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

General information

The consolidated financial statements of Henkel AG & Co. KGaA, Düsseldorf, as of December 31, 2013 have been prepared in accordance with International Financial Reporting Standards (IFRS) and the relevant interpretations of the International Financial Reporting Interpretations Committee (IFRIC), as adopted per Regulation number 1606/2002 of the European Parliament and the Council, on the application of international accounting standards in 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, 2013, 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. The Management Board of Henkel Management AG – which is the Personally Liable Partner of Henkel AG & Co. KGaA – compiled the consolidated financial statements on January 30, 2014 and approved them for forwarding to the Supervisory Board and for publication.

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 and pension obligations are measured using the projected unit credit method. The functional currency of Henkel AG & Co. KGaA and the reporting currency of the Group 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, 2013 include seven German and 166 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.

The following table shows the changes to the scope of consolidation in fiscal 2013:

Scope of consolidation

At January 1, 2013	**178**
Additions	7
Mergers	– 2
Disposals	– 9
At December 31, 2013	**174**

The changes in the scope of consolidation have had no effect on the main items of the consolidated financial statements.

Subsidiaries which are of secondary importance to the Group and to the presentation of a true and fair view of our net assets, financial position and results of operations due to their inactivity or low level of activity are generally not included in the consolidated financial statements. The total assets of these companies represent less than 1 percent of the Group's total assets; their total sales and income net of taxes are also less than 1 percent of the Group totals.

Acquisitions and divestments

The acquisitions and divestments in fiscal 2013 had no material effect on the business and organizational structure of Henkel, nor on our net assets, financial position, or results of operations.

Acquisitions

On June 6, 2013, we spent 3 million euros acquiring the outstanding non-controlling interests in Henkel Kenya Ltd., Nairobi, Kenya, increasing our shareholding from 80 percent to 100 percent. The difference between the previously held share of net assets and the purchase price has been recognized in retained earnings.

Effective September 4, 2013, we completed an acquisition in the professional hair care segment in South Africa. The purchase price paid was 4 million euros. This resulted in the recognition of goodwill amounting to 2 million euros.

On December 11, 2013, we spent 66 million euros acquiring the outstanding non-controlling interests in OOO Henkel Bautechnik, Moscow, Russia. A performance-related component of consideration was also agreed under which we will pay a maximum of 44 million euros to the seller within the next four years. Our shareholding has increased from 66 percent to 100 percent. The difference between the previously held share of net assets and the purchase price has been recognized in retained earnings.

Effective December 11, 2013, we completed the full acquisition of a production facility for hair styling products in Russia from Wellchem Holding GmbH, Austria. The purchase price paid was 27 million euros. This resulted in the recognition of goodwill amounting to 9 million euros.

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

The following table shows the acquisitions of subsidiaries in fiscal 2013. The acquisitions indicated, taken both individually and in sum, have not exerted any material effect on the net assets, financial position or results of operations of the Group.

Acquisitions 2013

January 1 to December 31 in million euros	Carrying amount	Adjustments	Fair value
Assets	25	– 5	20
Non-current assets	25	– 5	20
Current assets	–	–	–
Cash and cash equivalents	–	–	–
Liabilities	–	–	–
Non-current liabilities and provisions	–	–	–
Current liabilities and provisions	–	–	–
Net assets	25	– 5	20

Goodwill 2013

in million euros	Fair value
Purchase price (paid in cash)	31
Fair value of non-controlling interests	–
Less net assets	– 20
Goodwill	11

Divestments

Effective January 10, 2013, we sold Chemofast Anchoring GmbH, Willich, Germany, for 26 million euros. As of December 31, 2012, we reported the assets and liabilities of the company as "held for sale." The sale transaction included the transfer of 4 million euros in cash to the buyer. We recognized the gain of 9 million euros from the deconsolidation under other operating income.

Disposal and deconsolidation effects 2013

January 1 to December 31 in million euros	Chemofast Anchoring GmbH	Other companies	Total
Disposal effects			
Non-current assets	11	7	18
Current assets	5	–	5
Cash and cash equivalents	4	2	6
Non-current liabilities and provisions	– 3	–	– 3
Current liabilities and provisions	–	– 1	– 1
Net assets	17	8	25
Proportion of net income attributable to shareholders of Henkel AG & Co. KGaA	17	8	25
Total consideration	26	4	30
Transaction costs	–	–	–
Accumulated currency translation gains (+)/loss (–)	–	– 2	– 2
Deconsolidation gain (+)/loss (–)	9	– 2	7

Consolidation methods

The 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.

The purchase method is used for capital consolidation. With business combinations, therefore, all hidden reserves and hidden charges in the entity acquired are revalued at the time of acquisition, and fully reflected at fair value, and all identifiable intangible assets are separately disclosed if they are clearly separable or if their recognition arises from a contractual or other legal right. Any difference arising between the cost of acquisition and the (share of) net assets after purchase price allocation is recognized as goodwill. The goodwill of subsidiaries is measured in the functional currency of the subsidiary.

Entities acquired are included in the consolidation for the first time as subsidiaries by offsetting the carrying amount of the respective parent company's investment in them against their assets and liabilities. Contingent consideration is recognized at fair value as of the date of first-time consolidation. Subsequent changes in value do not result in an adjustment to the valuation at the time of acquisition. (Incidental) costs related to the acquisition of subsidiaries are not included in the purchase price. Instead, they are recognized through profit and loss in other operating charges in the period in which they occur.

In the recognition of acquisitions of less than 100 percent, non-controlling interests are measured at the fair value of the share of net assets that they represent. We do not apply the option of measuring non-controlling 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 (share of) 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.

Companies recognized at equity

Associated companies and joint ventures are recognized at equity.

An associated company is a company over which the Group can exercise material influence on the financial and operating policies without controlling it. Material influence is generally assumed when the Group holds 20 percent or more of the voting rights. Where a Group company conducts transactions with an associated company or a joint venture, the resulting profits or losses are eliminated in accordance with the share of the Group in that company.

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 generally 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. Equity items are recognized at historical exchange rates. 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.

In the subsidiaries’ annual financial statements, transactions in foreign currencies are converted at the rates prevailing at the time of the transaction. 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:

Currencies

		Average exchange rate		Exchange rate on December 31	
	ISO code	2012	2013	2012	2013
Chinese yuan	CNY	8.10	**8.16**	8.22	**8.35**
Mexican peso	MXN	16.90	**16.97**	17.19	**18.07**
Polish zloty	PLN	4.18	**4.20**	4.07	**4.15**
Russian ruble	RUB	39.93	**42.34**	40.33	**45.32**
Turkish lira	TRY	2.31	**2.53**	2.36	**2.96**
US dollar	USD	1.28	**1.33**	1.32	**1.38**

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	(Depreciated) 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
“Fair value option”	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, which are basically unchanged from the previous year, 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 pages 140 to 152) 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 the effect is material and 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.

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 based on past experience and 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 particular in the explanatory notes on taxes on income (Note 30 on pages 155 to 157), intangible assets (Note 1 on pages 119 to 122), pension obligations (Note 15 on pages 128 to 136), income tax provisions and other provisions (Note 16 on page 137), financial instruments (Note 21 on pages 140 to 152) and share-based payment plans (Note 33 on pages 158 and 159).

Essentially, discretionary judgments are made in respect of the following two areas:
- The US dollar liabilities of Henkel of America, Inc., Wilmington, USA, are set off against sureties of Henkel US LLC, Wilmington, USA, 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 as explained in Note 1 on pages 119 to 122.

Application of IAS 8 to accounting policies

In application of IAS 8 paragraph 28 ff., the following information is reported:

In June 2011, the International Accounting Standards Board (IASB) published amendments to IAS 19 "Employee Benefits" (IAS 19, revised 2011). IAS 19 revised replaces the expected income from plan assets and the interest expense on the pension obligations with a uniform net interest component. The announcement is applicable for fiscal years beginning on or after January 1, 2013. IAS 19 revised requires retrospective application and the presentation of the effects of the first-time application on the opening balance at January 1, 2012. The retrospective adjustment led to an increase of 40 million euros in interest expense for fiscal 2012. Actuarial gains increased accordingly by 40 million euros. Following application of IAS 19 revised, the interest result for the 2012 fiscal year amounts to –182 million euros (prior to adjustment: –142 million euros).

In addition, IAS 19 revised provides for recognition in profit and loss of non-vested past-service costs as they occur. We did not adjust our pension obligations retrospectively for the 2012 fiscal year as there was no material effect on the presentation of the consolidated financial statements.

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

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

	Significance
IAS 1 (Amendment) "Presentation of Items of Other Comprehensive Income"	relevant
IAS 19 revised "Employee Benefits"	relevant
IAS 36 (Amendment) "Impairment of Assets"	relevant
IFRS 7 (Amendment) "Disclosures – Offsetting Financial Assets and Liabilities"	relevant
IFRS 13 "Fair Value Measurement"	relevant
General standard "Improvements to IFRS 2009–2011"	relevant

- In June 2012, the IASB published amendments to IAS 1 "Presentation of Financial Statements." In the future, items of other comprehensive income in the consolidated statement of comprehensive income which are later reclassified ("recycled") to the statement of income must be presented separately from items of other comprehensive income which will never be reclassified.
- In June 2011, the IASB published amendments to IAS 19 "Employee Benefits" (IAS 19, revised 2011). The impact on the consolidated financial statements is presented on page 116.
- The Amendment to IAS 36 includes revisions to the disclosure requirements if the recoverable amount for the impaired assets was determined on the basis of fair value less costs of disposal. The change will be early adopted.
- In December 2011, the IASB published amendments to IFRS 7 "Financial Instruments: Disclosures." Disclosures with respect to offsetting financial assets and liabilities encompass the duty to disclose both netted financial instruments and any unnetted financial instruments that are subject to an enforceable master netting agreement or similar agreement.
- IFRS 13 "Fair Value Measurement," which was published in May 2011, governs the measurement of fair value. Fair value is defined as exit price, meaning the price that would be realized in the sale of an asset or the price that would have to be paid to transfer an obligation.
- Adjustments arising from the annual improvement cycle are intended to clarify existing regulations. They also provide for changes that affect accounting, methods, valuation and the information reported in the notes to the consolidated financial statements. The standards affected are IAS 1, IAS 16, IAS 32, IAS 34 and IFRS 1.

The first-time application of the amended standards had a material impact on the presentation of our consolidated financial statements only in connection with IAS 19 revised.

Accounting regulations not applied in advance of their effective date

The following standards 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 been applied early:

Accounting regulations not applied in advance of their effective date

	Mandatory for fiscal years beginning on or after
IAS 28 (Amendment) "Investments in Associates and Joint Ventures"	January 1, 2014
IAS 32 (Amendment) "Offsetting Financial Assets and Liabilities"	January 1, 2014
IAS 39 (Amendment) "Novation of Derivatives and Continuation of Hedge Accounting"	January 1, 2014
IFRS 10 "Consolidated Financial Statements"	January 1, 2014
IFRS 11 "Joint Arrangements"	January 1, 2014
IFRS 12 "Disclosure of Interest in Other Entities"	January 1, 2014
IFRS 10 (Amendment), IFRS 11 (Amendment) and IFRS 12 (Amendment) "Transition Guidance"	January 1,2014

- In December 2011, the IASB published amendments to IAS 32 "Financial Instruments: Presentation." The amendment to IAS 32 explains and clarifies the criteria for offsetting financial assets and financial liabilities in the statement of financial position. The amendment to IAS 32 is mandatory for fiscal years beginning on or after January 1, 2014.
- In May 2011, the IASB published the new standards IFRS 10 "Consolidated Financial Statements," IFRS 11 "Joint Arrangements," and IFRS 12 "Disclosure of Interest in Other Entities," as well as amendments to IAS 28 "Investments in Associates." Under the new concept of IFRS 10, control exists when the potential parent company holds decision power over the potential subsidiary based on voting rights or other rights, it is exposed to positive and negative variability in returns from the subsidiary, and these returns may be affected by the decision power held by the parent. Under the new concept of IFRS 11, a distinction is made in a joint arrangement as to whether it is a joint operation or a joint venture. In a joint operation, the individual rights and obligations are accounted for proportionately in the consolidated financial statements. In contrast, joint ventures are represented in the consolidated financial statements using the equity method. As part of the adoption of IFRS 11, adjustments were also made to IAS 28. The new IFRS 12 expands the disclosure requirements for interests in other entities. The

amendments relate to clarifications and additional changes to ease transition to IFRS 10, IFRS 11, and IFRS 12. The new standards and the amendments to standards must be applied beginning January 1, 2014. The amendments will have no impact on the scope of consolidation.

- With the amendment to IAS 39 in June 2013, a derivative maintains its designation as a hedging instrument under hedge accounting even if it is novated to a central counterparty as the result of legal requirements, provided certain criteria are met.

These new standards and amendments to existing standards will be applied by Henkel from fiscal 2014 or later. Unless otherwise indicated, we expect the future application of the aforementioned regulations not to have a significant impact on the presentation of the financial statements.

Accounting regulations not yet adopted into EU law
In fiscal 2013, the IASB issued the following standards and amendments to existing 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 on or after
IAS 19 (Amendment) “Defined Benefit Plans: Employee Contributions”	January 1, 2015
IFRS 9 “Financial Instruments”	open
IFRS 7 (Amendment) and IFRS 9 (Amendment) “Mandatory Effective Date and Transition Disclosure“	open
IFRIC 21 “Levies”	January 1, 2014
General standard “Improvements to IFRS 2010–2012”	January 1, 2015
General standard “Improvements to IFRS 2011–2013”	January 1, 2015

These standards and amendments to existing standards will be applied by Henkel starting in fiscal 2014 or later.