

Activity Report 2009

Financial Reporting Supervision



Activity Report of the Financial Reporting Supervision Division¹

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¹ This is an English translation of the original Dutch text, furnished for convenience only. In case of any conflict between this translation and the original Dutch text, the latter shall prevail.

1 Summary

The Netherlands Authority for the Financial Markets (*Stichting Autoriteit Financiële Markten*, or AFM) publishes this activity report to inform the public of its financial reporting supervision activities and findings in the 2009 calendar year. Following the implementation of the Transparency Directive into Dutch law, the AFM's supervision duties include supervision of the correct application of financial reporting standards in both annual and half-yearly financial reports, the supervision of half-yearly financial reports starting in 2009. Given that shareholders and auditors are not involved in the preparation of half-yearly financial reports, or have a limited involvement therein, and that the AFM has limited enforcement tools, its reviews of half-yearly financial reports are more limited in scope than its reviews of annual financial reports. Following the implementation of the Transparency Directive, issuers are required to publish their annual financial reports and to file these financial reports much more quickly than before, i.e. within four months of the end of the financial year.

The AFM's public database includes filings made in 2009 of annual and half-yearly financial reports of approximately 240 issuers and interim management statements of approximately 130 issuers. Compliance with the latter obligation requires improvement by some issuers. The AFM will pay attention to compliance with this requirement in 2010. Nine (2008: six) issuers filed their annual financial reports after having been instructed by the AFM to do so. 60% of issuers filed their financial reports electronically. With a view to enhancing efficiency in this area, the AFM intends to point out to all issuers filing in hardcopy form that financial reports can be filed electronically with the AFM.

The AFM commenced 63 reviews of annual financial reports in 2009, including 24 (2008: 27) reviews to establish whether issuers had adequately complied with notifications issued by the AFM in respect of the 2007 financial year. Eighteen (2008: fifteen) issuers had complied with their AFM notifications, six (2008: twelve) had not. As a consequence, the AFM performed a full desktop review of the financial reports of the latter group. The 2008 financial year saw an increase in the number of companies adequately complying with AFM notifications to 75 percent, up from 55 percent for the 2007 financial year. The AFM welcomes this upward trend, but believes that there is more room for improvement.

The AFM completed 62 (2008: 63) desktop reviews in 2009. 38 (2009: 38) of these reviews resulted in the AFM requesting additional information regarding the application of financial reporting standards. As in 2008, the AFM and issuers felt the statutory enforcement term² of six months to be restrictive. Dutch Parliament will discuss a proposal to extend this term from six months to nine months early 2010.

² Pursuant to Section 449 of Book 2 of the Netherlands Civil Code, any stakeholder, the Advocate-General or the AFM can initiate annual accounts proceedings with the Enterprise Section of the Amsterdam Court of Appeal within six months of adoption.

Only two (2008: eight) issuers were able to remove the AFM's doubts about the correct application of financial reporting standards. The other 36 (2008: 30) issuers were issued one or more notifications, one (2008: two) of which was accompanied by a recommendation. A recommendation requires an issuer to issue a press release explaining the incorrect application of financial reporting standards. In 2009, there were four (2008: two) cases where the AFM issued a notification which was not accompanied by a recommendation, although a recommendation was justified given the nature of the non-compliance with financial reporting standards. One issuer voluntarily included the AFM's findings in its half-yearly report. In three other cases, the statutory enforcement term of six months had expired. The AFM urged these issuers to voluntarily issue a press release. One issuer was not prepared to do so. At the time of publication of this activity report, it was unknown whether the other two issuers concerned were prepared to issue a press release.

2009 saw a 20 percent increase in the number of companies being issued one or more notifications, from 30 in 2008 to 36, based on an equal number of reviews performed. 2009 also saw an increase per company in the average number of standards covered by notifications, from 3.5 in 2008 to 4.9 in 2009.

The 2009 statistics show an improvement in the quality of financial reporting by the vast majority of the issuers that were issued one or more notifications in any year by complying with the notifications in the subsequent year. Unfortunately, the AFM found that the financial reports of the other companies still displayed the same defects, despite the AFM reporting in general terms on its findings and reporting defects in its activity report and its thematic reviews. In 2010, the AFM, together with issuers and audit firms, will review how to enhance the impact of its reports.

The notification issued that was accompanied by a recommendation related to the notes to the company financial statements, which did not include an adequate disclosure regarding the substantial difference between shareholders' equity in the consolidated financial statements and the company financial statements.

The notifications that were not accompanied by recommendations related to non-compliance with the following financial reporting standards: IFRS 7 *Financial Instruments: Disclosures*, IAS 12 *Income Taxes*, IAS 1 *Presentation of Financial Statements* and IAS 36 *Impairment of Assets*. In respect of company financial statements, the AFM's notifications mainly dealt with the accounting of investments in consolidated group companies. For these investments, reference to the accounting policies in the consolidated financial statements does not suffice, because the accounting policy applied in the consolidated financial statements, namely consolidation, cannot be applied in the company financial statements. In addition, companies cannot apply the equity method to these companies, given that Part 9 of Book 2 of the Netherlands Civil Code does not allow this accounting policy. Other notifications related to recognition of statutory reserves.

In many cases, our findings related to omitted, incomplete or inaccurate disclosures. This does not imply that financial reports cannot include any other errors or reporting defects. It should be noted that the AFM's primary focus is the correct application of financial reporting standards. Our reviews do not include verifying whether the financial report presents a true and fair view of a

company's financial position, financial results and cash flows. The AFM's work does not include a repetition of the auditor's work. Management estimates and judgements can only be subject to a limited review and any request for additional information can only be made if the AFM has doubts about the correct application of financial reporting standards based on public information.

The AFM reviewed the half-yearly financial reports of 39 companies in 2009. Virtually all reviews have been completed and one company was issued a notification.

The AFM reviewed how the effectiveness and efficiency of its supervision of financial reports can be improved. Our review followed the Spyker judgement in April 2009 and the investigation into the statutory powers and the performance of supervisory authorities during the credit crisis, as well as our supervision experience to date. The AFM reported both to the De Wit Committee³ and the Dutch Ministry of Finance that its powers are too limited to ensure rigorous enforcement. Rigorous supervision is paramount to investor confidence in financial markets. Any AFM request for additional information can only be made if, based on public information, it has doubts about the correct application of financial reporting standards. In addition, issuers are not required to submit any specific information and/or documents when asked to do so by the AFM. A review conducted by the Review Panel of the Committee of European Security Regulators (CESR) has confirmed that the AFM's powers are more limited than those of other European security regulators. In addition, the AFM supports the removal of the Chinese walls currently limiting information exchanges between departments insofar as this information is obtained by other AFM departments in a legally valid way in the course of their own supervision activities. The AFM's aim in advocating an extension of its powers expressly is not to repeat the auditor's work, which would be impossible with a department with a headcount below twenty. The AFM's supervision of financial reports will always be risk-based, as is customary in our surrounding countries. However, the AFM's aim is to be able to pursue its questions in cases where the AFM has identified specific risks regarding certain financial reporting areas. The AFM already has such powers in supervision areas governed by administrative law, such as market abuse, prospectuses and public offerings.

Finally, this report includes a summary of the AFM's findings from the thematic reviews performed in 2009. Our review of the application of the financial reporting standards regarding revenue recognition showed that there is room for marked improvement of disclosures in this area. In 34 percent of the financial reports reviewed, our thematic review resulted in a notification to the issuer involved regarding the application of IAS 11 *Construction Contracts* and/or IAS 18 *Revenue*. Some of our notifications dealt with disclosures that had been omitted or were incomplete. Others dealt with the use of boilerplate language, which rendered disclosures insufficiently specific. Disclosures require improvement in the following respects. Firstly, the accounting policies for revenue recognition should relate to the nature of the company's activities. Secondly, the notes to the financial statements must also include the conditions for revenue recognition and the methods used to determine the stage of completion of construction contracts. Finally, disclosures must include a breakdown of total revenue into important categories, such as the rendering of services, the sale of goods and other. For revenue recognition in respect of construction contracts the following disclosures are required: the methods used to determine

³³ The committee set up in June 2009 to conduct a parliamentary investigation into the credit crisis.

contract revenue and the stage of completion, the aggregate amount of costs incurred, the amount of advances received and the amount of retentions.

Our thematic review of the application of IAS 36 *Impairment of Assets* showed that there is also room for improvement regarding impairment disclosures. Improvements include disclosure of the events and circumstances leading to recognition of impairment losses, disclosure of the assumptions used to determine the value in use of the asset or cash generating unit to which the asset is allocated and a sensitivity analysis. In addition, IAS 36 requires cash flows to be discounted using a pre-tax rate to determine value in use. In cases where the company can only come up with a post-tax market rate, the pre-tax discount rate should be deduced from the post-tax rate. The AFM would like to point out that a post-tax discount rate grossed-up by the standard rate of tax does usually not result in the correct pre-tax discount rate.

The AFM's thematic review of the annual Management Board report pursuant to Section 391 of Book 2 of the Netherlands Civil Code showed that compliance with the statutory requirements can substantially be improved. Compliance with laws and regulations enhances transparency and promotes investor confidence. Approximately 70 percent of the issuers reviewed included in their Management Board report one or more of the three statements regarding their internal risk management and control systems. Approximately 30 percent of the issuers reviewed did not include any statement about their internal risk management and control systems in their Management Board report and only 50 percent of the issuers reviewed included a statement about the absence of any indications of these systems not operating properly in the current financial year. This outcome is alarming, given the importance of this information. In addition, the issuers concerned did not give any explanation for not providing this information.

The AFM was very active internationally as a member of CESR. In addition, the AFM's Chairman co-chairs the Financial Crisis Advisory Group (FCAG), he is Vice-Chairman of IOSCO's Technical Committee and in that capacity he chairs the IASCF's Monitoring Board.

2 Introduction

Supervision is currently attracting a great deal of attention. The credit crisis has given rise to questions about the effectiveness of supervision, supervisory legislation and co-operation between supervisors. The De Wit Committee has been set up by the Dutch House of Representatives to investigate the credit crisis. The committee's mandate includes a review of the role of supervisors, their statutory powers and the actions taken by the supervisors, including those in the area of financial reporting. Another important development in the area of financial reporting was the publication of the Dutch Supreme Court's judgement regarding Spyker's 2006 financial statements in April 2009. Like the Enterprise Section of the Amsterdam Court of Appeal, the Supreme Court paid attention to the supervisor's role and the auditor's opinion in its judgement. The Supreme Court requires the AFM to play an active role in investigating the facts and lends much weight to the auditor's opinion.

Partly as a result of the above developments, the AFM decided to review the effectiveness and efficiency of its supervision of financial reports. The AFM has concluded that its supervision effectiveness and efficiency are impacted by the AFM's limited powers and the Chinese walls

created by the legislator. The Chinese walls severely restrict the ability of the Financial Reporting Supervision Division to work together with other AFM departments and/or other supervisors. This issue is addressed in Chapter 6.

The implementation of the Transparency Directive into Dutch law as regards the preparation, publication and filing of financial reports has impacted both the number of companies under financial reporting supervision and the scope of the term financial report. Effective the 2009 financial year, the AFM's duties include supervision of compliance with the requirements for half-yearly financial reports. In addition, the population of issuers under supervision now includes the annual and half-yearly financial reports of 50 so-called third-country issuers (non-EU issuers⁴) and twelve closed-end investment institutions. 30 issuers with bond issues opted for another home Member State, as a result of which the number of issuers under our supervision saw a net increase of thirty issuers.

This report also sets out the AFM's activities in 2009 in its role as financial reporting supervisor, distinguishing between our supervision of the publication and filing of financial reports and our supervision of compliance with financial reporting standards. This report also includes the findings of the reviews we announced in November 2008 of the application of IAS 18 *Revenue*, IAS 36 *Impairment of Assets* and Section 391 of Book 2 of the Netherlands Civil Code regarding the annual Management Board report. In addition, this report provides supervision statistics and sets out the AFM's international activities.

3 Findings regarding supervision of compliance with financial reporting standards

3.1 Annual financial reports

3.1.1 General

In 2009, the AFM selected the annual financial reports of 110 issuers qualifying for an extensive analysis, or desktop review. Our selection was driven by risk analysis, financial reporting notifications in previous years and rotation. In 2009, the AFM selected the annual financial reports of seven companies on the basis of public signals. In 2009, the AFM started desktop reviews of the annual financial reports of 63 (2008: 70) issuers. Average staffing levels in 2009 and our limited powers (see Chapter 6) allow for a maximum of just over 60 desktop reviews per year. As a consequence, the AFM did not review the majority of the financial reports selected for rotation purposes. 54 of the reviews started were completed in 2009. In addition, we completed eight desktop reviews in 2009 which we started in 2008, making the total number of reviews completed in 2009 62 (2008: 63).

The AFM distinguishes two categories of desktop reviews. The first review category is a review of compliance with the notifications issued by the AFM regarding the previous financial year's financial report. In 2009, 24 (2008: 27) desktop reviews fell into this follow-up category. In eighteen (2008: fifteen) cases, we concluded that the notification had been adequately complied

⁴ Non-EU issuers whose securities are listed on a regulated market in the EU and whose home Member State is the Netherlands.

with. In six (2008: twelve) cases, we performed a full desktop review of the annual financial report of the companies because our notifications had not been adequately complied with. 2009 saw an increase in the percentage of issuers adequately complying with our notifications to 75 percent, compared with 56 percent in 2008, which is a very positive development. For the benefit of the users of financial reports, we would like to see issuers fully comply with notifications issued by the AFM.

The annual financial reports of seven other issuers also qualified for a follow-up review. However, their financial reports had already been selected for a full desktop review based on our risk analysis. Therefore, the follow-up reviews were included in the full desktop reviews. For these issuers, the degree of compliance with notifications previously issued was similar to the 24 issuers mentioned above. The total number of full desktop reviews of financial reports was 45 (2008: 48).

As regards the reviews completed in 2009, the AFM made a request for additional information to 38 (2008: 38) issuers about the application of financial reporting standards. Only two of these issuers were able to remove the AFM's doubts about the application of financial reporting standards. The other 36 issuers were issued one or more notifications, representing a 20 percent increase compared with 2008, when 30 issuers were issued one or more notifications, based on an equal number of reviews performed. 2009 also saw an increase per issuer in the average number of standards covered by notifications, from 3.5 in 2008 to 4.9 in 2009. It should be noted that these numbers do not take into account the impact of issuers where the AFM issued more than one notification per standard. These statistics show an improvement in the quality of financial reporting by the vast majority of companies that were issued one or more notifications in any year, by complying with the notifications in the following year. Unfortunately, the AFM found that the financial reports of the other issuers still included these defects, despite the AFM reporting in general terms on its findings and reporting defects in its activity reports and thematic reviews. The AFM therefore expected issuers and auditors to have been aware of these financial reporting defects. In 2010 the AFM, together with issuers and audit firms, intends to review how to enhance the impact of its reports on the correct application of financial reporting standards and, as a result, the quality of financial reports.

In one (2008: two) case, we issued a notification accompanied by a recommendation requiring the issuer to publish a press release explaining the impact on its 2007 financial report had the company applied the financial reporting standards correctly.

There were four cases (2008: two) in 2009 where the AFM issued notifications which were not accompanied by a recommendation although a recommendation was justified, given the nature of the non-compliance with financial reporting standards. One issuer voluntarily included the AFM's findings in its half-yearly report. In the case of three other issuers, the statutory enforcement term of six months had expired. The AFM urged these companies to voluntarily issue a press release. One company was not prepared to do so. At the time of publication of this activity report, it was unknown whether the other two issuers concerned were prepared to issue a press release. These findings show that adequate enforcement tools are paramount to the AFM's effectiveness. This issue is further addressed in Chapter 6.

Appendix A presents, in tabulated form, the AFM's activities in respect of its supervision of compliance with financial reporting standards and of the publication of financial reports. This appendix does not include any requests for additional information and notifications issued in connection with thematic reviews.

3.1.2 Recommendations and notifications

General

As regards financial reporting issues that are the subject of an AFM recommendation, the AFM believes that correct application of financial reporting standards significantly impacts an issuer's current and future financial reports. It is important for users of financial reports to be made aware of this information, because it will enable them to make well-considered investment and other decisions. It is in the public interest that such issues are made transparent. Such transparency is achieved by issuing a public statement following an AFM recommendation, thus contributing to an adequate functioning of the capital markets and promoting investor confidence in these markets. The AFM believes that greater transparency of such issues outweighs any interests of issuers to refrain from going public.

Recommendations can be issued in cases where any non-compliance with financial reporting standards affects a primary statement (i.e. balance sheet, income statement, cash flow statement or statement of changes in equity), possibly resulting in material misstatements in the financial report. Failing to provide essential disclosures may also result in the AFM issuing a recommendation.

Recommendations

In 2009 the AFM issued one (2008: two) notification accompanied by a recommendation. This recommendation related to a 2007 financial report. The issuer's Management Board is responsible for the contents of the required public statement. The recommendation issued by the AFM related to the notes to the company annual financial statements, which did not include an adequate disclosure regarding the substantial difference between shareholders' equity in the consolidated annual financial statements and the company annual financial statements.

Notifications

The AFM issued notifications to 35 issuers that were not accompanied by a recommendation. While these notifications related to material defects in financial reports, their nature did not require investors to be informed immediately. In some cases, investors had already been informed, e.g. through half-yearly financial reports. The notifications issued in 2009 concerned highly diverse issues and will not be made public, given the AFM's statutory obligation to observe confidentiality. That is why the AFM is only providing its general findings below.

Generally speaking, notifications often related to disclosures, which had been omitted or were incomplete. The AFM is under the impression that, in some cases, disclosures deserve greater attention in the preparation of financial statements. Disclosures are important because they enable users of financial reports to gain an understanding of the issuer's financial position, financial performance and cash flows. The lack of attention to disclosure requirements possibly is a

consequence of financial reporting practice in the Netherlands, where disclosure requirements were less strict than in some other countries.

Appendix A provides a summary of the number of issuers that were issued one or more notifications regarding certain financial reporting standards. The AFM issued one or more notifications to 36 issuers, nineteen (2008: ten) of which related to the incorrect application of IFRS 7 *Financial Instruments: Disclosures*. Most notifications related to the disclosure of the methods used in determining the fair value of financial instruments and disclosures regarding liquidity risk. The liquidity risk analysis required under IFRS 7, in many cases, included discounted payments and did not include interest payments. Chapter 7 further addresses this issue. Second place was held by IAS 12 *Income Taxes*. Most IAS 12 notifications related to omitted or insufficiently detailed disclosures of the major components of tax expense (income), an explanation of the relationship between tax expense and pre-tax profit, the amount of deferred tax assets and liabilities and/or deferred tax income or expense included in profit or loss and the nature of the evidence supporting the recognition of deferred tax assets. The AFM issued notifications relating to IAS 12 to seventeen issuers (2008: eleven). Third place was held by IAS 1 *Presentation of Financial Statements* (2008: eight) and IAS 36 *Impairment of Assets* (2008: six). Both standards were subject of notifications to fifteen issuers. The IAS 1 notifications related to the omission of additional information that, although not specifically required by other financial reporting standards, was relevant to investors gaining an understanding of the financial position and performance of issuers. In addition, the AFM found that some issuers should not have included a statement of compliance with IFRSs because they had failed to comply with a substantial number of IFRS requirements. Finally, there were a number of cases where issuers had failed to include comparative information. The increase in the number of issuers receiving notifications regarding the application of IAS 36 was to be expected, given the current economic circumstances. The main IAS 36 defects also related to disclosures. These disclosures can be improved by not merely referring to the current economic circumstances when disclosing the events and circumstances leading to the recognition of impairment losses, but also discussing circumstances specific to the issuer. The AFM also found that some issuers had failed to disclose the assumptions used to determine the recoverable amount or that these disclosures were too limited. Finally, IAS 36 requires issuers determining the value in use to use a pre-tax discount rate to discount the cash flows and to disclose this discount rate. Chapter 10 sets out the findings of our thematic review of the application of IAS 36. The AFM again saw non-cash items presented in cash flow statements, which is not in compliance with IAS 7. It is striking to note that the AFM issued notifications regarding IAS 24 *Related Party Disclosures* to eight issuers. The AFM reported on the application of this standard last year following one of its thematic reviews. In many cases, the notifications related to inadequate disclosures of key management personnel compensation.

In 2009, the AFM issued 33 notifications regarding the incorrect application of financial reporting requirements in Part 9 of Book 2 of the Netherlands Civil Code and the Act on Financial Supervision (*Wet Toezicht Financieel Toezicht*, or Wft), 26 of which related to the company financial statements. Most issues raised in notifications related to statutory reserve requirements and the accounting policy for consolidated participating interests in the company financial statements. Chapter 8 of this report further addresses the latter subject.

Many of our findings related to omitted, incomplete or inaccurate disclosures. This does not imply that financial reports cannot include any other errors or reporting defects. The AFM's primary focus is the correct application of financial reporting standards. Our reviews, therefore, do not include verifying whether the financial report presents a true and fair view of an issuer's financial position, financial results and cash flows. The AFM's work does not include a repetition of the auditor's work. Management estimates and judgements can only be subject to a limited review. Any request for additional information can only be made if the AFM has doubts about the correct application of financial reporting standards based on public information. Chapter 6 further addresses this issue.

3.2 Half-yearly financial reports

Half-yearly financial reports are selected for a limited review when the issuer's annual financial report for the previous period were or will be the subject of a desktop review. In addition, half-yearly financial reports will also qualify for a limited-scope review when the AFM has indications of potential financial reporting issues in this financial report. We were also requested by the AFM's Market Abuse Supervision Division to review a number of press releases. These requests were made prior to publication of these press releases. They also included releases of half-yearly financial reports of issuers not selected for our own limited-scope reviews.

The AFM started 39 limited-scope reviews of half-yearly financial reports in total, a few of which are still in progress. In the case of one of the completed reviews, the AFM requested additional information. The issuer concerned was not able to remove the AFM's doubts about the correct application of financial reporting standards. In this case, the AFM issued a notification, setting out how, according to the AFM, the transaction should be disclosed in the 2009 annual financial report. The AFM expects that it will make a few requests for additional information in early 2010.

4 Other activities

This chapter provides a summary of the AFM's other activities regarding its supervision of financial reports, successively dealing with the changes the AFM has made in its requests for additional information, its international work and its Committee Financial Reporting.

4.1 Additional information

Issuers are requested to provide additional information when the AFM has doubts about the correct application of financial reporting standards. The term 'doubts' within the meaning of the Wft means that the AFM wonders whether the financial report has been prepared in accordance with applicable financial reporting standards. It does not mean that the AFM believes that financial reporting standards have been applied incorrectly. This conclusion can only follow from a review of any additional information provided by the issuer and a discussion of the issue concerned. The AFM has learnt that some issuers were confused about the use of the term 'doubts'. Some issuers were concerned that the AFM was biased when reviewing any additional information provided. The AFM would like to remove such concerns.

The AFM changed its requests for additional information in two ways in 2009. We made a number of improvements to increase readability at the beginning of the year. Changes included moving relevant IFRS extracts to a separate appendix, the use of less formal language in our requests and restricting the use of the expression “doubts about the correct application of financial reporting standards” to the letter. Mid 2009, the AFM introduced a paragraph asking whether, and to what extent, the issues addressed in its request for additional information have been discussed with the issuer’s auditor following the audit of the financial report. The AFM also introduced a request to provide the information about these issues laid down in the audit report pursuant to subsection 4 of Section 393 of Book 2 of the Netherlands Civil Code, the management letter or in other documents from the external auditor. The latter change was prompted by the Dutch Supreme Court’s judgement on Spyker’s 2006 annual financial statements. The Supreme Court’s judgement confirmed the position taken by the Enterprise Section of the Amsterdam Court of Appeal in proceedings to revise the annual financial statements, i.e. that much importance can be attached to the opinion of the auditor. That is why the AFM would like to be able to know how the auditor has judged certain issues. Both issuers and auditors have commented on this new paragraph. In response, the AFM would like to point out that its request only relates to issues where it has doubts about the correct application of financial reporting standards and that this information is or may be relevant to removing the AFM’s doubts. The AFM has decided to clarify its request for additional information in this respect.

The AFM is increasingly seeing that the issuer’s audit committee is actively involved in responding to its requests for additional information. There were a number of cases where the issuer requested a substantially longer response time than our standard response time of ten working days, because the issuer’s audit committee would not be meeting for another few weeks. While the AFM welcomes the involvement of audit committees, unnecessary delays in the supervision process should be avoided, given the restrictions posed by the statutory six month enforcement period. The AFM also believes that today’s modern communication technology should enable audit committee involvement outside of their regular meetings.

As an experiment, the AFM has informed AEX-listed issuers one to two weeks in advance that the AFM would be making a request for additional information, with a view to enabling the issuer to properly plan for any resources required to deal with this request. Based on the responses from the issuers concerned, the AFM has concluded that issuers welcome this advance notice. We have therefore decided to announce all our requests for additional information in advance from 2010.

4.2 International activities

The AFM has been very active internationally. The AFM’s Chairman co-chairs the Financial Crisis Advisory Group (FCAG). He is also Vice-Chairman of the Technical Committee of the International Organization of Securities Commissions (IOSCO) and, in that capacity, chairs the Monitoring Board of the International Accounting Standards Committee Foundation (IASCF). The Monitoring Board has been set up to promote the public accountability of the IASCF. The FCAG was set up by the IASB and the FASB at the end of 2008 to provide them with input regarding the impact of the credit crisis on financial reporting standards and on worldwide supervision of financial institutions. The FCAG’s members are leaders with a broad range of experience in financial markets. The FCAG published its report on 28 July 2009 setting out that

effective financial reporting depends on high quality accounting standards as well as the consistent and faithful application and rigorous independent audit and enforcement of those standards.

The AFM's active participation in CESR-fin included attending seven European Enforcement Coordination Sessions (EECS). At these meetings, European financial reporting supervisors discuss supervision decisions made by individual supervisors, including twelve decisions made by the AFM. In addition, the AFM presented two complex cases to EECS prior to making its supervision decision. EECS aim to promote and ensure consistent application of IFRS in Europe. The AFM is a member of the agenda committee of EECS. In that capacity it can influence what decisions are selected for discussion at EECS. The AFM also participated in the CESR-fin working groups CESR-fin on IFRS and CESR-fin on Fair Value Accounting. The former is a permanent working group preparing comment letters to the IASB and EFRAG regarding Discussion Papers and Exposure Drafts of accounting standards. Some comment letters were authored by the AFM. Important Discussion Papers and Exposure Drafts that CESR-fin commented on included ED *Financial Instruments: Classification and Measurement* (IFRS 9), ED *Derecognition* (Proposed Amendments to IAS 39 and IFRS 7), ED *Fair Value Measurement* and the DP *Preliminary Views on Revenue Recognition in Contracts with Customers*. The comment letters are available on CERS's website (www.CESR.eu). The CESR-fin on Fair Value Accounting working group published a report on 2 November 2009 about compliance with IFRS 7 *Financial Instruments: Disclosures* in the 2008 financial reports of 96 European financial institutions. The report shows that certain disclosures require improvement, including disclosures of the methods used in determining fair value and the underlying assumptions. This information is important to gain an understanding of the issuer's financial position and performance, thus impacting the decisions made by users of financial reports. The results relating to Dutch financial institutions are similar to those described in the CESR report.

4.3 Financial Reporting Committee

The AFM and its Financial Reporting Committee (the Committee), an advisory committee comprising financial reporting experts, met three times in 2009. At these meetings, financial reporting topics and issues relating to supervision were discussed.

Partly in view of the Supreme Court's judgement regarding Spyker Cars N.V., the AFM reviewed its supervision role to see whether there are any bottlenecks in its supervision of financial reports. The consequences of the court's judgement and the main bottlenecks were discussed with the Committee. In addition, the AFM consulted the Committee on thematic reviews for the 2008 financial year and on complex, technical financial reporting issues in certain annual reports reviewed by the AFM. Finally, the AFM and the Committee discussed the possibility of giving preclearance regarding one or more financial reporting requirements.

Due to the set three-year appointment period, the Committee's composition changed in October 2009. Eight out of the twelve members were reappointed, while three new members were appointed. There is one vacancy.

5 Findings regarding supervision of publication and filing of half-yearly and annual financial reports and interim management statements

5.1 Publication and filing

Following the implementation of the Transparency Directive, the AFM again determined the composition of the group of issuers falling under its financial reporting supervision at the end of 2008. The issuers concerned were informed of their obligations in early 2009, following the implementation of the Transparency Directive.

The implementation of the Transparency Directive in 2009 raised many questions about the new legislation regarding the publication and filing of half-yearly and annual financial reports and interim management statements. The AFM has published a list of frequently asked questions and answers about the implementation of the Transparency Directive on its website.

The filings of half-yearly and annual financial reports with the AFM are checked to see whether they are complete, i.e. whether they contain a half-yearly or annual Management Board report, half-yearly or annual financial statements and a true and fair view statement. There is no substantive review of the financial reports at this point. Within five working days of filing, the AFM includes the financial report in its public database.

Issuers can file their half-yearly and annual financial reports and/or interim management statements in two ways: electronically via Loket AFM or by mail using the form for hardcopy filings of periodic information available at the AFM's website. Electronic filing is quick and easy. A large majority of issuers filed electronically. The AFM urges all issuers to file their financial reports for the 2009 financial year electronically. The AFM will advise issuers, where appropriate, of the possibility of electronic filing in 2010.

Due to some technical teething problems, the electronic filing process met with some delays in the spring of 2009. These technical problems have now been resolved and filing is expected to be a more efficient process in 2010.

Following the implementation of the Transparency Directive, it was unclear how the term 'shares' in Chapter 5.1a of the Wft should be interpreted, and about the contents of the true and fair view statement in the half-yearly Management Board report. Clarification of the term 'shares' is relevant, for instance, for determining an issuer's home Member State within the meaning of the Transparency Directive, and to determine whether interim management statements have to be published. That is why the AFM published an interpretation of the term 'shares' within the meaning of Chapter 5.1a of the Wft on its website on 22 September 2009.

Section 5:25d, subsection 2(c), under 2 of the Wft requires the management of the company to state that the half-yearly Management Board report gives a true and fair view of the state of affairs on the balance sheet date, the course of business during the financial half year of the issuer and of the expected course of business. This is consistent with the statutory requirements for the annual

Management Board report⁵, but differs from the statutory requirements for the contents of the half-yearly Management Board report⁶.

The wording of the true and fair view statement of some issuers was consistent with the Act, while other issuers included a statement which was consistent with the contents of the half-yearly Management Board report. The AFM considers both statements to be in compliance with the requirements of the Act. It should be noted that Dutch Parliament is currently considering a proposal to amend the Act that will eliminate this inconsistency.

5.2 AFM's public database

Up to publication of this report, approximately 260 issuers had filed their published annual financial reports with the AFM in 2009. Approximately 230 issuers filed their half-yearly financial reports. Approximately 120 issuers (with listed shares) filed interim management statements for two interim periods, while approximately ten issuers did so for one interim period. The number of issuers filing their annual financial reports exceeded the number of companies filing half-yearly financial reports. This is because issuers that have issued only debt securities with a denomination per unit in excess of €50,000 are not required to file their half-yearly financial reports.

There were nine cases (2008: six) where the AFM issued a notification relating to non-publication or non-filing of annual financial reports, half-yearly financial reports and/or interim management statements. The AFM did not impose any orders for incremental penalty payments in 2009. In one case, the AFM notified the issuer of its intention to impose an order for incremental penalty payments. Given the bankruptcy of the issuer concerned, the AFM in the end did not impose any order for incremental penalty payments.

Virtually all issuers preparing consolidated financial statements filed their financial reports with the AFM. Approximately 70 issuers only preparing company financial statements have not yet filed their annual and half-yearly financial reports. These are mostly issuers with issued debt securities only preparing company financial statements.

The AFM expects that issuers in 2010 will be familiar with the requirements resulting from the implementation of the Transparency Directive. As part of its supervision activities in 2010, the AFM will pay attention to timely and full compliance with the requirement to file half-yearly and annual financial reports. The AFM will take appropriate action where necessary, mainly focusing on issuers preparing company financial statements only.

The AFM issued one recommendation, which related to the 2007 financial year. Following our recommendation, this issuer published a press release regarding its financial report. This release

⁵ Section 391 of Book 2 of the Netherlands Civil Code

⁶ Section 5.25d subsection 8 of the Act on Financial Supervision requires that the half-yearly Management Board report includes at least a list of important events that occurred during the first six months of the financial year concerned and their impact on the half-yearly financial statements, as well as a description of the main risks and uncertainties for the other six months of the financial year concerned.

was filed with the AFM and included in our public database. The AFM did not include any press release relating to the 2008 financial year in its public database following a recommendation. The public database also included the judgement of the Dutch Supreme Court in the Spyker Cars N.V. case.

6 The AFM's limited powers and Chinese walls

6.1 Limited powers for supervision of financial reports

The AFM has reported to the De Wit Committee and the Dutch Ministry of Finance that its powers to conduct its supervision of financial reports are too limited, adversely impacting the efficiency and effectiveness of the AFM's supervision. This issue also raises the question whether the AFM's supervision currently qualifies as rigorous supervision. A rigorous enforcement regime is key to underpinning investors' confidence in the financial markets and is required by virtue of Article 10 of the Treaty establishing the European Community. The AFM has reported the following restrictions:

1. The AFM can only make a request for additional information if, based on public facts and circumstances, the AFM has doubts⁷ about the correct application of financial reporting standards. It has to be borne in mind that financial reports may include items involving a high risk of incorrect application of financial reporting standards without the AFM necessarily having doubts within the meaning of the Act on the Supervision of Financial Reporting. In such cases, the AFM believes it is important to be able to verify that financial reporting standards have been applied correctly, regardless of whether it has doubts based on public information about the correct application of these standards.
2. In any request for additional information, the AFM can specifically enquire after information and/or documents which it believes will remove its doubts⁸. However, the AFM does not have the power to require such information and/or documents to be provided, whereas the AFM does have this power in other supervision areas. Issuers are free to determine how to remove the AFM's doubts. There were several cases where issuers did not provide documents and/or information requested by the AFM, or did so after much delay, adversely impacting the efficiency and effectiveness of its supervision.
3. The powers and enforcement measures available to the AFM under administrative law, which governs its other supervision activities, do not apply to the AFM's supervision pursuant to the Act on the Supervision of Financial Reporting. Following the Spyker judgement, commentators have raised questions about the appropriateness of the request for additional information as an instrument for gathering information. For instance, having the powers available under administrative law to request information in the pre-proceedings stage would be a logical step and would not be troublesome⁹.
4. The enforcement regime under civil law is aimed at revising the annual financial statements, which means that starting proceedings with the Enterprise Section of the Amsterdam Court of Appeal to revise the annual financial statements is the only road open to the AFM in case of

⁷ See Section 2 subsection 1 of the Act on the Supervision of Financial Reporting

⁸ Explanatory Memorandum to the Act on the Supervision of Financial Reporting, House of Representatives, meeting year 2005-2006, 30.336, no. 3.

⁹ See P.N. Ploeger in JOR 2009/188

any non-compliance with a recommendation. The AFM believes that it is important for issuers to comply with any recommendation, because its aim is to inform the public quickly of any defects in financial reports. Initiating proceedings to revise annual financial statements with the Enterprise Section can be a disproportional measure.

5. The AFM has only six months after adoption of the annual financial statements to make a request to the Enterprise Section to:
 - a. order the issuer to provide additional information (when the issuer fails to comply or fully comply with a request for additional information); or
 - b. revise the annual financial statements (when the issuer fails to comply with a recommendation or when the annual financial statements are gravely defective¹⁰).

Parliament will discuss a legislative proposal to increase the six-month period to nine months in early 2010.

These restrictions are a particular obstacle where the measurement of items in the annual financial statements is concerned, given that case law has shown that issuers may exercise a certain degree of judgement in recognising and measuring items involving the assessment of certain risks and expectations. The accounting of items in the annual financial statements is defective only when:

1. management acted unreasonably in arriving at the adopted accounting approach; or
2. the accounting does not comply with:
 - a. the general norm regarding the true and fair view provided by the annual financial statements;
 - b. other applicable requirements.

In addition, the Spyker proceedings before the Enterprise Section has shown the Enterprise Section to be unresponsive and, pursuant to Section 149 of the Dutch Code of Civil Procedure, decides only on the basis of facts and circumstances brought forward during the proceedings and which have become unequivocal. The Spyker case has also shown that the Enterprise Section attaches much importance to the view of the auditor responsible for the audit of the annual financial statements and who, in many cases, has given an unqualified audit opinion. The Enterprise Section's unresponsiveness and the importance of the auditor's opinion have been confirmed by the Dutch Supreme Court.

This combination of factors, i.e. the burden of proof falling on the AFM, the room for judgement on the part of the issuer, the AFM's limited powers and the importance attached to the auditor's opinion, will result in the AFM not being able to detect accounting defects regarding measurement of assets and liabilities as part of its supervision of financial reports, or in the AFM not being able to demonstrate such defects sufficiently convincingly. The market's perception, however, is that the AFM detects such defects and acts on them, as supervisors in surrounding countries do. The above is illustrated by the fact that the AFM as supervisor of audit firms has made critical remarks about the adequacy of the audit of the measurement of financial assets by financial institutions and

¹⁰ The AFM can make a request for additional information or a request to revise annual financial statements to the Enterprise Section during a six-month period after adoption of the annual financial statements. See Section 449, subsection 1 and Section 452, subsection 2 of Book 2 of the Netherlands Civil Code.

the way the fair value of these financial assets was determined, while the AFM's findings from its supervision of financial reports are limited to disclosure defects.

The European Commission, through CESR, has developed a common enforcement approach. In this context, CESR published Standard No.1 on Financial Information: Enforcement of standards on financial information in Europe on 12 March 2003. This standard sets out principles aimed at harmonising supervision of financial reports in Europe. The Review Panel published its report¹¹ on compliance with this CESR standard in September 2009. 45 percent of EU countries fully comply with these principles. The Netherlands is one of the countries partially (but significantly) applying the principles. Its limited powers restrict the AFM in fully applying these standards.

On the basis of the analysis set out above, the AFM believes the following powers are needed:

1. The power to make a request for additional information without the requirement that the AFM has to have 'doubts' about the correct application of financial reporting standards. This would enable the AFM to ask for additional information on financial reporting areas where there is a risk of incorrect application of financial reporting standards.
2. The power to ask targeted questions about specific information and/or documents, similar to the power the AFM has in other supervision areas, without compliance with the AFM's request being at the issuer's discretion.
3. The power to take note of the auditor's views regarding specific financial reporting issues. This power is important to the AFM because the Enterprise Section has turned out to attach great importance to the views of the issuer's auditor.
4. The power to request the Enterprise Section to order an issuer to comply with a recommendation issued by the AFM. The AFM already has this power with regard to issuers whose seat is in a third country.

The extension of the AFM's powers is not aimed at repeating the auditor's work or to repeat many questions raised with the issuer by the auditor. Given the limited staff resources, the AFM will always have to follow a risk-based approach, as is customary in our surrounding countries. However, the AFM's aim is to be able to pursue its questions in cases where the AFM has identified specific risks regarding certain financial reporting areas. The AFM already has such powers in its supervision under administrative law of market abuse, prospectuses and public offerings. The AFM appreciates that any extension of its powers should not place too much of a burden on the open communication between the issuer and its auditor.

6.2 Chinese walls

The legislation governing financial supervision comprises certain restrictions (Chinese walls) limiting the AFM to exchange confidential information from supervision activities between supervision departments. As a consequence, the AFM's department supervising financial reports is not allowed to use information obtained by the AFM in the course of its other supervision duties, including its supervision of prospectuses, public offerings, audit firms and market abuse. This may lead to situations where the AFM has information which may be relevant to its

¹¹ Final report of the Review Panel concerning the updated self assessment and peer review of CESR's Standard No.1 on financial information (CESR/09-372), 25 September 2009

supervision of financial reports, but which may not be used for that purpose. In addition, there are limits on the AFM employing financial reporting expertise in other supervision areas. Finally, the department supervising compliance with financial reporting standards is not allowed to share with other departments information obtained in the course of its duties. In short, the above Chinese walls interfere with the AFM's ability to perform its supervision duties efficiently and effectively. The AFM's Chinese walls do not seem to promote a fair and efficient capital market and investor confidence in this market. The restrictions are hard to defend in the light of the AFM's supervision goals.

Efficient and effective supervision requires being able to use all supervision information available within the AFM obtained in a legally valid way by other AFM departments. Of course, other departments cannot be allowed to gather information for the benefit of the department supervising financial reports, if the latter department does not have the power to gather such information. Again, the AFM is looking for powers that are similar to the powers that supervisors in our surrounding countries currently have.

To enhance the effectiveness and efficiency of the AFM's supervision of audit firms, the department supervising financial reports has provided financial reporting support to the department supervising audit firms. This support took the form of IFRS training and providing financial reporting expertise regarding certain audit firm supervision reviews. The AFM has of course honoured the current limitations. Co-operation on specific audit firm supervision reviews has been limited to issuers that do not fall under the AFM's financial reporting supervision, in many cases non-public interest entities. The AFM finds this form of co-operation very useful, but it cannot cover reviews relating to issuers most relevant to the capital market.

7 Findings regarding IFRS 7 Financial Instruments: Disclosures

The financial crisis has had a great impact on the financial position and performance of financial institutions. While accounting standards did not create the financial crisis, the current crisis did draw attention to some weaknesses in standards and their application. These weaknesses related to determining fair value in inactive markets and the tremendous complexity of the accounting of financial instruments. Enhancing or regaining, as the case may be, the confidence of investors requires greater transparency regarding the financial position of financial institutions. This applies to disclosures on the measurement and the risks of financial instruments in particular. This information is important to users of financial statements, enabling them to gain a proper understanding of the impact of financial instruments on the financial position and performance of issuers.

The International Accounting Standards Board (IASB) has recognised the importance of transparency of financial reporting. The IASB has recently published a new standard (IFRS 9 *Financial Instruments: Classification and Measurement*) to reduce the complexity of the accounting of financial instruments. In addition, the IASB amended IFRS 7 *Financial Instruments: Disclosures* in March 2009. The amendments related to more extensive requirements for fair value and liquidity risk disclosures, including the introduction of a fair value hierarchy. For each class of financial instruments, entities are required to disclose to what extent fair value measurements are based on quoted prices in active markets (Level 1), on inputs other than quoted

prices in active markets that are observable (Level 2), and inputs that are not based on observable market data (Level 3). This information must be presented in tabular format, unless another format is more appropriate. IFRS 7 now also requires a maturity analysis for derivative financial liabilities. The new IFRS 7 rules are to be applied for annual periods starting on or after 1 January 2009.

Other international organisations have also recognised the importance of transparency in the light of the financial crisis. The Committee of European Banking Supervisors (CEBS), for instance, proposed guidance in 2009 to help financial institutions to improve their risk disclosures.

In 2009, CESR reviewed the 2008 year-end financial statements of 96 listed European banks and/or insurers focusing on the application of disclosure requirements related to financial instruments. CESR's findings in its report of 30 October 2009 revealed that financial institutions had not always disclosed adequate information on the measurement and the risks of their financial instruments. In some areas, a significant proportion of companies failed to provide adequate disclosures about financial instruments. Omission of this information might affect the ability of users of financial statements to make their decisions.

CESR's findings are to a large extent consistent with the AFM's findings, reported in December 2008, from its 2008 thematic review of 2007 year-end financial statements focusing on the application of IFRS 7. The AFM found that while IFRS 7 requirements had largely been complied with, improvements were required in a number of areas. For instance, improvements were required in disclosures of the categories of financial instruments whose fair value was based on quotes in active markets and financial instruments whose fair value was based on valuation methods, including the assumptions used. This equally applied to liquidity risk disclosures.

In 2009, the AFM again performed a desktop review of the 2008 financial statements of a large number of financial institutions. As in 2008, the AFM found that while IFRS 7 requirements had largely been complied with, there is still room for improvement in some areas. It should be noted that the AFM's notifications issued to financial institutions following its desktop reviews of 2007 financial statements seem to have resulted in better quality 2008 financial reports of these issuers. In many cases, however, the information provided did not go beyond the disclosures required under IFRS 7. In many cases, companies did not provide any additional information, even in cases where such information could be relevant for investors in understanding the risks associated with the financial instruments.

The 2008 financial statements of financial institutions showed an improvement in the quality of the breakdown of financial instruments into instruments whose fair value was based on price quotations in active markets and instruments whose fair value was determined using a valuation technique (using either observable or non-observable market data)¹². However, there were some cases where this disclosure was not transparent or entirely transparent. In some cases, the descriptions used in the financial statements differed from the terminology used in IFRS 7.27(b) and (c). At the same time, the information could not be derived from the disclosures provided. In addition, the information provided did not cover all financial instruments, excluding for instance

¹² IFRS 7.27(b) and (c)

derivatives. The AFM expects greater compliance with these requirements as a result of the introduction of the fair value hierarchy requirement (in tabular format) effective from 2009.

The AFM raised many questions and issued many notifications about liquidity risk disclosures¹³. IFRS 7 requires issuers to provide a maturity analysis for financial liabilities, showing the remaining contractual maturities. However, the AFM found that many maturity analyses included discounted amounts where non-discounted amounts were required and that they did not include all financial liabilities. In many cases, for instance, liabilities from future interest payments were not included. Given the proposed amendments to IFRS 7 regarding liquidity risk, the AFM expects that compliance with the maturity analysis requirements for financial liabilities will improve in the future.

In addition, the AFM reviews revealed that some issuers had not complied with the following requirements:

- Providing disclosures if the issuer has designated a financial liability as at fair value through profit or loss (IFRS 7.10 and IFRS 7.11) combined with the requirements in IFRS 7 Appendix B5(a);
- Providing disclosures about hedges (fair value hedges, cash flow hedges and hedges of net investments in foreign activities) as described in IFRS 7.22, IFRS 7.23 and IFRS 7.24;
- Disclosing information about financial assets that are past due or that have been impaired (IFRS 7.37);
- Disclosing the criteria used by the issuer to determine that there is objective evidence that an impairment occurred of an investment in an equity instrument (IAS 39.61 and Appendix B5(f) of IFRS 7). For instance, there were financial institutions that had not disclosed the criteria used to determine that there is a significant or prolonged decline in the fair value of an investment in an equity instrument below its cost. It is important for users to understand these criteria used by financial institutions.

8 Accounting policies used in the company financial statements

Under Section 362, subsection 8 of Book 2 of the Netherlands Civil Code, an issuer preparing consolidated financial statements in accordance with IFRS¹⁴ can use one of the following sets of accounting principles when preparing its company financial statements:

1. Part 9 of Book 2 of the Netherlands Civil Code;
2. Part 9 of Book 2 of the Netherlands Civil Code, applying the accounting policies used by the issuer in its consolidated financial statements under IFRS (hereafter: option 2);
3. IFRS.

An issuer applying option 2 must apply the accounting policies used in the consolidated financial statements to all items in the company financial statements, with the exception of any consolidated

¹³ IFRS 7.39(a) combined with the requirements in IFRS 7, Appendix B14-B16

¹⁴ IFRS being the IASB's accounting standards and IFRIC's interpretations as endorsed by the European Commission.

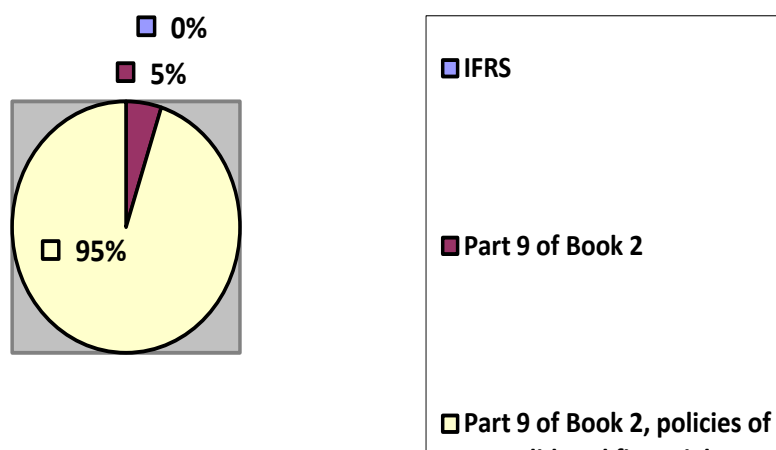
participating interests¹⁵. The accounting policy used in the consolidated financial statements, i.e. consolidation, cannot be applied to consolidated participating interests in the company financial statements.

The legislator has not explicitly prescribed the accounting of these consolidated participating interests in the company financial statements under option 2. However, given the legislator’s aim and the full applicability of Part 9 of Book 2 of the Netherlands Civil Code in all other respects, measurement of consolidated participating interests in the company financial statements at net asset value is the obvious approach. This accounting principle is in accordance with Section 389, subsections 1 and 2 of Book 2 of the Netherlands Civil Code, requiring participating interests over which the issuer has significant influence to be measured at net asset value. Net asset value is then determined using the IFRS accounting policies included in the consolidated financial statements.

The AFM’s review of the AEX and AMX-listed issuers falling under its supervision (21 and 22 issuers respectively) included a review of:

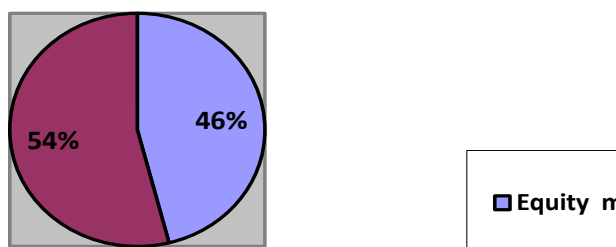
- the accounting policies used in the company financial statements;
- for issuers applying option 2, the accounting and measurement of consolidated participating interests in the 2008 company financial statements.

Our findings showed that nearly all issuers reviewed had applied option 2 in their company financial statements. There were no issuers applying IFRS in its company financial statements.



In the notes to the company financial statements, the issuers applying option 2 in their company financial statements paid attention to the accounting and measurement of consolidated participating interests in these financial statements. The AFM would like to point out that the notes generally referred to the measurement of participating interests.

¹⁵ Consolidated participating interests in the company financial statements are subsidiaries and other group companies included in the consolidation in the consolidated financial statements.



A majority of the issuers applying option 2 in their company financial statements accounted for their consolidated participating interests using the net asset value method, measuring these interests at net asset value, while a small minority used the equity method. Strikingly, over twenty percent of the small minority of issuers applying the equity method separately recognised goodwill in the company financial statements. Separate recognition of goodwill seems to be inconsistent with the application of the equity method.

As explained above, the AFM very much doubts whether the use of the equity method to account for and consolidated participating interests and measure such interest is in accordance with the requirements in Part 9 of Book 2 of the Civil Code. As a result of differing accounting rules for impairment testing and reversing impairment losses regarding, on the one hand, goodwill and, on the other hand, participating interests accounted for and measured using the equity method, the AFM doubts whether the legislator's goal is met by issuers applying the equity method to account for and measure consolidated participating interests.

9 Findings regarding IAS 18 Revenue

The AFM's thematic review covered 41 issuers operating in various business sectors. The AFM requested 21 issuers to provide additional information about the application of financial reporting requirements for revenue. The number of questions raised in our requests totalled 72. Nineteen reviews have been completed. Two issuers failed to answer or fully answer the questions raised in our requests for additional information. The AFM issued one or more notifications (eighteen in total) to fourteen issuers, not requiring issuers to publish any statement. The other reviews were concluded without the AFM having to take any further action.

Accounting policies

The AFM raised questions about accounting policies in twelve cases. These questions dealt with revenue measurement, conditions used for revenue recognition and the relationship between the activities of issuers and their accounting policies. The AFM issued nine notifications in this area. Two reviews are still in progress. All issuers included an accounting policy. However, the accounting policy as included in the financial report did not in all cases comply with the requirements in IAS 18. In addition, many issuers used boilerplate language. As a consequence, the accounting policies were not specific to the issuer nor did they give an indication of the nature of the issuer's activities. As a consequence of generic accounting policies for revenue recognition,

users are withheld important information about revenue recognition in relation to the nature of the issuer's activities.

IAS 18 identifies three categories of transactions and events: the sale of goods, the rendering of services and the use by others of the issuer's assets. IAS 18 sets out the conditions for revenue recognition for these categories. Given that these conditions are relevant to gain a proper understanding of the financial statements, we reviewed whether they had been included in the financial statements. The majority of issuers had not disclosed all applicable conditions. In addition, several financial statements did not include the method used to determine the stage of completion for the rendering of services. Non-disclosure of the conditions for revenue recognition and the methods used to determine the stage of completion interferes with users' ability to gain a proper understanding of the timing of revenue recognition.

The AFM found indications in the accounting policies that revenue had been measured at cost or amortised cost. The AFM believes that revenue can only be measured at fair value.

Revenue breakdown

Most questions raised, seventeen in total, dealt with the revenue breakdown required in IAS 18.35(b). The AFM found that the breakdown into categories had not been disclosed or that it was incomplete. As a consequence, the AFM issued four notifications in this area. In one case, our review of the revenue breakdown remains to be concluded. In the other cases, the AFM decided to take no further action against non-disclosure of the revenue breakdown on the grounds of materiality. The revenue breakdown was not disclosed in almost fifty percent of cases. Non-disclosure of the revenue breakdown interferes with the user gaining a proper understanding of the size of the activities in the various categories in relation to the accounting policies set out in the financial statements.

Construction contracts

Twelve issuers disclosed information about construction contracts. The AFM raised questions about the disclosures of construction contracts with seven issuers. One review is still in progress. The AFM issued notifications to four issuers on this subject. In the other cases, the AFM decided to take no further action on the grounds that the disclosures concerned were not material.

A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets. The nature of the activities undertaken in construction contracts is such that the project starting date and completion date often fall in different reporting periods. The revenues and costs associated with these projects must be allocated to the reporting periods in which the project is undertaken. Disclosures required for construction contracts include the amount of contract revenue, the methods used to determine the stage of completion, the aggregate amount of costs incurred, the amount of advances received and the amount of retentions. Not all issuers complied with these disclosure requirements.

Other findings

The AFM would like to draw attention to the following findings:

- None of the selected issuers disclosed any revenue from exchanges of goods or services or any accompanying disclosures;
- One issuer early adopted IFRIC 13 in its 2008 financial report, explaining its impact;
- None of the selected issuers early adopted IFRIC 15 in their 2008 financial reports. None of the issuers expected implementation to fundamentally change recognised revenue and profit or loss.

Summary

Based on eighteen notifications regarding the application of IAS 18 and IAS 11 in the 2008 financial reports of fourteen issuers, the AFM's conclusion is that there is room for improvement for revenue recognition disclosures in various areas. This view is supported by the number of requests for additional information (21 in total). As a consequence of the limited disclosures, users are unable to gain a proper understanding of the issuers' activities and their size, the timing of revenue recognition and revenue measurement. Improving these disclosures will provide the user with information about the size and nature of the issuer's activities.

In summary, the AFM believes that there is room for marked improvement of IAS 18 disclosures, in particular:

- disclosing accounting policies for revenue recognition that are tailored to the nature of the issuer's activities;
- disclosing the conditions for revenue recognition and the methods used to determine the stage of completion;
- disclosing a revenue breakdown into important categories; and
- for construction contracts, disclosing revenue, the methods used to determine revenue and the stage of completion, the aggregate amount of costs incurred, the advances received and the amount of retentions.

10 Findings regarding IAS 36 Impairment of Assets

Our thematic review of the application of IAS 36 *Impairment of Assets* showed that issuers recognised far more impairments in 2008 than in 2007, both in nature and size. This is consistent with the expectation expressed by the AFM at the time of deciding to conduct this review. It is also consistent with deteriorating economic circumstances in 2008.

All issuers included an accounting policy for impairments of assets. In many cases, the wording of the accounting policy seemed to have been copied from IAS 36. The use of boilerplate language interferes with the relevance of information provided to users of financial reports.

On a positive note, disclosures of many issuers with individually material impairment losses complied with the requirements in IAS 36.130. However, the disclosure of the events and circumstances leading to the recognition of the impairment loss is often very brief. In most cases, this disclosure stops at a reference to the economic crisis. This clearly is a disclosure that should be improved. The AFM believes that information about the events leading to impairment losses contains important information for users of financial reports, particularly, in the case of recent significant acquisitions. Users of financial reports would benefit from knowing what management

assumptions underlying the acquisition decision turned out differently and any consequences thereof for the financial position and performance of the issuer.

Most issuers provided the disclosures required in IAS 36.130 and IAS 36.134 about the allocation of goodwill, at the level where the entity's management tests the book value of the allocated goodwill, i.e. cash-generating units. Some issuers disclosed this information at business segment level, explaining that management tested goodwill at the lower level of cash-generating units. These issuers did not comply with the IAS 36 requirements.

A number of issuers determined the recoverable amount of cash-generating units based on the fair value of discounted future cash flows. The AFM would like to point out that issuers determining the recoverable amount of cash-generating units based on discounted future cash flows have to use assumptions used by market participants and cannot use management's assessments, which are not known in the market. In addition, the AFM found that some issuers had used post-tax discount rates to determine the value in use of cash-generating units. Using a post-tax discount rate is not in accordance with IAS 36.55, which requires the use of a pre-tax discount rate. Given the IASB's clear view on the use of a pre-tax discount rate, the AFM believes that this requirement has to be complied with.

The disclosures of the growth and discount rates used by issuers saw a marked improvement. The number of issuers not disclosing these rates saw a big drop in 2008 compared with 2007. The AFM, however, found that issuers had provided little information about the determination of the rate and the reasons for any rate change compared with 2007. In this area, issuers can improve their disclosures by providing clear disclosures to the users of financial reports.

A majority of issuers reviewed did not disclose the effects of reasonably possible changes in key assumptions based on which the recoverable amount of a cash-generating unit was determined. This disclosure is required if a change in an assumption would result in an impairment loss. There definitely is room for improvement in this area. Full compliance with the requirements in IAS 36.134(f) would give the user of the financial report a proper understanding of the forces at play in determining the recoverable amount of cash-generating units and any impairment loss that may or may not have been recognised.

In summary, the AFM's view is that there is room for marked improvement of some IAS 36 disclosures, in particular:

- disclosure of events and circumstances leading to the recognition of the impairment loss;
- clear disclosure of the assumptions used to determine the fair value of assets and cash-generating units, given that assumptions used to determine the recoverable amount based on fair value were not provided in all cases;
- disclosure of the assumptions used to determine the fair value based on value in use; and
- the impact of reasonably possible changes in assumptions used to determine the recoverable amount.

11 Findings regarding the annual Management Board report pursuant to Section 391 of Book 2 of the Netherlands Civil Code

Compliance with the statutory requirements for the annual Management Board report requires substantial improvement. Compliance with rules and regulations enhances transparency, in this way contributing to investor confidence in the Management Board of issuers and the supervision thereof.

Risk Profile

Virtually all fourteen AEX-listed issuers reviewed set out the major risk factors (financial, operational, strategic and compliance) in their annual Management Board reports. While a majority of the issuers reported the impact on profit or loss of any risk occurring, the AFM believes that the description of the risk profile can be improved by using the guidance provided by the Frijns Committee in its 2007 Monitoring Report.

A majority of issuers did not include the Corporate Governance section in their annual Management Board report within the meaning of Section 391 of Book 2 of the Netherlands Civil Code. As a consequence, the statement about the application of best practice provisions was not included in the Management Board report, of which this statement has to form part.

The AFM noticed that nearly 50% of the issuers reviewed had not included information about their objectives and policies for managing the risks of financial instruments in the Management Board report. This information was provided elsewhere in the financial report, in many cases, in the notes to the financial statements. In this context, it is worth noting that IFRS allows issuers to include this information in the Management Board report. For issuers intending to bring together this information in their financial reports, the Management Board report would be the most appropriate place to do so under the current rules.

Internal risk management and control systems

All issuers reviewed applied the Frijns Committee's good practice to implement the best practice provision regarding the in control statement.

With respect to financial reporting risks, issuers are required to state that their internal risk management and control systems provide a reasonable level of assurance that these systems operated properly and that there are no indications that these systems will not operate properly in the current year. There were ten issuers (71 percent) applying this best practice provision by including three statements in their Management Board reports. Given the importance of this best practice provision, it is alarming that 29 percent of issuers did not include any in control statement in their Management Board reports, nor did they explain why this information had not been included.

With respect to the statement that there are no indications that these systems will not operate properly in the current year, the AFM found that only seven issuers (50 percent) had included this statement in their Management Board reports. The other 50 percent of issuers failed to explain why this statement had not been included.

There were eleven issuers (78 percent) applying the best practice provision to describe the other risks. The AFM also found that issuers had not included the required information about their financial risks and other risks in the Management Board report, but elsewhere in the financial report.

The AFM has concluded that transparency in the Management Board report on compliance with the best practice provision regarding the internal risk management and control systems requires improvement. The AFM considers transparency about compliance with this best practice provision to be very important, given that transparency is a contributing factor to investor confidence in the management of companies.

Most issuers provided a general description of the way that non-financial reporting risks were embedded in the organisation. In addition, most issuers reviewed included in their financial reports the outcome of periodic evaluations of the design and operation of the internal risk management and control systems. This outcome, however, was less extensive and detailed than the description of how non-financial reporting risks had been embedded in the organisation. Regarding the description of the risk management systems of the issuers reviewed, the AFM found a high degree of compliance with the guidance provided by the Frijns Committee in its 2007 Monitoring Report.

Remuneration policy

The vast majority of issuers did not include the information about the remuneration policy for the members of the Management Board and the Supervisory Board in the Management Board report. In most cases, this information was included in the Supervisory Board report. Under Dutch company law, the general meeting of shareholders adopts the remuneration policy for members of the Management Board. The Management Board is required to set out this policy in its annual Management Board report. Another requirement is that it shall report on the implementation of this policy in the reporting year.

In practice, the Supervisory Board makes a remuneration policy proposal for the members of the Management Board to the Supervisory Board. This policy is implemented by the Supervisory Board after adoption of the policy by the general meeting of shareholders. Under the articles of association of most listed companies, the remuneration of individual members of the Management Board is determined by the Supervisory Board. The role of the Supervisory Board regarding the remuneration of the members of the Management Board is emphasised in the amended Dutch 2008 Corporate Governance Code.

Given this practice, it is understandable that the vast majority of the issuers reviewed included this information in the Supervisory Board report rather than in the annual Management Board report. In addition, the AFM learnt from both users and preparers of financial reports that the Supervisory Board report is considered to be part of the annual Management Board report. In other countries where there is a one-tier structure in place, this is not unusual. The AFM considers it appropriate for the legislator to amend the law with a view to classifying the Supervisory Board report as a component of the annual Management Board report. This would also be a consistent approach, given that issuers in the Netherlands are allowed to apply a one-tier structure.

The annual Management Board report within the meaning of the Netherlands Civil Code

Only a few issuers laid down the information required by law in a single section. In many cases, issuers did not clearly identify their annual Management Board reports within the meaning of Section 391 of Book 2 of the Netherlands Civil Code. In a majority of cases, the AFM could determine what the issuer had considered to be its statutory Management Board report, by using the auditor's opinion. However, in some cases, it was unclear what the auditor's opinion within the meaning of Section 393 of Book 2 of the Civil Code referred to.

From a transparency perspective, the AFM would like to see issuers be clearer with regard to what it considers to be its annual Management Board report. Investors would benefit from the Management Board rendering an account of the management conducted in an accessible and understandable way. For instance, it is important for readers of financial reports to know what section of the annual financial report¹⁶ deals with the Management Board rendering an account of the management conducted. That is why, the AFM expects companies to lay down the information required by law in a single section.

¹⁶ In this report, annual financial report refers to the annual Management Board report pursuant to Section 391 of Book 2 of the Netherlands Civil Code, the adopted annual financial statements pursuant to Section 361 of Book 2 of the Netherlands Civil Code, the additional information pursuant to Section 392 of Book 2 of the Netherlands Civil Code, and the statements made generally available regarding the annual financial statements and the annual Management Board report pursuant to Section 5:25c, subsection 2, under c, of the Act on Financial Supervision.

Appendix A: Tables of supervision activities

	Total	AEX	AMX	AScX	Local ¹⁷	Foreign ¹⁸	Bonds > €50,000 ¹⁹
Issuers under supervision ²⁰	300	21	23	24	140	92	approx. 280
Carried forward from 2008	8			1	6	1	
Selected issuers	110	13	13	14	46	24	-
Desktop reviews started:	63	10	11	8	22	12	
Follow-up	24	1	5	5	7	6	-
Risk analysis and rotation	34	9	5	2	13	5	
Signal	5	-	1	1	2	1	
Completed desktop reviews:	63	13	9	4	27	10	
2006-2007 annual financial statements	5	-	-	-	1	4	-
2008 annual financial statements	58	13	9	4	26	6	
Supervision activities:							
One or more requests for additional information	38	7	4	5	17	5	-
Notifications	35	6	4	5	16	4	-
Recommendations	1	-	-	-	1	-	-

¹⁷ Dutch issuers and issuers from third countries with shares (non-index) and/or bonds listed in the Netherlands.

¹⁸ Dutch issuers with one or more listings of shares and/or bonds outside the Netherlands only.

¹⁹ Dutch issuers only issuing bonds from €50,000 (par value per unit) and that are exempt from filing financial reports with the AFM. The size of this population is unknown (given that there is no filing obligation with the AFM).

²⁰ Population of Dutch issuers and issuers from third countries as per March 2009, so far as known to the AFM at that time.

Main subjects of notifications and recommendations per IFRS standard²¹ and subjects in notifications and recommendations stemming from Part 9 of Book 2 of the Netherlands Civil Code:

IFRS	Brief description	Total	AEX	AMX	AScX	Local	Foreign
IFRS 2	Share-based Payment	6	1	1	1	3	0
IFRS 3	Business Combinations	8	1	1	1	4	1
IFRS 4	Insurance contracts	2		1		1	
IFRS 5	Non-current Assets Held for Sale	2		1			1
IFRS 7	Financial Instruments: Disclosures	19	3	5	2	8	1
IAS 1	Presentation of Financial Statements	15	2	1	2	7	3
IAS 7	Statement of Cash Flows	9	1	1	1	5	1
IAS 8	Accounting Policies	3			1	2	
IAS 10	Events after the Reporting Period	1				1	
IAS 11	Construction contracts	1		1			
IAS 12	Income Taxes	17	2	3	2	8	2
IAS 14	Segment Reporting	3	1				2
IAS 16	Property, Plant and Equipment	1			1		
IAS 18	Revenue	1				1	
IAS 17	Leases	1		1			
IAS 19	Employee Benefits	7	1	1		5	
IAS 21	The Effects of Changes in Foreign Exchange Rates	1					1
IAS 24	Related Party Disclosures	8	2		1	4	1
IAS 27	Consolidated Financial Statements	1		1			
IAS 28	Investments in Associates	1			1		
IAS 31	Interests in Joint Ventures	1			1		
IAS 32/39	Financial Instruments	8			2	6	
IAS 33	Earnings per Share	3	1				2
IAS 36	Impairment of Assets	15	3	1	2	8	1
IAS 37	Provisions	1					1
IAS 38	Intangible Assets	2				2	
IAS 40	Investment Property	1			1		
Total		138	18	19	19	65	17

²¹ Standards included in notifications or recommendations more than once, e.g. for different aspects, have been counted once for the purposes of this summary. If notifications or recommendations contained references to more than one standard, each standard has been included once.

Provisions in Part 9 of Book 2:	Total	AEX	AMX	AScX	Local	Foreign
Corporate Governance	3				2	1
Takeover Directive	2					2
Management Board and Supervisory Board remuneration	2					2
Company Financial Statements	26	1	7		14	4
Total	33	1	7		16	9