

# Risk Report and Explanatory Report on Disclosures pursuant to Section 289 (5) of the German Commercial Code (HGB)

The goal of BASF's risk management is to identify and evaluate risks as early as possible and limit business losses by taking suitable measures. The aim here is to avoid risks that pose a threat to BASF's continued existence and to make improved managerial decisions to create lasting value. We understand risk to be any event that can negatively impact the achievement of our short-term operational or long-term strategic goals. We define opportunities as possible successes that exceed our defined goals.

## Organization, responsibilities and tools

**Operational opportunities and risks:** Short and medium term planning covers a period of one to three years. Within this framework, BASF's operating divisions, corporate units and competence centers decentrally identify and quantify opportunities and risks that may lead to positive or negative deviations from the respective business plan. The results are regularly reported to the Strategic Planning & Controlling unit, where they are checked and aggregated by means of Monte Carlo simulation. In addition, operational opportunities and risks are discussed in the monthly management report which is produced by the Corporate Controlling unit. Furthermore, if an individual risk is identified which has an impact on earnings of more than €10 million, this must be immediately reported to the Board of Executive Directors. The Strategic Planning & Controlling and Finance corporate divisions are responsible for aggregated risk management. Both corporate divisions also provide the necessary risk management tools and expertise, refine the methods and are responsible for communicating these globally. The Legal, Taxes & Insurance division and the Chief Compliance Officer report directly to the Board of Executive Directors on legal and tax risks as well as on compliance risks.

**Strategic opportunities and risks:** As part of the strategy development for our strategic business units and when major investment decisions are to be made, the Strategic Planning & Controlling unit conducts opportunity/risk analyses, together with the respective business units. These analyses cover a ten-year timeframe and are reviewed during the course of the strategic controlling and are updated if necessary.

## Risk management process

The BASF Group's risk management process is based on the international risk management standard COSO II Enterprise Risk Management – Integrated Framework, and comprises the following steps:

### – Identification of opportunities and risks

Operational divisions decentrally identify opportunities and risks using a variety of tools, such as expert interviews and teambased approaches. These are complemented by market, competitive and environmental analyses as well as statistical evaluations. The above are based on internal and external risk information sources, macroeconomic scenarios that evaluate important factors such as industry growth rates, and our companywide risk catalog, which acts as a checklist and supports the identification process.

### – Assessment and quantification

Where possible, opportunities and risks are quantified as to their probability of occurrence and impact on profitability. The respective business plan serves as the reference base. In addition, we quantify the dependence of the individual business units on macroeconomic factors, such as exchange rates and raw materials prices.

### – Aggregation

Opportunities and risks as well as the dependence on macroeconomic factors are aggregated on the division and group level to determine the spectrum of possible effects on profit and the probability distribution. Correlations between individual events and factors, as well as internal interactions within the Verbund, are taken into account.

#### **– Management, measures and control**

The management of opportunities and risks as well as the taking of measures takes place on the divisional level. Measures are taken at the BASF Group level for certain risks, such as risks associated with raw materials prices and exchange rates, which are partially reduced by Group-wide hedging effects. The details are governed by our risk management handbook, upon which divisional specific regulations are based. The Board of Executive Directors regularly receives reports on the risk situation of the BASF Group. If certain risk thresholds are reached, the Board is informed immediately.

#### **– Monitoring and development**

The Corporate Audit unit regularly reviews our risk management system. As part of the annual audit, the external auditor assesses the proper functioning of the early risk detection system set up in accordance with Section 91 (2) of the German Stock Corporation Act. In order to continuously develop our risk management system, we regularly enter into discussions and share ideas with comparable industrial companies and service providers in the risk management field. When BASF was once again included in the Dow Jones Sustainability Index in September 2009, the company received special recognition from analysts, for its risk management system, among other things.

### **Significant features of the internal control and risk management system with regard to the financial reporting process (Section 289 (5) HGB)**

The Financial Statements of BASF SE are prepared by a unit in the corporate division Finance. BASF SE's accounting process is based on the accounting provisions of the German Commercial Code, having regard to significant processes and consistent deadlines. There are binding directives for the internal reconciliations and other accounting operations. Standard software is used to carry out the accounting processes as well as the preparation of the Financial Statements. There are clear rules for the access rights of each participant in these processes. Employees involved in the accounting process meet the qualitative requirements and participate in training on a regular basis. There is a clear division of responsibilities between the involved specialist units, companies and regional service units. We strictly adhere to the principles of segregation of duties and dual control. Complex actuarial reports and evaluations are produced by specialized service providers or specially qualified employees. Our internal control system for financial reporting continuously monitors these principles. To this end, methods are provided for the structured and Group-wide uniform evaluation of the internal control system in financial reporting. A centralized risk catalog covers the significant risks for the BASF Group regarding a reliable control environment and proper financial reporting. The risk catalog is revised and updated annually. In a centralized selection process, the units are identified that are exposed to particular risks. All significant BASF sites as well as all regions and divisions are taken into account. The selection process is conducted annually. In the relevant units, one person is given responsibility to coordinate and monitor the execution of the steps.

The **annual evaluation process** consists of the following steps:

#### **– Evaluation of the control environment**

The adherence to internal and external guidelines that are relevant for the maintenance of a reliable control environment is checked by means of a standardized questionnaire. The assessment is performed by checking the awareness of rules and is supported by sample taking.

#### **– Identification of control activities**

In order to mitigate the risks to the financial reporting process listed in our central risk catalog, corresponding control activities are conducted. The control activities of the largest companies and those with special risks are documented in a global IT system.

#### **– Assessment of the control activities**

After documentation, a test is performed to verify whether the described controls are capable of adequately mitigating the risks. In the subsequent test phase, samples are taken to test whether the controls were effective in practice.

**– Monitoring of control weaknesses**

The managers responsible receive reports on any control weaknesses and their resolution, and an interdisciplinary committee investigates their relevance for the BASF Group. The Board of Executive Directors is informed once control weaknesses have been identified that have a considerable impact on the financial reporting.

**– Internal confirmation of the internal control system**

The responsible managing director and chief financial officer for each consolidated Group company confirm to the Board of Executive Directors of the BASF Group at the end of the annual cycle the effectiveness of the internal control system over accounting as well as the adequacy of financial reporting.