

Reducing Vehicle Costs



Next to salaries, wages and benefits, rising vehicle costs are a growing concern for businesses. Initial purchase prices combined with high fuel and maintenance costs are forcing owner/managers to take a second look at their vehicle policy.

When an employer provides an employee with a vehicle, both the employee and employer must realize that the vehicle is a resource for earning income and that the cost directly affects monthly cash flow and profits. The employee should want to treat the vehicle as if it were his or her own and use it with the same economy. This sense of responsibility can be achieved by including the employee in the selection process and sharing the facts of operating costs.

But before any vehicle is chosen, the owner/manager should consider some general policy issues regarding vehicles.

Who Needs a Vehicle?

The first step is to determine who needs a vehicle, what kind and how many for the job and geographic area to be covered. If, for instance, sales people are constantly travelling across the province, it may prudent to consider:

- Number of kilometres driven per year;
- Physical size of sales staff in relationship to the vehicle;
- Creature comforts required such as air conditioning, adjustable seats, power windows, hands-free cell phones, mapping software, etc.;
- Type of vehicle required: van, truck, midsize, diesel, number of cylinders, all-wheel drive;
- Original warranty and extended warranty coverage;
- Service centres in the areas most frequently travelled;
- Size and quantity of samples or display that must be transported;
- Image that the company wishes to portray to customers;
- Kilometers per litre;
- Insurance costs either on a group or individual basis;
- Cost of vehicle, including laid down cost, GST/PST, plus provincial add-on taxes such as air conditioning tax or gas-guzzler taxes;
- Cost of leasing the vehicles with increased emphasize on the per kilometre cost beyond the contracted distance limit; and

- Cost of returning the vehicle to its original condition after excessive wear and tear.

Working Capital

The next step is to review the company's ability to meet the working-capital requirements for financing or leasing. This requires gathering hard numbers on a vehicle-by-vehicle basis for comparison purposes. Consider:

If purchased:

- Total cost of each vehicle;
- Licensing, delivery, and processing cost;
- GST/HST lump sum refund investment tax credit that will be received;
- Financing terms, i.e. interest rate and duration of the loan; and
- Estimated trade-in value at the end of the financing term.

If leased:

- Monthly leasing cost;
- Licensing, delivery, and processing cost;
- Amount of deposit required, security, first and last, etc.;
- GST/HST refund that will be received monthly;
- Duration of the lease with a projection of the overall cost to term;
- Deposit amount, if any, to be refunded; and
- Estimated additional cost for excess kilometres.

With this information, you can project the estimated cash flow on a vehicle-by-vehicle basis for the initial purchase or lease as well as the operating cost of each vehicle. A spreadsheet with monthly estimates and annual summaries, under each the following headings will provide an idea of cash-flow requirements per vehicle over the life of each vehicle:

- Principal payment, interest payments (obtainable from an amortization table);
- Lease payment (obtainable from the dealer or the leasing company);
- GST/HST payments (if not included in the principal or lease payments);
- Insurance cost (assumed paid on a monthly basis);
- Fuel cost (based on Transport Canada ratings);
- Maintenance and service schedules for oil changes, tire rotations, etc. required to maintain warranty;
- Wear and tear cost outside the warranty such as new tires, lights, car washes, etc.; and
- Estimated residual value.

This spreadsheet will provide the owner/manager with an idea of the monthly cash flow requirements to keep vehicles on the road. For businesses with seasonal fluctuations, a monthly breakdown will assist in building cash reserves for those months that have minimal cash inflow.

The spreadsheet of comparable cost between leasing and purchasing will also provide insight into whether it may be more economical to lease or purchase.

Once the cash flow needed for operations and loan/lease have been determined, existing cash availability, business operating lines, and last year's 12-month history of cash flow will need to be reviewed. Using historic cash-flow information will assist in determining:

- The company's ability to manage cash requirements;
- Whether purchasing, leasing, or a combination of both, is the best solution to ensure adequate cash flow;
- Whether borrowing from the financial institution will curtail the company's ability to meet future capital expenditure or working capital needs; and
- Whether financing with other than the company's financial institution would offer better rates and less exposure to the volatility of lines-of-credit limits.

Although tax issues affect annual cash flow considerations, management may wish to exclude their introduction into a cash-flow module since the additional information may not be of great benefit in the process.

Consult With Your Chartered Accountant

Whether you decide to lease or purchase, the end result is a long-term commitment of resources. Be sure to review the information gathered in the foregoing analysis with your chartered accountant not only as a check on assumptions but also to determine the potential tax implications to your business and the impact, if any, on individuals who use the vehicles. Personal and corporate income tax issues will depend on vehicle users, purchase cost, capital cost allowance, residual value at trade in, and the cost of leasing.

A Good Vehicle Policy Can Mean Higher Earnings

A well-thought out policy that gives consideration to the vehicles needed to earn income, combined with an in-depth understanding of cost and cash-flow requirements should help you maximize the return on the capital investment, lessen exposure to unexpected fluctuations of working capital and improve earnings.