



AMF 2006 Report on  
Corporate Governance  
and Internal Control

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## CONTENTS

<b>INTRODUCTION</b> .....	<b>2</b>
<b>1 METHODOLOGY AND GENERAL STATISTICAL FINDINGS</b> .....	<b>4</b>
1.1 Methodology.....	4
1.2 Analytical procedure.....	4
1.3 Including the reports in registration documents.....	4
1.4 Compliance with publication rules.....	5
<b>2 FRENCH LEGISLATIVE AND REGULATORY FRAMEWORK</b> .....	<b>5</b>
2.1 Legislative framework.....	5
2.2 Regulatory framework.....	6
2.3 AMF recommendations for compiling registration documents.....	6
2.4 The new Internal control reference framework for listed companies.....	7
2.4.1 Historical background.....	7
2.4.2 System specified by the reference framework.....	7
2.4.3 Definition and objectives.....	8
2.4.4 Scope of internal control.....	8
2.4.5 Components of the internal control system.....	8
2.4.6 AMF Recommendations.....	9
<b>3 INTERNATIONAL ENVIRONMENT</b> .....	<b>10</b>
3.1 European Directives.....	10
3.1.1 Directive 2006/43/EC of 17 May 2006 on statutory audits of annual accounts and consolidated accounts.....	10
3.1.2 Directive 2006/46/EC of 14 June 2006 amending Council Directives 78/660/EEC and 83/349/EEC on the annual accounts and consolidated accounts of certain types of companies.....	10
3.2 The European Commission's positions.....	11
3.3 Other international provisions.....	11
3.3.1 IOSCO Action Plan.....	11
3.3.2 Application of the Sarbanes-Oxley Act to companies listed in the United States.....	11
<b>4 CORPORATE GOVERNANCE</b> .....	<b>12</b>
4.1 Procedures for preparing and organising the work of the board of directors or the supervisory board.....	12
4.1.1 Board organisation and practices.....	12
4.1.2 Specialised committee organisation and practices.....	14
4.1.3 Evaluation of the board's work.....	16
4.2 Restrictions that the board of directors places on the chief executive officer's powers.....	16
4.3 Directors' pay and executive pay.....	17
4.3.1 Directors' fees.....	17
4.3.2 Executive directors' compensation.....	17
<b>5 INTERNAL CONTROL PROCEDURES</b> .....	<b>19</b>
5.1 Description of internal control procedures.....	19
5.1.1 Internal control definitions and objectives.....	19
5.1.2 Scope of the chairman's reports.....	20
5.1.3 Benchmark applied.....	20
5.1.4 Risk identification and risk management systems.....	21
5.1.5 Details about internal control procedures.....	22
5.1.6 Internal control resources.....	22
5.2 Due diligence and the assessment of the internal control system.....	23
5.2.1 Due diligence in connection with the report.....	23
5.2.2 Assessment of the internal control system.....	23
5.2.3 Companies subject to the Sarbanes-Oxley Act.....	23
5.2.4 Statutory auditors' reports.....	24
<b>CONCLUSION</b> .....	<b>27</b>

## **INTRODUCTION**

The report has been prepared for the purposes of Article L. 621-18-3 of the Monetary and Financial Code, stemming from the Financial Security Act of 1 August 2003. Under this Article, the Autorité des Marchés Financiers (AMF) is required to prepare a yearly report on corporate governance and internal control, based on the information published by listed companies.

The first part of the report deals with French legislation and regulations on internal control and corporate governance, as well as developments in the international context. The other sections of the report focus on the AMF's findings following its analysis of companies' 2005 corporate governance and internal control reports.

### **1.1 Methodology**

The purpose of the report is to assess the relevance of the corporate governance and internal control information published by listed companies. It is based on documentary analysis and a series of informal interviews.

The sample comprises 109 companies, of which 52% are traded on Eurolist A (including 16 companies that are also traded in the United States), 13% are traded on Eurolist B (including one also traded in the United States), 29% are traded on Eurolist C, 3% are traded on Alternext and 4% issue only bonds. The sample includes 38 companies that were part of the CAC 40 index as of 31 December 2005.

### **1.2 Analytical procedure**

A grid representing the main aspects covered in the industry recommendations on corporate governance and internal control was drawn up as a basis for statistical analysis of the contents of reports published by the companies in the sample.

### **1.3 Including the reports in registration documents**

Ninety three percent of the 109 companies in the sample published a registration document. Article 221-8 of the AMF General Regulation stipulates that, "*whenever an issuer prepares a registration document (...), the said document shall include the reports and disclosures mentioned in Article 221-6 (...)*" An AMF Recommendation<sup>1</sup> published in March 2004 explains that "*such information may be included in a special chapter on corporate governance and internal control, with the stipulation that the issuer may refer readers to information presented elsewhere in the document (on risk factors, in particular).*"

If the company does not prepare a registration document, the chairman's report must be published separately, in accordance with the dissemination procedures set out in Article 221-7 of the AMF General Regulation. Similarly, issuers that are not covered by the provisions of the Commercial Code but by Article L. 621-18-3 of the Monetary and Financial Code are required to publish equivalent information to that in the chairman's report under the requirements set out in Article 221-6 of the AMF General Regulation.

In the case of companies in the sample that prepare a registration document, the chairman's report is either included in the main body of that document, usually in the chapter on corporate governance, or, more rarely, at the end of the document or in an appendix to it. Some reports refer readers to chapters in the registration document. When dealing with the conditions under which the Board's work is prepared and organised, the chairman's report usually refers readers to the chapter on "Board Membership and Practices<sup>2</sup>," if any such reference is made. If the chairman's report refers readers to the registration document when dealing with internal control, it usually refers them to the chapter on "Risk factors."

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<sup>1</sup> "Gouvernement d'entreprise et contrôle interne : obligations de publication des émetteurs faisant appel public à l'épargne," *Revue mensuelle de l'AMF*, March 2004, pages 39 to 41.

<sup>2</sup> Particularly the sections dealing with the disclosures required in Annex I of European Regulation 809/2004 implementing Directive 2003/71 as regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements, including Paragraph 14 on administrative, management, and supervisory bodies and senior management, Paragraph 15 on remuneration and benefits, and Paragraph 16 on board practices.

**The AMF Recommendation of March 2004 was intended to provide greater flexibility for companies that produce a registration document. Nevertheless, the content of the chairman's report must always be clearly identified in the registration document.**

#### **1.4 Compliance with publication rules**

As of 1 December 2006, 150 of the total of 807 listed companies were behind in their mandatory disclosures on corporate governance and internal control. These companies broke down as follows: 2 listed in the Eurolist compartment A, 11 in compartment B, 57 in compartment C, 62 in the "foreign securities" compartment, 7 listed on Alternext, 3 listed in the special compartment and 8 listed in the bond compartment.

**With the transposition of the Transparency Directive, the corporate governance and internal control report will no longer be posted on the AMF website. It will merely be filed with the AMF. On the other hand, companies will be required to post the report on their own websites, along with all other regulated disclosures.**

## **2 FRENCH LEGISLATIVE AND REGULATORY FRAMEWORK**

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### **2.1 Legislative framework**

Pursuant to Article L. 621-18-3 of the Monetary and Financial Code, listed companies are required to disclose information relating to the matters stipulated in the last paragraphs of Articles 225-37 and 225-68 of the Commercial Code, in accordance with the requirements of the AMF General Regulation.

In accordance with the last paragraphs of Articles L. 225-37 and L. 225-68 of the Commercial Code, the chairman of the board of directors or the supervisory board of any limited-liability company (*société anonyme*) must present a report to the annual general meeting of shareholders on "how the board prepares and organises its work and on the internal control procedures implemented by the company." This report, which must be appended to the management report, also indicates "any restrictions that the board of directors has placed on the powers of the chief executive officer."

Furthermore, under the provisions of Article L. 225-235 of the Commercial Code, the statutory auditors are required to produce a report that includes their remarks about the chairman's report with respect to the internal control procedures relating to the preparation and processing of accounting and financial information.

On the more specific issue of executive pay, Articles L. 225-102-1 of the Commercial Code stipulate that the management report must list the names and individual amounts of compensation and benefits of all kinds paid to each director and corporate officer during the year by the company, the companies that it controls or that control it. In accordance with the Breton Act of 26 July 2005, the report must also describe the fixed, variable and exceptional components of executive pay and benefits, along with the criteria used to calculate them or the circumstances under which they were determined. The report also gives details of any and all commitments the company has made on behalf of its corporate officers, which correspond to remuneration components, compensation or benefits owed or likely to be owed as a result of taking up, leaving or changing functions or

following such changes. The information provided about these matters must explain how the commitments are calculated.

Finally, the Employee Profit Sharing and Stock Ownership Act of 30 December 2006<sup>3</sup> stipulates that the corporate governance and internal control report must present the principles or rules, as appropriate, established by the board of directors or the supervisory board to determine compensation and benefits of all kinds granted to corporate officers.

## **2.2 Regulatory framework**

In accordance with Article L. 621-18-3 of the Monetary and Financial Code, the AMF General Regulation sets the requirements for disclosing information about corporate governance and internal control. These rules are set out in Articles 221-6 to 221-8 of the AMF General Regulation.

They stipulate that:

- Listed limited-liability companies must publish the reports stipulated in the last paragraphs of Articles L. 225-37, L. 225-68 and L. 225-235 of the Commercial Code on or before the day the management report is filed with the commercial court registry;
- These reports and disclosures shall be disseminated as follows:
  - They shall be accessible free of charge at the company's registered office, and a copy will be sent at no charge to any person who requests one;
  - An electronic version must be posted to the AMF website and to the company's website, if it has one.

If the company produces a registration document, this report and these disclosures must appear therein. In this case, the dissemination procedures stipulated above do not apply.

## **2.3 AMF recommendations for compiling registration documents**

On 27 January 2006, the AMF published a "*Guide for compiling registration documents: applicable regulations, interpretations and AMF recommendations*". In Interpretation 3, which deals with corporate governance, the AMF reiterates that the registration document must provide information about the membership of the board of directors or the supervisory board, the board's role and operating methods, the board's rules of procedure, the evaluation of the board and the work and operating procedures of the board and/or the committees it has set up.

The AMF states that companies may adapt corporate governance principles to their specific circumstances and amend them as their environment and market expectations change, supplementing them with other disclosures that they deem necessary.

Companies listed in the United States are encouraged to explain any measures that they have taken to comply with the new US rules and recommendations on corporate governance (Sarbanes-Oxley Act), specifying the policies that they apply, especially when these rules are not exactly the same as those in France.

## **2.4 The reference framework for the internal control system of listed companies**

### **2.4.1 Historical background**

In January 2005, the AMF published its first report on the corporate governance and internal control procedures of listed companies. At the time, the AMF stressed that, unlike corporate governance, where securities issuers can measure themselves against market-wide standards, the lack of a universally accepted internal control benchmark makes it harder for companies to describe their own procedures and could make reports published for this purpose harder to understand.

Consequently, the AMF tasked a working group with a Plenary Committee of twenty members,<sup>4</sup> co-chaired by Jean Cédelle and Guillaume Gasztowtt, with compiling an internal control benchmark for the use of companies subject to the statutory requirements.

This Market Advisory Group (MAG) took a pragmatic approach that focused on reconciling:

- Best practices observed in other countries and other existing benchmarks, such as the American COSO framework or the UK's Turnbull Guidance<sup>5</sup>.
- French regulations,
- Recommendations made in the reports on corporate governance<sup>6</sup>,
- Amendments to the fourth, seventh and eighth European Directives.

The MAG started by drafting the reference framework, which covers general principles applying to all internal control processes in a company, with appendices containing a questionnaire about internal control for accounting and financial reporting and a questionnaire about risk analysis and management.

Then, under the direction of Jean Cédelle and Michel Léger, special attention was paid to internal control for accounting and financial reporting. Procedures for preparing and processing accounting and financial information are a key component of internal control and they are covered in a special report by the statutory auditors. This is why the reference framework has been supplemented by an *"Application Guide for Internal Control Related to Accounting and Financial Information for Publication by Listed Companies"*. A consultation draft of the guide was published on 30 October 2006.

### **2.4.2 System specified by the reference framework**

The reference framework is intended to serve as tool for listed companies. It is not a set of binding rules or standards, since the law does not impose a specific set rules or benchmark. Instead, it is intended to provide issuers that wish to undertake a comparative analysis of their internal control procedures with an external benchmark that is recognised by the industry.

The reference framework includes:

- General internal control principles;
- A general questionnaire on internal control for accounting and financial reporting and another general questionnaire on risk analysis and management, which is another component of the internal control system;
- An application guide on internal control of accounting and financial information published by issuers.

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<sup>3</sup> Act 2006-1770

<sup>4</sup> The Working Group participants were: associations representing companies (AFEP, AMRAE, ANSA, IFACI, MEDEF, Middenext), accounting institutes (CNCC, CSOEC), qualified expert members and associate non-voting members (AMF, CCAMIP, CB, FBF, Treasury).

<sup>5</sup> Guide drafted by the Institute of Chartered Accountants in England and Wales (ICAEW) and published in 1999.

The application guide is based on the principles and key analytical points, and its approach is deliberately independent of the companies' organisational structures. This approach focuses on the elements involved preparing and processing published accounting and financial information.

The reference framework provides a simple, pragmatic approach that takes account of the diversity of companies that may have less organised structures and simpler procedures. It does not impose arrangements that might be disproportionate to some companies' activities and structures. This approach makes it possible to give a clear, consistent and proportionate account of the conditions under which internal control is organised. The system established by the MAG can be adapted to suit companies' operating processes, making it more than just a simple exercise in compliance.

### **2.4.3 Definition and objectives**

Internal control is a system that the company defines and implements under its own responsibility to ensure:

- Compliance with laws and regulations;
- Implementation of the instructions and directions given by executive management or the executive board;
- Smooth operation of the company's internal processes, especially those relating to the protection of its assets;
- Reliability of financial information.

More generally, it contributes to the management of the company's activities, the effectiveness of its operations and efficient use of its resources. Internal control cannot provide a hard and fast guarantee that the company's objectives will be achieved.

### **2.4.4 Scope of internal control**

It is up to each company to implement an internal control system that is appropriate for its situation. In a group, the parent company must ensure that its subsidiaries have internal control systems. These systems have to be adapted to the subsidiaries' specific characteristics and to the relations between them and the parent company.

### **2.4.5 Components of the internal control system**

The reference framework produced by the MAG shows that internal control encompasses the following components:

- An organisational structure with a clear definition of responsibilities, adequate resources and skills, information systems, operating procedures and methods, tools and appropriate practices;
- Internal dissemination of relevant and reliable information, which enables everyone to discharge their responsibilities;
- A system to identify and analyse the main risks with regard to the company's objectives and to ensure that management procedures are in place to deal with these risks;
- Control activities that are proportionate to the risk inherent in each process and designed to ensure that the necessary measures are taken to manage risks that are likely to affect the company in reaching its objectives;
- Ongoing monitoring of the internal control system and periodic reviews of its operations.

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<sup>6</sup> AFEP/MEDEF reports, consolidated in *Le gouvernement d'entreprise des sociétés cotées* published in 2003.

The COSO<sup>7</sup> framework is compatible with the reference framework on the whole, especially with regard to the broad principles.

Furthermore, two questionnaires have been appended to the MAG report, one on internal control for accounting and financial reporting, the other on risk analysis and management. The accounting and financial reporting questionnaire is a partial guide that can be adapted to suit the specific characteristics of each company. It is divided into six parts: role of governance bodies, accounting and financial structure, information system, identification and analysis of risks affecting accounting and financial information, control activities and investor relations. The questionnaire on risk analysis and management enables the company to assess its identification, analysis and management of its main risks.

The MAG asserts that, to be effective, internal control must be based on rules of conduct and ethics that are backed up by the governance bodies and communicated to all employees. It must not be a matter of merely going through the motions because this could lead to serious ethical violations.

#### **2.4.6 AMF Recommendations**

The reference framework, supplemented by the application guide, is an appropriate tool for analysing and designing internal control systems for listed companies to enhance best practices in this area. As stated in its 2005 report, the AMF wishes to make the chairman's reports more consistent and easier to understand. Consequently, the AMF recommends that all companies making public offerings 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 benchmark 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, in consideration of their business activity, their size and their organisational structure. Companies must highlight the events and information likely to have a material impact on their assets or earnings.

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

This recommendation applies to Chairmen's Reports on internal control procedures relating to financial years starting on or after 1 January 2007.

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<sup>7</sup> "Committee of Sponsoring Organizations of the Treadway Commission," the American benchmark, which is made up of the following components: the control environment, risk assessment, control activities, information and communication, monitoring.

### 3.1 European Directives

In 2006, two new Directives were adopted on establishing internal audit committees in listed companies and on internal control statements.

**3.1.1 Directive 2006/43/EC of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, which carries a transposition deadline of 29 June 2008.** Two points in this Directive are particularly noteworthy:

- The establishment of an audit committee and the definition of its role.

This Directive sets out the principle that *"each public-interest entity shall have an audit committee,"* but it allows Member States not to apply this principle under certain conditions. Thus, Member States may permit *"the functions assigned to the audit committee to be performed by the administrative or supervisory body as a whole,"* or else, they may permit or decide that all of the provisions relating to audit committees do not apply to an entity *"that has a body performing equivalent functions to an audit committee, established and functioning according to provisions in place in the Member State in which the entity to be audited is registered."* The Directive stipulates that *"at least one member of the audit committee shall be independent and shall have competence in accounting and/or auditing."*

The audit committee's tasks cited in the Directive include *"[monitoring] the financial reporting process [and monitoring] the effectiveness of the company's internal control, internal audit where applicable, and risk management systems."*

- Statutory auditors report to the audit committee on internal control procedures relating to the financial reporting process.

The Directive stipulates that the statutory auditor *"shall report to the audit committee on key matters arising from the statutory audit, and in particular on material weaknesses in internal control in relation to the financial reporting process."*

**3.1.2 Directive 2006/46/EC of 14 June 2006 amending Council Directives 78/660/EEC and 83/349/EEC (Fourth and Seventh Directives) on the annual accounts and consolidated accounts of certain types of companies, which has a transposition deadline of 5 September 2008**

This Directive introduces the concept of the collective responsibility of the members of the administrative, managerial and supervisory bodies with regard to the preparation and publication of annual and consolidated accounts and the management report.

It also requires listed companies with their registered office in the European Community to publish an annual corporate governance statement in a specific and clearly identifiable section of the annual report. If the company is bound by a corporate governance code or if it voluntarily chooses to apply one, the statement must identify that code and indicate any parts of it that are not applied and the reasons for not applying them. Furthermore, a company that does not apply any code must explain its reasons for doing so and report all of the relevant

information about the corporate governance practices that it applies above and beyond the requirements of national laws. In any event, the statements must also include a "*description of the main features of any existing risk management systems and internal controls in relation to the financial reporting process.*"

### **3.2 The European Commission's positions**

In its Communication on "*Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward*," the Commission deems that it is important to encourage the coordination and convergence of national legislation on corporate governance by holding regular high-level meetings of the European Corporate Governance Forum. On 24 July 2006, the Forum issued a statement on internal control calling for the establishment of best practices at the European level.

### **3.3 Other international provisions**

#### **3.3.1 IOSCO Action Plan**

In March 2005, the International Organization of Securities Commissions (IOSCO) released a report on "*Strengthening Capital Markets Against Financial Fraud*." The report was intended to identify possible weaknesses in the international financial systems in light of an in-depth examination of the existing regulation structures. IOSCO adopted a plan of action that includes a call for a survey of internal control procedures applicable to companies in IOSCO member-countries.

#### **3.3.2 Application of the Sarbanes-Oxley Act to companies listed in the United States**

Foreign companies listed in the United States are subject to the requirements of the Sarbanes-Oxley Act for financial years ending on or after 15 July 2006. Section 404 of the Act requires the chairman, the chief executive officer and the chief financial officer to conduct an annual evaluation of the effectiveness of internal controls and procedures relating to the financial reporting process.

In its Release dated 15 December 2006, the Securities and Exchange Commission (SEC) revised the Section 404 compliance dates, pushing them back for foreign issuers and, in certain cases, introducing a lag between the requirements for managers and those for auditors. This means that the compliance date for the management report on the effectiveness of controls and procedures relating to disclosures has been pushed back to 15 December 2007 for issuers classified as "non-accelerated filers" (less than 75 million dollars in outstanding equity). In the case of "accelerated filers" (outstanding equity of 75 million dollars or more and less than 700 million dollars) and "large accelerated filers" (outstanding equity of 700 million dollars or more), the compliance date is still 15 July 2006.

The compliance date for the auditor's attestation on internal control procedures over financial reporting is still 15 July 2006 for large accelerated filers. It has been pushed back to 15 July 2007 for "accelerated filers" and to 15 December 2008 for non-accelerated filers.

On 19 December 2006, the Public Company Accounting Oversight Board (PCAOB) published a proposed amendment to Audit Standard AS 2 intended to streamline the operational implementation of the Section 404 requirements, which was deemed to be excessive in the original AS 2 standard.

#### 4.1 **Procedures for preparing and organising the work of the board of directors or the supervisory board**

##### 4.1.1 Board organisation and practices

###### *Board membership*

Sixty-nine percent of the companies in the sample have a board of directors, and 31% have a supervisory board and an executive board. Virtually all companies provide a detailed description of board membership, with 97% of them specifying the number of board members, which averages 10.3 in the sample, or practically the same figure as in the previous year. The ages of the board members are given in 70% of cases and the length of their term of office is given in 90% of cases. Approximately 30% of the companies disclose their board members' qualifications, versus 19% in the previous year. These figures show that the level of disclosure remains adequate compared to the previous year.

###### *Independent directors*

Eighty percent of the companies in the sample (versus 76% in the 2005 report) explain that their board includes one or more independent directors, the average ratio of independent directors to the total number of directors<sup>8</sup> stood at approximately 46%. The average ratio has not changed from the previous year.

However, this figure conceals huge disparities in terms of information since:

- Some companies fail to specify clearly which directors are deemed to be independent;
- Family-owned companies and companies where a handful of shareholders, or even a single shareholder, hold a majority are encouraged to comply with "at least a third" rule set out in the 2003 AFEP/MEDEF Report<sup>9</sup>, whereas the proportion of independent directors in widely held companies should be 50% or more, according to the same report. This means that there are major differences in the way this ratio is calculated, depending on how widely held the shares are. For example, looking only at the CAC 40 companies in the sample, it can be seen that widely held companies have a ratio of 62%, versus 40% for other companies. Furthermore, a number of companies have deemed that they are too small to have any independent directors (usually these companies are traded on Eurolist C and are classified as family-owned).
- Nearly two-thirds of the companies with one or more directors whom they describe as independent define this term. More than 90% of such companies refer to the definition in the AFEP/MEDEF report mentioned above. However, the reference is more or less flexible. While some companies adhere to the

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<sup>8</sup> This statistic is based on the companies' statements. Companies explicitly stating that they do not have any independent directors were counted. Companies that do not indicate whether they have any independent directors were not counted.

<sup>9</sup> *Le gouvernement d'entreprise des sociétés cotées*, October 2003.

strict criteria set out by AFEP/MEDEF, others exclude certain conditions, such as the ones that bar directors from serving for more than 12 years, or, to a lesser extent, the one that rules out directors serving on the boards of the parent company or a consolidated company in the last five years. In one-third of the companies that claim to use the said definition refer only to the general statement that "a director is independent when he has no relationship of any kind with the company, its group or its management that could compromise his free judgment," ultimately leaving it up to the board to decide who qualifies on a case-by-case basis. Most companies that do not refer explicitly to the definition in the AFEP/MEDEF report use their own approach or concepts (such as "independent individuals" chosen for their expertise in specific areas) or other criteria, such as those established by a market or other national codes in Europe. Some companies even state explicitly that they have not used the definition in the AFEP/MEDEF report because they are small (these are mainly companies listed on Eurolist C). In this case, one or more independent directors are mentioned, but no definition is given.

**The AMF reaffirms that companies should indicate clearly whether their board includes one or more independent directors. Such directors should be identified. In addition, companies should explain why it is able to describe such directors as independent. More specifically, when companies refer to an industry standard, they must explain any material deviations from the criteria set by the standard and the reasons for them.**

#### Multiple directorships

Nearly 90%<sup>10</sup> of the companies in the sample provide information about the number and nature of other directorships held by board members. This disclosure is made in the main body of the registration document in the vast majority of the cases, not in the report itself.

Explanations about the terms of other directorships held are usually provided. In 76% of the companies, a director holds at least four directorships. This is primarily the case for companies on Eurolist A and half of Eurolist B. There has been a clear improvement in the disclosure of the nationality of the other companies in which board members hold directorships. Similarly, specific information is often provided about whether the said companies are publicly traded or not. On the other hand, it is rarely specified whether the companies in question are controlled or not.

**The AMF notes that many companies have followed the recommendation made in the 2005 report, which asked them for specific information about the companies in which board members hold directorships (companies in the same group, foreign companies and unlisted companies). The AMF reiterates its recommendation, particularly with regard to whether such companies belong to the same group.**

#### Role of the board

Some 66% of the companies in the sample clearly define the board's tasks. This figure has not changed from the previous year. The main tasks cited in the chairman's reports analysed by the AMF show little change from the

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<sup>10</sup> When companies do not disclose their directors' other directorships, it is not always possible to distinguish directors who do not actually hold any other directorships from those that do, but about whom the company does not provide any explanation.

previous year. They include examining financial statements, approving the annual budget, discussing strategic choices, appointing corporate officers and, where applicable, examining the committee reports.

As was the case in 2005, more than three quarters of the companies in the sample disclose the attendance records of their directors at the board meetings. The average attendance rate is 83%, similar to the previous year's figure. Some companies provide the attendance rates for individual board members. In two-thirds of the cases (including virtually all of the CAC 40 companies in the sample), explanations are provided about the information given to directors prior to board meetings. In most of the cases, the report states that all documents, technical reports and information necessary for the performance of their tasks is provided to the directors before the meetings, along with the meeting agenda. As a general rule, this is done one week ahead of the meeting (two weeks being the maximum).

The agendas for the various board meetings during the year are provided, by 68% of the companies, although they are sometimes given in very general terms. As was the case in 2005, a report on the board's activity is made in half the cases.

The existence of internal rules for board meetings is mentioned in 65% of cases. This figure has improved steadily from about only half of the companies in the sample covered in the 2004 AMF report and 56% in the 2005 report. Seventy-eight percent of the companies mentioning their rules of procedure (versus 75% in the previous year) list the topics covered, either in a summary, or, more rarely, by presenting substantial quotations from the rules. Some of them include the full text of their rules of procedure in their registration document, usually in an appendix. The internal rules describe how the board operates, its powers, duties and tasks, and those of the specialised committees set up and, where appropriate, the rules set out the principle for evaluating the operation of the board (see 1.1.3. below). In 23% of cases, the companies explain that the rules of procedure are completely public, which is the same proportion as in the previous year. Some companies explain that the rules of procedure can be obtained from the company's website and that any shareholder can obtain a paper copy from the registered office. Thirteen percent of the companies that already have rules of procedure for the board report that amendments were made to these rules in 2005.

**The internal rules for the board are critical for understanding how it is organised and how it works. Therefore, the AMF reiterates its recommendation that the rules should be included in an appendix to the registration document or the annual report or an equivalent document, or that substantial quotations be provided, or that the rules should be posted to the company's website, with a reference to the Internet link in the aforementioned documents.**

#### **4.1.2 Specialised committee organisation and practices**

Three-quarters of the companies – almost the same proportion as in the 2005 report – state that they have one or more specialised committees (e.g. audit committee, compensation and appointment committee). Seventy-two percent of the companies mention the interactions between the board and the specialised committees. In the vast majority of cases, their role is to make proposals to the board on matters falling within their respective areas of competence.

Three-quarters of the companies in the sample have set up an audit committee and a compensation committee. These two statistics have posted increases since the previous year's report, where the respective figures were

68% and 67%. The similarity of the percentages with regard to both committees does not necessarily mean that these companies always have both kinds of committee, even though the vast majority of them do. A handful of companies have a compensation committee but no audit committee, and vice versa.

#### Audit committee

Three-quarters of the companies have set up an audit committee and a compensation committee, including all of the CAC 40 companies in the sample. The numbers and names of the directors on the committee are provided in 88% of cases<sup>11</sup>. The average committee is made up of 3.6 directors. When companies identify their independent directors, approximately two-thirds of the audit committee members are independent directors, with very widely held companies tending to have an even higher proportion.

As was the case in 2005, virtually all the chairman's reports describe the audit committee's tasks. These tasks cover: analysis of financial statements (as well as specific accounting issues, as was the case for the transition to IFRS), examining risks and off-balance sheet liabilities, and sometimes even approving internal audit plans.

As was the case in 2005, 51% of the chairman's reports cite the participation of the audit committee in preparing the report. This means that the committee reviews the work of the internal audit department and even the chairman's report per se. Two-thirds of the chairman's reports also mention that the audit committee's tasks include relations with statutory auditors and more specifically interrogating them, reviewing their work and, to a lesser extent, supervising their appointment and compensation.

Nearly half the reports explain how the committee works in detail. In 84% of the reports, readers can find information about the number of meetings held during the year, and even the topics discussed by the audit committee or the attendance rate of committee members.

#### Compensation committee

Three-quarters of the companies have a compensation committee, including 35 of the 38 CAC 40 companies in the sample. As was the case in 2005, nearly all the chairman's reports give the names of the committee members. The average compensation committee has 3.4 members. Independent directors sit on 56% of the committees and on nearly three-quarters of them, independent directors account for half or more of the members. The committee's tasks are described in detail in 90% of the chairman's reports. These tasks consist primarily in making recommendations about the compensation of corporate officers, reviewing the system for distributing directors' fees and selecting new directors. In nearly 80% of the reports, there is an account of the compensation committee's activities, mentioning the various meetings and the topics discussed. The compensation committee also acts as an appointment committee in about half the cases.

#### Appointment committee

Approximately 13% of the companies have an appointment committee that is separate from the compensation committee, including nine of the CAC 40 companies in the sample. Some 76% of these companies describe the tasks and activities of their appointment committee. Generally these committees examine applications and short-list applicants for corporate officer positions. They may even assess the independence of board members and evaluate the board's practices.

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<sup>11</sup> This information is not usually in the chairman's report, but in the Chapter on "Board membership and practices."

**Three-quarters of the companies in the sample have an audit committee and/or a compensation committee. This represents a 10% increase from the 2005 report. One out of two compensation committees also acts as an appointment committee and some 13% of the companies have a separate appointment committee. The proportion of independent directors on the audit and compensation committee is two-thirds and more than half respectively. The AMF affirms that, when a company decides to refer to an industry standard for corporate governance, it is important for it to explain any areas of partial compliance.**

#### **4.1.3 Evaluation of the board's work**

Nearly half the companies in the sample say 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.

Some 84% of the companies that evaluated their board in 2005 reported that the evaluation was carried out internally, often using self-assessment questionnaires filled out by directors, even though some of the companies explained that the internal evaluation was carried out with the help of external consultants. Where applicable, the non-voting members of the board are given the task of drafting a detailed questionnaire about the membership, practices and effectiveness of the board and its committees, and then summarising the answers received. The board usually discusses the findings. As was the case in 2005, the frequency of the evaluation is specified in three-quarters of the cases and it is annual in most cases.

Half of the companies mention that the board has examined the evaluation findings, versus a quarter last year. Nevertheless, it is often stated in very general terms that the board's practices are deemed to be "satisfactory" or even "unanimously positive". In one out of two cases, however, areas for improvement are identified. Companies differ sharply on this point. Some report a need for "*more systematic provision of information between board meetings; more in-depth information on competition and competitors; a special meeting to discuss long-term strategy and development; more involvement of the board in strategic issues.*" Others call for: "*a more formal approach to the board's work.*"

**AMF notes that the number of companies reporting evaluations of the board's practices is increasing steadily, having doubled since 2004. The evaluation is usually carried out internally. However, only some of the companies describe this evaluation, and some use very general terms to do so. The AMF recommends that companies that carry out an evaluation of the board's practices should report any areas for improvement that the company is discussing following the evaluation.**

#### **4.2 Restrictions that the board of directors places 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 lack of restrictions, placed on the chief executive officer's powers by the board<sup>12</sup>. The restrictions placed on the chief executive officer's powers may be expressed in language explaining that the "*chief executive officer carries out his duties without any special restrictions, notwithstanding the powers explicitly assigned to the board of directors under the law, company bylaws and the*

<sup>12</sup> In companies where the chairman of the board is also the chief executive officer, the reports tend to use the words "*any restrictions that the board of directors places on the chairman's powers.*"

*rules of procedure*". Other companies explain that the chief executive officer needs to obtain the prior consent of the board for any transaction or investment in excess of a given amount. Some companies explain that the board of directors must discuss any investment in excess of certain amount.

**The AMF notes that a growing number of companies report potential restrictions that the board of directors places on the chief executive officer. The AMF points out that there is a legal requirement to mention any such restrictions in the chairman's report<sup>13</sup>. Some companies, however, just refer readers to the board's rules of procedures, which is only possible if shareholders have access to the said rules.**

### **4.3 Directors' pay and executive pay**

#### **4.3.1 Directors' fees**

Nearly all companies disclose the amount of their directors' fees, on an individual basis in most cases (16% of the companies do not pay directors' fees, most of these companies are listed on Eurolist C). In more than 80% of cases, the amount of the directors' fees is linked, partially at least, to attendance at meetings and work on specialised committees.

#### **4.3.2 Executive directors' compensation**

This paragraph applies only to companies that produce a registration document.

##### **4.3.2.1 General information about fixed and variable pay and benefits in kind**

Ninety percent of the companies in the sample distinguish the variable component from the fixed component. And 88% report providing benefits in kind. Most companies disclose the amount without necessarily explaining the evaluation methodology used. In cases where they are explained, these benefits primarily consist of a company car or a mobile phone. Ninety-five percent of the companies disclose information about individual compensation amounts.

##### **4.3.2.2 Determining the variable pay component**

Three-quarters of the reports mention the criteria for determining the variable component of compensation. This component is either based exclusively on the company's financial criteria, or, in most cases, on a combination of financial criteria and qualitative criteria relating to individual performance. A weighting coefficient usually determines the relative size of these two elements. And weightings are applied to the financial criteria themselves. Some criteria are fairly precise<sup>14</sup>, while others are broader. Even in the former case, qualitative objectives<sup>15</sup> still play a role, which leaves the board some discretion. The variable component is capped in slightly fewer than 20% of cases. Such caps are either a percentage of the fixed compensation amount or, less frequently, an absolute value.

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<sup>13</sup> The last paragraph of Article L. 225-37 of the Commercial Code stipulates that, "*without prejudice to the provisions of Article L. 225-56, the report shall also report "any restrictions that the board of directors has placed on the powers of the chief executive officer."*

<sup>14</sup> Net income before taxes, for example.

<sup>15</sup> Most companies use the term "*as a function of...*"

The board usually defines the process for determining the variable component after consulting the compensation committee or receiving a proposal from it. This point can be interpreted differently. Sometimes, the chairman's report merely states that the board received "assistance" from the compensation committee, without going into further detail. In some cases, the report mentions that the chairman, even if he is not a member of the committee, may sit in on the compensation committee's discussions, without taking part in them. The chairman is a member of this committee in nearly 19% of the companies with a compensation committee that also produce a registration document. Three-quarters of these companies have a supervisory board. It should be remembered that approximately 60% of the compensation committee members are independent directors.

#### **4.3.2.3 Benefits granted to executives that leave or change jobs**

Approximately one third of the companies do not disclose severance benefits or supplementary retirement benefits for corporate officers. The vast majority of companies that do disclose severance benefits (or a lack thereof) provide the individual amounts. Disclosures of retirement liabilities are more complex and are not usually given on an individual basis. This is because the relevant information may be dispersed, but also because corporate officers sometimes enjoy benefits that are available to all the company's employees or all its executives.

**The AMF recommends that companies disclose the exact fixed and variable components of compensation and any benefits in kind so as to avoid any ambiguity about executive pay and benefits. The AMF also recommends that companies provide more explicit information about the criteria used to determine the variable component of executive pay, and provide a clear indication of the percentage that is actually linked to these criteria and the percentage that is left to the discretion of the board. The AMF recommends that companies that do not provide any special severance or retirement benefits for their corporate officers should make an explicit statement to this effect to avoid ambiguity about deferred compensation, severance benefits and retirement liabilities. The AMF points out that such information should be provided individually for each of the corporate officers. Furthermore, some companies disperse this information in separate parts of the document, especially information about retirement liabilities. The AMF recommends, therefore, that companies should provide clear explanations on where to find this information in different parts of the document. The AMF further recommends that companies should disclose quantifiable information and, whenever possible, quantified information.**

## 5 INTERNAL CONTROL PROCEDURES

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### 5.1 Description of internal control procedures

#### 5.1.1 Internal control definitions and objectives

In 89% of the chairman's reports, there is a definition of internal control. The definition is primarily based on the resources implemented to attain the specified objectives. Slightly more than half of the companies use the exact objectives defined in the COSO<sup>16</sup> framework, namely effectiveness and efficiency of operations, reliability of financial reporting and compliance with applicable laws and regulations, even though they may not refer explicitly to the framework. The other companies either refer to the AFEP/MEDEF framework (approximately 13%) or to the regulations governing their business activity (e.g. CRBF Regulation 97-02<sup>17</sup> for banks), or else ad hoc definitions. Some companies refer to several different definitions at the same time, such as the AFEP/COSO definitions. Some companies use the COSO definition or the one in the AFEP/MEDEF report mentioned above, but then adapt them, for example by adding objectives relating to asset protection or to error and fraud prevention and, more generally, to managing the risks related to the group's own business activity. Other companies use a definition that contains none of the exact terms of the COSO definition or the one in the AFEP/MEDEF report but that still remains quite close to the objectives mentioned by both. Some companies refer to the professional standards of IFACI, the Internal Audit Institute.<sup>18</sup>

No matter which reference they choose, if any, almost all the companies report reliability of financial reporting as an objective in 87% of cases with regard to control of operations (even though the terminology may vary slightly), and compliance with applicable laws and regulations in more than 80% of cases. Yet, the discussion in the main body of the reports on these topics and the methodology used is patchy.

That a company adopts the internal control definition from a specific benchmark does not affect its ultimate choice of benchmark (see choice of benchmark).

In 76% of the reports, the companies disclose the inherent limitations of their internal control system. However, these limitations are described in very general terms and are often related to the definition of internal control per se. Very few companies explain the inherent limitations related to their own business activity. Thus, in virtually every case, either the expression "reasonable assurance" found in the COSO framework is used, or the document explains that internal control cannot provide an "absolute guarantee" that the risks have been completely eliminated. This seems to be in line with the future reference framework that deals with this notion.<sup>19</sup>

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<sup>16</sup> *Committee of Sponsoring Organizations of the Treadway Commission*

<sup>17</sup> CRBF Regulation 97-02 of 21 February 1997 on internal control in credit institutions and investment firms.

<sup>18</sup> IIA (Institute of internal Auditors)/IFACI Standard 2120-A1

Nearly all the companies have defined the reliability of financial reporting as one of the internal control objectives, and a vast majority also cite control of operations and compliance with applicable laws and regulations. In most cases, the reports note that the internal control system cannot be seen as an absolute guarantee that the company will meet its objectives.

These objectives are dealt with fully in the reference framework drawn up by the MAG. Under the terms of this framework, internal control is a system defined and implemented under the responsibility of the company. It is aimed at ensuring compliance with laws and regulations, enforcement of the guidelines set by executive management or the executive board, and the smooth operation of the company's internal processes, especially those relating to asset protection and the reliability of financial reporting. In addition to setting the objectives, the MAG found that internal control must, as a rule, contribute to the management of the company's business, the effectiveness of its transactions and the efficient use of resources.

### 5.1.2 Scope of the chairman's reports

More than 80% of the companies use the term "group" in their definition of internal control or in their stated internal control objectives. Few companies indicate exactly what the scope of their internal control system is. Many of them just use the term "group," explaining that some of the objectives apply to subsidiaries as well, with no further explanation. Companies explain that the internal control system may be decentralised, since the executive management of each operational entity (subsidiary or department) is responsible for defining the internal control system. In the vast majority of cases, however, the parent company's procedures apply to the subsidiaries, subject to differences in implementation by business area or by subsidiaries, especially for operational functions.

Companies stress that some of their subsidiaries may not apply the same definition of internal control as the group, either because the subsidiary is independent and has its own definition, or because the subsidiary is located in a country where specific internal control rules are applied.

**The AMF reiterates its recommendation that companies should explain the scope of the chairman's report. When companies refer to "the group", the AMF recommends that they should explain whether this notion covers the parent company and the consolidated companies or, failing that, specify which subsidiaries or branches are not covered by the chairman's report or which ones have internal control systems that are different from that of the rest of the group.**

**Furthermore, the MAG reference framework for internal control systems specifies that for the purposes of consolidated financial statements, the internal control system for accounting and financial reporting covers the parent company and the consolidated companies.**

### 5.1.3 Benchmark applied

Thirty-nine percent of the companies (versus 33% in 2005) explain which methodology they used to devise and implement their internal control system. In more than 83% of cases, the companies in question stated that they used benchmarks that were partially or fully derived from the COSO framework. This proportion has not changed

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<sup>19</sup> "Internal control cannot provide an absolute guarantee that the company's objectives will be achieved."

from the previous year. Some companies also use an approach that combines the COSO framework and internal benchmarks, which may even vary for each subsidiary.

Yet the use of a predefined methodology, whether based on the COSO framework or on the AFEP/MEDEF guidelines, is not necessarily correlated with the choice of format for the second part of the chairman's report<sup>20</sup>.

As a rule, the reports highlight the elements deemed to be preponderant or specific to the companies' activities, which may mean that they focus on one point of the standard format and/or omit another, leading to ad hoc formats<sup>21</sup>.

**The distinctive features of each company need not be taken into consideration, but the diversity of benchmarks used (or even the absence of benchmarks) makes it impossible for shareholders to fully assess the procedures that companies apply. Furthermore, the AMF notes that the presentation of internal control procedures does not always correspond to the benchmark chosen by the company. The AMF recommends that companies should follow the format corresponding to the benchmark used so that the information disclosed in the reports is more understandable and easier to compare. Establishing a reference framework should introduce a format that is convenient for companies to use and easy for shareholders to understand.**

#### 5.1.4 Risk identification and risk management systems

Two-thirds of the companies in the sample explain the main risks facing them in the chairman's report. This figure has not changed from the previous year. The description covers a wide variety of risks, ranging from operating risks to financial risks, yet the level of detail is fairly uniform. Half of the companies also report that they have a risk-mapping function, which may also be called an internal control grid or matrix. The information about risk mapping and how it is validated and implemented focuses primarily on the division of roles within the company. At best, there is a summary description of the process. For example, it is often presented as follows: in principle, the risk department determines the material risks and the executive committee (of which the head of internal audit is sometimes a member) validates this definition, which is then implemented by the internal audit department. To a lesser extent, the reports focus on the risk-mapping methodology, including the number of macroeconomic risks considered, and the parameters used to rank them: nature, frequency, criticality, hierarchical or geographical level affected.

**The AMF reiterates its recommendation to link risks, especially those described in the "risk factors" section of the registration document, to the procedures put in place, since the suitability of internal control procedures depends on identifying the main risks, which only the company itself can do. This link should make it easier to understand how the company perceives, formalises, ranks and ultimately manages its risks. The AMF stresses that simply referring readers to a later chapter is not enough. Readers should be referred to the parts of the report that deal specifically with the risks and categories of risks covered by internal control procedures.**

<sup>20</sup> This means that companies that use the COSO framework as a benchmark for some or all of the disclosures do not follow the COSO format exactly in the chairman's report (control environment / risk assessment / control activities / information and communication / monitoring).

<sup>21</sup> But this does not mean that they do not apply the COSO framework. In the interviews we conducted, some of the companies did mention differences that may exist between a brief presentation made in the chairman's report, where one or two specific points need to be stressed, and the work that is actually done within the company, which is often in line with the chosen benchmark.

### 5.1.5 Details about internal control procedures

As a rule, the figures have not changed since the 2005 report.

More than 90% of the companies in the sample described their internal control procedures. As in the previous year, 75% of the companies describe the extent to which their procedures have been formalised. The procedures may be set out in a procedural manual or charter<sup>22</sup>. However, some companies disclose only the procedures that concern accounting and financial reporting.

**Procedures relating to financial reporting** Eighty-seven percent of the companies in the sample provided detailed information about their internal control procedures for financial reporting. Such information includes a description of the accounting structure, the establishment of a monitoring system and the role of the finance department.

**Other internal control procedures** Slightly more than one-third of the chairman's reports mention and discuss compliance with laws and regulations and slightly more than 60% of the reports discuss control of transactions (investment and/or disposal oversight, procedures used to ensure comprehensive recording of transactions, etc.)

**The AMF recommends that companies strengthen the link between the statement of objectives and the description of internal control procedures in the chairman's report. The AMF also stresses that descriptions of internal control procedures must not deal only in general considerations; they should refer to the procedures actually used by the company.**

### 5.1.6 Internal control resources

Eighty-five percent of the companies in the sample disclose the resources devoted to internal control. This figure is the same as in the 2005 report. More than 80% of these companies provide information about the personnel assigned to this function and devote a section of the chairman's report to the people involved in internal control<sup>23</sup>. There are two noteworthy trends: some companies list all the functions involved, from the legal department to the human resources department, and including the executive committee. Some companies even list all of the employees involved. On the other hand, other companies cite only the internal audit department when discussing the people involved. In both cases, no figure is given for the cost of internal control (probably because this cost is difficult to evaluate and because the companies do not necessarily think this information is relevant). On the other hand, 27% of the companies in the sample (versus 23% in 2005) mention the investment effort made to establish and monitor internal control. More specifically, most of the companies subject to the Sarbanes-Oxley Act report major investments to achieve compliance.

**The AMF notes that the majority of companies identify the people involved in internal control. It recommends that in addition to this description, companies should include an organisation chart, if it helps to clarify the company's internal control system.**

<sup>22</sup> Approximately one-quarter of the companies use an audit charter, an internal control manual or best practices, or even a financial reporting guide. These are sometimes mentioned very briefly or in overly general terms. No summaries of these guides and manuals are found in the registration document or in the chairman's report. Nor is any mention made of the fact that such documents are available on request or on the company's website. In fact, such documents are for internal use and are distributed to the members of the internal audit department, or to the company's executives. A number of companies have established a code of ethics that applies to either the audit department or to all employees.

<sup>23</sup> Naturally, companies using the COSO framework deal with this in the "control environment" section.

## **5.2 Due diligence and the assessment of the internal control system**

### **5.2.1 Due diligence in connection with the report**

The reports by 68% of the companies in the sample explained the work that went into preparing the report.

In their descriptions of due diligence, 81% of the companies concerned report discussions of the topic by the board, and 73% report discussions by the audit committee. Eighty-eight percent report discussions by executive management (executive committee or executive board). All these figures are higher than those in the 2005 report.

**Noting companies' efforts to achieve transparency in 2005, the AMF reiterates its recommendation about the description of the due diligence involved in preparing the report and the list of units or departments concerned.**

### **5.2.2 Assessment of the internal control system**

In 2005, 34% of the companies' reports explained that the internal control system was subject to ongoing improvements. This figure reflects some disparities, however. Most companies simply disclosed various plans of action implemented by the internal control department<sup>24</sup>, while others highlight the establishment of a specific evaluation process in a special paragraph. In the first case, the reports do not necessarily explain whether improvements involve changes to existing procedures or the introduction of new procedures. Some 57% of the companies reporting ongoing improvements to their internal control system produced self-assessment questionnaires, which are given to each operational unit in most cases. The assessment mentioned in the report is often limited to the procedures discussed in the report<sup>25</sup>. In most cases, this means the procedures related to financial reporting.

Thirty-five percent of the companies that assess their internal control system report the findings of the assessment, in very general terms in most cases. This proportion has not changed from the previous year. Sometimes the report mentions an improvement in the current year's assessment compared to the previous year's. They may even mention that some specific areas for improvement have been identified. Only one company chairman clearly states that there are "weaknesses" in the internal control procedures.

### **5.2.3 Companies subject to the Sarbanes-Oxley Act**

Seventeen of the companies in the sample are listed in the United States. One company reproduced Chapter 15 of Form 20-F in full in its registration document and mentioned the weakness noted in this chapter not in the chairman's report but in the corporate governance section, since the weakness had been presented to the audit committee. Yet, no reference to the weakness was made in the section of the chairman's report dealing with internal control. Another company disclosed in its 20-F filing and the chairman's report a weakness in the internal control of some foreign transactions, but this weakness had no material impact on the financial statements.

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<sup>24</sup> The role of this department is to review transactions and procedures and to recommend improvements relating to internal control. Its task usually includes a full review of the system over a given number of years.

**The AMF reiterates its recommendation on companies' descriptions of work done to improve their internal control processes, particularly the use of self-assessment questionnaires.**

**The AMF deems that it is important for shareholders to know about the findings, particularly any areas for improvement that are identified.**

**The AMF thinks it would be better for companies to explain any failures or serious shortcomings they discover. This explanation is critical if the companies have disclosed such problems to markets in other countries. The AMF reminds companies listed abroad that information disclosed to those markets must be disclosed simultaneously to the French market. This is especially true for companies making public offerings of securities in the United States and that are therefore subject to the provisions of the Sarbanes-Oxley Act.**

#### **5.2.4 Statutory auditors' reports**

All the companies in the sample<sup>26</sup> (versus 95% in the previous year) reproduce the statutory auditors' report. This report is usually included in the chairman's report. In rarer cases, it is appended to the report, along with all of the statutory auditors' reports. In every case, the statutory auditors' report follows the format recommended by the national institute of statutory auditors, the CNCC. None of the reports contains any reservations or observations made in compliance with the CNCC standard<sup>27</sup>. All of the reports are descriptive, except for one that is evaluative because it deals with a company that has already engaged in the Sarbanes-Oxley Act process in the United States. The statutory auditors' reports do not raise any questions about the fairness of the information disclosed in the chairman's reports.

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<sup>25</sup> This is only logical since the companies subject to the Sarbanes-Oxley Act (SOX) that follow the COSO framework in their reports are also the ones that carry out the evaluation required by the said Act in accordance with the formalities set out in the COSO framework.

<sup>26</sup> If they are required to do so.

<sup>27</sup> Standard 2-107.

## **GENERAL CONCLUSION**

### **Corporate governance**

A degree of flexibility is acceptable with regard to the form of the reports, but it must not be to the detriment of the understandability of the documents.

There was a further improvement in the quality of the content of the reports in 2005, 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. The changes noted include the steady increase in the number of specialised committees set up to assist the board. Furthermore, nearly half of the reports mention an evaluation of the board's work, compared to only a quarter in 2004 and a third in 2005. The AMF recommends that companies should conduct such an evaluation and invites them to publish the findings, along with any suggestions for improvements. The AMF also urges companies to make complete versions of their boards' rules of procedure public, or substantial sections of these rules, as required for an understanding of how the board operates.

In general, the disclosures about executive pay present the distinction between fixed pay, variable pay and benefits in kind clearly, but the criteria and procedures for determining these components are still very vague in some cases.

### **Internal control**

As was the case in 2005, information about internal control is still quite patchy and theoretical, despite significant efforts to explain the control process for financial reporting. 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 benchmark.

As indicated in its 2005 report mentioned above, the AMF wishes to make the chairman's reports more consistent and easier to understand.

For this purpose, the AMF asked a Market Advisory Group (MAG) to develop a reference framework for internal control for the use of French companies subject to statutory requirements. Chaired by Jean Cédelle and Guillaume Gasztowtt, with Michel Léger for the section dealing with financial reporting, the MAG included representatives of all stakeholders

In May 2006, the MAG published a reference framework covering general principles applicable to all internal control processes. In December 2006, this framework was backed up by an application guide for the internal control procedures relating to published accounting and financial information. The reference framework, supplemented by the application guide, is an appropriate tool for analysing and designing internal control systems for listed companies to enhance best practices in this area.

Consequently, the AMF recommends that all companies making public offerings in France should use the framework and 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, in consideration of their business activity, their size and their organisational structure. Companies shall highlight the events and information that are likely to have a material impact on their assets or their 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 on internal control procedures relating to financial years starting on or after 1 January 2007.

The sample includes 109 companies, distributed as follows:

**57 Eurolist A (52%)**

**38 companies in the CAC 40 index (as of 31 December 2005)**

1. ACCOR
2. AGF
3. AIR LIQUIDE
4. ALCATEL
5. ARCELOR
6. AXA
7. BNP PARIBAS
8. BOUYGUES
9. CAP GEMINI
10. CARREFOUR
11. CREDIT AGRICOLE
12. DANONE
13. DEXIA
14. EADS
15. EDF
16. ESSILOR INTERNATIONAL
17. FRANCE TELECOM
18. GAZ DE FRANCE
19. L'OREAL
20. LAFARGE
21. LAGARDERE
22. LVMH
23. MICHELIN
24. PEUGEOT
25. PPR
26. PUBLICIS GROUPE
27. RENAULT
28. SAINT GOBAIN
29. SANOFI-AVENTIS
30. SCHNEIDER ELECTRIC
31. SOCIETE GENERALE
32. SUEZ
33. THALES
34. THOMSON
35. TOTAL
36. VEOLIA ENVIRONNEMENT
37. VINCI
38. VIVENDI UNIVERSAL

**- 19 others**

1. AIR France
2. ATOS ORIGIN
3. BIOMERIEUX
4. BOLLORE
5. CASINO GUICHARD-PERRACHON
6. CIC PARIS
7. CIMENTS FRANÇAIS
8. DASSAULT AVIATION
9. EIFFAGE
10. ERAMET
11. FAURECIA
12. FONCIERE EURIS
13. HAVAS
14. JC DECAUX SA
15. SAFRAN
16. SCOR GROUP
17. TECHNIP
18. TF1
19. VALLOUREC

**13 Eurolist B (12%)**

1. ALTRAN TECHNOLOGIES
2. AREVA
3. ARKOPHARMA
4. BOURSORAMA
5. BRIOCHE PASQUIER
6. COMPAGNIE GENERALE DE GEOPHYSIQUE
7. FINATIS
8. GAUMONT
9. GENERALE DE SANTE
10. GEODIS
11. GL TRADE
12. RHODIA
13. SR TELEPERFORMANCE

**32 Eurolist C (29%)**

1. ACCESS COMMERCE
2. ACTEOS
3. ADL PARTNER

4. ALTAMIR
5. ALTI
6. ARCHOS
7. AUBAY
8. AUFEMININ.COM
9. AUREA
10. AUSY
11. AVANQUEST SOFTWARE
12. BIOALLIANCE PHARMA
13. BRICODEAL
14. CARRERE GROUP
15. DEVEAUX
16. ENTREPOSE CONTRACTING
17. GENERIX
18. GENESYS
19. HIGH CO
20. HOLOGRAM INDUSTRIES
21. IDI
22. ITESOFT
23. LEON DE BRUXELLES
24. LE TANNEUR
25. NATUREX
26. NEOVIA ELECTRONICS
27. NET2S
28. NEURONES
29. NICOX
30. PHONE SYSTEMS ET NETWORK
31. PONCIN YACHTS
32. PROSODIE

**4. 3 Alternext issuers (3%)**

1. ADOMOS
2. CEDIP
3. EXONHIT THERAPEUTICS

**4. 4 bond issuers (4%)**

1. HSBC France
2. CAISSE DE REFINANCEMENT DE L'HABITAT
3. CREDIT DU NORD (GROUPE)
4. IXIS CORPORATE & INVESTMENT BANK

French companies in the sample that are subject to SOX: Air France–KLM, Alcatel, AXA Compagnie Générale de Géophysique, France Telecom, Groupe Danone, Havas, Lafarge SA, Publicis Group SA, Rhodia, Sanofi – Aventis, SCOR, Suez, TECHNIP, Thomson, Total SA and Véolia Environnement.