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Truck Times

The Financial Side of the Trucking Industry

In this issue:

Oscar Winning Operations Meetings

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Are attending weekly or monthly operations meetings a chore? Do the meetings last too long and are ineffective? Many trucking company leaders would probably answer these questions, yes. Why is that?

Patrick Lencioni, in his book *DEATH by Meeting*, gives his view on why meetings are typically boring and ineffective. He compares participating in good meetings to watching a good movie. At the heart of a good movie is typically some sort of conflict.

Lencioni believes meetings are boring because they lack drama, or conflict. Most leaders seem to be focused on ending the meetings on time instead of creating a forum for open and honest discussion and conflict.

Meetings are ineffective because they lack contextual structure. That is, too many organizations only have one kind of meeting that discusses every topic from administrative, to tactical, to strategic, to many other types of issues.

So how are boring and ineffective meetings changed to meetings worthy of Oscar nominations?

Set the Plot

Lencioni first suggests that leaders set up the plot during the first ten minutes of the meeting so that the participants understand what is at stake. By doing this, the participants get emotionally involved. This could be appealing to them on the importance of the decisions they are about to make about the financial viability and future of the company, competitive threats, key customers, employee morale, etc.

Mine for Conflict

Leaders should not avoid conflict in meetings, but should be miners of conflict. One would assume that the participants in the meeting are the best and brightest in the organization. Knowing what these people are thinking on the most important issues facing the company could be valuable. Debating and disagreeing on those issues is what makes a meeting productive, engaging, and fun; resulting in better decision-making. Thus, leaders should make it very clear that the participants are expected to be fully engaged in the meeting and that conflict is expected of them and is appropriate. Further, leaders should be ready to minimize the discomfort of participants and be willing to take risks in sharing their opinions and asking the tough questions on the important issues facing the company.

Different Meetings for Different Issues

Lencioni believes that the biggest structural problem with meetings is that leaders tend to include every type of issue in the same meeting. He suggests that the organization have four types of meetings:

- **The Daily Check In** - Team members meet briefly every morning for five minutes to discuss what they will be working on that day. (Depending on the organization, this may not be practical.)

- **The Weekly Tactical** - First, each team member will briefly indicate their two or three priorities for the week. Second, key performance indicators are reviewed. Based on the first two items, team members vote on the issues that will be discussed for the balance of the meeting. Leaders must be very disciplined to only discuss tactical issues and table strategic issues raised for a more appropriate meeting.

- **The Monthly Strategic** - Maybe the most interesting and most important type of meeting; team members analyze, debate and decide upon the critical issues facing the company. Leaders should schedule approximately 2 hours per topic so that participants feel comfortable in engaging in open-ended conversation and debate.

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State Taxation Trend: A CAT With Claws

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Ohio implemented it. Texas and Michigan followed it. Illinois seriously considered it. Many states are watching and waiting to see what happens with it. What is it? "It" is the trend away from net income taxes and towards gross receipts taxes.

As more states try to offset the effect of dwindling net income tax revenue on ever-increasing state expenses, they are looking to re-engineer their tax structures to help bridge the gap. Recently, Ohio overhauled its tax system and implemented a gross receipts-based tax to do just that.

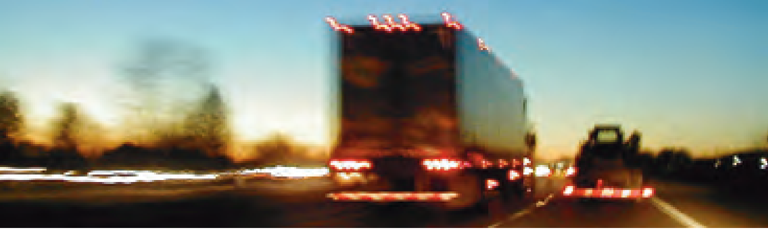
"As more states try to offset the effect of dwindling net income tax revenue on ever-increasing state expenses, they are looking to re-engineer their tax structures to help bridge the gap."

Since July 1, 2005, Ohio has imposed the Commercial Activity Tax ("CAT") on businesses with Ohio gross receipts. In effect, these companies are paying for the privilege to do business in the state. "Doing business" means engaging in any activity, whether legal or illegal, that is conducted for, or results in, gain, profit, or income, at any time during the year. In-state physical presence that has traditionally been viewed as a requirement for net income based taxes is not a prerequisite to be subject to CAT.

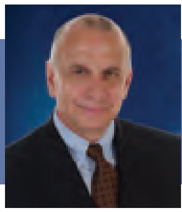
Transportation companies are deemed to be doing business and will have to pay CAT if they have property in Ohio for 14 or more days and that property is valued $50,000 or more (the 14 days do not have to be consecutive). Once an entity has met this threshold, it will pay CAT on its Ohio-based gross receipts. Transportation companies must source gross receipts to Ohio in proportion to the number of miles traveled by the carrier within Ohio to the total number of miles traveled during the tax year. Ohio has issued a publication specifically for the transportation industry that addresses these issues in more detail.

What is the bottom line effect of CAT on transportation companies? With the phase-out of the corporate franchise tax and the phase-in of CAT, companies with high Ohio gross receipts and low Ohio net income could end up paying higher tax bills.

Only time will tell if CAT is bridging the gap between revenue and expenses, but early numbers suggest that compliance is high and revenues are exceeding expectations. Initial reports on the new Texas and Michigan gross receipts-based taxes are expected in 2008. Assuming these states achieve the same high compliance rate as CAT, other states are sure to consider their own version of the Ohio plan. If that happens, transportation companies with high gross receipts could pay more in overall state taxes. •



Process and Considerations When Selling a Trucking Company



By Bruce Jones, CPA
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By all accounts, the long-term outlook for the truckload industry seems very favorable. However, the last six months have been a test even for the most seasoned management teams. With profit margins under pressure and bankruptcies on the rise again, the industry has entered another cyclical period where thoughts of business divestitures seem to occupy more conscious time than normal; leaving many middle market truckload carrier owners wondering what to do.

While there has been some pullback due to current margin erosion, merger and acquisition activities related to truckload and logistics deals continue. Private equity funds have selective interest in certain transactions, particularly asset-light operations, niche businesses and distressed buying opportunities. The capital markets are still looking for deals and are receptive to funding trucking acquisitions, although the costs appear to have increased slightly from last year.

The decision to sell a business is extremely difficult for most owners. There are family and employee issues, concerns surrounding the business valuation and selling process, uncertainties regarding the timing and alternatives, and the ability to be objective regarding the business' future viability. Many involved in the M&A business have suggested it is helpful to understand that selling a company is similar to the grieving process and must progress through four stages:

1. Denial
2. Anger
3. Negotiation
4. Accommodation and Acceptance

Once a decision has fundamentally been reached to sell a business, the question of timing becomes all important. The following "*Sell Quotient Model*" has been helpful for some owners in structuring their thoughts regarding this difficult question.

Sell Quotient = Seller Readiness + Company Infrastructure + (Company's Financial Health x Market Factors)

This model suggests that the opportune time to sell is a function of optimizing four primary variables:

1. the seller's readiness
2. the quality of the company's infrastructure
3. the company's current financial health
4. the status of financial and economic markets

The following general activities will assist with the optimization of the first three variables and improve the opportunity for an effective exit strategy while maximizing the company's value when economic conditions are favorable:

- Have *audited financial statements* and develop reliable timely monthly financial numbers. Investors ultimately must rely on the quality of the numbers to complete a transaction. (Numerous transactions have not closed simply because of poor accounting practices.)

- Maintain the highest *driver hiring standards* and turnover management practices possible. Many strategic buyers complete acquisitions simply to get drivers and assign a value to them, considering turnover history and hiring standards.

- Establish and maintain a *strong safety culture*, with low accidents and insurance costs. This will play a critical role in maximizing the company's value and marketability.

- Establish and maintain a *strong rate culture*. The primary reason for today's inadequate profits for many carriers is poor pricing and fuel surcharge programs.

- Maintain *equipment trade cycles*, and limit the use of leases. Many potential buyers find it

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New Standards to Affect Upcoming Audits

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In March 2006, the AICPA's Auditing Standards Board issued a series of eight audit risk assessment standards, Statements on Auditing Standards No. 104 - No. 111 that will go into effect for reporting periods beginning on or after December 15, 2006. Thus, these new standards will be effective for the upcoming 2007 calendar year audits of privately-held businesses and nonprofit organizations. They will have a significant impact on the scope, timing, and cost of all audits. These standards provide guidance on how auditors need to understand their clients' internal control environment in order to assess risk.

What requirements are detailed in the new standards?

- The audit team can no longer default to a "maximum" control risk assessment. A basis for a maximum control risk assessment is required and must be documented. In short, the audit team must understand, document and corroborate internal controls in order to assess the control risk.
- Simple inquiries of management are an insufficient basis for the assessment of internal controls. The audit team must corroborate answers by observation and by performing a "walk-through" of the related transaction.
- The new audit standards also include the requirement to assess controls related to a company's information technology (IT) environment.
- The internal control risk assessment must be performed in the year under audit.

How will these new standards affect the audit?

- The new standards magnify the importance of proper planning. It is likely that your audit team will start working much earlier in the year on the engagement. Expect the audit team to perform the internal control assessments during the summer or fall.
- Expect the audit team to conduct a more detailed understanding of your significant internal controls, including a "walk-through" of certain key controls, observations of employees using these control functions, or other testing to determine if key controls are operating effectively.

- Be prepared for the audit team to request more time from personnel, especially those outside of the financial area. The standards require auditors to interview sales and operations people as well.
- Depending on the IT environment, auditors may choose to have personnel meet with an IT specialist to discuss the IT controls and to test certain key attributes of these controls. In any case, expect auditors to inquire, observe, and perform "walk-throughs" to obtain a more robust understanding of your IT environment, especially key IT controls relating to specific risks identified in the risk assessment phase of the audit.

Will these standards affect the audit report?

Unlike the requirement for public companies under the Sarbanes-Oxley Act of 2002 (SOX), these new audit standards do not require the auditors of privately-owned businesses to report on the clients' internal con-

Continued on page 7. See "New Standards."

Get More From Investment in Process Documentation

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More and more, small companies are finding themselves needing to document their work processes. The question is, are they getting all of the benefit that they can from this work? By organizing these activities better, these companies can produce documentation that will help people in all parts of the organization.

What Is Process Documentation?

To begin with, processes are how work gets done. They represent the core of business activity - the activities that occur in each department on each day.

As for documentation, it is an "official" recording of, in this case, how the work gets done. It is the "official" way companies complete work.

"... processes are how work gets done. They represent the core of business activity - the activities that occur in each department on each day."

The Purpose of Process Documentation

Simple - *communicating*. Communicating to those inside the company (such as other departments, project teams and new employees) and communicating to those outside the company (such as customers, suppliers and auditors).

When done correctly, process documentation is essential for:

- Standardizing procedures to minimize process variability (i.e. best internal practices)
- Cross-training employees to work as supplemental staff for other parts of the company
- Training new employees faster and more effectively
- Supporting, supervising, monitoring and auditing of operations to assure performance

The Benefits

There are three major benefits from process documentation work. First, documenting processes inherently involves reviewing them (preferably by a team of people). This leads to the discovery of improvement opportunities that will translate into better efficiencies and lower costs. Second, as companies grow, communication and coordination becomes exponentially more difficult. Formalizing processes is necessary to sustain additional growth. Finally, process documentation supports improved flexibility. Most companies flex up and down by redeploying or adding people. The faster that the employees can download the learning curve, the more flexible the organization will become.

Basics for Getting Organized

Getting started can seem overwhelming. Using a core cross-functional team to work on:

- Designing and managing the project,
- building a process "organization chart" to organize the processes and related documents,
- developing simple documentation standards, templates, and tools, and
- training others on how to do it and reviewing their work

will go a long way in moving forward. Local, departmental teams can complete the work at a more detailed level.

Oscar Winning Meetings *(continued from page 2)*

- **The Quarterly Off-Site Review** - Topics for the off-site review might include: comprehensive strategy review, team review, personnel review, and competitive and industry review.

How in the world is there time for more meetings? The answer is meetings that are not boring and are effective will actually save the company time by accelerating the decision-making process. •

New Standards *(continued from page 5)*

trols. Internal control deficiencies that are deemed to be significant deficiencies or material weaknesses will continue to be communicated in a separate correspondence to management and those charged with governance.

What can be done to ensure a smooth transition?

- Plan to meet with the audit team during the summer/fall to discuss the key internal control processes. This will allow the audit team to design efficient and effective "walk-throughs" and observations of the key internal controls.
- Have adequate staff available during the internal control assessment and testing phases. This will increase the efficiency of the procedures performed.
- Document the key internal controls and gather examples to assist the audit team with the inquiries and observations.

As regulatory bodies and Congress debate the cost/benefit of proper oversight and regulation, the SOX "trickle-down" effect on privately-owned businesses and nonprofit organizations may begin to slow. •

Decision to Sell *(continued from page 4)*

desirable to avoid significant capital expenditures during the first year or so after the acquisition. Leases frequently have penalties associated with early termination and therefore can add to expense of a sale.

- Develop a *strong management* team with implemented process and structure. Financing for the buyer is usually very dependent on maintaining the company's historic cash flow, and a strong management group will buffer the concerns regarding the owner's departure.

- Maintain a *strong revenue cycle* with a low DSO (days sales outstanding). This will facilitate not only the company's current cash flow but also financing for the transaction.

Remember, Ralph Waldo Emerson once said "This time, like all times, is a very good one, if we but know what to do with it." •

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Here and There in the Trucking Industry

1st Quarter

Tim Almack, attended the Truckload Carriers Association annual meeting in Las Vegas. He serves on the association's Board of Directors.

Tim Almack, attended the Scopelitis, Garvin, Light & Hanson's Owner/Operator Contracts, Litigation & Regulation Seminar in Indianapolis.

Marty Wright, attended the IMTA Future Leaders Conference.

2nd Quarter

Mark Flinchum, Chris Cox and Marty Wright participated in the Indiana Motor Truck Association TIPAC golf outing on August 2nd at Hickory Stick Golf Club.

KSM's Committment to the Trucking Industry:

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

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