Reimbursing fuel expenses at actual cost

A TMC White Paper

The better way to control fleet fuel costs

In an era of high and often volatile fuel prices, this white paper asks whether flat rate expenses are still viable. It examines the alternative of paying drivers for business fuel at actual cost.

Fuel expenses typically involve a trade-off between holding down the cost of processing mileage claims and paying drivers the correct amount.

When fuel was relatively cheap and expenses were submitted on handwritten forms, most firms were happy to overlook the drawbacks and go for the administrative convenience of flat rate expenses.

Flat rates were given a strong boost in 2002 when HMRC launched the Approved Fuel Rates for company cars, which set out the maximum 'tax free' pence-per-mile figures that drivers can claim for fuel. The AFRs removed the need for fleets to calculate their own mileage rates, as well as the worry of whether drivers might incur unexpected tax bills.

Even so, the 2002 AFR rates were noticeably generous to drivers of more fuel-efficient cars, which led many firms to overpay tens of thousands of employees. Another sign that the early rates were generous was that HMRC did not increase them until June 2005, when pump prices had risen by over 20%.

In recent years, however, consistently high fuel prices led drivers to demand the full AFR rates at all times, while frequent price changes put pressure on HMRC to review the rates more often. In response, HMRC changed its timetable for updating the AFRs from half-yearly to quarterly.

However, the scale charges are still based on a car's engine size, making fuel the last area of fleet taxation still linked to engine capacity rather than CO_2 emissions.

Less convenient, more complicated

As well as changing up to four times a year, the fuel scale rates are also more complicated than they used to be, with a band for under-1,600cc diesels introduced in 2011. At that time, HMRC also increased the downward adjustment it makes to official fuel consumption figures, to allow for real-world driving, from 10% to 15%.

But that doesn't make flat rates realistic. Nor have the attempts to refine the system addressed the other intrinsic drawbacks of flat rates and pay-and-reclaim expenses (where drivers buy all their fuel and bill the company for business travel).

Moreover, since the AFRs are based on a wide spectrum of cars in each scale band, they will inevitably be too high for fleets and drivers at the leading edge of fuel efficiency, as the chart below shows. If this was a real company that paid fixed rates aligned to the AFRs, its 'reward' for operating with above-average efficiency would be to pay drivers nearly half a million pounds more than they actually spent on fuel over the period.

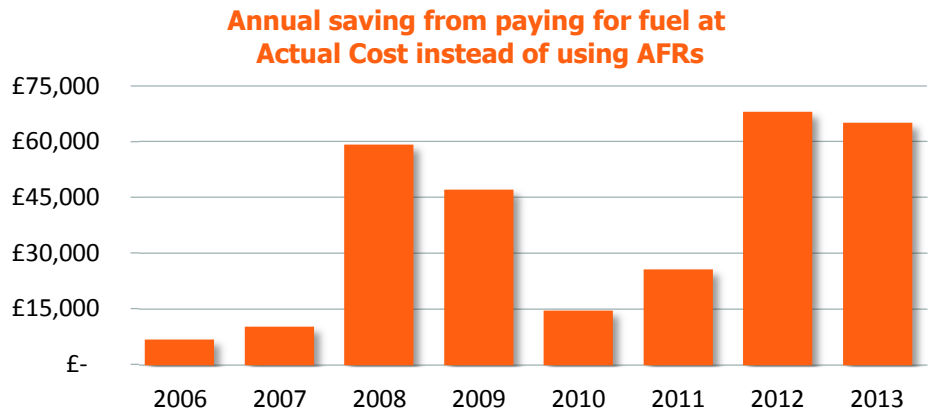


Fig 1. The difference between paying AFRs and the actual cost of fuel for 500, under-2-litre, diesel cars achieving an average of 47mpg in 2006 and 55mpg in 2013, based on 10,000 business miles p.a. and prevailing fuel prices and rates for each year. Total saving would be £320,000.

Flat rate fuel expenses

Flat rate fuel expenses will only be right for a small portion of a fleet's cars at any one time. Some drivers will receive too much and others too little. The idea is that, on average, the two ends of the spectrum will cancel each other out. Logically, that is like a man with his head in the freezer and his feet in the fire, who believes that he is comfortable overall. In practice, it is almost impossible to know who gains and who loses under a flat rate system.

Pay-and-reclaim expenses and flat mileage rates have been labelled 'faith-based fuel expenses', since users generally put their trust in pence-per-mile figures decided by one Government department (HMRC) using fuel consumption data gathered under artificial conditions by another (the VCA).

As it happens, HMRC do a creditable job of setting representative average pence-per-mile figures whenever they revise the AFRs. Unfortunately, two problems remain. First, the rates are still only broad-brush averages. Second, all flat rates, good or bad, leave companies in the dark regarding essential management information such as actual mpgs, fuel volumes, real pence-per-mile costs or actual prices paid for fuel.

Unreliable averages

To illustrate the dangers of relying on averages, the following table compares actual performance data for three identical cars taken from the TMC Fuel Management database. We selected a hybrid to illustrate the point because their fuel consumption varies dramatically depending on how and where they are driven but the principle behind the comparison applies to any type of car.

	Official mpg (combined)	Actual mpg from TMC database	Actual ppm	AFR ppm	Fuel cost difference over 10,000 miles
Car 1	70.6	70.7	9	15	**£600** (gain to driver)
Car 2	70.6	49.3	13	15	**£200** (gain to driver)
Car 3	70.6	39.6	16	15	**£100** (gain to company)
Average	**70.6**	**53.2**	**12.7**	**15**	**£233** (gain to driver)

Fig 2. Comparison of actual pence-per-mile and AFR Costs, based on examples from the TMC Fuel Management database. Total sample mileage: 90,000.

If the company running these cars paid a fuel expense rate of 15p per mile, each driver would simply claim £1,500 for 10,000 miles of business travel. As long as their mileage claims matched the total paid to them at the approved rate, everything would appear to be in order.

The reality is very different:

- One driver actually used only £900-worth of fuel; the second used £1,300 and the third used £1,600-worth
- Altogether, the company would have paid out £700 more in fuel expenses than the drivers actually used on business
- The most fuel-efficient driver actually cost the company the most in 'unnecessary' expenses

- In these examples, the Approved Fuel Rate was up to 66% higher than the actual cost of fuel
- Driver 3's fuel consumption clearly needs further investigation: perhaps a hybrid is the wrong choice for his usual travel pattern, or some other factor might be at work

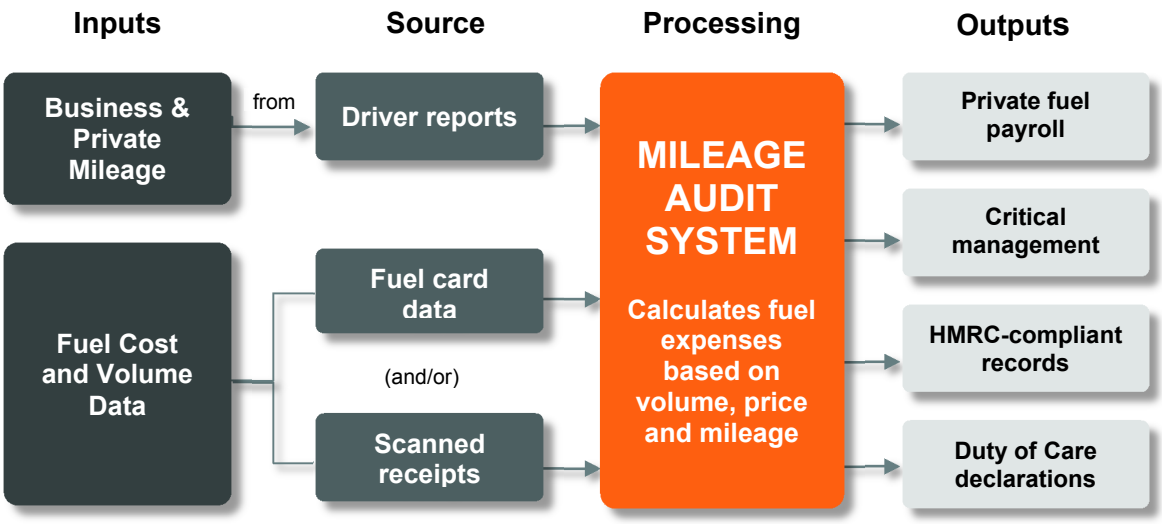
All of the preceding analysis would be available to management under an actual-cost fuel expenses process. But because a typical flat rate process collects no actual fuel data, essential information like this cannot be extracted from it.

In this example, the £700 payment over and above the actual cost of fuel for three cars is a high price to pay for the convenience of flat rate expenses. As already mentioned, fleets that use flat rates do so in the hope that overpayments and underpayments will cancel each other out. They may do. The point is the fleets will never know because the artificial fuel expense rates they pay prevent them from finding out.

Limited scope

Pay-and-reclaim expenses are a payment mechanism, not a management tool. They give companies very limited scope to manage fuel costs. That might be acceptable to a small fleet but pay-and-reclaim's tendency to obscure and dissipate vital management data can seriously undermine larger fleets' ability to effectively manage their costs, safety risks and environmental impacts.

Actual cost expenses



Companies have used actual cost fuel expenses for many years, although claiming them manually is more complicated and time-consuming for drivers than using flat rates. One alternative, when fuel was relatively cheaper and BIK on fuel benefit was much lower than it is now, was for companies to avoid expenses altogether and give staff private fuel benefit.

Breakthrough

Fleets needed a technological breakthrough to enable them to manage their fuel and mileage costs effectively. It came in the form of online mileage capture, which allows drivers to easily record detailed journey information and then combines it with fuel data (from fuel card transactions or uploaded receipts) so that fuel expenses can be calculated and paid automatically, at actual cost.

In fact a system such as TMC Mileage Audit is a complete fuel expenses solution in itself; capable of capturing mileages, importing fuel data, auditing the inputs for suspect or missing values, calculating payments and delivering payroll-ready expense payment files to the customer.

The use of mileage capture has risen in line with increasing Internet access, where the proportion of online households has risen from fewer than 40% in 2002 to 83% today, with 73% of adults making daily use of the web.

Visibility

Actual-cost fuel expenses and mileage capture are the opposite of flat rates and conventional pay-and-reclaim.

The latter process is opaque and actively hinders the effective management of fuel costs. As the performance table opposite demonstrates flat rate fuel expense figures can be dramatically out of step with real life performance. Mileage-driven actual-cost expense payment, on the other hand, provides almost total visibility over costs and business mileage activity.

Fairness

A key attraction of actual cost fuel payment is its fairness. No-one wins or loses because of an arbitrary decision about expense rates. The company and drivers feel the effects of volatile fuel prices equally.

Under the AFRs in effect at the time this paper was published, some drivers were making a profit of over 10p a mile from flat rate fuel expenses while others were subsidising their employer to a similar extent.

Convenience

For most drivers, the process of logging on to the Mileage Audit system to record journeys is no more time-consuming than filling out a paper expense claim or spread sheet. Mileage Audit saves drivers time and effort with features such as the ability to save favourite journeys and look up postcodes to verify distances. If the employer uses the system to calculate and pay expenses automatically, the driver only has to log in and record his or her journey details: the system does the rest.

Compliance

HMRC is known to target companies' past mileage records during tax investigations. Inspectors look for errors and omissions (which are not hard to find) and firms have faced fines and repayments running into seven figures. Using actual cost fuel expenses helps to protect your company from this risk, especially if it uses Mileage Audit, with its built-in checking and screening functions, to compile mileage records.

Choice

Although fuel cards are the most obvious source of price and volume data for actual-cost fuel expenses, not all fleets like to use them, so it is important to be able to use other data sources if needed. As well as taking in fuel card data, TMC's Mileage Audit system accepts fuel price and volume reports from drivers, supported with uploaded copies of scanned till receipts. Importing fuel data from driver reports and receipts is not quite as seamless as taking transaction data from cards but it does not affect expense payments and it allows customers to tailor the process to their situation and needs, rather than the other way round.

Actual cost vs. pay-and-reclaim		
	Actual cost	**Pay-and-reclaim**
Visibility of fuel spend	**Yes**	No
Visibility of fuel use	**Yes**	No
Centralised fuel and mileage data	**Yes**	No
Eliminates 'win or lose' for drivers	**Yes**	No
Eliminates 'win or lose' for employer	**Yes**	No
Automated payment capability	**Yes**	No
Online access to data	**Yes**	No
HMRC-compliant mileage records	**Yes**	No

Conclusion

The problem of high fuel costs is not going to go away. Global oil exports are now inexorably dwindling, which means structurally higher prices for all fossil fuels in future. The UK's deficit problem, one of the worst among developed economies, gives the Government scarce room to cut fuel tax, although it has been forced to abandon the long-running policy of raising fuel taxes faster than inflation.

In this era of rising energy prices, mileage is a critical factor for fleets. Mileage is the basic driver of all fleet costs: if you don't need business mileage, you don't need a fleet. If you do, the level of mileage determines the size, nature and total operating cost of the fleet.

It is already highly questionable whether pay-and-reclaim expenses using flat rates are still fit for purpose. The current HMRC AFR system – with frequent revisions and increased granularity in the capacity bands – would, if taken to its logical conclusion, become indistinguishable from an actual cost system, which leaves little doubt about the direction that expenses are taking.

Actual cost payment, with all its attendant benefits for businesses that desire to manage their vehicle and fuel costs more effectively, is undoubtedly the way of the future.

For more information about cutting your fleet fuel bill, please call TMC on **01270 525218** or send us an email at reply@themilesconsultancy.co.uk

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