

**Performance Audit:
Payroll Tax Compliance**

April 2006

**City Auditor's Office
City of Atlanta**



CITY OF ATLANTA

City Auditor's Office
Leslie Ward, City Auditor
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April 2006

Why We Did This Audit

We identified payroll tax withholding and reporting as a risk during our review of the city's payroll processes. We focused our audit on areas that the IRS identified as high risk of noncompliance for local government employers: reporting and withholding taxes on fringe benefit income, improperly classifying employees as contract workers, and Medicare withholding.

What We Recommended

The city should correct inaccurate reporting made to the IRS and refund amounts withheld in error. The chief financial officer should:

- Issue corrected W-2s for employees who did not have Medicare tax withheld, or who received taxable fringe benefits that were not reported as income;
- Determine the total amount of Medicare tax withheld in error and refund this amount to the employees;
- Work with the commissioner of human resources to revise policies on moving expense reimbursements and with the chief operating officer to revise the administrative order on cell phones to simplify the city's tax administration duties;
- Propose legislation to amend the city code on personal use of city-owned vehicles so the code complies with IRS regulations; and
- Develop procedures to accurately track and report the personal use of city equipment.

We also recommend that the chief procurement officer and city attorney develop guidance for departments on the proper classification of contract workers to be included in the city's procurement manual.

For more information regarding this report, please contact Gerald Schaefer at 404.330.6876 or gschaefer@atlantaga.gov.

Performance Audit:

Payroll Tax Compliance

What We Found

The city lacks central processes to ensure that employee income is accurately reported and employment taxes are withheld on all income. The city's policies on fringe benefits are inconsistent with, or do not address, federal employment tax requirements. Also, the city does not have a policy covering appropriate use of contract workers. The lack of processes exposes the city to potential liability for back taxes, penalties, and interest on amounts not withheld or incorrectly reported.

The city is not reporting all fringe benefit income to the IRS, nor is it withholding employment taxes from this income. We found problems with three types of fringe benefits: use of city cell phones, use of city vehicles, and payment of employee moving expenses.

The city does not track employees' personal use of city cell phones. Additionally, the city's process for tracking employees' personal use of city vehicles results in both underreporting taxable income, and failing to withhold employment taxes from the income that is reported. Furthermore, the city should revise its policy to only reimburse moving expenses that are deductible under IRS regulations.

The city could reduce its liability and simplify reporting and withholding for fringe benefits by revising its policies to align with federal requirements, and by granting a monthly allowance to employees with a business need for a cell phone or a vehicle. Employees who occasionally use their personal equipment for city business should seek reimbursement. In addition to simplifying tax reporting and withholding, these changes would promote more prudent use of city resources.

The city has no central process to ensure that workers hired under contract actually meet the criteria to be classified as independent contractors under IRS tax regulations. Department heads are responsible for hiring contractors but lack the expertise and guidance to ensure that they are complying with federal tax regulations.

We also found a few instances in which the city incorrectly withheld, or failed to withhold, Medicare taxes.



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AUDIT COMMITTEE
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Fred Williams
Mayor Shirley Franklin
Council President Lisa Borders

April 17, 2006

Honorable Mayor and Members of the City Council:

We identified non-compliance with Internal Revenue Service (IRS) regulations on employer tax reporting and withholding as a risk during our review of the city's payroll processes. The city risks potential fines and penalties if it fails to comply with IRS regulations.

Our review of the city's compliance with IRS payroll tax regulations, completed between August 2005 and November 2005, found that the city lacks central processes to ensure employee income is accurately reported and employment taxes are withheld on all income.

Our recommendations focus on revising city policies and practices to simplify the city's tax administration duties, and ensure taxable employment income and payroll tax withholding are properly reported. Management's responses to our recommendations are appended to the report. While management agreed with most of our recommendations, the director of the Department of Information Technology, responding on behalf of the chief operating officer, disagreed with our recommendation to fund business use of cell phones and PDAs primarily through allowances to employees, and, we believe, mischaracterized our analysis. We have issued comments to the director's response in Appendix 11.

The Audit Committee has reviewed this report and is releasing it in accordance with Article 2, Chapter 6 of the City Charter. We appreciate the courtesy and cooperation of city staff throughout the audit. The team for this project was Ty Elliott and Gerald Schaefer.

Leslie Ward
City Auditor

Wayne Woody
Audit Committee Chair

Payroll Tax Compliance

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Introduction

We conducted this audit of the city's federal employment tax reporting and withholding pursuant to Chapter 6 of the Atlanta City Charter, which establishes the City of Atlanta Audit Committee and the City Auditor's Office and outlines their primary duties.

A performance audit is an objective, systematic examination of evidence to independently assess the performance of an organization, program, activity, or function. The purpose of a performance audit is to provide information to improve public accountability and facilitate decision-making. Performance audits encompass a wide variety of objectives, including those related to assessing program effectiveness and results; economy and efficiency; internal control; compliance with legal or other requirements; and objectives related to providing prospective analyses, guidance, or summary information.¹

We identified compliance with Internal Revenue Service (IRS) regulations on employer tax reporting and withholding as a risk during our review of the city's payroll processes. The city risks potential fines and penalties if it fails to comply with IRS regulations. Consequently, we included this topic in our 2005 audit plan. The Audit Committee reviewed our specific audit scope in August 2005.

Background

Employers must report employee income, and withhold and remit employment taxes to the federal government. The IRS regulates and enforces employment tax collection. According to the IRS, local government employers face the highest risk of noncompliance in reporting and withholding taxes on fringe benefit income, improperly classifying employees as contract workers, and Medicare withholding. Failure to properly report employees' income and withhold employment taxes can result in fines and penalties.

¹ Comptroller General of the United States, *Government Auditing Standards*, Washington, DC: U.S. Government Accountability Office, 2003, p. 21.

Fringe Benefit Income Is Subject to Employment Taxes

A fringe benefit is an indirect, non-cash benefit provided to employees by employers in addition to regular wage or salary compensation. IRS regulations state that a fringe benefit is a form of pay for the performance of services; therefore, any fringe benefit an employer provides is taxable and must be included in the employee's pay unless the law specifically excludes it. IRS regulations provide a de minimis (minimal) exception for some fringe benefits, defined as when the benefit is of so little value that to account for it would be too burdensome, such as employee cafeteria discounts. Our preliminary review of city processes identified the following fringe benefits as high-risk areas of tax noncompliance: personal use of city-owned vehicles, personal use of city-owned cell phones, and moving expense reimbursements.

Use of city vehicles for personal business is taxable income.

An employee's personal use of a city-owned vehicle is a fringe benefit that IRS regulations treat as taxable income. The city is responsible for tracking personal use of city vehicles, reporting the value of the use as income, and withholding employment taxes on the income. IRS regulations limit an employee's personal use of a qualified non-personal use vehicle, defined as a vehicle that is not likely used more than a minimal amount for personal purposes. For example, clearly marked police or fire vehicles, flatbed trucks, school buses, and ambulances are qualified non-personal use vehicles. Employees may receive authorization to use such vehicles for commuting as long as it serves a public purpose. Otherwise, commuting to work is considered personal use regardless of the vehicle type. Appendix 1 summarizes IRS provisions for valuing personal use of employer-owned vehicles.

Use of city cell phones for personal business is taxable income. An employee's personal use of a city-owned cell phone is a taxable fringe benefit. The city is responsible for tracking personal use of city cell phones and similar devices, reporting the value of the use as income, and withholding employment taxes on the income.

Some moving expenses the city reimburses are taxable income. IRS regulations define employee moving expenses paid by employers as taxable fringe benefits when the expenses are not considered tax deductible. IRS regulations do not allow meal expenses, pre-move house-hunting expenses, and temporary living

expenses as deductible moving expenses. Therefore, reimbursement for these expenses is a fringe benefit that is taxable income.

Contract Workers Could Be Subject to Employment Taxes

The city is responsible for reporting employees' income to the IRS and for withholding employment taxes. The city must report payments made to contractors but does not withhold employment taxes for contract employees – the employing organization or an individual independent contractor is responsible for paying the employment taxes. IRS regulations provide criteria for determining whether a worker is an independent contractor or an employee under the common-law standard. The city must withhold employment taxes for workers who meet the criteria for being an employee even if the worker is working for the city under contract.

Worker status depends on the nature of the relationship between the employer and the worker. The common-law rule for distinguishing between an employee and a contractor is whether the employer has the right to tell the worker not only what to do but also how to do it. Generally, employees are paid for their time on the job and contractors are paid for a product or service. The IRS considers many factors in determining whether a worker is an employee or a contractor and groups these factors into three broad categories:

- **Behavioral Control**: Does the entity have the right to control the behavior of the worker through instructions, training, procedures, scheduling, or evaluation systems?
- **Financial Control**: Who bears the financial risk for unsatisfactory performance? Does the individual maintain a visible workplace, advertise, or work for more than one entity?
- **Nature of the Relationship**: Is the relationship between the worker and the entity functionally similar to an employer/employee relationship?

Appendix 6 summarizes other IRS provisions governing worker classification.

Medicare Must Be Withheld for Employees Hired After March 31, 1986

Local government employees hired (or rehired) after March 31, 1986 are subject to mandatory Medicare tax. Medicare should not be withheld for two groups: employees hired before March 31, 1986 who have been continuously employed by the city, and non-resident alien employees with visas authorizing the individual to work in the United States.

Audit Objectives

This report addresses the city's compliance with IRS regulations relating to payroll. It is designed to answer the following questions:

- Is the city correctly accounting for its provision of certain fringe benefits such as personal use of city-owned vehicles, personal use of city-owned cell phones and other mobile devices, and city payment for moving expenses?
- Is the city complying with IRS regulations in its tax treatment of contract workers?
- Is the city appropriately withholding Medicare tax from the pay of covered employees?

Scope and Methodology

This audit was conducted in accordance with generally accepted government auditing standards. We conducted our fieldwork from August 2005 through November 2005. The audit methods included:

- interviewing staff involved with recording and tracking fringe benefits;
- reviewing Medicare premiums withheld from January 2002 through July 2004;
- reviewing payments to contract workers from January 2002 through July 2005;

- reviewing moving expense payments and reimbursements from January 2002 through January 2005;
- reviewing processes for assigning and reporting on take-home vehicles, cell phones and other mobile devices; and
- reviewing IRS regulations, city ordinances, and administrative regulations governing Medicare withholding, contract workers, and fringe benefits.

Findings and Analysis

Lack of Processes Exposes the City to Risk

The city lacks central processes to ensure that fringe benefit income is properly reported and employment taxes are withheld on all income. IRS regulations require the city to report income and withhold employment taxes for fringe benefits, including personal use of city-owned equipment and reimbursements of some types of expenses. However, policies on private use of city-owned vehicles, cell phone use, and relocation for new employees are inconsistent with, or do not address, federal employment tax requirements. Individual departments are responsible for enforcing the policies but may lack expertise regarding federal employment tax requirements.

Departments also lack guidelines for hiring contract workers and monitoring their performance to ensure that the nature of the work and oversight are consistent with IRS regulations. In order to have no responsibility for withholding employment taxes for contract workers, the city must ensure that supervisory control of contract workers does not constitute an employee/employer relationship. IRS regulations to determine whether contract employees are subject to employment taxes are complicated. They depend on the nature of the work and the nature of the relationship between the city and the contractor.

Finally, we found a few instances in which the city incorrectly withheld, or failed to withhold, Medicare taxes.

The City Is Not Reporting Fringe Benefit Income and Not Withholding Employment Taxes on All Income

The city lacks a process for reporting the personal use of city-owned cell phones and vehicles, and the taxable portion of moving expenses reimbursement to the IRS. Employers who incorrectly report and withhold fringe benefit income may be held liable for back taxes, penalties and interest.

Personal use of city-owned vehicles is underreported. The city has no central process for tracking personal use of city vehicles.

Department heads or commissioners must approve personal use of city-owned vehicles. Once approved, personal use is recorded on an overnight vehicle report and submitted to Motor Transport Services (MTS). MTS summarizes and submits this information semiannually to the Payroll Division of the Department of Finance. However, the payroll division does not use the report prepared by MTS but rather conducts a year-end survey of departments to determine personal use of city vehicles. Significantly fewer employees reported personal use to payroll than were identified on MTS overnight vehicle reports. (See Exhibit 1.)

The MTS reports themselves are incomplete – the reports do not list employees who are regularly assigned a city vehicle and use the vehicle to commute.

Payroll reports the taxable benefit for personal miles driven on the W-2s of employees who self-report on the year-end survey, but does not withhold employment taxes on these amounts as required by IRS regulations. Based on vehicle information contained on the 2004 overnight vehicle reports compiled by MTS, we estimate that the city could be liable for \$194,000 to \$903,000 in back taxes, penalties, and interest for the 62 employees who did not have employment taxes withheld for the personal use of a city vehicle. We cannot calculate the exact amount of the liability because the city lacks complete data. The IRS can use several methods to calculate the taxable amount and has latitude over which penalties to apply. (See Appendix 1.)

EXHIBIT 1
PERSONAL USE OF CITY VEHICLES
2002 THROUGH 2004

Year	Payroll Survey	MTS Overnight Vehicle Reports
2002	11	Not Available
2003	0	19 ^(a)
2004	18	62 ^(b)
Notes: ^(a) for the period 4/1/03 through 10/1/03 ^(b) for the period 4/1/04 through 10/1/04 Source: <i>MTS and payroll records</i>		

Employees' personal use of cell phones is not reported. The city does not report personal use of city cell phones as taxable income as required by IRS regulations. To receive a city cell phone or wireless device, an employee must complete a Wireless Device Request and Assignment Form (which must be approved by their department head and the city's chief information officer) and provide justification for the need for the device. The city has no specific criteria for what constitutes a business need for a cell phone or wireless device. Department of Information Technology (DIT) personnel review each form to ensure that it is completed and approved before they issue a wireless device to an employee. DIT distributes monthly cell phone bills to departments. Department heads are responsible for reviewing the monthly bills to determine whether excess charges resulted from personal use.

Taxable portion of moving expense reimbursement is not reported. Department heads may request authorization to pay newly hired executive or managerial employees relocation expenses associated with a move from another state. The city reimbursed 15 employees \$88,254 for moving expenses between January 2002 and January 2005. According to IRS regulations, \$20,501 of the reimbursements (given to eight employees) should have been treated as taxable income because these reimbursements were for temporary living arrangements, meals, house-hunting trips, and other nonmoving related expenses. The city processes moving expense reimbursements through the accounts payable division. The payroll division did not report taxable moving expense reimbursements on the employees' W-2s or withhold employment taxes. The city could owe \$8,251 in federal taxes, penalties, and interest and \$1,125 in state taxes.

City Fringe Benefit Policies Do Not Address Tax Regulations

The city's policies on the personal use of city-owned vehicles, cell phone use, and moving expense reimbursements contradict the federal tax code. We previously made recommendations to address tax compliance with the city's cell phone and moving expense policies, but these recommendations were not implemented. The city should align its policies with federal requirements, and it could simplify administration by providing allowances to compensate employees for business use of their personal equipment rather than providing city-owned equipment.

The city's vehicle policy does not address tax regulations.

The city Code of Ordinances section on take-home vehicles (Section 2-1715) does not address tax implications and contradicts IRS regulations. The code focuses on the type of employee using the vehicle, whereas IRS regulations focus on the type of vehicle driven by the employee. For example, the code allows commissioners and employees in the Departments of Corrections, Fire, and Police to use city-owned vehicles for personal use without reporting such use to MTS. However, only vehicles that are not likely to be used more than a minimal amount for personal purposes may be taken home and not be considered a taxable fringe benefit, such as clearly marked police or fire vehicles, flatbed trucks, school buses, or ambulances.

The city's cell phone policy allows personal use. The city's cell phone policy (see Appendix 3) does not address tax implications and contradicts IRS regulations. Employees are only required to reimburse the city for personal use when the city is charged extra and their personal use exceeds 15 percent of their total use. Because the city uses a shared plan, the city is not charged extra for an employee going over his or her allotted minutes as long as there are minutes available from users that were below their allotted minutes. The city's two plans provide 800 or 900 minutes per cell phone. For example, a department with 10 phones has 9,000 shared minutes to use. One employee could use 8,000 minutes and the remaining nine employees could collectively use 1,000 minutes without any overage charges. In this example, the employee who used 8,000 minutes, under the city's cell phone policy, could use all 8,000 minutes for personal use without being required to reimburse the city for the use. Not reporting the taxable benefit of personal use of city cell phones appears to violate IRS regulations.

IRS regulations provide an exception for de minimis (minimal) benefits for some fringe benefits, which is defined as when the benefit is of so little value that to account for it would be too burdensome. However, the city's cell phone policy allows for more than a minimal amount of individual personal use, and the amount of personal use benefits given to employees in aggregate could be substantial. Therefore, using the de minimis regulation to justify unreported personal use as stated in the city's cell phone policy is inconsistent with IRS regulations. In addition, the burden of proof is on the employer to demonstrate that personal use is minimal. If the employer cannot provide ample evidence to demonstrate that their employees' personal use is minimal, the IRS could calculate that

taxable benefit provided to employees based on the full purchase price of the city-owned cell phones along with all monthly cell phone charges.

The city's moving expense reimbursement policy allows for taxable reimbursements. The city's moving expense reimbursement policy (see Appendix 5) allows for taxable reimbursements such as house hunting, meals, and temporary lodging expenses. These reimbursements are not reported on employees' W-2 forms and no employment taxes are withheld on such fringe benefit amounts, because of how the process is handled in the Department of Finance. The reimbursement function handled in the accounts payable division is not coordinated with the tax reporting and withholding function handled in the payroll division.

Previous recommendations were not implemented. We reviewed the Department of Human Resources' April 2004 draft moving expense reimbursement policy and identified inconsistencies with federal tax law. The draft policy allowed reimbursement of some expenses not deductible for tax purposes but did not provide for reimbursement of other moving expenses the IRS allowed as deductions. We issued a memorandum to the commissioner of human resources and chief financial officer in October 2004 (see Appendix 4) recommending changes to the policy:

- Include a provision in the city policy to allow reimbursement of any expenses the IRS would allow as a deduction, limited to the amount of reimbursement negotiated between the city and the employee.
- Identify expenses that will not be reimbursed, and such expenses should be consistent with those the IRS has identified as nondeductible.
- If the city's policy will be to allow reimbursement of nondeductible moving expenses, a procedure must be established to ensure such reimbursements meet the IRS requirements for reporting and tax withholding.

The revised policy issued on April 29, 2005 states that reimbursable expenses "will be consistent with IRS regulations" but still includes expenses that are not tax-deductible. The revised policy also states, "the payroll department will report moving expense reimbursements

to the employee on a W-2 and withhold the appropriate taxes, when applicable". However, the policy still assigns the responsibility of documenting and processing relocation expenses to accounts payable. We gave our recommendations to both the commissioner of human resources and the chief financial officer. Accounts payable and payroll staff stated they were unaware of the need to coordinate moving expense reimbursements.

The moving expense reimbursements we reviewed occurred before the policy was revised, but the city was still required to comply with IRS regulations. The current policy would not ensure compliance for future reimbursements because no process was established to implement it.

We also made recommendations to a task force appointed by the chief operating officer in 2004 to revise Administrative Order No. 2002-4 on city cell phones. Our primary recommendation (see Appendix 2) was that the city should provide an allowance for employees who have a business need for a cell phone, because monitoring and reimbursement requirements for non-business calls made or received on government-issued cell phones are costly and burdensome. Although the revised policy, Administrative Order No. 2004-3, gives the option of an allowance instead of a city-owned phone, it's not required and there's no incentive to do it (see Appendix 3).

The City Does Not Track Personal Use of City-Owned Equipment

The city does not have adequate data to determine the amount of personal use of city-owned equipment. The city bears the burden of proof to demonstrate that city-provided equipment is not being used for personal benefit. Without supporting data, the IRS could assess the full purchase value of city provided equipment as taxable income. Therefore, the city's tax liability is potentially large.

The city has many vehicles that could be used for personal benefit. The city owns at least 1,116 vehicles—purchased for \$19 million—for which employees' personal use should be reported to the IRS. In the event of an IRS audit, the city could be liable for taxes, penalties, and interests assessed on the full purchase value of these vehicles if the city cannot document the amount of personal use.

The city's cell phone plan is overly generous. The city uses two providers, both of which offer a shared plan. One plan provides 900 minutes per month per device and the other plan provides 800 minutes per month per device. With 1,777 phones, the city has purchased over 1.5 million minutes per month. The monthly charges are typically between \$50 and \$60 per user for cell phones and \$149 for BlackBerry Personal Digital Assistants (PDAs). Total charges for August 2005 were approximately \$125,000. (See Exhibit 2).

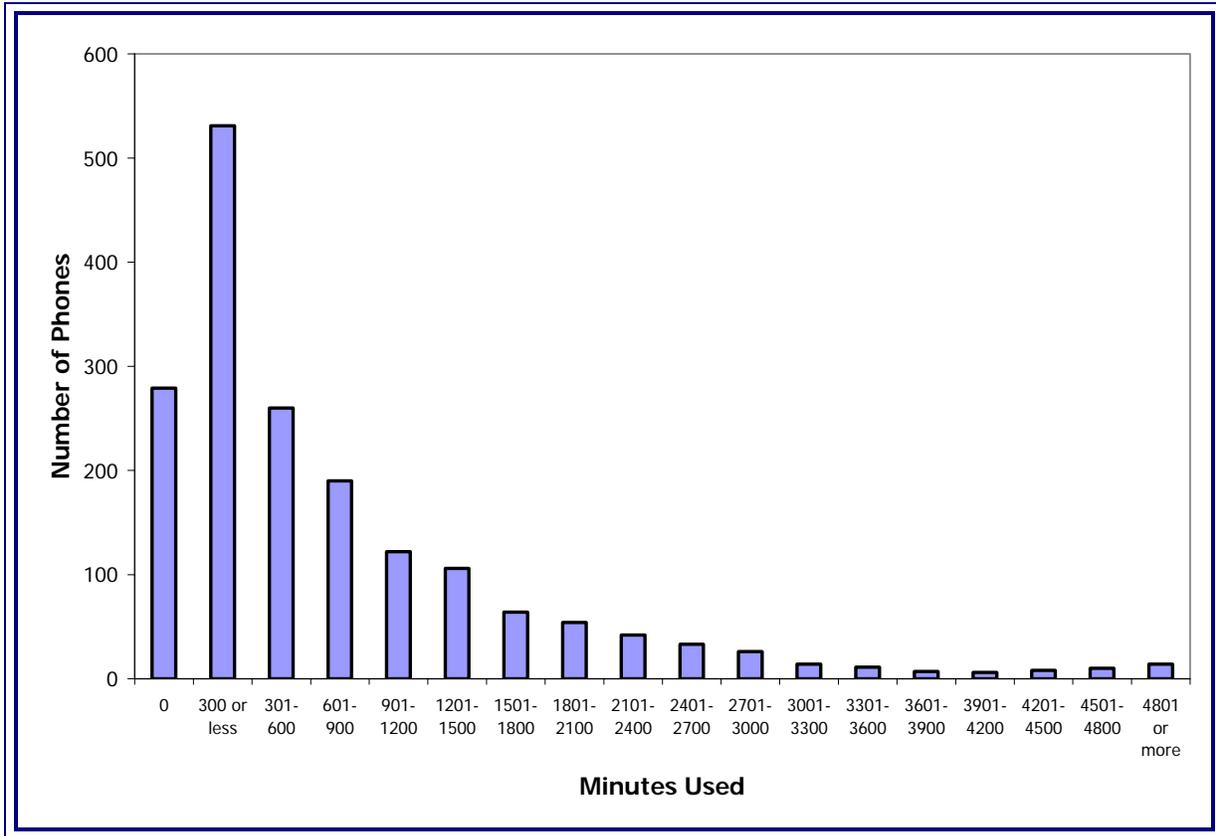
EXHIBIT 2
SUMMARY OF CELL PHONE AND PDA CHARGES
AUGUST 2005

Number of Phones and PDAs	1,777
Cellular Minutes	1,340,196
Cellular Hours	22,337
Total Charges	\$124,998
<i>Source: August 2005 invoices and city records</i>	

Cell phone use by employee varied considerably. Exhibit 3 summarizes cell phone use in August 2005. Many phones were not used at all (279, or 16 percent) and 517 (29 percent) used more than the 900 allotted minutes. Some of the cell phones were used a great deal more than 900 minutes (or 15 hours), as 129 cell phones had over 40 hours of use and 14 cell phones had over 80 hours of use.

The city pays for 100 percent of the cell phone charges regardless of use. An employee is required to reimburse the city for personal use only when their personal use is greater than 15 percent of their total use, and the personal use was the cause of extra charges billed to the city. Under the shared-minutes plan – and with many phones unused – employees can use thousands of minutes each month without incurring extra charges. Between January 1 and October 14, 2005, 114 employees reimbursed the city for \$6,815 for personal use.

**EXHIBIT 3
CELL PHONE AND PDA MINUTES USED - AUGUST 2005**



Source: August 2005 invoices

The City Should Revise Policies to Simplify Employment Tax Administration

The city could reduce its liability and simplify reporting and withholding for fringe benefits by revising its policies to align with federal requirements, as well as by providing employees with a business need for a cell phone or vehicle with monthly allowances instead of assigning them city-owned equipment. Employees who occasionally use their personal equipment for city business should seek reimbursement. Besides simplifying tax reporting and withholding, such changes would promote more prudent use of city resources.

If the city chooses not to adopt allowances instead of assigning city-owned equipment, the chief financial officer should develop procedures for departments to accurately track and report fringe

benefit income. The chief financial officer also should ensure the withholding of employment taxes on all fringe benefit income.

Contract Workers Could Be Misclassified

The IRS recognizes the classification of contract workers as a high risk for local governments. The city is not required to withhold employment taxes for contractors, but the regulations for deciding whether a worker is a contractor or an employee are complicated. If the city misclassifies an employee as a contractor, the city is liable for the employment taxes that should have been withheld.

IRS regulations governing worker classification are complicated. Proper classification depends on the nature of the work and the relationship between the city and the contract worker. The common law rule for determining whether a contract worker is truly an employee is whether the city has the right to tell the worker what work to do and how to do it. (See Appendix 1).

Departments lack direction on how to classify workers properly. No single city department is responsible for determining the correct classification of contractors. The city's procurement manual provides no guidance on the proper treatment of contract workers. Consequently, the city does not know whether it could be liable for federal and state back taxes including interest and penalties for contract workers.

The city pays an unknown number of contract workers. The city does not track the number of independent contractors they pay, so the total number used is unknown. We identified 348 individuals who were paid \$5.7 million from January 2002 through July 2005, were not associated with a corporation or business, provided social security numbers rather than business-tax identification numbers, and received payment for consulting or professional services. We did not try to determine how many of these contractors met the IRS criteria for exemption from withholding taxes. Since the city does not have a process to ensure that the nature of the contractors' work and the departmental oversight are consistent with IRS regulations, the city risks the possibility that some of these contractors should have been treated as employees.

City Incorrectly Withheld and Reported Medicare Taxes for Several Employees

IRS regulations require city employees hired (or rehired) after March 31, 1986 have Medicare tax withheld from their wages. City employees who have been continuously employed by the city since before March 31, 1986, or who are non-resident aliens (with F-1, J-1, M-1 or Q-1 visas), should not have Medicare tax withheld.

The city failed to withhold Medicare tax for some covered employees. We reviewed payroll payments from January 2002 through July 2004 and found that 37 employees should have had Medicare tax withheld from \$2.3 million in taxable gross wages. We found that these employees did not have Medicare tax withheld for one of the following reasons:

- PeopleSoft is not correctly set up to process Medicare withholdings for employees rehired by the city. Employees originally hired before March 31, 1986, and subsequently rehired, will not have Medicare withheld unless the payroll division manually adjusts PeopleSoft.
- Department of Human Resources employees inadvertently changed PeopleSoft Medicare tax withholding settings while making other changes.
- There is no process to ensure that employees who are non-resident alien employees do not have Medicare tax withheld from their wages. Some employees informed the Department of Human Resources that they were non-resident aliens and should not have Medicare tax withheld. We could not confirm the status of these employees because required employment eligibility verification documents were either incomplete or missing from Department of Human Resources' files.

Employers who fail to withhold Medicare tax may be liable for federal back taxes, penalties and interest. The city's potential liability could be as much as \$125,500.

The city incorrectly withheld Medicare taxes from some employees who are not covered. The city has withheld Medicare tax from three employees who are not covered. The employees

collectively had \$2,676 withheld in Medicare tax from January 2002 through July 2004. The city still employs two of these individuals and Medicare tax continues to be withheld from their wages. We could not identify the reason the Medicare tax has been withheld in error.

Recommendations

We recommend the city correct inaccurate reporting made to the IRS and refund amounts withheld in error. The chief financial officer should:

1. Issue corrected W-2s for employees who did not have Medicare tax withheld or received taxable moving expense fringe benefits that were not reported as income. The city has partial data on the personal use of city vehicles; therefore, the city should issue corrected W-2s for the taxable portion of this fringe benefit where possible. The city does not have data on the personal use of city owned cell phones; therefore, the city cannot issue corrected W-2s for this fringe benefit.
2. Determine the total amount of Medicare tax withheld in error and refund this amount to the three employees.

Going forward, we have already recommended changes in the new payroll system to better track and report taxable benefits in our *Pre-Implementation Review of the ERP System* issued in November 2005. The ERP Steering Committee agreed with the recommendation. The city could simplify its tax administration duties by revising policies on city vehicles, city cell phones, and relocation expenses as suggested in recommendations 3 through 6.

3. The chief financial officer and commissioner of human resources should simplify the city's policy on reimbursed moving expenses so it agrees with IRS regulations. Our office recommended this course of action in a memorandum dated October 18, 2004 to the commissioner of human resources and the chief financial officer (Appendix 4).
 - The policy should identify expenses that will not be reimbursed, and such expenses should be consistent with those the IRS has identified as nondeductible, thus eliminating any additional reporting to the IRS on taxable fringe benefits.
 - If the city's policy continues to allow reimbursement of nondeductible moving expenses, the chief financial officer and

commissioner of human resources should establish a process to ensure such reimbursements meet the IRS requirements for reporting and tax withholding.

4. The chief operating officer should revise Administrative Order 2004-3 to make cell phone allowances the primary mechanism for funding business use of cell phones and PDAs.
 - We recommend that the city create a cell phone allowance for employees, as we did in a memorandum dated October 5, 2004 to the task force charged with revising the previous policy, to eliminate the need for further reporting to the IRS.
 - If the city continues to issue city cell phones and PDAs to employees, the chief operating officer should revise Administrative Order 2004-3 to make personal use of this equipment easier to track and report to the IRS. We provided several examples of other cities' practices in the October 5, 2004 memorandum (Appendix 2).
5. The chief financial officer should develop procedures to accurately track and report the personal use of city vehicles. To simplify the city's reporting requirements, we recommend:
 - whenever possible, encourage employees to use their personal vehicle for city business, and reimburse the employee for mileage under IRS regulations;
 - when the extent of business use warrants it, grant employees a vehicle allowance instead of an assigned city vehicle, thus eliminating additional reporting to the IRS;
 - request that MTS distinguish between vehicles that qualify for personal use under IRS regulations and vehicles that do not (i.e. qualified non-personal use vehicle); and
 - provide MTS and/or operating departments with instructions on how personal use should be reported to the payroll division.
6. The chief financial officer should propose legislation to amend Section 2-1715 of the city Code of Ordinances on personal use of city-owned vehicles so that the code complies with IRS

regulations. Commuting to work is considered a taxable benefit regardless if the employee has permission or is on call. Vehicles assigned to executives and public safety employees are also considered taxable unless the vehicle meets certain specifications. Therefore, sections of the city Code of Ordinances that state otherwise should be modified.

7. The chief procurement officer and city attorney should create a policy to provide guidance to departments on the proper classification of workers and include this policy in the city's procurement manual.

Appendices

APPENDIX 1
IRS RULES USED FOR DETERMINING TAXABLE VALUE OF
PERSONAL USE OF CITY-OWNED VEHICLES

General rule: The use of an employer-owned vehicle by an employee results in taxable income. As taxable income, the employer is responsible for correctly withholding, depositing, and reporting taxes based on the value of the fringe benefit.

Exclusion rules:

- Section 132(a)(3) of the Internal Revenue Code allows an exclusion for a working condition fringe benefit.
- The value of a “qualified non-personal use vehicle” can be excluded from income as a working condition fringe benefit.
- A qualified non-personal use vehicle means any vehicle that is not likely to be used more than a minimal amount for personal purposes. If the individual is allowed to use the vehicle as a courtesy and for commuting purposes, it does not qualify as a non-personal use vehicle, and the commuting value is income subject to FICA and income tax withholding.
- Qualified non-personal use vehicles include the following:
 1. Clearly marked police vehicles
 2. Clearly marked fire vehicles
 3. Flatbed trucks
 4. School buses
 5. Ambulances
- The exclusion for a clearly marked police or fire vehicle applies only to a vehicle that is required to be used for commuting by a police officer or fire fighter who, when not on regular shift, is on call at all times. Other than commuting, personal use of the vehicle outside the limit of the police officer’s arrest powers, or the fire fighter’s obligation to respond to an emergency, must be prohibited by the governmental unit.
- There are limited circumstances in which an unmarked police car qualifies as a non-personal use vehicle.
 1. The driver must be a “law enforcement officer”.
 2. The officer must be a full-time city employee responsible for preventing or investigating crimes involving injury to persons or property.

APPENDIX 1 (continued)
IRS RULES USED FOR DETERMINING TAXABLE VALUE OF
PERSONAL USE OF CITY-OWNED VEHICLES

3. The officer must be authorized by law to carry firearms, execute search warrants, and to make arrests.
 4. The officer must regularly carry firearms.
- A “public safety director”, or any employee regardless of title, must meet these tests to qualify under this exclusion.

Valuation rules:

1. General valuation rule (lease value rule):

- The value of a fringe benefit is its fair market value.
- The fair market value of a 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.
- The city must begin using the rule on the first day the automobile is made available to any employee for personal use and the rule must be applied consistently throughout later years the vehicle is available to any employee. However, if the city uses the commuting rule when the vehicle is first made available for personal use, the city can later change the lease value rule. The city must continue to use the lease value rule if the primary reason a replacement vehicle is provided to an employee is to reduce federal taxes.

APPENDIX 1 (continued)
IRS RULES USED FOR DETERMINING TAXABLE VALUE OF
PERSONAL USE OF CITY-OWNED VEHICLES

- The city should use the following *Annual Lease Value Table* to find the annual lease value:

ANNUAL LEASE VALUE TABLE			
<u>Automobile</u> <u>Fair Market Value</u>	<u>Annual</u> <u>Lease</u> <u>Value</u>	<u>Automobile</u> <u>Fair Market Value</u>	<u>Annual</u> <u>Lease</u> <u>Value</u>
0 to 999	600	22,000 to 22,999	6,100
1,000 to 1,999	850	23,000 to 23,999	6,350
2,000 to 2,999	1,100	24,000 to 24,999	6,600
3,000 to 3,999	1,350	25,000 to 25,999	6,850
4,000 to 4,999	1,600	26,000 to 27,999	7,250
5,000 to 5,999	1,850	28,000 to 29,999	7,750
6,000 to 6,999	2,100	30,000 to 31,999	8,250
7,000 to 7,999	2,350	32,000 to 33,999	8,750
8,000 to 8,999	2,600	34,000 to 35,999	9,250
9,000 to 9,999	2,850	36,000 to 37,999	9,750
10,000 to 10,999	3,100	38,000 to 39,999	10,250
11,000 to 11,999	3,350	40,000 to 41,999	10,750
12,000 to 12,999	3,600	42,000 to 43,999	11,250
13,000 to 13,999	3,850	44,000 to 45,999	11,750
14,000 to 14,999	4,100	46,000 to 47,999	12,250
15,000 to 15,999	4,350	48,000 to 49,999	12,750
16,000 to 16,999	4,600	50,000 to 51,999	13,250
17,000 to 17,999	4,850	52,000 to 53,999	13,750
18,000 to 18,999	5,100	54,000 to 55,999	14,250
19,000 to 19,999	5,350	56,000 to 57,999	14,750
20,000 to 20,999	5,600	58,000 to 59,999	15,250
21,000 to 21,999	5,850		

For automobiles with a fair market value (FMV) of more than \$59,999, the annual lease value equal $(0.25 \times \text{the FMV of the automobile}) + \500 .

- Each annual lease value in the table includes the value of maintenance and insurance for the automobile.
- The annual lease value does not include the value of fuel the city provides to an employee for personal use regardless of whether the city provides it, reimburse its cost, or has the expense charged to the city. Therefore, the actual value of fuel the city provides (computed at 5.5 cents per mile) must be included in the employees taxable wages.

APPENDIX 1 (continued)

IRS RULES USED FOR DETERMINING TAXABLE VALUE OF PERSONAL USE OF CITY-OWNED VEHICLES

- If the city provides an automobile to an employee for a continuous period of 30 or more days but less than an entire calendar year, the city can prorate the annual lease value by multiplying the annual lease value by a fraction using the number of days of availability as the numerator and 365 as the denominator.
- If the city provides an automobile to an employee for a continuous period of less than 30 days, figure the daily lease value by multiplying the annual lease value by a fraction using four times the number of days of availability as the numerator and 365 as the denominator.

2. Cents-per-mile rule:

- The value of the vehicle is determined by multiplying the standard mileage rate by the total miles the employee drives the vehicle for personal use.
- For 2005, the standard mileage rate is 40.5 cents a mile. The 2004 mileage rate is 37.5 cents a mile.
- The city cannot use the cents-per-mile rule for an automobile that is first made available to an employee in 2004, if its value at that time was more than \$14,800.
- The city can use the cents-per-mile rule if either of the following requirements is met.
 - a. The employer reasonably expects the vehicle to be regularly used for business purposes throughout the calendar year.
 - b. The vehicle is actually driven at least 10,000 miles during the year (reduce the mileage proportionately if the vehicle is owned for only part of the year), and employees who use the vehicle use it consistently for commuting purposes.
- The cents-per-mile rule must be used on the day the vehicle is made available to the employee and the rule must be applied consistently thereafter, as the vehicle is available to any employee (providing the use of the vehicle continues to qualify for the cents-per-mile rule). However, if the city uses the commuting rule when the vehicle is first made available for personal use, the city can later change to the cents-per-mile rule. The city must continue to use the cents-per-mile rule if the primary reason a replacement vehicle is provided to an employee is to reduce federal taxes.

APPENDIX 1 (continued)
IRS RULES USED FOR DETERMINING TAXABLE VALUE OF
PERSONAL USE OF CITY-OWNED VEHICLES

- The cents-per-mile rate includes the value of maintenance and insurance for the vehicle. If the city does not provide fuel, the city can reduce the rate by no more than 5.5 cents. The general valuation rule should be used to value any other vehicle-related services the city provides to employees.

3. Commuting rule:

- The city can determine the value of a vehicle provided to an employee for commuting needs by multiplying each one-way commute (from home to work or from work to home) by \$1.50. If more than one employee commutes in the vehicle, this value applies to each employee.
- The city can use the commuting rule if the following conditions are met:
 - a. You provide the vehicle to an employee for use in your trade of business and, for bona-fide non-compensatory business reason, you require the employee to commute in the vehicle. This is be treated as if the requirement had been met if the vehicle is generally used each workday to carry at least three employees to and from work in an employer-sponsored commuting pool.
 - b. You establish a written policy under which you do not allow the employee to use the vehicle for personal purposes other than for commuting of de minimis personal use (such as a stop for a personal errand on the way between a business delivery and the employee's home).
 - c. The employee does not use the vehicle for personal purposes other than commuting and de minimis personal use.
 - d. If this vehicle is an automobile, the employee who uses it for commuting is not a control employee.²

² For tax year 2005, a control employee of a government employer is an elected official or one whose compensation is \$131,400 or more for the year.

APPENDIX 1 (continued)
IRS RULES USED FOR DETERMINING TAXABLE VALUE OF
PERSONAL USE OF CITY-OWNED VEHICLES

Withholding, depositing, and reporting rules:

- City-provided vehicle benefits must be treated as paid no less frequently than annually.
- The city must determine the value of non-cash fringe benefits no later than January 31 of the next year.
- The city must report the actual value of these benefits on Forms 941 and W-2.
- The city may choose not to withhold income tax on the value of an employee's personal use of a city-owned vehicle provided that:
 1. The employee is notified in writing by January 31 of the calendar year in which the benefit is received, or within 30 days after the vehicle is provided to the employee (whichever is later), that income tax is not being withheld for the value of the fringe benefit.
 2. The city must include the value of the benefits in boxes 1, 3, 5, and 14 on a timely furnished Form W-2. For use of a separate statement in lieu of using box 14, see the Instructions for Forms W-2 and W-3.³
- The city, however, must withhold the applicable Medicare taxes on such benefits.

Source: IRS Publication 15-B, "Employer's Tax Guide to Fringe Benefits", Instructions for Forms W-2 and W-3, and "FAQs Regarding Fringe Benefits" from the IRS webpage www.irs.gov

³ Although not required, you may include the total value of fringe benefits in box 14 (or on a separate statement).

APPENDIX 2
"CELL PHONE POLICIES AND PROCEDURES,"
MEMORANDUM FROM CITY AUDITOR, OCTOBER 5, 2004



CITY OF ATLANTA

LESLIE WARD
City Internal Auditor
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Henry A. Kelly, Vice-Chair
Fred Williams
Mayor Shirley Franklin
Council President Lisa Borders

TO: Rob Rivers, Janice Davis, Mario Diaz, Rob Hunter, Abe Kani

FROM: Leslie Ward, City Auditor

DATE: October 5, 2004 (sent via e-mail)

SUBJECT: Cell Phone Policies and Procedures

On Friday, October 1st, we sent a listserv message to members of the National Association of Local Government Auditors and conducted research on the internet to obtain information regarding cell phone policies for other municipalities around the country. We received about 20 responses to our listserv inquiry from city and county governments and obtained 12 more examples through our internet research, which were primarily from universities. We also reviewed the mayor's Administrative Order No. 2002-4 regarding the authorization, assignment, management, use, and reimbursement of cell phone services for city employees to compare with the policies we obtained from other sources.

We identified several common factors in the cell phone policies from other municipalities:

- The need for a cell phone must be justified. Justification is generally based on emergency response requirements, employees in field operations without access to other means of communication, increased efficiency in job performance, and "must have" vs. "nice to have." *The city's administrative order states that city employees must have a bona fide need for use of cellular equipment, but it does not provide any criteria for what constitutes such a need.*
- Overall control of cell phones varies – may be through the information technology department, the purchasing unit, the city manager, or individual departments. *The city's administrative order gives centralized control over cell phones to the Bureau of General Services; centralized control has since been transferred to the Department of Information Technology.*
- Cell phones are generally to be used as a secondary means of communication; land lines and two-way radios should be used first when available. *The city's administrative order states that cell phones are for the purpose of communicating for official city business when other means of communication are unavailable, impractical, or inappropriate.*
- Phones generally must be acquired through the purchasing or information technology units, but acquisition is sometimes decentralized. *The city's administrative order states that the Bureau of General Services will issue cell phones to requesting departments;*

APPENDIX 2 (continued)
"CELL PHONE POLICIES AND PROCEDURES,"
MEMORANDUM FROM CITY AUDITOR, OCTOBER 5, 2004

this responsibility has since been transferred to the Department of Information Technology.

- Employees are responsible for adequate safeguarding of the equipment and will be held responsible for repair or replacement if damage or loss is due to the employee's misuse or negligence. *The city's administrative order states that employees may be held responsible for the cost to repair or replace damaged, lost, or stolen cell phones, as determined in the judgment of the department head.*
- Employees may be disciplined, up to and including termination, for violating the municipality's policies regarding the use and care of cell phones. *The city's administrative order states that unauthorized use shall result in appropriate disciplinary action, up to and including termination of employment.*
- Policies remind employees that cell phones are not secure communication devices and that discretion should be used regarding the type of information provided through a cell phone. *The city's administrative order does not contain a similar provision.*
- For liability reasons, cell phone use is prohibited while driving, or employees must pull to the side of the road or use hands-free equipment when making or receiving phone calls while driving. *The city's administrative order does not contain a similar provision.*
- Monitoring of cell phone use is done through a review of monthly bills to identify lengthy calls, excessive roaming and/or long distance charges, significant call activity to outside agencies, and total costs in excess of the budget. *The city's administrative order requires department heads to review and distribute cell phone bills to employees. The employee is responsible for identifying non-business calls.*
- Employees who are authorized cell phones must sign a statement indicating that they have received the phone, have read the city's policy statement for cell phones, understand the restrictions and reimbursement requirements for personal use of the phone, and accept responsibility for repair and replacement costs for damage or loss that occurs through misuse of the phone. *The city's administrative order does not contain a similar provision.*
- Employees are only allowed one telecommunication device (e.g., a cell phone or a pager, but not both). *The city's administrative order does not contain a similar provision.*
- Monthly bills are reviewed for every phone to identify and obtain reimbursement of personal calls. *The city's administrative order requires employees to review their cell phone bills and reimburse the city for any non-business calls within 30 days of receipt of the bill.*

Provisions for personal use of cell phones included the following:

- Some municipalities completely prohibit personal use of cell phones, but most allow *de minimis*¹ personal use. Some allow personal use, without reimbursement, to the extent that such use is within the allotted monthly minutes or that the personal calls are infrequent and short in duration (e.g., less than three minutes).
- Employees who make personal calls on the phones must report them either by identifying them on the monthly phone bills or by maintaining and submitting a log of personal calls.

¹ The IRS allows employees to be provided a *de minimis* benefit that can be excluded from an employee's wages (i.e., nontaxable income) if the benefit has so little value that accounting for it would be unreasonable or administratively impracticable. One example the IRS provides in its Publication 15E is occasional personal use of a company copying machine as long as the use is sufficiently controlled "so that at least 85% of its use is for business purposes." The tax provision requires the employer to consider how frequently it provides similar benefits to its employees (e.g., an occasional versus an ongoing benefit).

APPENDIX 2 (continued)
“CELL PHONE POLICIES AND PROCEDURES”,
MEMORANDUM FROM CITY AUDITOR, OCTOBER 5, 2004

- The methods for calculating reimbursements vary:
 - Reimbursement in accordance with the plan's per-minute rate.
 - A flat rate per minute that is not specifically linked to the phone plan but is stated in the policy.
 - Reimbursement based on the ratio of personal calls to business calls. *The city's administrative order uses this basis for reimbursement.*
 - Reimbursement is required but the method is not specified.
 - Reimbursement is required at the excess-minute rate if the monthly minute allotment was exceeded due to personal use.
- Reimbursements include roaming charges, long distance charges, and taxes, in addition to the per-minute rate. *The city's administrative order does not address these charges.*

Less commonly cited issues addressed in policies obtained from other municipalities:

- Number of monthly minutes allowed is based on employees' positions (e.g., 300 minutes for employees and division managers, 1000 minutes for department managers, and over 1000 minutes for elected officials).
- Contract with cell phone carrier allows municipality to pool all minutes, which eliminates the ability for employees to incur personal use and justify it as excess minutes.
- The de minimis number of minutes allowed is specified in the policy (e.g., 30 minutes per month) to allow time for calls that cannot reasonably be made before or after work and when the employee does not have access to a land line.
- Annual reviews of cell phone use are to be performed to ensure that the optimum rate plans are obtained.
- More recently developed guidelines prohibit the use of additional functions and services, such as text messaging and digital photography, with government-owned cell phones.

Several of the listserv responses stated that the monitoring and reimbursement requirements for non-business calls made or received on government-issued cell phones were costly and burdensome to administer. Because of this, there is a growing trend to provide an allowance to employees who have a business need for a cell phone. Allowances vary but generally range from \$30 to \$35 per month. (Allowances could be based on employees' positions rather than being uniform for all who receive an allowance.)

Allowances were cited as a best practice by one respondent who had done research on cell phone policies and found that as much as 40 percent of the total cost of providing cell phones was indirect costs (see attachment). Providing allowances in lieu of cell phones eliminates the administrative costs associated with purchasing cell phones and making monthly vendor payments; shifts the cost of equipment management, including purchasing, replacement, and maintenance, to the employee; and eliminates the need to monitor how the phones are used for purposes of optimizing rate plans and seeking reimbursement for personal calls. (Even a policy providing for *de minimis* personal use without reimbursement would require compliance monitoring.) Allowances also leave it to employees to choose a plan that best serves their needs for both business and personal use.

It is important to note that allowances must be reported to employees as taxable income; however, the employee may be able to take a tax deduction for the expenses associated with business use of the phone.

Attachment

Copy: Lynnette Young

APPENDIX 3
CITY CELL PHONE – ADMINISTRATIVE ORDER NO. 2004-3

OFFICE OF THE MAYOR
ADMINISTRATIVE ORDER NO. 2004-3

AN ADMINISTRATIVE ORDER RE-ESTABLISHING A UNIFORM POLICY FOR THE AUTHORIZATION, ASSIGNMENT, MANAGEMENT, USE AND REIMBURSEMENT OF CELLULAR TELEPHONE SERVICE BY CITY OF ATLANTA EMPLOYEES; AND FOR OTHER PURPOSES.

WHEREAS, in 2002, the Mayor signed Administrative Order 2002-4 establishing a uniform policy for the authorization, assignment, management, use and reimbursement of cellular telephone service by City of Atlanta employees;

WHEREAS, the use of cellular telephones by City of Atlanta employees and the cost associated with the use of cellular telephones are necessary and significant; and

WHEREAS, it is necessary to reestablish a uniform policy for the authorization, assignment, management, use and reimbursement of service for cellular telephones by City of Atlanta employees to ensure that the cost associated with the use of cellular telephones is contained at a reasonable level and the provision of cell phones for city employees is essential for the job performance of the city employee; and

WHEREAS, this policy applies to all City of Atlanta Executive Branch employees who have been assigned a cellular telephone for City of Atlanta business use, have been authorized an allowance for compensation of the use of a personal cell phone for the performance of city business and supersedes any other Departmental policies.

NOW THEREFORE, I, Shirley Franklin, as Mayor of the City of Atlanta, Georgia, do so order as follows:

SECTION 1: Authorization for Use of Cellular Telephones

The authorization for use of all cellular telephones in the Executive Branch of government is hereby required to be audited by the Department Head no less than once every six months. Each Department Head is hereby authorized and required to conduct a complete review of cellular telephones currently assigned to the employees of the applicable Department prior to April 1 and October 1 of each year. The Department Head is authorized to assign cellular telephones or provide an allowance to City employees who the Department determines have bona fide need for the use of such equipment, according to the provisions outlined below.

SECTION 2: Authorized Use of Cellular Telephones

The City of Atlanta authorizes the assignment and use of cellular telephones as a tool of productivity for the purpose of communicating for official City business when other means of communication are not available, impractical or inappropriate. Unauthorized use shall result in appropriate disciplinary action, up to and including termination of employment. Each Department Head is responsible for managing, monitoring and controlling the use of their Department's cellular telephones and or the provision of a cellular phone allowance. Employees are fully responsible for the cost-effective use and care of the tool.

APPENDIX 3 (continued)

CITY CELL PHONE - ADMINISTRATIVE ORDER NO. 2004-3

SECTION 3: Departmental Responsibility - Compliance, Reimbursement and Record Retention

The Department Head is responsible for ensuring that all employees in the Department comply with the City of Atlanta policy on cellular telephone use.

The Department Head is also responsible for reviewing and retaining the department's billing detail for cellular telephone service in accordance with all state and local laws governing the retention of public documents and ensuring that all City employees reimburse the City of Atlanta for all non-business use of cellular telephones when the de minimis use of the city cell phone exceeds 15% of the usage and there is an increased cost to the city for the personal use of the phone in excess of the monthly minimum bill.

The Department Head is responsible for random audits of all cellular phone usage to determine compliance with all aspects of this Order.

SECTION 4: Cellular Telephone Users – Authorized Use; Responsibility for Replacement due to damage, loss or theft; Reimbursement for Non-Business Use by City Employees

- (a) The cellular telephone is to be used for City business. Non-business calls shall be charged to the user if the non business calls are in excess of 15% of usage and there is an increased cost to the city for the personal use of the phone in excess of the monthly minimum bill.
- (b) If the cellular telephone is damaged, lost or stolen, the City employee may be responsible for the cost to repair or replace the unit if the Department Head deems it is the responsibility of the employee to do so.
- (c) City employees are responsible for timely reimbursement for non-business use of the cellular telephone in accordance with Section 4 (a). Reimbursement is requirement within 30 days of receipt of the cellular telephone billing detail. All reimbursements should be submitted to the Department Head or designee. All appropriate reimbursement payments should be submitted to the Department Head or designee and should be accompanied by a completed Cellular Billing Certification Form (Attachment A). Failure to reimburse the City of Atlanta may result in punitive actions by the Department Head.
- (d) If the employee desires and the Department Head deems appropriate, the employee may receive reimbursement for City-business use of a personal cell phone in leau of the assignment of a City cell phone as long as the City has full access to the personal cell phone for city business. In no case shall the reimbursement to the employee be greater than the cost to the City to provide the employee a City cell phone and without special considerations the reimbursement cost should not exceed \$30.00 dollars a month.

SECTION 5: Assignment/Issuance of Cellular Telephones

- (a) The Department Head must submit a Cellular Telephone Request and Assignment Information Form (Attachment B, Part I) to the Department of Information Technology requesting the assignment of a cellular telephone. The Department Head must clearly state the bona fide need for the cellular equipment. All requests must be approved by the Department of Information Technology - Department Head. Upon approval, the Department of Information Technology will issue the cellular telephone to the requesting

APPENDIX 3 (continued)
CITY CELL PHONE - ADMINISTRATIVE ORDER NO. 2004-3

Department, accompanied by a completed Cellular Telephone Request and Assignment Information Form (Attachment B, Parts I and II). A copy of this form shall be retained in the records of the Department of Information Technology in accordance with State and Local laws governing the retention of public documents.

- (b) If cellular equipment is relocated, reassigned, lost or removed from the inventory of the user Department, the Department Head shall be responsible for notifying the Department of Information Technology within twenty-four (24) hours of the status change. The Department of Information Technology shall note the change in status on the Cellular Telephone Request and Assignment Information Form.
- (c) The Department Head for the Department of Information Technology shall review this process for accurate records and retention on a monthly basis.

SECTION 6: Distribution of Monthly Cellular Telephone Bills

The Department of Information Technology shall be responsible for the monthly distribution of individual cellular billing data for all department users to the respective Department Head. The Department of Information Technology shall maintain a perpetual inventory of all cellular telephones and cellular usage, which shall be submitted to the Chief Operating Officer or designee and the user Department for quarterly review. Any errors or omissions contained in this quarterly report shall be resolved within ten (10) working days of receipt by the user Department.

SECTION 7: Department Responsibility for Reimbursement for Non-Business Use by City Employees

Upon receipt of copies of cellular telephone bills from the Department of Information Technology, the Department Head or their designee shall review bills to determine if there are any excess charges (i.e., charges above the monthly minimum bill). If charges are above the monthly minimum bill then the bill must be reviewed to determine if the charges are due to excess charges as defined in Section 4 (a). If the excess charges are a result of non-business/personal use the charges will be paid in accordance with this Order. Within thirty (30) days of receipt of the cellular telephone bills, the Department Head shall forward all cellular billing certification forms and payments to the Department of Information Technology. After posting reimbursement information, the Department of Information Technology will deposit the reimbursement payments with the Department of Finance. The Department of Information Technology shall maintain a perpetual file of the monthly costs and reimbursements for all cellular telephones issued to City of Atlanta employees, such certification forms and files to be retained in accordance with the State and local laws governing the retention of public documents.

Reimbursement for personal/non-business calls shall be made based on the following calculations when there is an increased cost to the city for the personal use of the phone in excess of the monthly minimum bill and the personal use of City cell phone exceeds 15% and the total monthly cost of the cell phone is in excess of the City monthly minimum bill:

The actual cost of personal cell phone calls in excess of the minimum monthly billing.

The Department Head of the Department of Information Technology shall review this process for accurate and appropriate reimbursement and deposit records on a monthly basis.

8APPENDIX 3 (continued)
CITY CELL PHONE - ADMINISTRATIVE ORDER NO. 2004-3

SO ORDERED this 16th day of November, 2004.


Shirley Franklin
Mayor

ATTEST:


Rhonda Daughin Johnson
Municipal Clerk

APPENDIX 4

"COMMENTS ON POLICY FOR RELOCATION EXPENSES," MEMORANDUM FROM CITY AUDITOR, OCTOBER 18, 2004



CITY OF ATLANTA

OFFICE OF CITY INTERNAL AUDITOR

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AUDIT COMMITTEE
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Johnnie L. Clark
Mayor Shirley Franklin
Council President Pro Tem Ceasar Mitchell

TO: Benita Ransom, Commissioner of Human Resources

FROM: Leslie Ward, City Auditor

DATE: October 18, 2004

SUBJECT: Comments on Policy for Relocation Expenses

We have reviewed the draft policy on relocation expense reimbursement. Our comments follow, listed by section number of the draft policy. We especially want to highlight the effect the draft policy would have on the city's tax compliance responsibilities. As written, some reimbursements would have to be reported to the IRS as income and would be subject to tax withholding. We believe a simpler approach would be to reimburse only those expenses that would be deductible for individuals. To do otherwise would make it more complex for the city to correctly report the reimbursements to the IRS. A detailed explanation of the tax issues is included in our comments on Section 2 of the draft policy.

Because of the tax compliance issues, we are also sending a copy of this memo to the Chief Financial Officer.

Definitions:

The term "hard-to-fill" is defined, but this term is not used in the policy. If it is not needed, recommend it be deleted. If it is to be used in determining eligibility for reimbursement, this should be explained in the appropriate section of the policy.

Section 1, General:

This section limits reimbursement for relocation expenses to "executive or managerial employees" but does not define this group or provide criteria for applying it in individual decisions. Recommend that a general definition be provided in the Definitions section, including the types of positions that would normally be considered to meet the definition. Also recommend that provisions be added to 1) designate who will have final approval of eligibility, and 2) specify how to handle positions that don't clearly fit the definition of "executive or managerial employee" recommended in the Definitions section above. For example, the definition might list commissioners and department heads, deputies, and directors of bureaus or equivalent units as those who would normally be considered to meet the definition. The exceptions process might provide that hard-to-fill professional or

APPENDIX 4 (continued)

“COMMENTS ON POLICY FOR RELOCATION EXPENSES”, MEMORANDUM FROM CITY AUDITOR, OCTOBER 18, 2004

technical positions would be considered with documentation of the difficulty in hiring, subject to approval.

This section also references the requirement that only those moving from outside the State of Georgia be eligible for reimbursement. We realize that this is in the Code of Ordinances, but there is no apparent reason why this distinction is imposed. IRS Publication 521, Moving Expenses, allows deduction of moving expenses based on the distance in miles from one's residence to one's new place of employment. An amendment to the Code to allow reimbursement of moving expenses only to those who would be eligible to deduct them for tax purposes (provided that they meet the other criteria in the policy) would be more equitable.

This section also references the requirement, again from the Code of Ordinances, that only those new employees who "desire to establish a domicile" in the City of Atlanta are eligible for reimbursement. However there is no method described for determining such "desire." Recommend that the language from the Code be removed, and that the policy only apply to new employees who move to a residential address within the City of Atlanta and provide appropriate documentation of the location of their residence.

Section 2, Reimbursable Relocation Expenses:

In general, this section is not consistent with the provisions of the Internal Revenue Code for deductible and nondeductible moving expenses. The policy allows reimbursement of certain expenses that are not deductible for tax purposes but does not provide for reimbursement of other moving expenses that the IRS allows as deductions. From a tax perspective, it makes sense to allow reimbursement of any moving expenses that the IRS would allow as deductions on an employee's tax return, not to exceed the monetary limits of the city's relocation expense policy. The tax laws do not prohibit reimbursement of nondeductible moving expenses; however, they do require that such reimbursements be reported as income to the employee and that the appropriate taxes be withheld.

Section 217 of the Internal Revenue Code defines what is allowed as deductible moving expenses, and IRS Publication 521, Moving Expenses, clarifies the moving expenses that the Internal Revenue Code allows or disallows as deductions.

- IRS Publication 521 specifically identifies certain expenses that are deductible, including expenses for moving personal effects, travel expenses for the actual move, hotel expenses incurred while moving, the costs of connecting or disconnecting utilities associated with the move, and expenses for shipping vehicles and pets. However, the city's draft policy does not address whether these deductible expenses are reimbursable. Recommend that a provision be included in the city policy to allow reimbursement of any expenses that the IRS would allow as a deduction, limited to the amount of reimbursement negotiated between the city and the employee.
- IRS Publication 521 specifically states that the cost of using a personal vehicle to move to a new home may be deducted based on actual expenses (e.g., gas and oil) or at a standard mileage rate for moving. However, the city's draft policy does not address whether transportation by any mode other than air is reimbursable.

APPENDIX 4 (continued)
“COMMENTS ON POLICY FOR RELOCATION EXPENSES,”
MEMORANDUM FROM CITY AUDITOR, OCTOBER 18, 2004

Recommend that a provision be included in the policy to allow travel by automobile to be reimbursed at the prevailing IRS mileage rate for deductible moving expenses.

- IRS Publication 521 specifically states that expenses for house-hunting trips and temporary living expenses are nondeductible moving expenses. However, the city's draft policy would allow reimbursement of airfare expenses for house-hunting trips and temporary housing expenses incurred after arriving at the principal site of employment. If the city's policy will be to allow reimbursement of nondeductible moving expenses, it needs to establish procedures to ensure that such reimbursements meet the IRS requirements for reporting and tax withholding (see additional discussion in Section 7 below)
- If the city's intent is to not reimburse certain expenses, the policy should identify specific expenses that will not be reimbursed. These expenses should be consistent with what the IRS has identified as nondeductible expenses.

The policy allows moving expenses paid in advance by the employee to be reimbursed "up to the amount negotiated." It is not clear if the "amount negotiated" refers to an amount negotiated between the employee and the moving company or the employee and the city.

Section 3, Determining the Maximum Relocation Amount

The policy states that all amounts will be "grossed up" to ensure equitable payments regardless of the new employee's tax situation. It is not clear what this phrase means (e.g., how the amounts would be "grossed up" or how this would ensure equitable payments).

Section 4, Initiating the Relocation Process

The policy states that the hiring department will discuss the relocation policy with the new employee *after* the offer has been accepted. However, it is likely that acceptance of an offer will often be contingent upon the inclusion of relocation assistance. Recommend that the policy be reworded to state that the relocation policy should be discussed with the employee while an offer of employment is being negotiated.

Section 5, Collecting the Relocation Receipts

Section 2 of the policy states that moving expenses may be paid directly to the moving company or reimbursed to the employee. Payment, whether direct to the moving company or as a reimbursement to the employee, should be based on the actual cost rather than an estimate. Recommend that Section 5 be reworded to clarify that direct payment to the moving company will be based on a firm quote or invoice, and that reimbursement to the employee will be based on the amount shown on the moving company's receipt. The policy should also state that when direct payment is made to the moving company, the employee is responsible for the difference between the actual cost and the amount allowed for reimbursement under this policy.

Section 7, Issuing the Reimbursement Check and IRS Form

The policy states that Accounts Payable will send the appropriate IRS form to the new employee. The IRS requires nondeductible moving expenses that have been reimbursed to be reported as wages on the employee's W-2 and the appropriate taxes to be withheld. Since Accounts Payable does not issue W-2s or withhold taxes from employee

APPENDIX 4 (continued)
"COMMENTS ON POLICY FOR RELOCATION EXPENSES,"
MEMORANDUM FROM CITY AUDITOR, OCTOBER 18, 2004

reimbursements, recommend the policy be changed to state that Payroll will report moving expense reimbursements to the employee on a W-2 and withhold the appropriate taxes, when applicable.

Thanks for the opportunity to comment. Please call me at ext. 6804 or Harriet Richardson at ext. 6750 if you have questions or want to discuss. We appreciate your efforts to develop comprehensive human resource policies and procedures.

cc: Janice Davis, Chief Financial Officer
Sherri Dickerson, Department of Human Resources

APPENDIX 5
RELOCATION EXPENSES – POLICY NUMBER HR 1.30

	Relocation Expenses	Number HR 1.30
		Revision No. 0
	Originating Department Human Resources	Date April 19, 2004

OVERVIEW

This policy and procedure provides guidelines for managing the process of reimbursing an executive or managerial employee for relocation expenses.

1. General (p. 1)
2. Reimbursable Relocation Expenses (p. 2)
3. Determining the Maximum Relocation Amount (p. 2)
4. Initiating the Relocation Process (p. 2)
5. Collecting the Relocation Receipts (p. 3)
6. Processing the Relocation Documentation (p. 3)
7. Issuing the Reimbursement Check and IRS Form (p. 3)

DEFINITIONS

Dependent: Employee's spouse and/or children, 18 years of age or under, and children up to age 24 who are in full-time attendance at a high school or post secondary institution; other family member(s) residing with the employee may be considered for relocation expenses.

Executive/Managerial Employees: Employees paid at Pay Grade 27 and above. Examples of executive/managerial employees include, but are not limited to commissioners, department heads, deputies, and directors of bureaus, and equivalent positions.

Hard-to-fill Professional: A vacancy designated by a department as hard-to-fill based on previous recruitment experience relating to location and classification and/or availability of human resources. The hard-to-fill designation is subject to approval by the Department of Human Resources (DHR).

New Employee: An individual who is appointed to a position and is not currently employed by the City of Atlanta in a permanent fulltime position.

Spouse: Employee's husband or wife, including a common-law or same sex partner with whom the employee has lived with for more than one year.

1. General

A department head may request authorization to pay the relocation expenses of a newly hired executive or manager. Such expenses must be associated with a move from another state, and will be in an amount not to exceed ten percent of the maximum salary authorized for the position. The Chief Operations Officer, Chief Financial Officer, and Commissioner

APPENDIX 5 (continued)
RELOCATION EXPENSES – POLICY NUMBER HR 1.30

of Human Resources must approve such relocation expense reimbursement. Relocation expenses as provided herein shall be paid to newly hired persons who establish domicile within the corporate boundaries of the city.

2. Reimbursable Relocation Expenses

Reimbursable relocation expenses will be consistent with IRS regulations and may include, but are not limited to, the following:

- The cost of two roundtrip airfares for a new employee and his/her spouse/domestic partner for a maximum payment of two house-hunting trips. If children or relatives are involved, it is the responsibility of the new employee to pay for their transportation. Airfare will be economy class. Tickets are to be purchased in a manner that ensures the best fare.
- If the new employee chooses to travel by automobile, instead of air, reimbursable expenses will be at the prevailing IRS mileage rate for deductible moving expenses.
- The cost of packing and moving household goods and appliances. Moving expenses for household goods may be paid directly by the City to the moving company. If a new employee pays for moving expense in advance, the City may then reimburse the new employee up to the amount negotiated and may not exceed the maximum amount allowed.
- Storage costs and any costs incidental to storage of household goods and appliances.
- Temporary housing expenses of a new employee and immediate family incurred after arriving at the principal site of employment is limited to 30 days and should be used within the first 90 days of employment. Any living expenses beyond the 30 days are the responsibility of the new employee.

3. Determining the Maximum Relocation Amount

The Human Resources Generalist will notify the hiring department of candidates who may require relocation assistance. The Human Resources Generalist, in conjunction with the department, will calculate the maximum dollar amount. The total amount may not exceed the maximum amount allowed, ten percent of the authorized salary.

Relocation assistance may be negotiated and should be included in the offer letter. If relocation assistance is not contained in the offer letter, justification from the hiring authority for such allowance must accompany the itemized request.

4. Initiating the Relocation Process

The relocations policy should be discussed with the employee while an offer of employment is being negotiated. New employees receiving relocation reimbursement should be informed that if they terminate employment with the City prior to completing 12 months of service, they would be responsible for reimbursing all relocation expenses

APPENDIX 5 (continued)
RELOCATION EXPENSES – POLICY NUMBER HR 1.30

provided. The department will supply the new employee with the appropriate relocation forms and notify Accounts Payable of the relocation and maximum expense allowed.

5. Collecting the Relocation Receipts

The new employee should secure and obtain a written quote or a bona fide invoice from the moving company as documentation to support the reimbursable moving expense. Direct payment to the moving company will be based solely on the firm quote or an invoice, and reimbursements to the employee will be based on the amount shown on the company's receipt. When direct payment is made to the moving company, the employee is responsible for the difference between the actual cost and the amount allowed for reimbursement under this policy. The new employee should save all relocation receipts.

6. Processing the Relocation Documentation

The new employee should complete the employee section of the *Authorization To Pay Relocation Expenses* form and forward it to the hiring department for routing. The hiring department should submit the *Authorization To Pay Relocation Expenses* form to the Commissioner of Human Resources, Chief Financial Officer and Chief Operating Officer for written authorization. After the hiring department has returned the signed *Authorization To Pay Relocation Expenses* form to the new employee, the new employee should submit the form, the original receipts, or invoices, and a copy of the offer letter or the signed letter of justification to Accounts Payable.

7. Issuing the Reimbursement Check and IRS Form

The Payroll Department will report moving expenses reimbursements to the employee on a W-2 and withhold the appropriate taxes, when applicable

REFERENCE DOCUMENTS

- ❖ City of Atlanta Administrative Order No. 2002-92
- ❖ City of Atlanta Civil Service Code, Sec. 114-138

SUPPORTING FORMS (ATTACHED)

- ❖ *Authorization To Pay Relocation Expenses*
- ❖ *Authorization To Withhold Relocation Expenses From Paycheck*

This document is a general reference only. It is not intended as a contract and does not provide any legal advice or rights. If a discrepancy exists between this policy and procedure and city code, state law, or federal law, such law takes precedence.

APPENDIX 6

IRS WORKER CLASSIFICATION REGULATIONS

When making a worker status determination, the primary question is whether the worker is an independent contractor or an employee under the common-law standard. When workers are independent contractors, the governmental entity may have information-reporting responsibilities but is not required to withhold and pay employment taxes on behalf of the worker. Employment taxes consist of Federal Income Tax Withholding, Social Security tax, and Medicare tax. The social security tax and Medicare tax make up the Federal Insurance Contributions Act (FICA) tax. Local governments generally pay FICA tax concerning employees covered under Section 218 Agreements and on employees not covered by a public retirement system, and generally pay the Medicare portion on all other employees hired after March 31, 1986. Local governments do not pay taxes under the Federal Unemployment Tax Act (FUTA) but state unemployment taxes may apply.

The common-law rule for determining a worker as an employee is not only whether the government entity has the right to tell the worker what shall be done but also how it shall be done.

Criteria for Employee Classification: All the facts and circumstances must be considered in deciding whether a worker is an independent contractor or an employee. The facts fall into three main categories:

1. whether the entity has the right to control the behavior of the worker,
2. whether the entity has financial control over the worker, and
3. the relationship of the parties, including how they see their relationship.

Behavioral Control:

- *Instructions, Training, and Required Procedures:* Periodic or ongoing training of procedures followed and methods used indicates the employer wants the services performed in a particular manner, and this training is strong evidence of an employer-employee relationship. However, some types of training or minimal instructions may be provided to either an employee or an independent contractor, including orientation or information sessions about a government entity's policies and voluntary programs for which there is no compensation.
- *Government Identification:* When an individual represents himself or herself as an agent of a government, that gives the individual an appearance of authority.
- *Nature of Occupation:* Highly trained professionals such as doctors, accountants, lawyers, engineers, or computer specialists may require very little, if any, instruction on how to perform their specific services. In such cases, the entity may not train the individuals or

APPENDIX 6 (continued)
IRS WORKER CLASSIFICATION REGULATIONS

tell them how to practice their professions but may retain other kinds of control, such as requiring work be done at government offices, controlling scheduling, holidays, vacations, and other conditions of employment.

- *Evaluation Systems:* If there is a periodic, formal evaluation system that measures compliance with performance standards concerning the details of performance, the system and its enforcement are evidence of control over the workers' behavior.

Financial Control:

- *Method of Payment:* An independent contractor has a genuine possibility of profit or loss. An individual paid a contract price, regardless of what it costs to accomplish the job, has a genuine possibility of profit or loss. An individual paid by the hour, week, or month is typically an employee. However, this is not always the case; attorneys, for example, usually bill by the hour even when they work as independent contractors.
- *Offering Services to the Public:* Does the individual advertise, use a private business logo, maintain a visible workplace, or work for more than one entity?
- *Corporate Form or Business:* If the individual is incorporated and observes the corporate formalities, it is unlikely that he or she is an employee of the government entity.
- *Part-time Status:* The fact that workers work on a part-time or temporary basis, or work for more than one entity, does not make them independent contractors.

Relationship of the Parties:

- *Evidence of a Contract:* A written agreement describing the worker as an independent contractor is evidence of the parties' intent and, in situations where it is unclear whether a worker is an independent contractor or employee, the intent of the parties as reflected in the contract, may resolve the issue. A contractual designation, in and of itself however, is not sufficient evidence for determining worker status.
- *Providing Employee Benefits:* Providing employee benefits such as paid vacation, sick days, and health insurance is evidence that the entity regards the individual as an employee.
- *Filing a W-2:* Filing a Form W-2 indicates the employer's belief that the worker is an employee.

APPENDIX 6 (continued)
IRS WORKER CLASSIFICATION REGULATIONS

- *Doing business in Corporate Form:* Doing business in corporate form, with observance of corporate formalities, indicates the worker is not an employee of the government entity.
- *Termination of Contracts:* The government's ability to refuse payment for unsatisfactory work continues to be indicative of independent contractor status.
- *Permanency:* A worker engaged with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, is generally considered evidence of intent to create an employment relationship.

Effect of Misclassifying an Employee as an Independent Contractor: Employers who misclassify employees as independent contractors may be held liable for back taxes, penalties, and interest.

Section 530 Relief: If an IRS audit finds a government entity has misclassified workers, the government entity may seek relief under Section 530 of the Revenue Act of 1978. The purpose of Section 530 is to allow employers who misclassified employees as independent contractors to continue to treat those workers as independent contractors if they satisfy two conditions:

1. the employer has filed all information returns consistent with the worker being an independent contractor; and
2. not having treated the worker, or any other worker, in a substantially similar position as an employee.

Reporting Responsibilities - Employers of independent contractors have the following reporting responsibilities:

1. Payment to independent contractors of \$600 or more during a calendar year must be reported on IRS Form 1099-MISC, and a copy must be sent to independent contractors by January 31 of the following year.

Independent contractors are required to provide a taxpayer identification number (TIN) to the entity that pays them. A backup withholding is required if a payee does not provide the payer with a TIN, if the IRS tells the payer that the TIN is incorrect, or the IRS notifies the payer that backup withholding is required. Failure to do so could result in the employer paying a tax liability on behalf of the independent contractor for 28 percent of the total compensation paid to the independent contractor.

Source: Chapter 4 of IRS Publication 963, Federal-State Reference Guide

APPENDIX 7
AUDIT RESPONSE – DEPARTMENT OF FINANCE



RECEIVED FEB 09 2006

SHIRLEY FRANKLIN
MAYOR

CITY OF ATLANTA

DEPARTMENT OF FINANCE
68 MITCHELL STREET, S. W., SUITE 11100
ATLANTA, GEORGIA 30335-0312
VOICE (404) 330-6430 FAX (404) 658-6667

JANICE D. DAVIS
CHIEF FINANCIAL OFFICER

To: Leslie Ward
Internal Auditor

From: Janice D. Davis
Chief Financial Officer 

Date: February 7, 2006

Subject: Responses to Draft Audit Report – Payroll Tax Compliance

We recommend the City correct inaccurate reporting made to the IRS and refund amounts withheld in error. The Chief Financial Officer should

1. Issue corrected W-2s for employees who did not have Medicare tax withheld or received taxable moving expense fringe benefits that were not reported as income. The City has partial data on the personal use of City vehicles; therefore, the City should issue corrected W-2s for the taxable portion of this fringe benefit where possible. The City does not have data on the personal use of City-owned cell phones; therefore, the City cannot issue corrected W-2s for this fringe benefit.

Management Response: The Department of Finance concurs with this recommendation. Please provide us with a listing of the affected employees.

2. Determine the total amount of Medicare tax withheld in error and refund this amount to the three employees.

Management Response: The Department of Finance concurs with this recommendation. Please provide us with a listing of the affected employees.

The City could simplify its tax administration duties by revising policies on City vehicles, City-owned cell phones and relocation expenses as suggested in recommendations 3 through 6.

3. The Chief Financial Officer and Commissioner of Human Resources should simplify the City's policy on reimbursed moving expenses so it agrees with IRS regulations. Our office recommended this course of action in a memorandum dated October 18, 2004, to the Commissioner of Human Resources and the Chief Financial Officer.

The Department of Finance...because customer service is important to us

APPENDIX 7 (continued)

AUDIT RESPONSE – DEPARTMENT OF FINANCE

- The policy should identify expenses that will not be reimbursed, and such expenses should be consistent with those the IRS has identified as non-deductible, thus eliminating any additional reporting to the IRS on taxable fringe benefits.
- If the City's policy continues to allow reimbursement of non-deductible moving expenses, the Chief Financial Officer and the Commissioner of Human Resources should establish a process to ensure such reimbursements meet the IRS requirements for reporting and tax withholding.

Management Response: As a point of clarification, the memorandum dated October 18, 2004 was addressed to the Commissioner of Human Resources, not the Chief Financial Officer. The Department of Finance concurs with the recommendation that the policy on reimbursed moving expenses should agree with IRS regulations. As a means to accomplish this, the Finance Department recommends that the amount of any reimbursed relocation expense be included as income on the employee's W-2.

4. The Chief Operating Officer should revise Administrative Order 2004-3 to make cell phone allowances the primary mechanism for funding business use of cell phones and PDAs.
 - We recommend that the City create a cell phone allowance for employees, as we did in a memorandum dated October 5, 2004 to the task force charged with revising the previous policy, to eliminate the need for further reporting to the IRS.
 - If the City continues to issue cell phones and PDAs to employees, the Chief Operating Officer should revise 2004-3 to make personal use of this equipment easier to track and report to the IRS. We provided several examples of other cities' practices in the October 5, 2004 memorandum

Management Response: We concur with this recommendation. We recommend that the City adopt the following policy as it relates to City owned cell phones.

- Commissioners and their deputies will be furnished with a City-owned cell phone. 25% of the base cell phone or PDA charge will be included as taxable income on the employee's W-2.
- Employees below the level of deputy will be given a monthly cell phone allowance if they provide their commissioner with a valid cell phone number for use on City business. We will be glad to work with the Human Resources Department, the Chief Information Officer and the Chief Operating Officer to determine an adequate monthly cell phone allowance.
- Exceptions to the allowance provision will only be approved in instances where the employee is required to be away from the normal work area or is on-call. All exceptions must be requested in writing by the appropriate commissioner and approved in writing by the Chief Operating Officer and the Chief Financial Officer. If the exception is granted, that employee will have 25% of the base cell phone or PDA charge included as taxable income on the employee's W-2.

APPENDIX 7 (continued)
AUDIT RESPONSE – DEPARTMENT OF FINANCE

5. The Chief Financial Officer should develop procedures to accurately track and report the personal use of city vehicles. To simplify the city's reporting requirements, we recommend:
- Whenever possible, encourage employees to use their personal vehicle for city business and reimburse the employee for mileage under IRS regulations,
 - Whenever possible, grant an employee a vehicle allowance,
 - Request that MTS distinguish between vehicles that qualify for personal use under IRS regulations and vehicles that do not (i.e. qualified non-personal use vehicle), and
 - Provide MTS and/or operating departments with instructions on how personal use should be reported to the Payroll Division.

Management Response: While the Finance Department concurs with this recommend, we do not believe that it is within our purview to regulate. As with cell phone use, this should be addressed in an Administrative Order. We will be glad to assist the Chief Operating Officer in the drafting of the Order, if requested.

6. The Chief Financial Officer should propose legislation to amend Section 2-1715 of the City Code of Ordinances on personal use of city-owned vehicles so that the code complies with IRS regulations. Commuting to work is considered a taxable benefit regardless if the employee has permission or is on call. Vehicles assigned to executives and public safety employees are also considered taxable unless the vehicle meets certain specifications. Therefore, sections of the City Code of Ordinances that state otherwise should be modified.

Management Response: The Department of Finance concurs with this recommendation. We will work with the Law Department to draft the amended legislation.

7. The chief procurement officer and city attorney should create a policy to provide guidance to departments on the proper classification of workers and include this policy in the city's procurement manual.

Management Response: N/A

APPENDIX 8
AUDIT RESPONSE – DEPARTMENT OF HUMAN RESOURCES



CITY OF ATLANTA

SHIRLEY FRANKLIN
MAYOR

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DEPARTMENT OF HUMAN RESOURCES
BENITA C. RANSOM
COMMISSIONER

To: Leslie Ward, Internal Auditor
From: Benita C. Ransom *BCR*
Date: February 1, 2006
Re: **Response to Draft Audit Report – Payroll Tax Compliance**

The Relocation Policy serves as a great recruitment tool for executives and other sought after managers. The Department of Human Resources (DHR) will work with Finance on alternatives to the current process that will ensure compliance with the Internal Revenue Code. Many of the concerns regarding reimbursements to employees should be also resolved with implementation of the new Oracle software. The new process flow will allow all deductions related to employee expenses to be paid through payroll.

In the interim, DHR will recommend that Finance establish a “relocation” account to which relocation reimbursements could be charged. Such an account would allow Finance to track reimbursements and determine which expenses should be reported on a W-2 at the end of the year. DHR will revise the existing Relocation Policy accordingly.

c: Lynnette Young, COO

APPENDIX 9
AUDIT RESPONSE – DEPARTMENT OF LAW



CITY OF ATLANTA

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LINDA K. DISANTIS
CITY ATTORNEY

RECEIVED APR 17 2006

To: Leslie Ward
Internal Auditor

From: Linda DiSantis *LKD*
City Attorney

Date: April 17, 2006

Re: Performance Audit: Payroll Tax Compliance

I am writing you this memo in response to Recommendation number 7 in your April 2006 Performance Audit regarding Payroll Tax Compliance. Although I agree that the Chief Procurement Officer and the City Attorney should create a policy to provide guidance to departments on proper classification of workers, this policy would only have applicability to those workers hired through contracts with outside contractors. I recommend that a policy also be developed by the Commissioner of Human Resources and the City Attorney to address workers hired by the departments directly on a contractual basis.

cc: Serena Sparks
Jerry DeLoach
Melanie Wallace

APPENDIX 10
AUDIT RESPONSE – DEPARTMENT OF INFORMATION TECHNOLOGY



RECEIVED APR 11 2006

SHIRLEY FRANKLIN
MAYOR

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Abe A. Kani
Chief Information Officer
Department of Information Technology

MEMORANDUM

TO: Leslie Ward, City Auditor
Office of City Internal Auditor

FROM: Abe Kani/Anana Evans 
Department of Information Technology

SUBJECT: Response to Recommendation #4 Payroll Tax audit report

DATE: Monday, April 10, 2006

The City's Chief Operating Officer has asked me to respond to this finding. In addition, I would like to submit additional information that I believe to be very important in establishing the right perspective regarding the provision of cell phone services to City departments and the cost associated with this service. The readers of the audit report need to understand fully the current state of cell phone service provision in the context of the progress that DIT has achieved in managing cell phone portion of the telecommunications services since DIT took over the responsibility almost two years ago. Please be advised that my views address only those issues that are under DIT responsibilities and exclude such issues as tax reporting and the final recommendation for an algorithm to calculate the cost associated with the personal use of cell phone minutes.

As a result of DIT's efforts, which expand over the past two and a half years, the City of Atlanta has achieved great accomplishments with regard to efficient and effective delivery of cell phone services. DIT went through an extensive clean up process, which resulted in creation of a reliable cell phones/pagers inventory database. All City departments have online access to their specific inventory information and are responsible for validating its accuracy. In late 2004, DIT negotiated a "Pool of Minutes" service contract with Nextel and Verizon, which resulted in the elimination of the overage premiums the City used to pay when an employee exceeded allotted minutes under an individual plan. These actions resulted in cost reductions of over \$800,000 since 2004. Please bear in mind that the cost reductions mentioned above were realized at a time when the number of cell phones continued to increase! DIT has focused on monthly analysis of the minutes used to establish a better understanding of the needed volume of minutes under normal business conditions as well as establishing a reasonable surplus to address the City's needs under an emergency/disaster situation. I am happy to say that DIT expects additional cell phone cost reductions in 2006 because of the adjustments we have already made to the pool of minutes and are supported by the outcome of DIT's ongoing usage analysis.

APPENDIX 10 (continued)
AUDIT RESPONSE – DEPARTMENT OF INFORMATION TECHNOLOGY

Response to Recommendation #4 Payroll Tax Audit report

page 2

The establishment of the Administrative Order October 2004-3 further clarified the roles and responsibilities of all City departments and DIT with regard to the ownership of inventory data, appropriate protocol for new cell phone services requests as well as, the monitoring and reporting of the personal usage above the limit established by the Administrative Order. As an example, DIT requires each department head to sign a service request form and provide business justification for their request. It is the department head's responsibility to determine how important the provision of a cell phone to an employee is in order to perform their job functions effectively.

These facts are clear evidence of the City and DIT's focus to take the necessary steps to effectively manage both the provision of and the cost associated with the cell phone service to City departments. Let me reiterate that our goal is two fold first, to have a 100% reliable device inventory for tracking purposes and secondly, to provide cell phone services at the most cost effective manner. Therefore, I do not agree that the quality of the efforts and the progress made can be judged based on data collected for a single month. We do expect that overall usage will change from month to month and the addition of new cell phones will add minutes to the pool to compensate for the needs of new users. However, close monitoring of monthly usage will enable us to make needed adjustments to effectively manage cost.

With regard to audit report's recommendation #4 and the subsequent suggestion to revise the Administrative Order 2004-3, we do not agree with the recommendations findings since it was based on a snap-shot assessment. However, we do agree the policy that was developed initially with the assistance of the internal auditor's staff needs to be modified. The Chief Operation Officer has accepted and approved the following change to the policy:

- Amend the policy to provide a specific number of minutes for employee personal use (lean toward 135 minutes or 155 of the current 900 minutes provided by our plan.)
- Recognize \$ 7.00 per month as income to the employee.
- Change to criteria for providing cell phone to cover only those whose jobs require:
 - > That they be on call 24 hours a day;
 - > That they be away from their principal work location or a city facility where a phone is readily available for more that 25% of their work day;
 - > That the cell phone be used in place of a city-provided radio; or
 - > That they serve as Commissioners, Deputies and anyone they deem in a first responder category within their operations.

Thank you for the opportunity to provide my views and let me know if I can be of further assistance.

CC: Lynnette Young, COO
Janice Davis, CFO

APPENDIX 11
CITY AUDITOR'S COMMENTS ON DIT RESPONSE

City Auditor's Office Comments on Department of Information Technology Response

We appreciate the Chief Information Officer's comments on management of city-owned cell phones. We have discussed the findings and recommendations on this issue not only with DIT staff but also with senior management of the Department of Finance, the Chief Operating Officer and the Mayor over the last three months. Unfortunately, the written comments of April 10th do not reflect an accurate understanding of the audit. The Chief Information Officer disagreed with our finding and recommendation related to cell phones, believing that our conclusion was based on analysis of single month. We offer the following comments to clarify areas of apparent misunderstanding.

We do not disagree with DIT efforts to improve management of city-owned cell phones, but these efforts were not the focus of the audit. DIT is appropriately concerned with managing overall technology costs and tracking city equipment. Since our audit objective was to assess whether the city is complying with IRS regulations for reporting fringe benefit income and withholding payroll taxes, we examined the city's cell phone policies and procedures from this perspective. Consequently, our report offers no conclusions or recommendations regarding DIT management of cell phone inventory, negotiation of rates and usage, or other aspects of their role.

Our findings on the current cell phone policy are illustrated by a one-month "snapshot" but are not based on that data. We disagree with the assertion that we have judged the quality of DIT efforts and progress made based on data collected for a single month. As stated above, we did not audit the city's management of its cell phones or how practices have changed over time. Our focus was whether the city as an employer is meeting its responsibility to accurately report income to the IRS and withhold payroll taxes as required by law. We concluded that the city is not tracking or reporting taxable fringe benefit income related to personal use of city cell phones. Our conclusion is based on analysis of the city's policy (Administrative Order No. 2004-3), the pooled minutes plans, IRS regulations and guidance, and city payroll records. The best efforts of DIT to manage the equipment and obtain the best rates cannot change the fact that the city allows unknown amounts of personal use of city-owned cell phones without any process to report this use as imputed income. This fact is the result of the way the city's policy is written and the relatively high number of minutes per device included in the city's pooled plan, coupled with unrealistic monitoring requirements and a lack of attention to the tax implications of the policy when it was written.

APPENDIX 11 (continued)
CITY AUDITOR'S COMMENTS ON DIT RESPONSE

We analyzed the city's cell phone bills for August 2005, the most recent month for which data were available at the time of our analysis, to provide context for our finding. The average minutes used per device in August were not atypical for the year, as shown in the following table. (January is excluded from the annual average because it preceded the city's use of two vendors and the steady increase in number of phones.) The overall distribution of use is unlikely to vary substantially from month to month.

It's not accurate to say that we assisted with the development of the city's policy. We can't participate in management decisions because it impairs our independence and creates a risk that we could audit our own work. We made recommendations to the task force that was charged with revising the previous cell phone policy (see Appendix 2), at the chief operating officer's request. We did not participate in decisions about the administrative order, and we did not review or comment on it before it was adopted. Our primary recommendation – that the city should provide an allowance for employees who have a business need for a cell phone – was not implemented.

Number of Cell Phones and Usage Per Month - 2005

<u>Month</u>	<u>Total Devices</u>	<u>Total Minutes</u>	<u>Average Minutes Per Device</u>
Jan-05	1,168	752,859	644.6
Feb-05	1,451	1,104,479	761.2
Mar-05	1,513	1,028,479	679.8
Apr-05	1,614	1,178,322	730.1
May-05	1,654	1,214,781	734.5
Jun-05	1,730	1,251,430	723.4
Jul-05	1,766	1,266,661	717.2
Aug-05	1,777	1,340,196	754.2
Sep-05	1,847	1,433,022	775.9
Oct-05	1,877	1,348,179	718.3
Nov-05	1,870	1,481,969	792.5
Dec-05	1,909	1,387,740	726.9
Average (Feb-Dec)	1,728	1,275,932	737.6

Source: DIT wireless usage for 2005, City Auditor's Office calculations

DIT has not made a case for continuing to bear the cost and burden of city-owned cell phones rather than considering the use of cell phone allowances. After several months of discussion and attempts to clarify the pros and cons of the

APPENDIX 11 (continued)
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recommendation, we've yet to hear clear reasons for the city's reluctance to pay allowances for employees' business use of their personal cell phones. In addition to eliminating the city's tax compliance problems with this fringe benefit, there are other management advantages. Allowances are widely used in the private sector and increasingly so in the public sector. The indirect costs of purchasing, tracking, maintaining, and paying for city-owned equipment add considerably to the direct costs of the phones and monthly charges. Monitoring personal use and complying with employer tax requirements further increase indirect costs. Allowances can be set to cover a reasonable amount of employee business use plus the estimated amount of additional taxes to be withheld on this income.

Stricter criteria for determining who should have a city-issued cell phone are a step in the right direction. We recognize that some types of employees rely on cell phones in lieu of two-way radios for virtually all communication on the job. First responders, if adequately defined, could also warrant specific types of communication devices. On the other hand, employees whose only justification for a phone is that they are away from their work site for 25% of the time are clear candidates for an allowance. Finally, we encourage the city to investigate whether the proposed revisions to the administrative order would satisfy IRS requirements without additional monitoring to ensure that employees adhere to limits for personal use, and to articulate a clear basis for determining the value of the benefit.