Listed companies and integrated reporting

Supervision of Financial Reporting

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Contents

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The Netherlands Authority for the Financial Markets (AFM)

The AFM promotes fairness and transparency within financial markets. We are the independent supervisory authority for the savings, lending, investment and insurance markets. We promote the fair and conscientious provision of financial services to consumers and private investors, as well as professional and semi-professional parties. We supervise the fair and efficient operation of the capital markets. Our aim is to improve consumers' and companies' confidence in the financial markets, both in the Netherlands and abroad. In performing this task, the AFM contributes to the stability of the financial system, the economy and the reputation and prosperity of the Netherlands.

1 Management summary

The reason for this thematic review is the development towards integrated reporting in the external reporting of listed companies and the demand from users for more non-financial reporting. A draft framework for integrated reporting was published by the International Integrated Reporting Council (IIRC) in April 2013. The final version is expected to be published at the end of 2013.

Based on its thematic review of integrated reporting at 41 listed companies, the AFM has established the following:

- The quality of the reporting of non-financial information can be improved in terms of relevance, conciseness, accessibility and coherence;
- The companies provide information on their mission, activities and markets; information on their earnings model and risk attitude could be improved;
- A large majority of the companies provide a description of their strategy and its implementation; quantifying and translating this into KPIs, however, needs attention;
- All the companies include a report on governance and risk, however the information provided concerning the tone at the top, culture, competences and management remuneration could be improved considerably;
- The forward-looking information is too general, with very little substantiation from external sources;
- The information on policy, the result, risk and risk management with respect to human rights, anti-corruption and bribery issues is minimal.

The quality of the reporting of non-financial information can be improved in terms of relevance, conciseness, accessibility and coherence

It is pleasing to note that 7 out of 41 companies publish an annual report that contains many of the features of integrated reporting. Two of these companies actually called their annual report an integrated report. The vast majority of the companies include their non-financial report in the directors' report.

The size of the directors' report in relation to the annual report varies, but is relatively large in many cases. Lengthy descriptions of the company and its activities, photographs and repetition of information and in some cases the inclusion of a separately published sustainability or CSR report make the annual reports unnecessarily extensive, inaccessible and complex. Conciseness, relevance, readability and coherence are important factors in the integrated reporting concept. These aspects were also considered to be important by the various stakeholders with whom we conducted interviews.

The AEX companies performed better than the rest with regard to all the features of integrated reporting. Local companies (other listed companies) achieved the lowest scores in this regard. The scores for the AMX and ASCX companies were average, however there were substantial variations in this group.

The companies provide information on their mission, activities and markets; information on their earnings model and attitude to risk could be improved
Nearly all companies provide information on their mission, activities, markets, products and services. This information is essential for users to be able to form a good impression of the company. In order to provide even better information to users, companies could give a better description of the relationship between strategy, business model and value drivers. The information on the earnings model and risk attitude could also be improved.

A large majority of the companies provide a description of their strategy and its implementation; quantifying and translating this into KPIs needs attention, however
Companies provide good information on their targets and the strategy designed to achieve these targets. However, the reporting of the implementation of the strategy in the context of the targets with the use of key performance indicators (KPIs) needs to be improved. Investors consider this information to be essential, as it enables them to assess a company's performance.

All the companies include a report on governance and risk, however the information given on the tone at the top, culture, competences and management remuneration could be improved considerably
All companies devote attention to governance and risk. However, the informative value of the paragraph on governance is limited in many cases. This paragraph is an isolated element in the annual report. Information on the tone at the top and the corporate culture is often lacking. The same applies to information that can be used to form an opinion regarding the competences of the management in relation to the company's activities. It would be of great benefit to users if companies would describe how the members of their management complement each other, and provide information to demonstrate that they have the right management team for the company's current stage of development. This information would enable a user to form a well-informed opinion of a company's leadership in relation to its strategy and objectives.

It is also clear in many cases with respect to the remuneration policy that the variable remuneration is partly based on criteria other than financial ones. However, it is not always clear to what extent environmental and social standards are included in the criteria. There is limited transparency with respect to non-financial standards in the remuneration of senior management.

The forward-looking information is too general, with very little substantiation from external sources

Forward-looking information is useful to users in the context of gaining a better understanding of the business and the strategy for realising sustainable value development. Although the companies include forward-looking information, in most cases the information they provide is of little use. It is too general, it is not company-specific and also lacks substantiation from external sources.

The information provided on policy, the result, risk and risk management with respect to human rights, anti-corruption and bribery issues is minimal

The manner in which human rights, corruption and bribery are handled has consequences for the parties concerned. This can, moreover, have a major impact on the company's environment and reputation. It is therefore not surprising that users and regulators call for openness from companies with regard to these issues. The information provided in this respect is still minimal, especially with regard to the result of policy, risks and risk management.

2 Rationale, objectives and population

2.1 Rationale

The reason for this thematic review is the development towards integrated reporting in the external reporting of listed companies and the demand from users for more non-financial reporting. Integrated reporting is a form of annual reporting that enables companies to provide information on the connection between strategy, governance, performance and prospects, and on the social, economic, financial and environmental context in which the company operates.

Furthermore, a company's ability to create value is determined mostly by factors that cannot be directly measured in financial terms, such as employee commitment, the use of natural resources and the relationships with customers, suppliers and local communities, not only by the net assets in its statement of financial position. Integrated reporting, whereby non-financial aspects are also reported, provides more information on a company's actual value and value creation and the effects of the business strategy in the short, medium and long term.

This new form of reporting is currently undergoing intensive development. A draft framework for integrated reporting was published by the International Integrated Reporting Council (IIRC) in April 2013.

The aim of integrated reporting is to increase the transparency of reporting and is therefore entirely consistent with the AFM's strategic objective of promoting the fair and efficient operation of the financial markets. Integrated reporting moreover meets a need that has arisen as a result of a change in the information needed by investors. It is expected that this type of annual reporting will develop over the next few years into the most important source of information for investors and other stakeholders on a company's status and operations. Companies that adopt integrated reporting could therefore benefit from a first-mover advantage.

Integrated reporting will make it possible for countries with a government policy that is more future-oriented and sustainable and companies that operate in a socially responsible way to compete fairly with other jurisdictions and companies. By having a good focus now, a better starting point for the future conduct of the business will be created. Integrated reporting can positively contribute to a company's brand and reputation. These matters are becoming increasingly important to purchasers of products and services.

The AFM considers being well-prepared for this process of future changes to corporate reporting as part of its supervision of the capital markets. The AFM also endorses the concept of integrated reporting, as this enables companies to provide more relevant information to their investors and other stakeholders.

The AFM takes the view that market parties should take the lead in the further development and formulation of integrated reporting, whereby the role of the supervisors is limited to encouraging the development of integrated reporting. Enforcement will only be appropriate once the concept of integrated reporting has become more mature. The AFM supports the development and application of integrated reporting and will use the results of this review to monitor developments.

2.2 Objective

The objective of the thematic review of integrated reporting is to obtain information on the extent to which listed companies are applying the principle of integrated reporting in their financial reporting.

2.3 Population: 41 companies

For our thematic review, we looked at the 2012 annual reports of companies subject to supervision in the Netherlands and whose shares were admitted to trading on Euronext Amsterdam on 31 December 2012. The companies are divided across the AEX (eleven), AMX (ten), ASCX (ten) and other locally listed companies (ten). The draft framework for integrated reporting published by the International Integrated Reporting Council (IIRC) in April 2013 was used as the framework of standards for the review. At the time of the review and the reporting thereof, this draft framework had not yet been finalised.
Prior to the review, we also conducted interviews with eight stakeholders (users, providers and auditors) on the subject of integrated reporting. We also used the input from these interviews in the design of our review.

3 Key review results

3.1 The quality of the reporting of non-financial information can be improved in terms of relevance, conciseness, accessibility and coherence

The concept of integrated reporting is relatively new, and its form and regulation are still at an early stage. The draft framework for integrated reporting published in April 2013 is expected to take definitive shape towards the end of 2013. Many companies are conscious of the importance of reporting non-financial information and have begun to experiment with this approach. This is evident from the various ways in which non-financial information is reported. It is mainly the AEX companies that have taken the lead. As we will see further on in this report, the AEX companies score higher on all aspects of integrated reporting than the other companies. The local companies (other listed companies) scored lowest in this regard. The scores for the AMX and ASCX companies were average, but there were, however, substantial variations in this group.

Financial reporting, usually referred to as the annual report, consists of the following elements:

- Directors' report;
- Financial statements (consolidated and separate);
- Other data.

In the review, we treated all the sections appearing before the consolidated financial statements as the directors' report. In other words, the sections on corporate governance, risk management, segment reporting and management remuneration are treated as part of the directors' report.

Integrated thinking and reporting

During our review, we encountered two companies that publish an annual report that they refer to as an 'integrated report'. Five other companies (four from the AEX and one from the AMX) do not use this title explicitly, but their reports contain many of the elements that are addressed in the draft framework for integrated reporting. The strategy, objectives, activities, financial and non-financial information, stakeholder dialogue, risks and opportunities and management remuneration are discussed extensively and as a whole. In addition, we see that these companies embrace the concept of integrated thinking, which is the basis for integrated reporting. Integrated thinking means that the company establishes the relationship between its strategy, the economic context, the environment, the social context, and risks and opportunities. This is intended to create value over the medium to long term. Companies that have already made considerable progress in the field of integrated reporting all have a history of reporting non-financial information and may rightly be called pioneers in this respect.

Sustainability and CSR reports

Integrated reporting involves more than simply publishing a report containing both financial and non-financial information. During the review, we encountered several companies that had included sustainability information in their financial reporting and thereby considered that they had published an integrated annual report. It should be clear that this is not what the concept of integrated report means.

More than 20% of the companies publish a separate sustainability or CSR report. Around half of these are companies in the AEX. The number of companies from the other indices was equally divided. It is also possible that the actual number is higher in practice, since these separate reports are often published later during the financial year than the annual report, which has to be published by 30 April. We did not take account of separate sustainability or CSR reports during our review.
The vast majority of the companies include their non-financial report in the directors' report, that is, the section before the financial statements.

International standards

We furthermore observed that more than half of the companies prepare elements of their non-financial information on the basis of the international standard for sustainability reporting, the Global Reporting Initiative (GRI). Other frequently occurring references to national and international standards are, for example, the principles of the UN Global Compact, ISO 14001 Environmental Management, the Greenhouse Gas Protocol, the transparency benchmark of Economic Affairs and the CO_2 Performance Ladder.

Size, relevance and materiality

The size of the directors' report in relation to rest of the annual report varies in each case, but it is often relatively large. In many cases the directors' report accounts for around half of the total report. The annual reports of the AEX and AMX companies are especially lengthy, sometimes comprising approximately around 400 pages. We note that the extensive statements about the company, its activities, photographs and repetition of information and the inclusion of the separately published sustainability or CSR report in some cases are the reason for this. This information makes the annual reports unnecessarily long, inaccessible and difficult to read. Conciseness, relevance, readability and coherence are important factors in the integrated reporting concept. These aspects were also mentioned as important during the interviews we held with the various stakeholders. They would prefer a concise report that presents only relevant information. The message is 'less is more', rather than the current situation of 'more is better'.

According to the draft framework for integrated reporting, only material information should be reported: matters that are really important for the company. This will reduce the size of the report and make it more accessible. One way to achieve this is a materiality analysis conducted by a company in consultation with its stakeholders. During our review, we found one company that provided information on this process. Its annual report contains a materiality analysis matrix.

Companies need to find a form whereby they meet both the statutory requirements (the directors' report, the financial statements and the other data), which are mainly financial in nature, and report relevant, cohesive and concise financial and non-financial information.

Auditor

A small minority of the companies (15%) had their non-financial information explicitly assessed by an auditor. The assurance statement by the auditor attached to the non-financial information usually takes the form of a combined audit opinion and a review report. The auditor thus assigns greater audit certainty to certain elements of the non-financial information in the annual report than to other elements regarding the accuracy and completeness of the information concerned. In some cases we found only an audit opinion, or only a review report. In all cases the statements were made by an auditor from one of the big-4 audit firms (KPMG, PWC, EY and Deloitte).

3.2 Companies provide information on their mission, activities and markets; information on the earnings model and risk attitude could be improved

We investigated the extent to which information is provided on what the company does and how it creates and maintains value, in the short, medium and longer term. The aspects we investigated include the mission statement, information on activities, markets, products and services, earnings model, value drivers and attitude towards risks and opportunities.

Nearly all companies provide information on their mission, activities, markets, products and services. The number providing information on the earnings model, value drivers and risk attitude is significantly lower, at just over 65%. The earnings model and value drivers can mostly not be inferred from the directors' report. Few companies state the relationship between their strategy, business model and value drivers.

The review shows that the AEX companies score highest on this point, and the locally listed companies score lowest. The scores for the companies from the AMX and ASCX were average, however with significant disparity between individual companies.

3.3 A large majority of the companies provide a description of their strategy and its implementation; quantifying and translating this into KPIs needs attention, however

We investigated the extent to which information is provided on what the company does, where it wants to go and how it wishes to get there. Stakeholders, and especially investors, are very interested in a company's strategy and its implementation. This enables them to compare performance with the strategy and assess the company's ability to create value (also in the long term).

More than three quarters of the companies report on their targets and the strategy designed to achieve these targets. Here too, the AEX companies achieve the highest score. Nearly all AEX companies provide an explanation of their strategic objectives. The majority (approximately 80%) of the other companies from the AMX and ASCX and the locally listed companies also do this.

Quantification of targets

Less than half of all companies quantify their financial targets and translate these into key performance indicators (KPIs). There are large differences between the indices here. AEX companies score highest (over 80%) and locally listed companies score lowest (30%). The AMX and ASCX companies vary, with scores of around 40% - 50%. If the strategic targets are quantified, this almost always relates to financial targets.

Although strategy is generally described clearly, the fact that a large majority of the companies do not translate their strategy into KPIs that are of value to the users represents a missed opportunity. This information would put users in a better position to evaluate a company's performance.

Evaluation of performance

During the review, we looked at the information from which the company's performance in relation to its strategy could be inferred. We established that it is still not a simple matter for users to understand the connections between strategy, policy and objectives on the one hand, and realised and forecast performance on the other. Less than half of the companies state their performance in relation to their targets.

Key figures

The key figures that are reported are usually general in nature. Financial key figures usually consist of revenue, gross profit, operating result, EBIT, EBITDA, expenses, operational cash flow and solvency. Environmental measures reported include CO_2 emissions, use of paper, energy and water and production of waste. Regarding employees, the measures reported mostly concern employee involvement and satisfaction, absenteeism, education and training and the ratio of male to female employees. The number of key figures reported varies per company, and ranges from one key figure to more than ten.

Although companies report all these key figures, it is often not clear which should be considered important in the light of the company's strategy and the extent to which they are really KPIs. The challenge for the company is to make clear the relationship between the reported KPI and the strategy. Users want to know which strategic KPIs are used by the company leadership in its management of the business.

External factors

Slightly less than two thirds of the companies also report the most important negative and positive external factors affecting the company's performance. There is somewhat more extensive mention of the negative factors than of the positive. Over half of the companies express their view with regard to important economic, environmental and social factors.

3.4 All the companies include a report on governance and risk, but the information given on the tone at the top, the corporate culture, competences and management remuneration could be improved considerably

Governance, corporate culture and stakeholders

All companies provide information on governance. This is no surprise, as listed companies are obliged to comply with the corporate governance code. As a result of the 'apply or explain' principle, standard texts are often used. This means that the informative value of the governance paragraph is usually limited and it forms an isolated element in the annual report.

Less than half the companies provide information on the strategic decision-making process. Around 30% of the companies provide information on the tone at the top and the corporate culture. Approximately half the companies provide information on their stakeholders. This information is frequently superficial, and amounts only to a statement that there is an ongoing dialogue with the various stakeholders. Information on who the stakeholders are and the issues discussed with them is absent in the majority of cases.

Competences and remuneration

A minority of the companies provide information that allows users to form an opinion on the competences of the management in relation to the company's business activities. Significant improvements can still be made here by providing information on a broader layer of management. Companies could, moreover, provide information on how managers complement each other, and information showing that this is the right management team for the company's current phase of development. This information is currently lacking. The information provided on the top management (the executive board) and the supervisory board usually consists only of a summary list of ancillary and other functions performed by the individual directors.

With respect to the remuneration policy of executive directors, it is often clear in many cases that the variable remuneration is partly based on criteria other than financial ones. However, it is not always clear to what extent environmental and social measures are included in the criteria. There is limited transparency with respect to non-financial measures in the remuneration of senior management. Only a small number of companies actually quantify these measures.

Risks, opportunities and legislation

Nearly all companies report on significant risks. More than 70% also report on their significant opportunities. The methods used to identify risks are described in 70% of cases. More than 80% report on how risks are monitored and include a description of the mitigating measures in place. The relationship between risk and the company's ability to create value is described in only a very few annual reports. None of the companies provide quantitative information to substantiate the risks recognised. More than 30% also report significant legislation and regulations.

3.5 The forward-looking information is too general, with very little substantiation from external sources

During our review, we considered the extent to which companies provide information on future opportunities, uncertainties and challenges. This concerns information on the way in which the organisation will deal with future challenges, and how it deals with short and long term expectations, and the impact thereof on its business model and performance. This is useful information for users wishing to gain a better understanding of the company's business and strategy in order to achieve sustainable value development.

Outlook

More than half the companies include forward-looking information. However, if an outlook is provided, this is usually for the short term, i.e. the coming financial year. Companies are very cautious regarding forward-looking statements. They usually revert to economic generalities, and give little company-specific information.

Substantiation and making information available

The information provided is substantiated by external sources in only a very few cases. A minority of the companies issue concrete forecasts for the coming year. A large majority provide information on trends and markets. Only a small proportion provides information on their competitors.

Here too, companies could make big improvements by providing more specific information on their future challenges and their approach to them. We have the impression that this information is available internally, but that companies are not keen to share it in their annual reporting. We also understand from the various stakeholders we interviewed that this information is provided at analyst meetings and road shows. The logic of excluding it in the reporting therefore escapes us.

3.6 The information provided on policy, the result, risk and risk management with respect to human rights, anti-corruption and bribery issues is minimal

The European Commission issued proposals with respect to non-financial reporting on 16 April 2013. These suggest that companies should include information on policy, result and risks with respect to the environment, personnel, human rights and anti-corruption. The proposal somewhat overlap with our review, and is expected to become mandatory in the foreseeable future. We therefore also considered how companies reported on these issues during our review.

The manner in which human rights, corruption and bribery are handled has serious consequences for the parties concerned. This can moreover have a serious effect on the company's environment and reputation. It is in the public interest that companies make proper arrangements in these areas. Furthermore, companies that fail to respect these issues may encounter serious financial consequences, especially as enforcement is intensifying in these areas. Information on these issues is therefore relevant to users.

Policy

Approximately 75% of the companies already provide a description of policy in the areas of the environment and human resources. The figure for companies reporting on human rights, anti-corruption and bribery issues is just over 30%.

Results of policy

About half the companies provide information on the results of their policy with regard to environmental issues and human resources. The proportion reporting on human rights is around 20%. Information on results in the field of anti-corruption and bribery issues is provided by approximately 12% of the companies.

Risks and risk management

Around 30% of the companies report on risks and risk management with respect to the environment. For human resources the proportion is higher, at around 40%. Here too the information on human rights, anti-corruption and bribery issues is the least, and is reported in only 15% of cases.

A large majority of the companies provide information on policy regarding environmental issues and human resources. However, only a small proportion gives information on the result, risks and risk management in these areas. Information given on human rights, anti-corruption and bribery is minimal, as regards policy as well as result and risks. All companies that failed to provide information on policy also failed to state the reason why no company policy has been formulated with respect to these issues.

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