Financial statements

Consolidated financial statements

Summary of significant accounting policies

Basis of preparation
DSM's consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The accounting policies applied by DSM comply with IFRS and the pronouncements of the International Financial Reporting Interpretation Committee (IFRIC) effective at 31 December 2008.

Consolidation
The consolidated financial statements include Royal DSM N.V. and its subsidiaries as well as the proportion of DSM's ownership of joint ventures (together 'DSM' or 'group'). A subsidiary is an entity over which DSM has control. Control is the power to govern the financial and operating policies of the entity so as to obtain benefits from its activities. The financial data of subsidiaries are fully consolidated. Minority interests in the group's equity and profit and loss are stated separately. A joint venture is an entity in which DSM holds an interest and which is jointly controlled by DSM and one or more other venturers under a contractual arrangement. Joint ventures are included in the consolidated financial statements according to the method of proportionate consolidation.

Subsidiaries and joint ventures are consolidated from the acquisition date until the date on which DSM ceases to have control or joint control, respectively. On consolidation, all intra-group balances and transactions and unrealized profits or losses from intra-group transactions are eliminated. Unrealized losses are not eliminated if these losses indicate an impairment of the asset transferred. In such cases a value adjustment for impairment of the asset is recognized.

Segmentation
Segment information is presented in respect of the group's operating segments about which separate financial information is available that is regularly evaluated by the chief operating decision maker. The Managing Board decides how to allocate resources and assesses the performance of the clusters. Cluster performance is reported and reviewed down to the level of operating profit. DSM has determined that the Nutrition, Pharma, Performance Materials, Polymer Intermediates and Base Chemicals and Materials clusters represent reportable segments in addition to Other activities. The clusters are organized based on the type of products produced and the nature of the markets served. The same accounting policies that are applied for these consolidated financial statements are also applied by the operating segments. Prices for transactions between segments are determined on an arm's length basis. Segment results, assets and liabilities include items directly attributable to a segment as well as those that can reasonably and consistently be allocated. Selected information on a country and regional basis is provided in addition to the information about operating segments.

Foreign currency translation
The presentation currency of the group is the euro.

Each entity of the group records transactions and balance sheet items in its functional currency. Transactions denominated in currency other than the functional currency are recorded at the spot exchange rates prevailing at the date of the transactions. Monetary assets and liabilities denominated in a currency other than the functional currency of the entity are translated at the closing rates. Exchange differences resulting from the settlement of these transactions and from the translation of monetary items are recognized in the income statement.

Non-monetary assets denominated in a currency other than the functional currency continue to be translated against the rate at initial recognition and will not result in exchange differences.

On consolidation, the balance sheets of subsidiaries and joint ventures whose functional currency is not the euro are translated into euro at the closing rate. The income statements of these entities are translated into euro at the average rates for the relevant period. Goodwill paid on acquisition is recorded in the functional currency of the acquired entity. Exchange differences arising from the translation of the net investment in entities with a functional currency other than the euro are recorded in equity (Translation reserve). The same applies to exchange differences arising from borrowings and other financial instruments in so far as they hedge the currency risk related to the net investment. On disposal of an entity with a functional currency other than the euro the cumulative exchange differences relating to the translation of the net investment is recognized in the income statement.

Distinction between current and non-current
An asset (liability) is classified as current when it is expected to be realized (settled) within 12 months after the balance sheet date.

Intangible assets
Goodwill represents the excess of the cost of an acquisition over DSM's share in the net fair value of the identifiable assets and liabilities of an acquired subsidiary, joint venture or associate. Goodwill paid on acquisition of subsidiaries and joint ventures is

included in intangible assets. Goodwill paid on acquisition of associates is included in the carrying amount of these associates. Goodwill is not amortized but tested for impairment annually and when there are indications that the carrying amount may exceed the recoverable amount. A gain or loss on the disposal of an entity includes the carrying amount of goodwill relating to the entity sold.

Intangible assets acquired in a business combination are recognized at fair value on the date of acquisition and subsequently amortized over their expected useful lives, which vary from 5 to 15 years.

Acquired licenses, patents and application software are carried at historic cost less straight-line amortization and less any impairment losses. The expected useful lives vary from 4 to 10 years. Costs of software maintenance are expensed when incurred. Capital expenditure that is directly related to the development of application software is recognized as an intangible asset and amortized over its estimated useful life (5-8 years).

Research costs are expensed when incurred. Where the recognition criteria are met, development expenditure is capitalized and amortized over its useful life from the moment the product is launched commercially. The carrying amount of assets arising from development expenditures is reviewed for impairment at each balance sheet date or earlier upon indication of impairment. Development assets in use are tested for impairment when there are indications that the carrying amount may exceed the recoverable amount. Any impairment losses are recorded in the income statement.

Property, plant and equipment

Property, plant and equipment are stated at cost less depreciation calculated on a straight-line basis and less any impairment losses. Interest during construction is capitalized. Expenditures relating to major scheduled turnarounds are capitalized and depreciated over the period up to the next turnaround.

Property, plant and equipment are systematically depreciated over their estimated useful lives. Reviews are made annually of the estimated remaining lives of assets, taking account of commercial and technological obsolescence as well as normal wear and tear. The initially assumed expected useful lives are in principle as follows: for buildings 10-50 years, for plant and machinery 5-15 years, for other equipment 4-10 years. Land is not depreciated.

In oil and gas exploration, development and production costs are accounted for using the successful efforts method. Costs of successful and incomplete oil and gas drilling operations are capitalized as Property, plant and equipment. The estimated discounted costs for future drilling platform decommissioning and site restoration are capitalized and depreciated. Items of property, plant and equipment related to oil and gas exploration are depreciated on the basis of the unit of production method.

An item of property, plant and equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use or the sale of the asset. Any gain or loss arising on derecognition of the asset is recorded in the income statement.

Leases

Finance leases, which transfer to the group substantially all the risks and benefits incidental to ownership of the leased item, are capitalized at inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. All other leases are operating leases.

Lease payments for finance leases are apportioned to finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are included in Net finance costs. Capitalized leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term. Operating lease payments are recognized as an expense on a straight-line basis over the lease term.

Associates

An associate is an entity over which DSM has significant influence but no control, usually evidenced by a shareholding that entitles DSM to between 20% and 50% of the voting rights. Investments in associates are accounted for by the equity method, which involves recognition in the income statement of DSM's share of the associate's profit or loss for the year. DSM's interest in an associate is carried in the balance sheet at its share in the net assets of the associate together with goodwill paid on acquisition, less any impairment loss.

When DSM's share in the loss of an associate exceeds the carrying amount of the associate, including any other receivables, the carrying amount is reduced to zero. No further losses are recognized, unless DSM has responsibility for obligations relating to the associate.

Other financial assets
Other participations comprise equity interests in entities in which DSM has no significant influence; they are accounted for as available-for-sale securities. These other participations are measured against fair value with changes in fair value being recognized in equity (Fair value reserve). On disposal the cumulative fair value adjustments of the related other participations are released from equity and included in the income statement. If a reliable fair value cannot be established, the other participations are recognized at cost. The proceeds from these other participations and the gain or loss upon their disposal are recognized in the income statement.

Loans and long-term receivables are measured at amortized cost, if necessary after deduction of a value adjustment for bad debts. The proceeds from these assets and the gain or loss upon their disposal are recognized in the income statement.

Impairment of assets
When there are indications that the carrying amount of a non-current asset (an intangible asset or an item of property, plant and equipment) may exceed the estimated recoverable amount (the higher of its value in use and fair value less costs to sell), the possible existence of an impairment loss is investigated. If an asset does not generate largely independent cash flows, the recoverable amount is determined for the cash generating unit to which the asset belongs. In assessing the value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market interest rate and the risks specific to the asset.

When the recoverable amount of a non-current asset is less than its carrying amount, the carrying amount is impaired to its recoverable amount and an impairment charge is recognized in the income statement. An impairment loss is reversed when there has been a change in estimate that is relevant for the determination of the asset's recoverable amount since the last impairment loss was recognized.

All financial assets are reviewed for impairment. If there is objective evidence of impairment as a result of one or more events after initial recognition, an impairment loss is recognized in the income statement. Impairment losses for goodwill and other participations will never be reversed.

Inventories
Inventories are stated at the lower of cost and net realizable value. The first-in, first-out (FIFO) method of valuation is used. The cost of intermediates and finished goods includes directly attributable costs and related production overhead expenses.

Net realizable value is determined as the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs necessary to make the sale. Products whose manufacturing cost cannot be calculated because of joint cost components are stated at net realizable price after deduction of a margin.

Current receivables
Current receivables are stated at amortized cost, which generally corresponds to face value, less an adjustment for bad debts.

Current investments
Deposits held at call with banks with a remaining maturity between 3 and 12 months are classified as current investments. They are measured at amortized cost. Proceeds from these deposits are recognized in the income statement.

Cash and cash equivalents
Cash and cash equivalents comprise cash at bank and in hand and deposits held at call with banks with a remaining maturity of less than three months. Bank overdrafts are included in current liabilities. Cash and cash equivalents are measured at nominal value.

Non-current assets and disposal groups held for sale
Non-current assets and disposal groups (assets and liabilities relating to an activity that is to be sold) are classified as 'held for sale' if their carrying amount is to be recovered principally through a sales transaction rather than through continuing use. The reclassification takes place when the assets are available for immediate sale and the sale is highly probable. These conditions are usually met as from the date on which a first draft of an agreement to sell is ready for discussion. Non-current assets held for sale and disposal groups are measured at the lower of carrying amount and fair value less costs to sell. Non-current assets held for sale are not depreciated and amortized.

Discontinued operations
Discontinued operations comprise those activities that have been disposed of during the period or which have been classified as held for sale at the end of the period, and represent a separate major line of business or geographical area that can be clearly distinguished for operational and financial reporting purposes. DSM has identified its cash generating units as the components of the company that will be reported as discontinued operations in the event of their disposal.

Royal DSM N.V. Shareholders' equity
DSM's ordinary shares and cumulative preference shares are classified as Royal DSM N.V. Shareholders' equity. The price

paid for repurchased DSM shares (treasury shares) is deducted from Royal DSM N.V. Shareholders' equity until the shares are cancelled or reissued. Dividend to be distributed to holders of cumulative preference shares is recognized as a liability when the Supervisory Board approves the proposal for profit distribution. Dividend to be distributed to holders of ordinary shares is recognized as a liability when the Annual General Meeting of Shareholders approves the dividend proposal.

Provisions

Provisions are recognized when all of the following conditions are met: 1) there is a present legal or constructive obligation as a result of past events; 2) it is probable that a transfer of economic benefits will settle the obligation; and 3) a reliable estimate can be made of the amount of the obligation.

The probable amount required to settle long-term obligations is discounted if the effect of discounting is material. Where discounting is used, the increase in the provision due to the passage of time is recognized as borrowing costs. However, the interest costs relating to pension obligations are included in pension costs.

Any provision for costs that will arise from future drilling platform decommissioning and site restoration is made when the investment project concerned is taken into operation. These are included in Property, plant and equipment, along with the historic cost of the related asset, and depreciated over the useful life of the asset.

Borrowings

Borrowings are initially recognized at cost, being the fair value of the proceeds received, net of transaction costs. Subsequently, borrowings are stated at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any discount or premium. Interest expenses are accrued and recorded in the income statement for each period.

Where the interest rate risk relating to a long-term borrowing is hedged, and the hedge is regarded as effective, the carrying amount of the long-term loan is adjusted for changes in fair value of the interest component of the loan.

Other current liabilities

Other current liabilities are stated at amortized cost, which generally corresponds to the nominal value.

Revenue recognition

Revenue from the sale of goods is recognized when the significant risks and rewards of ownership are transferred to the buyer. Net sales represent the invoice value less estimated rebates and cash discounts, and excluding indirect taxes.

Royalty income is recognized in Other operating income on an accrual basis in accordance with the substance of the relevant agreements. Interest income is recognized on a time-proportion basis using the effective interest method. Dividend income is recognized when the right to receive payment is established.

Government grants

Government grants are recognized at their fair value where there is reasonable assurance that the grant will be received and all related conditions will be complied with. Cost grants are recognized as income over the periods necessary to match the grant on a systematic basis to the cost that it is intended to compensate. If the grant is an investment grant, its fair value is initially recognized as deferred income in Other non-current liabilities and then released to the income statement over the expected useful life of the relevant asset by equal annual amounts.

Share-based compensation

The costs of option plans are measured by reference to the fair value of the options on the date on which the options are granted. The fair value is determined using the Black-Scholes model, taking into account market conditions linked to the price of the DSM share. The costs of these options are recognized in the income statement (Employee benefits costs) during the vesting period, together with a corresponding increase in equity (Reserve for share-based compensation) in the case of share-settled options or Other non-current liabilities in the case of cash-settled options (Share Appreciation Rights). No expense is recognized for options that do not ultimately vest, except for options where vesting is conditional upon a market condition, which are treated as vesting, irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are met.

Performance shares are granted free of charge and vest after three years on the achievement of previously determined targets. The cost of performance shares is measured by reference to the fair value of the DSM shares on the date on which the performance shares were granted and is recognized in the income statement (Employee benefits costs) during the vesting period, together with a corresponding increase in equity (Reserve for share-based compensation).

Emission rights

DSM is subject to legislation encouraging reductions in greenhouse-gas emissions and has been awarded emission rights (principally CO_2 emission rights) in a number of jurisdictions. Emission rights are reserved for meeting delivery obligations and are recognized at cost (usually zero). Revenue is recognized when surplus emission rights are sold to third parties. When actual emissions exceed the emission rights available to DSM a provision is recognized for the expected additional costs.

Exceptional items

Exceptional items relate to material non-recurring items of income and expense arising from circumstances such as:

- write-downs of inventories to net realizable value or of property, plant and equipment to recoverable amount, as well as reversals of such write-downs;
- restructurings of the activities of an entity;
- releases of provisions;
- disposals of property, plant and equipment;
- disposals of associates or other financial assets;
- discontinued operations;
- onerous contracts;
- litigation settlements.

To provide a better understanding of the underlying results of the period, exceptional items are reported separately if the aggregate amount of the specific event or project exceeds € 10 million.

Income tax expense

Income tax expense is recognized in the income statement except to the extent that it relates to an item recognized directly within shareholders' equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the balance sheet date, and any adjustment to tax payable in respect to previous years. Deferred tax assets and liabilities are recognized for the expected tax consequences of temporary differences between the carrying amount of assets and liabilities and their tax base. Deferred tax assets and liabilities are measured at the tax rates and under the tax laws that have been enacted or substantially enacted at the balance sheet date and are expected to apply when the related deferred tax assets are realized or the deferred tax liabilities are settled. Deferred tax assets, including assets arising from losses carried forward, are recognized to the extent that it is probable that future taxable profits will be available against which the deductible temporary differences and unused tax losses can be utilized. Deferred tax assets and liabilities are stated at face value.

Deferred taxes are not provided for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future.

Financial derivatives

The group uses financial derivatives such as foreign currency forward contracts and interest rate swaps to hedge risks associated with foreign currency and interest rate fluctuations. Financial derivatives are initially recognized in the balance sheet at fair value including transaction costs and subsequently measured at their fair value on each balance sheet date. Changes in fair value are recognized in the income statement unless cash flow hedge accounting or net investment hedge accounting is applied.

Changes in the fair value of financial derivatives designated and qualifying as cash flow hedges are recognized in equity (Hedging reserve) to the extent that the hedge is effective. Upon recognition of the related asset or liability the cumulative gain or loss is transferred from the Hedging reserve and included in the carrying amount of the hedged item if it is a non-financial asset or liability. If the hedged item is a financial asset or liability the cumulative gain or loss is transferred to profit or loss. Changes in the fair value of financial derivatives designated and qualifying as net investment hedges are recognized in equity (Translation reserve) to the extent that the hedge is effective and the change in fair value is caused by changes in currency exchange rates. Accumulated gains and losses are released from the Translation reserve and are included in the income statement when the net investment is disposed of. Changes in the fair value of financial derivatives designated and qualifying as fair value hedges are immediately recognized in the income statement, together with any changes in the fair value of the hedged assets or liabilities attributable to the hedged risk.

Pensions and other post-employment benefits

For defined benefit plans, pension costs are determined using the projected-unit-credit method. Actuarial gains and losses are recognized in full under equity in the period in which they occur. Prepaid pension costs relating to defined benefit plans are capitalized only if they lead to refunds to the employer or to reductions in future contributions to the plan by the employer. Prepaid pension costs that do not meet this recoverability criterion are charged to equity in the period in which they occur and are recognized as effects of the asset ceiling. Payments to defined contribution plans are charged as an expense as they fall due.

Effect of new accounting standards

The IASB and IFRIC have issued new standards, amendments to existing standards and interpretations, some of which are not yet effective or have not yet been endorsed by the European Union. DSM has introduced standards and interpretations that became effective in 2008. The adoption of these standards and interpretations did not have any effect on the group's financial performance or position.

IFRS 8, 'Operating Segments', issued in November 2006, introduces the requirement to report financial and descriptive information about operating segments on the same basis as is used internally for evaluating operating segment performance. DSM is an early adopter of this standard and has applied it in these financial statements. DSM was already using the same performance measures and reporting structures for external financial reporting as were used for regular review of segment performance by the chief operating decision maker and therefore this new standard does not have a significant effect on the consolidated financial statements. In view of the changed grouping of clusters (the DSM term for business segments) as of 1 January 2008, the five clusters (Nutrition, Pharma, Performance Materials, Polymer Intermediates and Base Chemicals and Materials) are presented as business segments in addition to Other activities. The comparative information for the previous year has been represented accordingly.

The adoption of other standards and interpretations with an effective date after the date of these financial statements is not expected to have a material impact on the financial statements. Certain additional disclosures and accounting changes will be required and will be introduced as of the effective date of the standards and interpretations. The following new standards and amendments to existing standards are not yet being applied by DSM.

The revised IFRS 3, 'Business Combinations', will become effective as of 2010. It introduces a number of changes that will be relevant to the group's operations:

- The requirement that contingent consideration must be measured at fair value with subsequent changes in this value being recognized in the income statement.
- The requirement to expense transaction costs for business combinations when incurred.
- Additional guidance for step-acquisitions and for the measurement of non-controlling interests.

The amendment to IAS 23, 'Borrowing Costs', which removes the option of immediately recognizing as an expense borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets, will become effective as of 2009. It will not have any effect on the consolidated financial statements because the option is not applied by DSM.

The amendment to IAS 1, 'Presentation of Financial Statements', which introduces the requirement to report total comprehensive income in either a single statement of total comprehensive income or in a separate statement of comprehensive income will become effective as of 2009. It is already standard practice at DSM to provide a separate statement of comprehensive income (currently called 'consolidated statement of recognized income and expense') and the company will align this with the new requirements.

The amendment to IAS 27, 'Consolidated and Separate Financial Statements', providing further clarification on accounting for non-controlling interests in subsidiaries in the consolidated financial statements will become effective as of 2010. The changes are not expected to have a significant impact on the consolidated financial statements.

The amendment to IFRS 2, 'Share-based Payment: Vesting Conditions and Cancellations', clarifies the definition of vesting conditions, introduces the concept of non-vesting conditions that are to be reflected in grant-date fair value and provides the accounting treatment for non-vesting conditions and cancellations. The amendment will become applicable for the 2009 financial statements and the possible impact is under investigation.

The amendments to IAS 32 and IAS 1 with respect to puttable financial instruments and obligations arising on liquidation, the amendments to IFRS 1 and IAS 27 in relation to the cost of an investment in a subsidiary, jointly controlled entity or associate and the amendments to IAS 39 with respect to eligible hedged items are not expected to have any effect on the consolidated financial statements. The October 2008 amendment to IAS 39 and IFRS 7 that permits the reclassification of certain non-derivative financial assets will not be applied by DSM.

New IFRIC interpretations are not expected to have a material effect on the consolidated financial statements.

IFRIC 14, 'IAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction', provides further clarification on the recognition of defined benefit assets for economic benefits available in the form of refunds from a defined benefit plan or reductions of future contributions to the plan, particularly when a minimum funding requirement exists.

The interpretation is applicable to certain defined benefit plans of the group but the application does not have a material effect on the consolidated financial statements.

The same holds for IFRIC 12, 'Service Concession Arrangements', IFRIC 13, 'Customer Loyalty Programs', IFRIC 15, 'Agreements for the Construction of Real Estate' and IFRIC 16, 'Hedges of a Net Investment in a Foreign Operation'.