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THE AMF PUBLISHES ITS 2006 REPORT ON CORPORATE GOVERNANCE AND INTERNAL CONTROL, ALONG WITH ITS RECOMMENDATIONS ON THE USE OF THE REFERENCE FRAMEWORK FOR THE INTERNAL CONTROL SYSTEM OF LISTED COMPANIES

1. 2006 Report on Corporate Governance and Internal Control

Today, the French securities regulator, Autorité des Marchés Financiers (AMF), released its [third annual report on corporate governance and internal control procedures in listed companies](#). The report has been compiled on the basis of information published by a sample of 109 companies.

In its 2006 report, the AMF once again notes a constant improvement in the information provided to markets. There is room for additional clarity with regard to the descriptions of internal control procedures, which still tend to vary in terms of content.

The main findings of the 2006 report are as follows:

Corporate governance

Board membership: Virtually all companies provide a detailed description of the membership of their board, with 80% of the companies in the sample (versus 76% in the 2005 report) explaining that their board includes one or more independent directors, with reference to the definition given in the AFEP/MEDEF1 report2 in 90% of the cases. And 90% of the companies revealed the number of directorships or the type of positions that their board members held in other companies.

Role of the board: Some 66% of the companies in the sample give a clear definition of the board's tasks. This figure has not changed from the previous year. More than three quarters of the companies in the sample publish the attendance records of their directors at the board meetings. The average attendance rate is 83%, similar to the previous year's figure.

Internal rules of the board of directors: The existence of internal rules for board meetings is mentioned in 65% of cases. This figure has improved steadily from only about half of the companies in the sample covered in the 2004 AMF report. Three quarters of the companies in question provide a list of the topics dealt with in the rules of procedure, but only 23% explain that the rules are publicly available.

Specialised committees: As was the case last year, three quarters of the companies in the sample reported that they rely on specialised audit, compensation or appointments committees, as stipulated by the AFEP/MEDEF report. Three quarters of the companies in the sample had an *audit committee* (versus two thirds last year). The proportion is 100% in the case of CAC 40 companies. Of the companies reporting that they have set up specialised committees, three quarters have a *compensation committee* (versus two thirds last year), which also acts as an appointments committee in one out of two cases.

Evaluation of the board's work: Nearly half of the companies in the sample reported that they evaluate the work of their board. This proportion has risen steadily from less than a quarter in 2004 and 37% in 2005. The figure is 82% for the CAC 40 companies in the sample. Half of the companies mention that the board

¹ AFEP : Association Française des Entreprises Privées (association of French private-sector companies) and MEDEF : Mouvement des Entreprises de France (French business confederation).

² "Le gouvernement d'entreprise des sociétés cotées", published in October 2003.

has examined the evaluation results, versus a quarter last year. The board's work is often rated as "satisfactory" in general terms, but suggestions for improvements are nonetheless presented in one out of two cases.

Restrictions on the Chief Executive Officer's powers: More than 80% of the companies with a board of Directors (such companies account for 69% of the sample) specify potential restrictions, or explicitly mention the absence of restrictions, placed on the Chief Executive Officer's powers by the board, versus 71% in 2005 and only 30% in 2004.

Directors' compensation: Virtually all companies specify the total amount of directors' fees. Of the 90% of the companies that distinguish between fixed and variable remuneration, 77% explain the criteria for determining the variable portion, and 88% report providing benefits in kind.

Internal control

Description of internal control procedures:

- In 89% of the Chairman's reports, *internal control* is defined.
- Virtually all companies share the goals of reliability of accounting and financial information, 87% aim for control of operations and more than 80% strive for compliance with laws and regulations.
- As regards defining and setting internal control objectives, more than 80% of the companies use the term "group", but few of them define the *exact scope* of internal control.
- More than 40% of the companies in the sample specify which *framework* is used for preparing their report, and 33% report that they have used guidelines based on the COSO framework³.
- Two thirds of the companies described the *main risks* facing them. This figure is unchanged from 2005, and half of them report conducting risk-mapping exercises.
- The *resources allocated to internal control* are reported by 85% of the companies, and 27% mention the investments made.

Due diligence and the directors' assessment of the internal control system:

- The reports by more than two thirds of the companies in the sample explained the *due diligence procedures used to prepare the report*.
- The reports of 37% of the companies state that an assessment was made of the internal control system, versus only 26% last year. Of these companies, 57% developed self-assessment questionnaires and 35% disclosed the result of the assessment.
- As was the case last year, none of the reports reviewed reports any serious *internal control failures or shortcomings*. Of the companies in the sample listed in the United States, which are consequently subject to the Sarbanes-Oxley Act, two report a weakness in one of their internal control procedures.
- All of the companies print the *statutory auditors' report* (versus 95% last year) using the format prescribed by France's National Institute of Statutory Auditors (CNCC). None of the reports contains any reservations or observations in compliance with the CNCC standard.

Findings of the 2006 AMF Report

Corporate governance

There was a further improvement in the quality of the reports, not only in terms of the information produced, but also in the conditions under which the due diligence work underlying the reports was carried out. Examples include:

- The steady increase in the number of specialised committees set up to assist the board,
- The doubling of the number of reports mentioning an evaluation of the board's work, up to nearly half, compared to only a quarter in 2004 and a third in 2005.

The AMF urges companies keep conducting an assessment of their board's work and calls on them to publish the findings, along with any suggestions for improvements. The AMF also urges companies to make public complete versions of the Internal rules of the boards of directors, or substantial sections of these rules, as required for an understanding of how the boards operate.

³ An American framework devised by a private-sector body, the *Committee of Sponsoring Organizations of the Treadway Commission*.

There is still room for additional improvement in the information about directors' compensation. In general, the distinction between fixed compensation, variable compensation and benefits in kind is presented clearly, but the criteria and procedures for determining these components are still vague in some cases.

Internal control

As was the case in 2005, information about internal control still tends to vary, despite significant efforts to explain the control process for accounting and financial information. A specific, more systematic, link with the chapter on "*risk factors*" should improve understanding of the processes established. Similarly, companies are urged to facilitate comparisons of information by following the layout of their chosen framework.

2. Recommendations on the use of the reference framework for the internal control system of listed companies

Implementation of the internal control reference framework for listed companies drafted by the Market Advisory Group (MAG) set up by the AMF in January 2005 should make the Chairmen's reports more consistent and easier to understand.

In May 2006, the MAG published a reference framework covering the general principles that apply to all internal control processes. In December 2006, this framework was supplemented by an application guide for the internal control procedures relating to accounting and financial information.

[The reference framework, supplemented by the application guide](#), constitutes an appropriate tool for analysing and designing internal control systems for listed companies in order to improve the consistency and clarity of Chairmen's reports.

Consequently, the AMF recommends that all listed companies in France should use this reference framework and application guide.

However, the reference framework and application guide are not intended to be binding on companies, particularly companies that have to follow a different framework required by other regulations; nor are they intended to take the place of specific regulations applying to certain business sectors, such as banking and insurance.

Therefore companies are urged to explain in the Chairman's Report whether they have followed the reference framework and application guide when preparing the report. When companies apply only part of the reference framework or application guide, they should clearly identify the key internal control areas and processes concerned, having regard to their business activity, their size and their organisational structure. Companies should more particularly stress the information that are likely to have a material impact on assets or earnings.

The same transparency principles apply to the use of any other framework that a company chooses or is required to apply at the international level. Such frameworks should be presented clearly.

This recommendation applies to Chairmen's Reports and internal control procedures relating to the financial year 2007.