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TRUCK TIMES

The Financial Side of the Trucking Industry

In this issue:

Trucking is Easy?

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Over the years many owners have suggested that full truckload trucking (TL) is operationally an easy business. One simply picks up a load at point A and delivers it to point B.

In retrospect, the period shortly after deregulation may have in fact been almost that easy. Most carriers were relatively small, had a length of haul in excess of 1,000 miles and possessed fairly defined networks, in large part due to acquired operating authorities.

While very few would suggest that trucking is easy in today's environment, many companies unknowingly continue to operate as if TL is still a simple business. Surprisingly, many carriers still believe they can accept loads from shippers to random points, find loads to their home base usually with broker assistance and make money, assuming acceptable service levels and fair rates.

The success of this type of operation is very externally dependent upon overall supply and demand. When freight demand exceeds supplied capacity, rates provide profits, and when the supply/demand dynamics reverse, the business falters. Many owners accept this as simply a part of being in the trucking business. Interestingly, however, over the years a number of companies have developed numerous business practices that provide greater returns and more insulation from external events like changes in freight rates. There are carriers of all size and in all segments that are profitable in all economic environments including the current one.

The collection of business practices that allow certain carriers to earn superior returns relative to their competition can be referred to as the "Trucking Franchise." The Trucking Franchise is of course still evolving and finding new responses to ever changing external factors, including those of the current environment. But a review of the industry's history starting with deregulation and including major crises like driver shortages, the fuel embargo, five dollar a gallon fuel prices, insurance tight markets, and now the ridiculously low freight rates, documents that the Trucking Franchise has been successfully responsive.

"The evolving successful freight strategies are increasingly being shaped by sophisticated mathematically-based freight optimization models."

During the "perfect storm" of the late 1990s and early 2000s when many carriers struggled for survival, approximately 15 percent of the 300 middle-market carriers in our database not only made a profit, but generated an operating ratio better than 94 percent. Observational data suggests that the numbers may be slightly lower in the current environment, but there is no question that those carriers with a true Trucking Franchise are still producing superior results relative to the industry norm.

At the heart of the Trucking Franchise is a successful freight strategy. A variety of these strategies have evolved. What appears to be more definitive than what works, is what does not work. What appears to be increasingly less successful are those original TL practices associated with a long length of haul and a "shot gun" approach to load acceptance.

The evolving successful freight strategies are increasingly being shaped by sophisticated mathematically-based freight optimization models. Freight network optimization programs are not new and have been around for over 20 years. They were developed in response to the reality that trucking is exponentially more operationally complex as it increases in size, and making optimal decisions considering the numerous variables associated with equipment, drivers, geography, and customer requires mathematical modeling assistance.

There are several versions of freight network optimization programs available. The common objective of these programs is to optimize margins by finding the set of load movements that maximize revenue and minimize costs. While their algorithms differ slightly, most attempt to quantify the YIELD (i.e. network based margin per load per day) of each load movement as a function of:

- Revenue (Rate)
- Cost (Variable Cost)
- Efficiency (Time)
- Network Balance (Flow)

These applications can be extremely useful for the following tasks associated with the formulation of a successful freight network strategy:

- Identifying underperforming lanes and unnecessary in-transit delays;
- Identifying potential pricing adjustments on existing business;
- Identifying appropriate rates for new business;
- Understanding network imbalances and associated freight development areas; and
- Assisting with "What If" scenarios associated with:
    - o Pricing simulations
    - o Right sizing
        - – Amount of equipment required for only existing quality freight
        - – Amount of fixed costs appropriate given existing quality freight
    - o Reengineering lanes to fix major issues
        - – Balance
        - – Price
        - – Velocity

While the concept of trucking is easy to understand, operational execution is very complex and increasingly requires implementation of Trucking Franchise practices like freight network optimization technology.

IRS Raises Truck Driver Per Diem Rate

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Effective January 1, 2010, the Internal Revenue Service (IRS) raised the daily rate for per diem paid to truck drivers to $59 per day. The official notification from the IRS is "Rev. Proc 2009-47." For trucking companies and their drivers this is a 13 percent increase and comes as welcome news.

The previous rate was $52 per day. For most companies that have implemented a per diem pay program, this rate would normally be translated to a cents-per-mile rate that is calculated to approximate the actual days of driver overnight travel during a 30-day period. For example, if the current pay is 10 cents per mile for per diem in an overall driver pay package, perhaps an increase to 11 cents would now be possible.

An increase to the per mile per diem rate can often be offset by a decrease in the driver per mile taxable wage rate. The result is an overall increase in the driver's take home pay while potentially lowering the trucking company's overall operating expense. Trucking companies that have drivers who routinely travel overnight while on duty not using a per diem program, should perhaps now consider such a plan.

States Strengthen Nonresident Withholding Requirements

By Donna Niesen, CPA
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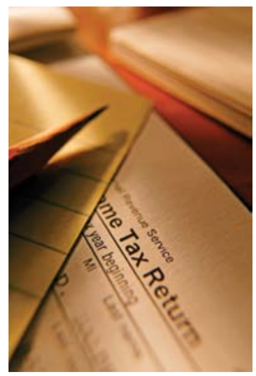
Everywhere one turns today there is talk about the weak economy and current recession. In response, businesses are tightening their belts and trying to find ways to increase earnings.

State governments are no exception. Newspapers and blogs are full of articles and commentary about the crisis plaguing many states and the difficulties lawmakers face in balancing their budgets during legislative sessions. In addition, states are becoming more aggressive during audits. They are less likely to bend the rules when taxpayers have not followed the letter of the law, even when the end result is the same. One area where states are becoming more aggressive and less lenient is nonresident withholding.

Many states now have a requirement that pass-through entities submit payments on behalf of their nonresident shareholders to cover any income tax liability of the shareholder. States began imposing this entity level withholding requirement in response to limited compliance with state law at the individual level by the nonresident. Even when a pass-through entity files a return showing in-state income, many nonresident individuals still choose to roll the dice and not file. This has left states with the heavy and expensive burden of tracking down all the non-filers to obtain unreported tax dollars. By imposing the withholding requirement on the entity, states increase the amount of actual revenue received. In addition, the percentage of nonresident individuals filing returns with the state rises.

In the past, if the nonresident individual made estimated payments directly with the state, the entity may have had a reasonable equity argument to not comply with its withholding requirement. In such a scenario duplicate payments of the estimate for the same liability would be avoided. When economic times were better, states may have chosen to look the other way on this issue because they had their revenue. However, in recent years states have become less apt to show leniency in these instances, even when the individual has already made estimated payments. Many states are imposing penalties, with limited abatement, on the entity for non-compliance with the withholding requirements. In some cases upon audit the state may require the entity to pay the full amount of withholding plus penalty. This forces the individual to amend the return to request refund of the withholding that has already been paid.



The amount of withholding due is generally based on the distributive share of the apportioned income of the entity. This presents an issue if the entity has income at the entity level but the nonresident has losses to offset that income at the individual level. In most cases, state law still requires the entity to withhold based on its income. Such a mandate presents a cash flow issue for the individual who will likely receive less in distributions from the entity because the entity has paid tax on their behalf.

Under such circumstances, the individual is forced to quickly file a nonresident individual return to obtain the refunds and restore their cash position. The nonresident should investigate whether or not the state allows for signing of a nonresident agreement between the individual and the entity. The nonresident agreement generally shifts the compliance responsibility from the entity to the individual with regard to payment of estimates and overall tax burden.

Not all states offer a nonresident agreement. In those that do, the agreement sometimes remains in place until revoked. Therefore, the individual must remain diligent on an ongoing basis to determine whether a liability exists in a particular state.

As a pass-through entity, it is important for businesses to evaluate and understand the withholding responsibility in each state where it does business. By understanding the rules up front the company will avoid filing errors and potentially high penalties under an audit. ●

Going Concern…Should You Be Concerned?

By Chris Felger, CPA, CMA, CFM
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In the accounting and auditing world the term "going concern" refers to a company's ability to continue as a viable business. There is a general presumption that a company will continue as a going concern unless there are reasons that indicate otherwise. However factors such as the current economic conditions, a decrease in the volume of freight and pressure on rates, restrictive credit and lending markets, and reduced profits and cash flows may lead to doubts about a company's ability to continue as a going concern.

According to information published by Audit Analytics in April 2009, the number of going concern doubt opinions issued by external auditors for publicly traded companies increased from approximately nine percent at the end of 2007 to approximately 23 percent at the end of 2008. This analysis did not include late filers or non-publicly traded companies. Furthermore, an article published earlier this year suggested that as many as 25 percent of all U.S. companies may not continue as going concerns. [1]

If there is substantial doubt regarding whether a company can continue as a going concern for a reasonable time period, there may be implications to the audit, review, or compilation report. These could include a qualification to the opinion of the auditor or accountant, additional disclosures required in the notes to the financial statements, and a change in the basis used to value certain assets and liabilities from historical cost to their net realizable value on the liquidation basis.

In September 2008 the Financial Accounting Standards Board (FASB) issued an exposure draft (ED) for a proposed statement related to going concern. The FASB is currently reviewing input from constituents and will be deliberating whether a revised ED will be issued in the first quarter of 2010. If adopted as currently proposed there will be several key changes, such as:

- The changes in the ED would put the responsibility of the going concern assessment on company management as opposed to the external auditors and/or accountants. Under previous guidance it was the responsibility of the external auditors and/or accountants to perform this assessment. The external auditors and/or accountants would have to evaluate the assessment performed by management for accuracy and reasonableness.

"If there is substantial doubt regarding whether a company can continue as a going concern for a reasonable time period, there may be implications to the audit, review, or compilation report."

- The changes in the ED would also change the required time frame for the going concern assessment from "a reasonable time period, not to exceed one year beyond the date of the financial statements being audited" to "all available information about the future, which is at least, but not limited to, 12 months from the end of the reporting period."

Because of the factors listed above, auditors and accountants are taking a closer look at the viability of their audit, review, and compilation clients to continue as going concerns. This is likely to be a continued area of focus in early 2010 for the December 31, 2009 year-ends given the proposed changes on the table and continued challenges facing the transportation industry. ●

[1] Johnson, Sarah "Auditors: Nearly 25 percent of Companies May Not Be Going Concerns," CFO.com April 22, 2009

Best Practices in Billing and Collections Improve Cash Flow

By Mark Flinchum, CPA
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Many economists close to trucking are forecasting another difficult year for the industry. The lack of a decrease in available capacity continues to pressure rates and the general decrease in freight as a result of the struggling economy is requiring business owners and executives to implement hard line billing and collection procedures. Survivors of this extended downturn will likely be those transportation companies that avoid unmanageable debt and turn transportation services into cash quickly.

"The longer an account remains outstanding, the more likely the shipper will find reasons not to pay, delay paying, or in some cases simply not pay at all."

Reducing the days outstanding on accounts receivable by converting accounts to cash provides significant flexibility. A strong cash position reduces the need to tap lines of credit that may already be topping out, or are being closely monitored by the lender in this difficult lending environment.

A strong cash position can allow for capitalizing on opportunities such as purchasing undervalued equipment, or investing in new lanes to grow the revenue base. Most importantly, cash can provide a cushion to weather expected and unexpected business crises such as spikes in fuel cost, loss of a shipper, or annual insurance deposits and plating.

Best practices in collections start with best practices in billing, such as the following:

- Set non-negotiable deadlines for drivers to submit paper work via scanning or TripPak that allow for the shortest turn around from delivery to invoicing.
- Ideally, receivable clerks should be expected to issue invoices within 24 hours of receipt of the delivery information.
- Eliminate excuses by shippers to delay remitting payment by providing all necessary information required in the initial invoice. The number and cause of re-bills should be monitored to eliminate delays in customer payments.
- If not currently utilizing, consider electronically submitting invoices to customers. Any questions or requests for additional information from customers should be given top priority and resolved with the agreement that payment is forthcoming.

Once the invoicing is complete, diligently manage accounts receivable to avoid having 30- or 45-day terms get stretched to 60 days, 90 days or even longer. Each account should be assigned to a specific person that takes ownership of the account. The assigned person should aggressively contact customers just before payment terms are about to elapse. Documenting all actions and discussions related to delinquent accounts should be maintained.

The longer an account remains outstanding, the more likely the shipper will find reasons not to pay, delay paying, or in some cases simply not pay at all. As a last resort, considering establishing a payment plan that is manageable for the shipper that will help ensure collection.

If all other efforts have been unsuccessful, consider employing a collection agency. However, upon reaching this threshold the business relationship has likely become strained beyond repair. Shippers unwilling to pay a fair rate for services provided in a timely fashion, or pay at all, make better customers for the competition.

Asset Impairment Issues

By Jason Miller, CPA
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The past year presented many challenges for the trucking industry. Factors such as overcapacity, reduced freight demand and declining rates had a direct impact on the utilization and fair value of equipment. Coupled with a poor equipment resale market, understanding the accounting concept of asset impairment becomes more important than ever.

Asset impairment is a condition that occurs when the carrying amount (book value) of a long-lived asset is not recoverable and exceeds its fair value. An impairment loss is measured as the amount by which the carrying amount exceeds its fair value.

The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. The undiscounted cash flows should include only the future cash flows (for the remaining useful life of the long-lived asset) that are directly associated with and are expected to arise as a direct result of the use and eventual disposition of the long-lived asset. Estimates of future cash flows should incorporate the entity's own assumptions about the use of the long-lived asset and should consider all available evidence.

A long-lived asset is to be tested for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Examples of these events and conditions include:

- A significant decrease in the market price of the long-lived asset;
- A significant adverse change in the extent or manner in which the long-lived asset is being used or in its physical condition;
- A current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of the long-lived asset; or
- A current expectation that, more likely than not, a long-lived asset will be sold or otherwise disposed of significantly before the end of its previously estimated useful life.

"Understanding asset impairment and its potential impact on the financial statements, along with proactive planning, can help eliminate surprises when discussing financial results with lenders."

The past year and the current environment have significantly increased the likelihood for these types of events and conditions for many trucking companies. Understanding asset impairment and its potential impact on the financial statements, along with proactive planning, can help eliminate surprises when discussing financial results with lenders. ●

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Here and There in the Trucking Industry

The next Trucking Owners Business Roundtable will be held on February 17, 2010 at Katz, Sapper & Miller. Thom Albrecht, Managing Director of BB&T Capital Markets will be the featured speaker and will discuss economic forecasts for the trucking industry. Contact khill@ksmcpa.com for more information.

Katz, Sapper & Miller and KSM Transport Advisors have joined the Alabama Trucking Association.

Tim Almack and Bruce Jones presented a webcast on "Key Performance Indicators and How Small Improvements Impact Cash Flow" to the Truckload Carriers Association on January 22, 2010. They also attended the Indiana Motor Truck Association Convention in November 2009.

Mark Flinchum and Chris Felger attended the American Trucking Associations Convention in October 2009.

Bruce Jones has earned the designation of Certified Merger and Acquisition Professional (CMAP) from the Middle Market Investment Banking Association (MMIBA) and its affiliate, the National Association of Certified Valuation Analysts (NACVA).

KSM's Committment to the Trucking Industry:

- Alabama Trucking Association
- American Trucking Associations
- Illinois Trucking Association
- Indiana Motor Truck Association
- Kentucky Motor Truck Association
- National Tank Truck Carriers
- Ohio Trucking Association
- Truckload Carriers Association
- Tennessee Trucking Association

For more information about Katz, Sapper & Miller, please visit www.ksmcpa.com.

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