

Search

[Advanced Search](#) | [Browse By Topic](#)

Print

Email

Write to the Editor

Reprints



Current R&I Issue

Issue Archive

Subscribe

Advertise

Magazine Content

Home

Features

Columnists

Industry Risk Reports

In-Depth Series

Special Reports

Resources and Tools

Power Broker™
Directory

Risk Innovators

Case Studies

Industry Events

WORKERSCOMP
Forum™

Award Nominations

Vendor Directories



RSS

R&I Information

Subscription Center

Advertiser Information

About Us

Contact Us

Acquisition Due Diligence: Know the Mod Impact

Let me tell you the story of ABC Co., which got two nasty surprises when it acquired a new company.

By G. MARTIN IRONS, CPCU, CIC, ARM, technical development team leader and member of the Construction and Mergers & Acquisitions practice groups at the Graham Co.

ABC Company completed a thorough due diligence of the acquired company's financials. It looked under the hood and kicked the tires to make sure it was a good purchase. However, its insurance broker did not review with them the impact on its workers' compensation insurance experience modification. As a result, six months after the acquisition, ABC received two surprises:

Surprise No. 1: Its workers' compensation audit was \$42,000 more than ABC had accrued.

Surprise No. 2: ABC's bid on a big job was rejected because its workers' comp mod was now above a 1.00.

What went wrong?

As part of the acquisition due diligence, an analysis of the impact to ABC's mod was not performed.

The workers' comp experience mod is a factor calculated by a state's workers' compensation bureau based on a company's prior loss experience. In simple terms, if ABC has lower loss experience than the average company for its class of business, ABC receives a credit mod, say, 0.750. This credit mod would correlate into a 25 percent discount off of the standard workers' comp rates.

Conversely, if ABC has a loss experience that is higher than the average company for its class of business, it receives a debit mod, say, 1.400, which would correlate to a 40 percent surcharge to the standard rates.

MOD + M&A

Now back to our two surprises. The mistake ABC made was thinking that only their loss experience would be used in calculating their experience mod. The firm's insurance broker failed to inform them that, when a company acquires another, it will typically also acquire that company's past loss experience and it will be included in

Related Coverage

- [For the City of Angels, Enterprise Risk Management Can Wait](#) (12/01/08)
- [Accountability and ERM](#) (05/01/09)
- [What's Next?](#) (04/15/09)
- [Studying Economic Ecology](#) (01/01/09)
- [Creating a Culture of Wellness](#) (08/01/08)

mod calculations.

Take an example of the stock purchase of a distressed company. Here, ABC Co. purchases the stock of a distressed company (XYZ Inc.). The state workers' compensation bureau includes the bad loss experience of XYZ in ABC's mod, and because of this ABC's mod is revised and increases 14 percent.

This negative impact results in an additional cost of \$42,000 the first year. The problem is further magnified because the impact of XYZ's bad losses gets felt for a total of three years--until all of XYZ's bad losses drop out of ABC's future mod calculations.

So in calculating the hidden additional cost of this acquisition, ABC gets hit for \$92,000 over those three years and the loss of a big \$800,000 job due to a mod above a 1.00 (surprise No. 2).

In another example, an asset-only purchase of a distressed firm, ABC Co. purchases only the assets of XYZ. ABC's mod is revised to include the positive impact of XYZ's good loss experience. The result? A mod reduction of 11 percent, resulting in savings of \$37,000 in the first year, \$24,000 in the second year and \$14,000 in the third year.

Here, the hidden additional savings due to this acquisition are \$75,000 over those three years.

The moral of the story? Purchasing another company will likely impact your experience mod (either positively or negatively) for three years, and your broker should be reviewing this analysis as part of the due diligence prior to the acquisition.

EXCEPTIONS TO REMEMBER

However, it is important to note that purchasing another company will not always impact your mod. Here are some additional items to consider:

--In a situation where there are two or more companies and ABC buys only one, it is important to verify if there are any other commonly owned entities that are combined in the experience mod of the company being acquired. If there are, ABC would likely not assume the prior loss experience.

--If ABC is involved in a partial sale and purchases only part of a company's assets or operations, ABC would likely not have assumed the prior loss experience.

--If ABC's intent of the acquisition is not to maintain a "substantial portion" of the employees (typically equaling 51 percent or more of the company's employees), in several states it will not assume the prior loss experience of the acquired company.

Keep in mind that these transactions are complex and answers vary based upon circumstances and the procedures of the specific state workers compensation bureau. Prior to making an acquisition, your insurance broker should complete a thorough analysis of the impact to your workers' comp mod based on the specific situation. This analysis may uncover extra savings created by the acquisition or prevent the surprise of additional costs that develop after the acquisition has been finalized.

April 1, 2009

Newsletter Sign-up
Click on the name of the **free newsletter** below to preview:

[R&I One™](#)

[WORKERSCOMP](#)

[Forum™ Update](#)

HTML Text
E-Mail Address:

[Click here to unsubscribe](#)

[Privacy Policy](#)

[Preferences](#)

RISK & INSURANCE

[Contact Us](#) | [Subscribe](#) | [Advertise](#)
National Workers' Compensation and Disability
Conference and Expo

[Back to top](#)

© Copyright 2009 LRP Publications. All rights reserved.