

Reaction

Risk and Disclosure in the Chemical Industry 2008 – 2009

KPMG INTERNATIONAL

Special Edition: September 2009

This special edition of Reaction presents the executive summary of KPMG's Chemicals Disclosures Handbook 2008 – 2009

The Handbook covers the following topics:

- Risks and success factors in the Chemical Industry
- Financial reporting aspects; risk factors, critical accounting policies, risks arising from financial instruments, regulation G- Non-GAAP Disclosure and Accounting Trends IASB and FASB
- Sustainability
- Reported performance of 50 of the top chemicals companies

Maintaining the quality of audits is perhaps even more important this year due to the global economic environment. To provide a background to the detailed analysis of risks and accounting policies in the economic downturn, this year's Chemicals Disclosures Handbook gives an overview of some of the accounting considerations of the Chemical industry as well as a description of trends. The handbook highlights that the changing global business environment has resulted in significant uncertainty in current and future demand, as well as volatile feedstock prices. Plant shutdowns in the Western hemisphere, due to the severe decrease in demand for chemical products, coupled with the huge planned increase in petrochemical capacity mainly in the Middle East, means expected overcapacity. Western chemical companies, in particular, are focusing on cost reduction and

liquidity to maintain competitiveness. The Chemical landscape is now changing significantly through plant closures, distressed portfolio management, expanding Asian markets and joint ventures.

Risks and success factors in the Chemical Industry

Our analysis of the annual financial reports from 50 of the top companies in the Chemical industry filters out individual company risks. The main risks mentioned in the 2008 financial reports reflect a shift resulting from the effect of the economic downturn on the Chemical industry in the last quarter of 2008. This followed after the industry faced economic overheating which peaked in the third quarter and generated dramatic price increases for feedstock. However, the full effect is expected to be detailed in the 2009 financials.



The main risks mentioned in the 2008 financial reports are:

- Legal and political environment
- Economic environment
- Raw material and energy costs

We note that, compared to previous years, the ranking of legal and political environment and economic environment risks increased as a result of the worldwide economic crisis. Risks resulting from globalization and internationalization, competition and innovation, and legal certainty were regarded as just as important as in previous years. Further significant risks included dealing with, producing and processing hazardous materials; disposal of hazardous materials, and potential legal disputes (e.g., product liability). Other significant risks included increasing indebtedness, with a related drop in credit ratings, and the rise in the cost of capital.

Companies reporting under both International Financial Reporting Standards (IFRS) and US Generally Accepted Accounting Principles (GAAP) must disclose their accounting policies

and accounting estimates (IAS 1.113, IAS 1.116, and SEC Financial Reporting Release No. 60). Critical accounting policies and accounting estimates included information on significant decisions relating to the use of accounting and measurement methods, and material assumptions on future developments. This implied that there is a considerable risk that the value of the company's assets and liabilities will require adjustment in the future.

Some of the most mentioned critical accounting policies over the last three years were:

- Measurement of (fair) values for impairment tests
- Accounting for pension commitments
- Deferred tax assets and their accounting

This prioritization reflects the impact of using assumptions and estimates in determining fair values especially when future economic developments expressed in growth rates, are more questionable than ever before. Impairment tests and sensitivity

Compared to previous years, the ranking of legal and political environment and economic environment risks increased as a result of the worldwide economic crisis.



analysis, for affected cash generating units, have become more important in determining the profitability of an investment.

Other critical accounting policies referred to contingencies for legal claims, resulting from for example, product sales, violations of patents, and competition regulations. In addition, companies recognized environmental commitments, and the related-cost estimates, such as contractual risks, from product liability and site cleanup. In capital-intensive companies, determining the depreciation method and useful life of an asset are especially important for the interpretation of periodic results.

IFRS and US GAAP

The accounting frameworks of IFRS and US GAAP have been subject to changes due to additions, amendments, and convergence since the US Financial Accounting Standards Board (FASB) and the IASB issued the Norwalk Agreement in their joint meeting in September 2002. As an increasing number of delistings and deregistrations continues in the US,

the SEC continues to discuss whether to allow US issuers to prepare their financial statements in accordance with IFRS as issued by the IASB. The SEC has proposed a potential “roadmap” for the phasing in of mandatory IFRS filings by US public companies. The roadmap is conditional on progress between now and 2011, and at that time, the SEC should decide whether to proceed and whether IFRS will become obligatory at the beginning of 2014 for large accelerated US filers.

Sustainability

Companies in the Chemical industry are monitored for their environmental and social responsibility by a broad variety of stakeholders (e.g. customers, financial institutions, and local and international communities). Stakeholders potentially impact the performance of chemical companies in various ways, such as license to operate, reputation, and access to capital. As a result, chemical companies increasingly view sustainability as a real and pressing business issue. In fiscal year 2008, 39 of the world’s top 50 chemical companies reported

sustainability issues either in separate reports, in a chapter in the annual reports, or on their web sites.

Some of the main environmental reporting issues were:

- Risks and opportunities related to climate change and greenhouse gas (GHG) emissions
- Activities to preserve resources
- Compliance with regulatory requirements such as REACH in the EU

Key social-responsibility reporting topics include:

- Occupational health and safety
- Headcount and employment as well as training and education of employees
- Support for society and local communities

This handbook includes selected 2008 financial performance data from 50 of the top global chemical companies. For reference, company data for the four years preceding 2008 is also provided.



KPMG Disclosures Handbook: Risk and Disclosure in the Chemical Industry 2008-2009

The sixth edition of KPMG's Disclosures Handbook is a detailed examination of the 2008 annual regulatory filings of some of the world's largest chemical companies. Our research for the handbook focused on the disclosure of business risk and critical accounting policies of the leading global chemical companies. Also summarized are selected 2008 comparative financial performance data from 50 of the top global chemicals companies.

We have also included an overview of sustainability reporting of the world's leading chemicals companies in 2008 and the sustainability issues they considered to be most crucial to their business.



Reaction

Reaction is KPMG's regular newsletter focusing on issues in the Chemicals industry. Previous issues have covered:

- REACH
- Transfer Pricing
- M&A
- Sustainability
- Specialty Chemicals in China
- Organizational Safety Culture
- Working Capital
- Value-based Pricing
- Legal Entity Rationalization
- Economic Outlook

For copies of these publications, please contact your local KPMG representative.

Contacts

Global

John Morris
KPMG in the U.K.
Tel: +44 (0)20 7311 8522
e-mail: john.morris@kpmg.co.uk

In the Americas

Michael J Shannon
KPMG in the U.S.
Tel: +1 973 912 6312
e-mail: mshannon@kpmg.com

In Europe

Chris Stirling
KPMG in the U.K.
Tel: +44 (0)20 7311 8512
e-mail: chris.stirling@kpmg.co.uk

In Asia

Norbert Meyring
KPMG in China
Tel: +86 (21) 6288 2298
e-mail: norbert.meyring@kpmg.com.cn

This edition of Reaction is part of a series focusing on issues in the chemicals industry. For more information, visit <http://www.kpmg.com/Industries/IM/CP/>

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2009 KPMG International. KPMG International is a Swiss cooperative. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved.

KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative. Designed and produced by KPMG LLP (UK)'s Design Services

Publication name: Reaction
Publication number: RRD-163062
Publication date: September 2009