Activity Report 2012

Supervision of Financial Reporting

January 2013

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The Netherlands Authority for the Financial Markets

The AFM promotes fairness and transparency within financial markets. We are the independent supervisory authority for the savings, lending, investment and insurance markets. The AFM promotes the conscientious provision of financial services to consumers and supervises the honest and efficient operation of the capital markets. Our aim is to improve consumers' and the business sector's confidence in the financial markets, both in the Netherlands and abroad. In performing this task the AFM contributes to the prosperity and economic reputation of the Netherlands.

1 Summary

This report provides an overview of the activities and results of the AFM's supervision of the financial reporting in 2012. The key findings concerning the financial reporting 2010 (9 completed reviews) and 2011 (36 completed reviews) are:

- **Financial statements containing one or more material errors decreased from 50% to 40%**
- **Investment property companies improve transparency concerning assumptions used**
- **AFM has not issued any notifications concerning the valuation of investment properties and the amount of impairments**
- **Investors appear to have valued the properties of the majority of the investment property companies at approximately 15% lower at the 2011 year-end**
- **Investors also price in more impairment losses on other assets**
- **Disclosures from six companies provide insufficient information concerning the circumstances and events that led to the impairment and the corresponding assumptions used for the impairment**
- **The more informal working method of AFM seems to be bearing fruit with respect to improving the quality of the financial reporting**

Percentage of financial statements containing one or more material errors decreased

The percentage of financial statements in which the AFM discovered material errors, with an approximately equal number of reviews (45), decreased from 50% in 2011 to 40% in 2012. The number of material errors for each set of financial statements also decreased: from an average of 2.9 in 2011 to 1.9 in 2012. These developments seem to indicate a gradual improvement in the quality of the financial reporting in the Netherlands. Further improvement is necessary, however, because 40% of the financial statements reviewed contained at least one material error. Larger companies, of which fewer financial statements were reviewed, generally score better than smaller companies.

Investment property companies improve transparency concerning assumptions used

A positive development is the fact that investment property companies have improved their transparency concerning the assumptions they use in determining the fair value of their investment properties. In the previous year, 2011, the AFM still had to send notifications to four investment property companies concerning this transparency.

No notifications sent concerning the valuation of investment properties and the amount of impairments

If the AFM discovers one or more material errors in the financial reporting, it sends the company a notification. In a notification, the AFM states why it believes that the financial reporting does not comply with the reporting requirements in one or more components.

The AFM did not send any notifications in 2012 concerning the valuation of investment properties and the amount of any impairment applied. This does not mean that the AFM has a positive opinion concerning the measurement of the corresponding items in the financial statements. It must be stated, however, that the limited powers of the AFM in performing this supervision and the high degree of discretion that is left to the management in the relevant standards and jurisprudence often impede a more detailed investigation and/or the effective enforcement of adjustments.

Investors appear to have valued the properties of the majority of the investment property companies at approximately 15% lower at the 2011 year-end

The AFM notes that investors seem less positive concerning the valuation of the investment properties than the management of the companies. As the AFM alerted in the report in response to the review concerning valuation and disclosures of investment properties, from the ratio between the market value of the investment property companies and net asset (equity) value reported in the financial statements at the 2011 year-end for the majority of these companies, it seems to follow that investors valued the property, on balance, at approximately 15% lower than reported by the companies.

Investors also price in more impairment losses on other assets

In the report on ‘Impairment of Assets’, the AFM notes that it is striking that, of the 27 companies that have not accounted for any material impairment loss, 11 companies have a market capitalisation (market value) that is less than the carrying amount of their net assets. Investors in these cases appear to be already pricing in an impairment loss, while companies themselves have not (or not yet) considered recognition of an impairment to be necessary.

Disclosures from six companies provide insufficient information concerning the circumstances and events that led to the impairment and the corresponding assumptions used for them

It is disappointing that at six (2011: three) companies, the AFM had to note a lack of transparency concerning the assumptions used in conducting the check for the presence of impairments and/or the results of the sensitivity analysis performed. The AFM had expected, as a result of the announcement of the thematic review 'Impairment of Assets' at the end of August 2011, that all of the companies would have become sufficiently transparent on this item. IAS 36 ‘Impairment of Assets’ is the only standard concerning which the AFM issued more notifications than in 2011.

The more informal working method of AFM seems to be bearing fruit with respect to improving the quality of the financial reporting

In 2012, the AFM continued the informal working method, developed in 2010/2011, with both the completion of the ongoing reviews from 2011 and the follow-up reviews and desktop reviews. On the basis of the more informal completion and informal contacts, the willingness of companies to implement adjustments increased, which improves the quality of financial reporting without formal legal action.

Additional considerations in the preparation of the financial reporting in 2012

In addition to what the AFM reported in 'Considerations for Financial Reporting 2012' and the examples of material errors included in Section 2.2, which the AFM discovered in financial statements, the AFM is requesting that particular attention be paid to the one-off crisis levy as part of the directors' remuneration and amount of the discount rate used in calculating the pension obligation.

The AFM is very active internationally

Finally, it should be reported that the AFM has been active internationally to promote the quality of the new financial reporting standards and the international consistency with regard to enforcement. The influence from Europe on the supervision of financial reporting is increasing. Thus, in consultation with national supervisory authorities, the European Securities and Markets Authority (ESMA) has formulated common priorities for the supervision of financial reporting in 2012, which are also endorsed by the AFM.

2 Findings from the supervision of the annual financial reporting

2.1 Quantitative analysis

40% of the financial statements contain one or more material errors

In 2012, the AFM completed 45 desktop reviews. In 40% of the financial statements reviewed, the AFM noticed one or more material errors. These material errors were reasons for the AFM to issue a notification with or without a recommendation. In 2011, this was still the case for 50% of the reviewed financial statements. Although the AFM considers that the 40% is still too high, these developments seem to indicate a gradual improvement in the quality of financial reporting in the Netherlands. Larger companies, of which fewer financial statements were reviewed, generally score better than smaller companies.

Section 2.2 of this report provides examples of material errors that the AFM encountered in one or more sets of financial statements and for which it issued a notification, whether or not accompanied by a recommendation. If the AFM discovers one or more material errors in the financial reporting, it sends the company a notification. In a notification, the AFM states why it believes that the financial reporting does not comply with the reporting requirements on one or more components. The AFM also states that these requirements must be correctly applied in future financial reporting.

The number of IFRS standards to which each notification refers has decreased. Only the frequency of IAS 36 'Impairment of Assets' has increased significantly

The average number of standards that is contained in one notification has decreased from 2.9 to 1.9. For most standards, the number of times that a notification has been issued concerning the standard has decreased. One exception is IAS 36 'Impairment of Assets'. The number of companies that received a notification from the AFM concerning this standard has increased from three to six. In all cases, the notification related to an inadequate disclosure concerning the assumptions used. Due to an inadequate disclosure, users of the financial statements receive an inadequate picture of the prudence that is used when estimating the recoverable amount[1]. The AFM considers it disappointing that the disclosure of impairment has not received more attention, especially since it had already specifically emphasised this point in August 2011 in the 'Impairment of Assets' thematic review.

[1] The AFM has reported previously concerning this lack of transparency on 29 October 2012. See: http://www.afm.nl/~/media/Files/fin-verslag/2012/engels/themaonderzoek-bijzondere-waardevermindering-activa.ashx

No notifications were sent concerning the application of IAS 40; the disclosures have improved significantly

The announcement of the 'Valuation and Disclosure of Investment Property' thematic review in September 2011 appears not to have been without effect. As the AFM already reported on 29 October 2012[2], the disclosures – in comparison with those of 2010 – have improved. The disclosures of property valuations provide more information on the valuation methods used and the related underlying assumptions. The most common assumptions concern expected rental income, the discount rate, and the expectation with respect to vacancy. The fact that the property sector has taken good heed of the AFM's criticism, and has improved the transparency, is a positive development. The AFM did not need to issue a single notification concerning the application of IAS 40 'Investment Property' in 2012. In 2011, the AFM still had to issue four companies with a notification concerning the application of this standard.

No notifications were sent concerning the valuation of investment properties and the amount of impairment

The notifications relating to the impairment and the fact that the AFM did not issue any notifications concerning the application of IAS 40 'Investment Property' does not mean that the AFM has a positive opinion about the valuation. It must be stated, however, that the limited powers of the AFM – which incidentally have been improved with effect from 1 January 2013 (see section 4 on this) – and the high degree of discretion of the management in the measurement of assets do often impede a more detailed investigation and/or effective enforcement of adjustments.

The investors, however, seem to have valued the properties of the majority of the investment property companies at approximately 15% lower at the 2011 year-end

The ratio between the market value of the investment property companies reviewed, and the net asset (equity) value of the property, suggests to the AFM that investors value the property of the investment property companies that were reviewed at approximately 15% lower at the 2011 year-end.

In addition, the investors price in impairment losses on other assets

In addition, at a large number of companies that were reviewed in the context of the thematic review into impairment, investors already appear to have priced in an impairment loss, while the companies themselves do not or do not yet see the need for this loss.

The number of observations concerning Title 9, Book 2 of the Dutch Civil Code increases

The number of companies that received a notification concerning the application of Title 9, Book 2 of the Dutch Civil Code (*Burgerlijk Wetboek*) increased from five to six. The six companies

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[2] *http://www.afm.nl/~/media/Files/fin-verslag/2012/engels/themaonderzoek-ias40.ashx*

were issued with notifications in the areas of the disclosures of the remuneration of directors and supervisory directors (4x), the management report (1x), and the measurement of a consolidated subsidiary in the separate financial statements (1x).

The number of reviews is approximately equal to that in 2011

When conducting the supervision of the compliance with the reporting requirements in the annual financial reporting, the AFM distinguishes between follow-up reviews and desktop reviews[3]. In a follow-up review, the AFM examines whether notifications from the previous year have been followed up and/or whether commitments made by companies have been honoured. The latter occurs if the AFM has had informal contact with the companies, as it may appear to be a less significant error in the financial reporting that must actually be improved in the future financial reporting. It is also possible that, in view of the rapid publication of the annual financial reporting in which the deficiency is visibly repaired, a review is informally closed. The follow-up review can also relate to a review of the semi-annual financial reporting.

In 2012, the AFM started a review at 86 (2011: 88) companies into the application of the reporting requirements in the annual financial reporting. These concerned 38 (2011: 41) follow-up reviews and 48 (2011: 47) desktop reviews. The selection of the 48 companies, of which the financial reporting was subjected to a desktop review by the AFM, took place as follows:

- On the basis of the risk analysis and rotation, the AFM subjected the annual financial reporting of 38 companies to a desktop review.
- The AFM receives regular public alerts about possible errors in a set of financial statements. Often these concern financial statements that have already been selected for a desktop review. In 2012, following public alerts of 1 (2011: 4) not previously selected company, its annual financial reporting was still selected for a desktop review.
- The AFM selected the financial reporting of five companies for a desktop review, because the follow-up reviews showed that the notifications had not been fully followed up.
- For four companies, the annual financial reporting was selected for a desktop review, because a quick scan of the financial reporting in 2012 provided a reason for doing so.

In total there were 83 (2011: 85) reviews completed. These were 9 (2010: 6) reviews ongoing from 2011, 38 (2010: 41) follow-up reviews, and 36 (2011: 34) desktop reviews that were selected on the basis of the risk analysis, alerts, and quick scans.

The following up of notifications in the 2011 financial reporting was again good, but not complete

The number of financial statements in which the notifications were sufficiently followed up amounted to 33, or 87% (2011: 35 or 85%). Of course, there continues to be room for further improvement.

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[3] In a desktop review, the AFM distinguishes between full and limited desktop reviews. Both are designated as a desktop review in this report.

The number of requests for information is stable

In 2012, the AFM completed 45 (2011: 44) desktop reviews. In 30 (2011: 28) reviews, requests for information on the application of the reporting requirements[4] were made to the companies.

Fewer notifications and fewer recommendations as a result of the full desktop review

12 (2011: 6) companies have been able to remove the AFM's doubts about the correct application of the reporting requirements. The AFM issued one or more notifications to 18 (2011: 22) companies. In 3 (2011: 4) cases, these notifications were accompanied by a recommendation-b. This contains a request to the company to make generally available a press release that explains how the financial reporting would have appeared if the issuer had properly applied the reporting requirements. All the recommendations were followed up.

In 2012, as well, the AFM continued the less formal working method in both the completion of the reviews ongoing from the previous year, and the follow-up reviews and desktop reviews

As in previous years, a number of ongoing reviews from 2011 were completed with agreements that the companies will follow in the preparation of the financial reporting on 2011. The follow-up reviews in 2012 showed that, as in 2011, the quality of financial reporting has improved, partly because agreements with the companies on the preparation of the financial reporting have been properly honoured.

The less formal working method that the AFM started in 2010/2011 was also applied regularly in 2012. In the informal working method, the AFM uses telephone or email to contact the company if, as a result of uncertainties, the AFM has questions regarding the financial reporting. As a result of the content of this informal contact, the uncertainties may be resolved. Sometimes agreements are made concerning adjustments in the financial reporting of the current financial year. It can also occur that, on the basis of the explanation the AFM receives, a (formal) request for information is still made. From the reactions of the companies, it has become clear to the AFM that this less formal working method is appreciated, and that through this development, the number of formal requests can be limited.

Appendix A provides a table with an overview of the activities concerning the supervision of the compliance with the reporting requirements. This overview does not take into account any requests for information and notifications issued as a result of the thematic reviews. The findings from the informal working method are also not included in the table.

2.2 Examples of material errors that have given rise to recommendations and notifications

In the 'Considerations for Financial Reporting 2012'[5] the AFM published its preliminary findings from the desktop reviews and thematic reviews that it had started at that time. As a supplement

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[4] *The AFM notes that the subjects on which requests were made do not differ from the subjects on which the notifications were issued, whether or not accompanied by a recommendation.*

[5] *http://www.afm.nl/~/media/files/fin-verslag/2012/considerations-fin-reporting.ashx*

to this publication, this section of the activity report briefly discusses the results of the reviews, and discusses the content of the recommendations and notifications.

Recommendations

If the AFM adds a recommendation to a notification, it believes that correct application of the reporting requirements should have a significant effect on the (future) financial reporting of the company. For users of this financial reporting, a major consideration is that they must be able to immediately take note of the error(s) or shortcoming(s) in the financial reporting, so that they can make a well-considered (investment) decision. The publishing of a press release in response to a recommendation provides this transparency. This means that the recommendation contributes to an adequate functioning of the capital markets and investors' confidence in those markets. In issuing a recommendation, the AFM believes that the increased transparency outweighs any interest that the issuer may have for not making such information public. A recommendation can relate to several standards.

The recommendations made by the AFM in 2012 related to the following subjects:

- *Carrying amount of a financial instrument was presented 56% too high*

  A financial instrument was incorrectly classified in the financial reporting as 'loan and receivable', because it did not comply with condition c set in letter c in IAS 39.9 in the definition of loans and receivables. For this reason, the financial instrument should have been classified as 'available for sale'. As a result of the incorrect classification, the financial instrument was incorrectly measured at amortised cost. The measurement should have been at fair value, which at the end of 2011 was 56% (2010: 41%) lower than the presented amortised cost. As a result of this error, the equity was presented 44% (2010: 32%) higher than it should have been, at the end of 2011.

- *No recovery was applied to a previous error concerning incorrectly recognised fee for listing*

  In its financial reporting on 2010, the company classified the fee paid for a listing as costs of issuing shares, and charged it directly to equity. The fee that is paid for a listing does not qualify as costs of issuing shares, and therefore should be charged to the result. With a correct treatment of the fee for the listing, the result would have amounted to approximately 60% less than reported. The company did not apply any error recovery in the financial reporting on 2011.

- *Inadequate disclosure of causes for negative goodwill*

  The company accounted in its result for negative goodwill that arose on the acquisition of a company. The amount thus recognised was more than 2.5 times as large as the reported net earnings. In the financial statements, the company disclosed the statement that, on the basis of IFRS 3.B64 (i), the purchase price of the acquired company was less than the fair value of the identified assets and liabilities at the acquisition, because the seller wanted to discontinue all of his activities in connection with having reached the retirement age. During the AFM's review, it became clear that this disclosure was incomplete, and that the negative goodwill was also caused by a party associated with the company at the time of the transaction, which was willing to acquire – for an amount of €1 – the other companies of the seller that had negative equity. Since this enabled the seller to divest all the companies he held, this was a reason for the seller to agree with the lower proceeds from this specific subsidiary. In addition, the seller was not expected to be able to realise the expansion of foreign operations, while the measurement of the client base actually took this expansion into account.

- *Factoring agreement was incorrectly classified as non-current liability*

  The company classified the financing from a factoring agreement as a non-current liability. However, the company has no unconditional right to defer settlement of the liability by at least 12 months after the reporting period, as required in IAS 1.69(d). For this reason, the company should have classified the liability as current. As a result of this error, the current liabilities were presented 14% lower than they should have been.

- *Share-based payments were not recognised for each director in the overview of the directors' remunerations*

  The overview of the remunerations for each director did not contain the 'share-based payments' component. This component of remuneration amounts – for each director – to between 70% and 80% of the total reported remunerations. In the 2011 Activity Report[6], the AFM stated that it believes that the share-based payments should also be recognised in the overview of directors' remunerations, which must be recognised in the financial statements on the basis of Section 2:383c of the Dutch Civil Code.

- *Press release issued even before the AFM issued a recommendation, regarding the fact that – incorrectly – no consolidated financial statements had been prepared*

  As a result of the review, and even before the AFM could issue a notification with a recommendation, one company had published a press release in which the company stated which parts of its 2011 financial reporting did not comply with the reporting requirements. As a result of this press release, the AFM did not issue the notification with a recommendation.

  The company had only prepared separate financial statements, and had – incorrectly – not prepared any consolidated (IFRS) financial statements, because it believed that the interest in the sole subsidiary was only held with the intention of disposing of this interest.

  In the notes to the IAS Regulations and the Fourth and Seventh Directives of the European Commission, in November 2003, however, the European Commission

[6] *http://www.afm.nl/~/media/Files/fin-verslag/2011/activity-report-2011.ashx*

stated how a listed company must decide whether it must prepare consolidated financial statements on the basis of IFRS. The issue of whether or not a consolidation requirement exists must be determined on the basis of national law. This consolidation requirement is stipulated in the Netherlands in Section 2:406 of the Dutch Civil Code. If, on the basis of Section 2:406 of the Dutch Civil Code, a consolidation requirement does exist, consolidated financial statements must, consequently, be prepared on the basis of IFRS. Then, on the basis of IFRS, it must be determined which entities are included in the scope of the consolidation. These entities must be included in the consolidation. Since the holding of an interest in a subsidiary with the intention to dispose of this interest does not provide any exemption from consolidation under IFRS, the company should have prepared consolidated financial statements on the basis of IFRS.

Notifications

The notifications issued by the AFM to six companies related to the following subjects:

- *Disclosures provided insufficient information concerning the circumstances and events that led to the impairment and the corresponding assumptions used*

  IAS 36.134 requires that, among other things, if the recoverable amount of a unit (group of units) is based on the value in use, the company must provide a description of the management's method for all the key assumptions for determining assigned value(s) and the extent to which these assumptions are consistent with external sources of information and experiences from the past.

  Several companies, which have applied impairment on a number of assets with an indefinite useful life, failed to mention in their financial statements which assumptions they had used in determining the value in use of these assets. This means that users of the financial statements do not have an adequate picture of how cautious or how optimistic this company has been in determining the recoverable amount of these assets.

  IAS 36.130 requires, among other things, that the events and circumstances that led to the impairment must be stated in the disclosures.

  One company applied an impairment, amounting to the full carrying amount, to two intangible non-current assets that were acquired several years previously in a business acquisition, because it no longer used these assets. The financial statements did not show this at all, nor did they state that the assets concerned had been fully written off. This means that relevant information had been withheld from users of the financial statements.

  Another company did indeed provide the information described above. However, it did so at too aggregate a level. The company reported the information at the level at which it reported the segmented information, and not, as is required, for each significant asset for which impairment has been recognised, or for each cash-generating unit (group of units) for which the carrying amount of goodwill is significant in relation to the total carrying amount of goodwill. Due to the high level of aggregation, much of the information value was lost.

- *Disclosures provided insufficient information to enable users to assess risks arising from financial instruments*

  IFRS 7.31 requires an entity to disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed on the reporting date.

  In its 2011 financial statements, one company only disclosed the financial ratios that were agreed upon with the bank at consolidated level, without separately reporting the financial ratios of subsidiaries segments that have their own bank arrangements. Furthermore, the financial statements disclose that the (maximum) loans/assets ratio may vary between a% and b% (difference is 20%) without going into more detail of the individual maximum ratios that were agreed upon with the various banks. It can also be derived that this ratio for the largest subsidiary segment almost exceeds the a%, although the actual financial ratios agreed upon between each individual segment and the banks are not disclosed. Therefore, users of the financial statements cannot properly assess the (liquidity) risks.

  IFRS 7.39 relates to the obligation to present a maturity analysis for the financial liabilities on the basis of non-discounted contractual amounts, including financial obligations arising from future interest payments. One company, when presenting its maturity analysis of its financial obligations, did not recognise the obligations arising from future interest payable, which means that users of the financial statements receive an insufficient picture of the company's future cash outflows.

- *Debt instrument issued and related investment were incorrectly removed from the statement of financial position*

  One company believed that in the past it had incorrectly recognised an issued debt instrument and a corresponding investment in the statement of financial position. On closer inspection, the management discovered that, based on the Conceptual Framework, it was in fact a case that entailed a 'pass-through' agreement. This involved two separate contracts for which the receipts and payments coincide. This had not been formally regulated. This meant it did not satisfy the condition for removing the investment from the statement of financial position as defined in IAS 39.19 and the conditions of IAS 39.30 for removing the obligation from the statement of financial position.

- *Advance financing from factoring agreement was incorrectly classified as cash and cash equivalents*

  IAS 7.8 states that a current account with the bank is a part of the funding concept if this current account relationship forms an integral part of the cash management. If this condition is not met, the change in the current account relationship is deemed to be a financing activity.

One company considered the advance financing from a factoring agreement as cash. This is not in accordance with IAS 7.8, because the advance financing by the bank is only payable once the debtor has paid the amount, and under this agreement the company can never have a receivable due from the bank, as can otherwise be the case in a current account relationship,.

- *Amount paid for the purchase of the non-controlling interest in a subsidiary was incorrectly classified as cash flow from investing activity*

  IAS 7.42B requires that cash flows resulting from changes in the interest in a subsidiary must be considered as a transaction between shareholders, if the control of the subsidiary is retained. The cash flow related to this should be presented as cash flow from financing activities.

  One company acquired a non-controlling interest in one of the subsidiaries it held. The purchase price paid was recognised in the cash flow statement as a cash flow from investing activities, instead of as a cash flow from financing activities.

3 Other considerations in the preparation of the financial reporting in 2012

On 27 September 2012, the AFM published 'Considerations for Financial Reporting 2012'[7]. This report presents the points for improvement for the financial reporting, based on the preliminary findings from the supervision. The previous chapter of this activity report focused specifically on recommendations and notifications. This chapter deals with a number of additional considerations that are also important in the preparation of the 2012 financial reporting.

- *Crisis levy is part of the directors' remunerations*

As a result of the 'Budget Agreement 2013 Tax Measures (Implementation) Act' (*Wet uitwerking fiscale maatregelen Begrotingsakkoord 2013*), which became effective on 18 July 2012, a one-off crisis levy will be payable by employers in 2013. This tax amounts to 16% on the wage from current employment that an employee has been paid in 2012, provided that wage was higher than €150,000. As a result of the crisis levy, the Dutch Accounting Standards Board (*Raad voor de Jaarverslaggeving*, hereafter: RJ) published RJ Statement 2013-1 on 7 January 2013. For companies that prepare their consolidated financial statements on the basis of IFRS, only the 'Amendment RJ 271.6 Employee remuneration - Remunerations of directors and supervisory directors' is important. This section deals with the question of whether the crisis levy forms part of the directors' remunerations.

According to the RJ, the amount of the crisis levy that is charged to the legal entity in the financial year and that relates to the remuneration of current and former directors and supervisory directors, should be disclosed separately for the joint directors and the joint supervisory directors if the reporting must take place according to Sections 2:383 (1) and 383c of the Dutch Civil Code.

The RJ states that some of the comments have argued that the crisis levy must be counted as part of the remuneration itself, but in the opinion of the RJ there is no obligation to do this. According to the RJ, there are also specific arguments for not doing this. All things considered, the RJ concluded that legal entities themselves have to consider whether or not to count the crisis levy as part of the remuneration.

Taking into account the different perspectives and the one-off nature of the crisis levy, the RJ believes that companies must indeed state in their disclosures whether or not this levy is counted as part of the remuneration. Furthermore, the RJ states that if the crisis levy is not counted as part of the remuneration, the amount that has been charged to the company in 2012 must be reported separately, provided that this amount relates to the remuneration of directors and supervisory directors.

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[7] *http://www.afm.nl/~/media/files/fin-verslag/2012/considerations-fin-reporting.ashx*

The AFM recognises that there are different views concerning the answer to the question of whether the crisis levy must be counted as employee benefits. For listed companies, however, this question must be answered on the basis of the requirements from IAS 19.

In its letter of comment to the RJ dated 25 November 2012[1], the AFM therefore stated that the crisis levy must be counted in the employee benefits under IAS 19, in the AFM's opinion, because it concerned a payment associated with the work performance. Listed companies must therefore, in the opinion of the AFM, account for the crisis levy in the 2012 financial statements as part of employee benefits. The crisis levy serves as part of the short-term remuneration to be reported in the overview of the remuneration paid to key management personnel as referred to in IAS 24.17, and should be recognised in the overview of directors' remunerations as referred to in Section 2:383c of the Dutch Civil Code.

The AFM has stated that it is highly preferable to include the crisis levy in the national standards as part of the remuneration of directors, and to do so, as well, from the background that the crisis levy concerns an employer's expense that is imposed if an employee performed services for the employer in 2012, and has been paid more than €150,000 for these services. In the opinion of the AFM, this also fits in better nationally with the definition of 'employee benefits'[2]. The fact that the crisis levy in no way benefits the employee, and can affect the public perception of the amount of the remuneration, does not detract from this, according to the AFM.

- *Discount rate IAS 19*

IAS 19.78 requires that the pension obligations are discounted at a discount rate derived from the interest rate for high-quality corporate bonds at the end of the reporting period. In countries where there is no highly liquid market for corporate bonds, the discount rate will be determined on the basis of government bonds. IAS 19.79 explains that the discount rate defines the time value of money, but not the actuarial risks and investment risks.

As a result of the debt crisis and deteriorating economic conditions, interest rates on government and corporate bonds have changed significantly. Also, the credit rating agencies have revised their assessment of the creditworthiness downwards for a number of companies and governments. As a result of these developments, a number of European companies are wondering to what extent they must otherwise determine the discount rate for their pension obligations. On 12 November 2012, ESMA paid attention to this issue in its publication 'European common enforcement priorities for 2012 financial statements'[8],

In line with the ESMA publication identified above, the AFM notes that:

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[1] This letter is only available in Dutch: http://www.rjnet.nl/PageFiles/928/Commentaar%201168%20-%20AFM%20op%20Uiting%202012-5.pdf
[2] IAS 19.7 Employee benefits are all payments that are made in exchange for the services that are provided by employees.
[8] http://www.esma.europa.eu/system/files/2012-725.pdf

- It believes that companies must not change how they determine the discount rate, unless the IFRS Interpretations Committee (IFRS IC) provides a more detailed explanation of the term high-quality corporate bonds before the date of the publication of the 2012 financial statements, which gives rise to a change. For the time being, the AFM, as well as its European counterparts, shares the view that companies in the Eurozone could only make use of AAA and AA- corporate bonds in determining the discount rate. These ratings are deemed to have (virtually) no default risk, in contrast to the lower ratings.
- Companies must be transparent about how they have determined the discount rate for pension obligations, including the significant assumptions that have been made in this context and the reference to markets for high-quality corporate bonds to which the company has access.

- *Error recovery as a result of a notification*

IAS 8.42 requires that material errors from a prior period are to be corrected retrospectively in the first subsequent financial statements by adjusting the comparative figures, unless this is impossible in practice. Furthermore, IAS 8.49 requires that the company must report a number of details, such as the nature of the material error from a previous period. For each line, the amount of the adjustment must be reported, as well as the amount of the correction at the start of the first period for which figures have been recognised in the financial statements. If it is practically impossible to recover an error retrospectively, there must be an explanation of why this is the case.

The AFM finds it notable that after it has issued a company with a notification concerning a current year, whether or not accompanied by a recommendation, this provision concerning error recovery is not always complied with. In the opinion of the AFM, the measure of following up the notification means that the IAS 8 provisions concerning error recovery must be applied.

In this activity report, the AFM once again directs the attention of companies to the existence of the requirements for error recovery, which of course also apply if a company itself discovers an error made in an issued set of financial statements. With effect from the 2013 calendar year, the AFM will further accentuate the relevant text in the notification.

- *IAS 19R Guide from the RJ*

In January 2012, the RJ published its 'IAS 19R Guide' (*Handreiking IAS 19R*, hereafter: Guide), which will soon be updated. According to the introduction, the Guide is intended as a support in applying IAS 19R in the Dutch pension situation, particularly in the classification and measurement of pension obligations.

The RJ decided to issue this Guide, although IAS 19R is not an RJ Guideline, but an IFRS standard. The reason for this is that Guideline 271.101 allows the application of IAS 19R, as well as a result of the specific Dutch pension situation.

The AFM supports any initiative to improve the quality of the financial reporting. This Guide can certainly contribute to this, because it is expected to contribute to proper application of the standard and to greater comparability. On the other hand, the AFM notes that, as the RJ states, the Guide is not an interpretation of IFRS and also not a Guideline containing definite conclusions or recommendations. Therefore it is important to emphasize that if listed companies use this Guide in preparing their financial statements, they must ensure that the use of the Guide in their specific situation is in accordance with the provisions of IAS 19R. If a company has doubts about this issue, it can always seek informal contact with the AFM.

4 Amendments to the Financial Reporting Supervision Act with effect from 1 January 2013

The Dutch Senate recently passed the Audit Firms Supervision Act (*Wet op het accountantsberoep*, or WA). With effect from 1 January 2013, Section 66 of the WA amends a number of provisions in the Financial Reporting Supervision Act (*Wet toezicht financiële verslaggeving*). Through the implementation of these amendments, the Chinese wall has been removed between the department responsible for the supervision of the financial reporting and the other supervision departments within the AFM. As a result of the elimination of this Chinese wall, the reporting expertise can be used more easily and more effectively for other supervision tasks, and the cooperation with other departments will be intensified.

The condition, applicable until the end of 2012, entailing the stipulation that the AFM could only send a request for information if, on the basis of public facts and circumstances, it had doubts about the correct application of these requirements, has also been removed. This means that, in the context of a thematic review, the AFM can now approach companies to request them to provide data.

The AFM expects that the effectiveness and efficiency of the supervision it exercises will improve in many areas.

5 Other activities

This section of the activity report provides an overview of the other activities of the AFM in the area of the supervision of the financial reporting. It successively discusses the following topics: the international activities, the Financial Reporting & Accountancy Committee, the role of the AFM with the RJ, and the concept of material significance in the financial statements.

5.1 International activities

The AFM has also been active internationally in 2012, in the area of financial reporting. Most activities were performed within the European Securities and Markets Authority (ESMA), and in particular within the Corporate Reporting Standing Committee. By being active within ESMA, the AFM has an influence on the reporting requirements that are drawn up by the IASB. For the AFM, it is important to ensure that these reporting requirements lead to relevant information for investors, and that these requirements can be enforced in the supervision. The AFM is chair of the project group that writes the ESMA letters of comment in response to proposals from the IASB.

The AFM participated in all eight European Enforcers Coordination Sessions (EECS) organised by ESMA. In these meetings, European supervisors of financial reporting discuss anonymised supervisory decisions taken by one of the members of the meeting, whereby a dozen decisions of the AFM were among those discussed. In addition, the AFM presented five complex cases before making a supervisory decision. Four of these cases were related to the treatment, measurement, and/or disclosure of financial instruments. The purpose of EECS is to promote and safeguard a consistent application of IFRS in Europe, and to improve the quality of financial reporting.

In the area of the supervision of the financial reporting, there is increasing coordination in the European Economic Area (EEA). In this connection, on 12 November 2012, ESMA published – for the first time ever – the common priorities[9] that will be observed by the national supervisory authorities in the EEA during their supervision in 2013. These priorities concern financial assets, impairment of non-financial assets, liabilities from defined benefit plans, and provisions. These subjects are of major importance in the light of the current economic conditions.

5.2 Financial Reporting & Accountancy Committee

With effect from 25 October 2012, the name of the Financial Reporting Committee was changed to Financial Reporting & Accountancy Committee. The name change accompanies the expansion of the committee's area of attention. The auditing area of specialisation has been added because the supervision of financial reporting and the supervision of auditing firms are

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[9] *http://www.esma.europa.eu/system/files/2012-725.pdf*

both aimed at improving the quality of the financial reporting, and many developments affect both areas.

The name change of the committee coincides with the appointment of five new members, because seven members had to resign as a result of reaching the maximum term in office. Together with three sitting members, the committee currently consists of eight members.

The committee contributes to the AFM's broader opinion forming concerning the supervision of financial reporting and auditing firms, which usually concerns policy aspects. The AFM values good dialogue on important discussions within the areas of specialisation in which it operates. In addition, it is precisely the specific expertise provided by experts in the area of financial reporting and auditing that is considered as being extremely valuable in enabling the supervisor to operate as effectively as possible.

5.3 The AFM and the Council for Annual Reporting

The AFM has served for many years as an observer at the meetings of the Dutch Accounting Standards Board (*Raad voor de Jaarverslaggeving*, hereafter: RJ). As an observer, the AFM has the opportunity to explain its vision and positions during the meetings of the RJ. Until recently, the AFM limited its contribution to the subjects that were relevant to the financial reporting of listed companies. This specifically concerned the separate financial statements, the annual report, and the provisions from Title 9, Book 2 of the Dutch Civil Code that also apply to companies that prepare their financial statements, whether consolidated or otherwise, on the basis of IFRS. The AFM also focuses on the letters of comment that the RJ writes to the IASB and EFRAG. As it does within ESMA, at the RJ the AFM pays attention to the interests of the investor and the enforceability of the reporting requirements.

Partly in response to the discussion on the desirability of applying cost price hedge accounting, the AFM has decided, as observer at the RJ meeting, to share more of its vision and perspectives with the RJ concerning provisions in the RJ's Guidelines that differ from the provisions in IFRS. In its Guidelines, the RJ generally gives more freedom of choice than the IFRS do. In the opinion of the AFM, the quality of financial reporting in the Netherlands would further improve if this freedom of choice would be more limited. In this context, the AFM realises that the Guidelines of the RJ are an elaboration of the statutory provisions as set out in Title 9, Book 2 of the Dutch Civil Code, and that these statutory provisions also provide a lot of freedom of choice.

In 2012, the RJ and the AFM agreed to act jointly on more subjects. This provides the RJ with the opportunity to make proposals for the AFM's thematic reviews. There is also the intention to jointly submit a proposal to the Minister, based on RJ 400, to establish detailed requirements for the annual report, as referred to in Section 2:392(5) of the Dutch Civil Code. In addition, there are currently discussions concerning the desirability of the application of cost price hedge accounting and the conditions that apply for this.

The AFM agrees with the statement of the RJ that cost price as well as fair value is an accounting policy that in principle is permitted in Title 9, Book 2 of the Dutch Civil Code[10]. With respect to situations entailing the application of this policy, the insight requirement as referred to in Section 2:362 (1) of the Dutch Civil Code must always be complied with. This insight requirement is so important because, on the basis of Section 2:362 (4) of the Dutch Civil Code, a company can be forced to deviate from the special provisions included in Title 9, Book 2 of the Dutch Civil Code, such as those concerning the allowable accounting policies, if the insight requires this.

In view of the nature and complexity of some derivatives, positions, and hedging relationships, and the sometimes low cost and potentially large changes in value, the AFM calls on companies and their auditors to always examine whether the measurement of derivatives at cost and the application of cost price hedge accounting will lead to a set of financial statements that provide such insight that users can form a responsible opinion concerning the equity and the result, and – insofar as the nature of the financial statements allows it – concerning the solvency and liquidity of the legal entity[11].

The AFM also calls on the legislator to consider whether the measurement of derivatives at fair value should not be made compulsory, or that the disclosures and criteria for applying hedge accounting should not have much stricter requirements set, in order to improve the provision of information on derivatives.

5.4 Materiality in the financial statements

For several years the AFM has been striving for more clarity on the application of the concept of materiality in the financial statements. Materiality is the criterion for determining whether information should be included in the financial statements and, therefore, whether a particular requirement of IFRS must be met. Information is material if the investor's knowledge of it can influence his/her decision-making. If information is not quantitatively and qualitatively material, it does not need to be included.

In this context, on 30 January 2012 the AFM organised a roundtable meeting[12], and it gave a presentation during the National Financial Reporting Day (*Nationale Verslaggevingsdag*)[13] on 26 June 2012. It has also designed part of its website[14] for this purpose. Following the presentation on the National Financial Reporting Day, on 16 October 2012 the AFM conducted a discussion of the concept of materiality in the financial statements during the Professional

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[10] In Section 2:389 (1 to 3 inclusive), for holdings in which the company has a significant control, the net equity value on the basis of the equity method is prescribed. However, the question is whether this is an accounting policy or a so-called 'one line' consolidation.

[11] In this context, the AFM also refers to existing and already applied alternative prescribed measurement methods, such as the requirement of the RJ to measure listed shares at the market price (RJ 226.204).

[12] http://www.afm.nl/en/nieuws/2012/jan/jaarrekening.aspx

[13] http://www.afm.nl/~/media/Files/fin-verslag/2012/presentatie-en-nationale-verslaggevingsdag-materialiteit.ashx

[14] http://www.afm.nl/nl/professionals/afm-voor/effectenuitgevende-ondernemingen/financiele-verslaggeving/materieel-belang.aspx

Practice Consultation Platform of The Netherlands Institute of Chartered Accountants (*Nederlandse Beroepsorganisatie voor Accountants*). Such discussions are useful in the context of the efforts of the AFM to improve the quality of financial reporting.

There is also a lot of attention being paid to this concept on the international level. For example, in November 2011 ESMA issued a consultation document on this concept, and it also organised a roundtable meeting on 1 October 2012. The relevant documentation can be found on the website of ESMA[15]. In the short term, ESMA will publish the key findings from the roundtable meeting and the intended actions.

5.5 Supervision of bankrupt companies

In the 2012 legislation letter, the AFM stated that the current legislation contains obstacles that hamper the transparency to investors. The Bankruptcy Act (*Faillissementswet*) does not contain a statutory requirement for the receiver to cooperate with a request from the AFM. The AFM considers the cooperation of the receiver to be important, because it cannot be excluded that the financial reporting, prior to a bankruptcy, will have contained errors, whereby investors have been misled. After all, the company will often have had trouble keeping its integrity, and will often have succumbed to the pressure to present its economic position in glowing, or even overly glowing, terms.

The Minister has meanwhile indicated the following: *the requirement for the receiver to cooperate with a request from the AFM is not currently deemed to be opportune*. The reasoning for this is that *the costs of cooperating with an information request would be at the expense of the estate.* The AFM has decided to adapt its policy in the sense that it will be very reluctant to continue the supervision of the financial reporting once a company becomes bankrupt. This does not affect the fact that a company that gets into financial problems will indeed appear on the risk radar of the AFM.

5.6 Response periods for request for information

In the 2011 activity report[16], the AFM reported that, following the extension of the review period at the Enterprise Chamber of the Amsterdam Court of Appeal (*Ondernemingskamer*), the standard response period for requests for information has doubled from 10 to 20 working days. Since the deadline for compliance with a recommendation by a company with a registered office outside the EEA has not been extended, the AFM still uses a standard response period of 10 working days for these companies. Once this review period has also been extended to nine months, the AFM will extend the standard response period to 20 working days.

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[15] *http://www.esma.europa.eu/hearing/Roundtable-materiality-financial-reporting*
[16] *http://www.afm.nl/~/media/Files/fin-verslag/2011/activity-report-2011.ashx*

6 Findings from supervision of the publication and filing of annual and semi-annual financial reports and interim management statements

Four companies with listed debt securities have not yet published their 2011 annual financial reports and/or 2012 semi-annual financial reports and/or filed them with the AFM. The other companies have fully complied with the publication requirement and the simultaneous filing of their financial reporting with the AFM. Companies that have listed shares must also ensure that an interim management statement is made publicly available twice a year, and must simultaneously file this with the AFM, in addition to the publication of their annual and semi-annual financial reporting.

Just as was the case last year, the AFM has had to remind a large number of companies, some of them several times, of the requirement for publication and simultaneous filing with the AFM of their financial reporting. The AFM sent a total of 135 reminder letters. Four companies received an order.

The AFM expresses the hope that, in 2013, many more companies will meet this requirement without reminder letters and/or orders. To accomplish this goal, at the beginning of the year companies will receive a summary of the latest dates on which publication and filing must take place. If no improvement occurs, the AFM will not hesitate to take more severe measures.

Finally, it can be reported that approximately 85% of the equity issuers and 70% of the debt issuers make use of the AFM Portal for the filing of their financial reporting. The other companies send the financial reporting in hard copy to the AFM.

Appendix A: Overviews of financial reporting supervision activities[17]

	Total	AEX	AMX	AScX	Local[18]	Abroad[19]
Companies under supervision[20]	**262[21]**	**21**	**22**	**21**	**112**	**86**
2011 ongoing	**9**	**0**	**1**	**1**	**1**	**6**
Desktop reviews started:	**86**	**12**	**13**	**8**	**46**	**7**
Follow-up	*38*	*4*	*5*	*2*	*24*	*3*
Risk analysis and rotation	*47*	*8*	*8*	*6*	*21*	*4*
Alert	*1*				*1*	
Completed desktop reviews[22]:	**83**	**12**	**10**	**8**	**43**	**10**
2010 Financial statements	*9*	*0*	*1*	*1*	*1*	*6*
2011 Financial statements	*74*	*12*	*9*	*7*	*42*	*4*
2012 ongoing	**12**	**0**	**4**	**1**	**4**	**3**
Supervision activities:						
Request(s) for information	30	4	4	6	12	4
Doubt removed	12	2	3	2	3	2
Notifications	15	1	1	4	7	2
Recommendations	3	1			2	

[17] Numbers mentioned in this overview can differ from the numbers mentioned in the AFM's annual report. This overview already includes notifications if they are known at the end of the year, while the AFM's annual report only includes the notifications that were issued during the calendar year.
[18] This concerns Dutch companies and companies from third-party countries with shares (not included in an index) and/or bonds with listings in the Netherlands.
[19] This concerns Dutch companies that only have listing(s) of shares and/or bonds abroad.
[20] This concerns the population of Dutch companies and companies from third-party countries as at March 2011, to the extent that these were then known by the AFM.
[21] For 25 bond funds that can choose their Member State of origin, it is unclear whether or not they fall under the supervision of the AFM.
[22] This concerns the 2010 ongoing reviews, the follow-up reviews, and the reviews as a result of an alert that were completed in 2011.

Main subjects of Notifications and Recommendations for each IFRS standard[23]

	Brief description	Total	AEX	AMX	AScX	Local	Abroad
IFRS 2	Share-based Payment	1					1
IFRS 3	Business Combinations	3				1	2
IFRS 7	Financial Instruments: Disclosures	5	1	1	1		2
IFRS 8	Operating Segments	1	1				
IAS 1	Presentation of Financial Statements	3				1	2
IAS 2	Inventories	1				1	
IAS 7	Cash flow Statement	4				2	2
IAS 8	Principles	1					1
IAS 12	Income Taxes	1				1	
IAS 19	Employee Benefits	1			1		
IAS 24	Disclosure of Related Parties	2		1		1	
IAS 28	Associates	1				1	
IAS 32/39	Financial Instruments	3				3	
IAS 36	Impairment	6	1	1	2	2	
IAS 37	Provisions	1				1	
	Reg. No. 1606/2002	1				1	
Total		35	3	3	4	15	10

Subjects of Book 2 Title 9 of the Dutch Civil Code in Notifications and Recommendations

Provisions in Book 2 Title 9 of the Dutch Civil Code	Total	AEX	AMX	AScX	Local	Abroad
	6	1			4	1

[23] *If a standard is included more than once in a notification or recommendation, e.g. concerning different aspects, the standard is only counted once in this overview. If multiple standards are referred to in a notification/recommendation, each standard is only included once. Informal notifications are not included in this overview.*

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