Internal Audit Report

DEPARTMENT OF COUNTY ADMINISTRATION
TAKE-HOME VEHICLE USE AUDIT
SEPTEMBER 2008

Office of the County Auditor

OFFICE OF THE COUNTY AUDITOR

Haskell N. Arnold, CPA
County Auditor

September 2008

The County Council and County Executive
of Howard County, Maryland

Pursuant to Section 212 of the Howard County Charter and Council Resolution 22-1985, we have conducted a review of selected activities of the

DEPARTMENT OF COUNTY ADMINISTRATION
TAKE-HOME VEHICLE USE

and our report is submitted herewith. The scope of our examination related specifically to a review of polices and procedures relating to the use of county vehicles by employees assigned take-home vehicles. The body of our report presents our findings and recommendations.

The contents of this report have been reviewed with the Chief Administrative Officer. We wish to express our gratitude to the Department of County Administration for the cooperation and assistance extended to us during the course of this engagement.

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SUMMARY

We performed a review of policies and procedures relating to the use of county vehicles by employees assigned take-home vehicles. We specifically reviewed those records relating to those individuals who were assigned a county vehicle during calendar year 2007. The County Administration administers this program. The Office of Central Services maintains records of the vehicles assigned. The Department of Finance prepares adjustments to employees' paychecks to record the fringe benefit included in taxable income related to the take-home vehicle benefit. For calendar year 2007, 47 employees were assigned county owned vehicles. We reviewed records assessing the taxable benefit in income for each employee, as well as other records available.

The purpose of our review of county take-home vehicles was to evaluate policies and procedures and to determine if they were in compliance with IRS and County guidelines. Based upon our discussions and testing, we feel that policies and procedures should be improved. We found that more internal controls are needed to ensure that take-home vehicles are accounted for properly.

We made several recommendations to improve the conditions noted within this review. These recommendations will help strengthen controls over take-home vehicles by requiring; written policies and procedures, logs, and more timely adjustments to include taxable income in employee paychecks. Our recommendations were made to ensure compliance with IRS regulations.

INTRODUCTION AND SCOPE

Our audit focused on the take-home use of county owned vehicles by employees. We included a review of record keeping and reporting requirements by employees assigned a take-home vehicle. We also reviewed applicable IRS regulations requiring the inclusion of the benefit in taxable income of the employees assigned vehicles.

The objective of our audit was to review the County's take-home vehicle practices to determine whether take-home vehicle assignments were consistent with relevant county policies and procedures and to ensure that vehicles are only allocated to and utilized by authorized staff for defined purposes. We performed tests to determine if records are consistent with policies and procedures. We reviewed the list of employees assigned take-home vehicles, the calculation of taxable benefits, the justification of business use, the miles driven and economic benefit. In addition, management of take-home vehicle assignments and ongoing monitoring and reporting practices were reviewed. The county's compliance with federal tax requirements for reporting the benefit value of take-home vehicles was also reviewed.

BACKGROUND

The Office of Central Services provides and maintains a fleet of vehicles to meet the needs of the County. Take-home vehicles are provided to a number of employees. We obtained and reviewed a listing of take-home vehicles as of November 2007. The following titles have take-home vehicles:

Citizen Services:
- Director

County Executive's Office:
- County Executive
- Chief of Staff

County Administration:
- Chief Administrative Officer
- Supervisor, Fleet
- Supervisor, Fleet

Corrections:
- Director

Housing & Community Development:
- Director

Inspections Licenses & Permits:
- Director

Planning & Zoning:
- Director
- Deputy Director

Public Works:
- Director of Public Works
- Deputy Director
- Chief, Bureau of Engineering
- Chief, Construction Inspection
- Supervisor, Inspections
- Supervisor, Inspections
- Supervisor, Inspections
- Specialist, Inspections
- Chief, Bureau of Environmental Services
- Chief, Collections Division
- Chief, Bureau of Facilities
- Chief, Bureau of Highways
- Superintendent, Highways
- Superintendent, Highways
- Superintendent, Highways
- Chief, Bureau of Utilities
- Manager, Utilities
- Supervisor, Utilities
- Supervisor, Wastewater
- Supervisor, Wastewater
- Superintendent, Wastewater

Recreation & Parks:
- Director
- Chief, Bureau of Recreation
- Manager, Sports
- Supervisor, Recreational Licensed Child Care
- Chief, Bureau of Parks
- Manager, Parks Operations
- Manager, Natural Resources
- Supervisor, Park Operations
- Supervisor, Park Operations
- Supervisor, Parks Operations
- Supervisor, Parks

Technology & Communication Services:
Director

State's Attorney:
State's Attorney

The non-business use, including commuting, of the 45 take-home vehicles listed above are taxable fringe benefits and subject to the reporting and substantiation requirements of the Internal Revenue Service. The vehicles are not qualified nonpersonal use vehicles. The term qualified nonpersonal use vehicle is any vehicle which, by reason of its nature, is not likely to be used more than a de minimis amount for personal purposes. Vehicles which are qualified nonpersonal use vehicles include clearly marked police and fire vehicles, vehicles designed to carry cargo with a loaded gross vehicle weight over 14,000 pounds, delivery trucks with seating only for the driver, specialized utility repair trucks, school buses, tractors, and unmarked vehicles used by law enforcement officers.

FINDINGS AND RECOMMENDATIONS

Policies and Procedures

Howard County Policy and Procedure Number 200.2, Vehicle Use, provides rules and procedures for the use and operation of county vehicles (last revised 07/01/02). The policy is also incorporated in the Employee Manual. This policy applies to all county vehicles including take-home vehicles. Much of the policy relates to the use of county owned vehicles during normal work hours. However, there is a section relating to records, and another section relating to taxable income which specifically relates to take-home vehicles.

All employees are required to comply with the record keeping requirements contained in Section (c)(5)(i) of the policy. Unless exempted by the Chief Administrative Officer, any person driving a county vehicle shall indicate, by an entry into the Office of Central Services **Uniform Vehicle Utilization Log** or equivalent form, the driver, date, destination and beginning and ending odometer reading of each trip, including each commute. During business use, law enforcement vehicles and other vehicles used continuously during the business day shall show beginning and ending odometer reading for each shift and all lunch/dinner breaks. Persons authorized to use vehicles for personal use may enter “personal” as the destination but must enter beginning and ending odometer reading for each day on the log. If an employee has been exempted from the requirements by the Chief Administrative Officer, the employee shall keep records of the employee’s personal miles and commuting use of the county vehicle and shall provide such information to the County upon request. For employees whose use is valued based on the number of commutes, the County calculates the value as if the employee worked 225 days in a taxable year and commuted two times each day. The number of days was determined by taking into consideration the number of holidays, vacation days and sick days of employees.

The value of the non-business use of a county vehicle assigned to an employee is includible in the employee’s income. Non-business use includes the use of the county vehicle to commute from an employee’s home to the office and from the office. For those employees who are required to bring their car home with them, personal use by the employee is prohibited, other than for commuting and for occasional, brief personal purposes.

The current policy is out of date and incomplete in regards to assignment and reporting of take-home vehicles. A current, written county-wide guide would ensure greater compliance, efficiency and cost effectiveness. We recommend that:

1. ***Howard County Policy and Procedure 200.2 Vehicle Use be updated to reflect changes made since 2002.***

Administration's Response:

The Administration concurs with this recommendation. The Howard County Central Fleet Manual has been revised and reflects changes made since 2002. This manual supersedes Howard County Policy and Procedure 200.2, Vehicle Use.

The policy requires the use of a Uniform Vehicle Utilization Log (see Attachment 1). This form is required to be completed on a monthly basis. This form is not being completed monthly as required by the policy. We recommend that:

2. ***The Uniform Vehicle Utilization Log be completed and submitted monthly as required by Howard County Policy and Procedure 200.2. Only employees assigned qualified nonpersonal use vehicles should be exempt from completing the log.***

Administration's Response:

The Administration concurs with this recommendation and the revised Howard County Central Fleet Manual requires the Vehicle Utilization Log be maintained on a monthly basis. A copy of this report should be forwarded to Central Fleet for all employees that have an On Call or Assigned Take Home Vehicle no later than the 10^{th} day of the month following the reporting period. Employees assigned nonpersonal use vehicles are NOT exempt from completing the log.

Those employees exempted from the reporting requirements in the policy must still keep records of their personal miles and commuting use of the county vehicle and provide such information to the County upon request. Even if all of the employees assigned take-home vehicles are exempt by the Chief Administrative Officer, there is no record of such exemption being granted. We recommend that:

3. ***No exemption from the reporting requirements be granted to any employee except employees assigned nonpersonal use vehicles.***

Administration's Response:

The Administration concurs with this recommendation and will delete the language referring to an exemption by the CAO on page 27 of the Howard County Central Fleet Manual.

The policy does not address the issue of vehicle assignment or specify the requirements for receiving a take-home vehicle. Written criteria should be established for take-home vehicle eligibility. One or more of the following could be used as justification for assignment of a take-home vehicle: frequent non-duty hour service calls (such as at least once a month), vehicle necessary for proper emergency response, response is required within a limited time frame, specialized equipment is in the vehicle and is necessary for proper response, or professional judgment. Department directors should submit justification to the Chief Administrative Officer who should then approve assignments. We recommend that:

4. ***<u>The Vehicle Use policy be revised to include specific requirements for granting take-home vehicles to employees who will receive taxable income from the fringe benefit. Written justification should be prepared and approved before take-home vehicles are assigned.</u>***

<u>Administration's Response:</u>

In some circumstances, the cost benefit may not be the overriding factor in determining whether a vehicle is assigned. In these cases, it is in the best interest of the County for the CAO to determine if a vehicle should be allocated to the employee. For example, the Department of Public Works, Traffic Division has an employee that is responsible for repairs to traffic lights. Even though this employee does not fit the on call criteria and the cost benefit is not in the best interest of the County, the CAO has determined that it is essential for him to have a vehicle because of the nature to his job function. The positions "specifically allocated assigned vehicles" are not required to complete a cost benefit analysis since they meet the criteria indicated in the policy.

Due to the increasing cost of fuel, consideration should be given to only allowing employees living within the County limits to be assigned a take-home vehicle. The County Executive or Chief Administrative Officer could, at his discretion, assign take-home vehicles to employees who live outside the County limits if it is in the best interest of the County. Even at a conservative cost of 50 cents per mile, the cost of take-home vehicles to the County is over $100,000 per year (commuting miles times cost per mile). We recommend that:

5. ***<u>The Vehicle Use policy be revised to limit assignment of take-home vehicles to employees who live within the County.</u>***

Administration's Response:

> An exception exists to allow On Call Take Home vehicles to be taken out of the County in certain cases. An example of this would be if there was only one employee who lives inside the County qualified to perform a particular emergency function. The decision was made that it would be unreasonable to expect the employee to be on call seven days a week. Therefore, it would be necessary to have an employee that lives outside the County on call to relieve this employee.

Providing a take-home vehicle to an employee is considered a form of compensation. As such, the value of the compensation must be properly calculated and taxed. We compared the list of assigned take-home vehicles to payroll records. We noted that all employees who are provided vehicles have their gross wages adjusted for this taxable fringe benefit. In accordance with IRS regulations, any commuting use of a vehicle (other than qualified non-personal use vehicles) is to be treated as compensation. Failure to ensure that employee fringe benefits are correctly accounted for can result in violations of Federal law with the possibility of fines.

The value of the non-business use of a county vehicle assigned to an employee is includible in the employee's income. Non-business use includes the use of the county vehicle to commute from an employee's home to the office and from the office back home. We reconciled the fleet records to records maintained by the Department of Finance. The current practice is to include the value of the non-business use of a county vehicle as a one-time adjustment to income on a paycheck.

The County calculates the tax period from November 1 to October 31. The taxable fringe benefit is reflected in the first pay check in December (December 7, 2007 for the year November 1, 2006 to October 31, 2007). Vehicles are monitored monthly, but reported annually. If an employee leaves, vehicle use is included on the final paycheck. We examined the paychecks and W-2s for employees who were charged for non-business use for the year ended October 31, 2007 and found several situations where mistakes were made which had to be corrected on subsequent paychecks or on the W-2. Timely reporting along with monthly logs would result in more accurate reporting and greater compliance with IRS regulations. We recommend that:

6. ***The value of non-business use be calculated monthly and added to the second paycheck of the following month. This would ensure timelier reporting of personal use. In addition, the possibility of mistakes would reduce.***

Administration's Response:

> In the Record Keeping section of the manual, it is stated that estimated personal use will be charged through payroll each pay period and adjusted each month following the receipt of the monthly Vehicle Utilization Mileage Log. In the Tax Consequences section of the manual, it is stated that the value of the non-business use of a County vehicle by an employee is included in the employee's income.

We obtained and reviewed a list of take-home vehicles assigned to employees. We noted that the list included employees who no longer work for the County, and omitted some employees who did have an assigned take-home vehicle. We recommend that:

7. ***Procedures be developed to ensure that the assignment of take-home vehicles is closely documented and updated as changes occur.***

Administration's Response:

> The Administration concurs with this recommendation and it is reflected in the Record Keeping section of the manual. On a monthly basis, each department shall submit an updated list of all Assigned Take Home vehicles to the Central Fleet Administrator. As a result, Central Fleet can closely monitor and document all Assigned Take Home Vehicles.

For calendar year 2007, 47 employees were assigned take home vehicles for some portion of the year. These 47 employees received taxable income on their W-2s for 2007. The total employees receiving taxable fringe benefits from the use of take-home vehicles differs from the number of positions assigned take-home vehicles because some positions were occupied by two different employees during the taxable year. One position, the Director of the Department of Housing and Community Development, was added after the taxable year.

Tax Consequences

The Internal Revenue Service's Publication 15-B, **Employer's Tax Guide to Fringe Benefits** provides guidance and requirements for the proper reporting of employees' use of a take-home vehicle as a fringe benefit. The Internal Revenue Service provides for strict requirements regarding the use by employees of employer-provided vehicles. In general, when an employer vehicle is used partly for business use and partly for personal use, the verified business use is not taxable to the employee, and the personal use is taxable to the employee as wages. Taxable personal use of an employer-provided vehicle includes commuting between residence and work station, and vacation, weekend use, or use by spouse or dependents. De minimis nontaxable personal use includes small personal detours while on business, such as driving to lunch while out of the office on business. Separate records of business and personal mileage are required. If records are not provided by the employee, the value of all use of the vehicle is wages to the employee. If records are provided by the employee, only the personal use of the vehicle is wages to the employee. Personal use of employer-provided vehicle is determined by computing the personal use percentage based on miles driven and applying the appropriate valuation rule, the General Valuation Rule or the Special Automobile Valuation Rules.

Under the **General Valuation Rule**, the value of a fringe benefit is its fair market value. In general the FMV of an employer-provided vehicle is the amount the employee would have to pay a third party to lease the same or similar vehicle on the same or comparable terms in the geographic area where the employee uses the vehicle. A comparable lease term would be the amount of time the vehicle is available for the employee's use, such as a one-year period. Under the General Valuation Rule, the fair market value of what the employee would pay to lease the vehicle is multiplied by the percentage of personal use.

There are also three Special Automobile Valuation Rules. Under the **Lease Value Rule**, the value of an automobile provided to an employee is determined by using its annual lease value. The fair market value of the vehicle on the first day it is made available to the employee is determined, then the table in Treasury Regulation §1.61-21(d)(iii) is used to compute the Annual Lease Value. The Annual Lease Value is multiplied by the percentage of personal use. Once computed, the Annual Lease Value remains in effect until 12/31 of the 4^{th} full calendar year after the rule is first applied. The annual lease value does not include the value of fuel provided to an employee for personal use. The value of the fuel must be included separately in the employee's wages. Fuel provided can be valued at fair market value or at 5.5 cents per mile.

Under the **Cents-Per-Mile Rule**, the value of a vehicle provided to an employee for personal use is determined by multiplying the standard mileage rate by the total miles the employee drives the vehicle for personal purposes. This amount must be included in the employee's wages. For 2007, the standard mileage rate was 48.5 cents a mile. The cents-per-mile rule can be used if either of the following requirements is met, the vehicle is regularly used for business, or the vehicle meets the mileage test. The cents-per-mile rule cannot be used if the vehicle's value exceeds $15,100 for a passenger automobile or $16,100 for a truck or van. The regular use requirement is met if at least 50% of the vehicle's total annual mileage is for business. The mileage test is met if the vehicle is driven at least 10,000 miles during the year. If fuel is not provided, the standard mileage rate can be reduced by up to 5.5 cents (48.5 cents – 5.5 cents = 43 cents in 2007).

Under the **Commuting Rule**, the value of a vehicle provided to an employee for commuting use is determined by multiplying each one-way commute by $1.50. The commuting rule can be used if all of the following requirements are met. The vehicle is provided to an employee for business use and, for bona fide non-compensatory business reasons, the employer requires the employee to commute in the vehicle. The employer must establish a written policy under which it doe not allow the employee to use the vehicle for personal purposes other than for commuting or de minimis personal use. The employee does not use the vehicle for personal purposes other than commuting and de minimis personal use. The employee who uses it for commuting is not a control employee. A **Control Employee** is one whose compensation is equal to or exceeds Federal Government Executive Level V ($136,200 for 2007) or an elected official.

According to the **Internal Revenue Service, Treasury Regulations §1.274-5T Substantiation Requirements**, taxpayers must substantiate each element of an expenditure by adequate records or by sufficient evidence corroborating his own statement. To meet the adequate records requirement, an account book, diary, log, statement of expense, trip sheet, or similar record must be prepared or maintained in such manner that each recording of an element of an expenditure or use is made at or near the time of the expenditure or use and is sufficient to establish each element of an expenditure. In order to constitute an adequate record of business purpose, a written statement of business purpose is generally required. However, the degree of substantiation necessary to establish business purpose will vary depending upon the facts and circumstances of each case. Where the business purpose is evident from the surrounding facts and circumstances, a written explanation of such business purpose is not required.

There are exceptions for qualified nonpersonal use vehicles. Use of a qualified nonpersonal-use vehicle, including commuting, is nontaxable to the employee and recordkeeping and substantiation by the employee are not required by the IRS. A qualified nonpersonal use vehicle is any vehicle that the employee is not likely to use more than minimally for personal purposes because of its design. The term qualified nonpersonal use vehicle means any vehicle which, by reason of its nature, is not likely to be used more than a de minimis amount for personal purposes. Vehicles which are qualified nonpersonal use vehicles include the following: clearly marked police and fire vehicles, ambulances used as such, vehicles designed to carry cargo with a loaded gross vehicle weight over 14,000 pounds, bucket trucks, cement mixers, combines, cranes, delivery trucks with seating only for the driver, or the driver plus a folding jump seat, dump trucks, flatbed trucks, forklifts, passenger buses used as such with a capacity of at least 20 passengers, qualified moving vans, qualified specialized utility repair trucks, refrigerated trucks, school buses, tractors, and unmarked vehicles used by law enforcement officers if the use is officially authorized.

Clearly marked police or fire vehicles include vehicles which are owned or leased by a governmental unit, that are required to be used for commuting by a police officer or fire fighter who, when not on a regular shift, is on call at all times, provided that any personal use (other than commuting) of the vehicle outside the limit of the police officer’s arrest powers or the fire fighter’s obligation to respond to an emergency is prohibited by such governmental unit. A police or fire vehicle is clearly marked if, through painted insignia or words, it is readily apparent that the vehicle is a police or fire vehicle. A marking on a license plate is not clear marking. The substantiation requirements do not apply to officially authorized uses of an unmarked vehicle by a “law enforcement officer”. To qualify for this exception, any personal use must be authorized by the Federal, State, county, or local governmental agency or department that owns or leases the vehicle and employs the officer, and must be incident to law-enforcement functions, such as being able to report directly from home to a stakeout or surveillance site, or to an emergency situation. Use of an unmarked vehicle for vacation or recreation trips cannot qualify as an authorized use. The term law enforcement officer means an individual who is employed on a full-time basis by a governmental unit that is responsible for the prevention or investigation of crime involving injury to person or property, who is authorized by law to carry firearms, execute search warrants, and to make arrests, and who regularly carries firearms.

The IRS requires that employers maintain a written policy statement that implements a policy restricting personal use of employer-provided vehicles. The County meets this requirement in

Howard County Policy and Procedure 200.2 Vehicle Use. However, it is also essential that the County comply with the Treasury Regulations requiring substantiation of the business use of county owned vehicles. Employees should keep logs of their usage of take-home vehicles and submit the logs monthly reporting daily working mileage and mileage driven between work and residence. We recommend that:

8. ***Monthly logs be completed by all employees assigned a take-home vehicle. The only exception to this requirement would be for employees assigned qualified nonpersonal use vehicles.***

Administration's Response:

The Administration concurs with this recommendation and as reflected in the Record Keeping section of the manual, drivers of Assigned Take Home Vehicles MUST maintain adequate records to support mileage activity. These employees MUST submit their mileage activity on a monthly basis to Central Fleet by the 10^{th} of the following month. As stated in recommendation #2, employees assigned nonpersonal use vehicles are NOT exempt from recordkeeping.

For calendar year 2007, the county reported fringe benefit for 47 employees on employee W-2 forms. Of the 47 employees, only one employee's fringe benefit was calculated using the cents-per-mile valuation method. The Lease Value Rule was used to calculate fringe benefits for 33 employees. Fringe benefits for 19 employees were calculated using the $3/day commuting valuation method. Of these 19 employees, six also received fringe benefits calculated based on annual lease value as well as the commuting rule. The commuting rule requires that, for bona fide non-compensatory business reasons, the employer require the employee to commute in the vehicle. We did not find documented bona fide non-compensatory business reasons that required the 19 employees to commute in the vehicles; therefore, we question the validity of the use of the commuting valuation method for these 19 employees. We recommend that:

9. ***Documentation be prepared to substantiate the valuation method used to determine the calculation of taxable fringe benefits for the use of each take-home vehicle subject to taxation as a fringe benefit.***

Administration's Response:

The Administration concurs with this recommendation and has added a statement on page 27 under the heading Tax Consequences. The statement reads as follows: *Any vehicle that has been assigned that does not meet the requirements of a qualified nonpersonal use vehicle will be considered a taxable fringe benefit. The Payroll Department will determine the value of the personal use by using the rules established by the Internal Revenue Service to decide which one of the three valuation methods (Commuter Valuation, Cents per Mile or Annual Lease Value) to use.*

LG:vu08

Attachment 1

DEPARTMENT OF COUNTY ADMINISTRATION
OFFICE OF CENTRAL SERVICES

UNIFORM VEHICLE UTILIZATION LOG

Complete this form on a Monthly basis. Forward the white to Central Services. Retain the yellow copy for your files or forward to your Department manager.

Month/Year ____/____ **Vehicle FAICS Number ____ ____ ____ ____ ____ ____**

Day	Odometer Reading Beginning	Odometer Reading Ending	Driver Name	Description
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