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FINANCIAL ACCOUNTING

International Financial Reporting Standards

ELEVENTH EDITION



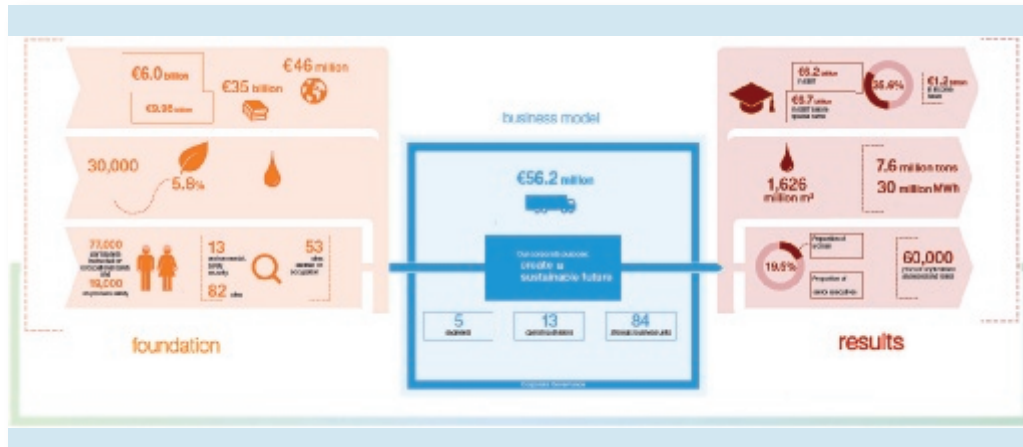
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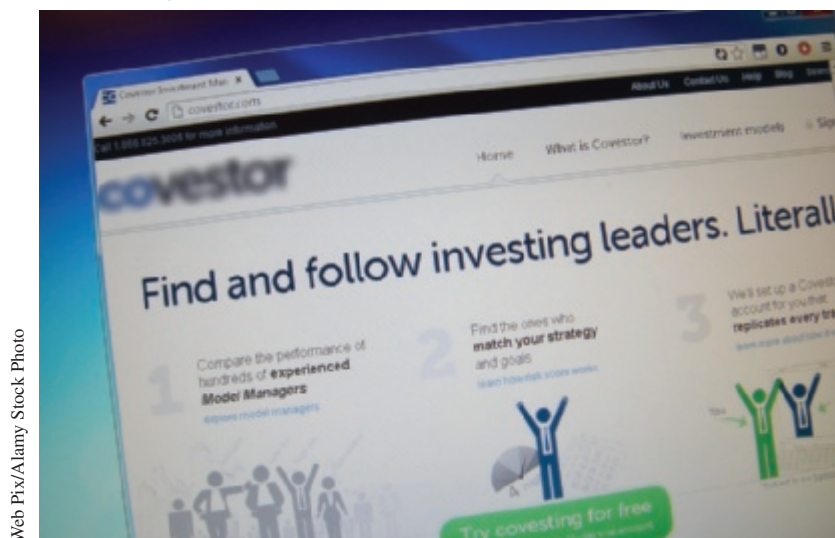
reports of any public companies online. With search engines such as Google or Bing, it is usually easy to find the websites of the companies you are interested in. Many companies have now developed “web versions” of their annual report, which allows for better navigation, use of digital media, and interactivity.

Note that some businesses separate their “corporate website” from their “consumer website.” The corporate website is where you will find company and financial information pertinent to you, the investor or potential investor, whereas the consumer website is where the company showcases its product and services offerings to the consumer. With many websites now making use of location-based data, sometimes you may be redirected to your local, country, or region consumer website by default. You will have to specifically navigate to the company’s corporate website in order to obtain financial statements. For example, for Sony Corporation, if you go to www.sony.com, you will arrive at the consumer side (either a global or local site, depending on your physical location), whereas www.sony.net will direct you to Sony’s corporate website.

Many companies are now dedicating more resources to connect with their shareholders through a specific section of their websites, typically labeled “Investors” or “Investor Relations” (see Exhibit 4-2).



Exhibit 4-2 | An Investor Relations Landing Page

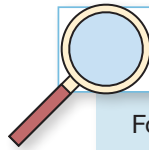


Web Pix/Alamy Stock Photo

For example, BASF's "investor relations" page offers investors company information, financial news and reports, a calendar of events, and other share holder-related information. You can read its financial reports online, even build your own charts, and download financial statements in spreadsheet formats. We will refer to various parts of BASF's 2015 annual report in this chapter, so it may be worth your while to download a copy of the report as you read this chapter.



In countries where the securities authority has a reporting repository, you can go to one common place to obtain all information about all companies trading in the country. The biggest such repository is that of the United States' Securities and Exchange Commission (SEC) at www.sec.gov/edgar.shtml. You can even download financial statements in XBRL (eXtensible Business Reporting Language) or spreadsheet formats.



A Closer Look

For SEC registrants, financial filings are referred to by their form numbers. For example, "Form 10-K" and "Form 10-Q" refer to annual and quarter filings, respectively. There are many others, such as:

- Form 1 for the offering of securities, typically for initial public offerings or additional securities issuances
- Form 4 for material changes in the holding of company securities by "insiders" (major shareholders, company executives)
- Form 8-K for important material events or corporate changes of high importance such as major asset acquisition or disposal, appointment or resignation of directors, etc.
- Form S-4 for important events related to mergers and acquisitions.

While these forms contain significant financial information, they are highly structured and largely dictated by the SEC's regulatory requirements. They are quite different from the typical annual reports that you will see in other parts of the world. Many U.S. companies produce annual reports in addition to their regulatory filings.

As filing requirements may differ from one country to another, your instructor may direct you to specific issues related to corporate reporting in your jurisdiction.

Typical Structure of an Annual Report

For some companies, the primary purpose of an annual report is to meet legal requirements. Consequently, they only focus on compliance and do not invest much in corporate reporting. Small private companies' annual reports, for example, primarily consist of financial statements and their accompanying notes. The larger the company and the more investors (or in some cases, creditors) it has, the more likely you will see more content in the annual report.

Regardless of their creative themes, annual reports must meet requirements as dictated by the regulatory authority and, in the case of listed companies, the stock exchange's **listing requirements**. You can visit your local stock exchange and check out its listing requirements or listing manual. It would most probably contain many disclosure items beyond the scope of this text, but it should give you an idea of the importance of communicating financial information and events to investors and potential investors.

Typically, an annual report has the following structure:

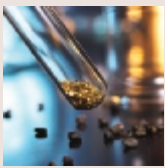


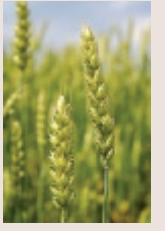

- corporate information
- analysis and commentaries
- other statements or disclosures
- financial statements

The BASF 2015 annual report has the following top-level headings in its table of contents: To our shareholders, Management Analysis, Corporate Governance, Financial Statements, and Supplementary Information.

Corporate Information

Companies provide various kinds of corporate information to their shareholders. For example, they could include information related to the history of the company, members of the board of directors and key management personnel, organizational structure of key subsidiaries or affiliates (more on this in Chapter 8), key markets and products, major events during the financial period (such as mergers and acquisitions, or disposal of business units), awards and accolades received, operating statistics, financial highlights, and any other general information about the company that may be useful to a reader's understanding of the company. You will not find all these examples in one single section, and different companies might present different items. For example, companies like BASF provide an introduction to its various business segments, as illustrated in Exhibit 4-3.

Exhibit 4-3 Segment Information

	<p>Chemicals</p> <p>The Chemicals segment comprises our business with basic chemicals and intermediates. Its portfolio ranges from solvents, plasticizers, and high-volume monomers to glues and electronic chemicals as well as raw materials for detergents, plastics, textile fibers, paints and coatings, crop protection, and medicines. In addition to supplying customers in the chemical industry and numerous other sectors, we also ensure that other BASF segments are supplied with chemicals for producing downstream products.</p>
	<p>Performance Products</p> <p>Our Performance Products lend stability, color, and better application properties to many everyday products. Our product portfolio includes vitamins and other food additives in addition to ingredients for pharmaceuticals, personal care and cosmetics, as well as hygiene and household products. Other products from this segment improve processes in the paper industry, in oil, gas, and ore extraction, and in water treatment. They furthermore enhance the efficiency of fuels and lubricants, the effectiveness of adhesives and coatings, and the stability of plastics.</p>
	<p>Functional Materials and Solutions</p> <p>In the Functional Materials and Solutions segment we bundle system solutions, services, and innovative products for specific sectors and customers, especially the automotive, electrical, chemical, and construction industries, as well as for household applications, and sports and leisure. Our portfolio comprises catalysts, battery materials, engineering plastics, polyurethane systems, automotive and industrial coatings, and concrete admixtures as well as construction systems like tile adhesives and decorative paints.</p>
	<p>Agricultural Solutions</p> <p>The Agricultural Solutions segment provides innovative solutions in the areas of chemical and biological crop protection, seed treatment and water management as well as solutions for nutrient supply and plant stress. Our research in plant biotechnology concentrates on plants for greater efficiency in agriculture, better nutrition, and use as renewable raw materials.</p>
	<p>Oil and Gas</p> <p>We focus on exploration and production in oil and gas-rich regions in Europe, North Africa, Russia, South America, and the Middle East. Together with our Russian partner Gazprom, we are active in the transport of natural gas in Europe. At the end of the third quarter in 2015, we exited the natural gas trading and storage business, which we previously operated together with Gazprom, and, in exchange, we are expanding our oil and gas production in western Serbia.</p>

Analysis and Commentaries

Like many other annual reports, the BASF 2015 annual report's first major item is the "Letter from the Chairman of the Board of Executive Directors." Depending on the organizational structure (and local practice), you may see the title President used in place of **Chairman**. You can read Dr. Kurt Block's (BASF's chairman of the board of directors) letter to shareholders on pages 9–11 of the BASF 2015 annual report. It talks about achievements in the financial year, returns to shareholders, and the key focus or goals for the future.

ADAPTED EXCERPTS FROM BASF'S ANNUAL REPORT

Excerpt from the Letter from the Chairman of the Board of Executive Directors

Dear Shareholder,

As this report goes to print, we are looking back at one of the most turbulent starts to the year for decades. At times, oil prices fell to below \$27 per barrel—the lowest level since 2003. In 2015, oil prices averaged \$52 per barrel, almost half the previous year's figure. This price slump reflects not only an oil surplus but also a slowdown in global economic growth, especially in emerging markets. Our share price has also suffered from these developments. Since the beginning of the year it has fallen significantly to below €60 and is thus substantially lower than the peak of nearly €97 in April 2015.

These figures underline the level of uncertainty about the future performance of the global economy. This raises some legitimate questions: How will demand for chemical products develop? What will be the impact if oil prices remain low for any length of time? How does one steer a company like BASF in such turbulent and challenging times?

[and so on]

Yours,

Kurt Block

Source: BASF, Annual Report 2015, page 9

The next set of commentaries is from the company's management. Before we go further, perhaps it is useful to explain how corporations, especially public or listed companies, structure themselves organizationally. The ultimate control of the company rests with shareholders, who appoint a **board of directors** to provide oversight of the company. The board, in turn, hires a management team to run the company. Of course, in many instances, an individual may be a shareholder, a member of the board of directors, and a CEO of the company. We discuss corporate structure later in more detail (in Chapter 10, for example, see Exhibit 10-2). For now, let's just take it that a board of directors means shareholders' representatives overseeing a management team that runs the company.

The objective of such commentaries is to provide users with an understanding of the company via an analysis of the company's businesses as seen through the eyes of the directors and management. These commentaries serve to facilitate assessment of the company's business and business objectives, its principal drivers of performance, the dynamics of the business, and the financial performance and condition of the company.

Thus, the management analysis and commentaries are basically management's explanations to shareholders of how the company has performed during the year. In some parts of the world, this set of commentaries may be known as "MD&A" (Management Discussions and Analysis) or "OFR" (Operating and Financial Review), or something similar. Typically,

management would explain the performance of various products or segments of the company, the status of the company's strategic initiatives or projects, and plans or goals for the upcoming financial year.

BASF's management analysis is extremely comprehensive (see pages 21 to 126 of its 2015 annual report). It describes its view of the trends in the global economy and the industries it operates in, the performance of its business segments (chemicals, plastics, performance products, functional solutions, agricultural solutions, and oil and gas), and geographical regions. It also describes BASF's corporate social responsibility to its employees and the society, and its commitment to the environment and overall safety. It even provides the management's outlook for the future.

ADAPTED EXCERPTS FROM BASF'S ANNUAL REPORT

Management's Report: Results of Operations

In 2015, the market environment continued to be volatile and challenging. Growth rates for the global economy, industrial production, and the chemical industry all lagged considerably behind our expectations. The economic environment deteriorated in important emerging markets, especially China. The sharp drop in the price of oil led to falling prices for basic chemicals in particular. The divestitures completed in 2015 also put a strain on both sales and income from operations (EBIT) before special items. Impairments in the Oil & Gas segment resulting from the reduced forecast for oil and gas prices led to considerably lower EBIT. In light of these factors, our overall business development remained behind our expectations.

Source: BASF, Annual Report 2015, page 52

Other Statements and Disclosures

This varies from one jurisdiction to another, but you will always find disclosures related to corporate governance. **Corporate governance** refers broadly to a set of principles adopted or practiced by organizations in order to ensure a clear corporate direction, responsibility, and accountability of those managing the organization. Typically, it prescribes matters such as the composition, duties, and responsibilities of the board of directors, oversights of management, and its dealings with shareholders.

BASF's corporate governance disclosures are on pages 129 to 147 of its 2015 annual report. The introduction to that section is shown below.

ADAPTED EXCERPTS FROM BASF'S ANNUAL REPORT

Corporate Governance Report

Corporate governance refers to the entire system for managing and supervising a company. This includes the organization values, corporate principles and guidelines, as well as all internal and external regulatory and monitoring mechanisms. Effective and transparent corporate governance guarantees that BASF is managed and monitored in a responsible manner focused on value creation. This fosters the confidence of our domestic and international investors, the financial markets, our customers, other business partners, employees, and the public in BASF.

Source: BASF, Annual Report 2015, page 129

A key part of any corporate governance framework is internal control. We will provide an introduction to internal control in Chapter 5.

Other statements and disclosures may include a compensation report for directors and the senior management team, economic-value added or EVA statements (more on this in Chapter 12), and sustainability and/or environmental reporting (often referred to as corporate social responsibility). An example of BASF's extensive "Safety, Security, Health and the Environment" disclosure is shown in the following adapted excerpt.

ADAPTED EXCERPTS FROM BASF'S ANNUAL REPORT

Safety, Security, Health and the Environment

Safety Security and Health		2015	2014	Change in %
Transportation incidents with significant impact on the environment		0	1	(100)
Process safety incidents	per one million working hours	2.1	2.2	(4.5)
Lost-time injuries	per one million working hours	1.4	1.5	(6.7)
Health Performance Index ¹		0.97	0.91	6.6
Environment				
Primary energy use ²	million MWh	57.3	59.0	(2.9)
Energy efficiency in production processes	kilograms of sales product/MWh	599	588	1.9
Total water withdrawal	million cubic meters	1,686	1,877	(10.2)
Withdrawal of drinking water	million cubic meters	22.1	22.7	(2.6)
Emissions of organic substances to water ³	thousand metric tons	17.3	18.7	(7.5)
Emissions of nitrogen to water ³	thousand metric tons	3.0	3.2	(6.3)
Emissions of heavy metals to water ³	metric tons	25.1	21.5	16.7
Emissions of greenhouse gases	million metric tons of CO ₂ equivalents	22.2	22.4	(0.9)
Emissions to air (air pollutants) ³	thousand metric tons	28.6	31.5	(9.2)
Waste	million metric tons	2.0	2.1	(4.8)
Operating costs for environmental protection	million €	962	897	7.2
Investments in environmental protection plants and facilities	million €	346	349	(0.9)

¹ For more information, see Production. <http://bericht.basf.com/2015/en/managements-report/responsibility-along-the-value-chain/safety-security-health-and-environment/production.html>

² Primary energy used in BASF's plants as well as in the plants of our energy suppliers to cover energy demand for production processes

³ Excluding emissions from oil and gas production

Source: BASF, Annual Report 2015, <http://bericht.basf.com/2015/en/shareholders/key-data.html>

Financial Statements

Typically the financial statement section starts with an acknowledgement by directors and management that they are responsible for the financial statements, followed by an auditor's report and the full set of financial statements.

ADAPTED EXCERPTS FROM BASF'S ANNUAL REPORT

Statement by the Board of Executive Directors and Assurance Pursuant to Sections 297(2), Section 315(1) of the German Commercial Code (HGB)

The Board of Executive Directors of BASF SE is responsible for preparing the Consolidated Financial Statements and Management's Report of the BASF Group.

The Consolidated Financial Statements for 2015 were prepared according to the International Financial Reporting Standards (IFRS), which are published by the International Accounting Standards Board (IASB), London, and have been endorsed by the European Union.

We have established effective internal control and steering systems in order to ensure that the BASF Group's Consolidated Financial Statements and Management's Report comply with applicable accounting rules and to ensure proper corporate reporting.