or over-collection of premiums, result in rates that do not appropriately reflect actual exposures, and lead to incorrect experience modification factors that affect future pricing and underwriting decisions. These misalignments can have long-term financial and reputational consequences for insurers

## Why premium audit matters

### Business & underwriting perspective

- Ensures correct exposure validation
- Improves loss ratio performance
- Protects profitability
- Identifies change in operations or risk trends
- Helps recommend safety improvements and can contribute to reduced number of future claims

- Strengthens underwriting discipline
- Supports fraud detection
- Enhances reserving and pricing accuracy
- Provides Insurers with reliable operational and statistical data

### Strategic value

Modern premium audit is no longer just

a back-office reconciliation process with digitization, automation, and AI become a key lever for:

- Pricing accuracy
- Operating cost reduction
- Better risk selection
- Improved customer transparency

Insurers with advanced audit capabilities gain measurable competitive advantage.

## Common audit problems & causes of errors

Premium audit accuracy depends on multiple stakeholders: The insured, agent, underwriter and auditor. Errors occur when these elements are misaligned.

### Common issues

- Incorrect application of classification or codes
- Wrong identification of operations, processes, or materials
- Misinterpretation of the named insured and ownership structure
- Inaccurate payroll or exposure projections
- Improper reclassification of risk during

or after the policy term

- Misunderstanding of remuneration rules
- Hidden subcontractor or statutory employee exposure
- Poor communication of operational changes during the policy year
- Improper application of state, bureau or rating authority rule

### Why mistakes happen

- The insured or the agent is not aware of premium audit requirements
- The underwriter misapplies the classification based on limited

information

- Operations change during the year without notification
- The client does not maintain proper documentation
- The auditor receives incomplete or unclear data
- Input errors: Audit errors may arise when information is:
  - Misread
  - Incorrectly entered
  - Incorrectly processed in the system
  - Not understanding what needs to be processed

## Importance of communication & knowledge sharing

### For the insured

- Must accurately describe their business when policy is established
- Must provide true payroll, sales, subcontractor records and exposure data
- Must notify insurer of any operational changes

### For the agent/underwriter

- Apply correct classification based on client operations
- Educate clients on exposure base
- Provide accurate projections at policy inception

### For the auditor

- Review accurate and complete records
- Understand client operations across the entire policy term
- Communicate findings clearly to insurer and insured



## Types of audits conducted

### 1. Physical audit

Best for:

- Medium/Large business
- Multiple locations
- Complex payroll or contractor operations

### 2. Telephone or virtual audit

Best for:

- Small to mid-sized businesses
- Straightforward operations

### 3. Voluntary or self-audit

Best for:

- Very small accounts
- Low-risk exposures
- Minimal complexity



## Adjustable vs flat-rate policies

Generally, commercial insurance policies are written in two ways.

- Flat rate policy
- Adjustable/auditable policy

**Flat rate policy** where there is no additional premium or refunds will be due under the policy regardless of loss exposure or changes in exposure during the term of the policy.

**Adjustable policy** where there is an additional premium or refund due if there are any changes in loss exposure at the end of policy term.

The primary purpose of premium audit is to determine the actual premium. When

the policy was issued to the insured (policy holder), the premium was charged based on the estimated/projected exposure by the underwriter.

Once the policy expires or cancels in mid-term, premium audit department ensures that insured pays premium which is equal to the actual exposure.

Premium determination is one of the main activities performed by the underwriting department. Determining policy premium is called rating. Underwriters follow the same process in calculating commodities. An insurance rate is the "unit price" for that insurance. Multiplying the rate by the number of exposure units determines the

premium. Premium audits are commonly performed on commercial insurance policies such as general liability, liquor liability, workers' compensation policies.

In general, premium calculation involves a simple mathematical formula:

Rate per unit x number of exposure units = premium

Exposure units: During policy inception the underwriter may not be able to determine the actual exposure for the policy period, so the underwriter estimates the exposure and subsequently the premium based on previous years' records. This premium is called minimum and deposit premium.

## How minimum premium & deposit premium are determined

**Minimum premium:** Insurance (especially commercial policies like WC, general liability, etc.) the minimum premium is the lowest amount an insurer will charge for the policy, regardless of actual exposure (like payroll, sales).

The Minimum premium is typically set by:

1. Underwriting guidelines or manual rules (e.g. ISO or state regulations)

2. A percentage of the estimated premium, often certain percentage (like 40%)
3. Flat premium values defined per line of business

If the audit premium/actual premium is less than M&D premium, then the insured will not pay any additional premium.

**Deposit premium** is the amount the

insured pays upfront when policy begins, and it acts as a down payment based on the estimated exposure (e.g. expected payroll, sales or turnover)

Suppose a company estimates annual payroll at 5Mn

- Rate \$2 per 1000 of payroll
- Estimated (Deposit) Premium = \$10,000 (5,000,000/1000 \*2)

## Most of the time minimum & deposit premium will be same

Usually, premium audit department will generate reports to see all the policies

that are expiring in the current month and initiate the audit the next day or the

following day of the expiry date

## Audit examples (summarized)

**The adjustable policy calculation will be as below.**

- **Here's an example of an audit with additional premium due:**
  - At the beginning of the policy: 100 concerts x \$13.24 (rate) = \$1,324 (deposit premium)
  - Audit is conducted and actual concerts discovered to be: 120 concerts
  - Recalculation of policy: 120 (audited total concerts) X \$13.24 (rate) = \$1,589 (audited premium)
  - Final premium calculation: \$1,589 (audited premium) - \$1,324 (deposit premium) = \$265 (audit bill)
- **Here's an example of an audit with a return premium:**
  - At the beginning of the policy: \$100,000 (payroll-best guess)/100 x \$13.24 (rate) = \$13,240 (deposit premium)
  - Audit is conducted and actual payroll is discovered to be: \$90,000
  - Recalculation of policy: \$90,000 (audited payroll)/100 x \$13.24 (rate) = \$11,916 (audited premium)
  - Final premium calculation: \$13,240 (deposit premium) - \$11,916 (audited

premium) = \$1,324 (audit return premium)

- **Here is an example of an audit with minimum and deposit premium as two separate charges:**

If the premium is shown as minimum premium of one amount and deposit premium of another amount, there may be additional or return premium, depending on each individual situation: If the difference between earned premium and deposit premium is a positive number, it is the additional premium. If the earned premium is less than the deposit premium but more than the minimum premium, then there will be a return premium due to the insured.

Total Numbers of Vehicles: 17

Rate: \$250 per vehicle

Earned Premium: \$4,250

Minimum Premium: \$3,750

Deposit Premium: \$5,000

**Returned Premium Due: \$750**

Deposit premium - earned premium (but more than minimum) = return premium

**\$5,000. - \$4250. (\$3750) = \$750 RP**

**Premium broke down at two or more rates (composite rates):**

Total Exposure: \$950,000

Rate (up to \$500,000) \$5,000 Flat Charge

Earned Premium: \$5,000

Rate (Excess to \$500,000) \$2 per \$1,000

Earned Premium: \$900 (\$450,000 /1,000 \*\$2)

Total Earned Premium: \$5,900

Minimum and Deposit Premium: \$5,500

**Additional Premium Due: \$400**

For an additional or return premium the insured will be notified with an endorsement.

Fortunately, an insurance premium audit might be the one type of audit in this world that doesn't necessarily mean doom and gloom. Instead, premium audits are designed to guarantee that business owners only pay the

premium they truly owe rather than a premium based on the estimated figures provided when their insurance policy was issued.

Premium audits are commonly performed on general liability, liquor liability and workers compensation policies. Auditors examine business records to determine the actual figures and make sure that the correct classification codes and rates are used in determining final premiums.

## Reason and implications of premium audit

**Why is the insurance company allowed to conduct an audit?** An insurance policy is a contract between Insured and the insurance company. Within the contract, you will find duties and conditions. When you purchase a policy, the insured agrees to abide by the terms of it. One of the policy agreements is called "AUDIT." You will generally find this under the policy section titled "PREMIUM." It's here that you give the insurance company the right to examine your records.

**Delay in the premium audit process:** This can occur when the insurer has high volume of audits to complete, or when the information submitted is incomplete or needs clarification. In many cases, audits are targeted to be completed within a set period after policy expiration, but complex operations or missing documentation can extend that timeline. Also, late audits or delays in receiving audit information can extend the process which can create billing delays.

**What kind of information will they want to review?** Within the "PREMIUM" section of a policy you'll find that the insurance company has the right to examine your records. They go on to identify the type of

records including tax reports, vouchers, contracts, payroll and other disbursement records, various journals, registers and ledgers. Records may also include computer programs and other electronic storage and retrieval systems.

**When can the insurance company conduct an audit?** The standard policy allows the insurance company access to your records for audit during regular business hours during the policy period and within three years after end of the policy. Within this section of the policy, you also allow insurance rates or advisory organizations to have the same rights as the insurance company.

**What happens if you do not complete the audit?** Typically, an insurance company needs to complete the audit within 60 days after the expiration of the policy. Audits are time-sensitive because there are certain reports that must be filed by the insurance company with the [rating authority](#) within certain reporting periods, so it's important that you work with the auditor to complete the audit in a timely fashion. If the audit is not completed, the insurance company may label your account "non-cooperative" causing your current policy to be cancelled.

They will produce an estimated audit adjustment to your policy and send you a bill. In some states an estimated audit may cause as much as 25% increase over your original policy premium. They may also report you to the rating authority as "non-compliant" and in some situations a non-compliant status may make you non-eligible to buy insurance policy. Some insurers calculate premium using industry averages, prior audits, payroll estimates, or exposure assumptions. Often results in higher premiums.

**Premium audit dispute resolution:** Disagreements over audit findings can arise among the firm, broker and insured and in these cases a defined process is followed to review and revise the audit results.

**Third-party audit agency involvement:** In some complex risks, insurers may engage an external audit firm (such as SML, FARA, Berkley & Overland solutions) to perform the audit, enabling access to specialized expertise and technology that can improve accuracy and turnaround times compared with inhouse teams.





## Executive summary

Premium audit is no longer a back-office reconciliation activity. It is a strategic lever for premium accuracy, loss ratio improvement, risk selection, and fraud detection. Audit accuracy directly strengthens underwriting profitability, while automation and targeted auditing significantly reduce operating costs.

Premium audit model best suits:

**1. Physical audit (auditor visit):** Medium or large (complex) business, complex payroll or multiple locations and business with

contractors

**2. Telephonic or virtual audit:** Small to mid-sized business, straightforward operations and when physical visits are not necessary

**3. Voluntary audit or self-audit:** Very small business, simple or low risk

Insurers that modernize premium audit using data, analytics and AI gain a measurable competitive advantage.

Premium audits remain a critical yet

complex function in commercial insurance, demanding precision, responsiveness, and stakeholder collaboration. While operational improvements have helped streamline workflows, a more profound transformation requires rethinking how audit data is captured, verified, and shared. With digital transformation, data-driven audit models – including automation, remote audits, and AI – continue to elevate accuracy and efficiency while reducing costs.

For more information, contact [infosysbpm@infosys.com](mailto:infosysbpm@infosys.com)

**Infosys**<sup>®</sup>  
Navigate your next

© 2026 Infosys Limited, Bengaluru, India. All Rights Reserved. Infosys believes the information in this document is accurate as of its publication date; such information is subject to change without notice. Infosys acknowledges the proprietary rights of other companies to the trademarks, product names and such other intellectual property rights mentioned in this document. Except as expressly permitted, neither this documentation nor any part of it may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, printing, photocopying, recording or otherwise, without the prior permission of Infosys Limited and/ or any named intellectual property rights holders under this document.