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AMF

AMF 2007 Report on Corporate Governance and Internal Control

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Autorité des marchés financiers
17, place de la Bourse 75082 Paris cedex 02
Tél. : 01 53 45 60 00 – Fax : 01 53 45 61 00

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INTRODUCTION

This report has been prepared pursuant to Article L. 621-18-3 of the Monetary and Financial Code, stemming from the Financial Security Act of 1 August 2003[1]. Under this article, the Autorité des marchés financiers (AMF) is required to compile an Annual Report on Corporate Governance and Internal Control based on information published by legal persons making public offerings. Furthermore, following the passage of the Act of 30 December 2006 for the development of employee profit-sharing and shareholding, and various economic and social provisions, the AMF may "approve any recommendation that it deems helpful" in this matter.

The first section of the report deals with methodology and general statistical findings (1). The second and third sections deal with French laws and regulations (2) and international developments regarding internal control and corporate governance (3). The other sections focus on the AMF's findings in its analysis of companies' corporate governance reports (4) and internal control reports (5), along with the guidelines and rules laid down by the Board of Directors or the Supervisory Board for determining the compensation and sundry benefits granted to executives in 2006 (6).

1. METHODOLOGY AND GENERAL STATISTICAL FINDINGS

1.1. Methodology

1.1.1. Sample and sub-samples

The purpose of this report is to assess the relevance of the information about corporate governance and internal control published by issuers making public offerings and the information published by listed companies on rules and principles governing executives' pay and benefits. The report was compiled on the basis of documentary analysis.

The sample used covers 100 companies, of which 47 are traded on Eurolist A, 3 on Eurolist B, 40 on Eurolist C, 8 on Alternext[2] and 2 companies that issue only bonds. The sample includes 38 of the companies in the CAC 40 index as of 31 December 2006[3].

More than a third of the companies in the sample were not in the sample used for the AMF's 2006 report. Virtually all the new companies in the sample are traded on Eurolist C or on Alternext. Consequently, this year's sample contains a larger number of companies traded on Eurolist C (40 in 2007, compared to 29 in 2006) and on Alternext (8 in 2007, compared to 3 in 2006).

The AMF decided to increase the number of small cap and midcap issuers in its sample, for two reasons:

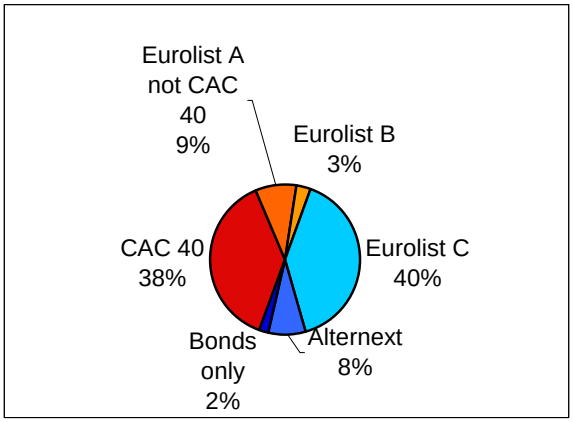
- to improve its knowledge of the contents of the reports produced by small caps and midcaps and to gain a better understanding of the difficulties they face, in light of the findings of the small cap-midcap working group set up in April 2007 (see 2.2.4);
- to strike a balance in the sample between companies with large market capitalisations and smaller companies so as to refine the statistics by dividing the sample into two sub-samples of equal size.

[1] Act 2003-706 of 1 August 2003, published in the *Journal Officiel* dated 2 August 2003: Article 117 (amending Articles L.225-37 and L.225-68 of the Commercial Code), Article 120 (amending Article 225-235 of the Commercial Code) and Article 122 (introducing Article L.621-18-3 in the Monetary and Financial Code) as amended by Act 2005-842 of 26 July 2005 and Act 2006-1770 of 30 December 2006.

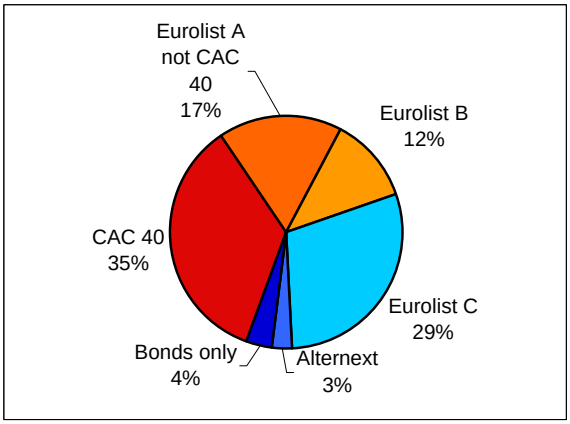
[2] NB: of the 8 companies traded on Alternext, 3 published a report with a certificate from the statutory auditors, 2 published a report without such a certificate and 3 companies published only partial information. A total of 5 companies explained that their legal form and the fact that they did not make any public offerings in 2006 meant that they were not required to produce a report under the provisions of the law.

[3] The two companies in the CAC 40 index as of 31 December 2006 that were not included in the sample were two foreign companies: ARCELOR-MITTAL and ST MICROELECTRONICS.

Composition of the 2007 sample

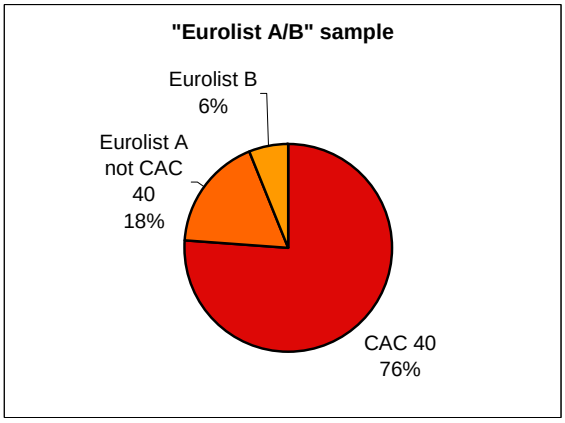


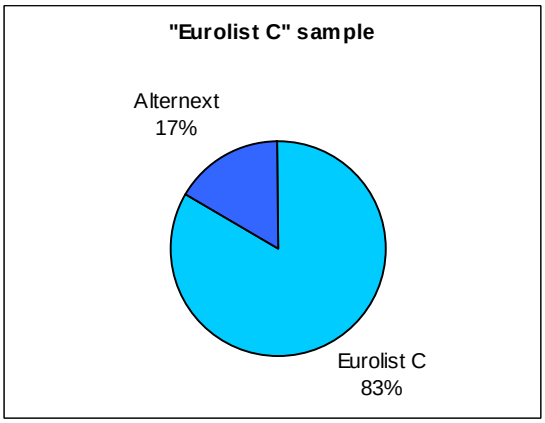
Composition of the 2006 sample



This year's report contains three sets of statistics:

- the first set relates to all the companies in the sample (see chart "Composition of the 2007 sample"),
- the second set encompasses 50 companies traded on Eurolist A or B (hereinafter, "Eurolist A/B" or "Eurolist A/B sub-sample",
- the third set encompasses 48 issuers on Eurolist C or Alternext (hereinafter, "Eurolist C" or "Eurolist C sub-sample").





The list of companies analysed can be found in the appendix.

1.1.2. Analytical procedure

A grid representing the main aspects covered in the industry recommendations on corporate governance and internal control was drawn up. It was then completed for the three previous years to serve as a basis for the statistical documentary analysis of the reports published by the companies in the sample. The section of the grid dealing with executives' pay has been substantially expanded.

1.1.3. Comparison of statistics with previous years and between sub-samples

Explicit mention will be made when the statistics are substantially different from those in the previous year's AMF report and, especially, from those in the 2005 report. On the other hand, for the sake of brevity, no mention of the previous year's statistic will be made if there is no change. Specific mention will also be made when an analysis of the "Eurolist A/B" or the "Eurolist C" samples gives substantially different results compared to those from the whole sample.

1.1.4. The AMF's recommendations

For the sake of clarity, the AMF will summarise the different recommendations that it made in its first three reports, if they are still applicable, so that companies do not have to refer to the three previous reports when preparing their 2007 reports in 2008. These recommendations will be supplemented by some new recommendations, which will be identified as such, as appropriate.

1.2. General statistical findings

1.2.1. Report format

The number of pages in the reports varies from five to more than thirty, not including references to other sections of the registration document. As a general rule, the section dealing with corporate governance is longer than the section on internal control.

The chairmen of banks and insurance companies, along with companies subject to the Sarbanes Oxley Act, prepared longer and, more importantly, more detailed reports. Banks and insurance companies have been subjected to strict regulations in this area for many years now and companies listed in the USA have had to make major efforts to present the steps that they have taken to enhance their internal control systems.

1.2.2. Including the reports in registration documents

Out of the 100 companies in the sample, 92 have published a registration document[4]. Of the companies in the sample that produce registration documents, most present the chairman's report in the body of the registration document, usually as part of the chapter on corporate governance. More rarely, the chairman's report is presented at the end of the document or as an appendix.

1.2.3. References to other chapters of the registration document

There are many explicit references to other chapters in the registration document.
When dealing with the corporate governance, the chairman's report usually refers readers to the chapter on "Board Membership and Practices". More specifically, when readers are referred to the sections covering the requirements in Annex I of European Regulation 809/2004 implementing the Prospectus Directive[5], paragraph 14 (administrative, management and supervisory bodies, and senior management), paragraph 15 (remuneration and benefits) and paragraph 16 (board practices).
In the section dealing with internal control, readers are generally referred to the chapter on "Risk Factors".

The AMF stresses the need for clarity in the presentation of the report on corporate governance and internal control and recommends that, if the contents of the report are spread out in several sections of the registration document, the report should refer readers to such sections. Companies that publish their registration document in the form of an annual report should complete the cross-reference table with such references.

1.3. Compliance with publication rules

The AMF is responsible for ensuring that regulatory and statutory publications are produced by companies making public offerings. It periodically verifies the publication of the report on internal control procedures and corporate

[4] Of the 8 companies traded on Alternext, 5 included information on corporate governance and internal control in their listing document, 2 included such information in their listing prospectus and the remaining company published its report separately from any other document.
[5] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC.

governance. In this context, it may make public any information that it deems necessary to keep the market properly informed.

As of 30 September 2007, 547 companies representing 58.5% of the total of 935 companies surveyed[6], were not up to date with their publications on corporate governance and internal control, according to the mandatory filings with the AMF[7]. More specifically, filings from 22 (16%) of the companies traded on Eurolist A, 81 (40%) of the companies traded on Eurolist B and 176 (56%) of the companies traded on Eurolist C[8] were overdue.

In early November 2007, the AMF sent reminder letters to French companies traded on Eurolist or on Alternext following a public offering that had not filed their reports on corporate governance and internal control. As of 31 December 2007, 3% of the companies traded on Eurolist A, 8% of the companies traded on Eurolist B and 18% of the companies traded on Eurolist C still had not filed their reports.

In the first quarter of 2008, a new survey of delinquent filers will be carried out and a second letter will be sent stipulating that failure to file immediately will lead to inclusion on a list posted to the AMF's website.

This type of procedure was used successfully in 2006 to achieve a major reduction in the number of companies that had not met the publication requirements set out in Article 222-9 of the AMF General Regulation (see below) from more than 300 companies, before the first reminder sent out in October 2006, to only 15 companies ultimately included on the list published by the AMF in April 2007.

Following the transposition of the Transparency Directive into French law in January 2007, companies are required to file their reports on corporate governance and internal control with the AMF and to post the reports to their websites, along with the rest of the regulatory information defined in point 2 of Article 221-1 of the AMF General Regulation. They are also required to disseminate a news release announcing that the report is available.
As was the case last year, The AMF will draw up a list of the companies that have not met their obligations to publish reports on corporate governance and internal control and post the list to its website[9].

[6] These statistics do not include companies listed on the Marché libre and companies that made public offerings that were not followed by a listing.
[7] This does not necessarily mean that these companies have not produced a chairman's report on corporate governance and internal control.
[8] This concerns only those companies listed on Alternext through a public offering.
[9] Since 2003, this action has been taken against companies listed on regulated markets that fail to meet their obligations to publish their annual financial statements, interim financial statements or quarterly turnover in the *Bulletin des annonces légales obligatoires* (BALO) as required by law.

2. FRENCH LEGISLATION AND REGULATIONS

2.1. French legislation, regulations and recommendations applicable to 2006 reports

2.1.1. Legislation

Article L. 621-18-3 of the Monetary and Financial Code stipulates that legal persons making public offerings are required to disclose information relating to the matters mentioned in the last two paragraphs of Articles L. 225-37[10] and L. 225-68[11] of the Commercial Code, in accordance with the requirements set out in the AMF General Regulation. Article L. 621-18-3 of the Monetary and Financial Code further stipulates that the AMF shall compile an annual report based on this information and that it may approve any recommendations that it deems to be helpful.

In accordance with the second to last paragraph 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*) making public offerings must present a report to the annual general meeting of shareholders on "corporate governance and on the internal control procedures implemented by the company". This report, which must be appended to the management report, must also indicate "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 appended to the report mentioned in Article L. 225-100. Their report must contain their observations about the report mentioned in Articles L. 225-37 and L. 225-68 with respect to the internal control procedures relating to financial reporting.

On the more specific issue of executives' pay, Article L. 225-102-1 of the Commercial Code stipulates that the management report must list the names and individual amounts of compensation and benefits paid to each executive during the year by the company, the companies that it controls and the companies 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 pay and benefits, along with the criteria used to calculate them or the circumstances under which they were determined. The report must also provide details about any and all commitments that the company has made on behalf of its executives, which correspond to remuneration, compensation or benefits owed or likely to be owed as a result of taking up, leaving or changing functions or following such events. The information provided must explain how these commitments are calculated.

2.1.2. AMF regulations

Following transposition of the Transparency Directive, amendments were made to Title II of Book II of the AMF General Regulation and approved by the Minister for the Economy on 4 January 2007. The amendments mean that the report on corporate governance and internal control is now part of the regulatory disclosures governed by point d) of Article 221-1 of the AMF General Regulation.

Section I in Article 222-9 of the AMF General Regulation stipulates: "Public limited companies (*sociétés anonymes*) making a public offer of securities shall publicly disclose, in accordance with Article 221-312, the reports mentioned in the last point of Articles L. 225-37, L. 225-68 and L. 225-235 of the Commercial Code no later than the day of filing of the report with the clerk of the commercial court mentioned in Article L. 225-100 of the Commercial Code".

[10] Limited-liability companies with a board of directors.
[11] Limited-liability companies with a supervisory board.
[12] Article 221-3 stipulates that:
I. – the issuer shall ensure full and effective disclosure of the regulatory information defined in Article 221-1.
II. - The issuer shall post the regulatory information to its website as soon as it is disclosed. Such information shall be displayed for at least five years after the disclosure date.
If an issuer does not have any financial instruments traded on a regulated market, publication of the regulatory information on its website shall constitute full and effective disclosure for the purposes of I.

Other French and foreign legal persons making public offerings must disclose information about the matters mentioned in the last paragraph[13] of Articles L. 225-37 and L. 225-68 of the Commercial Code in accordance with the same requirements as those mentioned above, if they are required to file their financial statements with the commercial court registry or, if such filing is not required, immediately after the annual financial statements for the previous year are approved.

These reports and the information must be posted to the relevant company's website and displayed for at least 5 years.

Section II of Article 222-9 stipulates that, when an issuer compiles registration documents in accordance with Article 212-13, the registration documents shall include the reports and information mentioned in section I. In this case, the dissemination procedures defined in Section I shall not apply.

From now on, reports on corporate governance and internal control are no longer disseminated via the AMF website; they are simply filed with the AMF.

2.1.3. AMF recommendations for compiling registration documents

On 27 January 2006, the AMF published a "*Guide for Compiling Registration Documents: Regulations In Force and AMF Interpretations and 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 practices, the board's rules of procedure, the assessment of the board and the work and practices 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 USA are encouraged to explain any measures that they have taken to comply with the new US rules and recommendations on corporate governance in the Sarbanes-Oxley Act, specifying the policies that they apply, especially when these rules are not exactly the same as those applied in France.

Interpretation 4 deals with executives' pay. This Interpretation points out that, with regard to compensation of executives and the stock options granted to them, headings 15 and 17.2 of Annex I of the European Regulation shall be completed on the basis of the information required by Article L. 225-102-1 of the Commercial Code and, more specifically, by the clarification set out in the Breton Act of 26 July 2005 and mentioned above:

- distinction between the fixed, variable and exceptional components of executives' pay and benefits;
- criteria used to calculate them or the circumstances under which they were determined;
- any and all commitments that the company has made on behalf of its executives, which correspond to remuneration, compensation or benefits owed or likely to be owed as a result of taking up, leaving or changing functions or following such events. The information provided must explain how these commitments are calculated.

2.1.4. Professional Standard NEP-9505 applying to statutory auditors

Professional standard NEP-9505 on "internal control procedures for financial reporting – statutory auditors' report on the chairman's report" was approved by a decree of the Minister Justice dated 5 March 2007 and published in the *Journal Officiel* dated 6 April 2007. It replaces the professional practice with regard to "internal control procedures" identified by the Superior Council of Statutory Auditors as a best practice[14].

[13] Article 222-9 of the AMF General Regulation will have to be amended to include a reference to the two last paragraphs of Articles L. 225-37 and L. 225-68 of the Commercial Code.

[14] Approval followed the favourable opinions handed down by the AMF board and the Superior Council of Statutory Auditors on 20 February 2007.

This standard defines the principles for drafting the statutory auditors' report on the chairman's report mentioned in Articles L. 225-37 and L. 225-68 of the Commercial Code.

2.1.5. Recommendations of industry associations

AFEP and MEDEF published a set of recommendations on the pay of listed companies' executives. This document incorporates, supplements and explains the recommendations set out in the AFEP/MEDEF corporate governance code and the recommendations of the MEDEF ethics committee. The document is intended for listed companies' boards of directors and supervisory boards, and for their compensation committees.

The recommendations deal with five main topics:

- Principles for setting compensation and the board's role,
- Executives' pay policy, stock options and bonus shares,
- Compensation committee
- Factors to be considered by the compensation committee (under four subheadings: fixed pay, variable pay, stock options and bonus shares)
- Information for shareholders

The French Asset Management Association (AFG) presented an update of its recommendations on corporate governance on 28 February 2007. This update, the fourth since 1998, saw major changes in the recommendations, including greater emphasis on the control and transparency of compensation arrangements. The recommendations are intended to guide managers in exercising their voting rights at general meetings. The AFG also has a monitoring programme that enables it to draw managers' attention to general meeting resolutions put forward by SBF 120 companies in breach of these recommendations.

2.2. Legislation, regulations and other measures aimed at supplementing the system applicable for 2007 reports

2.2.1. Application of the employee profit-sharing and shareholding development Act 2006-1170 of 30 December 2006

The last paragraphs of Articles L.225-37 and L.225-68 of the Commercial Code, introduced by the Act of 30 December 2006, stipulate that, "in companies traded on regulated markets[15], this report shall present the principles and rules set down, as the case may be, by the board of directors or the supervisory board to determine executives' pay and benefits of all types".

It should be remembered that some of the information about executives' pay can be found in the management report (paragraph 1 of Article L. 225-102-1 of the Commercial Code: compensation and benefits of all types provided to each executive during the financial year). Other information can be found in the chairman's report on internal control (last paragraphs of Articles L. 225-37 and L. 225-68 of the Commercial Code: principles and rules set down by the board of directors or the supervisory board to determine executives' pay and benefits of all types).

[15] The rest of the Article applies to companies making public offerings.

2.2.2. Application of the work, employment and purchasing power Act 2007-1223 of 21 August 2007

Article 17 of Act 2007-1223 of 21 August 2007[16] to promote work, employment and purchasing power (TEPA Act) institutes greater transparency and stricter limits on deferred compensation[17], i.e. so-called "golden parachutes", to the executives of companies traded on a regulated market.

To this end, Article 17[18] of the Act places new constraints on executives' pay with regard to the definition of performance requirements, transparency and oversight by the statutory auditor.

Definition of performance requirements (second paragraphs in Articles L. 225-42-1 and L. 225-90-1 of the Commercial Code). Components of compensation, pay and benefits that are not subordinated to the recipient's meeting performance requirements, to be assessed with regard to the performance of the company that the recipient directs[19], shall be prohibited.

Transparency (3rd, 4th and 5th paragraphs of Articles L. 225-42-1 and L. 225-90-1 of the Commercial Code). The procedures for granting such compensation is subjected to greater transparency:

- The authorisation granted for the compensation agreement by the board of directors or the supervisory board must be disclosed under procedures and time limits to be set by decree;

- The general meeting must approve the compensation agreement for each beneficiary individually, in a specific resolution and each time the agreement is renewed;

- The board of directors or the supervisory board is required to ensure that the performance requirements have been met before any payment is made, when or after the beneficiary leaves or changes functions, and its decision must be disclosed under procedures and time limits to be set by decree, otherwise the payment shall automatically be deemed invalid null and void;

- These constraints do not apply to remuneration due under the terms of a non-compete clause, supplemental pension benefits or commitments dependent on the characteristics of collective and mandatory retirement provision systems.

Oversight of the statutory auditors. The statutory auditors now certify "especially the accuracy and fairness" of the information about the pay and benefits of all types provided to each executive (new Article 823-10 of the Commercial Code).

These new provisions apply to the compensation commitments made since the Act was passed, as well as to commitments outstanding at that time, which must be brought into compliance within eighteen months. Failing that, such commitments may be cancelled, if "they have had harmful consequences for the company". Meanwhile, the statutory auditors must spell out in their special report the circumstances that explain why they have not been brought into compliance.

[16] This Act supplements Commercial Code Articles L. 225-42-1 (for joint-stock companies with a board of directors) and L. 225-90-1 (for joint-stock companies with a supervisory board).

[17] However, the Act does not make the following types of deferred compensation subject to the beneficiaries' performance:
- payments due under the terms of non-compete clauses;
- defined-benefit pension commitments under the systems mentioned in Article L. 137-11 of the Social Security Code, meaning supplementary executive retirement packages, as well as commitments dependent on the characteristics of collective and mandatory retirement provision systems mentioned in Article L.242-1 of the same Code.

[18] This Act supplements Commercial Code Articles L. 225-42-1 (for joint-stock companies with a board of directors) and L. 225-90-1 (for joint-stock companies with a supervisory board).

[19] The persons covered by the Act are those who chair the board of directors or perform senior management functions, or delegated senior management functions, or sit on the executive board.

2.2.3. Reference framework for the internal control systems of listed companies

In January 2005, the AMF published its first report on listed companies' corporate governance and internal control procedures. 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 framework makes it more difficult 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[20], co-chaired by Jean Cédelle and Guillaume Gasztowtt, with compiling an internal control framework for the use of companies subject to the statutory requirements. The market advisory group took a pragmatic approach, striving to reconcile best practices observed abroad and other frameworks, such as the COSO framework in the USA and the UK's Turnbull Guidance[21], French regulations, recommendations made in the reports on corporate governance, and changes resulting from the 4th, 7th, and 8th European Directives.

The market advisory group first drafted a reference framework covering the general principles applying to all internal control processes in a company, with appendices containing a questionnaire about internal control over 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 focused on internal control over 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 the special report by the statutory auditors. This is why the reference framework was supplemented by an "*Application Guide for Internal Control Related to Accounting and Financial Information Published by Listed Companies*".

The market advisory group wanted this guide to be used by companies making public offerings for conducting a comparative analysis of their internal control procedures for accounting and financial reporting.

The application guide is based on principles and key analytical points. Its approach is deliberately applicable to all types of company organisation and focuses on the elements involved in financial reporting.

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 how internal control is organised. The system established by the market advisory group can be adapted to suit companies' operating processes, making it more than just a simple exercise in compliance.

2.2.4. An AMF recommendation for the 2007 financial year amended following the work of the small cap and midcap working group

The reference framework and the application guide constitute a suitable tool for analysing and designing listed companies' internal control systems to enhance best practices in this area. Consequently, in January 2007, the AMF recommended that all companies making public offerings in France should use the reference framework and the application guide for their chairman's reports on internal control procedures for financial years starting on or after 1 January 2007.

[20] The participants in the group were: associations representing companies (AFEP, AMRAE, ANSA, IFA, IFACI, MEDEF, Middlenext), accounting institutes (CNCC, CSOEC), qualified expert members and associate non-voting members (AMF, CCAMIP, CB, FBF, Trésor).

[21] Guide drafted by the Institute of Chartered Accountants in England and Wales (ICAEW) and published in 1999.

The reference framework and the application guide are not intended to constitute binding rules for companies to follow, particularly companies that are required to apply another benchmark under other regulations; nor are they intended to take the place of specific regulations in force in certain business sectors, such as banking and insurance.

Therefore, companies are encouraged to explain in the chairman's report whether they have followed the reference framework and the application guide when preparing the report. When companies apply only part of the reference framework or the 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 and earnings.

The same transparency principles apply to the use of any other framework that the 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. Following the findings of the working group on small caps and midcaps, this recommendation is restricted to companies listed on Eurolist A in Paris, meaning companies traded on a regulated market and having a market capitalisation in excess of EUR 1 billion[22].

The AMF and MiddleNext set up a working group chaired by Yves Mansion, a member of the AMF board and CEO of Société Foncière Lyonnaise[23], to propose changes to financial disclosure requirements for small caps and midcaps, so as to implement the commitments that the AMF made following public consultations on the Better Regulation approach.

Among other objectives, the working group aimed to propose some immediate simplifications for the disclosure requirements incumbent upon midcaps that would not require amendments to regulations.

As it stands, the reference framework (hereinafter, "general reference framework") can be tailored to the specific organisational structure of the company. But the working group wanted to build on the work of the previous market advisory group to provide additional implementation guidance for small caps and midcaps, deeming that the general reference framework was still too burdensome for such companies.

More specifically, the general reference framework contains general internal control principles and a detailed application guide covering the various control processes. Following the work of the working group on small caps and midcaps, the AMF would like to propose using a simpler version of the general internal control principles and taking only the questionnaires from the application guide, meaning the first annex on internal control over accounting and financial reporting and the second annex on risk analysis and management.

Consequently, as would have been the case under the January 2007 recommendation, small caps and midcaps are encouraged to explain in the chairman's report whether they have followed the application guide for the reference framework when preparing the report. Yet, they are not asked to answer the questionnaires contained in the guide in their chairman's report. When preparing their report, the companies concerned should highlight events and information that is likely to have a material impact on their assets and earnings.

If the company does not follow the guide when preparing the chairman's report, the same transparency principles apply to the use of any other framework chosen or required at the international level, which should be clearly presented.

[22] AMF Position dated 9 January 2008 on the report by the working group on changes to financial regulations for small caps and midcaps chaired by Yves Mansion.

[23] In addition to the representatives of MiddleNext and the AMF, the working group members were companies traded on Eurolist B and Eurolist C in Paris and on Alternext, associations representing issuers (Medef, Croissance Plus), representatives of Euronext, IFA, statutory auditors, lawyers and intermediaries that work with small caps on a regular basis.

Following public consultations on the work of the working group on small caps and midcaps, the AMF decided, in a Position published on 9 January 2008, to adapt its January 2007 recommendation so that companies making public offerings, other than those traded on Eurolist A in Paris, may prepare their reports on internal control following the simplified application guide for the internal control reference framework. Consequently, the AMF recommends that this guide should be used for financial years starting on or after 1 January 2007, particularly by companies listed and Eurolist B or Eurolist C in Paris, but without intending to make its use mandatory.

2.2.5. Work by industry associations

The French Directors' Institute (IFA) published a précis of current best governance practices in May 2007. The five chapters of the summary covered the board's tasks, the board's operating procedures, the board's specialised committees, managers' and executives' pay, and the board's role in investor relations. A special working group analysed all the recent recommendations (AFEP-MEDEF, AFG, AMF, IFA, Institut Montaigne, Observatoire de la qualité comptable, OECD) to come up with a coherent, up-to-date and practical summary for directors.

2.3. Future changes to legislation that will not apply to the 2007 financial year

Two new European Directives are to be transposed into French law in 2008. One calls for listed companies to have audit committees and sets out the minimum attributes of such committees, but it leaves the Member States some options in this area (Directive 2006/43/EC)[24], while the other calls for an annual statement on internal control and corporate governance (Directive 2006/46/EC)[25].

A bill that incorporates various adaptations to bring French company law into line with European law was tabled in France's National Assembly on 14 November 2007. One of the goals[26] of the bill is to transpose Directive 2006/46/EC of the European Parliament and Council of 14 June 2006 amending the fourth and seventh accounting Directives into French law. This Directive enhances the transparency requirements for commercial companies with regard to corporate governance and internal control.

Title IV of the bill amends the Commercial Code to establish the principle that, in addition to presenting the board membership and organisation, and the preparations for board meetings, the chairman's report must indicate which corporate governance code the company has chosen to follow, or, failing that, the corporate governance practices implemented by the company in addition to the statutory requirements, along with any special procedures regarding shareholders' participation in general meetings. The bill also establishes the principle of having the board approve the chairman's report in order to engage the board's responsibility. Finally, in compliance with the Directive, the bill requires the statutory auditors to certify the information provided. These amendments concern companies with boards of directors (Article L.225-37) and companies with a supervisory board (Article L.225-68).

To date, the AMF has no information about the transposition of Directive 2006/43/EC. [25]

The AMF backs the recommendation of the small cap and midcap working group that the special characteristics of small caps and midcaps should be taken into account and that their compliance burden should not be increased. Consequently, when the Directive of 17 May 2006 is transposed into French law, small caps and midcaps would like to be exempted from the audit committee requirement. The working group also recommends that the board of directors' statement on internal control called for in the Directive of 14 June 2006 should be provided in place of, rather than in addition to, the report required under French law.

[24] Directive 2006/43/EC of 17 May 2006 on statutory audit of annual accounts and consolidated accounts, with the deadline for transposition set at 29 June 2008 (8th Directive).
[25] Directive 2006/46/CE of 14 June 2006 amending Directives 78/660/EEC and 83/349/EEC (4th and 7th Directives) on the annual and consolidated accounts of certain types of companies, with the deadline for transposition set at 5 September 2008.
[26] The primary purpose of the bill is to transpose Directive 2005/56/EC of 26 October 2005 on cross-border mergers of limited liability companies (Title I).

3. INTERNATIONAL DEVELOPMENTS

3.1. European Commission Reports

In July 2007, the European Commission published two reports on the Member States' application of the Commission Recommendations on directors' remuneration and on non-executive directors. Both reports find that application of corporate governance standards has improved, but they also focus on some remaining shortcomings.

Report on directors' remuneration[27]
In its 2004 Recommendation on directors' remuneration (IP/04/1183), the Commission called for high standards regarding investor information and recommended greater involvement of shareholders in pay decisions. The report on directors' remuneration shows that the transparency standards are applied on the whole, but some Member States still do not recommend putting the matter to a vote by shareholders.

Report on non-executive directors[28]
In 2004, the Commission also issued its Recommendation on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (IP/04/1182), which was aimed at giving shareholders greater control over the decision-making bodies and increasing the presence of independent members at board meetings and on board committees. The report on the role of non-executive directors finds that real progress has been achieved in improving governance standards in this area, but it points out that some of the recommended standards are not applied in all Member States. For example, the report highlights that fact that some Member States do not recommend an adequate number of independent directors to sit on compensation committees and audit committees.

3.2. Application of the Sarbanes-Oxley Act in the USA

Foreign companies listed in the USA with a float of more than USD 75 million are subject to the requirements of Section 404 of the Sarbanes-Oxley Act for financial years ending on or after 15 July 2006[29]. This section of the Act requires the chairman, the CEO and the CFO to make an annual assessment of the effectiveness of internal control over financial reporting. Virtually all the French companies listed in the USA are now covered by Section 404.

On 23 May 2007, the SEC approved new interpretive guidance aimed at improving compliance with Section 404. Rather than being given a long list of control requirements, managers are encouraged to examine the potential risks as they perceive them. Following this relaxation of requirements, the SEC decided that it was no longer necessary to grant extra time to companies with a float of less than USD 75 million and such companies shall be required to apply Section 404 for financial years starting on or after 1 January 2007.

The Public Company Accounting Oversight Board (PCAOB) adopted a new internal control audit standard that emphasises the importance of auditing higher risk areas, such as the financial statement close process and controls designed to prevent fraud by management, rather than a more thoroughgoing control of all transactions. More specifically, auditors are encouraged to "tailor their approach to the circumstances of individual companies". On 24 October 2007, the PCAOB also launched two months of public consultations on the planned recommendation on auditing internal control over financial reporting for smaller public companies.

[27] Link: http://ec.europa.eu/internal_market/company/directors-remun/index_fr.htm.
[28] Link: http://ec.europa.eu/internal_market/company/independence/index_fr.htm.
[29] In a press released dated 15 December 2006, the SEC extended the date by which companies, and foreign issuers in particular, must comply with the requirements of Section 404, and introduced a lag between compliance with the requirements for managers and compliance with the requirements for auditors. This means that the application of the managers' assessment of the effectiveness of control over financial reporting shall be extended to financial years ending on or after 15 December 2007 for issuers deemed to be "non-accelerated filers" (float of less than USD 75 million).
The statutory auditors attestation on internal control over financial reporting is still required for financial years ending on or after 15 July 2006 in the case of "large accelerated filers". It has been extended to financial years ending on or after 15 July 2007 for "accelerated filers", to financial years ending on or after 15 December 2008 for "non-accelerated filers".

4. CORPORATE GOVERNANCE

4.1. Preparation and organisation of the work of the board of directors or the supervisory board

4.1.1. Board organisation and practices

Board membership

Ninety-six percent of the companies in the sample are limited-liability companies (*sociétés anonymes*) [30] and 4% are limited partnerships with share capital (*sociétés en commandite par actions*). Seventy-five percent of the companies in the sample have a board of directors and 25% have a supervisory board and an executive board or a management board, as the case may be. This compares with the proportions of 69% and 31% in 2006. Nearly a quarter of the companies with a board of directors have separated the functions of the chairman of the board and the chief executive officer.

All the companies in the sample provide a detailed description of their board members and indicate the number of members, which averages 9.7. In the "Eurolist A/B" and "Eurolist C" sub-samples, the average numbers of directors are 12.9 and 5.9 respectively.

The term of office for board members is stipulated in 83% of the cases. The average term lasts 4.6 years[31]. Average directors' terms are longer in the "Eurolist C" sub-sample, at approximately 5.3 years, as opposed to 4.2 years for the "Eurolist A/B" sub-sample.

Twenty-three percent of the companies in the sample, including 83% from the "Eurolist A/B" sub-sample, specify the nationality[32] of their directors and in such companies, the average number of foreign directors is 3.4.

The directors' ages are given in 66% of the cases, with 90% of the companies in the "Eurolist A/B" sub-sample and 40% of the companies in the "Eurolist C" sub-sample disclosing this information.

Nearly half the companies provide information about directors' educational background[33], as opposed to 19% in 2005.

Presence of independent board members (hereinafter, "independent directors")

Eighty-five percent of the companies (as opposed to 76% in 20005) report that their board includes one or more independent directors, with an average ratio of independent directors to total directors[34] of 44%. One company in the "Eurolist A/B" sub-sample and 10 companies in the "Eurolist C" sub-sample expressly report that they have no independent directors.

The notion of an independent director is defined in 82% of the reports of companies with one or more directors described as independent. This represents an increase compared to 2006, when the figure was nearly two-thirds. In 83% of the cases, the AFEP/MEDEF[35] definition is used. Some companies adhere strictly to the criteria set out in the AFEP/MEDEF report, but others have a more specific interpretation of the company's situation and explain that the decision to describe a director as independent is ultimately up to the board of directors.

More specifically, 92% of the companies in the "Eurolist A/B" sub-sample report that their board of directors includes one or more independent directors and the average ratio of independent directors to total directors is about 54%. The

[30] Two companies have their registered office outside of France and have a board of directors as defined by Belgian law in one case and by Dutch law in the other case.
[31] The directors' terms in the companies in the sample last between 3 and 6 years.
[32] This includes only directors whose nationality is expressly mentioned and those who are described as foreign.
[33] This statistic refers only to the education of the board members; it does not refer to their working experience.
[34] This statistic is based on what companies state in their reports. Companies that expressly mention the fact that they have no independent directors are counted, but not companies that do not say whether they have independent directors or not.
[35] Corporate governance principles derived from the AFEP and MEDEF reports published in 1995 ("Vienot I Report"), 1999 ("Vienot II Report") and 2002 ("Bouton Report")

figures for companies in the "Eurolist C" sub-sample are 76% and 32% respectively. Of the companies in the "Eurolist A/B" sub-sample reporting that they have one or more independent directors, 91% provide a definition of the notion, which corresponds either fully or partially to the AFEP/MEDEF definition in 88% of the cases.

Family-owned companies and companies where a handful of shareholders, or even a single shareholder, hold a majority are encouraged to apply the "at least a third" rule set out in the 2003 AFEP/MEDEF report, whereas the proportion of independent directors in widely held companies should be 50% or more, according to the report. This means that there are major differences in the way this ratio is calculated, depending on the company's size and how widely held its shares are. For example, looking only at the companies in the "Eurolist A/B" sub-sample (CAC 40 companies and companies traded on Eurolist A and B), widely held companies show an average ratio of 60%, compared to approximately one-third for other companies. Furthermore, a number of companies have deemed that they are too small to have any independent directors. Such companies are usually traded on Eurolist C and classified as family-owned.

Some companies do not specify which directors are deemed to be independent, which means it is not always easy to determine how independent the chairs and members of the specialised committees are.

The percentage of companies reporting that one or more independent directors on their board stood at 85% this year, marking an increase of nearly 20% in two years.
The AMF reiterates that companies should indicate whether their board includes one or more independent directors. The representation of independent directors on the board's specialised committees cannot be determined, unless these directors are identified. Furthermore, companies should explain what criteria were used to qualify directors as independent. More specifically, when they refer to a market-wide standard, companies must explain any material deviations from such standards and the reasons for the deviations.

Multiple directorships

Ninety-seven percent[36] of the companies in the sample provided information on the number and type of other directorships held by board members. This figure has increased steadily from 80% in 2005 and nearly 90% in 2006. In the vast majority of the cases, this disclosure is made in the main body of the registration document—usually in the chapter on corporate governance—and not in the report itself.

Detailed explanations are usually given about other directorships held, but they are still very patchy. More than one third of the companies in the sample distinguish between French and foreign directorships. And nearly half the companies in the sample specify whether the companies concerned belong to the same group. There is usually a specific indication of whether the companies concerned are listed or not. More specifically, 38% of the companies in the "Eurolist A/B" sub-sample expressly mention whether their directors' other directorships are in the same group or not, and 54% specify the national origin of the companies concerned.

The AMF repeats its recommendation that companies specify the details of their directors' other directorships (other companies in the group, foreign companies, unlisted companies)

The board's role

Two-thirds of the companies in the sample define the board's tasks. The figure is 76% for companies in the "Eurolist A/B" sub-sample and 56% for companies in the "Eurolist C" sub-sample.

The main tasks mentioned in the chairman's reports studied are similar to the one mentioned in the previous financial year. They include examining financial statements, approving the annual budget, discussing strategic choices, appointing executives and, where appropriate, examining committee reports.

[36] When companies do not specify which other directorships their directors hold, it was sometimes impossible to distinguish directors who hold no other directorships from those who do, but about whom the company fails to provide any explanation.

Board meetings

Ninety-five percent of the reports studied report the number of board meetings held. The average number of board meetings for the companies in the sample is 7.2 per year.

Seventy-seven percent of the companies in the sample report the directors' attendance at board meetings, with the average attendance rate standing at 86%. Ninety percent of the companies in the "Eurolist A/B" sub-sample report the attendance rate[37], as opposed to only 63% of the companies in the "Eurolist C" sub-sample. A few companies even give the attendance rates of the individual directors.

Eighty-one percent of the reports give information about the materials provided to directors prior to board meetings. Such information was provided by 94% of the companies in the "Eurolist A/B" sub-sample. When companies do disclose this type of information, it is usually general explanations about providing the meeting agenda or technical reports. When a timeframe is specified, it is usually one week or, more rarely, two weeks prior to the meeting.

Information about the topics discussed at board meetings is given in 70% of the reports studied. Such information is provided by nearly 80% of the companies in the "Eurolist A/B" sub-sample. Some companies mention the topics on the agenda, or even provide a meeting-by-meeting breakdown of topics, in order to distinguish the board's tasks.

In half the cases, the report contains an account of the board's activity, reporting on the major decisions made at each meeting. The following decisions are reported in varying detail, depending on the company: capital increases, authorisations for acquisitions, approval of the 2007/2008 budget or approval of cooperation agreements.

Some companies mention that the statutory accountants are called on to attend some or even all the board meetings, particularly when the financial statements are examined. The workers' committee or the employee representatives appointed by this committee, the chief financial and administrative officer, the finance department or a lawyer are other persons who may attend the board meetings whenever their presence is deemed necessary.

Companies are encouraged to list the topics discussed at board meetings, as well as providing an activity report. The AMF also recommends that the handful of companies that still do not disclose the directors' attendance rates at board meetings should do so.

Rules of procedure

The existence of rules of procedure[38] for board meetings is reported in 68% of the cases. This figure has risen steadily from approximately 50% of the companies in the sample in the 2004 AMF report, to 56% in 2005 and to 65% in 2006. Eighty-two percent of the companies that mention the board's rules of procedure disclose information about the content of the rules. Thirty-five companies list the topics covered by the rules of procedure, either in the form of a summary or, more rarely, by quoting long passages. Eleven companies, which are nearly all in the "Eurolist A/B" sub-sample, publish the rules of procedure in full, either in the report itself or in an annex to their registration document. A further 13 companies explain that the rules of procedure can be consulted on their website or that a paper copy can be obtained from the registered office by any shareholder who submits a request. As a general rule, the explanation states that the rules of procedure describe how the board works, its powers, attributions and tasks, and those of the specialised committees of board members and, where appropriate, the principle of assessing the board's operations.

Seven percent of the companies in the sample reporting the existence of rules of procedure explain that the rules were instituted in 2006. About a quarter of the companies that already had rules of procedure report that these rules were amended in 2006, compared to only 13% in the previous year. There were reports of some amendments to rules

[37] Some of the companies traded on Eurolist A that did not give exact attendance figures did provide such explanations as, "absentism is very low" and "absent members always provided a proxy in order to be represented", "three board members were present at all four meetings" (out of 8 members), "one member attended three meetings, including two by telephone, "two members were present at three of these meetings", or else, "three meetings had full attendance. At the four other meetings, one member was absent and had given a proxy to another member of the supervisory board".

[38] Or a director's charter drafted to facilitate the board's work.

of procedure following a change in the specialised committees, changes in the company's articles of incorporation, revisions of the rules on directors' dealings, or a new definition of the criteria determining a director's independence in accordance with the regulations in force.

A detailed breakdown shows that 92% of the companies in the "Eurolist A/B" sub-sample report the existence of rules of procedure for board meetings, whereas only 44% of the companies in the "Eurolist C" sample mention such rules. Of such companies, 59% of those in the "Eurolist A/B" sub-sample list the topics covered by the rules of procedure, either by summarising them or, more rarely, by quoting extensive passages, while only 38% of the companies in the "Eurolist C" sub-sample do so.

More than two-thirds of the companies in the sample now disclose the existence of rules of procedure for the board meetings. The AMF recommends that companies should choose one of the three following solutions for disclosing their rules of procedure: printing them in an annex to their registration document or annual report, summarising the main points, or posting the rules to their website and giving the 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 and 2006 reports – state that they have one or more of the specialised committees called for under the AFEP/MEDEF corporate governance principles, such as audit committees[39], compensation committees and appointments committees. Seventy-three percent of the companies mention the interactions between the board and the specialised committees that it has set up. In the vast majority of cases, the committees' role is to make proposals to the board on the matters falling within their respective areas of competence.

More than 70% of the companies in the sample have set up an audit committee and more than two-thirds have a compensation committee. The fact that the proportions are the same does not necessarily mean that both systematically coexist within the same company. A small number of companies have a compensation committee, but no audit committee, and vice versa.

Nearly all the companies in the "Eurolist A/B" sample have set up both committees: 98% have an audit committee and 94% have a compensation committee. On the other hand, fewer than half the companies in the "Eurolist C" sub-sample have such committees: 44% have an audit committee and 40% have a compensation committee. The companies that do not have such committees make two types of disclosures. They either explain that they intend to set them up in the near future ("to date, the company does not have an audit committee or a compensation committee, but it intends to set up such committees by the end of the financial year"), or else they explain that the board has not deemed it appropriate to set up such specialised committees because of the company's size.

Some companies state that the Chairman of the board has the right to attend some of the committee meetings[40].

Companies should continue their efforts of the last three years to describe the board's tasks and give an account of work of the committees set up by the board. Furthermore, the interactions between these committees and the company's board should always be explained.

Audit committee

More than 70% of the companies have set up an audit committee, which is the same proportion as last year, despite the higher number of small caps in the sample. The names of the directors sitting on the committees are given in 96%

[39] Sometimes called an accounts committee.
[40] The phrases used include: "the Chairman is entitled to attend the audit committee meetings", "the Chairman should attend the committee meetings, but without the right to vote", "the Chairman and chief executive officer attends the meetings of the compensation and appointments committee, but refrains from taking part in any discussion about himself".

of the cases[41]. The average number of directors sitting on the audit committee is 3.4 (3.7 for the "Eurolist A/B" sub-sample and 2.7 for the "Eurolist C" sub-sample). In the case of companies that identify their independent directors, 74% of the directors on the committee are independent and widely held companies tend to have a higher proportion. When such information is provided, it turns out that, in 83% of the cases, the chair of the audit committee is an independent director.

Committee practices are explained in 71% of the reports, as opposed to fewer than half the reports in 2006 (82% for the "Eurolist A/B" sub-sample and 43% for the "Eurolist C" sub-sample). The reports often contain passages from the board's rules of procedure or refer readers to these rules, which are not always presented in full. Ninety-one percent of the companies in the sample with an audit committee disclose the number of meetings held during the financial year and 71% disclose the attendance rate.

The audit committee's tasks are described in 94% of the chairman's reports. These tasks include: analysing financial statements, overseeing the quality and the comprehensiveness of the financial information provided to shareholders, examining risks and off-balance sheet liabilities and validating internal audit plans.

In nearly half the cases, it is reported that the audit committee was involved in drafting the chairman's report. More specifically, a large number of companies explain that audit committee examines the work of the internal audit department, or even the chairman's report per se. In addition, relations with the statutory auditors, including meetings with them, examination of their work and, to a lesser extent, supervision of their appointment and remuneration are often cited as some of the audit committee's tasks.

Three companies set up their audit committees in 2006. All three are in the "Eurolist C" sub-sample.

Some companies that are subject to the Sarbanes-Oxley Act (either because they are listed in the USA or because they are subsidiaries of US-listed companies) explain that they have taken the necessary steps to ensure that all the audit committee members are independent, in keeping with the principles laid down by the SEC.

Compensation committee

More than two-thirds of the companies in the sample have a compensation committee. This figure stands at 94% in the "Eurolist A/B" sub-sample and only 40% in the "Eurolist C" sub-sample. Details of the membership of the committee are given in 90% of the cases. The average number of directors sitting on the committee is 3.1. An average of 68% of the directors sitting on each committee are independent. This is an increase from the figure of 56% in the previous year's report. At least half the members of nearly three-quarters of these committees are independent directors. In companies where such information is available, the chairman of the compensation committee is not the chairman of the board and, in 80% of the companies, the chairman of the compensation committee is described as an independent director.

The tasks of the committee are described in detail in 94% of the chairman's reports. These tasks primarily involve coming up with recommendations on executives' pay, examining the system for distributing directors' fees the choice of new directors, when the committee also has the task of giving its opinion on nominations. An account of the committee's activity is given, with details of the different meetings and the relevant agendas, in about three-quarters of the cases, as opposed to fewer than two-thirds of the companies in 2005. More specifically, this information is disclosed by nearly 90% of the companies in the "Eurolist A/B" sub-sample and by 44% of the companies in the "Eurolist C" sub-sample.

In 54% of the cases, the compensation committee is combined with the appointments committee.

Five companies report that they set up such a committee in 2006. Four of the companies were in the "Eurolist A/B" sub-sample.

[41] This information is not usually included in the chairman's report, but in the chapter on "board membership and practices".

Appointments committee

Twenty-four percent of the companies in the sample have set up an appointments committee that is separate from the compensation committee, as opposed to 13% last year. Of these companies, 94% are in the "Eurolist A/B" sub-sample. All the companies disclose details about the committee members. The average number of directors sitting on the committee is 3.4. Each committee has an average proportion of 61% of independent directors and, in 63% of the cases, the Chairman of the committee is an independent director.

The tasks of the appointments committee are presented, in brief at least, in every case. These tasks usually include examining, or even short-listing, applicants, for executive positions and possibly assessing the independence of directors or even evaluating the board's practices. An account of the committee's activity is provided in 87% of the cases (compared to 76% last year) and, more specifically, in 92% of the cases for companies in the "Eurolist A/B" sub-sample and 50% for companies in the "Eurolist C" sub-sample.

Three companies report that they set up their committee in 2006, including two companies in the "Eurolist A/B" sub-sample.

Other committees

Some 40% of the companies in the sample mention the existence of one or more other committees. Three-quarters of these companies are in the "Eurolist A/B" sub-sample. Nearly a third of the companies have set up a strategy committee. The tasks of this committee consist primarily in giving an opinion to the board on the company's or the group's overall long-term strategy, as well as monitoring the completion or progress of major operations in some cases.

One of the companies in the "Eurolist A/B" sub-sample set up an internal control and risk committee. The tasks of this committee are to analyse the reports on corporate governance and internal control, and reports on risk measurement and surveillance, along with the activity reports of the audit department and their main findings. The committee also examines the group's overall policies on risk, based on measuring the risks and earnings associated with operations that are disclosed to it in accordance with the regulations in force, along with any specific questions relating to these topics and methods. Another company reports that it set up a risk committee to identify the main risks incurred by the group and to ensure that a system for monitoring and managing these risks has been set up.

Some companies also report setting up ethics committees, environmental committees and sustainable development committees. The specific business of some companies in the "Eurolist A/B" sub-sample led them to set up such bodies as a committee for monitoring nuclear liabilities, a technology committee or a contract committee.

4.1.3. Assessment of the board's work

Even though there is nothing in the laws or regulations that require them to do so, more than half the companies report that they assessed the board's collective work in 2006. But there is a great disparity in this statistic between the two sub-samples. The figure is 86% for companies in the "Eurolist A/B" sub-sample and only 18% for companies in the "Eurolist C" sub-sample.

Of the companies that assessed their board in 2006, 82% report that the assessment was conducted internally, using self-assessment questionnaires that were given to the directors. The handful of companies that organised external assessments report that in most cases it involved an in-depth assessment conducted with the help of an outside expert or firm every three years. The same companies reported conducting parallel internal assessments every year.

When such details are provided, it seems that the assessments focus primarily on the membership of the board, the frequency and length of its meetings, the topics dealt with, the quality of the debates, the work of the board committees, directors' information, directors' pay and their access to group managers. The findings of the assessment are usually discussed by the board. The frequency of the assessment is specified in 72% of the cases and it is nearly always once a year.

More than half the companies that assessed their board in financial year 2006 referred to the examination of the assessment findings by the board. Of these companies, nearly half disclosed the results of their assessment in general terms, with a statement to the effect that the board's work was "deemed satisfactory" or "obtained a high rate of satisfaction". Nearly 60% of the companies that carried out an assessment found that the work of their board was satisfactory, but pointed out some areas for improvement. More than 90% of such companies are in the "Eurolist A/B" sub-sample. Some companies conduct ongoing assessments, describing the measures taken to improve the board's work during the year.

The AMF found that the number of companies reporting that they had conducted an assessment of their board's work has increased. More than half of them conducted such assessments in 2006. It also found that some of the companies in the sample made an effort to disclose more about the assessment findings and identified the main areas for improvement.

The AMF repeated its recommendation that companies that have yet to conduct an assessment of their board's work should do so and should disclose the details of the assessment process, the follow-up to the assessment and, more specifically, any areas for improvement that the company is considering following the assessment.

4.2. Restrictions that the board of directors places on the chief executive officer's powers[42]

More than 90% of the companies with a board of directors, which make up 75% of the sample, report restrictions or specifically mention that there are no restrictions that the board has placed on the chief executive officer's powers. This is contrast to 71% of the companies in 2005. The most commonly used phrases are: "there are no specific restrictions on the chairman's powers" or "the articles of incorporation contain no restrictions on the chief executive officer's powers, other than those imposed by law".

Thirty companies report restrictions. They include 23 companies in the "Eurolist A/B" sub-sample, as opposed to only 7 in the "Eurolist C" sub-sample. The restrictions placed on the chief executive officer's powers may be expressed using a recurrent phrase stating 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 and the articles of incorporation" and sometimes "the rules of procedure". On the contrary, other companies report that the chief executive officer needs to obtain the prior consent of the board of directors for any transaction or investment in excess of a set amount, or even give the list of the transactions requiring such prior consent. Some companies report that only the board of directors shall have the power to make any investments in excess of a set amount.

The AMF finds that a growing number of companies make specific disclosures about the existence or lack of any restrictions placed on the chief executive officer by the board of directors. More than 90% of the companies now make such disclosures, compared to slightly more than 70% two years ago.
The AMF repeats its recommendation that the reports should systematically explain all the restrictions resulting from internal practices and or rules. For this purpose, a distinction should be made between matters that require the board's prior consent and those that require ongoing specific reporting to the board, as appropriate. If the restrictions have been set out officially, readers could be referred to the rules of procedure, if they have been published. If no restrictions have been placed on the chief executive officer's powers, the company should mention the fact.

[42] In companies where the chairman of the board is also the chief executive officer, the reports tend to use the heading, "*Restrictions that the board of directors places on the chairman's powers*."

5. INTERNAL CONTROL PROCEDURES

5.1. Description of internal control procedures

5.1.1. Internal control definition and objectives

More than 90% of the companies in the sample define the notion of internal control, as compared to 89% last year. The definition is primarily based on the resources implemented to achieve the specified objectives. Half the companies use the exact objectives defined in the COSO[43] 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. Some 80% of the companies in the "Eurolist A/B" sub-sample use the COSO framework objectives, without necessarily referring to the framework explicitly, compared to 26% of the companies in the "Eurolist C" sub-sample. Some 31% of the companies use the AFEP/MEDEF framework, compared to 13% last year, even if they do not refer to it explicitly. Some companies use the IFACI[44] professional standards. There are also some companies that refer to regulations governing their business, such as CRBF Regulation 97-02[45] for banks, or to ad hoc definitions.

Ten of the companies making disclosures in this matter refer to several definitions simultaneously, such as AFEP/COSO, AMF/COSO or even AMF/CRBF. Some of the companies also use the COSO definition or the definition in the AFEP/MEDEF report mentioned above and 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.

Seven companies (4 in the "Eurolist A/B" sub-sample and 3 in the "Eurolist C" sub-sample) report that they now refer to the AMF reference framework. In this case, they explicitly cite the four objectives mentioned in the reference framework. The objectives are preceded or followed by a sentence referring to the work of the market advisory group. Two samples are reproduced here: "the methodology now used relies on the reference framework established by the market advisory group set up under the aegis of the AMF" and "this definition and the related principles are in line with the work of the market advisory group set up under the aegis of the AMF". One company announces that it will follow the recommendations in the AMF reference framework for the coming financial year. Two other companies report that they will adopt the framework, but without saying whether they intend to do so soon.

No matter which framework they choose, if any, 92% of the companies declare reliability of financial reporting as an objective, 85% declare compliance with applicable laws and regulations and 82% declare control of operations as an objective[46]. Yet the discussion in the main body of the reports on these topics and the methodology is patchy. All the companies in the "Eurolist A/B" sub-sample cite reliability of financial reporting and compliance with laws and regulations as objectives and 96% cite control of operations as an objective.

The fact that a company uses the internal control definition from one framework does not affect its ultimate choice of framework to be implemented (see Choice of reference framework).

In 83% of the cases, companies disclose the inherent limitations of their internal control systems. These limitations are described in general terms and are often linked to the internal control definition per se. Very few companies explain the inherent limitations related to their specific business. Thus, in virtually every case, either the expression "reasonable assurance" found in the COSO framework is used (by about 15% of the companies), or the document explains that internal control cannot provide an "absolute guarantee" that risks have been completely eliminated (about half the companies) This seems to be in line with the future reference framework that deals with this notion[47].

[43] Committee of Sponsoring Organizations of the Treadway Commission
[44] IIA (Institute of Internal Auditors)/IFACI (Institut français de l'audit et du contrôle interne) standard 2120-A1.
[45] CRBF Regulation 97-02 of 21 February 1997 on internal control in credit institutions and investment firms.
[46] Even if the companies do not always use these exact words.
[47] "Internal control cannot provide an absolute guarantee that the company's objectives will be achieved."

Virtually all the internal control objectives defined by companies include reliability of financial reporting. The vast majority also include control of operations and compliance with applicable laws and regulations. The majority of the reports point out that the internal control system cannot be seen as an absolute guarantee that the company will achieve its objectives.

These objectives are all included in the reference framework established by the market advisory group, which explains that 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, the smooth operation of the company's internal processes, including those that contribute to asset protection and the reliability of financial reporting. In addition to these objectives, the market advisory group concluded that, in general terms, internal control contributes to control of the company's business, the effectiveness of its operations and efficient use of its resources.

5.1.2. Scope of the chairman's reports

Virtually all the companies in the sample provide information about the scope of the chairman's reports. The vast majority of the companies use the term "group" in their definition and stated objectives for internal control. This is the case for 80 companies, which is the same number as last year. Ten companies explain that the internal control system may be decentralised[48], since the task of defining the internal control system lies with the senior executives of each operational entity, such as subsidiaries or departments. In 96% of the cases, the procedures of the lead company in the group are followed by most or all their subsidiaries, subject to differences in implementation depending on the businesses and subsidiaries concerned, especially with regard to operational functions. More than a quarter of the companies point out that some of their subsidiaries may apply a different internal control definition from the one used by the group, either because the subsidiary has its own definition, as in the case of a recent acquisition, or because it is located in a country where specific internal control rules apply. Under these circumstances, four companies, including three in the "Eurolist A/B" sub-sample, explicitly refer to subsidiaries or branch offices that are not covered by the chairman's report.

Nearly all the reports describe internal control over financial reporting in a special section. This presentation is in line with the wishes of the CNCC[49], the AFEP/MEDEF recommendation on the chairman's report and the scope of the COSO framework.

Almost all companies now specify the scope of the chairman's report. When companies refer to the group, the AMF recommends that they specify whether this term encompasses the parent company and the consolidated companies or, failing that, list any subsidiaries or branch offices that are not covered by the chairman's report or where the internal control system is not the same as in the rest of the group. The application guide stipulates that when consolidated financial statements are produced, the scope of internal control over financial reporting encompasses the parent company and the consolidated companies.

[48] The reference may be made in very general terms: "some internal control functions are devolved to the subsidiaries", or it may be very detailed: "internal control procedures are devolved to each subsidiary, where management is responsible for implementing them to prevent risk and ensure compliance with local laws. Work on identifying and monitoring the main risks is based on surveys or analytical matrices that apply to the whole group. This work is validated by the board or directors of each subsidiary. The boards also define the measures to be taken and draw up the annual plans of action. Under this arrangement, the legal and operational control procedures ensure that the subsidiaries' market transactions are properly executed, with due consideration of labour legislation, as well as human and social factors".

[49] Technical Opinion of the Compagnie nationale des commissaires aux comptes dated 24 March 2004: "In terms of presentation, it would be helpful if the report deals with the financial reporting procedures that the auditor is required to comment upon in separate paragraphs".

5.1.3. Framework used

Slightly more than half the companies (compared to approximately two-thirds in 2005) explain the methodology that they use in developing and then implementing their internal control systems. Nearly three-quarters of such companies report that they use a framework that is partially or fully derived from the COSO framework. Some other companies use an approach that combines the COSO framework with an internal framework, which may be adapted for each subsidiary, or another framework, such as the AMF framework.

Once again, the outline, meaning the structure of the section of the report dealing with internal control, is not necessarily determined by the choice of framework. Some companies report that they follow a given framework and yet present their work using an outline that is more or less different from the standard outline[50]. As a general rule, the reports highlight the items that they deem are preponderant or specific to the companies' businesses. This may lead them to focus on one point in the outline and/or leave out another point, resulting in ad hoc outlines.
Some companies explain that they are subject to specific regulations governing their business. This includes insurance companies that are subject to the insurance supervisory authority, Autorité de contrôle des assurances (ACAM). These companies argue that they are required to file a report on their internal control system to this authority[51]. In addition, companies in the banking sector explain that they follow the Basel Committee recommendations on internal control, risk management and solvency. Credit institutions point out that they are governed by CRBF Regulation 97-02 on internal control.

More than half the companies in the sample explain which methodology they used to develop and implement their internal control system, as compared to one third of the companies in 2005.
The AMF recommends that companies follow the outline for their chosen framework in their descriptions to make these descriptions easier to understand and easier to compare. Implementation of a reference framework, or the use of any other internal control framework chosen by issuers, should make it possible to follow an outline that that is easy for companies to use and easy for shareholders to understand.

5.1.4. Risk identification and risk management systems

More than three-quarters of the companies in the sample specify the main risks facing them in the chairman's report. Most of the time, these risks are dealt with fairly briefly in the chairman's report and readers are referred to the "risk factors" or "risk management" sections of the registration document for greater detail. In addition to the financial risks cited by all companies, the most frequently mentioned risks are: legal risks, environmental risks, operating risks or risks related to the company's business, industrial risks, computing risks and risks of error or fraud. The descriptions cover a wide variety of risks and the level of detail varies greatly. Seventy percent of the companies make a link between risk identification and management procedures, usually in very general terms. This is the case of 80% of the companies in the "Eurolist A/B" sub-sample and only 60% of the companies in the "Eurolist C" sub-sample. A handful of companies describe the procedures in a specific paragraph under the title "resources implemented for risk management".

Forty-three percent of the companies report that they have a risk-mapping function, which is sometimes called a risk "grid" or "matrix". The process of risk-mapping development, validation and implementation is described briefly at best, with the primary focus on the division of roles within the company. To a lesser extent, the reports focus on risk-mapping methodology, including the number of macroeconomic risks considered, as well as the parameters used to rank them: type, frequency, criticality, hierarchical and/or geographical level affected[52].

[50] Companies using some or all of the COSO framework do not follow the COSO outline exactly in the chairman's report (control environment / risk assessment / control activities / information and communication / monitoring).
[51] Following the enactment of the Decree of 13 March 2006 on information that insurance companies file with the Commission de contrôle des assurances, des mutuelles et des institutions de prévoyance and amending the Insurance Code.
[52] One company presented this as follows: "The risk map is updated periodically, and at least once a year. It is the foundation of the risk management policy. The map is based on a survey of losses experienced in the group (in terms of the occurrence and severity of losses) and an analysis of catastrophic risks in the rest of the industry. Periodic interviews with business groups or operational regions supplement the analyses and identify the operating risks incurred" and, "the method used for mapping operating risks consists of taking stock of all the risks that process managers and the internal auditor can identify, assessing the critical risks, in terms of impact, frequency and level of control, in order to rank them with a view to implementing targeted actions".

More than two-thirds of the companies make a link between risk identification and the management procedures implemented for the main risks.
The AMF reiterates its recommendation to link risks, especially those described in the "risk factors" section of the registration document, to the procedures implemented, 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 attempts to manage its risks.

5.1.5. Details about internal control procedures

More than 90% of the companies in the sample described their internal control procedures. Nearly 90% of the companies in the sample describe the extent to which their procedures have been formalised, compared to 75% in 2006. Some 85% of the companies mention the preventive nature of their procedures. Internal control procedures may be documented in a procedural manual or charter. About half the companies report that they use an audit charter, an internal control manual, best practices, or a financial reporting guide. These are internal documents distributed to the members of the internal audit department or all of the management personnel in the company. A number of companies have established a code of conduct that applies either to the audit department or else to all personnel.

In some companies, this practice is still limited to financial reporting only.

Procedures relating to financial reporting

Eighty-eight percent of the companies in the sample, and all of the companies in the "Eurolist A/B" sub-sample, provide detailed information about internal control procedures relating to financial reporting. This information includes a description of the accounting structure, the implementation of a monitoring system and the role of the finance department. Companies provide information about procedures for accounting and consolidation, reporting, monitoring off-balance sheet liabilities, monitoring assets and monitoring the quality of financial reporting.

Other internal control procedures

Nearly half the chairman's reports from companies in the sample discuss compliance with laws and regulations and nearly two-thirds discuss control of transactions (investment and/or disposal oversight, procedures used to ensure comprehensive recording of transactions, etc.), compared to slightly more than one-third and 60% respectively last year. The figures for the "Eurolist A/B" sub-sample were 67% and 82% respectively and the figures for the "Eurolist C" sub-sample were 30% and 52%.

The most commonly cited internal control procedures include: internal control procedures relating to support functions (human resources, purchasing, marketing), operational, computing and legal internal control procedures, delegation of powers procedures, authorisation of decisions, separation of tasks, procedures to ensure the security of persons, property and data, and quality procedures.

The AMF recommends that companies strengthen the link between their stated objectives and the description of internal control procedures in the chairman's report. The AMF also points out that the scope of internal control is not limited solely to procedures for making financial reporting more reliable.

5.1.6. Internal control resources

Ninety-two percent of the companies in the sample disclose the resources that they devote to internal control. This marks a slight increase over 2006, when the figure was 85%. All of the companies in the "Eurolist A/B" sub-sample disclose the human resources assigned to internal control and devote a section of the chairman's report to internal control personnel[53] (numbers, functions, hierarchical structure).

There are three noteworthy trends. Some companies list all of the departments and even all of the employees involved. On the other hand, some companies limit internal control personnel to the members of the internal control and/or internal audit department. Meanwhile, other companies refer to some functional departments of the group, such as the finance department, the risk control department or the information technology department. The vast majority of companies attempt to define different levels of control.

As part of this effort, companies highlight any current or upcoming establishment of an internal audit department. This department often reports to the Chairman and/or the chief executive officer. It tasks may include providing advice for establishing internal control plans, as part of the audit plans, monitoring the relevance of procedures and their enforcement by line and staff units and informing senior executives and line and staff units of any problems found. Two of the companies in the "Eurolist A/B" sub-sample include an organisational chart showing the internal control players and the hierarchical and functional links between the different levels of control.

None of the companies discloses the cost of their internal control system. One company in the "Eurolist A/B" sub-sample, however, provides a partial cost estimate and explains that the annual internal audit budget is equal to 0.1% of the group's turnover, stating that this is in line with the standards in the group's industrial sector.

On the other hand, about one-third of the companies mention their investments in establishing internal control monitoring. More specifically, most of the companies governed by the Sarbanes-Oxley Act report major investments to achieve compliance.

More than 90% of the companies in the sample disclose the resources devoted to internal control.
The AMF recommends that companies include an organisation chart, in addition to a description of the resources devoted to internal control, if it helps provide a clearer picture of the internal control system. The AMF also recommends that issuers describe the roles of the various internal control players.

5.2. Due diligence and the assessment of the internal control system

5.2.1. Due diligence in connection with the report

Nearly two-thirds of the companies in the sample explain the work that went into preparing the chairman's report. This figure includes 46 companies in the "Eurolist A/B" sub-sample and 20 companies in the "Eurolist C" sub-sample. Most companies explain the work in the general introduction to their report or in the introduction to the section of their report dealing with internal control.

Two-thirds of the companies concerned illustrate due diligence by reporting that the topic was discussed at a board meeting or at a meeting of the audit committee, and three-quarters of the companies report that the topic was discussed by senior executives, during a meeting of the executive committee or the executive board.

The AMF reiterates its recommendation on the description of the due diligence carried out in preparing the report and the list of the units, departments and bodies concerned. For the sake of clarity, this description should be presented in the introduction to the report.

[53] For issuers following the COSO framework, this is dealt with under the "control environment" heading.

5.2.2. Assessment of the internal control system

More than 60% of the companies in the sample, as opposed to only 34% last year, explain in their report that their internal control system is subject to ongoing improvements. This is the case of the 76% of the companies in the "Eurolist A/B" sub-sample and 44% of the companies in the "Eurolist C" sub-sample. There are some underlying disparities, however. Most of the companies simply disclose various plans of action implemented by the internal control department[54], while others highlight the establishment of a specific assessment process in a separate paragraph. In the first cases, the reports do not necessarily explain whether improvements involve changes to existing procedures or the introduction of new procedures. More than half 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 scope of the assessment dealt with in the report often encompasses the procedures discussed in the report, which usually relate to financial reporting. However, some companies explain that other processes are assessed. One report cited an assessment of the computer system and administrative processes. Two companies mention the number of processes assessed and one of them lists six processes: purchasing, sales, inventory, reporting, cash management and investment. Ten companies explain that they commissioned an external assessment.

More than one-third of the companies that assess their internal control system report the findings, though usually in very general terms. Slightly fewer than one-third of the companies presenting the findings mention weaknesses in the system, as opposed to only one company last year. Even though these companies specify which activity is affected by the weaknesses, they then express them in very general phrases, such as "weaknesses in certain administrative cycles", "weaknesses in certain branches" or "weaknesses that came to light during an acquisition". One company is more specific, speaking of "identification of a immaterial error in the accounting treatment of returned equipment under financial leasing contracts, which has since been corrected". Some companies explain that they have drawn up plans of action to improve the processes assessed.

Sometimes, improvements are reported in relation to the previous assessment. There may even be mention that some areas for improvement have been identified, but few details are provided, other than to say that remedial plans have been implemented or the standardisation of certain procedures has been reinforced. Four companies report that they will soon undertake an assessment of their internal control systems. Two of these companies explain that the assessment should have taken place in 2007 and provide information about the resources implemented to carry out the assessment and progress made. Some of the other approaches that companies would like to take to improve their internal control systems include further analysis of risk monitoring, extending the scope of internal control or else harmonising and updating procedures.

None of the reports examined report any serious failings or inadequacies with regard to internal control.

The number of companies reporting improvements to their internal control systems has virtually doubled since the previous year.
The AMF reiterates its recommendation on the describing work on improving internal control processes, especially through the use of self-assessment questionnaires.
The AMF also reiterates its recommendation that issuers disclose any serious internal control failings or inadequacies revealed by an assessment or at any time, especially when preparing the chairman's report.

[54] This department's role is to review transactions and procedures and to recommend improvements relating to internal control. It usually has the task of conducting a full review of the system over a number of years.

5.2.3. Companies subject to the Sarbanes-Oxley Act

Companies concerned in the sample

Sixteen companies explain in their reports that they are subject to the Sarbanes-Oxley Act. Thirteen are listed on the NYSE, two are subsidiaries of a company listed on the NYSE and one has a float under USD 75 million and is listed on NASDAQ.

One company that is required to comply with the Sarbanes-Oxley Act explains that since it was delisted in mid-July 2006 and its registration with the SEC was suspended in mid-October 2007, it is no longer subject to the Act. However, after consulting with its statutory auditors, the company decided to change its objectives with regard to the assessment of its internal control system, while continuing the efforts undertaken with regard its obligations in France under the Financial Security Act and AMF recommendations.

Two other companies explain that they have filed for suspension of registration with the SEC, ending the financial disclosure commitments that their group made under the US Securities Exchange Act of 1934, including the provisions of the Sarbanes-Oxley Act.

Companies' disclosures regarding this matter

Most of the companies explicitly state that they have implemented a system to ensure compliance with American regulations in parallel to French internal control regulations.

All companies mention that they have taken major steps over several years to be able to draft their report on the assessment of the effectiveness of their internal control over financial reporting as of 31 December 2006. They disclose details of their investments in the process of documenting, assessing and improving procedures and internal control that has an impact on financial statements under Section 404 of the Sarbanes-Oxley Act. Nearly all of these companies explain that they have established an internal audit department and an internal control department. Many also refer to the establishment of a communication and supervision committee that oversees financial reporting and auditing procedures.

Most of the companies explain in their chairman's reports that the assessment process carried out under the terms of Section 404 of the Sarbanes-Oxley Act is ongoing at the time their registration document is published. Companies often refer readers to their American report (Form 20F) filed with the Securities and Exchange Commission (SEC). Six companies in the sample present a section called "Assessments conducted under the terms of the Sarbanes-Oxley Act" or "Work carried out under the terms of the Sarbanes-Oxley Act". Yet, the description provided is often expressed in general terms and standardised phrases.

The AMF points out that any company listed on a foreign market that discloses information on that market is required to publish equivalent information on the French market simultaneously. This is particularly true for companies listed in the USA, which are subject to the provisions of the Sarbanes-Oxley Act.

5.2.4. Statutory auditors' reports

All of the companies in the sample that are required to do so, meaning 92 companies[55], present the statutory auditors' report on their chairman's report in their chairman's report itself, or, more rarely, they append it to the report, along with all of the statutory auditors' other reports. In every case, the statutory auditors' report follows the format recommended by the national institute of statutory auditors, the CNCC.

[55] The statutory auditors for eight companies did not comment on the chairman's reports. The eight include a limited partnership with share capital listed on Eurolist A, five companies listed via a public offering on Alternext in 2007 and two companies with their registered offices in other countries.

In two reports from companies subject to the Sarbanes-Oxley Act in the USA, the statutory auditors explain that they examined the assessment made of the adequacy and effectiveness of procedures, and that they considered the relevance of the assessment process followed and the tests carried out. The statutory auditors' findings in this case deal with the disclosures and the statements in the chairman's report regarding the adequacy of the company's internal control procedures for financial reporting.

Two statutory auditors' reports refer to the report that the auditors compiled as part of the work on the report filed with the SEC ("Form 20F"), under the terms of Section 404, "finding, based on the criteria defined in the COSO internal control framework, that the assessment of the internal control system for financial reporting conducted by the chief executive officer and the chief financial officer is reliable and that the system is effective as of 31 December 2006".

One report noted that, "improvements should still be made in formalising internal control procedures and applying them thoroughly". In other reports, the statutory auditors have not found anything that compromises the fairness of the disclosures made in the chairman's reports.

6. DIRECTORS' AND EXECUTIVES' PAY

6.1. Directors' pay

Ninety-seven percent of the companies in the sample disclose the amount of directors' fees paid. Fifteen of these companies, of which 14 are in the "Eurolist C" sub-sample, state explicitly that they do not pay directors' fees. Of the companies that do pay directors' fees, 96% disclose the fees paid to each individual director.

Approximately two-thirds of the companies explain precisely how they calculate the directors' fees. In 83% of the cases, the amount of the fees is linked, at least in part, to the directors' attendance of board meetings and in 89% of the cases, to their sitting on specialised committees. The chairmen of the board and/or committee chairmen are often paid higher fees. As a general rule, directors sitting on the audit committee are paid more than directors sitting on other committees. Foreign directors are often paid higher fees as well. Some companies explain that certain members of the board do not receive directors' fees.

Sixty percent of the companies also disclose the fees paid to individual directors in the previous year or, in some cases, the two previous years. Twelve percent of the companies in the sample have announced changes in how they calculate directors' fees so as to introduce incentives for attendance and sitting on committees.

The companies in the "Eurolist A/B" sub-sample producing a registration document were subjected to a more detailed analysis. It shows that 98% of these companies pay directors' fees. In 96% of the cases, the fees paid to individual directors are disclosed. Nearly a quarter of the companies pay the whole amount allocated by the general meeting of shareholders.

In nearly 80% of these companies, a flat fee is paid to each director. This fee is often presented as linked to the specific liability that comes with being a director. In nearly 80% of the cases, directors' fees are variable or include a variable component linked to the directors' actual attendance of board meetings. In addition, 80% of the companies report that they pay extra fees for sitting on a board committee and 65% pay higher fees to the committee chairmen or the chairman of the board. It should be noted that nearly 50% of the companies paying higher directors' fees for sitting on committees, actually pay members of the audit committee more than members of the other committees.

6.2. Executives' pay

This section deals only with the 48 companies in the "Eurolist A/B" sub-sample that produce a registration document.

6.2.1. Principles and rules for determining executives' pay

Nearly 80% of the companies present at least a summary of the principles and rules set out by the board of directors or the supervisory board, as the case may be, to determine the pay and benefits of all types for executives. Some of the companies disclosing these principles and rules provide information about short-term benefits only, while a larger number disclose the pay and benefits likely to be received in the short term or the long term. One-quarter of the companies disclose this information in the chairman's report, while the other companies disclose it in the section of the management report that deals with compensation or in the chapter on corporate governance.

The wording used by the companies in the "Eurolist A/B" sub-sample shows that the compensation committees in existence all have the task of making proposals regarding executives' pay. In fact, this is their primary task.

The process for determining the variable component of pay is usually laid down by the board, after hearing the opinion, proposals or recommendations of the compensation committee. In some companies, the chairman of the board, even if he is not a member of the committee, may attend the meetings of the compensation committee, but without taking part in the discussions. On more than 80% of the compensation committees at least half the members are independent directors.

6.2.2. General information about fixed and variable pay components and benefits in kind

All of the companies in the "Eurolist A/B" sub-sample disclose individual pay amounts and distinguish between the fixed and variable components, at least for 2006.

All of the companies disclose individual pay amounts.

Eighty-eight percent of the companies disclose pay information in a table. All of the companies break pay down into its fixed and variable components. About half the companies show fixed pay, variable pay, directors' fees and benefits in kind in the table. Ten percent of the companies have also added a column showing stock options granted. Sixty-one percent of the companies disclose information covering two years, while 14% disclose information for the current year only (following a recent change in management) and 20% of the companies disclose information covering three to four years.

Twenty percent of the companies provide some information about how the fixed pay component is determined. These companies refer to market practices or a benchmark established by an external consultant with reference to pay levels observed for similar positions in large listed companies.

Ninety-two percent of the companies report providing benefits in kind. Two-thirds of these companies disclose the amount, but without necessarily explaining which benefits are concerned. When they are specified, the benefits usually consist of the use of a company car, with or without a driver, and, more rarely, housing provided by the company.

Forty percent of the companies report that the variable pay component is linked to the pay for the year for which it has been calculated, even though it is not paid until the following year. One third of the companies also disclose all of the compensation paid during the year.

6.2.3. Determining the variable component of pay

Ninety-two percent of the companies in the "Eurolist A/B" sub-sample disclose the criteria for determining variable pay. In two-thirds of the companies, the variable component of pay is based on a combination of financial criteria and qualitative criteria relating to individual performance. These two types of criteria are assigned a weighting coefficient and, in virtually every case, financial criteria are predominant. As a general rule, companies use several financial criteria. The average is three criteria and the available information shows that they usually carry equal weight. Some disclosures are quite specific, while others are made in broader terms. Details about the qualitative targets are rarely provided and the board of directors has a great deal of latitude in its assessments. The variable component is capped in more than half the companies, either as a percentage of the fixed component, or, more rarely, the cap is expressed in absolute value. About one-quarter of the companies disclose a pay range. Some companies explain that the variable component of pay is linked to the relative performance of the company's shares. The benchmarks cited in this case are the CAC 40 index or the index for the European industrial sector that the company belongs to.

Ten percent of the companies report that the criteria used in 2006 are the same as those used in 2005. Sixteen percent of the companies in the sample report that they reviewed the criteria for use in 2007 in 2006. These companies often highlight current standards and practices in France, on the international market and/or in the company's sector. Nearly 30% of the companies disclose how the criteria chosen have been applied with regard to the plans for 2006 and if personal targets have been achieved.

Five percent of the companies report that special circumstance led to special compensation, without explaining the circumstances or the grounds for such payments.

6.2.4. Executives' severance packages

About half the companies in the sample disclose special severance packages for executives. These companies state that the special packages are granted to executives or a limited number of senior managers. The information that

companies reporting severance packages or a lack of severance packages give is provided on an individual basis and can be quantified in the vast majority of cases. The companies rarely disclose whether severance packages were provided for in the executives' contracts from the outset. As a general rule, a company's severance packages are substantially larger for foreign executives.

Nearly half the companies disclosing severance packages provide information about how they are calculated. As a general rule severance packages are based on the sum of fixed and variable pay. Some companies disclose that the packages include supplementary retirement benefits. The average figure for severance payments to senior executives is two times annual fixed and variable pay, excluding any severance payment due under a collective bargaining agreement. Some companies disclose that a the severance package is larger if the executive signs a non-compete clause or a loyalty close, under which the executive commits to remain in place for a set number of months after a takeover. Some companies explain that severance packages are ruled out in cases of dismissal with just cause, which some companies deem to be serious offences or gross negligence or both.

The intrinsic value of the company during the executive's term does not seem to be considered when calculating severance packages.

6.2.5. Supplementary retirement liabilities towards executives

As a general rule descriptions of retirement liabilities are better than last year and more information is provided on retirement liabilities towards individual executives. This information is sometimes dispersed and the executives are sometimes also entitled to benefits offered to all of the company's employees or senior managers under the general retirement plan.

More than 60% of the executives have a personalised retirement plan. Nearly two-thirds of the companies offering such plans describe the main characteristics of the plans and how benefits are calculated. About one-third of the companies explain that the executives are entitled to the same retirement plan as the group's other senior managers. Nearly 20% of the companies were very transparent, providing information about the potential amounts of their liabilities towards individual executives.

About one-quarter of the companies described their liabilities under an employee benefit plan.

6.2.6. Stock options and bonus shares

Eighty-five percent of the companies in the "Eurolist A/B" sub-sample report that they implemented stock option plans and/or free distributions of shares in 2006. Two-thirds of these companies presented an outline of their general policy for distributing stock options or bonus shares. All of the companies explained that the general policy is discussed by the compensation committee and that the board of directors or the supervisory board makes its decision on the basis of the committee's proposals.

None of the stock option plans described and for which such information is disclosed featured a discount when the options were distributed. Some companies distribute stock options at irregular intervals, while others offer plans at the same time every year. Some companies spread the exercise of options out over several years and exercise of some options is conditional on achieving targets. About a quarter of the companies that implemented stock option plans in 2006 made exercise conditional in part on achieving performance targets over one or more years. In a few cases, the performance targets are set for executives, but not for senior managers. Performance targets are sometimes calculated on the basis of such factors as the company's stock price outperforming the relevant European sector index over a given period or the stock price having increased by a given percentage compared to the exercise price by the exercise date.

Some companies explicitly state in their registration document that they have instituted a procedure that executives must follow before exercising their stock options to ensure that they do not have any inside information that could prevent them from exercising their options.

Some companies explain in the documents studied how they deal with unexercised options and bonus shares that have not been acquired upon leaving the company, stating, for example, that the executive must still be with the company when the options are exercised. A few companies allow early exercise of stock options in the event of a takeover. Some companies explain the holding requirements[56] applying to executives with regard to shares obtained by exercising stock options or through distributions of bonus shares.

The AMF found that some companies make an effort to achieve transparency by presenting a special section in their chairman's report devoted to the principles and rules set by the board for determining executives' pay and benefits.

The AMF recommends that companies specify exactly the fixed and variable pay components and any benefits in kind. It also recommends that companies should be more explicit about the criteria used to determine the variable component of senior managers' pay and to indicate the percentage that is actually determined according to these criteria and the percentage that is left to the discretion of the board.

The AMF recommends that companies should state explicitly if they do not offer any special benefits to executives in order to avoid any ambiguity about deferred compensation, severance packages and retirement liabilities. This information must be disclosed for each individual executive.

In some companies, this information is dispersed in several different sections of the document, especially information about retirement liabilities. Consequently, the AMF recommends that companies should indicate where the information can be found in the different sections of the document. It also recommends that companies should provide quantifiable information and, wherever possible, quantified information.

The AMF encourages companies to follow the AFEP/MEDEF recommendations published in January 2007 with regard to transparency, so that companies provide shareholders with comprehensive information about the amounts of compensation paid to individual executives, as well as the total cost of their group's senior executives, and the policy for determining their pay.

[56] The provisions of Articles L.225-185 and L.225-197-1 of the Commercial Code apply to options and shares distributed following the publication of the Act of 30 December 2006 on promoting employee profit-sharing and shareholding.

GENERAL CONCLUSION

The overall quality of information on corporate governance and internal control in 2006 that was provided to the market in 2007 is higher. Because the sample contained many more companies traded on Eurolist C in Paris and newly listed companies on Alternext, stable statistics can be interpreted as showing an improvement nonetheless. This is because the AMF finds that in the three previous years small caps and midcaps made less progress with regard to the topics covered in this report.

The AMF finds that there has been a further improvement in the quality of the discussion of corporate governance in the reports. Examples that can be cited include the improvements that issuers have made to disclosures about the activity of board committees, rules of procedure and assessment of the board's work.

The AMF finds that companies have made efforts to disclose more information about risk management systems and assessments of internal control systems.

The AMF reiterates its recommendation on the use of the reference framework and the application guide that it published in January 2007 for financial years starting on or after 1 January 2007, but restricts this recommendation to companies traded on Eurolist A in Paris, meaning companies with market capitalisations in excess of EUR 1 billion as of 31 December 2007.

This reference framework can already be adapted to a company's specific organisational structure, but the working group on small caps and midcaps chaired by Yves Mansion wished to provide further guidance for such companies, in line with the work of the market advisory group working on the same topic. The working group proposes a simpler version of the general internal control principles and reduces the application guide to only two of the appended questionnaires. The first deals with internal control over financial reporting, and the second deals with risk analysis and management. After publishing its position on 9 January 2008, the AMF recommends that all legal persons making public offerings that are not traded on Eurolist A in Paris should follow this simplified application guide.

The full reference framework and the application guide aimed primarily at small caps and midcaps are not meant to be imposed on companies, particularly those that must follow another framework under the terms of other regulations. Nor is it meant to take the place of special regulations applying to certain business sectors, such as banking and insurance. All companies are encouraged to explain in their chairman's report if they follow the reference framework or the application guide when drafting their report. Furthermore, companies should highlight information that is likely to have a material impact on their assets or earnings when drafting their reports. The same transparency principles apply for the use of any other framework that the company chooses or is required to apply at the international level. The report should then present such frameworks.

With the transposition of new European Directives into French law slated for 2008, including some measures with a direct impact on listed companies, the AMF's position published on 9 January 2008 backs the recommendation made by the working group on small caps and midcaps that the specific characteristics of small caps and midcaps be taken into consideration so as to prevent a greater compliance burden with respect to corporate governance and internal control. Therefore, with the transposition of the Directive of 17 May 2006, small caps and midcaps would like to be exempted from having an audit committee. The group also recommends that the board of directors' statement on internal control called for by the Directive of 14 June 2006 should replace the report called for under French law, instead of constituting an additional report.

As required by law, the AMF report next year will also cover the principles and rules set down by the board of directors or the supervisory board for determining executives' pay and benefits, which companies traded on a regulated market must present in the chairman's report.

Annex 1: Sample of companies used for the analysis

Sample description

The analysis of information published by companies making public offerings was conducted on 30 October 2007 on the basis of the following sample:

- 100 reports were analysed, including 92 that were printed in registration documents.
- 96 companies incorporated as limited-liability companies and 4 as limited partnerships with share capital.
- 98 companies with their registered office in France, 2 in other countries.
- 16 companies in the sample are subject to the American Sarbanes-Oxley Act, either because they are listed in the USA or because they are subsidiaries of parent companies listed in the USA.
- The classification of companies listed on Eurolist in Paris by compartment was based on the situation as of 31 December 2006.
- The 34 companies followed by an asterisk in the list below were not in the 2006 sample.
- 7 of the 8 Alternext companies in the sample were listed in 2007 through a public offering.

List of companies in the sample

"Eurolist A/B" sub-sample

CAC 40

1. ACCOR
2. AGF
3. AIR LIQUIDE
4. ALCATEL-LUCENT
5. ALSTOM*
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. PERNOD-RICARD*
25. PEUGEOT
26. PPR
27. RENAULT
28. SAINT-GOBAIN
29. SANOFI-AVENTIS
30. SCHNEIDER ELECTRIC
31. SOCIETE GENERALE
32. SUEZ
33. THOMSON
34. TOTAL
35. VALLOUREC
36. VEOLIA
37. VINCI
38. VIVENDI

EUROLIST A (not in CAC 40)

1. ATOS ORIGIN
2. CASINO GUICHARD-PERRACHON
3. CIE GENERALE DE GEOPHYSIQUE
4. EIFFAGE
5. GENERALE DE SANTE
6. HAVAS
7. JC DECAUX
8. RHODIA
9. SCOR

EUROLIST B

1. CLUB MEDITERRANEE*
2. GAUMONT
3. GL TRADE

"Eurolist B" sub-sample

EUROLIST C

1. ACCESS COMMERCE
2. ACTEOS
3. ALTAMIR
4. ALTI
5. ARCHOS
6. AUSY
7. BIOALLIANCE PHARMA
8. BOIZEL CHAMPAGNE*
9. CESAR*
10. EGIDE*
11. GENESYS
12. GROUPE ARES*
13. GROUPE FLO*
14. GROUPE OPEN*
15. HIGH CO
16. HOLOGRAM INDUSTRIES
17. I.D.I.
18. I.P.B.M.*
19. JACQUET METALS*
20. LAFUMA*
21. LE TANNEUR
22. LEON DE BRUXELLES
23. LVL MEDICAL GROUP*
24. NATUREX
25. NEURONES
26. NICOX
27. ORAPI*
28. PAREF*
29. PHARMAGEST INTERACTIVE*
30. PROSODIE
31. QUANTEL*
32. RADIALL*
33. RISC GROUP*
34. ROCAMAT*
35. SILICOMP*
36. SYLIS*
37. THERMOCOMPACT*
38. TRANSGENE*
39. TRANSPORTS DU NORD*
40. UMANIS*

ALTERNEXT

1. EUROGERM*
2. EXONHIT THERAPEUTICS
3. FOUNTAINE PAJOT*
4. GROUPIMO*
5. HOMAIR*
6. REIMS AVIATION INDUSTRIE*
7. VERGNET*
8. YIN PARTNER*

BOND ISSUERS

1. HSBC France
2. CREDIT FONCIER DE FRANCE

French companies in the sample subject to the Sarbanes-Oxley Act as of 31 December 2006:
AGF, ALCATEL, AXA, COMPAGNIE GENERALE DE GEOPHYSIQUE, FRANCE TELECOM, GENESYS, DANONE, HSBC FRANCE, LAFARGE, RHODIA, SANOFI-AVENTIS, SCOR, SUEZ, THOMSON, TOTAL, VEOLIA