

### 3. Effects of new accounting pronouncements

#### Accounting standards applied for the first time in 2009

In 2009, the following accounting standards and interpretations were applied for the first time. None of the new standards had a material impact on the presentation of the Group's financial position or results of operations, or on earnings per share.

In November 2006, the IASB published IFRS 8 (Operating Segments), which replaces IAS 14 (Segment Reporting), the existing standard in this field. IFRS 8 follows the "management approach," which means that segment reporting must be based on the information used internally by management to identify operating segments and to evaluate their performance.

In March 2007, the IASB issued amendments to IAS 23 (Borrowing Costs) requiring the capitalization of interest on borrowings made to acquire, construct or produce a qualifying asset. Interest on borrowed capital that is directly attributable to qualifying assets was already capitalized in the past, utilizing the option that existed under the previous version of the standard.

In September 2007, the IASB issued amendments to IAS 1 (Presentation of Financial Statements). Apart from proposing the renaming of certain sections of the financial statements, these amendments mandate that in certain circumstances an opening statement of financial position for the previous financial year be published along with a separate presentation of changes in equity arising from transactions with owners and with non-owners, and that the income tax effects of each component directly recognized in equity be disclosed separately in the statement of comprehensive income or in the notes.

In January 2008 the IASB published amendments to IFRS 2 (Share-based Payment) to clarify the definitions of vesting conditions (exercisability) and cancellation of share-based payment. The revised standard basically states that vesting conditions are defined as normal service and performance conditions only. It also mandates that all plan cancellations, whether by the company or the employee, receive the same accounting treatment.

In February 2008, the IASB issued amendments to IAS 32 (Financial Instruments: Presentation) and IAS 1 (Presentation of Financial Statements). The changes relate mainly to the distinction between equity and debt in accounting for company capital to which cancellation rights are attached (puttable financial instruments). Such cancellable instruments may now be classified as equity in certain circumstances.

In May 2008 the IASB published amendments – mainly of a terminological or editorial nature – to a number of International Financial Reporting Standards as part of its "Annual Improvements" project.

The amendments to IFRS 7 (Financial Instruments: Disclosures) issued in March 2009 mandate additional disclosures about financial instruments that are measured at fair value. Further information also has to be provided on liquidity risks. Notably, the revised version of IFRS 7 requires a three-level disclosure hierarchy according to the basis on which the fair values have been measured. The top level comprises fair values based on quoted market prices, while the bottom level contains instrument fair values not based on observable market data. Additional disclosures are required for the latter category, mainly regarding the effects of the fair value measurement of these instruments on the income statement. A company's maturity analysis must include financial guarantees and credit facilities.

In June 2007 the IFRIC issued Interpretation IFRIC 13 (Customer Loyalty Programmes), which addresses both revenue and expense recognition relating to "award credits" that are granted to customers as purchase incentives and can be exchanged for free or discounted goods or services in the future. An amount reflecting the value of the award credits granted in connection with a transaction must be accounted for as a separate transaction component. Part of the fair value of the goods or services delivered is allocated to the award credits and recognized as a liability. Revenue recognition then occurs in the period in which the credits are redeemed or expire.

IFRIC 15 (Agreements for the Construction of Real Estate), issued in July 2008, addresses revenue recognition for real estate sold before completion. The interpretation defines the criteria for applying either IAS 11 or IAS 18.

IFRIC 16 (Hedges of a Net Investment in a Foreign Operation), also issued in July 2008, defines the type of currency risk to which hedge accounting may be applied when hedging a net investment in a foreign operation and which entity or entities within a group may hold the respective hedging instrument.

IFRIC 18 (Transfer of Assets from Customers) was issued in January 2009. The interpretation defines the accounting treatment of assets and liabilities in the context of agreements under which a company receives from a customer an item of property, plant or equipment that the company must then use either to connect the customer to a network or to provide the customer with long-term access to a supply of goods or services. It also sets forth the conditions for revenue recognition.

Amendments were issued in March 2009 to IFRIC 9 (Reassessment of Embedded Derivatives) and IAS 39 (Financial Instruments: Recognition and Measurement). These amendments clarify the accounting treatment of embedded derivatives for companies that make use of the reclassification amendment to IAS 39 issued by the IASB in October 2008. The reclassification amendment allows companies to reclassify certain financial instruments out of the "at fair value through profit or loss" category in specific circumstances. The amendments of March 2009 clarify that, when a financial asset is reclassified out of the "at fair value through profit or loss" category, all embedded derivatives must be remeasured and, if necessary, accounted for separately in the financial statements.

### **Published accounting standards that have not yet been applied**

The IASB and the IFRIC have issued the following standards, amendments to standards, and interpretations whose application was not yet mandatory for the 2009 fiscal year and is conditional upon their endorsement by the European Union.

In January 2008, the IASB published the revised standards IFRS 3 (Business Combinations) and IAS 27 (Consolidated and Separate Financial Statements). Significant changes required by IFRS 3 (revised 2008) include:

- In future, a non-controlling interest may be measured either at fair value (i.e. including goodwill) or at the proportionate share of the identifiable net assets of the entity in which the non-controlling interest is held.
- In the case of a step acquisition, the acquirer must remeasure its previously held interest at fair value on the date on which it gains control of the acquiree and recognize the resulting gain or loss in income. The difference between the (remeasured) carrying amount of the interest in the subsidiary and the acquirer's remeasured proportionate share of the net assets of the subsidiary must be recognized as goodwill.
- Liabilities recognized as of the acquisition date for the purpose of future purchase price adjustments in light of future events can no longer be offset against goodwill in subsequent periods.
- Ancillary acquisition costs must be recognized in income.

The principal changes required by IAS 27 (revised 2008) are:

- A reduction in the equity interest held in a subsidiary that does not result in a loss of control by the parent is to be accounted for in future as an equity transaction.
- If a reduction in the equity interest held in a subsidiary involves a loss of control, the assets and liabilities of the subsidiary must be derecognized in their entirety. The remaining interest in the company is to be recognized at fair value. The difference between the remaining carrying amounts and the fair values must be recognized in income.
- Non-controlling interests that become negative due to incurred losses must be recognized at their net negative amounts.

IFRS 3 (revised 2008) and IAS 27 (revised 2008) are applicable prospectively for annual periods beginning on or after July 1, 2009. Their impact on the presentation of the Group's financial position and results of operations will depend on the scale of future business combinations or divestments.

The amendments to IAS 39 (Financial Instruments: Recognition and Measurement) issued in July 2008 deal with one-sided risk hedging using options and with inflation hedging. They clarify the circumstances in which a hedged risk or portion of cash flows is eligible for hedge accounting. The amendments are to be applied for the first time for annual periods beginning on or after July 1, 2009. They will not have a material impact on the presentation of the Group's financial position or results of operations.

In April 2009 the IASB issued a second collection of amendments as part of its annual project "Improvements to IFRSs." The amendments address details of the recognition, measurement and disclosure of business transactions and serve to standardize terminology. They consist mainly of editorial changes to existing standards. Except as otherwise specified, the amendments, which have not yet been endorsed by the European Union, are to be applied for annual periods beginning on or after January 1, 2010. They will not have a material impact on the presentation of the Group's financial position or results of operations.

In June 2009 amendments were issued to IFRS 2 (Share-based Payment) that clarify the accounting for group cash-settled share-based payment transactions. The amendments specify how an individual subsidiary in a group should account for certain share-based payment arrangements in its own financial statements, and also incorporate the rules previously included in IFRIC 8 (Scope of IFRS 2) and IFRIC 11 (IFRS 2 – Group and Treasury Share Transactions). The revised standard, which has not yet been endorsed by the European Union, is to be applied retrospectively for annual periods beginning on or after January 1, 2010. The amendments will have no impact on the presentation of the Group's financial position, results of operations or earnings per share.

An amendment to IAS 32 (Financial Instruments: Presentation) was issued in October 2009. The amendment clarifies that rights issues, options and warrants denominated in a currency other than the issuer's functional currency and offered on a pro-rata basis to all owners of the same class of equity must be classified as equity. Such rights issues have so far been accounted for as liabilities. The change relates only to issues of a fixed number of shares at a fixed foreign-currency exercise price. The amendment is to be applied for annual periods beginning on or after February 1, 2010. Earlier application is permitted. It will not have a material impact on the presentation of the Group's financial position, results of operations or earnings per share.

In November 2009 the IASB issued the revised standard IAS 24 (Related Party Disclosures), which simplifies the reporting requirements of companies in which a government owns an interest. Under the revised standard, certain kinds of related-party transactions resulting from government ownership of private companies are exempt from some of the disclosure requirements. In addition, the definition of related parties was amended in several respects. The revised standard applies for annual periods beginning on or after January 1, 2011. Earlier application is permitted. It has not yet been endorsed by the European Union. The Bayer Group is currently evaluating the impact that the application of the revised standard may have on the presentation of its financial position and results of operations.

In November 2009 the IASB issued IFRS 9 (Financial Instruments), which addresses the classification and measurement of financial assets. Publication of IFRS 9 marks the completion of the first part of a three-part project to completely revise the accounting treatment of financial instruments. The new standard defines two instead of four measurement categories for financial assets, with classification to be based partly on the company's business model and partly on the characteristics of the contractual cash flows from the respective financial asset. An embedded derivative in a structured product will no longer have to be assessed for possible separate accounting treatment unless the host is a non-financial contract. A hybrid contract that includes a financial host must be classified and measured in its entirety. Application of IFRS 9 is mandatory for annual periods beginning on or after January 1, 2013. It has not yet been endorsed by the European Union. The Bayer Group is currently evaluating the impact that the application of the new standard may have on the presentation of its financial position and results of operations.

IFRIC 17 (Distributions of Non-cash Assets to Owners) was issued in November 2008. The interpretation addresses the recognition and measurement of liabilities related to non-cash dividends. It clarifies when an obligation to distribute a non-cash dividend is to be recognized, that it must be measured at fair value, and that the difference between the dividend paid and the carrying amount of the net assets distributed must be recognized in profit or loss at the distribution date. This interpretation is to be applied prospectively for annual periods beginning on or after July 1, 2009. It will not have a material impact on the presentation of the Group's financial position or results of operations.

IFRIC 19 (Extinguishing Financial Liabilities with Equity Instruments) was issued in November 2009. The interpretation addresses the accounting treatment in cases where a company settles all or part of a financial liability by issuing equity instruments to the creditor. It is to be applied for annual periods beginning on or after July 1, 2010. Earlier application is permitted. The interpretation has not yet been endorsed by the European Union. Its impact on the presentation of the Group's financial position and results of operations will depend on the extent to which financial liabilities are settled with equity instruments in the future.

In November 2009 amendments were issued to IFRIC 14 (IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction), an interpretation of IAS 19 (Employee Benefits). The amendments apply when a company is subject to minimum pension plan funding requirements. They enable prepayments of the respective contributions to be recognized as an asset. The amendments are to be applied for annual periods beginning on or after January 1, 2011. Earlier application is permitted. They have not yet been endorsed by the European Union. These amendments will not have a material impact on the presentation of the Group's financial position or results of operations.