



The Bottom Line

Business advisers and auditors to the shipping industry

Inside

Hedging your bets

AIMing for Greece

Bigger and better OpCost

Moore clients

Pension scheme
sponsor risk

Maritime finance seminar

Rum do for DAIT rebadging

Profile: Helen Tang

Moving on

Clubbing together

Has anybody checked recently if the Baltic really does unfreeze each year on 20 February, the date which is enshrined in the marine insurance calendar as the anniversary for P&I renewals? It seems unlikely, and unnecessary. But one thing that shipowners do check is their P&I renewal terms and, at this time of year, it is not unusual to detect a level of unhappiness among club members.



The recently concluded renewal season was no exception, with brokers being quoted extensively in the maritime press complaining about eight successive years of premium increases and questioning the need for clubs to impose on the shipowners whose

interests they represent the level of general increases which has been commonplace this year.

The arguments advanced in favour of lower increases - or no increases at all - encompass everything from a buoyant shipping industry to a recovering investment market. This year, in addition, they include the argument that, since most clubs are satisfied that they are well placed to meet the risk-based Solvency II capital adequacy regime introduced in the UK by the Financial Services Authority, why do they need more money?

So are the arguments justified? In most cases the answer is 'No'. Individual owners will always have individual issues with individual clubs, but the essence of P&I is its mutuality. And while different clubs have different philosophies on how best to use their investment returns in the interest of members, the fact remains that investment income should never be used to massage or distort underwriting results, which are the heart of P&I.

Strong freight markets and a generally buoyant shipping industry, meanwhile, do not translate, historically, into lower P&I premiums. The more ships there are trading, the greater the scope for a potential increase in casualties. Put bluntly, more ships must inevitably mean more claims. By November of last year, for example, it was reported that International Group Pool claims for the 2006/07 underwriting year had

already reached \$100m, which was more than the same figure for the two previous years.

The so-called 'churn effect' must also be taken into account. All clubs want to get more and more modern tonnage onto their books. But old ships attract generally much higher levels of premium than new ones. With so much new tonnage on the market, and much more waiting in the yards, rating of this business will be a key issue in P&I for some years to come.

When claims increase across a book of mutual business, then so too will premiums. This is not something unique to P&I clubs, or even to mutual insurance. If the cost of meeting claims increases, then so must the premiums.

Finally, there is the argument about Solvency II, a regulatory regime which will establish a revised set of EU-wide capital adequacy requirements for the insurance industry. Although it is not expected to come into effect before 2010, at the earliest, it is incumbent on the insurance industry - and that includes the P&I clubs - to familiarise itself now with the issues at stake.

Almost half of the International Group of P&I Clubs will already be familiar with strict financial regulation, since they are regulated by the FSA. And FSA-regulated insurers have already been required to meet Enhanced Capital Requirements and to develop their own Individual Capital Adequacy Standards, based on principles similar to those that seem to be developing under Solvency II.

In short, most clubs are now ready for something like Solvency II. That fact alone should serve as a singular reminder that the clubs generally are in good financial health. And if the price to be paid for that is increased premiums, it might be deemed a price worth paying.



AIMing for Greece

Arthur Davey from Moore Stephens London was a speaker at a recent seminar in Athens entitled "Raising capital on AIM: a guide for Greek companies".

The meeting was organised in conjunction with London-based law firm Withers and was held in the splendid surroundings of the British Embassy Residence, where proceedings were opened by the UK Ambassador.

Arthur explained to an assembled audience of 140 Greek business leaders and advisers the financial aspects of an AIM admission and the role of the Reporting Accountant, and then participated in a lively question and answer session.

Moore Stephens was well known to many of the attendees, who included clients in both Greece and London. The event was generally deemed to have been informative and a great success. A second seminar may be organised, possibly with a shipping focus. "There is interest in AIM amongst Greek companies," says Costas Constantinou, of Moore Stephens Greece, who attended the seminar.

Moore Stephens was the first international accounting network to set up a member firm in Greece, in 1963. With its main base in Piraeus, the firm's business is highly focused on shipping, which accounts for around 60% of client work. "Shipping is still the main thing we are known for," says Costas.

arthur.davey@moorestephens.com

Hedging your bets

The two key questions that need to be addressed when considering how to account for freight derivatives in most major accounting frameworks are the value at which derivatives need to be stated in a balance sheet, and whether or not changes in value give rise to profits or losses, or else are deferred.



Under International Financial Reporting Standards, all freight derivatives need to be stated at their fair value at each balance sheet date. The problem arises when it comes to accounting for changes in fair value. For this purpose it is useful to divide market

participants into three categories:

- speculators;
- hedgers; and
- hedgers treated as speculators.

In all cases, the derivative is stated at its fair value. The difference arises in the treatment of value changes. For speculators the derivative is categorised as being "at fair value through profit or loss", and the value change is recognised in income.

If a company wishes instead to treat the derivatives as hedges, there are various conditions that need to be met. Any party that does not wish to apply hedge accounting simply fails to meet the conditions, whereupon the derivative is treated in precisely the same way as if entered into for speculative purposes. All value changes are then treated as profits and losses as they arise.

If a company wishes to be able to defer gains and losses, the hedge accounting conditions must be met. And a freight derivative can only be designated as a hedge in its entirety.

The difficulty with accounting for freight derivatives as hedges lies primarily in demonstrating effectiveness. Traded, and most OTC, derivatives are highly standardised, but this means that it is virtually impossible to identify a 'perfect' hedge. There is no realistic chance that a shipowner, for example, will trade on the precise route, in the precise quantity and at the precise time covered by an FFA into which it has previously entered.

International Financial Reporting Standards for instance, require the party wishing to use hedge accounting to demonstrate a close correlation between paper and actual. The documentation therefore needs to be extremely precise in identifying the exposure that is being hedged, why the hedge is expected to be effective and how effectiveness will continue to be measured.

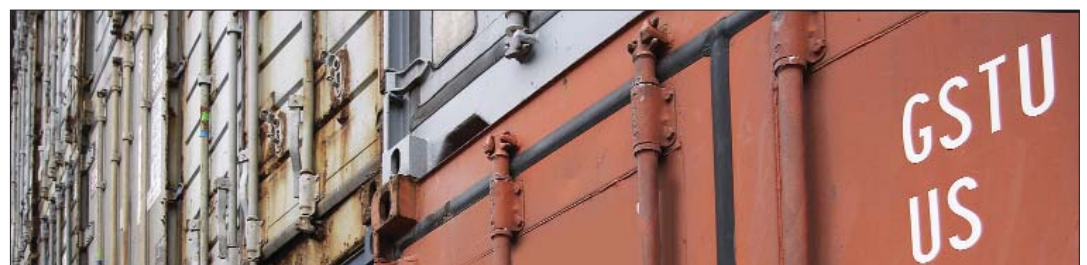
Effectiveness needs to be tested at inception, at each accounting date thereafter, and at the time the hedge comes to fruition. Any failure to meet the documentation criteria or effectiveness tests means that the hedge is either treated as though it were speculative from the date on which it was entered into, or becomes treated as speculative at the date the effectiveness test is failed.

Assuming the conditions are met, hedge accounting allows value changes in open positions to be deferred. This means that, while recognised in the asset or liability value in the balance sheet, profits are not immediately affected by those changes. The value change is taken directly to equity.

On closure, all gains and losses that have previously been deferred are taken from equity and recognised in profit, or 'recycled'. If, for example, an owner hedges against freight rate falls, and they rise, it will ultimately record a loss on the hedge, but its profits on trading will be higher than originally anticipated.

While a hedging strategy may lead to stabilisation of profits, it will not necessarily do so for any particular accounting period unless hedge accounting is applied. Companies that wish to use hedge accounting will find that it is a considerable commitment to ensure that the documentation is adequate and to monitor effectiveness.

david.chopping@moorestephens.com





Moore news



Bigger and better OpCost

OpCost, the Moore Stephens operating cost benchmark tool, has established itself as a primary industry resource for benchmarking shipping costs, forensic accounting and the preparation and

checking of business plans. Its scope and flexibility is continually being expanded, and there was an increase of 10% in the number of vessels included in the 2006 report, compared with the previous year.

Work is already well underway on OpCost 2007, and this promises to be even bigger and better than its predecessors. Moore Stephens Shipping Industry Group partner Richard Greiner says, "OpCost has developed into an industry standard, and demand for it has increased steadily, year-on-year. Over 1,300 ships were included in the 2006 report.

"The information is extracted from our database of actual running costs, and covers the twenty most common vessel types. The report contains real data from real ships, and can be used to identify significant trends. For example, OpCost 2006 showed insurance and crew costs were the biggest contributors to an overall increase of just under 4% in shipowners' total operating costs. "

Contributors to the database receive copies of the report free of charge, and are guaranteed absolute confidentiality. To submit your data, or to reserve a copy of OpCost 2007, contact richard.greiner@moorestephens.com.



Moore clients

Moore Stephens has been appointed to prepare US GAAP accounts for Belgian ship operator Kleimar NV following its acquisition by SEC-listed Greek shipowner Navios Maritime Holdings Inc.

Moore Stephens has also been appointed auditor to major Russian container terminal operator, NCC Group. NCC was formed as result of a 2002 joint venture between Severstaltrans, an affiliate of giant steel maker Severstal, and oil trader First Quantum, and is currently going through a major expansion and reconstruction programme.

NCC has interests in a number of major ports in the CIS, including St Petersburg, and has also formed a joint venture with freight forwarding company Delo to operate Russia's leading Black Sea port, Novorossiysk.



Pension scheme sponsor risk

Moore Stephens and Standard & Poor's Ratings Services have jointly launched a new flexible covenant management service for pension trustees, which may be of interest to

international shipping groups.

Trustees of defined benefit pension schemes in the UK are required to consider the strength of their sponsoring employer when putting in place funding plans. To help them, trustees have traditionally had the option of either obtaining an assessment from Standard & Poor's that assesses the risk of their sponsor's failure, or seeking advice from an accounting firm on how to improve the pension scheme's security.

The new service will enable trustees to benefit for the first time from a rating agency approach to assessing company risk, plus tailored advice from an experienced accounting firm on managing that risk. The service will be flexible, so that trustees can choose the most cost-effective solution that meets their particular circumstances.

Richard Hall, head of pension services at Standard & Poor's, says, "We have been aware for some time that much of the work done in this area by ourselves and by accounting firms is complementary. Standard & Poor's analysis enables trustees to clearly understand the risk of their sponsor failing. Moore Stephens' corporate experience and thorough understanding of our analysis enables them to provide advice on managing that risk." For more information please contact paul.clark@moorestephens.com



Maritime finance seminar

Moore Stephens is to sponsor the Lloyd's Maritime Academy seminar on Accounting and Tax for Maritime Finance, to be held in London on 5 and 6 July. Richard Greiner will

chair the event, while Philip Parr and David Chopping will speak on tonnage tax and shipping accounting issues, respectively.



Rum do for DAIT rebadging

The Moore Stephens Dispute Analysis and Investigations Team (DAIT) has rebadged itself as 'Forensic Accounting Services'.

"Many people don't know what dispute analysis is, and we found that that narrowed our field to dispute work," explains Moore Stephens partner Julian Wilkinson. "But we operate across a much broader field. Our forensic work includes providing expert witness and analytical skills in cases of claims, disputes and investigations."

The FAS team plans to extend the sources of its work even further. In addition to solicitors - the traditional source - it plans to build contacts with other providers of forensic assignment, including insurance companies and government bodies such as the Serious Fraud Office. The team is already busy and recently recruited newly qualified Iain Potter as a forensic specialist. A number of further appointments are also planned.

In February, the FAS team took the opportunity to promote and celebrate its expertise at its annual party. This year's event, held on board HQS Wellington on the Thames and attended by about 120 litigation solicitors, featured a rum tasting. "It seemed to go down well," says Julian, although it is not clear whether his reference is to the party or to the rum.

julian.wilkinson@moorestephens.com



Quote

"I have enough money to last me the rest of my life, unless I buy something."

Jackie Mason

Who to contact

If you would like further information on any item in this issue of The Bottom Line, or information on our services to the shipping industry please contact:

Chris Chasty
Richard Greiner

Email: firstname.lastname@moorestephens.com

Moore Stephens LLP
St Paul's House
Warwick Lane
London EC4M 7BP

T: +44 (0)20 7334 9191

F: +44 (0)20 7248 3408

www.moorestephens.co.uk

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Profile: Helen Tang



Moving from Hong Kong to Sheffield does not sound like much of a reward to some for passing your O Level exams, but Helen Tang was happy to make the switch.

Helen was born and raised in Hong Kong, but came to the UK to study at Sheffield, where she passed her A Levels. Thereafter, she went to the City of London Polytechnic to study accountancy. She says

she was undecided whether to study law or accountancy, and admits that the fact that one of her brothers was studying accountancy at the London School of Economics at that time probably influenced her choice.

Today, Helen is an audit partner with the Moore Stephens International member firm in Hong Kong. She looks after audit clients, as well as clients who have outsourced their accountancy functions to the firm. She also looks after Moore Stephens' in-house accounting. There are more than 100 people in the Hong Kong office, and audit is the largest department.

In addition to shipping, Helen's clients include electronics manufacturers, garment makers, trading houses and investment companies. She is also responsible for the audit of a number of non-shipping listed companies. She says, "Although I am mainly office-based, I do of course get to visit clients, which can be a very valuable exercise. As yet, however, I haven't been invited on board any of our clients' ships!"

Hong Kong is a big shipping city, with lots of maritime tradition. Helen says, "It is a good place for an accountant to be. Hong Kong is essentially a hub connecting China and the rest of the world, although China itself is opening up rapidly. Hong Kong is well served in terms of its infrastructure, and its systems remain intact, despite the fact that it is now part of China."

Asked what she sees as the biggest challenge facing shipping in the short term, Helen replies, "I think the main challenge is to maintain the buoyant market we are enjoying at the moment. How long can it last?"

When Helen isn't working, she likes nothing better than to spend time at the weekends with her two sons, aged ten and eight. "The boys are both at local Chinese schools," she explains. "I think having the opportunity to learn more Chinese is very important for their generation."

Once a regular participant in a variety of sports, Helen admits that, these days, her busy schedule allows time only for dancing, of the ballroom and Latin varieties. She likes Latin best, because "it combines great exercise with mental relaxation." You don't get much Latin in Sheffield.

helen.tang@moorestephens.com

Moving on

Moore Stephens doesn't like to lose good people. But when they leave to accept a new challenge, they go with our blessing.



Such was the case with Alex Eustace, who joined Moore Stephens in September 2000 and who in February 2007 traded her role as an audit manager with the shipping team to take up an offer to join Foreland Shipping Limited, where she is in charge of finance.

Foreland Shipping was formed by four leading British shipping companies to supply the UK Ministry of Defence with ro-ro vessels. The ships have now been delivered, and Foreland has agreed a structure with the MoD under the Private Finance Initiative for some of them to be employed in the

commercial market while remaining available in times of crisis.

Alex misses her colleagues at Moore Stephens. She recognises the value of the experience she gained there. And she appreciates the opportunities it afforded her to travel, which is one of her great passions. Places she visited while wearing a Moore Stephens' hat included Nigeria, Cyprus, Monaco and Vancouver. But she is enjoying her new role at Foreland, and indeed her continuing involvement with shipping.

Alex is still an Arsenal supporter. Old habits die hard.