

Activity Report 2011
Supervision of Financial Reporting

January 2012



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Disclaimer

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 text, the latter shall prevail.

1 Summary

This report provides an overview of the activities of the Netherlands Authority for the Financial Markets (Stichting Autoriteit Financiële Markten, or AFM¹). In addition, it sets out some important findings not yet published in 2011. The AFM reported most of its findings in its report Considerations for Financial Reporting 2011² and the reports³ published on 28 September 2011 and 27 October 2011 dealing with the three thematic reviews carried out by the AFM in 2011.

The most important additional findings included in this activity report relate to the results of the AFM's additional thematic review of the disclosures regarding share-based compensation of key management personnel including members of the Management Board⁴ and the Supervisory Board and the presentation of payments to a pension entity made by operating companies in another Member State than the Netherlands. The AFM will pay attention to these topics in its desktop reviews in 2012.

The AFM's thematic review of share-based compensation disclosures found an increase in 2010 in the number of issuers disclosing awarded share-based compensation compared with the 2007 financial reporting. However, share-based compensation disclosures still require improvement in several respects. The disclosure of the share-based compensation of key management personnel including members of the Management Board and Supervisory Board has to include the amount of share-based compensation. More than 30% of the 2010 annual financial statements did not include a share-based compensation amount. Nearly 25% of the issuers disclosing the share-based compensation amount did not include this amount in the total awarded compensation amount. The amount of this compensation component has to be derived from the costs recognised in the income statement in accordance with IFRS 2. More than 25% of the issuers disclosed amounts on another basis, including the fair value of the rights on the award date or the date such awards vest. The AFM did not express a view on the level of share-based compensation.

The AFM's desktop reviews brought to light that two issuers with an operating company in a Member State outside the Netherlands had presented as cash flows from investing activities in the cash flow statement payments to pension entities funding defined-benefit plans. The pension entity used the amounts received to purchase insurance policies. The fair value of these policies was offset against the defined benefit obligation in the balance sheet. The issuers concerned claim that it would be wrong to present such payments as cash flows from operating activities, given that the funding of the pension plan does not generate any revenue and is non-recurring. In addition, such payments result in investments generating income benefiting the issuer in the form of reduced pension costs. Furthermore, the issuers have pointed out that they remain responsible for paying out the pensions and that this responsibility is not removed by making payments to the pension entity. The issuers claim that their reporting of such payments

¹ AFM refers to the department responsible for the supervision of financial reporting.

² <http://www.afm.nl/rapport/2011/eng-aandachtspunten-fv-2011>

³ <http://www.afm.nl/nl/professionals/afm-actueel/nieuws/2011/okt/themaonderzoek-fv> (in Dutch only)

⁴ The term 'members of the Management Board' refers to the issuer's Management Board members as included in the articles of association.

is not uncommon in the Member State in question, referring to a number of other annual financial statements. The AFM and its European colleagues hold the view that payments to pension entities should be presented as cash flows from operating activities. The payments to fund the pension plan are made for the benefit of the employees. They do not result in assets recognised in the balance sheet.

In the context of the statutory evaluation of the Financial Reporting Supervision Act (*Wet toezicht financiële verslaggeving*, or Wtfv) Tilburg University (TU) carried out a review. The review team has concluded that the Wtfv and the AFM's supervision have contributed to the quality of financial reporting.

TU's review team made a number of practical suggestions for the AFM to further enhance the effectiveness of its supervision. Their suggestions related to the way in which requests for information are made, the contents of questions raised and the risk analysis. Virtually all suggestions made by the review team have been implemented. Their suggestions also included a recommendation to the legislature to make AFM recommendations enforceable through the Enterprise Chamber of the Amsterdam Court of Appeal (*Ondernemingskamer*, or OK) and to extend the statutory period to initiate proceedings with the OK to revise annual financial statements from six to nine months upon adoption of the financial statements. This extension largely became effective in 2011. The AFM expects that making recommendations enforceable through the OK will contribute to the efficiency of the AFM's supervision, given that the current procedure, i.e., initiating proceedings to revise financial statements could in many cases be considered disproportionate.

The AFM's other needs in the context of its supervision of financial reporting⁵ are currently being discussed by the Minister of Finance with the Dutch House of Representatives. These needs relate to limitations as a consequence of the Chinese walls within the AFM and the AFM's limited powers in this supervisory area significant to the capital markets. As a consequence of the Chinese walls, relevant supervisory information cannot be shared within the AFM. The AFM has been following the developments and expects the legislative process to be completed by the end of 2012.

Following the positive feedback from the issuers concerned, the AFM has continued its more informal approach and has extended this approach to its desktop reviews. This approach involves the AFM getting in touch with the issuer's known contacts first by telephone and/or email to discuss any issues that require some clarification. Such informal exchanges can result in clarification of the issues raised. In some cases, the AFM informally reached agreement with the issuer about the treatment of a reporting issue in the financial report for the current or next financial year. At the request of issuers, the AFM in some cases is prepared to discuss certain topics. In addition, the AFM uses its powers in cases where it has doubts about the correct application of financial reporting standards. The AFM's powers include requesting additional information and issuing notifications that may or may not be accompanied by recommendations.

⁵ www.afm.nl/en/professionals/afm-actueel/nieuws/2011/sep/kamerbrief-acc-fv

The AFM undertook desktop reviews of 88 annual financial reports in 2011 including 47 full and limited-scope desktop reviews and 41 follow-up reviews. The number of follow-up reviews saw a marked rise (up 14). The AFM completed 85 reviews in total, up 23% compared with 2010, in particular, on account of follow-up reviews.

The follow-up reviews showed that 85% of the issuers concerned had adequately complied with 2009 notifications in their 2010 annual financial statements. The AFM welcomes the increase in the absolute percentage (up from 70%) compared with the 2009 annual financial statements. Two follow-up reviews resulted in the AFM issuing a notification. Furthermore, the AFM reached agreement with some issuers on improvements in their 2011 financial reporting.

Following feedback from issuers, the AFM's written communications with issuers are now in English if the annual financial statements as adopted have been prepared in a language other than Dutch. In addition, following the extension of the period available to the AFM to initiate proceedings with the OK to revise financial statements, the AFM has doubled the standard response period available to issuers from ten to twenty working days.

The percentage of completed full desktop reviews where the AFM asked the issuers for additional information decreased from 86% to 64%. This decrease, mainly on account of issuers included in the AEX or AMX indices, is attributable to issuers on average improving their compliance with the financial reporting standards⁶ and the AFM's more informal approach.

2011 saw a decrease in the number of notifications resulting from full and limited-scope desktop reviews, from 26 to 22, with the number of completed full desktop reviews slightly increasing by two. In addition, the average number of IFRS standards per notification decreased from 3.7 to 2.9. IAS 1 and IFRS 7 are the standards most frequently referred to in the AFM's notifications, with ten and eight notifications relating to those standards respectively. Four (2010: three) of the AFM's notifications were accompanied by a recommendation.

Two issuers did not adequately comply with the AFM's recommendations. In one case, the AFM considered that it would not be appropriate to initiate proceedings with the OK to revise the issuer's financial statements. In the other case, the AFM has not yet made a decision.

The AFM carried out a limited-scope review of the semi-annual financial reports of 49 issuers, 37 of which have been completed. Two issuers were issued notifications. The AFM established that the financial institutions had properly applied the financial reporting standards to the reporting of Greek sovereign debt. The public statement of the European Securities and

⁶ *As a consequence of the AFM's limited powers and the discretion of issuers in applying accounting standards, there is a risk that non-compliance with financial reporting standards, particularly errors in the measurement of assets and liabilities, goes undetected by the AFM, or cannot be adequately demonstrated.*

Markets Authority⁷ (ESMA) on 25 November 2011 showed that there were other European countries where this was not the case.

2011 saw an improvement in issuers filing their financial reports on time, resulting in a decrease in the number of reminders and orders issued by the AFM, from 110 in 2010 to 55 in 2011. The AFM found that some issuers had not filed their annual financial reports with the AFM at the time of publication of the report as required. Their reports were filed with the AFM a few weeks later, just before the end of the filing period of four months after the end of the financial year.

Finally, the AFM has been very active in the international arena promoting the international consistency in the enforcement and quality of the new financial reporting standards. The AFM submitted four complex cases to ESMA's European Enforcement Coordination Sessions (EECS) prior to making supervisory decisions.

⁷ www.esma.europa.eu/system/files/2011_397.pdf

2 Introduction

The AFM's Activity Report 2011 provides an overview of the AFM's work supervising financial reporting. The supervision of financial reporting aims to contribute to enhancing the quality of financial reporting by Dutch listed companies. This aim is achieved by deploying a mix of instruments. Firstly, the AFM announces well in advance of the end of the financial year the areas to be covered by its thematic reviews for the coming calendar year. We announced the thematic review topics for 2012⁸ on 31 August 2011. On 27 October 2011⁹ the AFM published the results of its thematic reviews carried out in 2011. In September the AFM published its *Considerations for Financial Reporting 2011*¹⁰ for the following year. These timely publications aim to enable issuers to take account of the reported topics and considerations in preparing their 2011 financial reports.

This activity report draws attention to two reporting topics, i.e., the presentation in the cash flow statement of payments to fund defined benefit plans and the disclosure of share-based compensation of key management personnel including members of the Management Board and the Supervisory Board. The timing of the publication of the AFM's activity report allows issuers to take account of the AFM's findings regarding these topics in their 2011 financial reports.

Other instruments deployed by the AFM include informal discussions with issuers, sometimes at the request of issuers, and roundtable meetings about specific reporting topics. For example, the AFM organised a roundtable meeting on 23 December 2011 about the measurement and disclosures of sovereign debt instruments and other exposures to country risk¹¹.

In addition, the AFM uses its powers where it has doubts about the correct application of financial reporting standards. These powers include requesting additional information and issuing notifications with or without a recommendation. This activity report provides an overview of the AFM's use of its powers.

This report also deals with the evaluation of the Wtfv resulting in Tilburg University's report of findings published in early 2011.

⁸ www.afm.nl/en/professionals/afm-actueel/nieuws/2011/aug/themaonderzoeken-fv

⁹ www.afm.nl/nl/professionals/afm-actueel/nieuws/2011/okt/themaonderzoek-fv (in Dutch only)

¹⁰ www.afm.nl/rapport/2011/eng-aandachtspunten-fv-2011

¹¹ www.afm.nl/nl/professionals/afm-actueel/nieuws/2011/dec/staatsobligaties-financiele-verslaggeving (in Dutch only)

3 Thematic review of the disclosure of share-based compensation of key management personnel including members of the Management Board and the Supervisory Board

The AFM carried out a thematic review of the disclosures of share-based compensation of key management personnel including the members of the Management Board¹² and the Supervisory Board. The thematic review involved a review of 100 annual financial statements 2010, in particular, reviewing compliance with the disclosure requirements in IAS 24.16¹³. To the extent that key management personnel are members of an issuer's Management Board or Supervisory Board, the AFM's review also comprised the application of Section 383c of Book 2 of the Netherlands Civil Code¹⁴. The AFM did not express a view on the level of share-based compensation. However, the AFM's investigation included a review of the measurement of share-based compensation in the disclosures. In addition, the AFM compared the outcome of its review with the results of the AFM's 2008 review of related party disclosures in the 2007 annual financial statements.

The AFM's thematic review found that the number of issuers disclosing awarded share-based compensation had increased compared with the 2007 financial reporting. However, transparency in financial reporting can be improved in several respects. Disclosures of share-based compensation of key management personnel including members of the Management Board and Supervisory Board require improvement in the following respects:

- Disclosure of the share-based compensation amount. 30% of the annual financial statements did not disclose this amount.
- Inclusion of the share-based compensation amount in the total compensation amount. Nearly 25% of the issuers disclosing a share-based compensation amount failed to include this amount in the total compensation amount.
- Disclosure whether the vesting of share-based compensation or such compensation becoming binding was linked to performance targets achieved in the reporting year.
- Consistency between the disclosed share-based compensation amounts and the amounts recognised in the income statement in accordance with IFRS 2. More than 25% of the issuers disclosing amounts reported amounts on a different basis, including the fair value of the rights on the award date or vesting date.
- If the required disclosures are included in the remuneration report, the relevant parts of this report should be incorporated clearly in the annual financial statements.

The AFM's desktop reviews in 2012 will pay attention to this reporting topic.

¹² The term 'Members of the Management Board' refers to the issuer's Management Board members as included in the articles of association

¹³ For financial years starting on or after 1 January 2011, IAS 24.16 has been renumbered IAS 24.17.

¹⁴ The disclosure requirements in IAS 24.16 are not identical to the requirements in Section 383c of Book 2 of the Netherlands Civil Code. More details are included in section 4.2.1 of Appendix C.

More details about this thematic review are included in the full report in Appendix C.

4 Introduction Presentation of the funding of a defined benefit plan in the statement of cash flows

The AFM's desktop reviews brought to light a reporting issue relating to the cash flow statement of two issuers. The issue involves the presentation of payments made by operating companies in a Member State outside the Netherlands to fund a defined benefit plan within the meaning of IAS 19. Under IAS 19, payments made to a pension entity and used to purchase insurance policies are considered to be plan assets and are offset against the defined benefit obligation in the balance sheet. Both a one-off payment and payments made over a number of years had been presented as cash flows from investing activities in the statement of cash flows.

The issuers claim that it would be wrong to present such payments as cash flows from operating activities, given that the funding of the pension plan does not generate any revenue and is non-recurring. In addition, according to the issuers, such payments result in investments generating income benefiting the issuer in the form of reduced pension costs, which means that such payments would qualify as cash flows from investment activities. The issuers also claim that the fact that the defined benefit obligation and the pension assets are offset in the balance sheet does not mean that no asset exists in the balance sheet. In addition, the issuers continue to be responsible for paying out the pensions, and this responsibility is not removed by making a payment or payments to the pension entity. Finally, the issuers hold the view that their reporting of such payments is not uncommon in the Member State in question, referring to a number of other annual financial statements. These financial statements include comparable payments presented as cash flows from investing or financing activities, rather than cash flows from operating activities. The AFM has brought these financial statements to the attention of the relevant Member State supervisor.

European supervisors believe that payments to pension entities should be presented as cash flows from operating activities

The AFM and its European colleagues hold the view that payments to pension entities should be presented as cash flows from operating activities. Such payments are made for the benefit of the employees given that pensions are a component of an employee's compensation package. IAS 7.14 requires issuers to present as cash flows from operating activities cash flows derived from the principal revenue-producing activities including cash payments to and on behalf of employees. The fact that the issuer continues to pay out the pensions and/or continues to be responsible for paying out the pensions does not affect the requirement in IAS 7.14. In addition, it follows from IAS 7.16 that only expenditures resulting in an asset in the balance sheet qualify as cash flows from investing activities. It follows from the definition in IAS 19.7 that the issuer does not gain control over the plan assets resulting from the payments to the pension entity. Furthermore, the non-recurring nature of the payments does not play a role in the classification of such cash flows in the cash flow statement.

Presentation as a cash flow from investing activities would be appropriate had the payments to the pension entity resulted in an investment controlled by the issuer, rather than a plan asset. However, if this were the case, the defined benefit obligation and the plan assets could not be

offset in the balance sheet. In the past, pension plans in the Member State concerned were carried out by companies themselves, rather than pension entities, the companies acquiring investments to be able to make pension payments in due course. This past practice may explain why the issuers concerned – in the eyes of the AFM and other European supervisors – failed to comply with IFRS.

Point of attention for supervision of 2011 financial statements

As part of its supervision of the 2011 financial statements of issuers with a subsidiary in the Member State concerned, the AFM will establish that such issuers have either presented payments to pension entities as cash flows from operating activities or presented the plan asset concerned gross in the balance sheet, i.e., without offsetting it against the defined benefit obligation.

5 Evaluation of the Financial Reporting Supervision Act

In the context of the statutory evaluation of the Wtffv, the Minister of Finance commissioned Tilburg University (TU) to carry out a review of the effectiveness and efficiency of the AFM's supervision under the Wtffv. In addition, TU reviewed whether the implementation of the Wtffv had contributed to an improvement in the quality of financial reporting. TU presented its report of findings¹⁵ to the Minister of Finance on 25 February 2011, who sent the report and his policy response to the Dutch House of Representatives.

The report's main conclusion is that the Wtffv and the AFM's supervision have had a positive impact on the quality of financial reporting. TU's review team noted that "the AFM's supervision [...] has a disciplinary effect on issuers applying IFRS correctly, contributing positively to the quality of reporting in the Netherlands". TU's review team have noted that issuers and auditors experience incentives to improve the application of IFRS. TU's review team make a number of practical suggestions for the AFM to further increase the effectiveness of its supervision, including the form of enquiry, the contents of its questions, the AFM's reporting and the risk analysis applied by the AFM to select annual financial statements for desktop review. Virtually all suggestions made by TU's review team have been acted on. Appendix B provides an overview of the actions taken.

The review team have recommended two amendments be made to the Wtffv. Firstly, making AFM recommendations enforceable through the OK and, secondly, extending the statutory period for initiating proceedings with the OK to revise annual financial statements from six to nine months after adoption of the annual financial statements. Both recommendations are consistent with the AFM's needs, which it drew attention to in its 2010 letter¹⁶ to the Minister of Finance outlining bottlenecks in laws and regulations.

The AFM expects that making AFM recommendations enforceable through the OK will enhance the efficiency of its supervision. The AFM's powers are currently limited to initiating proceedings with the OK to revise annual financial statements if an issuer fails to adequately comply with a recommendation. Given the legal history of the Wtffv and the consequences for the issuer and its stakeholders, the AFM tries to avoid a situation where such an enforcement action could be considered disproportionate. Particularly, in cases where the reporting issue is limited to one item in the financial statements, the AFM exercises due restraint. Effective 1 July 2011, the statutory period to initiate proceedings with the OK to revise annual financial statements, with the exception of so-called third country issuers¹⁷, has been extended from six to nine months after adoption of the financial statements.

¹⁵ www.rijksoverheid.nl/documenten-en-publicaties/rapporten/2011/03/11/rapport-over-de-evaluatie-van-de-wet-toezicht-financiele-verslaggeving.html (including an English-language synopsis)

¹⁶ www.afm.nl/nl/professionals/afm-actueel/nieuws/2010/okt/wet-regelgeving-fm.aspx (in Dutch only)

¹⁷ Issuers based outside Europe with a listing in Europe.

The Minister of Finance and the Dutch House of Representatives are currently discussing the AFM's other needs in the context of its financial reporting supervision¹⁸ including the Chinese walls issue and the AFM's limited powers in this supervisory area significant to the capital markets. As a consequence of the Chinese walls, relevant supervisory information cannot be shared within the AFM. The AFM is following the developments closely and expects the legislative process to be completed by the end of this calendar year.

¹⁸ www.afm.nl/en/professionals/afm-actueel/nieuws/2011/sep/kamerbrief-acc-fv.aspx

6 Annual financial reports

6.1 General

2011 saw a 23% increase in completed reviews

The AFM's supervision of compliance with financial reporting standards distinguishes between two types of review: the follow-up review and the full or limited-scope desktop review. Follow-up reviews involve the AFM establishing whether issuers have adequately complied with notifications issued by the AFM in the previous year and/or have lived up to undertakings given by issuers. The AFM contacts an issuer in an informal way if there appears to be a less important issue relating to the financial report which may require improvement in the issuer's future financial reporting. A follow-up review can also be related to reviews of semi-annual financial reports. The AFM undertook 41 follow-up reviews in 2011.

Based on its risk analysis and rotation approach, the AFM selected for a full desktop review the annual financial reports of 57 issuers, 43 of which were started in 2011. The selected full desktop reviews that were not started were mainly the ones selected on a rotation basis. The AFM selected four additional issuers for a limited-scope desktop review based on public signals.

The AFM undertook desktop reviews of the annual financial reports of 88 (2010: 67) issuers, comprising 47 full and limited-scope desktop reviews and 41 follow-up reviews. There was a marked increase in the number of follow-up reviews (up 14). The AFM completed 79 of the reviews undertaken in 2011. The AFM completed a further six (2010: eight) desktop reviews that had been started in 2010 dealing with 2009 annual financial reports. We completed 85 (2010: 69) reviews in total, representing an increase of 23% compared with the previous year. The total of 85 can be broken down as follows: six (2010: eight) reviews carried forward from 2010, 41 (2010: 27) follow-up reviews, four (2010: one) reviews based on public signals and 34 (33) full or limited-scope desktop reviews selected on the basis of the AFM's risk analysis.

Continuation in 2011 of less formal completion of the reviews carried forward from the previous year, again resulting in improved financial reporting

After having received the issuer's written and/or oral clarification, the AFM completed a number of reviews carried forward from 2010 by reaching agreement on improvements to be made in their 2010 financial reporting. As in 2010, the follow-up reviews in 2011 showed that the quality of financial reporting had improved, partly because issuers had complied with the agreements reached with the AFM. The findings from the reviews that were concluded in an informal way have not been included in the table in Appendix A *Main subjects of notifications and recommendations per IFRS*. Issuers involved have expressed their appreciation of this approach.

Follow-up reviews are less formal, resulting in positive feedback. The follow-up of notifications in the 2010 financial reports improved considerably compared with 2009

The AFM also applied its informal approach to its follow-up reviews in 2011. Under this informal approach, the AFM gets in touch with its known issuer contacts to resolve any lack of clarity, initially by telephone and subsequently via email. The AFM's contacts often are corporate staff

officers rather than the CFO. Any agreement reached by de AFM is confirmed by email. In 2011 the AFM needed to contact only a relatively small number of companies. In the end, the AFM issued notifications to two issuers that had inadequately complied with previous-year notifications, and the AFM reached agreement with four issuers about their 2011 financial reporting. The AFM's findings from the reviews that were dealt with informally have not been included in the table in Appendix A *Main subjects of notifications and recommendation per IFRS*.

The number of annual financial statements reviewed where issuers had adequately complied with the notifications issued to them was 35, or 85% (2009: 19, or 70%). Whilst the AFM welcomes this improvement, there remains room for further improvement.

The less formal approach in 2011 was also applied to its full and limited-scope desktop reviews
The AFM extended its more informal approach in 2011 from its follow-up reviews to full and limited-scope desktop reviews. This informal approach may result in a lack of clarity being resolved. In some cases, agreement is reached on the current financial year's financial reporting. The AFM concluded two reviews by informally reaching agreement. In other cases, the clarification provided by the issuer may result in the AFM making a formal request for additional information.

Introduction of requests for additional information in English and extension of the response period to 20 working days

Since 1 February 2011, the AFM has drafted its requests for additional information in English if the adopted annual financial statements are in another language than Dutch, following repeated requests from issuers to that effect. Following a request in English, all communications including any notifications with or without recommendations are drafted in English.

A further improvement made by the AFM is the extension of the response period. Following the extension on 1 July 2011 of the statutory period to initiate proceedings with the OK to revise financial statements from six to nine months, the AFM doubled the standard response period from ten to 20 working days.

Fewer requests for additional information, partly as a result of, on average, improved compliance with financial reporting standards and the less formal approach to full and limited-scope desktop reviews.

The AFM completed 44 (2010: 42) full desktop reviews in 2011. 28 (2008: 36) desktop reviews involved the AFM making a request for additional information about the application of financial reporting standards¹⁹. The decrease in the number of requests for additional information is linked to, on average, an improvement in compliance with financial reporting standards and the AFM's less formal approach²⁰. The decrease in the absolute number of requests for additional

¹⁹ The AFM notes that the topics raised with issuers do not differ from the areas covered in its notifications issued.

²⁰ As a consequence of the AFM's limited powers and the discretion of issuers in applying accounting standards, there is a risk that non-compliance with financial reporting standards, particularly errors in the measurement of assets and liabilities, goes undetected by the AFM, or cannot be adequately demonstrated.

information is mainly on account of issuers included in the AEX and AMX indices. As a percentage, the number of completed reviews where a request for additional information was made decreased from 86% to 64%.

Whilst full desktop reviews resulted in fewer notifications, the number of AFM recommendations increased

Six (2009: ten) issuers were able to remove the AFM's doubts about the correct application of financial reporting standards. The AFM issued one or more notifications to 22 (2010: 26) issuers, four (2010: three) of which were accompanied by a recommendation requiring the issuer to issue a press release. The press release is set out in what respects the financial report would have been impacted had the issuer applied the relevant financial reporting standards correctly.

The percentage of reviews that did not result in the AFM issuing notifications, with or without a recommendation, saw an increase from 38 percent to 50 percent. This decrease is mainly on account of issuers included in the AEX and AMX indices, whilst issuers included in the AScX index saw an increase in notifications issued. The AFM reached agreement with two issuers about issues where the AFM had not expressed any doubts. The agreement was laid down in a no-action letter. The AFM issues a no-action letter if the issuer has removed the doubts expressed in the request for additional information.

Decrease in number of standards (IFRS) per notification. Increase in IAS 40 Investment Property notifications only. Decrease in notifications about Book 2 of the Netherlands Civil Code

The average number of standards per notification decreased from 3.7 to 2.9. Whilst most standards saw a decrease in the number of times they were included in a notification, IAS 40 *Investment Property* saw an increase in the number of times it was included in a notification, from one to four. IAS 1 *Presentation of Financial Statements* (ten times) and IFRS 7 *Financial Instruments: Disclosures* (eight times) were the standards most frequently referred to in notifications, with their frequency unchanged from the previous year. The number of issuers receiving a notification about the application of Book 2 of the Netherlands Civil Code decreased from nine to five. Five issuers were issued notifications relating to eight areas in total, including the report of the Management Board (three times) and the disclosure of the remuneration of the Management Board and the Supervisory Board members (twice).

Non-compliance with two of the four AFM recommendations

Two issuers who had been issued a recommendation in 2011 did *not* comply with the AFM's request to issue a press release. In the case of inadequate compliance or non-compliance by issuers with AFM recommendations, the AFM currently has no power to enforce compliance with recommendations through the judicial system. Under Section 4(3) of the Wtffv, the AFM's power is limited to initiating proceedings with the OK to revise annual financial statements. In

the first case, the AFM considered that it would not be appropriate to request revision of the financial statements through the OK.

In the second case, the AFM has not yet made a decision about whether it will initiate proceedings with the OK to revise the financial statements. The deadline for filing such a request with the OK is end of January 2012. The error in the financial report was not an isolated error; other financial reports included the same error. The AFM has provided further guidance in section 4 of this report to prevent any errors in this area in the financial reporting from 2011.

There were no instances where the AFM refrained from issuing a recommendation because the enforcement period had ended

As a result of the extension of the period for enforcement through the OK from six to nine months, the AFM was not restricted in issuing notifications accompanied by recommendations due to the enforcement period being exceeded. In 2010, there were two cases where the AFM did not issue a recommendation, although the shortcomings identified warranted such an enforcement measure. In both cases the statutory six-month enforcement period had ended. The AFM urged both issuers to publish a press release on a voluntary basis. One of the issuers complied with the AFM's request in its press release on the annual results in February 2011.

The table in Appendix A provides an overview of the AFM's financial reporting supervision activities. The table does not include the requests for additional information and notifications relating to the AFM's thematic reviews.

6.2 Recommendations and notifications

General

The AFM published its *Considerations for Financial Reporting 2011*²¹ in September 2011, which included the preliminary findings from its desktop and thematic reviews. This section of the activity report only deals with the contents of the recommendations and points for improvement not yet raised in the report of September 2011.

Recommendations

The AFM issues recommendations regarding financial reporting areas where the AFM believes correct application of the financial reporting standards has an important impact on the most recent or future financial reporting by the issuer. It is important for users of the financial report to be made aware of such financial reporting areas without delay because that will enable him to make well-considered investment decisions. 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.

²¹ www.afm.nl/rapport/2011/eng-aandachtspunten-fv-2011

The AFM in 2011 issued four (2009: three) notifications accompanied by a recommendation, all of which related to 2010 annual financial reports.

The AFM's recommendations included:

- Disclosure of share-based compensation to Management Board members and key management personnel. This topic was covered by one of the AFM's thematic reviews and is dealt with in more detail in section 3 of this report.
- Classification of a financial instrument issued by an issuer. The AFM believes that the issuer was wrong in classifying this financial instrument as an equity instrument.
- Treatment of the termination fee of a lease contract. The AFM believes that the issuer was wrong in not fully recognising the fair value of this income item in the income statement.
- Presentation of the payment to a pension body to fund a defined benefit plan in a Member State outside the Netherlands. This issue is covered in more detail in section 4 of this report.

Notifications

Whilst there were fewer notifications about the cash flow statement, it remains a point of attention

As in 2010, the AFM found errors in cash flow statements in 2011. As with other standards, the number of notifications related to IAS 7 decreased. The errors identified by the AFM included 'non-cash items' presented as cash payments – for example, the issuance of shares to board members for no consideration – and incorrect classification of cash flows. One of the annual financial statements reviewed included a cash flow relating to share issuance costs that had been presented as a cash flow from operating activities.

7 Semi-annual financial reporting

The selection of issuers whose semi-annual financial reports were subject to a limited-scope review was based on whether the annual financial report for the previous year has been subject to a full desktop review. In addition, the AFM reviewed a number of press releases at the request of the AFM's market abuse supervision department. Finally, the AFM selected a few semi-annual financial reports based on signals received indicating potential financial reporting issues in semi-annual financial reports.

Two notifications regarding semi-annual financial reports

The AFM undertook a limited-scope review of 49 semi-annual financial reports, twelve of which are yet to be completed. The conducted reviews resulted in two requests for additional information and two notifications, one of which is discussed below. In a few cases the AFM contacted issuers by telephone. In addition, the AFM issued a notification in early 2011 relating to 2010 semi-annual financial report.

Financial institutions' reporting of sovereign debt was correct

The AFM reviewed the 2011 semi-annual financial reports of nine financial institutions focusing, in particular, on their reporting of Greek sovereign debt. There were two cases where the AFM made a request for additional information about the application of the financial reporting standards relating to the treatment of Greek sovereign debt and investments linked thereto. The AFM issued a notification to one financial institution setting out the issuer's non-compliance with IFRS measurement requirements. Whilst the issuer concerned had used observable market data, the issuer had failed to use data related to the end of the reporting period (30 June 2011). The issuer referred to this measurement as a so-called level-three measurement.

The results of the AFM's review showed a more positive picture than the results of the fact-finding exercise carried out by ESMA²² in Europe. The ESMA analysis, carried out with the help of national supervisors, showed a lack of appropriate and consistent application of financial reporting standards in the 2011 semi-annual financial reports. Inconsistent application of financial reporting standards carries great risk. Firstly, transparency and accountability will fall short. Secondly, inconsistent application does not contribute to the much-needed confidence in the financial sector.

²² www.esma.europa.eu/system/files/2011_397.pdf

8 Other activities

This part of the activity report provides an overview of the AFM's other activities in the area of financial reporting supervision. This section successively deals with international activities, the Financial Reporting Committee, the AFM's role at the Dutch Accounting Standards Board, an AFM roundtable meeting, the amendments proposed by the European Commission to the fourth and seventh EC directives and the Dutch Accounting Standards Board allowing the equity method to account for consolidated group companies in the company annual financial statements.

8.1 International activities

The AFM actively participated in the activities of the Corporate Reporting Standing Committee of the European Securities and Markets Authority (ESMA-CRSC), including by participating in the eight European Enforcement Coordination Sessions (EECS). These sessions are used by European supervisors to discuss anonymised supervisory decisions by individual national supervisors relating to financial reporting, four of which were AFM decisions. In addition, the AFM submitted four complex cases prior to making its supervisory decision. EECS aims to promote and ensure consistent application of IFRS in Europe.

With a view to achieving consistent application in Europe, EECS spent a full meeting in October 2011 discussing the reporting of Greek sovereign debt in the 2011 semi-annual financial reports. The primary purpose of this meeting was to coordinate the European supervisory activities in Europe in this area. The outcome of this meeting formed the basis for ESMA's statement *Sovereign Debt in IFRS Financial Statements*²³ published on 25 November 2011.

In addition, the AFM has participated in the ESMA on IFRS project team. This permanent project team has been chaired by the AFM since 1 March 2011. The project team's aim is to draft ESMA-CRSC comment letters to the International Accounting Standards Board (IASB) and the European Financial Reporting Advisory Group (EFRAG) regarding Discussion Papers (DP) and Exposure Drafts (ED) published for consultation by the IASB and EFRAG. ESMA's comment letters are published on its website. ESMA's main focus in assessing DPs and EDs is on whether proposals result in relevant information for investors and on the enforceability by the supervisor of proposed financial reporting requirements. Important EDs commented on by ESMA in 2011 included:

1. SD²⁴ – Financial Instruments: Amortised Cost and Impairment (IFRS 9);
2. ED – Financial instruments: Hedge accounting (IFRS 9);
3. ED – Financial instruments: Offsetting Financial Assets and Financial Liabilities (IAS 32);
4. 2011 Agenda Consultation.

²³ www.afm.nl/publicatie/2011/aankondiging-esma-sovereign-debt-ifs

²⁴ *Supplementary document*

Finally, the AFM took active part in the project team that drafted ESMA's consultation document *Considerations of materiality in financial reporting*²⁵ published on 11 November 2011. The consultation document was prepared and published because national supervisors had observed preparers, users and auditors holding different views about the application in practice of the materiality concept. Following this document's publication, the AFM will organise a roundtable meeting on this topic on 30 January 2012.

8.2 Financial Reporting Committee

The AFM held three meetings in 2011 with the Financial Reporting Committee (Committee), an advisory body comprising financial reporting experts including academics, accountants, lawyers, users and preparers of financial reports. Such meetings deal with supervision-related financial reporting topics. Topics discussed in 2011 included the impact of the Chinese walls within the AFM, the AFM's powers in the context of financial reporting supervision and the report Cutting Clutter: Combating clutter in annual reports published in the UK by the Financial Reporting Council's Accounting Standards Board in April 2011. In addition, the AFM asked the Committee for advice on thematic review topics for the 2011 financial year and about complex financial reporting issues encountered during the AFM's reviews of financial reports. Finally, Committee members have been given an opportunity to comment on draft AFM publications.

Two members retired from the Committee in 2011. One member was appointed as a director of the AFM on 15 September 2011. Mrs S.G. van der Lecq was appointed as a Committee member on 15 October 2011.

8.3 The AFM's observership at the Dutch Accounting Standards Board

The AFM is an observer at the meetings of the Dutch Accounting Standards Board (*Raad voor de Jaarverslaggeving*, or DASB). This role enables the AFM to bring forward its views about the topics discussed at the DASB's meetings. The AFM's main focus is on the DASB's comment letters to the IASB and EFRAG and topics relevant to listed companies, in particular, the company annual financial statements, the report of the Management Board and the stipulations in Part 9 of Book 2 of the Netherlands Civil Code that are also applicable to companies preparing their annual financial statements under IFRS. Like ESMA, the AFM focuses on the interests of investors and the enforceability of financial reporting standards.

8.4 Roundtable meeting about the measurement and transparency of sovereign debt and other exposures on 23 December 2011

As noted in the AFM's report *Considerations for Financial Reporting 2011* of September 2011, much attention is paid to sovereign debt and other exposures to country risk, including credit default swaps (CDS) and receivables secured by guarantees granted by the governments and

²⁵ www.esma.europa.eu/system/files/2011_373_.pdf

governmental bodies concerned. That is why ESMA published its 'Public Statement Sovereign Debt in IFRS' on 25 November 2011. The statement comprises two sections. The first section discusses accounting issues related to the measurement and disclosure of sovereign debt in the 2011 financial reports of financial institutions and other companies. The second section provides ESMA's view about the appropriate measurement of Greek sovereign debt in the 2011 semi-annual reports.

Following the ESMA letter, the AFM held a roundtable meeting²⁶ on 23 December 2011 with representatives of financial institutions, audit firms and investors (including the Dutch association of security holders VEB and Eumedion). The meeting was also attended by the Netherlands Institute of Chartered Accountants (*Nederlandse Beroepsorganisatie van Accountants*), the Dutch central Bank (*De Nederlandsche Bank*), the Ministry of Finance and ESMA. The meeting's aim was to prevent any surprises in the 2011 annual financial reports. The participants agreed that companies applying financial reporting standards may arrive at different outcomes, provided the company's assumptions are adequately disclosed. The AFM expects the meeting to contribute to correct and consistent application of financial reporting standards relating to the measurement and disclosure of sovereign debt and other exposures to country risk.

8.5 Amendments proposed by the European Commission to the 4th and 7th EC Directives

The Accounting Regulatory Committee (ARC), the political body advising the European Commission on accounting, has discussed the amendments proposed by the European Commission to the 4th and 7th Directives. The Ministry of Security and Justice is the Dutch representative on the ARC. The Dutch representative has asked the AFM, among others, to provide advice on the proposed amendments.

The AFM is generally supportive of the proposed amendments. However, the AFM believes that the amended Directive should make clear that the exemption as included in Section 403 of Book 2 of the Netherlands Civil Code does not apply to listed companies. The current Directive already limits a number of other exemptions including the exemption included in Section 408 of Book 2 of the Netherlands Civil Code. In addition, the Directive should make clear to what extent a capital reduction should be added to the revaluation reserve if the capital reduction follows a conversion of the revaluation reserve into capital. Finally, the AFM believes that the Directive should deal with issues relating to business combinations under common control.

8.6 The DASB's approval of companies applying the equity method as a net asset value method

The proposed amendments to paragraph 100.107 of DASB's standards aim to clarify the measurement of group companies in company financial statements of companies applying combination three (i.e., financial reporting where the issuer applies a combination of Part 9 of

²⁶ www.afm.nl/nl/professionals/afm-actueel/nieuws/2011/dec/staatsobligaties-financiele-verslaggeving (in Dutch only)

Book 2 and the accounting policies for the consolidated financial statements). The DASB's view is that combination 3 allows companies to apply the equity method as a net asset value method (*vermogensmutatiemethode*) when measuring group companies in the company financial statements. The AFM has written a comment letter to the DASB setting out that it believes the equity method cannot be applied as a net asset value method, the equity method being inconsistent with Part 9 of Book 2 of the Netherlands Civil Code and the purpose of combination three. This purpose is to maintain a situation where there is no difference in a company's results and shareholders' equity between the company and the consolidated financial statements. In addition, applying the equity method implies that the accounting policy for goodwill in the consolidated financial statements is not applied.

The AFM also believes that the measurement of group companies in the company financial statements should not enable companies to reverse goodwill impairment losses relating to group companies, particularly in the light of the function of the company financial statements in the determination of statutory reserves and the ability to pay out dividends and the amount of such dividends. The AFM's aim is for the DASB to abandon its intent to adopt the draft guideline in its current form.

9 Findings from the AFM's supervision of the publication and filing of annual and semi-annual financial reports and interim management statements

9.1 Publication and filing

A marked decrease in the number of reminders to companies failing to file their financial reports on time

The AFM in 2011 sent 40²⁷ reminders to companies that had not filed their annual or semi-annual reports on time, representing a marked decrease compared with 2010 when the AFM sent out nearly 100 reminders and orders.

The AFM requests issuers to file their financial reports as a PDF file via loket

The percentage of issuers filing their annual or semi-annual financial reports and/or interim management statements as PDF files via Loket AFM²⁸ was about 70%, the other issuers filing in hardcopy form. Filing via Loket AFM is quick and easy. The AFM would urge all issuers to file their financial reporting electronically.

Time lag between filing and publication of annual financial reports

As in 2011, some issuers filed their annual financial reports with the AFM just a few days before the filing deadline²⁹. Publication, however, had taken place earlier, in some cases more than four weeks. The AFM again draws attention to the obligation of issuers to file their annual financial reports with the AFM at the time of publication of the reports.

Smooth publication and filing of interim management statements requiring hardly any enforcement measures

Over 140 issuers with listed shares are required to file interim management statements twice a year. Regarding the first six and second six months of 2011, there were eight and six issuers, respectively, that were late in their publication and filing of interim management statements. Following AFM reminders, virtually all issuers filed their interim management statements with the AFM.

9.2 The AFM's public financial reporting database

2011 filings in the public financial reporting database

In 2011 approximately 225³⁰ issuers were required to file their published annual and semi-annual financial reports with the AFM. Partly as a consequence of the delay in sending out

²⁷ As a consequence of an IT system disruption, reminders relating to the semi-annual financial reports were not sent until January 2012.

²⁸ One of the AFM's two digital portals

²⁹ Four months after the end of the financial year

³⁰ Fifteen companies whose financial reporting falls under AFM supervision do not have a listing in the EU. That is why they are exempt from publication and filing. In addition, there are 25 companies with listed bonds where it is unclear whether they are under AFM supervision. They are not included in the number of 225.

reminders about the 2011 semi-annual financial reports, there were still seven annual financial statements and fifteen semi-annual financial statements at the end of 2011 that still needed to be filed. The approximately 140 share issuers complied with their obligation to publish and file with the AFM interim management statements in the second and fourth quarter.

The AFM issued four recommendations in 2011. Following the AFM's recommendations, two of the issuers concerned published and filed with the AFM a press release about their financial reporting. These press releases have been included in the public financial reporting database.

Appendix A: Tables of supervision activities³¹

	Total	AEX	AMX	AScX	Local ³²	Foreign ³³
Issuers under supervision³⁴	266³⁵	21	24	22	129	70
Carried forward from 2010	6			1	5	
Selected issuers	100	10	17	10	42	21
Desktop reviews started:	88	12	13	10	39	14
<i>Follow-up</i>	41	7	5	4	21	4
<i>Risk analysis and rotation</i>	43	3	7	6	18	9
<i>Signal</i>	4	2	1			1
Completed desktop reviews³⁶:	85	12	12	10	42	9
<i>2009 annual financial statements</i>	6	-	-	1	5	
<i>2010 annual financial statements</i>	79	12	12	9	37	9
Carried forward to 2012	9	0	1	1	1	6
Supervision activities:						
One or more requests for additional information	30	2	2	4	20	2
Doubts removed	6	0	1	2	3	0
Notifications	20	1	1	0	16	2
Recommendations	4	1	0	2	1	0

Main subjects of notifications and recommendations per IFRS³⁷:

³¹ Numbers in this table may differ from the numbers in the AFM's Annual Report. This table includes notifications when they are known at the end of the year, whereas the AFM's Annual Report only includes recommendation issued in the calendar year.

³² Dutch issuers and issuers from non-EEA countries with shares (non-index) and/or bonds listed in the Netherlands.

³³ Dutch issuers with one or more listings of shares and/or bonds outside the Netherlands only.

³⁴ Population of Dutch issuers and issuers from non-EEA countries as per March 2011, so far as known to the AFM at that time.

³⁵ Regarding 25 issuers with listed bonds that can chose their home member state, it is unclear whether they fall under the AFM's supervision.

³⁶ The reviews carried forward from 2010, the follow-up reviews and the reviews following a signal have been completed in 2011.

	Brief description	Total	AEX	AMX	AScX	Local	Foreign
IFRS 2	Share-based Payment	1				1	
IFRS 3	Business Combinations	3				3	
IFRS 7	Financial Instruments: Disclosures	8	2	0	1	5	
IFRS 8	Operating Segments	3				2	1
IAS 1	Presentation of Financial Statements	10	1	1	1	7	
IAS 7	Statement of Cash Flows	4		0		4	
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors	2				2	
IAS 12	Income Taxes	4				3	1
IAS 17	Leases	1			1		
IAS 18	Revenue	2		1	1		
IAS 19	Employee Benefits	3		1		1	1
IAS 21	The Effects of Changes in Foreign Exchange Rates	1				1	
IAS 24	Related Party Disclosures	4	1	1	1	1	
IAS 27	Consolidated Financial Statements	2	1			1	
IAS 28	Investments in Associates	3	1	0	1	1	
IAS 31	Interests in Joint Ventures	2	1	0	0	1	
IAS 32/39	Financial Instruments	4	1	0	1	2	0
IAS 33	Earnings per Share	1				1	
IAS 36	Impairment of Assets	3	0		0	3	0
IAS 37	Provisions	4	1	0	0	3	0
IAS 40	Investment Property	4	0	1	1	2	
Total		69	9	5	8	44	3

Subjects in Part 9 of Book 2 of the Dutch Civil Code in notifications and recommendations:

Provisions in Part 9 of Book 2:	Total	AEX	AMX	AScX	Local	Foreign
Total	5	1	0	0	4	0

³⁷ Standards mentioned more than once in a notification or recommendation (for instance, regarding different aspects) are still only counted once in this table. If one or more standards is referred to in a notification or recommendation, each standard is included once. 'Informal' notifications are not included in this table.

Appendix B: Follow-up of suggestions made by Tilburg University

Tilburg University has evaluated the Wtfv and the AFM's supervision. Their report provides a number of suggestions to further enhance the effectiveness of the AFM's supervision. Appendix B summarises how the AFM has acted on the suggestions made by Tilburg University.

No.	Suggestion made by Tilburg University	Follow-up by AFM
1	Applying a more informal supervision approach and adopting a less stern tone in AFM communications (approach directly)	<ul style="list-style-type: none"> • Issuers receive prior notice of AFM letters. • Requests for additional information are less legalistic. For example, such requests make no more reference to 'doubt'. • In the case of information being unclear, the AFM contact the issuer by telephone or via email.
2	Applying a relatively low threshold for initiating proceedings with the OK to revise annual financial statements	<ul style="list-style-type: none"> • There are two situations where the AFM can go to the OK: if the issuer has not complied with a recommendation; and if the AFM believes that it is in the interest of the functioning of the capital market or the position of investors active in those markets that the AFM initiates proceedings with the OK to revise annual financial statements. The legal history of the Wtfv shows that this refers to situations where, for example, the issuer's non-compliance with financial reporting standards is extensive or blatant and a court ruling is needed in that area. This can be a severe measure with far-reaching consequences for the issuer and all its stakeholders. The AFM believes that given the legal history and the consequences, initiating proceedings to revise annual financial statements in its current form may be a disproportionate measure in many cases, particularly when the material reporting issue is limited to, for example, one item in the annual financial statements.
3	Drafting requests for additional information in English	<ul style="list-style-type: none"> • Effective 2011, the AFM's letters are drafted in English if the financial report as adopted is not in Dutch.
4	Extending the standard response period from 10 to 20 working days	<ul style="list-style-type: none"> • The response period has been extended to 20 days.
5	Focusing on material shortcomings	<ul style="list-style-type: none"> • The materiality concept has been further explained in the AFM's <i>Considerations for Financial Reporting</i> report • Internal process has been further tightened up in 2011 to limit enforcement to material shortcomings. Relevant less material shortcomings are agreed 'informally' with the issuer.

6	Improving the reporting quality of the AFM's activities	<ul style="list-style-type: none"> • The readability of letters and questions has been improved • Appendix II items of less material items are no longer included. Such items are provided to corporate staff officers, at the request of the issuer. • Financial reporting considerations for the coming year will be reported earlier. • The tone of the AFM's reports will focus more on things that go well.
7	Changing risk indicators: <ul style="list-style-type: none"> - Focus on the current year - Identification of unusual/abnormal patterns in accruals 	<ul style="list-style-type: none"> • Risk analysis indicators from TU's report were included in the AFM's risk analysis used to select 2010 financial reports. • Updating selection of issuers based on quick scans of published 2010 financial reports.
8	Focusing thematic reviews on accessibility and readability of annual financial statements	<ul style="list-style-type: none"> • We will further look into this suggestion. The standards to be applied in such a thematic review seem to be weak.

Appendix C: Thematic review of disclosures of share-based compensation of key management personnel including members of the Management Board and the Supervisory Board

1. Conclusion and summary

The AFM carried out a thematic review of the disclosures of share-based compensation of key management personnel including the members of the Management Board³⁸ and the Supervisory Board. The thematic review involved a review of 100 annual financial statements for the 2010 financial year, in particular, reviewing compliance with the disclosure requirements in IAS 24.16³⁹. To the extent that key management personnel are members of an issuer's Management Board or Supervisory Board, the AFM's review also comprised the application of Section 383c of Book 2 of the Netherlands Civil Code (hereafter: Section 2:383c BW)⁴⁰. The AFM did not express a view on the level of share-based compensation. However, the AFM's investigation included a review of the measurement of share-based compensation in the disclosures. In addition, the AFM compared the outcome of its review with the results of the AFM's 2008 review of related party disclosures in the 2007 annual financial statements.

The AFM's thematic review found that the number of issuers disclosing share-based compensation had increased compared with the 2007 financial reporting. However, transparency in financial reporting can be improved in several respects. Disclosures of share-based compensation of key management personnel including members of the Management Board and Supervisory Board require improvement in the following respects:

- Disclosure of the share-based compensation amount. 30% of the annual financial statements did not disclose this amount (see sections 4.1 and 4.2).
- Inclusion of the share-based compensation amount in the total compensation amount. Nearly 25% of the issuers disclosing a share-based compensation amount failed to include this amount in the total compensation amount (see sections 4.1 and 4.2).
- Disclosure whether the vesting of share-based compensation or such compensation becoming binding was linked to performance targets achieved in the reporting year (see section 4.2.3).
- Consistency between the disclosed share-based compensation amounts and the amounts recognised in the income statement in accordance with IFRS 2. More than 25% of the issuers disclosing amounts reported amounts on a different basis, including the fair value of the rights on the grant date or vesting date (see section 4.3).
- Disclosure of the composition of key management personnel (see section 4.5).

³⁸ The term 'Members of the Management Board' refers to the issuer's Management Board members pursuant to the articles of association.

³⁹ For financial years starting on or after 1 January 2011, IAS 24.16 has been renumbered IAS 24.17.

⁴⁰ The disclosure requirements in IAS 24.16 are not identical to the requirements in Section 383c of Book 2 of the Netherlands Civil Code. More details are provided in section 4.2.1.

- If the required disclosures are included in the remuneration report, the relevant sections of this report should be incorporated clearly in the annual financial statements (see section 4.6).
- The traceability of information through clear referencing (see section 4.7).

2. Introduction

Some AFM reviews carried out last year highlighted some issuers failing to disclose, or inadequately disclosing, share-based compensation of key management personnel including members of the Management Board and Supervisory Board. As a consequence, these issuers did not comply with the requirements in IAS 24.16 and Section 2:383c BW. In view of this finding, the AFM met with issuers under its supervision to discuss their disclosures and the measurement basis for reporting share-based compensation. Following these discussions, the AFM decided to conduct an exploratory review of the application of IAS 24.16 and Section 2:383c BW. The AFM did not express a view on the level of share-based compensation. Share-based compensation comprises compensation whose value is linked to the value of shares or comparable rights including depositary receipts. In practice, such compensation can take a variety of forms including the award of shares and share options.

The AFM's stocktaking exercise showed that there is diversity in practice regarding the application of the relevant requirements, which is why the AFM decided to carry out an additional thematic review to look at this topic. The AFM's thematic reviews aim to draw attention to the application of reporting requirements. The AFM's report *Considerations for Financial Reporting 2011* of September 2011 noted this topic as a financial reporting area where there is room for improvement⁴¹.

Share-based compensation, including granted shares and share options, in many cases is part of the compensation package of key management personnel including members of the Management Board and Supervisory Board. Such shares and share options are often conditional awards that vest after a number of years. Most plans have a vesting period of three years or more. Some plans have only one condition, i.e., a requirement for the employee to be employed on the vesting date. An increasing number of plans link the vesting of rights to the achievement of certain performance targets. In a small minority of cases, granted rights vest immediately.

IFRS 2 requires an entity to allocate the costs associated with such plans to the period between the grant date and the vesting date. These costs have to be disclosed in the notes pursuant to IAS 24.16(e) and Section 2:383c BW. The latter requirement only applies if a key manager is a member of the Management Board or Supervisory Board.

⁴¹ <http://www.afm.nl/layouts/afm/default.aspx~/media/files/rapport/2011/eng-aandachtspunten-fv-2011.ashx>

IAS 24.16 also requires an entity to disclose key management personnel compensation in total and the composition thereof⁴². One of the components to be disclosed separately is the share-based compensation component. Section 2:383c BW requires an entity to disclose the compensation amount for each member of the Management Board to the extent that such compensation is borne by the entity. As does IAS 24.16, Section 2:383c BW requires an entity to disclose a breakdown of the compensation amount into its constituent parts including profit share and bonus payments.

The disclosures pursuant to IAS 24.16 and Section 2:383c in many cases were provided on a combined basis. This is allowed provided that the disclosures meet both sets of requirements, with the requirements not being equal in all respects.

The intense public debate about board compensation has not abated in the past years, the focus of the debate being on the level and composition of such compensation and on the vesting conditions of awarded compensation. Section II.2 of the Dutch Corporate Governance Code deals with the principles and best practices relating to compensation in the form of options and shares. The code sets out as a best practice that realisation of such compensation has to be dependent on the achievement of challenging targets specified in advance. In addition, the code's best practices set out that the vesting period of any options granted shall be at least three years, with a vesting period of at least five years for any shares granted.

Paragraph BC6 of the Basis for Conclusions on IAS 24 sets out that disclosure of key management personnel compensation is required given that the structure and amount of compensation are major drivers in the implementation of business strategy. That is why key management personnel compensation is relevant to decisions made by users of financial statements.

Further review

The AFM is required to carry out its review based on public information. That is why the AFM is unable to establish the cause of a number of its findings and the consequences thereof for the picture portrayed by the financial statements. The AFM will include the above findings in its risk analysis carried out to select the annual financial reports subject to desktop review in 2012. The AFM will ask issuers for additional information about the application of IAS 24.16, IFRS 2 and Section 2:383c BW, where necessary. The AFM will also try to find out why a large group of issuers do not include share-based compensation in their disclosure of compensation of members of the Management Board and Supervisory Board, or why such information is incomplete or inaccurate.

⁴² For financial years starting on or after 1 January 2011, IAS 24.16 has been renumbered IAS 24.17.

3. The thematic review's objectives, design and population

3.1 Objectives

The AFM's thematic review seeks to encourage listed companies to improve the quality of financial reporting of key management personnel compensation. The AFM expects its supervision will contribute to enhancing the public's understanding, thus improving the functioning of the capital markets. The Basis for Conclusions on IAS 24 sets out that the disclosure of key management personnel compensation is a relevant source of information for users of the financial statements in making decisions.

3.2 Design

The AFM's review of key management personnel compensation disclosures in 2010 financial reports included:

- The disclosure of key management personnel compensation, focusing on compliance with IAS 24.16 in terms of the disclosure of the total amount of share-based compensation and the inclusion of this total in the total amount of key management compensation.
- The disclosure of the remuneration for each Management Board member, focusing on compliance with Section 2:383c BW in terms of disclosure of share-based compensation.
- Whether the amounts included in the above disclosures are based on amounts recognised in the income statement in accordance with IFRS 2.

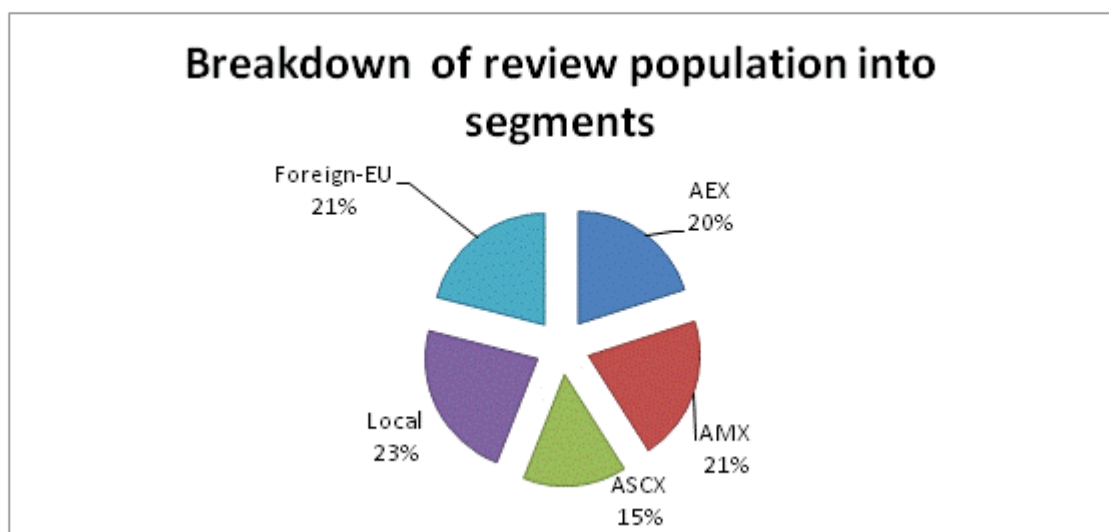
The AFM also looked at share-based compensation relative to total compensation of key management personnel including members of the Management Board and Supervisory Board.

The AFM carried out a similar review of related party disclosures in 2008. The AFM's review of 2010 annual financial reports included a comparison between 2010 and 2007 of the number of issuers granting share-based compensation and the number of issuers disclosing the associated costs.

3.3 Population

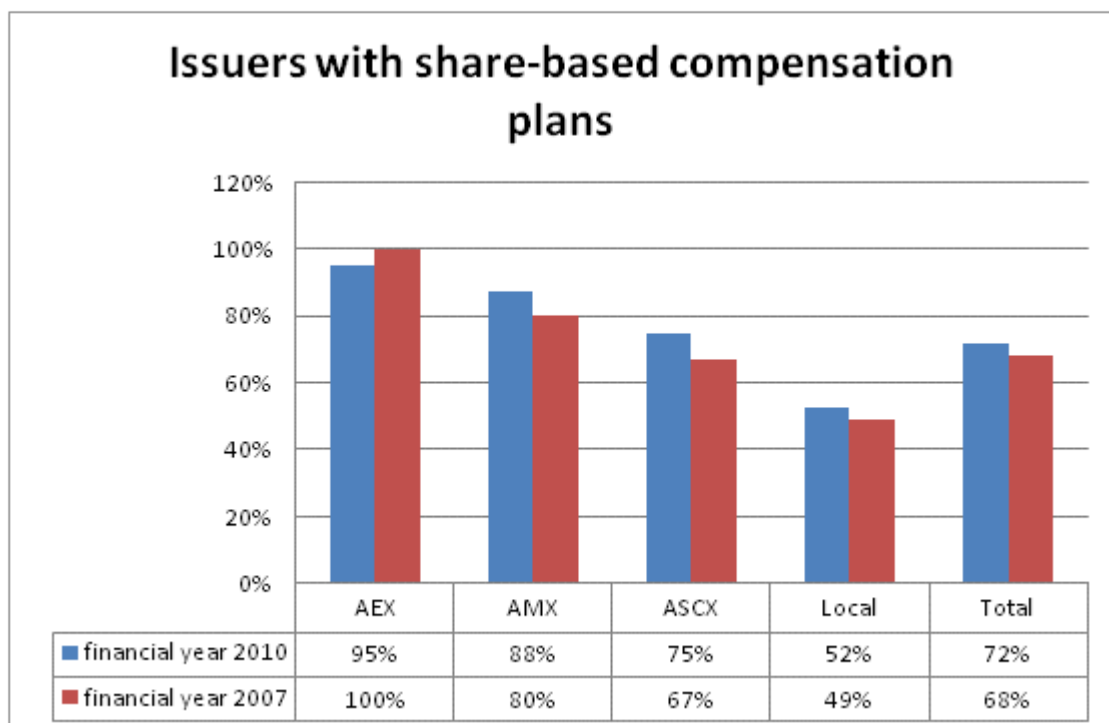
The thematic review included the 2010 annual financial reports of all issuers having their corporate seat in the Netherlands, with shares listed on a regulated exchange in Europe and falling under the AFM's supervision pursuant to the Wtftv. This population comprised 139 issuers in total. The AFM's review included only the financial reports of issuers whose remuneration policy included a share-based compensation plan for members of the Management Board. On this basis, the AFM selected 100 issuers. For issuers with a Euronext Amsterdam listing, the AFM distinguished between the indices AEX, AMX and AScX, and the local category. The Foreign-EU category includes issuers with a listing on another regulated exchange in Europe. The review population can be broken down into segments as follows:

Graph 1



A large majority of the issuers with listed shares falling under the AFM's supervision reported share-based compensation plans for members of the Management Board. The occurrence of such plans diminished with the size of the issuers with listed shares. The total percentage of issuers with share-based compensation plans was virtually unchanged from our previous review.

Graph 2



4. Findings

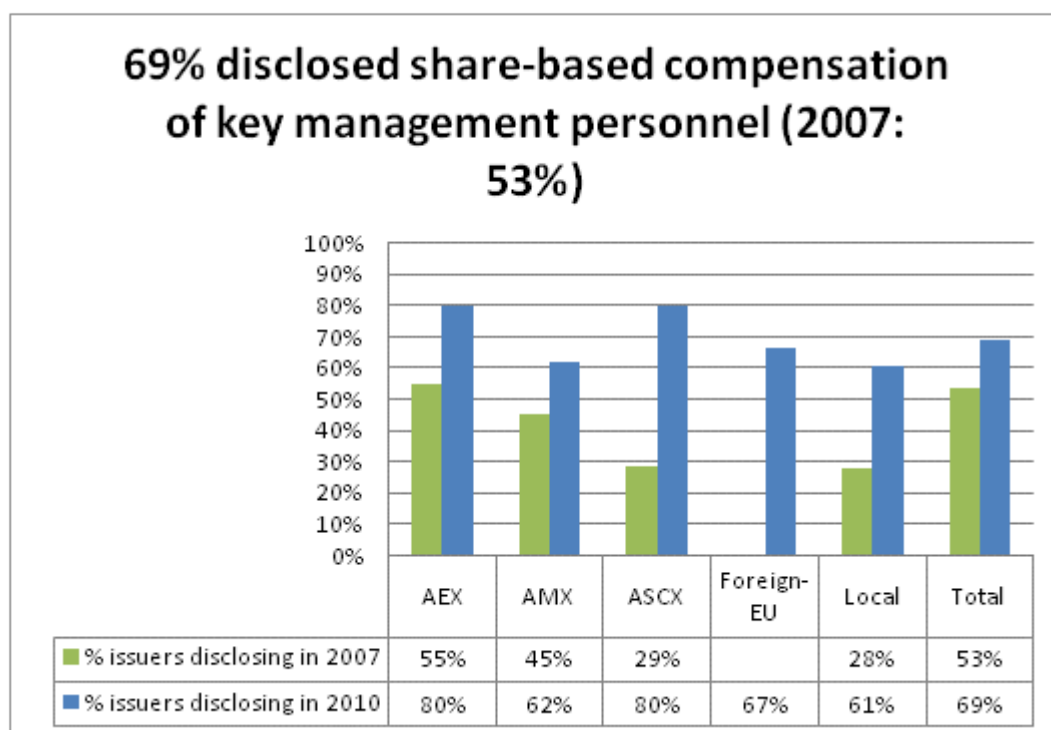
4.1 Just over 50% of the issuers included their share-based compensation amount in the total compensation amount

Well over 50% of the issuers reviewed included in the notes an amount or several amounts relating to share-based compensation of key management personnel. Just over 50% of the issuers reviewed included this amount in the total compensation amount in accordance with IAS 24.16⁴³. IAS 24 defines key management personnel as those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity. Some of the issuers reviewed disclosed amounts that were different from the amounts recognised in the income statement in accordance with IFRS 2. For more details see section 4.3.

More than 30% of the issuers reporting share-based compensation plans for Management Board members in their 2010 remuneration policy did not disclose share-based compensation amounts for key management personnel.

Graph 3 provides a distribution of share-based compensation across segments and makes a comparison with the AFM's 2008 review of 2007 financial reports. The 2008 review did not include any issuers from the Foreign-EU segment.

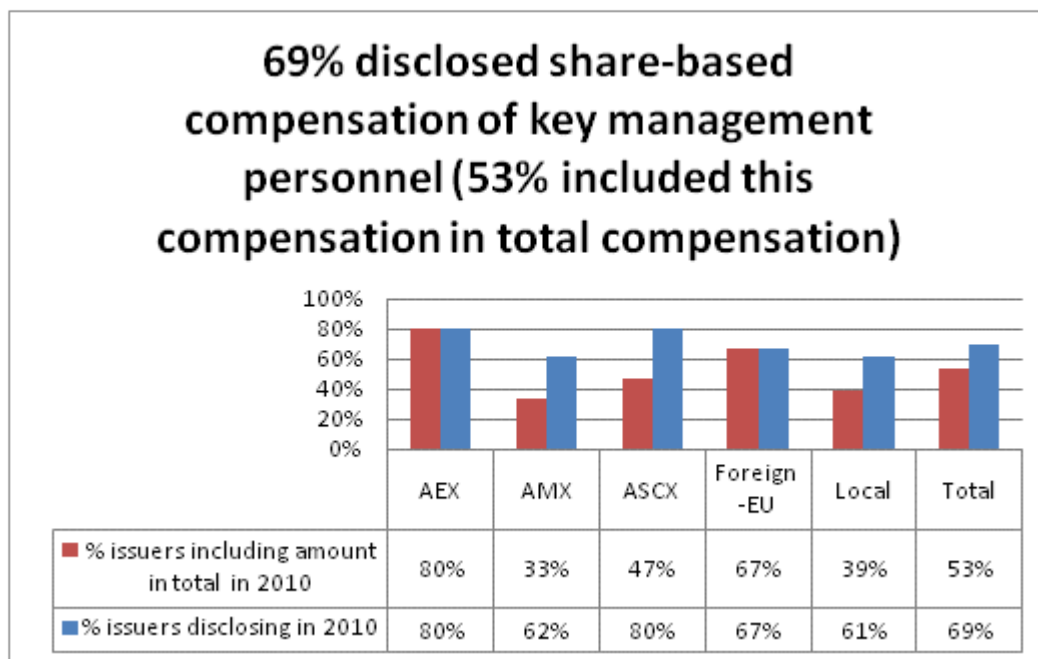
Graph 3



⁴³ The text of IAS 24.16 is included in Appendix 1 to this report.

Graph 4 provides a distribution across segments of the percentage of issuers disclosing share-based compensation amounts and of the percentage of issuers including share-based compensation in total compensation of key management personnel in accordance with IAS 24.16.

Graph 4



4.2 A significant percentage of issuers did not provide the disclosure pursuant to Section 2:383c BW

To the extent that key management personnel include members of the Management Board or Supervisory Board pursuant to the articles of association, issuers are required to apply the requirements in Section 2:383c⁴⁴. For the sake of completeness, the AFM notes that the review did not pay attention to the disclosure relating to share option plans required under Section 383d Book 2 of the Netherlands Civil Code (Section 2:383d BW).

4.2.1 Management Board members

Almost 70% of the issuers reviewed disclosed share-based compensation amounts per Management Board member. Just over 50% of the issuers reviewed included this amount in the total compensation amount per Management Board member, in accordance with appendix 3 to Guideline 271 of the Dutch Accounting Standards Board (DASB).

⁴⁴ The text of Section 2:383c BW is included in Appendix 1 to this report.

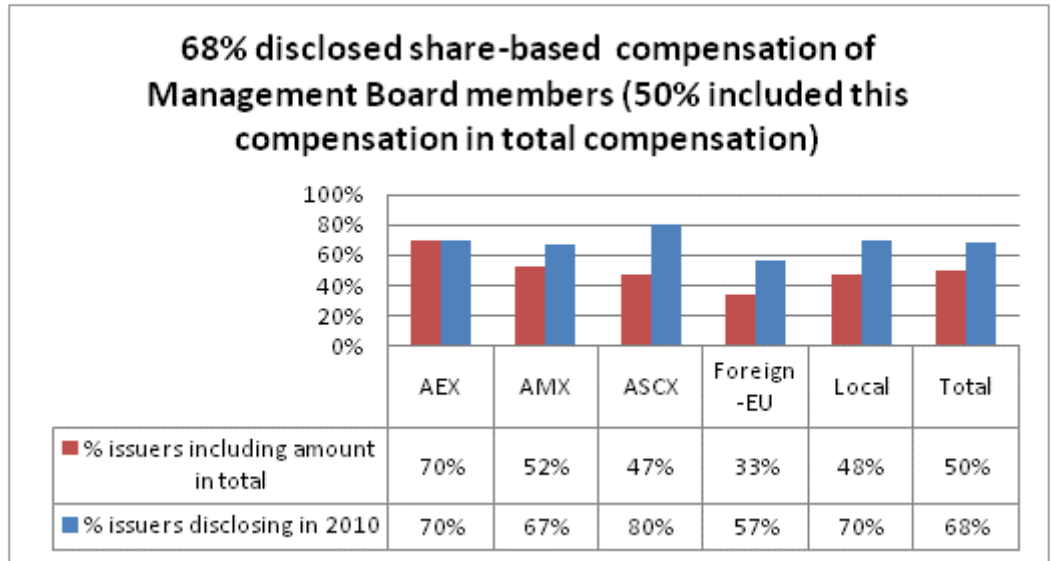
The issuers failing to provide this disclosure seem to have acted in accordance with the 2000-2001 Explanatory Memorandum accompanying Section 2:383c BW. According to this Explanatory Memorandum, option plans would fall under the regime of Section 2:383d BW, rather than Section 2:383c BW. On the basis of the Act's legal history, one could argue that this distinction was based on the classification in the DASB's Guidelines at a time when the DASB and the IASB had not issued guidance for the treatment of costs associated with share option awards. However, entities are now required to recognise such costs in the income statement based on the mandatory application of IFRS and the recent amendment to the DASB's Guidelines. The legislature seems to hold the same view, given that the current legislative Claw Back proposal (meeting year 2009-2010, 35 512) considers payments in the form of share options and other share-based compensation components to be bonuses.

In view of the above, the AFM believes that issuers are required to comply with Appendix 3 to Guideline 271 of the DASB. As a result, issuers are required to include recognised option plan costs in the disclosure of the compensation per Management Board member. The AFM will recommend to the legislature, for their consideration, that such requirements should not be open to interpretation. Given the objective and intent of the Act and the financial reporting standards, the AFM will advise the legislature to make explicit the intention that, consistent with the treatment of the costs of share-based compensation under IFRS and the DASB's Guidelines, this compensation component should also be disclosed per Management Board member pursuant to Section 2:383c BW.

Some issuers disclosed this compensation component as an aggregated total including all Management Board members. Such a disclosure complies with IAS 24.16 if Management Board members are the only ones receiving such a compensation component. In many cases, however, this is not the case. Some issuers disclosed amounts that were not consistent with the amounts recognised in the income statement in accordance with IFRS 2. For more details see section 4.3.

Graph 5 provides – in the right hand columns – the distribution across segments of the issuers disclosing share-based compensation amounts per Management Board member. The left hand columns reflect the percentage of issuers including share-based compensation amounts in their total compensation amounts.

Graph 5



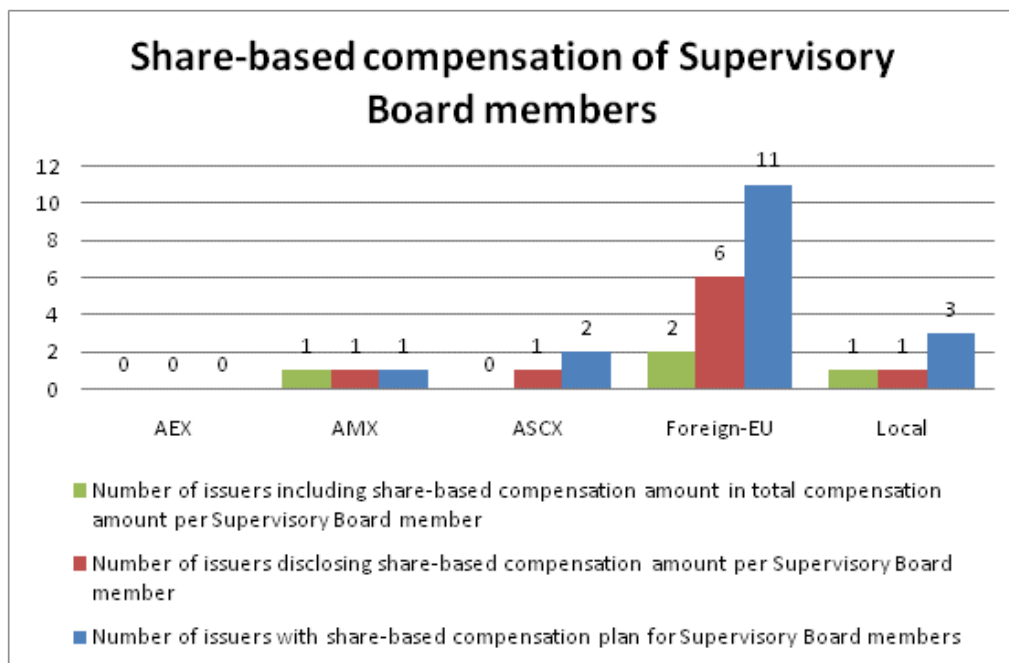
4.2.2 Supervisory Board members

The Dutch Corporate Governance Code says that it is not common practice to remunerate Supervisory board members in the form of shares. Nevertheless, almost 20% of the issuers reviewed granted share-based compensation to Supervisory Board members. It appears that this is common practice particularly at issuers having their corporate seat in the Netherlands and with a listing on a foreign exchange only⁴⁵. 50% of that group of issuers disclosed the amount per Supervisory Board member, the others failing to disclose this amount. The vast majority (78%) of these issuers did not include this amount in the total remuneration amount per Supervisory Board member. As a consequence, they did not comply with the requirements in Section 2:383c BW.

Graph 6 below provides the distribution across segments of share-based compensation amounts related to Supervisory board members.

⁴⁵ In many cases, they are large companies' holding structures having their corporate seat in the Netherlands and with a listing and activities outside the Netherlands.

Graph 6



4.2.3 Achievement of targets

If the nature of the share-based compensation is that of a bonus that is dependent on the achievement of targets, Section 2:383c(1) BW requires disclosure of the extent to which these targets have been achieved. Most issuers had linked their share-based compensation to the achievement of targets in accordance with the Dutch Corporate Governance Code. Issuers where share-based compensation vested in 2010 virtually all disclosed the targets to be achieved and the achieved targets underlying the vesting of the rights granted.

Many issuers have only recently changed their remuneration policy to make the vesting of a Management Board member's share-based compensation dependent on more than just an employment condition. Given that the achievement of targets is partly dependent on performance in at least three years' time, the number of issuers where such conditional compensation vested in 2010 was very limited. That is why, in many cases, this disclosure was not yet applicable.

4.3 Relationship between disclosed amounts and amounts recognised in the income statement

50% of the issuers included in the AFM's review disclosed share-based compensation amounts per Management Board member derived from the amounts recognised in the income statement and, as such, determined in accordance with IFRS 2. The other issuers either (i) failed to disclose the amount per Management Board member (31%), or (ii) disclosed amounts – including amounts per Management Board member – that could not have been derived from the income statement, because they appeared not to have been determined in accordance with IFRS 2 (19%). Given that the disclosure per Management Board member in many cases is linked to the disclosure pursuant to IAS 24.16, this issue applies more or less equally to the key

management personnel disclosure. The table below provides a breakdown of the nature of non-compliance with Section 2:383c BW. A breakdown of non-compliance with IAS 24.16 would provide a similar outcome.

Table 1

	AEX	AMX	ASCX	Foreign-EU	Local	Total
Number of issuers with share-based compensation:	20	21	15	21	23	100
• Number of issuers disclosing share-based compensation amounts per Management Board member in accordance with IFRS 2	9	12	7	10	12	50
• Number of issuers <u>not</u> disclosing share-based compensation amounts per Management Board member	6	7	3	8	7	31
<i>including:</i>						
o <i>Issuers failing to disclose a total of all Management Board members</i>	6	5	3	7	7	28
o <i>Issuers disclosing a total of all Management Board members</i>	-	2	-	1	-	3
• Number of issuers disclosing share-based compensation amounts per Management Board member <u>not</u> determined in accordance with IFRS 2	5	2	5	3	4	19
<i>Basis for disclosed amount:</i>						
o <i>Value on grant date</i>	3	1	3	1	1	9
o <i>Value on vesting date</i>	2	1	1	-	2	6
o <i>Amount is wrong for another reason</i>	-	-	1	2	1	4

4.4 The amount of share-based compensation was significant relative to total compensation of key management personnel

The costs of share-based compensation as a percentage of total CEO compensation ranged from 0% to 92%. Occasionally, share-based compensation was even negative, reflecting that rights had been canceled in 2010 following the departure of a Management Board member resulting in the reversal of costs recognised in prior years. The AFM observed a wide range in share-based compensation relative to total compensation of Management Board members. Given the significance of the share-based compensation component in total compensation in many cases, it is important that issuers enable users to gain a good understanding of the costs and structure.

Share-based compensation as a percentage of total compensation varied greatly. Table 2 below provides the distribution of share-based compensation in terms of percentage. The percentages have been sorted in blocks of equal size from low (i.e. limited size of share-based compensation relative to total compensation) to high (i.e. large size of share-based compensation relative to total compensation). Table 2 provides information about share-based compensation as a percentage of total compensation. The maximum percentage is the percentage where share-based compensation relative to total compensation was highest.

Table 2

	All key management personnel	CEOs*)
first quartile	7%	8%
median value	15%	22%
third quartile	30%	37%
maximum	55%	92%
Number of usable observations	46	35

*) CEO data include only issuers included in the AEX and AMX indices and foreign issuers to the extent that the relevant information could be derived from the financial statements. These categories comprised 61 issuers in total, 35 of which provided sufficient cost information in their financial statements to make determine the percentage.

Share-based compensation of Supervisory Board members relative to their total compensation ranged from 32% to 82%, with an average of 52%, based on seven observations.

4.5 Unclear description of key management personnel

In some cases, it was not clear whether key management personnel comprised others than members of the Management Board and Supervisory Board. Whilst there is no requirement to disclose the composition of key management personnel, such a disclosure would enhance the understanding of users of the financial statements. The AFM also found that some issuers erroneously failed to include Supervisory Board members in key management personnel. For more information about this topic, please refer to the AFM's thematic review on IAS 24 carried out in 2008⁴⁶.

4.6 References to the remuneration report are acceptable provided that issuers are clear in stating that those remuneration report sections are part of the audited financial statements

There were eight issuers referring to their remuneration report for disclosures on the remuneration of members of the Management Board and Supervisory Board. A number of issuers stated that the relevant remuneration report sections formed part of the financial statements. The AFM believes that issuers have to include such a reference to the audited financial statements, given that IFRS and Part 9 of Book 2 of the Netherlands Civil Code require that such disclosures are included in the annual financial statements. Section 5:25c of the Financial Supervision Act requires the annual financial reporting to include the audited annual financial statements. The AFM found that some auditor's reports did not include a reference enabling users to understand that the relevant remuneration report sections were part of the audited financial statements. The AFM believes that the auditor's report should be clear in this respect and should state that it also covers the annual report sections considered to be part of

⁴⁶<http://www.afm.nl/nl/professionals/afm-voor/effectenuitgevende-ondernemingen/financiele-verslaggeving/activity-reports/~media/09F1AD63C877465B99DA477DFE9FFC8E.ashx>

the annual financial statements. The AFM considers references to the remuneration report acceptable if these conditions are met.

4.7 Frequent omission of references to disclosures

In most cases, the AFM found the information required under IAS 24.16 and Section 2:383c BW in the consolidated financial statements. Of the eighteen issuers not including the IAS 24.16 disclosure in the consolidated financial statements, eight referred to the company financial statements. The AFM was unable to establish whether the information in the company financial statements also included the information under IAS 24.16. Most issuers including the information pursuant to Section 2:383c BW in their consolidated financial statements only included a reference to this information in the company financial statements. However, a large group of issuers did not include such a reference.

Users of the financial statements would benefit from issuers including the information pursuant to IAS 24.16 in their consolidated financial statements and the information pursuant to Section 2:383c BW in their company financial statements, or issuers making clear cross references to the relevant information.

1. The company shall disclose the remuneration of each management board member.

This amount shall be broken down into:

- a. Compensation paid out periodically,
- b. Compensation payable in the future,
- c. Severance payments,
- d. Profit share and bonus payments,

to the extent that such amounts have been borne by the company in the financial year.

If the company has awarded compensation in the form of a bonus dependent, in part or in full, on the achievement of targets set by or on behalf of the company, the company shall state this fact. The company shall also state whether these targets have been achieved in the financial year.

2. The company shall disclose the remuneration amount for each former management board member, broken down into compensation payable in the future and severance payments, to the extent that such amounts have been borne by the company in the financial year.
3. The company shall disclose the remuneration of each supervisory board member to the extent such amounts have been borne by the company in the financial year. If the company has awarded remuneration in the form of profit share or bonus payments, it shall separately disclose such amounts including the reasons for the decision to remunerate a supervisory board member in this form. The final two sentences in subsection 1 shall apply equally.
4. The company shall disclose the remuneration of each former supervisory board member to the extent that this amount has been borne by the company in the financial year.
5. If the company has subsidiaries or consolidates the financial information of other companies, the amounts borne by such subsidiaries and other companies shall be included in the disclosures and allocated to the remuneration categories referred to in subsections 1 to 4.

IAS 24.16

An entity shall disclose key management personnel compensation in total and for each of the following categories:

- (a) short-term employee benefits;
- (b) post-employment benefits;
- (c) other long-term benefits;
- (d) termination benefits; and (e) share-based payment.

The Netherlands Authority for the Financial Markets

T +31 20 797 3721

P.O. Box 11723 | 1001 GS AMSTERDAM

www.afm.nl

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