EXTERNAL AUDIT CIRCULAR No. 5

CONNECTICUT DEPARTMENT OF TRANSPORTATION

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SUBJECT: Vehicle, Mileage, and Airfare Costs

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This Circular presents interpretative guidance regarding advertising and selling costs and includes examples for use in determining the allowability of such costs. Please refer to Chapter 8 and 6.3B of the 2010 edition of the AASHTO Uniform Audit & Accounting Guide for additional guidance.

I. VEHICLE COSTS

A. ISSUE

During an indirect cost rate audit of a consultant, auditors typically encounter vehicle and mileage costs that are either charged directly to projects or are included in the consultant's indirect cost rate computation. Vehicle and mileage costs must be analyzed to determine allowable charges to Government contracts.

B. FAR Guidance

FAR 31.205-46(d) provides the following—

> Costs of contractor-owned or -leased automobiles, as used in this paragraph, include the costs of lease, operation (including personnel), maintenance, depreciation, insurance, etc. These costs are allowable, if reasonable, to the extent that the automobiles are used for company business. That portion of the cost of company-furnished automobiles that relates to personal use by employees (including transportation to and from work) is compensation for personal services and is unallowable as stated in 31.205-6(m)(2).

FAR 31.205-46(a)(1) further states that—

> Costs incurred by contractor personnel on official company business are allowable, subject to the limitations contained in this subsection. Costs for transportation may be based on mileage rates, actual costs incurred, or on a combination thereof, provided the method used results in a reasonable charge.

FAR 31.205-6(m)(2), limits allowability to costs associated with the *business use* of vehicles—

> That portion of the cost of company-furnished automobiles that relates to personal use by employees (including transportation to and from work) is unallowable regardless of whether the cost is reported as taxable income to the employees (see [FAR] 31.205-46(d)).

Consultants that choose the standard mileage rate may not deduct actual expenses, such as depreciation, lease payments, maintenance and repairs, gasoline (including gasoline taxes), oil, insurance or vehicle registration fees. Business-related parking fees and tolls may be deducted in addition to the standard mileage rate. Fees for parking at an employee's main place of business or tolls related to commuting to and from that main place of business are personal expenses which are not deductible.

C. Operating Lease

When an operating lease exists, the following may be charged to indirect costs: the portion of the periodic lease costs (and directly-associated costs such as repairs and maintenance, insurance, license fees, and gas and oil) that is associated with business-use indirect mileage. Note that all direct mileage costs, personal mileage costs, and mileage costs associated with unallowable advertising and selling must be excluded from indirect costs.

D. Cash Purchase, Traditional Financing, or Capital Lease

The consultant may acquire vehicles through a cash purchase, a traditional financing arrangement (e.g., bank loan), or through capital-lease contracts. Vehicles acquired via cash purchases or traditional financing arrangements must be capitalized. Similarly, when a vehicle lease meets any of the four capitalization criteria set forth in FASB Statement No. 13, the lessee must capitalize the vehicle. Capital leases are effectively treated as purchase arrangements, accordingly, the lessee/consultant is considered to have an ownership interest in the leased vehicles.

When a vehicle is acquired through a cash purchase, traditional financing arrangement, or a capital lease, only a portion of the periodic depreciation expense and related property taxes associated with the capital lease are allowable indirect costs. These costs are limited to the business use, indirect mileage incurred in connection with use of the vehicles. In a similar fashion, directly-associated costs such as repairs and maintenance, insurance, license fees, and gas and oil also are allowable, but only to the extent that such costs represent the business use, indirect mileage incurred in connection with use of the vehicles. Also note that interest costs associated with the amortization of capital leases must be excluded from indirect costs (see ConnDOT External Audit Circular No. 10 for more details).

E. Recordkeeping and Compliance

Consultants are required to keep complete records to substantiate the vehicle expenses claimed on an indirect cost schedule. Regardless of whether actual costs are claimed or the standard mileage rate is used, consultants must maintain a daily log for each vehicle that records the total miles traveled, each destination point and the purpose of the trip.

1. Actual Costs: Consultants generally are permitted to charge the actual allowable costs associated with the business use of vehicles. Costs that cannot be substantiated should be disallowed. Consultants should determine the allowable overhead amount as follows:

Step 1: Compute the total annual operating expenses for each vehicle. Operating expenses include fuel, oil, tires, repairs, license fees, lease payments, registration fees, insurance, and depreciation. Consultants must retain receipts, invoices, and other documentation to show cost and establish the identity of the vehicle for which the expense was incurred. For depreciation purposes, consultants must track the original cost of the vehicle, the date the vehicle was placed in service, and the annual depreciation deductions amounts recorded for financial statement purposes and income tax reporting. As specified in FAR 31.205-11(c), the depreciation amount used for overhead purposes must not exceed the amount used for financial accounting purposes.

Step 2: Compute the total actual business-related operating costs by multiplying the total operating expenses computed in Step 1 by the percentage of business use (from the mileage log) for each vehicle. Costs for the business use of vehicles are the costs that remain after all personal commuting costs have been removed.

Step 3: Subtract direct vehicle costs from the business operating expenses computed in Step 2 to compute the total indirect business costs for the vehicles. Business-related parking and road tolls are fully allowable expenses that do not have to be reduced to the percentage of business usage.

Step 4: Subtract any costs associated with unallowable business activities such as marketing and advertising and/or unallowable selling. Unallowable selling includes activities that do not qualify as 'direct selling' within the meaning of FAR31.205-38(5).

2. Optional Standard Mileage Rate: In lieu of claiming actual vehicle costs, the consultant may use the GSA Mileage Reimbursement Rate to determine appropriate charges to indirect costs.

Step 1: Compute the total business-related operating costs by multiplying the total business mileage for each vehicle (from the mileage log) by the GSA Mileage Reimbursement Rate. Mileage associated with commuting and or personal use is unallowable per FAR 31.205-6(m)(2).

Step 2: Subtract direct vehicle costs from the business operating expenses computed in Step 1 to compute the total indirect business costs for the vehicles.

Step 3: Subtract any costs associated with unallowable business activities such as marketing and advertising and/or unallowable selling.

3. Vehicle Costs for Owners and Senior Executives
As used in this section—

- "Senior executives" is defined as "the five most highly compensated employees in management positions at each home office and each segment of the contractor, whether or not the home office or segment reports directly to the contractor's headquarters." See FAR 31.205- 6(p)(2)(ii)(B).
- "Owner" includes any individual with an equity interest of five percent or more of the firm.

Generally, costs for company vehicles assigned to Senior Executives and Owners (SE&O) are allowable, subject to reasonableness and allocability. The procedures for determining the allowable portion of these costs are similar to those described above in Sections E.1 and E.2; however, as SE&O generally have the ability to influence the types of vehicles they drive, special scrutiny is merited. Consultants bear the burden to prove that costs for SE&O's vehicles are reasonable, especially costs for luxury vehicles.

When assessing reasonableness, consultants are encouraged to convert the vehicle costs for SE&Os into a per-mile recovery/usage rate. The costs included in this analysis should consist of lease or depreciation costs, insurance, maintenance, licensing, and repairs. If the SE&Os are paid a vehicle allowance in lieu of being assigned a company vehicle, then said allowance also should be converted into a per-mile recovery rate. Generally costs for the business use of the SE&O's vehicles will be considered allowable if the consultant can justify that either—
(a) the costs for the SE&Os' vehicles are similar in amount to costs for the firm's other, general-use vehicles; or
(b) there is a justified business need for incurring higher costs for the SE&O's vehicles.

EXAMPLE

Example 5-1. As illustrated in Attachment 5.1, *Consultant X* owns fourteen vehicles (two assigned to Senior Executives and twelve general fleet vehicles). The vehicles were driven a total of 353,000 miles during 2009, of which 55,250 were unallowable personal-commuting or advertising/selling[6] miles, 132,050 were direct miles, and 165,700 were indirect miles driven in connection with allowable business activities. The consultant incurred $172,000 in total vehicle costs for the year.

Analysis: Costs associated with the personal commuting and direct mileage, $26,918 and $64,345, respectively, must be removed from overhead. A maximum of $80,737, the costs associated with the allowable indirect mileage, may be included in overhead, subject to reasonableness. For the vehicles assigned to the Senior Executives, the consultant should perform an analysis to determine whether the related costs are comparable to the costs for the general fleet. Any portion deemed unreasonable should be removed from overhead.

II. MILEAGE-REIMBURSEMENT COSTS

A. ISSUE

A consultant may reimburse its employees for the business use of their personal vehicles.

B. ALLOWABILITY

Indirect Costs. Reimbursements paid to employees for the business use of their personal cars is limited to the applicable GSA mileage rates. Any reimbursement paid in excess of the GSA mileage rates must be removed from the consultant's indirect cost-rate computation.

Direct Costs. Maximum mileage-reimbursement costs that are charged directly to CTDOT contracts are based upon contractual language. If a consultant reimburses its employees at a rate in excess of the allowable rate, the difference between the reimbursement rate and the rate per mile billed CTDOT contractual maximum may NOT be included in indirect costs.

C. COMPLIANCE REQUIREMENTS

Consultants are required to maintain detailed records of reimbursements paid to employees and must adjust the indirect cost rate to compensate for reimbursements in excess of the GSA mileage rate.

EXAMPLE 5-2

During 2011, *Consultant X* reimbursed its employees for 21,000 business miles driven in personal vehicles, of which 10,000 were directly charged to projects, and 11,000 were included in indirect costs. The consultant reimbursed its employees for all miles driven based on $0.55 per mile. The GSA mileage rate is $.51 for 2011.

Analysis. Consultant is entitled to bill $5,100 directly to CTDOT projects and may include $5,610 in the indirect cost pool. The consultant must disallow $400 for project mileage and must disallow $440 from indirect costs for amounts paid to employees in excess of the GSA mileage rate for 2009.

NOTE: The consultant may not shift the $400 to the indirect cost pool. The inability to bill a cost should not influence the consultant's cost allocation procedures.

EXAMPLE 5-3

During 2011, *Consultant X* reimbursed its employees for 21,000 business miles driven in personal vehicles, of which 10,000 were directly charged to projects, and 11,000 were included in indirect costs. The consultant reimbursed its employees for all miles driven based on the $0.45 per mile.

Analysis. Since the rate reimbursed is less than the GSA mileage rate, no disallowance is necessary. Consultant X is entitled to bill $4,500 directly to CTDOT projects and may include $4,950 in the indirect cost pool.

III. AIRFARE COSTS

A. ISSUE

During an indirect cost audit of a consultant, auditors typically encounter airfare costs that are included in the consultant's indirect cost-rate computation.

B. ALLOWABILITY

Actual costs for airfare are allowable but are limited to the lowest customary standard, coach, or equivalent airfare offered during normal business hours. In some limited circumstances, airfare in excess of rates described above may be allowable; however, this generally is limited to situations in which the lowest cost airfare would result in circuitous routing, require travel during unreasonable hours, excessively prolong travel, result in increased cost that would offset transportation savings, or are not reasonably adequate for the physical or medical needs of the traveler.

C. COMPLIANCE REQUIREMENTS

Consultants are required to maintain detailed records of actual costs related to air travel. This includes copies of tickets, itinerary, and cancelled checks to show proof of payment. Additionally, the consultant must document the lowest cost fare available during each travel period. In cases where a consultant claims costs in excess of the standard rate described above, these costs must be documented and justified and may be subject to review by CTDOT auditors. Costs in excess of the above must be removed from the indirect cost-rate computation.

IV. REFERENCES

- CTDOT External Audit Circular No. 1 (definitions, audit authority, and general guidance regarding the computation of overhead rates).
- State of Connecticut Office of Policy and Management General Letter No. 97-1 (establishes maximum reimbursement rate for mileage; incorporated into all contracts between CTDOT and consultants).
- United State General Services Administration (mileage reimbursement rates for privately owned vehicles)
- FAR 31.201-2(a)(4) (costs are allowable only to the extent provided by the terms of the contract).
- FAR 31.205-6(m)(2) (personal use of company-furnished vehicles).
- FAR 31.201-6(a) (when an unallowable cost is incurred, its directly associated costs are also unallowable).
- FAR 31.205-20 (requirement to exclude interest costs from overhead).
- Statement of Financial Standard No. 13 (capital-lease criteria).
- FAR 31.205-11(i) (treatment of capital leases).
- FAR 31.205-41 (State and Local Taxes); see also DCAA Contract Audit Manual § 7-1403.
- FAR 31.205-20 (Interest and Other Financial Costs).
- FAR 31.205-46 (Travel Costs)
- CTDOT External Audit Circular No. 10 (Interest and Other Financial Costs and Facilities Capital Cost of Money).