RAILROAD WEEK IN REVIEW
July 5, 2024

“Deterioration in the supply chain or service provided by connecting carriers, or in our relationship with those connecting carriers, could result in our inability to meet our customers’ demands or require us to use alternate train routes, which could result in significant additional costs and network inefficiencies. Additionally, any significant consolidations, mergers or operational changes among other railroads may alter our market access and reach.” — Page 14, NS 2023 Form 10-K

“BMWED recommends that FRA deny BNSF’s request for relief, asserting that granting the relief would adversely affect railroad safety. BMWED noted that it ‘does not feel’ that any of the test programs or waivers issued related to railroads’ Automatic Track Geometry Measurement Systems programs provide a ‘level of safety equal to the minimum safety requirements’ of FRA’s Track Safety Standards’ (emphasis omitted).” — Brotherhood of Maintenance of Way Employees Division/IBT in response to FRA request for comment in the Federal Register

“The FRA’s denying BNSF the opportunity to expand ATI made no sense to me whatsoever. As FRA noted, there was only one public comment filed, from the BMWED, giving the impression, at least to me, that the denial was politically motivated.” — Bill Vantuono, Editor-in-Chief, Railway Age, July 2

I continue to suspect that some Class I CFOs are playing financial games to make the numbers look good. Revenue reporting is one of them. Take NS, for example.
Like many transportation and logistics companies, NS recognizes freight revenue based on when the service is performed. According to their financial statements and accounting policies, revenue recognition follows these general principles:

1. Completion of Service: Revenue is recognized when the freight has been delivered to its final destination, indicating that the transportation service has been completed.
2. Transfer of Control: Revenue is also recognized when control of the goods or services is transferred to the customer, which in this case is usually at the point of delivery.
3. Performance Obligation: The company must have a clear performance obligation, which in this case is the transportation of freight from one location to another.

These principles align with the guidelines provided by generally accepted accounting principles (GAAP) and, more specifically, with the revenue recognition standard ASC 606, which focuses on the transfer of control and satisfaction of performance obligations.

The 2023 10-K filed with the SEC states, "Under the typical terms of our freight contracts, payment for services is due within fifteen days of billing the customer, thus there are no significant financing components. *Accounts receivable – net* on the Consolidated Balance Sheets includes both customer and non-customer receivables."

Moreover, "Transportation revenues are recognized proportionally as a shipment moves, and related expenses are recognized as incurred. These performance obligations are generally short-term in nature with transit days averaging approximately one week or less for each commodity group."

Here is a potential fudge factor, buried on page K86: "We recognize that there are inherent limitations in the effectiveness of any internal control over financial reporting, including the possibility of human error and the circumvention or overriding of internal control. Accordingly, even effective internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal control over financial reporting may vary over time."

In a nutshell, my suspicion is the Class I may recognize revenue according to the trip plan, not when the car is actually placed or the bill is paid. If the freight bill is not paid properly, it goes into receivables, and that reduces the reportable revenue number. Point is, higher revenue against no change in operating expense reduces the OR and leads to favorable analyst reports.

I am particularly concerned about short lines and others, especially with regard to "completion of service." Is the service completed when the car is placed on the short line's interchange track or when the short line has actually placed the car at the receiver's facility and made it available for unloading? Where the short line is an ISS road, do the interchange rules kick in?

The NS 10-K says, "Revenues related to interline transportation services that involve another railroad are reported on a net basis. Therefore, the portion of the amount that relates to another party is not reflected in revenues." But when the short line gets a "handling fee," that amount comes out of revenue, according to FASB rules.[1],[2]

My suspicion is that Class Is may recognize revenue according to the trip plan, assuming the "final mile" service is by a short line, though the customer is billed when the car is placed. If the freight bill is not paid within 15 days, it goes into receivables, and that reduces the reportable revenue number. Point is, higher revenue against no change in operating expense reduces the OR and leads to favorable analyst reports.

The FRA denial of the BNSF request for relief is…startling…and *Railway Age's* Bill Vantuono may be on to something.

Just thought you might like some cheerful reading for your Fourth of July holiday.

[1] FASB Rule EITF 99-19 ,"Reporting revenue gross as a principal vs. net as an agent"

[2] If the market manager is paid based on net revenue to NS, the shortline fees could be a disincentive to use a shortline origin or destination.