

Remuneration of management boards in financial reporting
Audit and Reporting Quality

October 2014



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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. 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 remuneration of management boards continues to be a subject of public debate. The disclosure of the remuneration of managers in key positions, including the remuneration of executive and supervisory directors, is therefore an important and relevant source of information for decisions by users of financial reporting. Despite the attention devoted by the AFM to the reporting of the remuneration of management boards in recent years, we are still seeing signals that too many of the disclosures on remuneration are not transparent enough. The AFM accordingly carried out another thematic review of the disclosure of the remuneration of management boards in 2014 as included in the 2013 financial statements of 119 listed companies. In this review, the AFM focused on accuracy, comparability and relevance as measures of quality in transparent financial reporting.

The findings of the present review will be analysed further in order to identify the reasons why companies are not or not adequately complying with the statutory disclosure requirements. Based on the results of this analysis, the AFM will determine which other supervisory instruments can be applied in order to influence companies' behaviour more effectively. With its publication of the results of the review, the AFM's intention is to draw further attention to the application of the regulations governing the remuneration of management boards and to call on companies and auditors to include its recommendations in the financial reporting for 2014.

The main finding of this review is that too many of the disclosures relating to the remuneration of management boards are not transparent enough. This is shown by the following findings:

- Actual costs are not adequately disclosed
- The remuneration structure is reasonably well described, but in many cases it is not clear whether the bonus targets were achieved
- The information is not sufficiently accessible

Actual costs are not adequately disclosed

The regulations require that the actual costs of the remuneration of management boards are disclosed. Depending on the remuneration component, the AFM observes that between 7% and 39% of the companies do not disclose the actual costs, but disclose amounts calculated on different principles. For another quarter to one third of the companies, it is not clear whether the actual costs or other amounts are disclosed. The AFM mostly encountered deviations with regard to share-based payments, bonuses and the crisis levy. It was regularly the case that disclosures concerned the amounts paid and not the actual costs. Although this information can be useful in some cases, this does not discharge companies of their obligation to disclose the actual costs as well.

If a company decides to also include the remuneration payments made in the reporting year, it is important that such statements clearly define what is stated and in which part of the disclosure it is stated. For the users, it is important that the accounting policies used in this context are stated.

The disclosure of this item needs to be improved in this respect. The AFM takes the view that companies must comply with the statutory requirements and that from 2014 they must accordingly disclose the actual costs in their financial reporting.

The remuneration structure is reasonably well described, but in many cases it is not clear whether the bonus targets were achieved

Users need to understand the targets that directors strive to achieve in the short and the long term, and the extent to which these targets were achieved in the reporting year. The company's remuneration policy is usually related to these targets. It is therefore important that the users can understand how the remuneration policy is implemented. Virtually all the companies presented a description of their remuneration policy. In just over half of the cases, this description ranges from satisfactory to good. The AFM calls on the other half of the companies to further improve the description they provide.

Two thirds of the companies did not state whether the targets set had been achieved or not. This disclosure is a statutory requirement. The AFM's view is that companies must provide this mandatory disclosure in their financial reporting with effect from 2014.

The information is not sufficiently accessible

The Corporate Governance Code, IAS 24 and the Dutch Civil Code include requirements for the disclosure of the remuneration of management boards. As a result of this, more or less all the companies include information on this remuneration in several places in their financial reporting. While in some cases the information included in several places is in addition to that previously provided, in other cases it appears that the same information is repeated several times. It would help the users if clear references were made between the various disclosures regarding the remuneration of the management board. It would also be helpful to the users if this information was included in one place and in its entirety in the financial statements. The AFM calls on companies to take account of this in the preparation of their financial reporting for 2014.

Furthermore, disclosure of total amounts with a breakdown into the various remuneration components would help users to establish that they are aware of all the remuneration components. The AFM considers the fact that many companies do not include total amounts, or do not include them correctly, to be a cause for concern. The AFM takes the view that companies must include the statutory required total amounts in their financial reporting for 2014 and thereafter.

2 Rationale, objectives and follow-up

2.1 Rationale: the remuneration of management boards continues to be a subject of public debate

There has been a public debate concerning the remuneration of management boards of listed companies and public organisation ongoing for many years. The debate concerns the size of the remuneration, and the performance on which entitlement to that remuneration is based. More recently, there has been media attention regarding reactions to severance payments, remuneration of supervisory directors and the targets on which entitlement to a variable remuneration is based.

The debate has led to the following actions by the legislator:

- The *Wet Normering bezoldiging topfunctionarissen publieke en semipublieke sector* (Senior Officials in the Public and Semi-Public Sector (Standards for Remuneration) Act), which came into force on 1 January 2013;
- The *Wet tot wijziging van Boek 2 van het Burgerlijk Wetboek* (Act of Amendment to Book 2 of the Dutch Civil Code) and the *Wet op het financieel toezicht* (Financial Supervision Act) in relation to the power to adjust or reclaim bonuses and profit-sharing payments to directors and persons in charge of day-to-day policy, which came into force on 1 January 2014; and
- A proposal recently put forward by the European Parliament¹. The proposal aims firstly to increase transparency regarding the remuneration policy and the remuneration actually awarded, and secondly to create a closer connection between performance and remuneration by giving shareholders the authority to control the remuneration of management boards. Under the proposal, shareholders will have the power to approve the remuneration policy and vote on the implementation of that policy at the shareholders' meeting.

In view of the above, the disclosure of the remuneration of managers in key positions, including the remuneration of executive and supervisory directors, is an important and relevant source of information for decisions by investors. It is not appropriate for the AFM to comment on the size of the remuneration; however, the AFM certainly has a duty to ensure that the social debate is conducted on the basis of correct and complete information. The disclosure of the remuneration of management boards must therefore be transparent.

¹ Proposal for a Directive of the European Parliament and of the Council amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement and Directive 2013/34/EU as regards certain elements of the corporate governance statement, dated 9 April 2014.

2.2 Objective: the disclosure of the remuneration of management boards must be transparent

One of the objectives of the thematic review was to establish whether the current disclosures were sufficiently transparent. If this is found not to be the case, the AFM will consider the measures it can employ to influence behaviour and bring about an improvement. In this review, the AFM focused on accuracy, comparability and relevance as measures of quality in transparent financial reporting.

From its thematic review of the financial statements for 2010, the AFM concluded that the disclosure of the remuneration of management boards had improved in comparison to the financial statements for 2007, but that more than 30% of the companies could improve in this respect. Regarding the financial statements for 2011 and 2012, the AFM took individual actions against companies as part of the desktop reviews it conducted. As a result of these actions, two companies actually published a press release in which the correct disclosure of the remuneration of the management board was included². The AFM is nonetheless still receiving signals that the disclosure of the remuneration of management boards is not up to standard. In its report 'In balance 2013', published in October 2013, the AFM accordingly announced that it would conduct a thematic review of the reporting of remuneration, including the remuneration of management boards. The intention of this review was to establish whether this is the case.

Review design and population

This review was carried out on the 2013 financial statements of public companies incorporated under Dutch law whose shares are listed on a regulated market in Europe. These 119 companies form a cross-section of the market, which makes it possible to detect differences that may exist between indices.

2.3 Follow-up: analysis of causes and bringing influence to bear

There may be many reasons why companies do not or not fully comply with the statutory and other requirements with respect to disclosures. What instruments will be deployed to achieve the desired effect depends very much on the reasons for the non-compliance.

In order to identify the causes of the shortcomings, the review results will be analysed further. Based on the results of this analysis, the AFM will determine which supervisory instruments can be applied in order to positively influence companies' behaviour. These may include enforcement, or the influencing of behaviour. We expect this report and the good practices described therein to provide a certain degree of influence. This will be taken into account when setting our follow-up strategy.

² See the press release by Wolters Kluwer N.V. dated 27 July 2011 http://www.afm.nl/registers/fv_documents/7001.pdf and the press release by TomTom N.V. dated 30 December 2012 http://www.afm.nl/registers/fv_documents/10575.pdf.

3 Key review results

The results are given below. This section also lists certain ‘good practices’³. These good practices are intended to provide examples of how a company can comply with the disclosure requirements in a manner specific to its own situation. The AFM hopes these good practices will inspire companies and assist them in the transparent disclosure of the remuneration of their management board.

3.1 Actual costs are not adequately disclosed

Regulation requires that the disclosure of the remuneration of the management board states the costs incurred by the company in that respect in the reporting year. A limited group of companies do not disclose the actual costs, they disclose amounts calculated according to other principles. The key findings are described in more detail below. The most variations were found with reference to:

- share-based payments (19%)
- bonuses (7%)
- the crisis levy (39%)

Improvement is needed in these areas.

The Dutch Civil Code⁴ and IAS 24⁵ require that costs incurred by the company in the reporting year are disclosed. The *Raad voor de Jaarverslaggeving* (Dutch Accounting Standards Board⁶) states explicitly that it is not the timing of the actual payment that is the determining factor for the disclosure of the remuneration of management boards, but that it is the year in which the payment in question is charged to the company’s result according to the reporting standards.

It would appear that some companies consider it necessary to disclose the remuneration paid. While the AFM acknowledges that this information may be useful in some cases, this does not discharge companies from their statutory obligation to state the costs recognised in their result. If a company decides to state both the costs and the remuneration payments made, it is important that it clearly defines what is stated and in which part of the disclosure it is stated.

It would also be helpful to the users if the accounting policies applied are stated in the disclosure. This would mean that the basis on which the amounts of material remuneration components stated have been calculated would be immediately clear.

³ The good practices cited in this report are examples of specific disclosures from existing financial statements and annual reports. The AFM hopes that other companies will be inspired by these good practices to increase the quality and relevance of their own disclosures. The good practices quoted should not be seen as a standard or as the only correct substance of existing or future disclosures. Other formulations to comply with legislation and regulation are possible. The inclusion of good practices in this report does not imply any judgement by the AFM regarding the financial statements in question as a whole.

⁴ Section 383c Book 2 Title 9 of the Dutch Civil Code (*Burgerlijk Wetboek*).

⁵ IAS 24 ‘Related parties’ paragraph 17.

⁶ Annual Reporting Guidelines 271 ‘Employee benefits’ paragraph 606.

Good practice 1: Statement of accounting policies

Source: 2013 financial statements of Nutreco N.V., page 177

Underneath the table 'Remuneration of members of the Executive Board 2013', Nutreco discloses the policies applied for a number of material remuneration components.

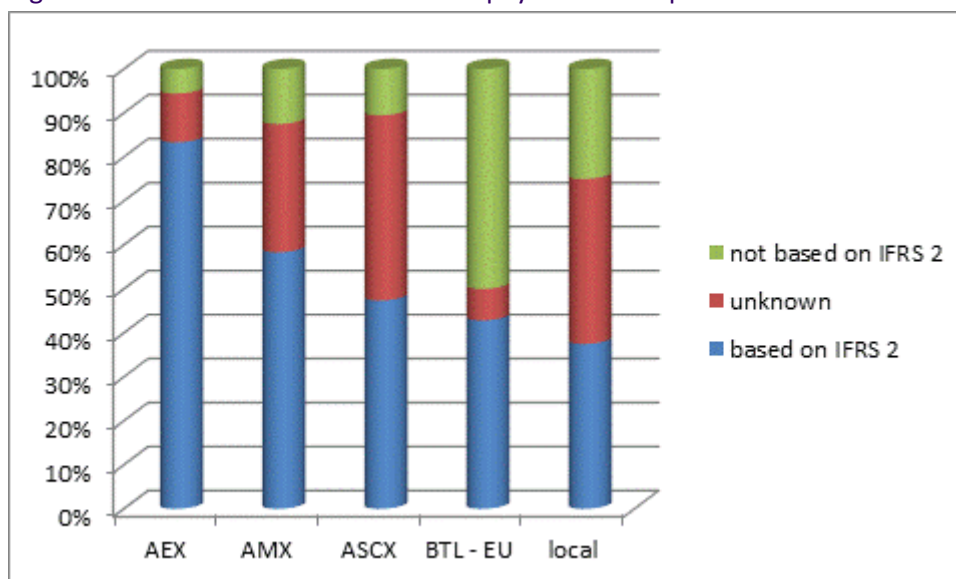
- 1 The performance bonus relates to the performance in the year reported and is to be paid in the subsequent year.
- 2 The valuation of the LTI shares is based on IFRS accounting principles and does not reflect the value of vested LTI shares.
- 3 Other compensation mainly includes insurances, private use of company cars, allowances for expenses and housing.
- 4 The crisis tax of 16% as imposed by the Dutch government is payable by the employer on the part of the salaries exceeding € 150,000.

Disclosure of share-based payments on the basis of IFRS 2

IFRS 2 'Share-based payments' requires that the costs associated with such arrangements are attributed as employee expenses to the period between the date of vesting of the entitlements and the date on which the entitlements become unconditional. According to the regulation, these costs must be included in the disclosure of the remuneration of management boards.

It emerged that 19% of the companies with a share-based remuneration component included an amount in the disclosure of the remuneration of the management board that differed from the costs recognised in the income statements on the basis of IFRS 2. This for instance concerned the value of the options that had become unconditional during the reporting year. 26% of the companies did not make it clear how the amount disclosed in the disclosure of the remuneration of the management board had been determined. It was thus not clear whether the amounts disclosed corresponded to the actual costs. The figure below shows these results per index.

Figure 1: Disclosure of the 'share-based payments' component on the basis of IFRS 2



Bonuses earned in the current reporting year must be disclosed

In the case of eight companies (7%), the disclosure of the remuneration of the management board states the bonus paid in the reporting year rather than the costs attributed to the reporting year. A further 39 companies (33%) did not make it clear whether the bonus concerned the current or the previous reporting year. Besides the fact that this does not meet the requirements, it is also not experienced by the users as current information⁷.

If an actual or legal obligation exists at the end of the reporting year and its size can be reliably estimated, short-term and other bonuses due to directors must be recognised and disclosed in the reporting year to which they relate.

The crisis levy is part of the remuneration of management boards

The crisis levy had to be recognised in the 2012 financial statements for the first time. 39% of the companies included an explicit disclosure that the amounts disclosed were excluding the crisis levy. On the other hand, 20% of the companies included a disclosure including the crisis levy. It was notable that the remainder of the companies reviewed (41%) did not make it clear whether the amounts stated included the crisis levy or not. A majority of the companies failed to disclose the amount of the crisis levy per director. Companies must be more transparent regarding the amount of the crisis levy and the way in which the costs of the crisis levy form part of the management boards' remuneration disclosed.

The Activity Report 2012⁸ states under IAS 19 'Employee benefits' that the crisis levy must be counted in employee benefits, because it concerns a payment that is related

⁷ See the evaluation of the 2013 shareholder meetings season by Eumedion.

⁸ <http://www.afm.nl/nl-nl/professionals/doelgroepen/effectenuitgevende-ondernemingen/financiele-verslaggeving/publicaties>

to the employment services received by the company. In their financial statements, listed companies must therefore include the crisis levy in employee benefits and present this as an element of the short-term remuneration in the disclosure of the remuneration of the management board.

3.2 The remuneration structure is reasonably well described, but in many cases it is not clear whether the bonus targets were achieved

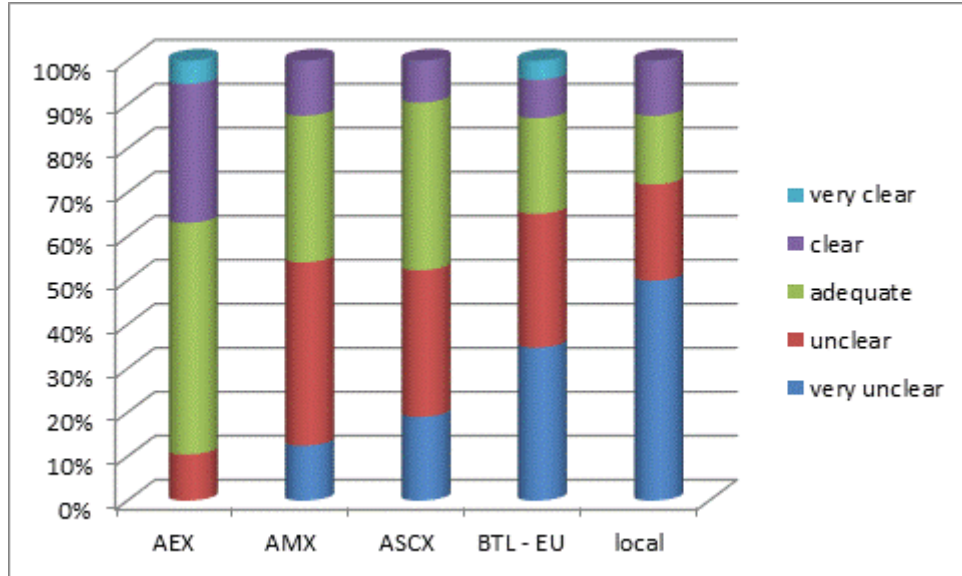
In addition to the size and composition of remuneration, the public debate has focused on the conditions that must be met in order for a variable remuneration to be awarded. Virtually all the companies present a description of their remuneration policy. Around half of them give a description that states that the remuneration is dependent on a peer group, targets to be met (KPIs), a relative weighting of KPIs and/or individual targets. Only 40% of the companies states whether the targets set were achieved or not. The description of the criteria for the award of a bonus and the degree to which the underlying targets have been met leaves room for improvement.

Investors can derive relevant knowledge from this information, because it enables them to understand the targets directors are striving to achieve in the short and the long term, the extent to which these targets have been met in the reporting year and whether this has led to a bonus being awarded. For this reason, the AFM looked at the extent to which companies provide clear descriptions of:

- the various remuneration components
- the peer group
- the targets, or performance indicators
- the weighting of the various targets
- the realisation of the various targets
- the individual targets

The information provided was ranked according to a scale from 1 to 5 (very unclear to very clear). If the description shows that the bonus for instance depends on EBITDA, net operating cash flow or the company's performance relative to a peer group, the disclosure is considered to be adequate. If this is not stated, or not stated for all the remuneration components, the disclosure is considered to be unclear or very unclear. Disclosures by companies that provide further information, for example regarding what it considers a peer group and/or the ranges used for the targets, are considered to be clear or very clear. The figure below shows that the descriptions provided by the AEX companies contain the most information.

Figure 2: Degree of clarity in description of remuneration policy



Disclose whether targets have or have not been met

The Dutch Civil Code requires that a statement be provided regarding whether the targets set were achieved or not. It is notable that mainly local and foreign companies frequently do not state whether the targets giving entitlement to a bonus were achieved or not. This is contrary to the situation with the AEX companies, 74% of which do provide this disclosure. The AFM’s view is that companies must provide this mandatory disclosure in their financial reporting with effect from 2014.

Good practice 2: Targets met or not

Source: 2013 Annual Report TNT Express N.V., pages 54 and 55

This part of the disclosure explains the targets set by the supervisory board for the members of the management board, the weighting of the targets, the actual performance and the related payment.

The Supervisory Board has assessed and scored the performance against the targets and objectives set for 2013. The following table sets out the 2013 targets, their weighting, the performance achieved and the related payout:

Targets variable income - Executive Board				
Target	Focus area	Weighting	Performance	Payout as a % of base salary
60% financial	Company results	70%	Target almost met	20.83%
	Net cash	30%	Target not met	0.00%
40% non-financial	Customers	33.3%	Target not met	0.00%
	Employees	33.3%	Target partially met	3.34%
	Sustainability	33.3%	Target partially met	3.34%
Total				27.51%

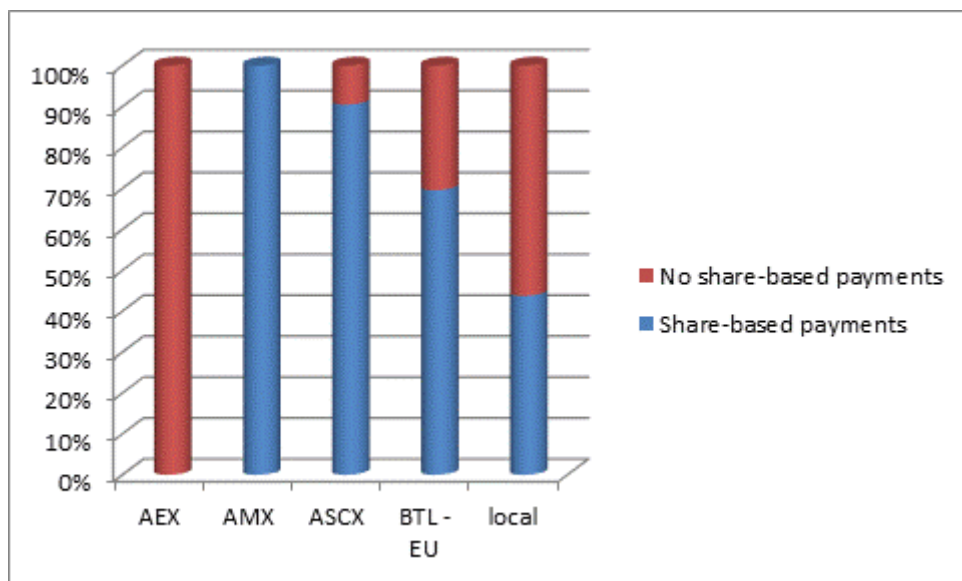
Complex arrangements require greater transparency

There are countless forms of share-based payments in practice. Usually, they involve the conditional vesting of shares and options, which becomes unconditional after a number of years. By their nature, these schemes are often complicated.

In their financial statements for 2013, 91 companies state that they have schemes for share-based payments to members of the management board. Eight of these companies also give share-based payments to the members of their supervisory board. This turns out to be usual practice mainly at companies with a registered office in the Netherlands but which are listed only on a foreign stock exchange. There are few changes in comparison with the 2010 reporting year; three companies have abolished the scheme, while six others have introduced such a scheme.

The figure below shows the count of companies with and without a share-based remuneration scheme for members of the management board. The application of this type of remuneration becomes less frequent as the size of the company diminishes.

Figure 3: Share-based payments for members of the management board (or not) by index



Share-based payments often form a significant part of the total remuneration of the management board. The AFM notes that the percentages of variable remuneration in the total remuneration of management boards vary widely. The costs of share-based payments as a percentage of total remuneration range from 0% to 82%. In one non-recurring case the share-based payment was negative, because the entitlements lapsed in 2013 and therefore the previously recognised costs had to be reclaimed.

Since variable remuneration is frequently a material remuneration component, it is important that companies give good account of the costs involved and the remuneration structure. The AFM calls on companies to take account of this in the preparation of their financial reporting for 2014.

3.3 The information is not sufficiently accessible

Companies apparently have difficulty in making their disclosure of the remuneration of the management board accessible. More or less all the companies include this information in several places in their financial reporting. While in some cases the information included in several places is in addition to that previously provided, in other cases it appears that the same information is repeated several times. Some companies report all the information relating to the remuneration of the management board together in one place in the report of the management board (the annual report). This is convenient for users, but often also raises the question of whether the statutory required information has been audited by the auditor.

The AFM suspects that this variety in presentation is related to the variety in the legislation. The Corporate Governance Code⁹, IAS 24 and the Dutch Civil Code all contain disclosure requirements with respect to the remuneration of the management board. As an additional complication, the disclosure requirements in the Dutch Civil Code and in IAS 24 are similar, but not identical.

It would help the users if clear references were made between the various disclosures regarding the remuneration of the management board. It would also be helpful to the users if this information was included in one place, in its entirety, in the financial statements. The AFM calls on companies to take account of this in the preparation of their financial reporting for 2014.

Total counts are important and are a statutory requirement

Disclosure of total amounts with a breakdown into the various remuneration components helps users to establish that they are aware of all the components. The AFM considers the following findings to be a cause for concern in this context:

- Only 29% of the companies include a total count of the remuneration of managers in key positions, including the members of the management and supervisory boards. Over 60% of the foreign companies include this total count, compared to only 30% by companies in the AEX and AMX.
- 16% of the companies do not state a total count for each management board member. Over 20% of the local and foreign companies omit this total count, compared to only 5% for the AEX companies.
- A further 12% of the companies that do present a total count omit remuneration components in the total count they present. In virtually all cases, this concerns the share-based payments and/or the severance

⁹ Best practice provisions II.2.12 and II.2.13 of the Dutch Corporate Governance Code.

payment. Mainly foreign companies and to a lesser extent smaller Dutch equity funds disclose a total count that is incomplete.

- 28% of the companies do not state a total count for each remuneration category. Over 38% of the AMX and local companies omit this total count.

Every company is obliged to disclose the total amount of the remuneration of managers in key positions and the total amount for each member of the management board. The AFM accordingly takes the view that companies must include total counts in their financial reporting for 2014 and thereafter.

Good practice 3: Combination of legislation and total counts

Source: 2013 financial statements of Koninklijke Ahold N.V., page 142

This part of the disclosure shows how information required pursuant to the Dutch Civil Code (upper table) and IAS 24 (lower table) can be presented in combination with total counts.

31 Related party transactions (continued)							
Remuneration of the Management Board by member							
€ thousand	Direct remuneration			Deferred remuneration			Total remuneration ⁵
	Base salary	Bonuses ¹	Other ²	Total direct remuneration	Share-based compensation ³	Pensions ⁴	
Dick Boer							
2013	975	868	12	1,855	1,114	433	3,402
2012	965	478	13	1,456	890	95	2,441
Jeff Carr							
2013	615	547	154	1,316	615	257	2,188
2012	600	330	155	1,085	386	175	1,646
Lodewijk Hijnans van den Bergh							
2013	537	478	16	1,031	545	212	1,788
2012	530	292	49	871	412	120	1,403
James McCann							
2013	650	579	414	1,643	665	239	2,547
2012	600	330	153	1,083	386	138	1,607
Total 2013	2,777	2,472	596	5,845	2,939	1,141	9,925
Total 2012	2,695	1,430	370	4,495	2,074	528	7,097
Remuneration of the Executive Committee including Management Board							
During 2013, the ExCo was formed. The table below specifies the remuneration of the ExCo, comprising the Management Board members as above and the additional ExCo members that were not part of the Management Board.							
€ thousand							2013
Base salary							3,183
Bonuses ¹							2,821
Other ²							865
Share-based compensation ³							3,983
Pensions ⁴							1,320
Total remuneration⁵							12,172

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Amsterdam, October 2014