



CITY OF ATLANTA

City Auditor's Office
Leslie Ward, City Auditor
404.330.6452

April 2006

Performance Audit:

Payroll Tax Compliance

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.

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.