Accounting principles and methods applied in preparation of the consolidated financial statements

General information

The consolidated financial statements of Henkel AG & Co. KGaA as of December 31, 2011 have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and in compliance with Section 315a of the German Commercial Code [HGB].

The individual financial statements of the companies included in the consolidation are drawn up on the same accounting date, December 31, 2011, as that of Henkel AG & Co. KGaA.

Members of the KPMG organization or other independent firms of auditors instructed accordingly have audited the financial statements of the material companies included in the consolidation. Having prepared the consolidated financial statements, on January 27, 2012 the Management Board of Henkel Management AG – which is the Personally Liable Partner of Henkel AG & Co. KGaA – approved the release of same to the Supervisory Board. The Supervisory Board is responsible for reviewing the consolidated financial statements and declaring whether it approves them.

The consolidated financial statements are based on the principle of historical cost with the exception that certain financial instruments are accounted for at their fair values. The Group currency is the euro. Unless otherwise indicated, all amounts are shown in million euros. In order to improve the clarity and informative value of the consolidated financial statements, certain items are combined in the consolidated statement of financial position, the consolidated statement of income and the consolidated statement of comprehensive income, and then shown separately in the Notes.

Scope of consolidation

In addition to Henkel AG & Co. KGaA as the ultimate parent company, the consolidated financial statements at December 31, 2011 include seven German and 170 non-German companies in which Henkel AG & Co. KGaA has a dominating influence over financial and operating policy, based on the concept of control. This is generally the case where Henkel AG & Co. KGaA holds, directly or indirectly, a majority of the voting rights. Companies in which not more than half of the voting rights are held are fully consolidated if Henkel AG & Co. KGaA, on the basis of contractual agreements or rights held, has the power, directly or indirectly, to appoint executive and managerial bodies and thereby to govern their financial and operating policies.

Compared to December 31, 2010, four new companies have been included in the scope of consolidation and eleven companies have left the scope of consolidation. Seven mergers also took place. The changes in the scope of consolidation have not had any material effect on the main items of the consolidated financial statements.

Acquisitions and divestments

The acquisitions and divestments made in fiscal 2011 had no material effect on the business and organizational structure of Henkel, nor on our net assets, financial position or results of operations.

Acquisitions

Effective January 1, 2011, we assumed control of Schwarzkopf Inc., Culver City, California, USA. We own 100 percent of the voting rights of the company. Having a direct presence in the US hair salon segment enables us to better exhaust the potential of this market. The purchase price paid was 42 million euros. Goodwill in the amount of 41 million euros was recognized. It is assumed that the capitalized goodwill is completely tax-deductible. Cash acquired in the amount of 1 million euros is shown in the consolidated statement of cash flows under payments for acquisitions. Customer and supplier relationships were capitalized in the amount of 3 million euros. The fair value applied to the acquired trade accounts receivable is 6 million euros.

As from April 1, 2011, we now include Purbond Group, Hatfield, UK, which was previously recognized at equity, as a fully consolidated entity in our consolidated financial statements. Our share of the voting rights is 100 percent. The purchase price paid amounted to 4 million euros. Fifty percent of the shares had already been acquired as of April 3, 2008. Taking into account the provisions of IFRS 3 pertaining to business combinations achieved in stages (step acquisition) and the corresponding revaluation of previously held shares at fair value, there ensued a positive contribution to earnings amounting to 2.5 million euros recognized under other operating income.

In the second half of 2011, we spent 3 million euros acquiring outstanding non-controlling interests in Rilken Cosmetics Industry S.A., Athens, Greece. Effective December 31, 2011, we increased our shareholding from 50 percent to 78 percent with the purpose of acquiring 100 percent of the shares in the future. The difference between the previously held share of net assets and the purchase price was recognized in retained earnings.

The goodwill recognized in the year under review essentially represents the market position and profitability of the acquired businesses, together with expected synergies.

The purchase price allocation procedure for all acquisitions was completed as of December 31, 2011.

The following table shows the acquisitions made in fiscal 2011. The acquisitions indicated, taken both individually and in sum, did not exert any material effect on the net assets, financial position or results of operations of the Group.

Acquisitions

January 1 to December 31 in million euros	Carrying amount	Adjustments	Fair value
Assets	14	3	17
Non-current assets	1	2	3
Current assets	12	1	13
Cash and cash equivalents	1	–	1
Liabilities	13	2	15
Non-current liabilities and provisions	6	–	6
Current liabilities and provisions	7	2	9
Net assets	1	1	2

Goodwill 2011

in million euros	Fair value
Purchase price	46
Fair value of non-controlling interests	3
Less net assets	2
Goodwill	47

Divestments

At the end of January 2011, we disposed of our non-core TAED bleach activator business in Ireland for 4 million euros.

On May 31, 2011, we sold our shares in Henkel India Ltd., Chennai, India. The sale proceeds amounted to 29 million euros while the gain totaled 48 million euros. In the course of the divestment, bank liabilities amounting to 66 million euros were discharged.

Effective June 30, 2011, we sold our roofing membrane business under the Wolfin brand operated by the Adhesive Technologies business sector. The proceeds of the sale amounted to 13 million euros with a gain of 9 million euros.

On December 9, 2011, we also disposed of our non-core corrosion-protection business in the USA operated by the Adhesive Technologies business sector. The proceeds of the sale were 8 million euros, resulting in a gain of 4 million euros.

On December 15, 2011, we sold our 51 percent share in the joint venture Cemedine Henkel Co. Ltd., Tokyo, Japan, generating proceeds of 6 million euros and a gain of 1 million euros.

The proceeds from the divestments indicated were received in cash. The gains were recognized under other operating income.

The following table shows the disposal and deconsolidation effects from entity sales in 2011 and from the divestment in 2011 of operations that no longer form part of our core business.

Divestments and deconsolidation effects

January 1 to December 31 in million euros	Henkel India Ltd.	Other entities	Other operations	Total
Disposal effects				
Non-current assets	4	6	2	12
Current assets	16	10	6	32
Assets held for sale	–	4	–	4
Cash and cash equivalents	–	4	–	4
Non-current liabilities and provisions	–	1	2	3
Current liabilities and provisions	69	9	–	78
Net assets	–49	14	6	–29
Share of net assets owned by shareholders of Henkel AG & Co. KGaA	–19	10	6	–3
Total consideration	29	10	21	60
Incidental costs of disposal	–3	–	–2	–5
Accumulated currency translation gains	3	1	–	4
Deconsolidation gain (+)/ loss (–)	48	1	13	62

Consolidation methods

The annual financial statements of Henkel AG & Co. KGaA and of the subsidiaries included in the consolidated financial statements were prepared on the basis of uniformly valid principles of recognition and measurement, applying the standardized year-end date adopted by the Group.

Such entities are included in the consolidated financial statements as of the date on which the Group acquired control.

All receivables and liabilities, sales, income and expenses, as well as intra-group profits on transfers of non-current assets or inventories, are eliminated on consolidation. Intra-group transactions are effected on the basis of market or transfer prices.

The purchase method is used for capital consolidation. With business combinations, therefore, all hidden reserves and hidden charges in the entity acquired are fully reflected at fair value and all identifiable intangible assets are separately disclosed. Any difference arising between the cost of acquisition and the (share of) net assets is recognized as goodwill. Entities acquired are included in the consolidation for the first time as subsidiaries by offsetting the carrying amount of the Henkel AG & Co. KGaA investment in them against their assets and liabilities. Contingent consideration is recognized at fair value as of the date of first-time consolidation. (Incidental) costs related to the acquisition of subsidiaries are not included in the valuation of those shares. Instead, they are recognized in other operating expenses in the period in which they occur. In the recognition of acquisitions of less than 100 percent, minority interests are measured at the fair value of the share of net assets that they represent. We do not apply the option of measuring minority interests at their fair value (full goodwill method).

In subsequent years, the carrying amount of the Henkel AG & Co. KGaA investment is eliminated against the current equity of the subsidiary entities concerned.

Changes in the shareholdings of subsidiary companies, as a result of which the participating interests of the Group decrease or increase without loss of control, are recognized within equity as changes in ownership without loss of control.

As soon as the control of a subsidiary is relinquished, all the assets and liabilities and the non-controlling interests, and also the accumulated currency translation gains or losses, are derecognized. In the event that Henkel continues to own non-controlling interests in the non-consolidated entity, these are measured at fair value. The result of deconsolidation is recognized under other operating income or charges.

Currency translation

The annual financial statements of the consolidated companies, including the hidden reserves and hidden charges of Group companies recognized under the purchase method, and also goodwill arising on consolidation, are translated into euros using the functional currency method outlined in International Accounting Standard (IAS) 21 “The Effects of Changes in Foreign Exchange Rates.” The functional currency is the currency in which the foreign company predominantly generates funds and makes payments. As the functional currency for all the companies included in the consolidation is the local currency of the company concerned, assets and liabilities are translated at closing rates, while income and expenses are translated at the average rates for the year, based on an approximation of the actual rates at the date of the transaction. The differences arising from using average rather than closing rates are taken to equity and shown as other components of equity or non-controlling interests, and remain neutral in respect of net income until the shares are divested.

Financial assets and liabilities in foreign currencies are measured at closing rates and recognized in profit or loss. For the main currencies in the Group, the following exchange rates have been used based on 1 euro:

Currency

		Average exchange rate		Closing exchange rate Dec. 31	
	ISO code	2010	2011	2010	2011
Chinese yuan	CNY	8.98	8.99	8.82	8.16
Mexican peso	MXN	16.75	17.31	16.55	18.05
Polish zloty	PLN	4.00	4.13	3.98	4.46
Russian ruble	RUB	40.26	40.91	40.82	41.77
US dollar	USD	1.33	1.39	1.34	1.29

Recognition and measurement methods

Summary of selected measurement methods

Items in the consolidated statement of financial position	Measurement method
Assets	
Goodwill	Lower of carrying amount and recoverable amount ("impairment only" method)
Other intangible assets	
with indefinite useful lives	Lower of carrying amount and recoverable amount ("impairment only" method)
with definite useful lives	(Amortized) cost less any impairment losses
Property, plant and equipment	(Amortized) cost less any impairment losses
Financial assets (categories per IAS 39)	
"Loans and receivables"	(Amortized) cost using the effective interest method
"Available for sale"	Fair value with gains or losses recognized directly in equity[1]
"Held for trading"	Fair value through profit or loss
Other assets	(Amortized) cost
Inventories	Lower of cost and net realizable value
Assets held for sale	Lower of cost and fair value less costs to sell

[1] Apart from permanent impairment losses and effects arising from measurement in a foreign currency.

Liabilities	
Provisions for pensions and similar obligations	Present value of future obligations ("projected unit credit" method)
Other provisions	Settlement amount
Financial liabilities (categories per IAS 39)	
"Measured at amortized cost"	(Amortized) cost using the effective interest method
"Held for trading"	Fair value through profit or loss
Other liabilities	Settlement amount

The methods of recognition and measurement are described in detail in the Notes relating to the individual items of the statement of financial position on these pages. Also provided as part of the report on our financial instruments (Note 21 on AR pages 128 to 138) are the disclosures relevant to IFRS 7 showing the breakdown of our financial instruments by category, our methods for fair value measurement, and the derivative financial instruments that we use.

Changes in the methods of recognition and measurement arising from revised and new standards are applied retrospectively, provided that there are no alternative regulations that supersede the standard concerned. The consolidated statement of income from the previous year and the opening balance of the consolidated statement of financial position for this comparative period are adjusted as if the new methods of recognition and measurement had always been applied.

In order to standardize the disclosure of financial instruments in accordance with IFRS 7 and IAS 39, we disclosed the assets from overfunding of pension obligations falling under IAS 19 (previous year: 15 million euros) and the reimbursement rights relating to employee benefits (previous year: 90 million euros in non-current assets and 9 million euros in current assets) under other assets instead of in other financial assets. Since 2011, the liabilities to employees falling under IAS 19 have been recognized under other liabilities instead of other financial liabilities. We have adjusted the consolidated statement of financial position as of December 31, 2010. There were no effects on the consolidated statement of income or the consolidated statement of comprehensive income.

In addition, we reclassified portions of liabilities to employees in the USA resulting from deferred compensation to pension obligations (previous year: 50 million euros) in the 2011 fiscal year. In economic terms, and based on the analysis of the actual treatment of the payments, these constitute post-employment benefits as defined in IAS 19. The reimbursement rights related to those pension obligations in the USA (previous year: 84 million euros) are therefore accounted for in accordance with the provisions of IAS 19 in the same way as the corresponding liabilities. Due to the change in this recognition method, we have appropriately adjusted the prior-year figures for pension obligations in the consolidated statement of financial position and also revised the prior-year Notes relating to pension obligations and other assets. The disclosures pertaining to the financial result have been expanded. There was no effect on the total amount of the income and expenses disclosed under financial result in the previous year, as the expected return from reimbursement rights corresponded to the actual return generated.

The reclassifications had the following effects on the relevant items of the consolidated statement of financial position dated December 31, 2010:

Reclassifications

in million euros	Dec. 31, 2010
Non-current assets	15
Other financial assets	–90
Other assets	105
Current assets	–15
Other financial assets	–24
Other assets	9
Non-current liabilities	3
Pension obligations	50
Other financial liabilities	–55
Other liabilities	8
Current liabilities	–3
Other financial liabilities	–28
Other liabilities	25

Accounting estimates, assumptions and discretionary judgments

Preparation of the consolidated financial statements is based on a number of accounting estimates and assumptions. These have an impact on the reported amounts of assets, liabilities and contingent liabilities at the reporting date and the disclosure of income and expenses for the reporting period. The actual amounts may differ from these estimates.

The accounting estimates and their underlying assumptions are continually reviewed. Changes in accounting estimates are recognized in the period in which the change takes place where such change exclusively affects that period. A change is recognized in the period in which it occurs and in later periods where such change affects both the reporting period and subsequent periods. The judgments of the Management Board regarding the application of those IFRSs which have a significant impact on the consolidated financial statements are presented in the explanatory notes on taxes on income (Note 30 on AR pages 140 to 142), intangible assets (Note 1 on AR pages 111 to 114), pension obligations (Note 15 on AR pages 120 to 124), financial instruments (Note 21 on AR pages 128 to 138) and share-based payment plans (Note 32 on AR pages 143 to 145).

Essentially, discretionary judgments are made in respect of the following two areas:

- The US dollar liabilities of Henkel of America, Inc. are set off against sureties of Henkel AG & Co. KGaA, as the deposit and the loan are with the same lender and of the same maturity, there is a legal right to set off these sums and the Group intends to settle net.
- The demarcation of the cash-generating units is also a discretionary judgment of the Group management and is explained under Note 1 on AR pages 111 to 114.

New international accounting regulations according to International Financial Reporting Standards (IFRS)

Accounting regulations applied for the first time in the year under review

Application of the following standards, amendments and interpretations has been mandatory since January 1, 2011:

Accounting regulations applied for the first time in the year under review

	Significance
Collective standard: “Improvements to IFRS 2010”	Minor
IAS 24 (Rev. 2009) “Related Party Disclosures”	Irrelevant
IAS 32 “Classification of Rights Issues” (Amendment)	Irrelevant
IFRIC 14 “Prepayments of a Minimum Funding Requirement” (Amendment)	Irrelevant
IFRIC 19 “Extinguishing Financial Liabilities with Equity Instruments”	Irrelevant

- In May 2010, the International Accounting Standards Board (IASB) issued amendments of existing standards and interpretations as part of its annual improvement project. In addition to editorial revisions introduced to clarify existing regulations, amendments also relate to changes of individual standards affecting recognition, measurement or disclosure.
- In November 2009, the IASB published a revision of IAS 24 “Related Party Disclosures.” The revised standard clarifies the definition of a related party and simplifies the disclosure requirement for government-related entities.
- In October 2009, the IASB published amendments to International Accounting Standard (IAS) 32 “Financial Instruments: Presentation.” The amendments stipulate the accounting at the issuer of pre-emptive rights, options and warrants issued to acquire a fixed number of equity instruments that are denominated in a currency other than that of the issuer. Such cases were hitherto reported as derivative liabilities. Pre-emptive rights that are issued pro rata at a fixed currency amount to the existing shareholders of a company are in future to be classified as equity. The currency in which the exercise price is stated is irrelevant.

- International Financial Reporting Interpretations Committee (IFRIC) 14 "IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction" deals with the accounting treatment of voluntary prepaid contributions made by a company in order to meet existing minimum funding requirements. The amendment allows a company to recognize the benefit arising from such a prepayment as an asset.
- IFRIC 19 "Extinguishing Financial Liabilities with Equity Instruments" states in particular that if a debtor issues equity instruments to a creditor to extinguish all or part of a financial liability, those equity instruments are "consideration paid" in accordance with IAS 39.41. The debtor should measure the equity instruments issued to the creditor at fair value. The debtor recognizes in profit or loss the difference between the carrying amount of the financial liability extinguished and the initial measurement of the equity instruments issued.

The first-time application of the revised and amended standards and interpretations had no material impact on the presentation of our financial statements.

Accounting regulations not applied in advance of their effective date

The following interpretations and amendments to existing standards of possible relevance to Henkel, which have been adopted into EU law (endorsement mechanism) but are not yet mandatory, have not yet been applied:

Accounting regulations not applied in advance of their effective date

	Mandatory for fiscal years beginning on or after
IFRS 7 "Disclosures Relating to the Transfer of Financial Assets and Liabilities" (Amendment)	July 1, 2011

- In October 2010, the IASB published an amendment to IFRS 7 "Financial Instruments: Disclosure." The purpose of the extended disclosure requirements is to provide financial statement users with a better understanding of the relationship between the transferred financial assets and the corresponding liabilities. Particularly where financial assets are completely derecognized, the additional information now required should enable an assessment of the type and the risks of any continuing involvement. The amendment is applicable for financial years beginning on or after July 1, 2011, with earlier application permitted.

This amendment of IFRS 7 will not be applied by Henkel until fiscal 2012. We do not expect application to have any material impact on the presentation of our financial statements.

Accounting regulations not yet adopted into EU law

In fiscal 2011, the IASB issued the following standards or interpretations of and amendments to standards of relevance to Henkel which still have to be adopted into EU law (endorsement mechanism) before they become applicable:

Accounting regulations not yet adopted into EU law

	Mandatory for fiscal years beginning or after
IAS 1 "Presentation of Items of Other Comprehensive Income" (Amendment)	July 1, 2012
IAS 19 (Rev. 2011) "Employee Benefits"	January 1, 2013
IAS 28 "Investments in Associates and Joint Ventures" (Amendment)	January 1, 2013
IAS 32 "Offsetting Financial Assets and Liabilities" (Amendment)	January 1, 2014
IFRS 7 "Disclosures – Offsetting Financial Assets and Liabilities" (Amendment)	January 1, 2013
IFRS 9 "Financial Instruments"	January 1, 2015
IFRS 10 "Consolidated Financial Statements"	January 1, 2013
IFRS 11 "Joint Arrangements"	January 1, 2013
IFRS 12 "Disclosure of Interests in Other Entities"	January 1, 2013
IFRS 13 "Fair Value Measurement"	January 1, 2013

These amendments and standards will be applied by Henkel from fiscal 2012 or later. We expect the future application of the aforementioned regulations not to have a significant impact on the presentation of the financial statements.