WHITE PAPER SERIES

FLEET VS. EMPLOYEE- OWNED VEHICLES

CHOOSING THE BEST APPROACH TO DRIVE YOUR BUSINESS

An organization's approach to business driving impacts many different stakeholders, including operations, sales, finance, compliance, security, safety, IT, and procurement. Companies have options on how to provide for business driving. They can compensate the employee for driving their own vehicle, or they can provide a company vehicle (a.k.a. fleet vehicle) for business use. These options have gained increased scrutiny fueled by pressure on all sectors to take cost out of their operations.

This white paper will examine both business driving options and evaluate the impact of each on today's business challenges.

INTRODUCTION

Following the global financial crisis, businesses continue to face many challenges, including maintaining or returning to profitability, achieving regulatory and corporate compliance, minimizing risk, maximizing efficiencies, maintaining corporate image, instituting green fleet initiatives and hiring and retaining valuable employee resources. A company's approach to business driving impacts all of these areas.

There are two options when it comes to business driving: first, offer a fleet vehicle to employees, or second, provide an allowance/reimbursement program for employees to drive their personal vehicles for business.

Company Vehicle (Fleet) Programs

Today, most fleet programs involve professional fleet management companies (FMCs). By using fleet professionals, such as Automotive Resources International (ARI), companies can leverage their investment in fleet systems and fleet expertise at a cost far less than creating a similar structure within their own organization. Companies that choose to manage a fleet program in-house do so for various reasons, including the organic evolution of their business and size of their fleet.

Two myths that persist, despite having been disproved by many successful businesses, are that reimbursement / car allowance programs greatly reduce risk and costs for an organization, and that fleet vehicles are cumbersome to administer and offer less cost control.

Technology and service developments in corporate fleet management enable fleet clients to maintain tight controls while operating with minimal involvement.

Reimbursement / Car Allowance Programs

Reimbursement and car allowance programs employ different methodologies:

- **Reimbursement —** The company pays employees for business mileage and/or related expenses that are reported on a scheduled basis, usually monthly, and tracked internally.
- **Car allowance —** The company gives employees a fixed amount each month to cover expenses related to business driving.
- **Fixed and Variable Reimbursement (FAVR) -** Under a FAVR plan employees receive both a fixed monthly amount and a cents-per-mile reimbursement for business driving. If this arrangement meets all IRS regulations it can be provided as a tax-free program.

There are a number of ways to design reimbursement and allowance plans, but ARI studies have shown that there are generally only two outcomes for these programs: they are more expensive than fleet programs, or they are pushing costs onto employees by underfunding business use of their personal vehicle.

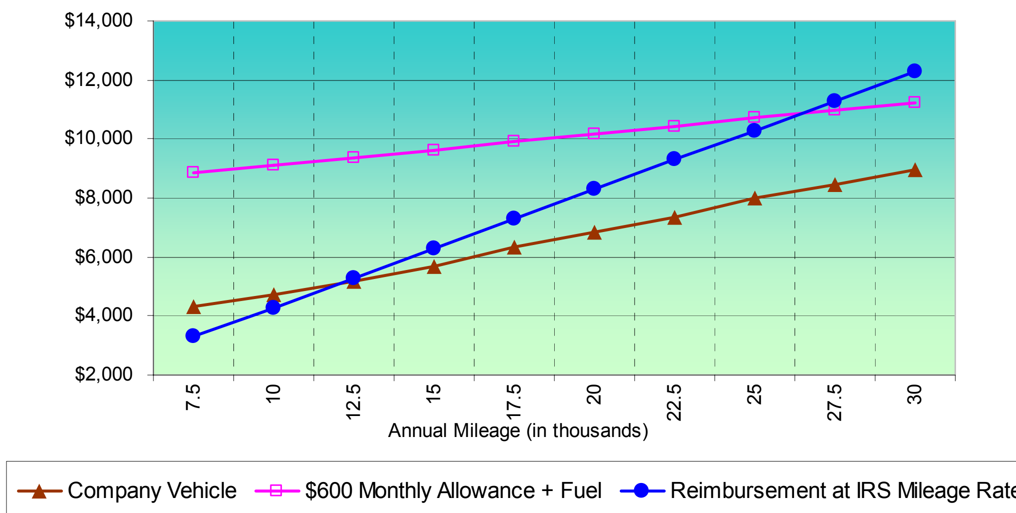
CRUNCHING THE NUMBERS

Total life of vehicle costs vary based on usage of the vehicle. Higher mileage drivers need vehicle replacements on a more frequent basis, and incur greater operating costs in the same period of time, when compared against the costs of a lower mileage driver. At certain mileage ranges, typically fewer than 12,000 per year, it may make sense to reimburse mileage, because it is less costly than providing a company vehicle.

If an employee drives 1,000 business miles per month, it is more economical to place them in a fleet vehicle.[1]

ROI Model

The figure[1] below shows that for a 2011 Ford Fusion SE Sedan, the breakeven point for a typical fleet program is around 12,500 miles per year when compared to the IRS standard business mileage rate of $0.50 per mile. When compared to a $600 monthly allowance plus fuel reimbursement plan, the company vehicle plan is more economical for all mileages studied up to 30,000 miles per year.



Over the past several years, there has been a significant gap between the IRS business standard mileage rate and fleet vehicle cost per mile rates. Much of the difference in costs can be explained by the fact that the IRS rate is based on the retail environment of an individual buyer, and fleet costs are based on discounted rates resulting from a company's centralized purchasing power.

According to Automotive Fleet's Fact Book Guide for 2010 – 2011, the average cost per mile for an intermediate car in a fleet program, net personal use, runs $0.30 -$0.35 per mile, depending on the model type and regional distribution.[2] The same source estimates costs for Sport Utility Vehicles roughly $0.08 per mile higher than intermediate cars.

Since 2003, the business standard mileage rate for reimbursement set by the IRS has risen by more than 40%. The rate for calendar year 2010 has been set at $0.50 per mile, which is a $0.14 per mile increase over 2003's rate. By comparison, fleet costs per mile for intermediate cars have risen by 12.3% in the same timeframe.[3]

Each company has its own priorities and characteristics, so one cost analysis does not fit all. It is recommended that you perform a careful cost comparison that evaluates each option on a common set of criteria. Companies such as ARI have tools that can aid you in this process.

Financing

Since the financial crisis began at the end of 2008, corporate financing has changed dramatically. Lenders are more cautious about credit risk, and borrowing costs have gone up across the board. Corporate fleets have felt the pinch of increased costs of funds, and may have faced suspension in funding if their lender had liquidity issues of its own. Individuals financing personal vehicles also felt the financial impact of this crisis. They faced a tighter retail credit market and experienced increased finance rates as well.

For corporate fleets, there are three sources for funding – banks and third-party lenders, FMCs and self-funding. Companies with enough volume and liquidity may be able to obtain more attractive rates going to a bank directly, or they may choose to self-fund their vehicles. FMCs also provide attractive financing, though borrowing costs may vary depending on their own credit rating.

When evaluating fleet finance rates the devil is in the details. There are a number of cost factors to consider when comparing borrowing costs.

- Interest adder (markup) – This is the easiest to detect, as it is part of the up front quoted rate.
- Issuance fees – Sometimes this is included in the quote, sometimes it is only found in the contract.
- Rounding – Some companies round up to the nearest 1/4th percent, some round up to the nearest 1/8th percent.
- Index – Some companies peg the base interest rate to an index published in an independent source, such as the Wall Street Journal. Other companies create their own "market basket rate", which is usually difficult to independently verify.

Leasing

Company and driver owned vehicles can be either leased or purchased outright. While a separate analysis and discussion is needed to compare leasing and purchasing, we have provided a basic explanation of the different choices, and the advantages of each type.

Quite simply, leasing frees cash so companies can invest in other activities, most often on core business expenditures. Depending upon the type of lease, the lease obligation may not appear on an organization's balance sheet as a liability, and the lease payments may be deductible as operating expenses. Another reason to lease is to have access (through the lease) to funds at an attractive rate. There are two main types of operating leases – open end and closed end leases.

- **Open-End Leases a**ccount for more than 95% of all leases. With this financing method, the amount owed at the end of the lease term is based on the difference between the vehicle's residual value and its book (depreciated) value.

- **Closed-End Leases** more closely resemble the kind of lease available through a dealership – the buyer leases the vehicle for a stated period of time and mileage, and returns the vehicle at the end of this period. It is assumed at lease inception that the vehicle will be returned in good condition. If a vehicle is returned in poor condition or with excess mileage, additional charges are incurred at the end of the lease. Closed-End leases are easier to budget than open-end leases, because the residual is accounted for in the lease payment. There are certain closed end leases, such as ARI's Easy Lease, that offer additional budgeting features which eliminate surprises with excess mileage charges and returned car damage.

Purchasing

Vehicles can be purchased with cash, savings or debt. Each approach has advantages and disadvantages. The most suitable alternative for a given organization depends largely on the financial aspects of their strategic plan. Rental is another vehicle acquisition option for temporary requirements or to augment an organization's fleet for periods of peak demand.

Financing vehicle purchases with cash involves paying for a vehicle in full at the time it is acquired and placed in service. Contrary to leasing and debt financing approaches, there are no interest charges involved in using this financing method. However, there is still a cost of money to be considered and possibly an opportunity cost associated with investing in a depreciable asset rather than other endeavors that might create a return on investment. If the return on investment value would exceed the cost of alternative vehicle funding then it would be more attractive to seek outside funding.

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RISK MANAGEMENT AND MITIGATION

The risk management process is a systematic, methodical system ensuring the level of risk within an organization remains within an acceptable range. It consists of well-defined steps that provide a greater insight into risks as well as their impacts, followed by implementation of measures to minimize the probability of frequent and/or significant losses. When managing fleet risk, risk managers must strive for maximum compliance with corporate policies and regulations, and for minimum liability through driver monitoring and training, and preventive maintenance programs.

Accurate Reporting Ensures Compliance

The Sarbanes-Oxley Act (SOX) includes numerous rules for financial disclosures with which businesses must comply, including accounting for tax liabilities. A SOX audit typically examines the processes in place to validate the accuracy of corporate payments and ensure that calculations are done consistently and correctly.

Because tax-free FAVR plans carry the potential of unmet tax obligations should the program not comply with IRS regulations, this kind of reimbursement plan requires rigorous monitoring. There are over 45 IRS rules that apply to a FAVR plan,[4] and without proper tracking and verification of these requirements for each employee, businesses can open themselves up to tax liabilities, penalties and interest.

There are over 45 IRS rules governing FAVR reimbursement plans that require tracking and verification.

For these reasons, most companies do not attempt to institute a FAVR reimbursement plan without third-party management of the program. Additionally, both the setup and ongoing administrative requirements of a FAVR program may cause a company to become non-compliant with SOX requirements.

Personal Use

Employers are required to “impute income” to employees who utilize a company vehicle for their personal use of the vehicle, and to report this “fringe benefit” as income to the employee through the payroll process subject to all employment taxes. There are a number of ways to calculate this obligation, but the most common (and preferred by the IRS) method is based on the annual lease value of a vehicle. The IRS provides an Annual Lease Value Table which is based on the initial cost of the vehicle and the vehicle age. The appropriate Annual Lease Value amount is multiplied by the percentage of personal use of the vehicle to produce the taxable “imputed income” reported to the employee.

Another practice that is growing in popularity is to collect a monthly payment from drivers in the form of a payroll deduction to cover personal use. A study conducted by Automotive Fleet found the average payroll deduction for personal use of company vehicles is $108 per month.[5] Companies true up these payments at year end and compare them to what would have been imputed income based on personal use. If the payments are equal to, or in excess of, the imputed income, no imputed income is recorded on the W2, which eliminates tax payments by

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the employee and by the company in the case of matching FICA payments. FMCs can manage the tracking of personal mileage reporting and provide imputed income calculations for each driver.

Liability

Liability losses resulting from company vehicles typically result from claims alleging an organization's legal responsibility for damage to property or bodily injury suffered by another person or organization. Three liability arguments are associated with motor vehicles: *respondeat superior, vicarious liability,* and *negligent entrustment*.

- ***Respondeat superior*** provides that a principal (employer) is responsible for the actions of his/her/its agent (employee) in the course of employment.
- ***Vicarious liability*** holds an employer of an employee who injures someone through negligence while in the scope of employment (doing work for the employer) liable for damages to the injured person.
- ***Negligent entrustment*** often refers to entrusting a vehicle to an individual without ensuring that the individual has a valid driver's license or allowing the person to drive a vehicle despite the individual's past driving history, known or unknown.

Negligent Entrustment is the main concern of many who manage fleet risk, and therefore this aspect of fleet risk tends to receive the most focus. However, the principles of Respondeat Superior and Vicarious Liability are risk elements that impact companies regardless of whether they operate fleet vehicles or have employees drive personal vehicles on business. Risk managers will be well served in becoming conversant in these matters.

It is often thought that a company will have less liability exposure under reimbursement because they avoid risk for Negligent Entrustment. However, this will not eliminate the risk present under the two other legal arguments summarized above which are applicable for employees driving on business in either a fleet or personal vehicle.

In a study of over 110,000 fleet accidents reported to ARI, over 80% occurred during likely working hours.

According to statistics by the National Traffic Safety Administration, 66% of all accidents occur during likely work hours (6:00 am to 9:00 pm)[6], Monday through Friday. For fleet drivers, the numbers are even more significant. Based on over 110,000 accidents reported to ARI in the past 5 years, over 80% of all fleet accidents occurred during likely working hours.[7] These accidents occur when employees are acting as agents of their companies, thus exposing the companies to risk. It is clear that simply eliminating fleet programs will not address the great majority of risk. Companies need to take additional steps to mitigate risk from business driving.

Mitigating Risk

There are two areas to concentrate efforts in mitigating risk: managing driver behavior and ensuring a safe operating vehicle is used for business driving.

Managing driver behavior begins by identifying drivers that pose high risk, and following a plan to reduce that risk which can include documenting their understanding and acceptance of corporate safety policies, providing safety training and even termination of employment.

There are tools available to help identify high risk drivers, and most companies utilize at least one of these tools. These include basic steps such as checking motor vehicle records during pre-employment screenings and performing ongoing motor vehicle record checks. In states where it is available, companies are enrolling in a "Pull Program," where states or a third party provider will notify companies whenever one of their registered employees has a driving infraction. Some companies employ more sophisticated evaluations such as evaluating a driver's performance utilizing a simulated driving environment, such as that available through ARI's Hazard Perception Evaluation program.

FMCs offer sophisticated driver safety training and tracking systems to help mitigate risk. FMCs can offer Motor Vehicle Record (MVR) checking services, can evaluate potential hazard driving behaviors through driving simulations, and can manage the data gathered by technologies like telematics to generate reports that identify habitual offenders that require remedial or disciplinary action.

Because the employee driver is a constant factor in both fleet and reimbursement programs, identifying a driver's risk, as well as providing appropriate safety training is a prerequisite to prudent risk management.

Properly maintaining vehicles is a crucial step in ensuring a vehicle is in safe operating condition for driving. Deferred maintenance is a risk the company incurs when drivers are unable to pay out-of-pocket for expensive repairs. Employees in fleet vehicles are much less likely to postpone maintenance because of budgetary concerns. Fleet programs also provide control by monitoring vehicles for compliance with recommended preventive maintenance schedules and advising drivers and interested managers of overdue maintenance.

Each organization needs to examine which approach is better from a risk management standpoint:

- Using reimbursement / allowance programs to "eliminate" the small portion of risk from personal use of vehicles, or
- Using a managed fleet program to gain control over the great majority of risk arising from business driving.

KEY STAKEHOLDERS

Car allowance / reimbursement programs and company fleet programs affect many individuals throughout an organization. Those most affected are drivers, but other corporate stakeholders, as well as the public, also are impacted.

Employee Drivers

If companies choose reimbursement/allowance programs in an effort to cut costs by eliminating a fleet program, the employee driver will experience unreimbursed out of pocket costs associated with business driving. The reason for this is that employees lack the volume purchasing power and are purchasing in the retail environment for goods and services. This is the main reason companies experience an increase in turnover in response to eliminating company vehicle programs. According to an article in *Automotive Fleet* magazine, there is about a 10% turnover in workforce when company vehicles are eliminated.[8] During tight labor markets this can be of particular concern, but even during times when new candidates are waiting in the wings, there is still a cost to conducting the hiring process and lost productivity until the new employee is fully trained.

One argument for reimbursement is that employees are able to drive the vehicle of their choice. This may be initially appealing, but it may not be attractive in the long run. Increased out-of-pocket costs and administration become a burden on employees. Documentation of business use, maintaining receipts, searching for and acquiring new vehicles, managing maintenance repairs and managing accident repairs are some activities for which drivers may be responsible. With a fleet vehicle, the company, (or fleet management provider), assumes the administrative and management burden for many fleet functions. This translates to increased job satisfaction.

FMCs offer additional competencies to further increase driver efficiency. One example is route optimization through telematics. A sales force that makes numerous calls throughout the day can make the same number of calls in less time, or more calls in the same amount of time. Route optimization can also result in additional savings through reduced fuel consumption.

Corporate Stakeholders

The scope of a reimbursement / car allowance program stretches beyond payments made to drivers, and includes stakeholders throughout the organization:

- **Accounting** keeps track of expense and mileage reporting, and issues variable payments
- **Payroll** keeps track of payments for taxable income
- **Risk** deals with corporate liability exposure from employees acting as the company's agents on the road
- **Finance/Treasury** must determine fair payment levels for each employee classification each fiscal year
- **HR** is often the department responsible for administering reimbursement/allowance programs. They also may utilize a company vehicle program as a recruiting tool.
- **IT** must develop or purchase, integrate and maintain reporting, fringe benefit taxation, etc., if an FMC is not retained to perform these tasks
- **Sales** must deal with employee motivation and productivity.

> "A company-provided vehicle can be used as a recruiting tool and company benefit by giving your company a competitive edge in hiring top-caliber salespeople, technicians, and managers. Past industry surveys have shown prospective employees view a company vehicle as an equivalent benefit to health care coverage and pension benefits."
>
> Mike Antich, Automotive Fleet – Jan. 2008

The effect of a company vehicle program on these corporate stakeholders varies based on the extent to which an FMC is leveraged. As examples:

- System integration with Enterprise Resource Planning (ERP) systems such as PeopleSoft can automate HR activities regarding driver database maintenance.
- System integration with ERPs such as SAP, or other accounting systems, automates loading of all fleet expenses and assigning of general ledger coding
- Fringe benefit taxation is calculated by the FMC and reported to Payroll

The Public's Point of View

Controlling the type, condition and appearance of vehicles used for work is an important part of the corporate image presented to customers and the community. Companies can mark vehicles with logos or other identifying items for marketing purposes and standardize models and colors to reflect organizational image. They also can ensure that proper maintenance and prompt repair of accident damage is performed, protecting the company image reflected by the employee when visiting customers.

If the organization is concerned with its environmental impact, this adds another consideration to the decision regarding company vehicles. Because there is less control over employee-owned vehicles, there is less control over their environmental impact. Fleet programs, on the other hand, enable companies to exert control over resulting green house gas emissions. Some fleets have capitalized on the public relations opportunity presented by operating a fleet of alternative-fuel vehicles, and branding them to relate this to the public.

CONCLUSION

The method a company chooses to handle business driving impacts many areas of corporate governance. Choosing the right option can increase return on investment, compliance and employee productivity / satisfaction.

The table below depicts a fleet program's clear advantages (+) related to key business challenges.

Business Challenge	Fleet Program	Allowance/ Reimbursement Program
Return on Investment	+	-
Achieving Regulatory & Corporate Compliance	+	-
Minimizing Risk	+	+
Maximizing Efficiencies	+	-
Recruiting & Retaining Employees	+	-
On-vehicle Advertising	+	-
Controlling Environmental Impact	+	-
Ability to Monitor Vehicle Condition	+	-

When the additional cost to the driver and the impact of lost productivity to the company are considered, the economics strongly favor company-provided vehicles. Still, a reimbursement program can have a place in certain situations, such as:

- Highly transient workforces
- Thinly capitalized companies
- Low business-mile applications

The consideration of all the facts and influences in your organization is a prerequisite to choosing the right program. Should you desire a cost analysis specific to your company, please contact ARI. Our fleet management professionals are happy to work with you.

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FOOTNOTES

[1] Analysis performed by Automotive Resources International (ARI), utilizing proprietary Lease vs. Reimbursement Analysis system.
[2] Automotive Fleet Fact Book Guide 2010-2011, p. 36
[3] Automotive Fleet 2004 Fact Book, p. 51
[4] Source: IRS Rev. Proc. 2009-54
[5] Fletcher, Lauren. "Average Monthly Personal Use Charges Increase to $108." Automotive Fleet, July 2009.
[6] National Highway Traffic and Safety Administration, Traffic Safety Facts 2008, pg. 47.
[7] Analysis of ARI accident data for accidents reported between 6/1/2005 and 5/31/2010.
[8] Antich, Mike. "More Salespeople on the Street Pitching Reimbursement." Automotive Fleet, March 16, 2010.

ABOUT ARI

ARI, a subsidiary of Holman Enterprises based in Mt. Laurel, N.J., is an industry leader and the largest privately-held fleet leasing and management company in the world.

As a single-source fleet management leader, ARI customizes innovative solutions that streamline fleet operations, help lower the cost of fleet ownership and create long-term value for customers.

Today, with a workforce numbering more than 1,400 and offices throughout the U.S., Canada, Mexico, Puerto Rico and Europe, the company manages more than 2,000 outsourced fleets (over 700,000 autos and trucks) in North America and, combined with its strategic partners, more than 2.0 million fleet vehicles globally.