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Truck Times

The Financial Side of the Trucking Industry

In this issue:

Fuel Surcharge Recovery

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A fuel surcharge is a fee that can be added to the freight charges that allows a carrier to be reimbursed for *incremental or excessive* fuel costs. While most companies understand the mechanics of a fuel surcharge (FSC) and the need for incremental fuel expense recovery, few carriers quantitatively measure the effectiveness of their FSC programs. This article is about how to measure FSC recovery effectiveness.

History and Purpose of Fuel Surcharge

FSC first appeared in response to the 1973 oil crisis with the goal of reimbursing carriers for the unusual spikes in oil prices. On Feb. 7, 1974, the Interstate Commerce Commission (ICC) promulgated Special Permission No. 74-2525, denominated "Emergency Fuel Surcharge for Line Haul Transportation Charges and Other Charges Motor Common Carriers." Paragraph one of that order authorized carriers to increase their freight rates by surcharge, up to six percent (at the time). Fuel surcharges became a permanent part of carrier pricing again in the mid-90s when prices reached a high around $1.15 per gallon; $1.10 to $1.20 became the baseline price for most carriers in establishing their fuel surcharge programs at the time and remains basically unchanged today.

In general, little has changed in the surcharge calculation mechanics. Each Monday, the Department of Energy (DOE) collects data from a representative group of approximately 350 retail diesel outlets then issues the national average diesel price for that week. Most carriers use the national average or components of it to calculate their fuel surcharge. The surcharges are still generally calculated using one or two popular methods (i.e., cent per mile and/or percent of line haul rates). Despite alternative approaches, such as the Fuel Surcharge Index and computation aids like the phone app, PocketFuelCal, the basic formula used by the most carriers is:

FSC per mile = ((DOE self-serve diesel fuel price average) - (carrier's baseline price)) / (miles per gallon (MPG))

The effectiveness of the surcharge to meet its intended objectives varies widely from carrier-to-carrier primarily due to calculation nuances and the inaccuracies inherent in using weekly averages. Many carriers have known for a number of years that this effectiveness can and must be managed. There are several ways to approach the analysis of fuel expense recovery. One approach is to evaluate total fuel expense compared to total revenue, specifically and theoretically related to fuel. Focusing on the effectiveness of the surcharge, however, requires a comparison of the incremental fuel surcharge revenue with incremental fuel expense. A primary management metric developed to monitor the FSC effectiveness is the FSC Recovery Percentage, or simply the Recovery %.

The Recovery % may be calculated several different ways, but the objective is to compare the incremental shipper revenue associated with fuel to the carrier's incremental fuel cost. One formula used to calculate the Recovery % is as follows:

Recovery % = Incremental fuel expense / incremental fuel related revenue

Where:

- Incremental fuel expense = ((DOE self-serve diesel fuel price average) - (carrier's baseline price)) multiplied by gallons purchased and consumed during the period
- Incremental fuel revenue = fuel surcharge revenue + base rate revenue related to abnormally high fuel prices

Like the basic fuel surcharge, the recovery formula is simple, but the "devil is in the details." Typically, the carrier baseline price is the starting point for its fuel surcharge table of $1.10 to $1.20. As a practical matter, however, most carriers will have a number of shipper required surcharge programs with different starting points. It is also difficult to

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Sales Tax Savings Opportunities for Interstate Motor Carriers

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A number of states provide a variety of sales and use tax exemptions to Interstate Motor Carriers (IMCs). The types of exemptions vary from state to state, but generally apply to the acquisition of tangible personal property used by IMCs in transportation operations. Common exemptions include the purchase and lease of rolling stock (tractors and trailers), repair parts for exempt rolling stock, property that becomes part of rolling stock (GPS type devices), and fuel.

IMCs may benefit by scheduling periodic reviews of purchase invoices to ensure these exemptions are being taken. To the extent that an IMC is not currently able to take advantage of such exemptions, there may be opportunities to adjust a company's operations to maximize the use of these exemptions.

What Is an IMC?

The definition of an IMC and who qualifies for transportation-related exemptions varies from state to state. Exemptions are generally afforded to companies operating in interstate commerce. States may determine eligibility based on an evaluation of time spent, or miles traveled, while operating in interstate commerce.

In addition, a state may follow the interstate activity of the product hauled. A review of driver logs, mileage reports, and other relevant information pertaining to products moving in interstate commerce are common audit procedures. To the extent the requirements for an exemption are not met, sales tax exposure results. It is important to understand the eligibility requirements of the state(s) where sales tax exemptions are taken, in order to ensure compliance and preserve the exemptions. Modifying dispatching efforts may assist in achieving the best sales tax result.

To the extent that transportation-related sales tax exemptions are available to a company, the following are common action items that may maximize these benefits:

- Implement a policy that all schedulable repairs are to be performed in a state that offers an exemption for repair parts and labor.

- Modify operations to maximize potential benefits. If a company's "home state" taxes the purchase of tractors/trailers, the business may want to consider a terminal/location in a state that offers an exemption for these purchases. This location could pay for itself and will most likely appreciate over time. For example, if a company typically purchases 10 tractors per year for $100,000 per vehicle at a sales tax rate of seven percent, then the annual savings on the purchase of the vehicles would be $70,000.

- Educate and incentivize drivers to purchase fuel in states that offer an exemption on the purchase of fuel. For example, a company's fleet is located in the state of Illinois next to a truck stop just a few miles

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Current FASB Projects and the Potential Impact on the Trucking Industry

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In the past year, the Financial Accounting Standards Board (FASB) has issued a number of exposure drafts aimed at converging U.S. Generally Accepted Accounting Principles (GAAP) with the International Accounting Standards Board (IASB). Below are a few of the exposure drafts that could impact trucking company financial statements.

Leases

As discussed in the last issue of *Truck Times*, the FASB issued an exposure draft on lease accounting in August 2010. The objective of the project is to not only create common lease accounting requirements to ensure leases are recognized on the balance sheet, but also provide users of financial statements with useful and complete information about leasing transactions.

In summary, some of the key items in the exposure draft that would likely affect many trucking companies include:

- Substantially all long-term (greater than 12 months) equipment leases would be recorded as capital leases.
- Accounting for independent contractor agreements could be impacted (depending on the terms of the agreements). If the trucking company is deemed to have exclusive rights to the use of the independent contractor's equipment and the right to control that equipment, then the agreement *may* contain a lease.
- Existing operating leases at the date of implementation would not be excluded (i.e., no grandfather clause).

The FASB is expected to issue the final accounting standards update by the end of 2011, with implementation likely expected in 2013.

Revenue Recognition

In June 2010, the FASB issued an exposure draft on revenue recognition. The exposure draft would replace the FASB's current revenue recognition rules (Topic 605 of the Accounting Standards Codification), which were derived from a number of sources, and include specific guidance developed over time to address the peculiarities of different industries and transactions. The FASB intends to have a single revenue recognition model that can be applied to all contracts with customers over all industries.

"The FASB intends to have a single revenue recognition model that can be applied to all contracts with customers over all industries."

The definition of contract in the exposure draft is broad but includes purchase orders, verbal agreements and signed agreements. Companies would be required to identify, and account for separately, all "performance obligations" in each contract. Revenues would be recognized upon satisfaction of each performance obligation, as evidenced by the customer obtaining control, or having the ability to use or receive benefit from the related goods or services in each performance obligation.

The exposure draft will likely not have a significant impact on most trucking companies. Currently, revenue from the transportation of freight is generally recognized upon the delivery of that freight to the customer. The exposure draft likely would require no change to the current revenue recognition policies for freight delivery services.

The greatest impact for trucking companies will likely be when the trucking company also provides warehousing,

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Opportunities for Enhanced Propane Fuel Credit

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Propane used to power forklifts at truck terminals may be eligible for an enhanced $.50 per gallon tax credit. When President Barack Obama signed the Tax Relief, Unemployment Insurance Authorization, and Job Creation Act of 2010, the fuel tax credit, which was to expire at the end of 2009, was revitalized. The credit is extended through Dec. 31, 2011 and made retroactive to 2010. The credit could be extended beyond its current sunset date.

All taxpayers are allowed a credit of $.183 per gallon for the use of propane fuel to power forklifts. Taxpayers that file Form 637 and become a registered Alternative Fueler are granted the enhanced $.50 per gallon credit. An Alternative Fueler is defined by the Internal Revenue Service (IRS) as the person that is liable for the tax on alternative fuels.

In providing further guidance, the IRS made clear that forklifts fit the definition of an off-highway business motor vehicle and the end user, namely the forklift operator, is entitled to apply for the fuel credit.

The fuel tax credit is generally taken by filing Form 4136 with the taxpayer's income tax return. The registration number applied for on Form 637 must be listed on Form 4136 or the enhanced credit may be denied. The credit is refundable, which means that even if the trucking company is in a taxable loss for the year, the IRS will issue a refund check providing for immediate benefit.

Transportation companies have other opportunities to receive a credit with this form, including the off-highway use of fuel to refer units, auxiliary power units and other equipment that uses a separate motor. •

Fuel Surcharge Recovery *(Continued from page 2)*

match or determine the exact number of gallons purchased and used to generate the fuel surcharge revenue in a period. Which DOE price to use also presents choices. Further complicating the computation is the assertion that some base freight rates include an incremental fuel component.

Despite the analytical imperfections, a consistently applied methodology will provide a meaningful tool to focus management's attention on the components affecting any differential. Focus can lead to accountability, which provides the incentive to improve results. With typical recovery percentages of 65 percent to 75 percent, it is not surprising that carriers fully engaged in managing the effectiveness of their recovery programs have developed responsive solutions, including improving their fleet MPG while using static numbers in the surcharge computations, applying the surcharge to all miles (not just loaded), updating the FSC amounts daily instead of monthly or weekly, managing out-of-route miles, and finding ways to increase the differential between the DOE and company average fuel price.

To quote the old adage, "What gets measured gets done," start measuring Recovery % and join the large number of carriers who understand the benefits of making this a key business management metric. •

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Change the Team Concept to a Problem-Solving/Profit Team

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Positive Attitude + Positive Actions = Positive Financial Results

This is a new concept in team building. It ensures that teams become profit teams that strive toward profit goals, not self-serving goals. In addition, this type of environment improves communication and positive attitudes to improve the bottom line.

For years, a paradigm in the business world was to create positive attitudes. Books on this concept hit the best-seller list in the 1950s. The concept became another business fad because Ivy Leaguers preached it as the new wave of “enlightened” management. The purpose of a positive attitude was to avoid conflict and facilitate cooperative action. It became acknowledged that hammering staff members was not an effective way to manage.

Since that time, positive attitude evolved to: Do not object – ever. Objecting does not mean that someone is negative; it means there could be a better alternative. Team players are thought of as those who are proactive in promoting positive attitudes. This can be destructive to trucking companies in the long run because it develops teams of “yes people” concerned about not rocking the boat, even though it may be in the best interest of the company.

Have any of the following issues ever been observed: waste, inefficiencies, poor business decisions, inadequate staff, ineffective corporate policies, unnecessary procedures and other profit-wasting ideas? Often employees feel compelled to close their eyes to these issues to be considered team players with positive attitudes. It is foolish to waste precious company profits, but this is often the outcome. Too often people are promoted because they are team players, but they are unwilling to step up to the plate and dare to make the suggestion that certain ideas may not be in the best interest of the company.

Today, the role of team players must be redefined in trucking companies. Team players must now become profit teams to play a significant role in the business world. They should work toward profit goals, not self-serving goals. Profit teams should advance a project if it contributes to the bottom line. Members of these teams should do what is best for the company and should be obligated to communicate their concerns about problems that may have negative effects. Even more importantly, profit teams need to be problem solvers.

Profit teams can succeed if a forum is created that introduces profit issues. Without this, no one can communicate differences of opinion. This forum must be non-threatening and encourage tough issues to be brought to the table. How can this be achieved?

Such a forum has been created with Katz, Sapper & Miller (KSM)’s Problem-Solving Workshop. Rules have been established to which profit teams adhere, assuring open and honest communication. Operations teams are introduced to

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Savings Opportunities *(Continued from page 3)*

from the Indiana border. While the company's drivers enjoy the convenience of being able to fuel at an Illinois truck stop, the same driver could fuel a few miles further away in Indiana and save significant tax dollars by purchasing the fuel exempt from sales tax. If one were to multiply this per tank savings by the number of times a fleet fuels per year, the tax savings could become significant in a short period of time.

In an environment where a business' cost-cutting measures may dictate the company's ability to survive, some businesses cannot afford to pay more taxes than the law requires. Company programs and processes to identify these savings, restructure operations and review purchases could result in potential refund opportunities. •

Profit Team *(Continued from page 6)*

and trained on problem-solving concepts to help them develop a profit tree for their trucking company. This tree lists all the possible ways their trucking company can improve profitability.

Evaluating these profit opportunities and determining the impact on the bottom line is encouraged. Discussions about what people previously did not do are not tolerated because there is no purpose in finding fault with others. No topics are precluded from the discussion because only when tough issues surface can a business do something positive about them.

In business, the bottom line is hurt immeasurably when positive attitudes and teamwork are not in the best interest of the company. Bad ideas have no place in business. They need to be turned into positive ideas. Profit teams have the responsibility of doing what is best for the company and its bottom line. •

FASB Projects *(Continued from page 4)*

cross-docking and other value-added services. As currently proposed, the exposure draft would require the company to identify, and account for separately, all performance obligations associated with the value-added service.

Due to the amount of feedback received, the FASB is expected to re-expose the exposure draft in the third quarter of 2011 for a comment period of 120 days.

Goodwill

In April 2011, the FASB issued an exposure draft on testing goodwill for impairment. The objective of this proposed update is to simplify how an entity is required to test goodwill for impairment.

Currently (Topic 350 of the Accounting Standards Codification), an entity is required to test goodwill for impairment on at least an annual basis, using a two-step approach, by comparing the fair value of a reporting unit with its carrying amount, including goodwill (step one). If the fair value of a reporting unit is less than its carrying amount, then the test must be performed to measure the amount of the impairment loss (step two), if any.

The proposed amendments would permit an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. An entity would not be required to calculate the fair value of a reporting unit unless the entity determines that it is more likely than not that its fair value is less than its carrying amount.

The exposure draft comment period ended on June 6, 2011. If approved, the proposed amendments would be effective for annual and interim goodwill impairment tests performed for fiscal years beginning after Dec. 15, 2011. Early adoption would be permitted. •

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Here and There in the Trucking Industry

The next Trucking Owners Business Roundtable will be held on Sept. 13, 2011 at Katz, Sapper & Miller. The roundtable is part of an ongoing series co-sponsored by Katz, Sapper & Miller, LLP, KSM Transport Advisors, LLC and Scopelitis, Garvin, Light, Hanson & Feary. For more information, contact Christopher Djonlich at cdjonlich@ksmcpa.com.

Tim Almack and David Roush will be presenting at TMW Systems Inc.'s TransForum Users Conference on Sept. 19, 2011 in Dallas, Texas, to be attended by more than 1,400 transportation service professionals and decision makers.

Tim Almack has also been reappointed to the Truckload Carriers Association board of directors.

KSM Transport Advisors and Katz, Sapper & Miller's Transportation Services Group were recently featured in the Vendor Spotlight section of Transportation Alliance Bank, Inc.'s (TAB Bank) publication, *The TABloid*.

Katz, Sapper & Miller has joined the Michigan Trucking Association and the Intermodal Association of Chicago.

KSM's Committment to the Trucking Industry:

- Alabama Trucking Association
- American Trucking Associations
- Illinois Trucking Association
- Indiana Motor Truck Association
- Intermodal Association of Chicago
- Iowa Motor Truck Association
- Kentucky Motor Truck Association
- Michigan Trucking Association
- Mid-West Truckers Association
- National Tank Truck Carriers
- Ohio Trucking Association
- Pennsylvania Motor Truck Association
- Truckload Carriers Association
- Tennessee Trucking Association

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