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WORLD MARITIME UNIVERSITY
Malmö, Sweden

THE FINANCIAL STATEMENTS AND THE PROCESS OF DECISION MAKING IN SHIPPING COMPANIES

By

Rolfi Manuel Chevalier Hernandez
Dominincan Republic

A dissertation submitted to the World Maritime University in partial fulfillment of the requirements for the award of the degree of

MASTER OF SCIENCE
in
SHIPPING MANAGEMENT

2000

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DECLARATION

I certify that all material in this dissertation that is not my own work has been identified, and that no material is included for which a degree has previously been conferred on me.

The contents of this dissertation reflect my own personal views, and are not necessarily endorsed by the University.

……………………………………

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DEDICATION

TO
MY ADORED PARENTS,
MY BROTHERS, MY SISTER
AND MY LOVELY GIRLFRIEND

ACKNOWLEDGEMENT

My gratitude and appreciation go to My GOD who never let me alone and who has helped me to take this important step in my life.

To my parents Blanca and Juan Baron who gave me the life, thanks to them I am who I am, they gave an invaluable education.

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My thankfulness to my girlfriend Camilla and her parents, who made my life easier in Sweden and helped and supported me when sadness hit me

ABSTRACTS

Title of Dissertation**: The Financial Statements and The Process of Decision Making in Shipping Companies**

Degree: **MSc**

This dissertation tries to explain the different kinds of financial statements, the audit report and the notes to the financial statement as well as their uses in shipping companies, how the top shipping management uses those financial statements in order to make a decision.

A definition and brief explanation of the audit report, and its uses for the top shipping management is given. In addition we also explain the different kinds of opinions and how they can help or not the shipping financial analysis.

Moreover, this study deals with financial ratios, shipping decision makers and explains how these people make a big influence in the shipping activities apart from the shipowners.

To explain the process of decision making in shipping companies, we divided analysis by purposes of decision making : Ship Financing, Mergers and Outsourcing. Therefore, we explain each one of these processes and we comment why, and how the financial statements help top shipping management in this process.

The dissertation concludes with recommendations in order to maximize the uses of the financial statements in order to reflect the process of decision making in shipping companies and related activities

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LIST OF ABBREVIATIONS

AICPA	American Institute of Certified Public Accountants.
CFF	Cash flow from Financing Activities.
CFI	Cash flow from Investment Activities.
CFO	Cash flow from Operations.
CP SHIPS	Canadian Pacific Ships.
FASB	Financial Accounting Standard Board.
GAAP	General Accepted Accounting Principles.
GDP	Gross Domestic Product.
MTO	Multimodal Transport Operator.
PWC	Price WaterhouseCoopers.
SFAS	Statement of Financial Accounting Standard.
USA	United States of America.

CHAPTER 1

INTRODUCTION

The worldwide business environment has benefited from the financial data obtained through the financial statements. However, many new techniques have appeared and have made the decision making process much easier and more reliable for the players involved in it. The shipping sector, which is a totally international business, is not an exception.

In spite of these techniques the information of the financial statements is still useful for the decision-makers, which are mainly the shipowner, shipper, banker, shipbuilder, government regulatory authority and investor.

Financial analysis in some cases is nothing more than a simple report. Analysts accept the financial statement and what management tells them at face value. Good analysis is hampered by inadequacies of published financial data. Many analysts examine the trend of reported earnings but are unable to go "behind the numbers" or beyond them. The analysis taught in most areas starts and ends with reported financial statements.

Shipping is one of the world's most international industries and in studying maritime economics and shipping finance we are drawn into a discussion of the world economy as a whole. Seaborne trade is, in a sense, at the apex of the world economic activity. In addition, the international market composed of many decision-makers needs to rely on real information and data in order to make the correct decision at the right time.

Financial analysis requires the analyst to understand how the financial statements are generated in order to separate the economic process that generates the numbers from the accounting process that (sometimes) obscures it. Such analysis requires the use of assumptions and approximation, as reported financial data are inadequate. We may dislike the need to make assumptions, but most financial analysis depends on them. Good analysis also requires the recasting of reported data into other formats when the latter yield superior insight.

However, we do not believe that there are always simple solutions to analytic problems. There is for example, no precisely correct or " optimal" leverage ratio; there are many possible ratios, depending on the goals of the analysis and the judgement of the analyst. Our view is that asking the right question is more than half the battle. (White. G.I.)

This paper attempts to examine the different factors involved in the process of decision making in shipping companies, and to explain at the same time how financial statements can help or not in this important process. Therefore, to have a clear vision about this topic we will have to analyse many techniques available and used in order to carry out a good decision.

This paper specifically sets out to:

- Clearly define and explain the financial statements.
- Analyse and evaluate every component of the financial statements.
- Understand the financial reporting issued by the external auditor.
- Analyse the uses of the recommendation letter to top shipping management.
- Evaluate some financial ratios, which may support or affect the decision making in shipping companies.
- Examine the investment analysis and modern management practice in shipping.

The research has been carried out with material gathered from lecture notes, interviews, seminar papers, field studies and library research, in addition to the financial statements of Anangel Shipping Companies, which are for public use.

Nevertheless it has not been possible to carry out an in depth analysis because of the negative attitude of some shipping companies to disclose publicly their strategies and methods used in this respect. There is a lack of information due to the fact that there are few public companies in the shipping business. In addition the fact that shipping companies often are family owned business sometimes makes it impossible to carry out a full assessment of their performance.

CHAPTER 2

THE THREE ESSENTIAL FINANCIAL STATEMENTS AND THEIR NOTES IN SHIPPING COMPANIES.

The financial statements of the business firm serve as the primary financial reporting mechanism of the firm, both internally and externally. Financial statements are the method by which management communicates financial information to decision makers such as owners, personnel, customers, suppliers, competitors, regulatory agencies and academics, all of whom have their own view and goals in how they use the financial statements in their evaluation. Financial statement analysis is a prevalent method for processing relevant data for decision-makers. Typically, the information is summarised in the form of financial ratios. On the stock market the investors use market-based indicators of the stock-price behaviour combined with the firm's accounting information.

2.1 The balance sheet, its parts and importance

What is the balance sheet? It is one of the most important financial statements in the shipping industry. It describes the real situation of any company at a specific moment. In the balance sheet companies show the financial value of assets (belongings or resources), liabilities (commitments to third parties), and what it is worth at a certain moment in time. Today, finances are going so fast that it is very important for a company to know at every moment their financial position. Therefore, balance sheets are normally compiled at the end of each month and sometimes in special cases at the end of each week. Nevertheless generally speaking the requirements force financial statements to be issued at the end of every fiscal period, which is standard.

Assets reported on the balance sheet are either purchased by the firm or generated through operation; the creditors and stockholders of the firm finance them, directly or indirectly. This fundamental accounting relationship provides the basis for recording all transactions in financial reporting and is expressed as the balance equation:

Assets (A)= Liabilities (L) + Stockholder' Equity (E)

By simple definition this equation means: what is in the company's name partly belongs to third parties, and the other part belongs to the shipowner (shareholder). If the situation is such that the company does not have any liabilities then all assets are owned by the shipowner. In the shipping activity this last situation is quite rare if we take into consideration that this industry is capital intensive and always needs a huge amount of capital.

2.1.1 Assets

Assets represent what the company has gotten and normally are presented in the following sections: cash, accounts receivables, inventory, machinery, buildings, etc., but are also shown under other assets, which are not tangible, e.g. marine insurance, royalties, etc.

Normally assets are grouped in the balance sheet according to their characteristics. In most of the cases this characteristic is liquidity, which is also used to define the structure of the liabilities.

The assets which can be converted in to cash easily are considered as liquid assets e.g. accounts receivable, inventory etc. Those assets which cannot be classified under this theoretic model are normally called fixed assets, and these are subject to depreciation or loss of their value over time.

Liquid Assets = Cash and Securities.

Assets for sales = Inventory

Fixed Assets = Property, plant and equipment.

2.1.2 Current Assets

By definition, current assets are cash or equivalent or items which are expected to be converted into cash. These are listed in order of liquidity, so the first asset shown is the most easy to convert into cash.

a) Cash

b) Accounts receivable

c) Inventory

d) Prepaid expenses.

The current assets are said to be ”working capital” because these are in a constant movement within the accounting cycle.

2.1.3 Fixed assets

Fixed assets are also known as property, plant and equipment. These are the resources that the organisation uses to produce income or profit. As we said before, fixed assets lose value through depreciation. Therefore, those asset need to be replaced in order to maintain the normal operation of the company.

2.1.4 Fixed assets in the shipping industry

The “Ship” can be said to be the most important asset in the shipping business. There are a lot of definitions of a ship but for the purpose of our concern the ship can be defined as the main unit of a shipping company which is used in order to produce a profit at the lowest cost.

Ships can be acquired by shipping companies in many ways, as we can see in chapter IV.

2.1.5 Depreciation of ships

The depreciation of a ship could be defined as:

"The decline in useful value of a ship due to wear and tear from use and the passage of time". Depreciation indicates when the ship has to be replaced. In the balance sheet the sum of all the depreciation charges taken since the asset was first acquired are reflected.

2.1.6 Net value of ships

The company owns the total historic value of the ships less all depreciation charges taken per each fiscal period over the years (Accumulated depreciation).

2.1.7 Liabilities

Liabilities are economic obligations of the shipping companies, money that the organisation owes to third parties. Liabilities are also classified according to their liquidity, depending on the time of maturity for the obligation.

2.1.8 Current liabilities

These include the obligations the firm is expected to settle within one year. Liabilities exceeding this period of time then are named long term liabilities.

2.1.9 Long term liabilities

Long term liabities are moneys owed by the company, the overall term of which is more than 12 months, e.g. a mortgage on a ship is a common example.

The acquisition of a ship could be done in two ways. The first one is when the ship is acquired in cash, and in which case there is no liability involved. The other way is when the ship is financed. Then we can say that the organisation acquired a long-term debt. Raising ship finance is essentially a matter of persuasion and extremely important, so it is a good starting point to return to two basic questions:

The first question is: Where does the money to finance a ship come from? The second is: what do businessmen have to do in order to get it?

The answers to these questions are developed chapter IV.

2.1.10 Equity

Capital stock

This is the first amount of money that the owners contributed on their investment in the stock of the business unit.

Retained earnings

These are the accumulated earnings of the company, which have been retained, therefore not paid as dividend to owners.

Common stock

"Is the regular denomination of ownership" For the shipping companies, this defines a person as a shipowner.

2.1.11 Uses of balance sheet

The balance sheet provides information about the shipping company's resources in all respects. For creditors, the balance sheet provides information about the nature of assets (ship) that the firm uses as debt collateral. The balance sheet provides data consistent with its long-run "going concern" forecast for cash collections, evaluation of profitability, and also, together with the income statement can be used to measure the efficiency of a firm's operation and its return of investment.

2.1.12 Limitation of the balance sheet

Sometimes the usefulness of the balance sheet can be limited by the following factors**:**

a) Selective reporting: important assets and liabilities may be omitted from the balance sheet because of the General Accepted Accounting Principles (GAAP), e.g. leasing of ship and other off-balance sheet financing techniques.

b) Measurement: some assets and liabilities are carried at historical cost, others at market value. Historical cost may bear little relationship to their real market value. Inventories and long-lived assets are good examples of this.

c) Delayed recognition GAAP permit companies to delay recognition of value changes; one important example is an employee benefit plan. (White.G, 1997).

2.2 The income statement, its part and importance

The income statement (statement of earnings) reports on the performance of the firm, the result of its operating activities. Its explains some, but not all, of the changes in the assets, liabilities, and equity of the shipping companies between two consecutive balance sheet dates. Use of the accrual concept means that income and the balance sheet are interrelated. The preparation of the income statement is governed by the matching principle, which states that performance can be measured only if revenues and related costs are accounted for during the same time period. This requires the recognition of expenses incurred to generate revenues in the same period as the related revenues. For example, the cost of a ship is recognised as an expense (it is depreciated) over its useful life (as it is used in the production) rather than as an expense in the period it is purchased. (White G.I. 1997).

The income statement documents for a specific period (quarter or year) the second basic equation of accounting:

Sales (revenues)-Costs and Expenses =Income.

2.2.1 Revenues

Revenues are the inflows of a shipping company from the delivering or rendering of services (transportation), or other activities that constitute the entity's ongoing major or central operation.

2.2.2 Cost and Expenses

These are Outflows from delivering or rendering services, or carrying out other activities that constitute the entity's ongoing major or central operation.

2.2.3 Gains or losses

Gains or losses can be defined as increases in equity (net assets) from peripheral or incidental transactions. Therefore, they can be considered as nonoperating events, eg. lawsuits and any changes in market values, including currency rates.

2.3 The cashflow statement, its parts and importance

2.3.1 Statement of cash flow

This statement is a real combination of information and data which supplements that provided by the income statements. Both link consecutive balance sheets. The major purpose of the cash flow statement is to supply information about the outflow and inflow of cash in the organisation for any specified period. This statement could also provide information about that period's non-cash investing and financing activities.

The classification of cash flow among operating, financing, and investment activities is essential to the analysis of cash flow data. Net cash flow (the change in cash and cash equivalents during the period) has little information content by itself; it is the classification and individual components that are informative.

2.3.2 Cashflow from operating activities (cash from operation or CFO)

In this section the statement presents the amount of cash generated or used by the company as a result of its production and sale of good and services. Although deficits or negative cash flow from operation are expected in some circumstances (e.g. rapid growth), for most firms positive operating cash flow is essential for long term survival. Internally generated funds can be used to pay dividends or repurchase equity

2.3.3 Investment cash flow (CFI)

This part reports all the cash used by the firm in order to get assets such as property, plant and equipment (ships) as well as the investment and acquisition of entire businesses. These outlays are necessary to maintain a firm's current operating capacity and to provide capacity for future growth. CFI also present any cash received by assets sold as well as cash received from sale of segments of the business.

2.3.4 Financing cash flow (CFF)

Includes cash flows related to the firm's capital structure (debt and equity), including proceeds from the issuance of equity, returns to shareholders in the form of dividend and repurchases of equity, and incurrence and repayment of debt.

2.3.5 Importance and uses of the cashflow statement

Today cash management is as important as the management of any other company resource and has developed into a full and prestigious financial profession. Today's cash managers deal with the traditional areas of collection, disbursement, and concentration, but in addition, they are also involved in the company's banking relationships, investment decisions, and forecasting.

2.3.6 Cash flow in shipping

As shipping is a very special industry, which needs large amounts of capital, proper cash management is essential all the time. The statement provides more objective information about the shipping company's ability to generate cash flow from operations, it also identifies the trends in cash flow components and cash consequences for investment and financing decisions. The top shipping management uses it to make decisions regarding such critical areas as financial policy (leverage), dividend policy, and investment for growth. It is important to say that neither the statement of cash flows nor the income statement alone contain sufficient information for the decision making in shipping. Therefore, the income statement as well as the balance sheet must be combined with the cash flow in order get the real financial scenario in shipping companies and thereby assist the financial management in the development of other measures relevant for evaluation.

2.4 The footnotes to the financial statements and the relation with them

Normally all the amounts which are stated in the financial statements are supported by the footnotes and other disclosures. In the shipping industry the footnotes are extremely important because they are an integral part of the financial statements. Therefore, they provide data on such subjects as business segments, and the financial position of off-balance sheet obligations etc. GAAP, the Financial Accounting Standards Board (FASB) or other regulatory authorities require these data. Together with the financial statements and the footnotes some supplementary schedules are required. Those schedules provide additional useful information, which help a lot in the interpretation of the financial statements. Some of these supplementary data are un-audited.

2.4.1 Footnotes to the financial statements in shipping companies

Footnotes give a better picture of the financial statements of shipping companies. They provide information about the accounting methods, assumptions, and estimates used by the top shipping management to develop the data reported in the financial statements. They are designed to allow the user to improve his assessment of the amount, timing, and uncertainty of the estimates reported in the financial statements.

Footnotes provide additional disclosure related to such areas as:

- Fixed Assets (ships)
- Inventories (spare parts)
- Income taxes (tonnage tax)
- Debt (Mortgage or Collateral)
- Lawsuits and other law contingencies (Limitation of liabilities)
- Marketable securities and other investment
- Significant customer related party's transactions, etc.

Footnotes often contain disclosures relating to contingent losses e.g. maritime liens, etc. Firms are required to accrue a loss (recognise a balance sheet liability) when both of the following conditions are met:

1-It is probable that the assets have been impaired or a liability has been incurred.

2-The amount of the loss can be reasonably estimated.

If the amount of loss lies within a range, the most likely amount should be shown have accrued. When no amount in the range is a better estimate than any other, the firm may report the minimum amount in the range. The Statement of Financial Accounting Concept No.5 (SFAS), defines probable event as those "more likely than not" to occur, suggesting that a probability of more than 50% requires recognition of a loss. However, in practice, firms generally report contingencies as losses only when the probability of loss is significantly higher.

Footnotes of (unrecognised) loss contingencies are required when it is reasonably possible (more than remote but less than probable) that a loss has been incurred or when it is probable that a loss has occurred but the amount cannot be reasonably estimated. The standards provide an extensive discussion of loss contingencies. (White G.I. 1997).

CHAPTER 3

THE FINANCIAL REPORTING AND THE RECOMMENDATION LETTER IN SHIPPING COMPANIES.

3.1 The financial reporting and the audit opinion

3.1.1 Financial reporting

The objectives of financial reporting vary in different countries. This reflects the importance given to the various parties who have an interest in accounting information. These are themselves the result of different business environments, in particular the significance of various sources of finance, and of more general differences in social attitudes.

The main distinction that can be made is between those nations where reporting the results and position of the particular business unit is the most important objective, a microeconomic approach, and those where providing information in conformity with rules is the principal aim, a macroeconomic basis. Ireland, the Netherlands and the UK naturally fall into the first class while France and Germany are part of the second. As with all such classifications, there is no rigid dividing line between the two groups and even within one group there are important differences in approach.

The microeconomic approach has generally developed on the basis of considering the shareholder as the most important party entitled to receive financial information. This approach has arisen where business has obtained a substantial proportion of their funds from investors and the business is divorced from ownership. Investors require regular reports to assess the performance achieved by management and the future prospects. Annual accounts ensure that the stewardship function is being exercised properly. Analysts are concerned about comparability between businesses, but the position and development of each individual company is of more importance.

The macroeconomic approach arises where uniformity is necessary as the annual accounts are provided largely for the tax authorities and other government bodies interested in national economic planning. The assessment of tax liabilities must be based on standard rules regarding the recognition of income, deduction of expenses and valuation of assets. In this way, all businesses are subject to tax on the same basis. In Germany, Greece, Italy and Luxembourg and to a lesser extent in Belgium and France also, annual accounts have been used to measure taxable profits. The provisions of tax law, therefore, have had a significant influence on financial reporting. In other countries, particularly Ireland, the Netherlands and the UK, tax liabilities are based on calculations quite separate from the financial accounts. The various rules that determine taxable income have had only limited impact on the policies adopted and disclosures made in the annual accounts in these countries.

Where annual accounts are used to compile national statistics, this also creates a requirement for uniformity. Governments in certain countries, such as Belgium and France, seek to plan in some detail the development of the national economy. They base decisions on information derived from annual accounts. Such figures are only reliable if they have been compiled on a uniform basis. The law, therefore, prescribes in detail the method to be applied and the analyses to be given.

The macroeconomic approach arises where businesses have largely been run by their owners and external finance has been provided in the form of loans from banks or other credit institutions. Shareholders do not need to be supplied with accounts on an annual basis as they have direct knowledge of the activities of the business. As providers of capital, the banks are principally concerned with security. In so far as they are interested in financial reporting, a conservative approach to asset valuation and provision for potential losses is favoured, since this reduces certain risks for the banks.

3.1.2 Conformity with professional standards in USA

In the USA the reports should conform to professional standards prescribed by the American Institute of Certified Public Accountants (AICPA). Staff members are expected to be fully informed on these standards. All requirements of professional standards are not repeated.

Reports on financial statements should express an opinion on the fairness of presentation, report on the review or compilation of the financial information statements or disclaim an opinion and the reasons for not expressing an opinion. Disclaimers, however, are restricted to instances where the auditor has not performed an examination sufficient in scope to be able to form an opinion on the financial statements and, under certain rare circumstances, to cases involving substantial doubt about the entity's ability to continue as a going concern.

3.1.3 Tax considerations in reports

In the preparation reports containing additional information, management reports, reports to audit committees or other reports, the external auditors should be careful how they word matters with tax connotations; careless wording, which does not accurately describe the facts may have unfortunate repercussions on a company's tax situation.

3.1.4 Tax considerations in shipping companies' reports

In recent years many countries have adopted the tonnage tax regime, which allows shipping companies to pay taxes based on the tonnage of each vessel and exempts the net income obtained from normal operations of the company from taxation. This system has been introduced in recent years in countries such as Greece, Germany, Norway and Denmark.

3.1.5 Taxation of dividends in shipping companies

In a tonnage tax system, apart from dividends, the taxation of which normally depends on the tax and residence status of individual shareholders, shipping companies' profits will not be taxed in any other jurisdiction. Nevertheless, the dividends obtained by a shareholder or shipowner are subject to taxation.

Example of the tax assessment under a tonnage tax regime.

The "assumed profit" is calculated as follows:

Table 1

For the first 1,000 net tonnage	**\$1,80 per 100 net tons/ per day**
For the exceeding tonnage up to 10,000 net tons	\$1,35 per 100 net tons/ per day
For the exceeding tonnage from 10,000 up to 25,000 net tons	\$0,90 per 100 net tons/ per day
For every 100 net tons exceeding 25,000 net tons	\$0,45 per 100 net tons/ per day

Source: German Shipowners' Association

Based on the above scale the assumed profit for a vessel with 1,000 net tons will amount to \$ 6,570. The Assumed annual profit of a vessel with 10,000 net tons will be equivalent to \$ 50,917,50. For a vessel with 20,000 net tons the assumed annual profit amounts to \$ 80,482.50. The net tonnage of a containership with a capacity of 1,000 TEU would result in an assumed annual profit of approximately \$ 26,000. Any capital gain resulting from the sale of a vessel is covered under the above method of profit assessment. The assumed profits computed on the above basis will be taxed in accordance with the applicable rate. Any income resulting from bareboat charter will be taxed like any other income accrued from leasing or letting out; i.e. it does not fall under the tonnage tax regime. (German Shipowner Asociation, Rathjen, H. H. 2000)

3.1.6 The audit opinion in shipping companies

The auditor (independent certified public accountant) is responsible for seeing that the issued financial statements conform to generally accepted accounting principles. Therefore, the auditor must agree that the management's choice of accounting principles is appropriate and any estimates are reasonable. The auditor also examines the company's accounting and internal control systems, confirms assets and liabilities, and generally tries to be sure that there are no material errors in the financial statements. The auditor may express three types of opinions on audited financial statements:

a) Unqualified opinion
b) Qualified opinion
c) Adverse opinion
d) The auditor may also issue a disclaimer opinion or not to express an opinion, which is an alternative.

Additionally, certain circumstances, while not affecting the auditor's unqualified opinion on the financial statements, may require that an explanatory paragraph or other explanatory wording be added to the report.

Circumstances which may require a departure from the standard report relate to

1) Limitation of the scope of audits
2) Part of the audit performed by other auditors
3) Departure from generally accepted accounting principles, including adequacy of disclosure.
4) Accounting principles not consistently applied.
5) "Going concern" consideration.

6) Other circumstance identified by the auditor.

The Statement on Auditing Standard and the statement on Standard for Attestation engagements as well as the wording of the report on the firm should, in general, be uniform. It is of course, not practicable in all cases to adhere completely to the wording and the deviations should be supported by valid reasons.

3.2 Different kinds of audit opinion

As we expressed before, the statements are fairly presented in conformity with the General Accepted Accounting Principle (GAAP). The introductory paragraph identifies the statements being audited and defines responsibilities. The scope paragraph describes the nature of the audit and the opinion paragraph gives the auditor's opinion as to fairness. As we mentioned before, opinions could be Qualified, Unqualified, Adverse or Disclaimer. Audited financial statements are always accompanied by the auditor's report, which is normally referred to as an opinion. Failure to read this report, however, may cause the financial analyst to miss significant information.

3.2.1 Unqualified Opinion

In a situation where no qualifications or exceptions are to be taken either with respect to scope or accounting, the external auditor continues to issue an unqualified opinion, stating that the company has registered its data without any material mistake which could affect any decision to be taken.

In some cases the auditor may explain matters concerning the auditing procedures in a separate paragraph of his report and express an unqualified opinion on the fairness of presentation without any additional reference to the scope of the audit. (Price WaterhouseCoopers, 1999)

The following is an example of an Unqualified Opinion:

To the Board of Director and
Shareholders of X company.

"In our opinion, the accompanying consolidated balance sheet(s) and the related consolidated statement for income and retained earnings and of cash flows present fairly, in all material respects, the financial position of X Company and its subsidiaries at December 31, 19X2 and 19X1, and the result of their operations and their cash flows for each of the three years in the period ended December 31, 19X2, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosure in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above. (Price WaterhouseCooper, 1999).

3.2.2 Qualified Opinion

Qualified opinions should be issued when there is a lack of sufficient competent evidential matter or there are restrictions on the scope of the audit, which have led the auditor to conclude that he cannot express an unqualified opinion and the auditor has concluded not to disclaim an opinion. Another situation is when the external auditor believes, on the basis of the audit, that the financial statements contain a departure from generally accepted accounting principles, the effect of which is material, but the auditor has concluded not to express an adverse opinion.

An auditor expressing a qualified opinion should disclose all of the substantive reasons in one or more separate explanatory paragraphs preceding the opinion paragraph of the report.

3.2.3 Adverse Opinion

An adverse opinion on the financial statements taken as whole may be expressed only when the auditor has completed his audit in accordance with generally accepted auditing standards and he has concluded that the financial statements do not present fairly the financial position or result of operations or cash flow in conformity with generally accepted accounting principles.

3.2.4. Disclaimer of Opinion

When a scope limitation exists, a disclaimer of opinion may be necessary. However, if such a conclusion is reached, the report should also disclose any other reservations the auditor has regarding fair presentation in conformity with generally accepted accounting principles.

CHAPTER 4

FINANCIAL RATIOS AND THE PROCESS OF DECISION MAKING IN SHIPPING COMPANIES.

4.1 The financial ratios

Financial ratios are the figures the companies and third parties use in order to know and compare the risk and return of any other companies. The investor and creditors make intelligent decisions based on the financial ratios. A primary advantage of ratios is that they can be used to compare the risk and return relationship of firms of different sizes. A common analysis of financial ratios can provide the economic characteristics and competitive strategies of a company, and its unique operating, financial, and investment characteristics.

4.1.1 Most used financial ratios in the shipping industry

As we have said before shipping activities demand at every moment large amounts of money. Therefore, in order to obtain these resources the shipping companies normally are analysed by the provider of funding. The main ratios that creditors and investors commonly look at in the shipping business are:

$$\textbf{Current Ratio} = \frac{\text{Current assets}}{\text{Current Liabities.}}$$

$$\textbf{Quick Ratio} = \frac{\text{Cash+Marketable Securities+Accounts Receivable.}}{\text{Current Liabilities}}$$

$$\textbf{Cash Ratio} = \frac{\text{Cash + Marketable Securities}}{\text{Current Liabilities}}$$

$$\textbf{Debt to Total Capital} = \frac{\text{Total Debt (Current+Long Term)}}{\text{Total Capital (Debt+Equity)}}$$

$$\textbf{Capital Expenditure Ratio} = \frac{\text{Cash from Operation}}{\text{Capital Expenditures}}$$

4.1.2 The importance of the financial ratios in the decision making process in shipping companies

In the shipping industry, as in other companies the objective of the financial analysis is to evaluate the performance of the company in function of its strategies and objectives. In the financial analysis of shipping there are two main tools: The analysis of the financial ratios and the cash flow analysis.

The analysis of the financial ratios attempts to evaluate the relationship of different items of the financial statements of a shipping company.

The analysis of the financial ratios is extremely useful in the credit evaluation for the financial forecasting, and the analysis for fusion, merger or acquisition of another business. In all these contexts, the analysis of the financial ratios constitutes a key factor to execute a reliable prediction of the future perspectives of a company.

In the analysis of ratios, the analyst can compare the ratios of a shipping company which correspond to several years, to compare the ratios of the company with those of other companies of the same segment of the industry and compare them having some absolute point of reference, eg. the tanker market, liner shipping etc.

Additionally, the shipping financial analysts very often use the financial ratios to carry out analysis of tendencies that consist at present of two types of comparison. Secondly, the analyst can compare a current ratio with the previous ratio and others that are expected for the near future of the same company.

Because the presented financial information and the ratios calculated through them are numeric, They tend to be considered as exact representations of the true financial situation, resulting from the operation and cash flows of a company. For some shipping companies, the financial information can be very approximate to the economic reality; for others, it is necessary to go beyond the shown quantities with the purpose of calculating in an appropriate form its financial situation.

In the shipping industry analysts regularly tend to group the financial ratios in four groups: Liquidity ratios, Debt ratio, ratios of profitability and covering ratios.

None of the financial ratios provides enough information to be able to judge the financial condition and the performance of a company. Only when the financial ratios are analysed and classified in groups is this possible. It is necessary in the shipping industry to take into consideration seasonal freight variations. The fundamental tendencies should be evaluated through the comparison of the gross quantities and the ratios in the same part of the year; a balance sheet issued at December 31 should not be compared with a balance sheet issued at May 31.

4.2 Who are the decision makers in the shipping business?

At first sight it might appear that the key decision maker is the shipowner, but this is a misleading, narrow view. In reality, a whole network of decision makers controls the growth of shipping capacity and in the last thirty years the shipowner has been fairly low down on the list, as the following brief analysis suggests.

1) Shipowner: places the order for the ship. However, his ability to do so depends largely on the availability of finance and shipbuilding capacity.

2) Shippers: control cargo and have a direct influence on investment through issuing "bankable" long term charters which can be used by owners as cash flow collateral. Their chartering policy plays a crucial part in investment planning and it is interesting to contrast the current unwillingness to make long term commitments with their willingness to do so in the early 1970's.

3) Bankers: control the flow of debt finance into the shipping industry. The willingness to lend, the rate of advances available and the amount of risk they are prepared to accept have a major impact on the investment in new ships.

4) Shipbuilders: control the volume of shipyard capacity, and the rate at which orders are taken. Shipyard capacity is not particularly flexible because facilities take several years to build and nowadays adjusting the personnel level is a slow and painful exercise.

5) Governments: provide shipbuilder credit and may be active in controlling domestic shipping and shipbuilding capacity.

6) Regulatory Authorities: have an increasing impact on shipping through safety and environmental control, which impact on tecnical obsolescence.

The common feature of all these decision makers, with the exception of the independent shipowner, is that they are corporate or bureaucracies for whom shipping is a small part of a much larger organisation.

The root of the problem is that in reality many needs in this sector are controlled by decision makers remote from the marketplace. These decision maker banks, shipbuilders and shippers, probably do not see it as their responsibility to plan according to the needs of the shipping industry. Even if they do, the corporate decision making process makes it difficult for their planning to divert significantly from the crude market consensus and take a different tack when this is required.(Stopford,M 1990. Page 41)

4.3 The process of decision making in shipping companies based on the financial information

Decision making is a big word, so to discuss this topic and address the shipping industry it is better to separate the following purposes of the decision:

1) Ship financing
2) Mergers
3) Outsourcing

4.4 Financial Management in shipping companies

The role of financial management has been changing a lot, the responsibilities that lay in the job of a financial manager are now vital for the companies whole existence to raise and allocate financial capital.

A proper financial management system allows managers to put the resources to use in an efficient way, control their uses and ensure availability of funds when needed. In addition the role of financial management it to provide appropriate information for decision making. Companies will always have the problem of how to raise the financing and to identify the sources of finance to carry out their goals when you deal with a profit in a business such as shipping. Consideration must be given to the competing uses immediate requirements, profit prospects and financial and overall management plans.

The following discussion on sources of finance, management of risk credit control, income, cost, cash flow and cash management can help the management of shipping companies.

The cash flow in the recent years of the shipping market has gone through booms and depressions in the freight markets. Since profits are easily made in booms they are not a big deal. With a robust cash flow the enterprise can decide to expand through the procurement of additional ships, replacement of old ships and maintenance of the existing ships.

Cash-Flow represents the difference between cash receipts and cash payments in the accounting period. In practice, the shipping market operates by using cash flow pressures of the type described above to force shipowners to make the necessary decisions to bring the market into balance. Cash flow is therefore a criterion for survival in the shipping market and it can be determined by the revenue received from operations.

Income from operations: For any shipping company to be viable, revenue must be assured. It involves squeezing the maximun revenue out of the operation. Revenue is generated from the freight charge collected for a voyage.

The shipping activity is one of the markets with a large range of revenues due to the fact that almost 75% of the world cargo is carried by sea. Revenues can be obtained by long time charter or in the spot market and can be increased by careful management and flexible ship design.

Cost: This is vital in shipping. Why? Because in today's business it does not matter how much revenues you are getting, if you do not control the cost. During periods of low freight rates, many shipping companies have slashed their budgets in an attempt to maintain their profitability level.

4.5 Main sources of finance in shipping

Apart from the individual shareholders, there are potential sources of financing for the purchases of ships which have not changed over the past five to seven years. Among the most important sources of finance are:

a) Bank borrowings
b) Equity Investments
c) Leasing

4.5.1 Banks

Banks play an important role in the shipping business, the activities of which can obtain large amount of money from them. There are currently over one hundred institutions world wide providing bank finance. The beginning of the 1970's was considered the leading shipping boom. However, many banks, due to the asset based approch to lending, made losses in financing the shipping bussines. Commercial banks are now more guarded in their approach to shipowners. In the early 1990's, banks restored their capital base following a deterioration of balance sheets, lower quality assets and diminishing earnings in the late 1980's. More importantly, new Capital Adequacy Rules were introduced in January 1993 under the auspices of the Bank International Settlements, effectively restricting the extent to which banks could expand their risk taking activities.

4.5.2 Equity Investment

Equity investments can be seen to form two different aspects, external or internal. The latter one is obtained from the normal operation of the company, eg. profit from prior periods, earnings, sales of assets, accumulated depreciation or other reserves. In the past, internal sources have played a dominant role in the capital structure in existing shipping enterprises.

External funds are in the form of issuing shares on the stock exchange, limited liability or ship fund shares. The stock exchange may offer the all-important source of new equity to shipping companies. This source has been neglected, mainly because of shipowner 's reluctance to disclose publicly information about their company and the project, their desire to be sole owners of the company, and because of the volatile freight market rates.

4.5.3 Leasing Financing

This rental system is designed to facilitate the amortisation of the capital cost of the equipment to the owner and earn a return representing a financing charge on the initial cost. Leasing can be considered as "off balance sheet" financing. There are two principal types of leasing arrangements- the financial lease and the operating lease. Under the terms of a financial lease substantially all the risks and rewards of ownership of the asset are transferred from the lessor to the lessee**.** In contrast, the equipment something still mining at various periods for differing lengths of time during the life of the equipment. Leasing arrangement structures can be very complex, with such variants as leveraged leases and cross-border financing leases, for example, but they often have the advantage of being very tax efficient (Mottram, D. 1999)

4.5.4 Risk Management techniques

In the shipping industry today, there is a need for all shipping companies to develop a risk management system, and for the managers of the company to address risk identification and assessing techniques.

Financial risk management can be accomplished by using on-balance sheet transactions. For example, a company can manage a foreign exchange exposure resulting from foreign competition by borrowing in the competitions' currency or by moving their office abroad. But such on-balance methods can be costly.

Financial risk can be also managed with the use of off-balance sheet instruments or derivatives. The use of these instruments by shipowners to hedge, or manage risk has been limited. In the past, interest rate risk management has been considered a zero sum game by many given that the cost and revenues of many companies are denominated in US dollars, the demand for currency based derivatives has naturally been limited.

The idea of a hedge is to reduce physical contractual exposure by purchasing an appropriate paper contract or derivative such that a rise in one contract would be offset by a fall in the other, thus fixing the cost of the physical contract that is hedged. (Mustapha; A 1997).

4.5.5 The uses of the financial statement in ship finance

The financial statements are regularly used in the process of acquisition of assets by the following entities that can intervene in this process:

a) The institutions that facilitate the resources to finance the acquisitions of the assets
b) The supplier of the ship or shipyards.

c) The entities that are going to acquire the ship.

Among the institutions that will finance the acquisition of the assets, we can mention the commercial banks, cash providers and leasing institutions. It is very important for these institutions to use the financial statements of the entities that will carry out the acquisition or leasing of the ship. The main purpose of this is the interpretation and the financial analysis of any company. This analysis will be the initial base, which will provide information about the ability of the shipping company to generate necessary cash in order to pay back the present and future commitments, since the most important thing for these entities is that the shipping company acquirer can generate sufficient cash in order to pay the debt.

In addition, the financial statements can provide information to the financial institutions and shipyard about the structure of the company, the shareholders, as well as the debt capacity. Finally, they can be used to identify inherent risk associated with the industry. The same financial statements can give information, if the assets that will be acquired are going to be used in a segment of the existing business or if these are going to be used in a new unit of the company. In such a situation the financial statements can be analysed by business segment.

4.6 Mergers in the shipping industry

We are living in a time of dynamic global growth and development. Nothing is as closely connected with the liberalisation and globalisation of world trade as the shipping industry and all its markets. World trade has almost consistently outpaced world Gross Domestic Product (GDP) growth on account of the globalisation of trade, and because of increasing liberalisation of trade on the one hand and significant reduction in the cost of transportation on the other. As the trend in globalisation in going to continue, shipping companies have to be big enough in order to meet customers requirements with respect to service coverage and shipping cost. In 20 to 30 years time no more than 10 top operators in each market are expected to control 85% of the business. Therefore, shipping companies have to either make alliances or merge. (Maersk Sealand, 2000).

Economic globalisation is now affecting the transport and logistic industries in a more profound manner, particularly as importers/ exporters seek multi-trade deals with their service providers, in order to make more efficient the processes of delivering and selling of goods.

4.6.1 Types of mergers

For our concern mergers, alliances, joint ventures and acquisitions will be treated as synonyms, although the term merger is often restricted to big corporate combinations. Three types of mergers can be identified:

1) Horizontal
2) Vertical
3) Conglomerate.

4.6.1.1 Horizontal merger

Combining the assets of two shipping companies, which are engaged in a similar line of activity. Liner shipping provides examples of such horizontal mergers. Economies of scale in production, research and management are often cited as the underlying motives for this type of merger. Nevertheless the upgrade of the shipping market power, appears to have been a primary motive for many horizontal mergers in the past.

4.6.1.2 Vertical merger

A vertical merger is one in which a firm acquires the sources of its supply of raw material, or other input of the productive process, or alternatively, acquires control over sale outlets for its products or services. Essentially, such a combination represents the replacement of part of the market allocation mechanism by internal organisation and control within the company. This kind of merger raises questions about the possible building of market power and restriction of complexion.

4.6.1.3 Conglomerate mergers

This kind of combination is done when companies whose economic activities are relatively unrelated are combined. Such mergers often appear to spread the risk, rather than aim at the achievement economic of scale. Normally these types of mergers create a new type of company, e.g. Multimodal Transport Operator (MTO).

4.6.2 Trend in mergers

While economies of scale played a role, monopolisation and promoters' profit were the prime movers behind many of the most famous and largest mergers. In many ways this was the most important of the merger movements. Although many of the mergers of this period have been of the conglomerate type, it also marks the reappearance of horizontal and vertical mergers. Two changes in government policy have sparked the latest increase in merger activity. The removal, in 1982 of the anti-trust rule against vertical mergers and the deregulation for specific industries, for example the deregulation of the banking, transportation and communication industries, has permitted the combination of assets of those industries.(Levy, H.1990 page 617)

4.6.3 Motives for mergers

Several reasons for looking for a merger are often in the financial field; these include desire to grow, integration of production process, acquisition of marketing facilities, and so on. At simple sight these objectives are achievable via the alternative route of internal expansion. The motivation for a merger can be divided into four major categories for financial management purposes:

Table. 2 Merger Motives.

Efficiency	**Managerial efficiency** -Acquire more efficient management -Replace inefficient management **Operating Synergy** -Scale economies -Cost minimisation -Acquire technical know-how -Exploitation of markets -Reduction of risk -Improved liquidity **Financial Synergy** **-**Reduction of debt cost -Increase in debt capacity **Market power**
Managerial	**Agency considerations** -Managerial risk diversification -Executive compensation -Power size and growth
Target undervaluation	**Better analysis -**insider information
Tax consideration.	**Loss carryovers** **-**Dividends vs. acquisition

4.6.4 Uses of financial statement accounting techniques, in mergers in the shipping industry

As mergers became a fashion in the shipping industry in late 90's, as is so often the case in finance, mergers also have some implications for the firm's accounting staff. Generally speaking there are two alternative accounting treatments which can be used. The combination of the two shipping business organisations can be handled as a pooling of interests or as a purchase.

In the first case, any payment beyond the tangible book value of the acquired firm must be shown as goodwill in the balance sheet and written off over a reasonable period of time. Since the depreciation of goodwill is not deductible for tax purposes, future net income will be reduced as the goodwill is amortised, which constitutes perhaps an economic disadvantage of this type of treatment. On the other hand, this disadvantage can be avoided by combining the balance sheets of the two organisations, assets and liabilities are simply combined together, (e.g. Maersk Sealand). In this approach neither goodwill, nor charges against future income are created. Unfortunately, this type of accounting has led to some abuse, called "dirty pooling" by overvaluation of asset values at the time of merger. As a result, in many jurisdictions this kind of merger has been restricted to companies of the same size in which, most of the time, both managements continue to function in the merged companies, e.g. P&O Nedlloyd.

Shipping is part of a global logistic chain; to survive, these business companies require strong management and professional staff teams. For example, the sale of the North Sea line was due to its continuing poor financial result and trading conditions. The key element to the strategy is improving the basic service to the customer at lower unit cost to the operator. To achive this a shipping company has to have reliable information at every moment. Therefore, financial statements constitute important tools to know at every time the performance of the company.

During the processes of mergers and acquisitions the uses of the financial statements play important role. The companies involved use the financial statements as their main tools in a process called "Due diligence" which is one of the initial steps when shipping companies merge.

With the simple analysis of the financial statements, which method normally is called "Tiger", the shipping companies will easily identify matters of big interest.

- The amount of intangibles assets
- The capacity of the entity to generate revenues and pay back its liabilities and debt
- Capital structure of the company
- Operational result in the last years, months, by market , by sector, etc.
- Loss contingencies, if these are probable or less probable
- Litigation and other legal problems
- Accounting practices in order to alter the figures or numbers in the financial statements
- The quality of the assets which form the company's structure
- Level of indebtedness of the company
- Method of acquisition of shareholders capital.
- Operational cash flow and financial investments.

Conjugating and analysing the factors mentioned above the analyst can reach a conclusion about the feasibility or viability that an entity can be merged or acquired.

4.7 Outsourcing in the shipping business

4.7.1 Outsourcing

Outsourcing is the strategic use of outside resources to perform activities traditionally handled by internal staff and resources. Outsourcing is a management strategy by which an organisation buys major, non-core functions from specialised, and efficient service providers.

Companies have always hired special contractors for particular types of work, or to level off peaks and valleys in their workload. They have always partnered-formed long-term relationships with firms whose capabilities complement their own. Companies have always contracted for shared access to resources that were beyond their individual reach-whether it be buildings, technology or people. But the difference between simply subcontracting and outsourcing is that outsourcing involves the wholesale restructuring of the corporation around core competencies and outside relationships.
http://www.outsourcing.com/profiles/ey/index.htm

4.7.2 What can be outsourced within the shipping industry?

For a shipping company that requires high level distribution or transportation, outsourcing these functions can show an immediate and dramatic return on investment. Depending on the size of the company there can be areas, which can be outsouced by any shipping company:

- Freight audit
- Consulting and training
- Freight brokering
- Leasing
- Warehousing
- Distribution and logistics
- Information systems
- Operations and Fleet operations
- Rail and road transportation
- Fleet management
- Fleet maintenance

The outsourcing offers significant benefits to shippers, carriers and advisors within the shipping marketplace. It allows managers from the industry to concentrate on their core business. For example, shipping service providers will be better able to anticipate market place demand for various services and better allocate resources and infrastructure based on current and projected demand.

4.7.3 Why and how shipping companies should make decisions when outsourcing?

For any shipping business to benefit from outsourcing, the initiative should come from the top shipping management. Only the top-level executives have the power to define the vision and implement the changes that are necessary for outsourcing to succeed. As you develop a strategy, consider the following:

Clarify organisational goals in relation to outsourcing and also identify areas to outsource. Define core competencies of the organisation and the functions of the business that are not core. An organisation should outsource its non-core functions so that in can focus on its core competencies. Having identified non-core functions, gather facts and figures to determine where you will get the quickest and best return on investment. To determine the return on investment, analyse current return compared to what an outside vendor may offer.

Develop a long-term strategy. If a shipping company is outsourcing a function that already exists, remember that employee support and morale will be critical. Job retention should be a major feature of your strategy. In some relationships, the new vendor hires workers. From the beginning, communicate honestly and openly with employees about how their needs will be met.

People inside and outside of the shipping business provide more detailed information and advice. This is a research phase in which you learn about your own specific needs, and find out which qualified vendors will be best to meet those needs.

To find out more about the shipping needs, research the needs within the organisation, and learn from other shipping companies who have outsourced the same kind of function. Plan to visit these companies to find out what their experience has been. Form a team of people to help you ask the right questions and analyse the information the company gathers. The shipping company may need team members with expertise in the following areas:

Legal
Human resources
Finance
Procurement
Logistic.

http://www.outsourcing.com/profiles/ey/index.htm

To make the right choice, be sure the vendor demonstrates a clear understanding of your needs and ability to solve your problems, financial stability, cultural fit and proven track record. Shipping companies should take into account that shipping is a very special business, which is totally regulated. Therefore, when shipping companies select other companies to outsource any services all such regulations and conventions should be taken into consideration, e.g. Solas, Marpol, STCW etc.

Decide in advance how the company is going to manage the relationship. Create a system that allows you ways to:

Monitor and evaluate performance
Identify and communicate issues early
Resolve issues quickly and fairly

Help people in your organisation adapt to a new way of doing things.

It is critical, that in the shipping business the company understands the market reasons for considering outsourcing and the benefits the company seeks. A list of examples of reasons to outsource and the related benefits sought are summarised as follows:

Organisationally Driven

Enhance effectiveness by focusing on what the shipping company does best

Increase flexibility to meet changing business conditions, demand for products/services, and technologies

Transform the organisation

Increase products/services, customer satisfaction and shareholder value

Improvement Driven

Improve operating performance

Obtain expertise, skills and technologies, which would not otherwise be available.

Improve management and control

Improve risk management

Receive innovative ideas for improving the business, products, services, etc.

Improve credibility and image by associating with superior providers

Financially Driven

Reduce investments in assets freeing up these resources for other purposes.

Generate cash by transferring assets to the provider

Revenue Driven

Gain market access and business opportunities through the provider’s network.

Accelerate expansion by tapping into the provider's developed capacity, processes and systems.

Expand sales and production capacity during periods when such expansion could not be financed.

Commercially exploit the existing skills.

Cost Driven

Reduce costs through superior provider performance and the provider’s lower cost structure.

4.7.4 Maritime Logistics

The maritime logistics form a key-component of international logistics Without maritime transport, the major international seaborne trade flows would be physically impossible and world trade and the world economy would look quite different from what we see today.

The management of the flow of goods and information can also be considered as enabling the corporate management to provide a profitable level of distribution services to customers trough the effective planning, organising and controlling of activities that facilitate production flow. (Wergeland, Tor, page 496).

CHAPTER 5

CONCLUSION

The financial statements can be described by a simple definition as the presentation of all financial data of a year or the history of the company. Therefore, the financial statements give to the readers a better picture of the real situation at a specific moment.

As we can see, the three financial statements have their purpose in common and all of them are closely related. The advantages that the financial statements can offer to investors and other decision-makers are tangible. Financial statements give important information in terms of the company, the reports clarify doubts, notes to the financial statements provide a clear understanding of the figures and numbers, the audit report can alert a decision maker about future problems.

Readers are cautioned not to place undue reliance on forward-looking information because it is possible that predictions, forecasts, projections and other forms of forward –looking information will not be achieved by a shipping company. By its nature the forward-looking information of many shipping companies involves numerous assumptions, inherent risks and uncertainties, including, but not limited to, the following factors: changes in business strategies; general global and economic and business conditions; the availability and price of energy commodities; the effects of competition and pricing pressures; industry over-capacity; shifts in market demands, changes in laws and regulations including environmental and regulatory laws; potential increases in maintenance and operating costs; uncertainties of litigation; labour disputes; timing of completion of capital or maintenance projects; currency and interest rate fluctuations; various events which could disrupt operations including severe weather conditions.(CP Ships, annual report).

As observed in chapter number two, the financial statements sometimes present difficulties and limitations.

-Important assets and liabilities may be omitted.
-Some assets and liabilities are carried at historical cost and others at market value.
-Financial statements always have to be compared at the same date or for the same period of time.

Nevertheless the financial statements constitute one of the most important tools in today's financial analysis.

In chapters number one and two it was pointed how the balance sheet, income statement and cash flow allow the top shipping management to make decisions on how to reduce cost and how to improve the cash flow management.

The financial reports issued by the external auditor help the readers to understand and analyse the company's performance. The financial analyst as well the investor may use these reports issued by the external auditor in order to make future financial decisions.

Financial ratios are among the most useful figures obtained from the financial statement. Many ratios used in the shipping companies help to make a better decision at any given moment. It was concluded in chapter number four that in the shipping process it is more than important to observe the financial ratios, taking into consideration that shipping is very capital intensive and needs at every time large amounts of money.

When shipping companies acquire a ship, if we build the process of decision making as Martin Stopford did, then the financial statements are very important and it can be said that they have an internal and external role. Banks as well as other cash providers take into consideration the financial statements in order to evaluate the companies' performance over the recent years. Financial ratios like liquidity, working capital, gearing etc. are analysed by those external decision-makers in the shipping industry.

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