

# Supervisory Board report

## General

The supervision of the policies and actions of the executive management (the 'Board of Management') of Koninklijke Philips Electronics N.V. (the 'Company') is entrusted to the Supervisory Board, which, in the two-tier corporate structure under Dutch law, is a separate body and fully independent of the Board of Management. This independence is also reflected in the requirement that members of the Supervisory Board be neither a member of the Board of Management nor an employee of the Company. The Supervisory Board considers all its members to be independent under the applicable US standards and pursuant to the Dutch Corporate Governance Code of December 9, 2003 (the 'Dutch Corporate Governance Code').

While retaining overall responsibility, the Supervisory Board assigns certain of its tasks to three permanent committees: the Corporate Governance and Nomination & Selection Committee, the Remuneration Committee and the Audit Committee. The separate reports of these committees are part of this report and are published below. The members (of the committees) of the Supervisory Board are listed in the chapter Our leadership that begins on page 110 of this Annual Report.

For further information on the Company's corporate governance structure and a more detailed description of the duties and functioning of the Supervisory Board see the chapter Corporate governance that begins on page 254 of this Annual Report.

## Activities of the Supervisory Board

During 2008 the Supervisory Board devoted considerable time to discussing the Company's strategy. In particular the performance and integration of recent acquisitions, such as Genlyte and Respironics, and the economic situation and impact thereof on Philips and Vision 2010 were discussed extensively. The Supervisory Board also discussed the capital and financing structure of the Philips Group and approved the sale of some or all of the Company's remaining shares in TSMC and LG Display. In June the strategy of the Company and the sectors, including various risks and opportunities scenarios, were discussed during a one and a half day meeting.

Other discussion topics included:

- financial performance of the Philips Group and the sectors
- status of merger and acquisition projects
- rebranding of products of acquired companies
- management agenda of the Board of Management and especially the steps taken to deal with the unsatisfactory EBITA margins in the TV business
- remuneration policy
- management development and succession planning
- evaluation of the Board of Management and its members
- geographic performance and growth opportunities in Emerging Markets and particularly the shift of resources from mature to emerging markets
- the shift of R&D spend from existing product categories to new product categories
- the situation and improvement measures at some businesses that did not perform according to plan
- the results of the Employee Engagement Score and the implementation and impact of the Net Promoter Score
- financial scenarios for 2009
- the situation at Philips Pension Fund in the Netherlands
- restructuring in various sectors
- the system of internal business controls and risk management
- the investigations into possible anticompetitive activities in the CRT industry.

The Supervisory Board visited Lighting and Healthcare to further familiarize itself with the business and the respective management teams. Also, the yearly Corporate Research Exhibition was visited, at which event the latest technological projects and inventions of the Company are presented. The members spent two days in Boston/Andover where they discussed the Philips businesses in the United States of America and visited, amongst others, the head office of Healthcare and attended presentations of various businesses, including the recently acquired business of Respironics, Colour Kinetics, Genlyte, Emergin and VISICU. Finally, several members of the Supervisory Board also attended external training programs, which are often dedicated to specific topics.

## Composition and evaluation of the Supervisory Board

The Supervisory Board currently consists of nine members. The Supervisory Board aims for an appropriate combination of knowledge and experience among its members in relation to the global and multi-product character of Philips' businesses. Consequently the Supervisory Board aims for an appropriate level of experience in marketing, technological, manufacturing, financial, economic, social and legal aspects of international business and government and public administration. The full profile is described in the chapter Corporate governance. Members are appointed for fixed terms of four years and may be re-appointed for two additional four-year terms.

All members of the Supervisory Board completed a questionnaire to verify compliance in 2008 with applicable corporate governance rules and the Rules of Procedure of the Supervisory Board. The Chairman of the Supervisory Board discussed the functioning of the Supervisory Board and its members in private discussions with all members. He shared common themes and conclusions in a private session of the Supervisory Board; items discussed include the follow-up to the evaluation regarding 2007, the composition and competencies of the Board, the set-up and content of meetings and meeting materials. In the same meeting the relationship with the Board of Management was discussed. The three committees of the Supervisory Board reviewed their charters and their functioning and reported thereon to the full Supervisory Board.

## Report of the Corporate Governance and Nomination and Selection Committee

The Corporate Governance and Nomination & Selection Committee currently consists of three members. In line with the New York Stock Exchange listing rules and other developments in the field of corporate governance, the committee reviews the corporate governance principles applicable to the Company at least once a year, and advises the Supervisory Board on any changes to these principles as it deems appropriate.

As in prior years, the committee discussed developments in the area of corporate governance and legislative changes as well as further steps the Company could take to improve its corporate governance structure. It also discussed possible agenda items for the upcoming 2009 General Meeting of Shareholders.

### Meetings 2008

- Six regular meetings were held in 2008.
- All members were frequently present at the regular meetings of the Supervisory Board. Four members could not attend one or two regular meetings due to agenda conflicts. In 2008, one meeting took place by means of a conference call to discuss a specific matter.
- The Audit Committee met nine times.
- The Remuneration Committee met six times.
- The Corporate Governance and Nomination & Selection Committee met four times.

### Changes Supervisory Board and committees 2008

- Messrs Kist and Van Miert have been reappointed as members of the Supervisory Board.
- Mr Hessels has succeeded Mr De Kleuver as Chairman of the Supervisory Board.
- Mr Schweitzer has resigned as a member of the Supervisory Board.
- Mr Kist has succeeded Mr Hessels as Chairman of the Audit Committee.
- Mr Von Prondzynski has become a member of the Audit Committee.
- Mr Schiro has become a member of the Corporate Governance Nomination & Selection Committee.

### (Re)appointments Supervisory Board 2009

- It is proposed to reappoint Mr Schiro.<sup>1)</sup>
- Mr Wong has expressed his wish to relinquish his position as a member of the Supervisory Board.<sup>2)</sup>

<sup>1)</sup> Subject to approval by the General Meeting of Shareholders

<sup>2)</sup> As from the closing of the 2009 General Meeting of Shareholders

### Changes Board of Management and Group Management Committee 2008

- Mr Van Deursen has retired as a member of the Board of Management.
- Mr Hartert and Mrs Kux have resigned as members of the Group Management Committee.

### (Re)appointments Board of Management 2009

- It is proposed to reappoint Mr Sivignon.<sup>1)</sup>

<sup>1)</sup> Subject to approval by the General Meeting of Shareholders

### Remuneration 2008<sup>1)</sup> in euros per year

	Chairman	Member
Supervisory Board	110,000	65,000
Audit Committee	15,000	10,000
Remuneration Committee	12,500	8,000
Corporate Governance and Nomination & Selection Committee	12,500	6,000
Fee for intercontinental traveling per trip	3,000	3,000

<sup>1)</sup> Details are disclosed in note 34 Information on remuneration

In accordance with its charter, the Corporate Governance and Nomination & Selection Committee consulted in 2008 with the President/CEO and other members of the Board of Management on the appointment or reappointment of candidates to fill current and future vacancies on the Board of Management and the Group Management Committee, prepared decisions and advised the Supervisory Board on the candidates for appointment, and supervised the policy of the Board of Management on the selection criteria and appointment procedures for Philips' senior management.

The committee devoted specific attention to the composition and diversity of the Supervisory Board and the search for a female member with knowledge of the healthcare industry.

### Report of the Remuneration Committee

The Remuneration Committee, currently consisting of four members, is responsible for preparing decisions of the Supervisory Board on the remuneration of individual members of the Board of Management and the Group Management Committee. In performing its duties and responsibilities the Remuneration Committee is assisted by a remuneration expert acting on the basis of a protocol ensuring that the expert acts on the instructions of the Remuneration Committee and on an independent basis in which conflicts of interest are avoided. The Remuneration Committee's tasks are laid down in the Charter of the Remuneration Committee that forms part of the Rules of Procedure of the Supervisory Board. Currently, no member of the Remuneration Committee is a member of the management board of another listed company.

### General remuneration policy

The objective of the remuneration policy for members of the Board of Management is in line with that for Philips executives throughout the Philips Group: to focus on improving the performance of the company and enhancing the value of the Philips Group, to motivate and retain them, and to be able to attract highly qualified executives, when required.

For the Board of Management, Philips benchmarks with companies in the general industry in Europe and aims at the median market position.

In order to link executive remuneration to the company's performance, the remuneration package includes a significant variable part in the form of an annual cash incentive and a long-term incentive in the form of restricted share rights and stock options.

Scenario analyses are conducted annually and serve as an input for the review of the remuneration policy.

### Contracts of employment

Members of the Board of Management have a 4-year contract of employment with the Company.

#### Contract terms for current members<sup>1)</sup>

	end of term
G.J. Kleisterlee	April 1, 2011
P.-J. Sivignon	June 15, 2009
G.H.A. Dutiné	April 1, 2011
R.S. Provoost	April 1, 2010
A. Ragnetti	April 1, 2010
S.H. Rusckowski	April 1, 2011

<sup>1)</sup> Reference date for board membership is December 31, 2008

The main elements of the contracts are made public no later than the date of the notice calling the General Meeting of Shareholders where the appointment of the member of the Board of Management will be proposed.

The severance payment is set at a maximum of one year's salary, or in case this is 'manifestly unreasonable' for a member of the Board of Management in his first appointment period, the amount shall not exceed twice the annual salary.

Information on the individual remuneration of the members of the Board of Management is shown in the tables below as well as in the tables in note 34.

## Remuneration costs

The tables below give an overview of the costs incurred by the Company in the financial year in relation to the remuneration of the Board of Management. Costs related to stock option and restricted share rights grants are taken by the

Company over a number of years. As a consequence, the costs mentioned below in the columns stock options and restricted share rights are the accounting cost of multi-year grants given to board members during their board membership.

### Remuneration costs Board of Management 2008<sup>1)</sup> in euros

	base salary	realized annual incentive <sup>2)</sup>	stock options	restricted share rights	pension costs	other compensation
G.J. Kleisterlee	1,100,000	490,512	491,878	645,155	(314,893) <sup>3)</sup>	324,346
P.-J. Sivignon	687,500	217,386	326,729	382,268	250,951	8,738
G.H.A. Dutiné	618,750	200,664	284,446	365,531	192,153	135,673
R.S. Provoost	620,000	247,607	265,791	343,011	192,003	26,406
A. Ragnetti	613,750	329,571	255,997	338,156	202,281	37,665
S.H. Rusckowski	620,000	103,164 <sup>4)</sup>	177,629	307,685	235,852	66,356

<sup>1)</sup> Reference date for board membership is December 31, 2008

<sup>2)</sup> Annual incentive amount paid relates to performance in the previous year

<sup>3)</sup> No further accrual of pension benefits after having reached the age of 60 in September 2006, leading to a negative cost

<sup>4)</sup> Pay-out related to period April 1 - December 31, 2007

### Remuneration costs Board of Management 2007<sup>1)</sup> in euros

	base salary	realized annual incentive <sup>2)</sup>	stock options	restricted share rights	pension costs	other compensation
G.J. Kleisterlee	1,087,500	1,186,618	467,467	612,844	(323,687) <sup>3)</sup>	304,047
P.-J. Sivignon	637,500	508,550	284,166	373,969	243,940	25,218
G.H.A. Dutiné	587,500	513,691	284,033	354,526	192,549	140,116
R.S. Provoost	562,500	335,551 <sup>4)</sup>	184,050	295,059	176,867	22,007
A. Ragnetti	531,250	354,893 <sup>4)</sup>	174,256	284,860	178,611	37,031
S.H. Rusckowski <sup>5)</sup>	431,250	–	93,489	209,370	184,633	137,741

<sup>1)</sup> Reference date for board membership is December 31, 2008

<sup>2)</sup> Annual incentive paid relates to performance in the previous year

<sup>3)</sup> No further accrual of pension benefits after having reached the age of 60 in September 2006, leading to a negative cost

<sup>4)</sup> Pay-out related to period April 1 - December 31, 2006

<sup>5)</sup> All amounts mentioned relate to the period of board membership (April 1 - December 31, 2007), therefore no amount is mentioned under annual incentive

### Remuneration costs Board of Management 2006<sup>1)</sup> in euros

	base salary	realized annual incentive <sup>2)</sup>	stock options	restricted share rights	pension costs	other compensation
G.J. Kleisterlee	1,042,500	1,500,560 <sup>3)</sup>	415,054	409,106	(52,145) <sup>4)</sup>	300,064
P.-J. Sivignon	568,750	519,191 <sup>3)5)</sup>	163,797	247,408	224,481	60,671
G.H.A. Dutiné	540,750	433,998	271,824	264,427	194,309	99,373
R.S. Provoost <sup>6)</sup>	393,750	–	73,319	124,835	138,802	34,632
A. Ragnetti <sup>6)</sup>	356,250	–	65,974	112,329	121,358	13,971
S.H. Rusckowski <sup>7)</sup>	–	–	–	–	–	–

<sup>1)</sup> Reference date for board membership is December 31, 2008

<sup>2)</sup> The annual incentive paid relates to performance in the previous year

<sup>3)</sup> The annual incentive amount mentioned includes the special payment made in relation to the divestment of the Semiconductors division

<sup>4)</sup> No further accrual of pension benefits after having reached the age of 60 in September 2006, leading to a negative cost

<sup>5)</sup> Pay-out related to period June 15 - December 31, 2005

<sup>6)</sup> All amounts mentioned relate to period of board membership (April 1 - December 31, 2006), therefore no amount mentioned under annual incentive

<sup>7)</sup> Date of appointment as member of the Board of Management April 1, 2007, therefore no amounts mentioned

### Base salary

In 2008 base salaries have been increased in line with the policy, with the exception of the President/CEO for whom the salary is fixed for the duration of his contract of employment.

### Annual Incentive

Each year, a variable cash incentive (Annual Incentive) can be earned, based on the achievement of specific and challenging targets. The Annual Incentive criteria are for 80% the financial indicators of the Company (net income, comparable sales growth and free cash flow) and for 20% team targets in the areas of responsibility monitored by the (individual) members of the Board of Management.

The Supervisory Board determines whether performance conditions are met, and has the ability to adjust the pay-out upward or downward if the predetermined performance criteria would produce an unfair result due to extraordinary circumstances. The related targets for the members of the Board of Management are determined annually at the beginning of the year.

The on-target Annual Incentive percentage is set at 60% of the base salary for members of the Board of Management and 80% of the base salary for the President/CEO, and the maximum Annual Incentive achievable is 120% of the annual base salary for members of the Board of Management and for the President/CEO it is 160% of the annual base salary.

The Annual Incentive pay-out in any year relates to the achievements of the preceding financial year in relation to agreed targets. As a result, Annual Incentives paid in 2009 relate to the salary levels and the performance in the year 2008.

Based upon the 2008 results as published in this Annual Report, the realized Annual Incentive amounts mentioned in the table below will be paid to members of the Board of Management in April 2009.

#### Pay-out in 2009<sup>1)</sup> in euros

	realized annual incentive	as a % of base salary (2008)
G.J. Kleisterlee	220,000	20.0%
P.-J. Sivignon	105,000	15.0%
G.H.A. Duti��	93,750	15.0%
R.S. Provoost	95,250	15.0%
A. Ragnetti	95,250	15.0%
S.H. Rusckowski	221,470	34.9%

<sup>1)</sup> Reference date for board membership is December 31, 2008

### Long-Term Incentive Plan (LTIP)

The LTIP consists of a mix of stock options and restricted share rights and serves to align the interests of the participating employees with the shareholders' interest and to attract, motivate and retain participating employees.

The actual number of stock options and restricted share rights that will be granted to members of the Board of Management is performance-related and depends on Philips' Total Shareholder Return (TSR) and the team targets of the Board of Management.

The 2007 General Meeting of Shareholders approved a new list of peer group companies and a new simplified TSR-based LTI multiplier based on the ranking table below:

#### Philips' position compared to peer companies

	LTI multiplier
Top 4	1.2
Middle 4	1.0
Bottom 4	0.8

The peer group contains the following companies: Electrolux, Emerson Electric, General Electric, Hitachi, Honeywell International, Johnson & Johnson, Matsushita (Panasonic), Philips, Schneider, Siemens, Toshiba, 3M.

For 2008, the Supervisory Board has applied a multiplier of 1.0, based on the Philips share performance over the period from December 2004 to December 2007.

The stock option plan has a three-year vesting term (vesting dependent on employment upon the vesting date), and a 10-year total option term.

Restricted share rights grants apply a vesting term of respectively 1, 2 and 3 years after grant, and vest based on employment upon vesting. Through the granting of additional (premium) shares after the grantees have held the restricted shares for three years after delivery, provided they are still in service, grantees will be more stimulated to focus on the longer term as shareholders of the Company.

To further align the interests of the members of the Board of Management and shareholders, restricted shares granted to the Board of Management members shall be retained for a period of at least five years or until at least the end of their employment, if this period is shorter. Similarly, for other Philips Senior Executives compulsory share ownership was introduced in 2004.

In 2008, 9,979,902 stock options and 2,321,634 restricted share rights were granted under the LTIP (excluding the 20% premium shares to be delivered after a three-year holding period).

For more details of the LTIP, see note 33.

### Pensions

Eligible members of the Board of Management participate in the Executives Pension Plan in the Netherlands consisting of a combination of a defined-benefit (career average) and defined-contribution plan. The target retirement age under the plan is 62.5. The plan does not require employee contributions.

### Additional arrangements

In addition to the main conditions of employment, a number of additional arrangements apply to members of the Board of Management. These additional arrangements, such as expense and relocation allowances, medical insurance, accident insurance and company car arrangements are broadly in line with those for Philips executives in the Netherlands. In the event of disablement, members of the Board of Management are entitled to benefits in line with those for other Philips executives in the Netherlands.

In line with regulatory requirements, the Company's policy forbids personal loans to members of the Board of Management and Supervisory Board or to the other members of the Group Management Committee, and consequently no loans were granted to such members in 2008, nor were such loans outstanding as of December 31, 2008.

Unless the law provides otherwise, the members of the Board of Management and of the Supervisory Board shall be reimbursed by the Company for various costs and expenses, like reasonable costs of defending claims, as formalized in the articles of association. Under certain circumstances, described in the articles of association, such as an act or failure to act by a member of the Board of Management or a member of the Supervisory Board that can be characterized as intentional ("opzettelijk"), intentionally reckless ("bewust roekeloos") or seriously culpable ("ernstig verwijtbaar"), there will be no entitlement to this reimbursement. The Company has also taken out liability insurance (D&O - Directors & Officers) for the persons concerned.

### 2009

In view of the current economic circumstances, salaries of the members of the Board of Management will not be increased in 2009 and Philips will be restrictive in the salary review for all employees.

After extensive consultation with important stakeholders, Philips will propose to the General Meeting of Shareholders in 2009 the introduction of a new TSR multiplier range for restricted share rights. If adopted, the new multiplier will be applied starting with the grant in April 2009. The new multiplier range has more down side and more upside than previously: minimum is "zero" (from 0.8), and maximum is 2 (from 1.2). As the multiplier is applied to determine grant numbers, this means that grants can be zero at minimum, or double the target number at maximum. In this way, the link between pay and performance is further enhanced.

#### Proposed TSR

TSR Ranking	1	2	3	4	5	6
Multiplier (current)	1.2	1.2	1.2	1.2	1	1
Multiplier (proposed)	2	1.8	1.6	1.4	1.2	1

#### Proposed TSR

TSR Ranking	7	8	9	10	11	12
Multiplier (current)	1	1	0.8	0.8	0.8	0.8
Multiplier (proposed)	1	0.8	0.6	0.4	0.2	0

The current multiplier range for stock options will be maintained (ranging from 0.8 – 1.2).

The so-called ultimum remedium clause and claw back clause of best practice provisions II.2.10 and II.2.11 of the new Dutch Corporate Governance Code, as presented by the Corporate Governance Code Monitoring Committee in its report of December 2008, is applicable to Annual Incentive payments and LTIP grants over the year 2009 onwards to all members of the Board of Management.

## Report of the Audit Committee

The Audit Committee, currently consisting of four members, assists the Supervisory Board in fulfilling its supervisory responsibilities for the integrity of the Company's financial statements, the financial reporting process, the system of internal business controls and risk management, the internal and external audit process, the internal and external auditor's findings and recommendations, independence and performance, as well as the Company's process for monitoring compliance with laws and regulations and the General Business Principles (GBP).

The Audit Committee met 9 times in 2008 and reported its findings periodically to the plenary Supervisory Board. The President, the Chief Financial Officer, the Internal Auditor, the Group Controller and the External Auditor attended all regular meetings. Furthermore, the Audit Committee met each quarter separately with each of the President, the Chief Financial Officer, the Internal Auditor and the External Auditor. In accordance with its charter, which is part of the Rules of Procedure of the Supervisory Board, the Audit Committee in 2008 reviewed the Company's annual and interim financial statements, including non-financial information, prior to publication thereof. It also assessed in its quarterly meetings the adequacy and appropriateness of internal control policies and internal audit programs and their findings.

In its 2008 meetings, the Audit Committee periodically reviewed matters relating to accounting policies and compliance with accounting standards. Compliance with statutory and legal requirements and regulations, particularly in the financial domain, was also reviewed. Important findings identified risks and follow-up actions were examined thoroughly in order to allow appropriate measures to be taken. With regard to the internal audit, the Audit Committee reviewed, and if required approved, the internal audit charter, audit plan, audit scope and its coverage in relation to the scope of the external audit, as well as the staffing, independence and organizational structure of the internal audit function. An assessment by an independent auditor of the effectiveness of the Internal Audit Function, including various recommendations, was discussed. With regard to the external audit, the Audit Committee reviewed the proposed audit scope, approach and fees, the independence of the external auditors, non-audit services provided by the external auditors in conformity with the Philips Policy on Auditor Independence, as well as any changes to this policy. Within the framework of the Philips policy on auditor independence, the evaluation of the performance of the external auditor takes place every three years. On the basis thereof,

the Supervisory Board has recommended to reappoint KPMG as auditor of the Company (which was resolved by the 2008 General Meeting of Shareholders).

### Fees KPMG in millions of euros

	2006	2007	2008
Audit fees	20.6	17.6	17.3
- consolidated financial statements	7.0	7.2	7.6
- statutory financial statements	5.0	4.7	4.8
- internal controls over financial reporting	8.6	5.7	4.9
Audit-related fees	9.8	3.9	4.4
- acquisitions and divestments	4.4	2.3	2.3
- other	5.4	1.6	2.1
Tax fees	0.9	1.2	1.2
- tax compliance services	0.9	1.2	1.2
Other fees	2.4	2.3	2.5
- royalty investigation	1.9	1.9	1.8
- sustainability and other services	0.5	0.4	0.7
	33.7	25.0	25.4

In 2008, the Audit Committee periodically discussed the company's policy on business controls, the GBP including the deployment thereof and amendments thereto, and the company's major areas of risk, including the internal auditor's reporting thereon. The Audit Committee was informed on, discussed and monitored closely the company's internal control certification processes, in particular compliance with section 404 of the US Sarbanes-Oxley Act and its requirements regarding assessment, review and monitoring of internal controls. It also discussed tax issues, IT strategy, litigation (including asbestos) and related provisions, environmental exposures and financing and liquidity of the company, dividend, pensions (including the situation at Philips Pension Fund in the Netherlands and the governance of the other major pension funds), valuation of financial holdings (and related impairments), the investigations into possible anticompetitive activities in the CRT industry, as well as a financial evaluation of the investments made in 2005.

## Financial statements 2008

The financial statements of Koninklijke Philips Electronics N.V. for 2008, as presented by the Board of Management, have been audited by KPMG Accountants N.V., independent auditors. Their reports have been included in the chapter IFRS financial statements on page 243 and the chapter Company financial statements on page 249 of this Annual Report. We have approved these financial statements, and all individual members of the Supervisory Board (together with the members of the Board of Management) have signed these documents.

We recommend to shareholders that they adopt the 2008 financial statements. We likewise recommend to shareholders that they adopt the proposal of the Board of Management to make a distribution of EUR 0.70 per common share from the retained earnings.

Finally, we would like to express our thanks to the members of the Board of Management, the Group Management Committee and all other employees for their continued contribution during the year.

February 23, 2009

*The Supervisory Board*