<Company>
Attn Management Board
<P.O. Box>
<Postal code City>

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Telefophone + 31 20 - 55 52 456
Email André.Delger@afm.nl

Dear members of the Board,

Under the Act on the Supervision of Financial Reporting (*Wet toezicht financiële verslaggeving* - Wtfv), the financial reporting of Dutch listed companies for the financial years beginning on or after 1 January 2006 falls under the supervision of the Netherlands Authority for the Financial Markets (AFM). The Wtfv became effective on 31 December 2006.

Prior to the statutory supervision taking effect, the AFM carried out reviews in the context of pre-supervision of the financial reporting of Dutch listed companies. We reported our findings regarding the 2004 financial statements in our letter of 21 July 2006, while also announcing that pre-supervision would be extended to include the 2005 financial reporting of Dutch listed companies.

The purpose of this letter is to inform you of our findings of our review of the 2005 financial reporting of Dutch listed companies. The goal of our review is twofold: to improve financial reporting and to allow both the companies under review and the AFM to gain experience with the supervision process.

The findings of our review of the 2005 financial reporting are set out in Appendix A to this letter. In addition, this appendix includes information on the Wtfv. It also addresses the requirements for the filing of financial reports with the AFM following the introduction of the Wtfv and other specific aspects of the financial reporting which the AFM will pay attention to in 2007.

Appendix B includes a summary of illustrative questions put to companies by the AFM as part of its review. They provide an indication of the points that can be raised under the supervision regime.

This report concludes the pre-supervision stage. We trust that this report gives sufficient insight into our pre-supervision work and findings, and hope that the information provided will contribute further to your preparations for the supervision of financial reporting.

Yours faithfully,
Netherlands Authority for the Financial Markets

A.J. Delger
Head of Financial Reporting Supervision

Prof. S.J. Maijoor
Director

Appendix A

Contents:

1 Pre-supervision of the 2005 financial year

1.1 Approach to the review of the 2005 financial reporting

The review of the 2005 financial reporting was set up in the context of our supervision preparations, partly as a result of which it was limited in nature and scope. Our report is based on 30 desktop reviews of the 2005 financial reporting of listed companies.

Following our desktop reviews and depending on our findings, some companies were requested to provide additional information on the application of reporting standards. Since the financial reporting reviews in the pre-supervision stage were not performed under the Wtfv, companies participating in our review did so entirely voluntarily and without any obligations.

Under the European IAS Regulation, Dutch listed companies are required to prepare their consolidated financial statements as from the 2005 financial year in accordance with the International Financial Reporting Standards (IFRS) endorsed by the European Commission for use in the European Union. The company financial statements, the directors' report and the other information are subject to Part 9 of Book 2 of the Netherlands Civil Code. Some of the provisions of Part 9 of Book 2 of the Netherlands Civil Code also apply to the consolidated financial statements.

1.2 Main findings of our review of the 2005 financial reporting

As for our review of the 2004 financial reporting, companies generally were prepared to co-operate in the review for 2005. In addition to the specific findings in the financial reporting areas set out below, the AFM has the following two general findings:

Firstly, the AFM noticed that the desktop reviews resulted in fewer information requests compared with the review of the 2004 financial reporting. This could be an indication of improved compliance with the applicable reporting requirements and, as such, of an improvement of the quality of financial reporting. However, it should be noted that the 2005 financial statements reviewed were not selected using a risk-based approach, whereas the selection of the 2004 financial statements was risk-based. Companies whose financial statements were selected for the 2004 review were excluded from the selection of the 2005 financial statements. It is also important to note the differences in financial reporting standards: the reporting framework for 2005 was IFRS, the 2004 the financial statements were based on Dutch GAAP.

Secondly, the AFM found that most companies co-operating in the review appeared to experience difficulties in providing detailed written responses on time. The AFM has set a response time of ten days. It is possible that the relatively long time companies took to respond is due to the voluntary and obligation-free nature of the review. However, several companies indicated that the required response time could cause operational problems. When preparing for its supervision role, the AFM already acknowledged the bottleneck that the response times would pose. This is where the AFM has to strike a balance between, on the one hand, thoroughness and, on the other hand, swiftness. A longer response time may allow a better quality of response, thereby possibly resulting in a faster resolution of the issue raised (directly dispelling any doubts or reaching a speedier resolution of any issue by mutual agreement). However, the statutory time frame of six months for bringing annual accounts proceedings (*jaarrekeningprocedure*) before the Enterprise Section of the Amsterdam Court of Appeal (section 2:449 of the Netherlands Civil Code) gives the AFM limited scope to set a longer response time. In principle, for information requests in the context of our supervision, the current response time for an information request of ten working days will apply. If a company can put forward sound arguments for a longer response time, that company and the AFM can agree on a reasonable time frame, provided, at least, that the company is sufficiently co-operative and that the time frame agreed on is practicable in view of the statutory time frame of six months.

Main financial reporting areas for which questions were raised about the application of reporting standards

Below is a summary of the ‘top-five’ financial reporting areas for which the AFM raised questions concerning the application of financial reporting standards. It has to be emphasised that raising questions does not necessarily imply non-compliance with reporting standards.

The classification of the financial reporting areas is based on the standards framework for the consolidated financial statements of listed companies in force from 1 January 2005, i.e. EU-endorsed IFRS. Questions raised about the requirements of Part 9 of Book 2 of the Netherlands Civil Code are not included in this summary but are disclosed separately in this document.

	Subject	**Applicable standard**	**Indication of background to information request**
1	Financial instruments: disclosure, presentation, recognition and valuation	IAS 32/39	Questions mostly dealt with the equity versus liability classification in the balance sheet and with the omission of required disclosures.
2	Income taxes	IAS 12	Questions concerned deferred tax balances and effective tax rates, and questions concerned the omission of required disclosures. In addition, when the amount and/or relationship with other information so dictated, questions were raised concerning the amount and breakdown of the item ‘Other’.
3	Conversion to IFRS	IFRS 1	Questions mainly concerned the level of transparency of disclosures in the notes. In addition, questions were raised concerning differences presented between Dutch GAAP and IFRS in cases where these standards are almost identical.
4	Presentation of the financial statements	IAS 1	Questions concerning this standard were often combined with questions concerning other standards. IAS 1 includes the general IFRS reporting principles. In some cases, its requirements may be greater than those in standards dealing with a specific subject.
5	Leases	IAS 17	Questions mostly concerned the omission of disclosures required under IAS 17.

In addition to the above subjects, the AFM also raised questions concerning other areas. One third of the questions raised by the AFM addressed recognition and measurement issues and two thirds addressed disclosures, or absence thereof, for certain items or events.

To provide an understanding of the nature and detail of the questions the AFM may raise, Appendix B includes a summary of the questions raised concerning the application of reporting standards.

Financial reporting areas from our review of the 2004 financial reporting recurring during our review of the 2005 financial reporting

The questions raised during our review of the 2004 financial reporting were mostly in the following financial reporting areas: provisions, contingent liabilities and contingent assets (IAS 37), income taxes (IAS 12), segment reporting (IAS 14), consolidated and separate financial statements (IAS 27), investments in associates (IAS 28), interests in joint ventures (IAS 31) and impairment of assets (IAS 36).

Points raised regarding IAS 12 (Income taxes) during the review of the 2004 financial reporting have recurred during our review for 2005. This is one of the reasons why the AFM will specifically pay attention to this area in its review of the 2006 financial reporting.

1.3 Part 9 of Book 2 of the Netherlands Civil Code

In addition to the correct application of IFRS, the scope of the AFM's pre-supervision and subsequent supervision of the financial reporting of Dutch listed companies covers the correct application of the provisions of Part 9 of Book 2 of the Netherlands Civil Code. Many Dutch listed companies use the option provided by Part 9 of Book 2 allowing them to prepare their company financial statements using the same accounting policies applied in their consolidated financial statements. Companies using this option still have to comply with the disclosure and presentation requirements in Part 9 of Book 2 of the Netherlands Civil Code, including the reconciliation of changes in equity, and the capital protection rules. The latter rules also apply when the company opts to prepare its company financial statements in accordance with IFRS.

In addition to the above provisions, all listed companies are subject to the provisions of Part 9 concerning the annual report, other information and publication. Over two thirds of the information requests concerned the application of provisions of Part 9 of Book 2 of the Netherlands Civil Code. Appendix B includes examples of questions raised in the context of Part 9 of Book 2 of the Netherlands Civil Code.

2 Important aspects to carrying out our supervision responsibilities

2.1 Act on the Supervision of Financial Reporting

General

Under the Act on the Supervision of Financial Reporting (Wtfv), the AFM examines whether the financial reporting has been prepared in accordance with the applicable standards, and it will act if it has doubts concerning the correct application of these standards. Financial reporting includes the annual report, the adopted financial statements and the other information required by law. The Wtfv allows the AFM to independently perform a critical and thorough examination of compliance with the applicable standards, and, if necessary, to institute so-called annual accounts proceedings before the Enterprise Section using its individual power to take such matters to court.

Under the Wtfv, the AFM has the following powers:

- If, based on the adopted financial statements, the AFM has doubts concerning the correct application of reporting standards, it can request a company to provide additional information. If a company is insufficiently co-operative in responding to this request, the AFM can apply to the Enterprise Section to order the company to provide the requested information.
- If, with or without the Enterprise Section intervening, a company provides the additional information requested and that information dispels the AFM's doubts, the AFM will conclude its internal examination.
- If the additional information is provided and such information does not dispel the AFM's doubts, or confirms such doubts, it will notify the company in writing that the AFM has doubts whether reporting standards have been applied correctly.
- The AFM's notification may include a recommendation to the effect that the company issues a written public statement. Should a company fail to act on this recommendation, or act inadequately, the AFM can apply to the Enterprise Section to order the company to amend its financial reporting. Another option for the AFM is to make no recommendation, but to apply directly to the Enterprise Section after issuing the written notification to order amendment of the financial reporting.

AFM's supervision strategy

The AFM's Wtfv supervision strategy is designed to improve the application of reporting standards for external financial reporting for the benefit of investors in particular, ensuring that, with the co-operation of the companies, companies inform the public of their financial position in accordance with applicable reporting standards. Of course, while the AFM must act conscientiously, the co-operation of companies is also essential. The AFM seeks to find solutions by mutual agreement with the companies involved, avoiding any involvement of the Enterprise Section as much as possible.

An important aspect of our supervision strategy is co-ordination of consistent application of IFRS with other European regulators, by taking part in the European co-ordination mechanism of the Committee of European Securities Regulators (CESR).

2.2 Filing of financial reports

Under the Wtfv, the AFM is obliged to keep a register in which, among other items, the company's financial reporting is filed. Companies are obliged to file their financial reports with the AFM within eight days after adoption of the financial statements.[1] As regards the form of filing, the company has the choice of filing in hardcopy or in digital form. Filing financial reports is easily done through the AFM Portal using a DigiD access code. The AFM will include the financial reports received in a public register within five working days following the working day on which the AFM receives the financial report. Access to this register is via the AFM website, www.afm.nl.

2.3 Other reviews in 2007

The financial reporting of Dutch listed companies for financial years beginning on or after 1 January 2006 falls under the supervision of the AFM. In addition to the aforementioned desktop reviews, the AFM will examine specific aspects of the financial reporting by performing thematic reviews.

In 2007, the AFM's thematic reviews of the 2006 financial reporting will focus on the application of IAS 12 (Income taxes) and IAS 7 (Cash flow statements).

In this context, a thematic approach involves a further examination of the specified areas for a large population of financial reports. As a result, the probability of being selected under such an approach is high.

[1] Pursuant to section 5(a) of the Act on the Supervision of the Securities Trade 1995, companies must file their financial reporting with the AFM within eight days after adoption of the financial statements referred to in section 2:361 of the Netherlands Civil Code.

Appendix B – Illustrative questions

Below is a summary of questions raised during the pre-supervision stage. Please note that in most cases these questions should be seen in the context of the financial statements involved. Given the confidential nature of our supervision, the questions raised are not dealt with comprehensively.

IAS 32/39 Financial instruments

- *Financial instrument disclosures*
  ”………. Pursuant to IAS 32.67, for each class of financial assets and financial liabilities, an entity shall disclose information about its exposure to interest rate risk, including (a) contractual repricing or maturity dates, whichever dates are earlier; and (b) effective interest rates, when applicable. IAS 32.69 requires, among other things, that information about the maturity dates of financial instruments is provided if they are before the maturity dates referred to in paragraph 32.67. Pursuant to IAS 32.71, an entity indicates which of its financial assets and financial liabilities are (a) exposed to fair value interest rate risk, such as financial assets and financial liabilities with a fixed interest rate; (b) exposed to cash flow interest rate risk, such as financial assets and financial liabilities with a floating interest rate that is reset as market rates change; and (c) not directly exposed to interest rate risk, such as some investments in equity instruments. Based on the above, the AFM has doubts whether the interest rate disclosure requirements have been applied correctly. Consequently, the AFM has the following questions:

  <u>*Question*</u>
  Please set out your considerations for omitting disclosures of:
  a) the applicable effective interest rates, except for the disclosure of the interest rates for subordinated loans;
  b) the financial assets and financial liabilities (excluding debt instruments) exposed to fair value interest rate risk, cash flow interest rate risk, or the financial assets and financial liabilities which are not exposed to such interest rate risk;
  c) the impact of using hedging instruments on the above interest rate risk;
  d) the repricing dates of financial instruments; and
  e) any early repayment options.
  When answering this question, please pay particular attention to the provisions in IAS 32.67, IAS 32.69 en IAS 32.71……………..”

- *Financial risks and disclosures of financial instruments*

  “………….. for financial risks an entity is exposed to, IAS 32 requires the entity to disclose in the financial statements the associated risk management measures. Your financial statements do not include such disclosures. The directors’ report, on page …, refers to the <*public information*> for a

description of the risk factors. The existence of financial risk factors could follow from the following information in your financial statements:
- The balance of debtors outstanding as at 31 December 2005 represents 87% of total 2005 sales excluding the change in work in progress;
- ….. shows that <*X company*> realised a foreign currency gain of EUR ……..;
- <*X company*> has participating interests in the USA, UK, China, …..;
- ……. shows that <*X company*> has non-current interest-bearing loans.

Based on the above, the AFM has doubts whether <*X company*> has fully complied with the requirements in IAS 32.

<u>*Question*</u>
Please set out your considerations for omitting the disclosures required under IAS 32."

- *Recognition of financial instruments*

  "………………….Your disclosure of transactions with related parties shows that <*Y company*> holds a share in the combined activities of <*Z company*> with an option to sell this share from 2007. Based on the notes to the financial instruments, it is not clear to the AFM whether this option has been recognised in the balance sheet.

  IAS 32.11 defines a financial instrument as a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. IAS 32.11(c)(ii) defines a financial asset as a contractual right to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity.

  Pursuant to IAS 32.11, this option qualifies as a financial instrument and as such should be accounted for in accordance with IAS 32 and IAS 39. Since it is unclear whether the option has been recognised in the balance sheet, the AFM has the following question.

  <u>*Question*</u>
  What was the accounting treatment for this option? Please set out your considerations."

IAS 12 Income taxes

- *Unused tax losses*

  "………..Note .. states that your company had EUR … million in unused tax losses on 31 December 2005. … states that EUR <*XX*> million in unused tax losses may be carried forward indefinitely. For these losses no deferred tax asset has been recognised. The directors' report, on page …, states, among other things, that it is expected that … will be profitable again from 2006.

Pursuant to IAS 12.34, among other things, a deferred tax asset shall be recognised to the extent that it is probable that future taxable profit will be available.

Question
Please set out your considerations underlying your decision not to recognise a deferred tax asset for the accumulated unused tax losses that can be carried forward indefinitely, in particular, given the profit expectations set out prominently in the directors' report?………".

- *Expected tax rate*
  "…………..Note .., on page …, states that the expected tax rate for 2005 is ..%, compared to ..% in 2004.
  IAS 12.81(d) requires such a change to be explained. The AFM has not found such explanation in <*X company*>'s financial statements.

  In addition, this note includes the reconciliation of the expected tax rate to the effective tax rate. This reconciliation includes an item 'Other' of 14% for 2005 and 12% for 2004. The note does not clarify the composition of this item 'Other'. Pursuant to IAS 1.103, the notes shall disclose all information that is relevant to an understanding of the financial statements.

  Questions
  a) Please set out your considerations for omitting the disclosures required in IAS 12.81(d).
  The AFM would like to receive this disclosure.
  b) Please set out your considerations to provide no further breakdown of the item 'Other', also in view of IAS 1.103(c). The AFM would like to receive this breakdown……………"

IFRS conversion

- *Disclosure of impact of IFRS adoption*
  "……………Pages ..–.. set out <*Y company*>'s 'Adoption of IFRS'. Page .. provides reconciliations of equity under previous GAAP and IFRS from 1 January 2004 to 31 December 2004.

  The note 'Adoption of IFRS' does not include the impact of the adoption of IFRS on the cash flow statement. Comparison of the 2004 cash flow statement under IFRS in the 2005 financial statements with the 2004 cash flow statement as included in the 2004 financial statements shows that there are several changes. For example: according to the 2004 financial statements, the cash flow from operating activities was EUR .. million, whereas the 2005 financial statements show an operating cash flow of EUR .. million for 2004, amounting to a 20% increase.

  Pursuant to IFRS 1.38, an entity shall explain how the transition from previous GAAP to IFRS affected its reported financial position, financial performance and cash flows. Furthermore, IFRS 1.39(a) stipulates that to comply with paragraph 38, an entity's first IFRS financial statements shall include, among other things, a reconciliation of its equity reported under previous GAAP to its equity under IFRS, for both the date of transition to IFRS and the end of the latest period in the entity's most recent annual financial statements under previous GAAP. Pursuant to IFRS 1.40, an entity shall explain the material adjustments in the cash flow statement.

Due to the omission of the reconciliation of equity as at 31 December 2004, as required in IFRS 1.39(a), the AFM has doubts whether the company has provided sufficient information to understand the impact of the adoption of IFRS on equity.

Question
a) Please set out your considerations for omitting from the 2005 financial statements the reconciliation as at 31 December 2004 required in IFRS 1.39(a).
b) Please set out your considerations for omitting the disclosures of the impact of the adoption of IFRS on the cash flow statement required in IFRS 1.38 and 1.40.
c) Please provide the omitted disclosures required in IFRS 1.39(a) and 1.40….."

Leases

- *Disclosure of leases*
  "…………Note .. does not provide a description of the material leasing arrangements of the finance lease contract. Pursuant to IAS 17.31, such description should include the existence and terms of renewal or purchase options and escalation clauses and any restrictions imposed on the entity's financial policies. In addition, the financial statements do not include the disclosures for the 2005 operating lease expenses required in IAS 17.35.

  Question
  Please set out your considerations for omitting the above disclosures or for not providing full disclosure. If there are materiality considerations underlying the omission of disclosures, please explain how you determined materiality …………"

Provisions

- *Description of the nature of liabilities and the expected timing of any outflow of economic benefits*
  "……….The 2005 annual report, on page .., includes disclosures of the balance sheet item 'Provisions'. The provided breakdown shows that this item comprises two categories: 'Reorganisations' and 'Other'. Of total provisions amounting to EUR … million as at 31 December 2005, the category 'Other' is the largest provision, amounting to EUR …million. In addition, provisions of EUR … million of total other provisions of EUR … million were formed in 2005. The note states that other provisions are for specific business risks in the Netherlands and abroad.

  IAS 37.85 stipulates, among other things, that for each category of provision an entity shall disclose a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits.

  According to the note to the provision category 'Other' included in the 2005 financial statements, this provision is for specific business risks in the Netherlands and abroad. Therefore, this disclosure does not include a description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits. Based on the amount of the addition (EUR .. million) to 'Other provisions' in 2005 in relation to the 2005 operating result (EUR … million), the AFM has doubts whether the requirements in IAS 37.85 have been complied with.

  Question
  Please set out your considerations for omitting a description of the nature of the obligation and of the expected timing of any resulting outflows of economic benefits for the category 'Other', as required in IAS 37.85…….

- **Cash flow statement**

  "…………….. The accounting for the acquisitions of ………, ……….and ………….. in your consolidated cash flow statement was for the full acquisition amount disclosed in the notes to the consolidated financial statements. However, the note to the provisions states that EUR … million in acquisition amounts represent earn-out arrangements. However, these earn-out arrangements are non-cash items. Pursuant to IAS 7.43, these non-cash items shall be excluded from the cash flow statement.

  In addition, the acquisitions have been recognised as additions to intangible fixed assets and not as business acquisitions, while these acquisitions are presented as business acquisitions elsewhere in the financial statements. Paragraphs IAS 7.39–7.42 stipulate the accounting for acquisitions in a cash flow statement.

  While using the operating result as the starting point for the cash flow from operating activities (indirect method), and financial income and expense not forming part of the operating result, the operating cash flow is adjusted for foreign currency results (IAS 7.20(b)).

Question
a) Please set out your considerations for including the above non-cash items in the cash flow statement.
b) Please set out your considerations for the accounting treatment of acquisitions as additions to intangible fixed assets.
c) Please set out your considerations for adjusting the operating cash flow for foreign currency results……………..”.

Part 9 of Book 2 of the Netherlands Civil Code

- *Disclosure of statutory reserves*

”………..The company balance sheet as at 31 December 2005 includes a statutory reserve of EUR ……………. (31 December 2004: EUR ………….).

Pursuant to section 2:373(1) of the Netherlands Civil Code, among other things, statutory reserves shall be shown separately under shareholders' equity, subdivided by type.
The financial statements do not disclose the nature of the statutory reserves. Based on the above, the AFM has doubts whether the requirements pursuant to section 2:373(1) of the Netherlands Civil Code have been fully complied with.

Question
Please set out your considerations for not disclosing, or not fully disclosing, in the company financial statements the information required in section 2:373(1) of the Netherlands Civil Code.”

”…………, on page…, shows a negative reserve of EUR ……… described as 'Foreign currency translation effects'. …….shows a negative reserve of EUR ……… described as 'Unrealized gains (losses) on derivative instruments'.

Pursuant to sections 2:373(4), 2:389(8) and 2:384(8) of the Netherlands Civil Code, the above reserves qualify as statutory reserves.

Both on the company balance sheet and in the reconciliation of changes in equity, the reserves for foreign currency translation effects and for unrealised gains (losses) on derivative instruments have not been classified as statutory reserves.

As a consequence, the AFM has doubts whether the requirements in sections 2:373(4), 2:389(8) and 2:384(8) of the Netherlands Civil Code have been applied correctly.

Question
Please set out your considerations for not classifying the above reserves for foreign currency translation effects and for unrealised gains (losses) on derivative instruments as statutory reserves ……….”

- *Corporate Governance*
  ”……………the Annual report 2005 refers to the appendix <*public information*> (hereafter referred to as the “Appendix”) to the Annual report 2004 and to <*public information*>. In summary, it is stated that you already apply, or will apply, 92 of the applicable best practice provisions of the Dutch corporate governance code (hereafter referred to as the “Code”). As regards best practice provision X, it is stated that, due to the specific nature of the company, the best practice applied is different from a provision of the Code.

  While <*X company*>, on page … of the Appendix, reports that best practice provision XX is applied, part of the information required in best practice provisions XX and XX and the information required in best practice provisions XX, XX, XX, XX and XX, all regarding remuneration policy, appear to have been omitted in the Report of the Supervisory Board.

  In accordance with section 2:391(5) of the Netherlands Civil Code and section 3 of the Decree of 23 December 2004 establishing further regulations for the contents of the annual report (hereafter referred to as the “Decree”), a public limited company shall report in its annual report on compliance with the principles and best practice provisions of the code of conduct designated in section 2 of the Decree directed at the Management Board or the Supervisory Board of the company. If the company has not complied with these principles or best practice provisions, or has no intention of complying with them during the current or the next financial year, it should explain why in its annual report.

  For the explanation why principles and best practice provisions have not been complied with, the company refers to the Appendix. However, neither this Appendix nor the annual report include any explanation of non-compliance. As a consequence, the AFM has doubts whether the disclosure regarding the Code pursuant to section 2:391(5) of the Netherlands Civil Code and section 3 of the Decree is adequate.

  Question
  Please set out your considerations for omitting in the 2005 annual reporting an explanation of any non-compliance with the above best practice provisions.