Risk management and internal control systems

Reference Framework

FOREWORD

This AMF Reference Framework for French companies whose securities are admitted to trading on a regulated market is a revised and enhanced new edition of the Reference Framework published in January 2007. The first edition was compiled by a group that produced remarkable work under the chairmanship of Jean Cedelle and Guillaume Gasztowtt. It was supplemented by an application guide for internal control of accounting and financial information published by issuers produced under the authority of Michel Léger. It has provided a genuine tool for improvement for the many companies that have adopted the reference framework over the last three years.

This new edition is presented in the same spirit as the original. It is a reference tool for companies to improve oversight of activities and to ensure that they achieve their objectives. As in the case of the original framework, nothing is obligatory. It is a methodology that needs to be adapted to the infinite variety of individual circumstances resulting from the business activities, size and organisational structures of the companies concerned.

Even though it is in the same vein as the original edition, the new edition includes several substantial improvements to the 2007 reference framework.

It also incorporates changes made to laws and regulations since 2007. The Act of 3 July 2008 and the Order of 8 December 2008 transposed into French law the European Directives that create new requirements for listed companies with regard to risk management and set out the duties of audit committees.

This edition also incorporates changes in the main international standards and, more specifically, COSO II and ISO 31000.

In January 2008, the AMF published an application guide for the 2007 reference framework that is adapted for small cap and midcap companies. This guide has also been updated and can be used as an aid for small caps and midcaps, which are currently defined as companies with a market capitalisation of less than 1 billion euros.

The AMF is happy to make this contribution to good management and, consequently, to the protection of investors in French companies.

It would like to express its heartfelt thanks to the members in the working group that updated the reference framework that it publishes. Special mention must be made of Gérard Lancner, Chairman of AMRAE, Bénédicte Huot de Luze, Scientific Director of AMRAE, Louis Vaurs, of IFACI, and Michel Léger, Chairman of BDO, for their outstanding contribution. Etienne Cunin, Chief Accountant's Deputy was the rapporteur for the application guide for the 2007 edition and he played the same role for the 2010 edition of the reference framework.

The Chairman of the working group

Olivier Poupart-Lafarge
Member of the AMF Board

CONTENTS

I - INTRODUCTION

1. The context

European Directive 2006/46/EC on the annual accounts and consolidated accounts of companies amends the fourth and seventh European Directives and stipulates, “A company whose securities are admitted to trading on a regulated market shall include a corporate governance statement in its annual report. That statement shall be included as a specific section of the annual report and shall contain […] a description of the main features of the company's internal control and risk management systems in relation to the financial reporting process”.

The Act of 3 July 2008 transposed this Directive into French law and supplemented the Financial Security Act of 1 August 2003 at the same time. This resulted in amendments to Articles L. 225-37 and L. 225-68 of the Commercial Code that extend the scope of the chairman’s report on internal control and risk management procedures implemented by companies making public offerings to include details about “procedures relating to financial reporting for the parent company financial statements and, where appropriate, the consolidated financial statements”.

Article 41 of the European Directive 2006/43/EC on statutory audits (Eighth Directive) requires an audit committee to be created with the following duties:

- monitoring the financial reporting process;
- monitoring the effectiveness of the internal control, internal audit and, where appropriate, risk management systems;
- monitoring the statutory audit of the annual financial statements and the consolidated financial statements;
- examining and monitoring the independence of the statutory auditor or the audit firm.

The Order of 8 December 2008, which transposes the European Directive on statutory audits into French law, institutes specialised committees, or audit committees, for entities issuing securities that are admitted to trading on a regulated market, as well as for credit institutions, insurance and re-insurance companies, mutual insurance companies and provident institutions. The Order mentions the four specific duties in the Directive, but it does not mention monitoring the effectiveness of internal audits. Instead it stipulates that these duties are part of a general duty to ensure “monitoring of matters relating to financial reporting and auditing”.

The committees act under the “exclusive and collective responsibility” of the members of the administrative body or the supervisory body, as the case may be, and they act “without prejudice to the attributes of the administrative, management or supervisory bodies”.

The Order provides for exemptions when: persons and entities that have a body that performs the functions of the specialised committee stipulated in Article L. 823-19, provided that this body, which may be the administrative body or the supervisory body, is identified and its membership is disclosed (4° of Article L. 823-20 of the Commercial Code).

Under these circumstances, in September 2009, the AMF charged a working group to draft a guide on audit committees and **to adapt the 2007 AMF reference framework** in order to supplement the section on risk management.

2. Approach

The Working Group initially took a pragmatic approach that focused on reconciling:

- French regulations,
- recommendations made in the reports on corporate governance,
- changes in European Directives, and
- best practices observed in other countries.

With respect to the reference framework for internal control, the working group originally examined two renowned standards, which were COSO[1] and the "Turnbull Guidance[2]" in the United Kingdom.

With respect to risk management, the working group deemed it appropriate to take advantage of the legislative amendments of July 2008 to develop the risk management provisions and, for this purpose, it based its work on major international standards, such as COSO II[3] and ISO 31000: 2009.

The working group also ensured that the reference framework is compliant with the European Directives, and the Eighth Directive on statutory audits in particular.

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The working group drafted this reference framework for internal control and risk management based on domestic and European laws and regulations, along with good governance practices that are already recognised in France and the main internal control and risk management models. It includes:

- general internal control and risk management principles;
- a general questionnaire on internal control for accounting and financial reporting and another general questionnaire on risk analysis and management, which is a key component of any internal control system;
- an application guide on internal control and risk management with regard to accounting and financial information published by issuers.

  This guide could be provided to the relevant functions of a company and used, as needed, for drafting the chairman's report on internal control and risk management procedures relating to financial reporting.

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This reference framework is based on general principles and not on binding rules.

This framework is not intended to be binding on companies, nor is it intended to take the place of specific regulations applying to certain business sectors, such as banking and insurance.

It can be used by companies whose securities are admitted to trading on a regulated market to supervise and, as the case may be, develop their internal control and risk management systems. Yet it does not give directives on how to design their organisational structure.

Each company is responsible for its own organisation and, consequently, for its internal control and risk management systems, which should be part of a good governance framework as presented in the reports by French industry organisations.

Ultimately, it is a tool that should ensure greater uniformity of the concepts underpinning the drafting of chairmen's reports on internal control and risk management and the work of audit committees.

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[1] COSO (Committee of Sponsoring Organizations of the Treadway Commission) published an "Internal control- Integrated Framework" in 1992

[2] Guide developed by ICAEW (Institute of Chartered Accountants in England and Wales) and published in 1999. This guide was updated by the Financial Reporting Council in 2005.

[3] COSO II published the Entreprise Risk Management – Integrated Framework

II - GENERAL RISK MANAGEMENT AND INTERNAL CONTROL PRINCIPLES

Risk-taking is an inherent trait of any enterprise. There can be no growth or creation of value in a company without risk-taking. However, if risks are not properly managed and controlled, they can affect the company's ability to attain its objectives. Risk management and internal control systems play a key role in directing and guiding the company's various activities by continually preventing and managing risks.

1. General risk management principles

A) Definition

Risk management is the business of every stakeholder in a company. It should be comprehensive and cover all of the company's activities, processes and assets.

Risk management is a dynamic system, defined and implemented under the company's responsibility.

Risk management encompasses a set of resources, behaviours, procedures and actions that is adapted to the characteristics of each company and that enables managers to keep risks at an acceptable level for the company.

Risk represents the possibility of an event occurring that could affect the company's personnel, assets, environment, objectives or reputation.

B) Risk management goals

Risk management is a lever for managing the company that helps:

a) Create and preserve the company's value, assets and reputation:
Risk management is used to identify and analyse the main potential threats and opportunities for the company. The aim is to anticipate risks instead of submitting to them passively, thus preserving the company's value, assets and reputation.

b) Secure decision-making and the company's processes to attain its objectives:
Risk management aims to identify the main events and situations that could have a significant impact on the attainment of the company's objectives. Controlling these risks facilitates the attainment of these objectives.
Risk management is an integral part of the company's decision-making and operating processes. It is an oversight and decision-making aid.
Risk management gives managers an objective and comprehensive outlook on the company's potential threats and opportunities. It enables managers to take measured and informed risks and provides a basis for their decisions regarding the attribution of human and financial resources.

c) Promote the consistency of the company's actions with its values:
Many risks reflect a lack of consistency between the company's values and day-to-day decision-making and actions. These risks mainly threaten the company's credibility.

d) Bring the company's employees together behind a shared vision of the main risks and raise awareness of the risks inherent in their activity.

C) Components of the risk management system

It is up to each company to create a risk management system that is appropriate to its specific circumstances.

The risk management system includes:

1) An organisational framework with:

- a organisational structure that defines roles and responsibilities, sets out the procedures and clear and consistent standards for the system,
- a risk management policy that formally sets out the system objectives in accordance with the corporate culture, the common language, the approach to identifying, analysing and managing risks and, as the case may be, the risk limits that the company sets (risk tolerance),
- an information system that disseminates risk information internally.

2) A three-stage risk management process in the company's internal and external context:

- Risk identification: this stage indentifies and centralises the main risks threatening the attainment of the company's objectives. A risk is a threat or a missed opportunity. It involves an event, one or more sources and one or more consequences. Risk identification is part of an ongoing approach.
- Risk analysis: in this stage, the potential financial, personal, legal and reputational consequences of the main risks are examined and the likelihood of their occurrence is assessed. This is an ongoing approach.
- Risk management procedures: in this stage, the most appropriate action plan or plans for the company are chosen. Several measures can be considered to maintain acceptable risk levels: reducing, transferring, eliminating or accepting a risk. The choice is made by weighing the opportunities against the cost of risk management measures, with due consideration of their potential effects on the occurrence and/or consequences of the risk.

3) Ongoing oversight of the risk management system:

The risk management system is subject to supervision and periodic reviews. Monitoring the system contributes to ongoing improvements.

The objective is to identify and analyse the main risks and to learn the lessons of risks that occurred.

A risk management questionnaire can be found in Chapter III.1 "*Risk management questionnaire*".

2. Coordination of risk management with internal control

Risk management and internal control systems complement each other in controlling the company's activities.

- The risk management system aims to identify and analyse the company's main risks. Risks that exceed the acceptable levels set by the company are dealt with and, as the case may be, subject to plans of action. These plans may call for the implementation of controls, a transfer of the financial consequences (through insurance or an equivalent mechanism) or an adaptation of the organisational structure. The controls to be implemented are part of the internal control system. In this way the internal control system contributes to the management of the risks incurred in the company's activities.
- The internal control system relies on the risk management system to identify the main risks that need to be controlled.
- In addition, the risk management system needs to include controls that are part of the internal control system and aimed at ensuring the proper functioning of the risk management system.

The coordination and balance between the two systems depend on the control environment, which constitutes their shared foundation, and, more specifically: the company's own risk and control culture and its ethical values.

3. General internal control principles

A) Definition

Internal control is a system that the company defines and implements under its own responsibility.

It encompasses a set of resources, behaviours, procedures and actions that are adapted to the individual circumstances of each company that:

- contribute to control over its activities, the efficiency of its operations and efficient use of its resources, and
- enable the company to assess all significant operational, financial and compliance risks appropriately.

More specifically, the system aims to ensure:
a) compliance with laws and regulations;
b) implementation of the instructions and directions given by executive management or the executive board;
c) proper functioning of the company's internal processes, especially those relating to the protection of its assets;
d) reliability of financial information.

Therefore, internal control is not limited to a set of procedures or to accounting and financial processes.

The definition of internal control does not cover all of the initiatives taken by the executive or management bodies, such as defining the company's strategy, setting objectives, making management decisions, dealing with risks and monitoring performance.
Furthermore, internal control cannot provide an absolute guarantee that the company's objectives will be achieved.

B) Internal control objectives

The internal control objectives are aimed more particularly at ensuring:

a) Compliance with laws and regulations
This means compliance with the laws and regulations applying to the company. The laws and regulations in force set standards of conduct that the company incorporates into its compliance objectives.
Given the many areas concerned, such as company law, commercial law, environmental law and social law, the company needs an organisational structure that enables it to:

- be aware of the various rules applying to it;
- be informed in a timely manner of changes to these rules via a legislation watch;
- transpose these rules into its internal procedures;
- inform employees and train them in the rules that concern them.

b) Implementation of the instructions and directions given by executive management or the executive board
Instructions and directions from executive management or the executive board help employees understand what is expected of them and what scope they have for freedom of action.
These instructions and directions must be communicated to the employees concerned, based on the objectives allocated to each of them, so as to provide guidance on how their activities should be conducted. The instructions and directions must be defined in accordance with the company's overall objectives and the risks incurred.

c) Proper functioning of the company's internal processes, especially those relating to the protection of its assets
All operational, industrial, commercial and financial processes are concerned.
In order for processes to function correctly, standards or operating principles have to be established, along with monitoring indicators.

The term “assets” refers not only to tangible assets, but also to intangible assets, such as know-how, image and reputation. Theft, fraud, lack of productivity, errors, as well as poor management decisions and internal control weakness, can make these assets disappear. The related processes require special attention.
The same is true for processes relating to financial reporting. These processes include not only those which deal directly with the preparation of financial reports, but also the operational processes which generate the accounting data.

d) Reliability of financial information
Reliability of financial information can only be achieved by implementing internal control procedures that promote faithful recording of all the organisation’s operations.
The quality of the internal control system can be improved by:

- segregation of duties, for a clear separation between recording duties, operational duties and record retention duties;
- function descriptions, which should make it possible to identify the origin of the information produced and its recipients;
- an accounting internal control system to ensure that the operations have been performed in accordance with general and specific instructions, and that the accounting system produces financial reporting that complies with generally accepted accounting principles.

<u>C) Internal control components</u>

Introduction

The main directions for internal control are determined in accordance with the company’s objectives.
These objectives must be adapted to the company and clearly communicated to employees so that they can understand and adhere to the organisation’s risk and control policy.
Internal control will be more relevant if it is built on rules of conduct and integrity upheld by the governance bodies and communicated to all employees. It must not be a purely formal system where serious breaches in business ethics could occur on the sidelines.

It is true that the internal control system cannot, in itself, prevent company personnel from committing fraud, contravening legal or regulatory provisions, or communicating misleading information outside the company about its situation.
In this context, leading by example (or “Tone at the Top”) is key to disseminating values within the company.

Components

The internal control system consists of five closely related components.
Although these components apply to all companies, the way they are implemented will vary depending on the individual characteristics of each company.

These five components are:

1) An organisational structure with a clear definition of responsibilities, suitable resources and competencies that is supported by appropriate information systems, procedures or operating methods, tools and practices

Implementation of an internal control system must be based on fundamental principles, as well as:

→ **a suitable organisational structure** that provides the framework in which the activities implicit in meeting the objectives are planned, carried out, followed up and controlled;

→ **clearly defined responsibilities and powers** that are granted to the right people according to the company’s objectives. They can be formalised and communicated by means of task or job descriptions, staff and line organisation charts, delegation of powers, in accordance with the principle of segregation of duties;

→ **a human resource management policy** that should enable the company to employ people with the appropriate knowledge and competencies to discharge their responsibilities and to meet the current and future objectives of the company;

→ **information systems** that are adapted to the current objectives of the organisation and designed to be able to respond to its future objectives. The IT systems on which these information systems depend must be effectively protected, both in terms of physical and logical security, thereby ensuring that there is no loss of the information stored. Their operational continuity is guaranteed by back-up procedures. Information on analyses, programming and processing functions must be documented;

→ **operating procedures or methods** that specify how an action or process should be carried out (objectives to be achieved within a given time-frame, definitions of functions and operating/reporting lines, policy framework, decision-making and assessment tools, control frequency, person responsible for control, etc.), regardless of format and medium. Section III.2, "Accounting and finance internal control questionnaire" lists some questions that could be asked about the company's accounting and financial procedures.

→ **tools** or work facilities (office automation, IT) that are adapted to everyone's needs and suitable training for every user;

→ **practices** which are commonly accepted within the company.

2) In-house dissemination of relevant and reliable information that enables everyone to exercise their responsibilities

The company's processes should ensure that all relevant and reliable information is communicated in a timely manner to all relevant players within the company, thereby enabling them to exercise their responsibilities.

3) A risk management system to identify, analyse and manage the main risks identified with regard to the company's objectives.
The risk management system is described in section II.1. General risk management principles.

4) **Control activities proportionate to the implications of each individual process and designed to ensure that appropriate measures are taken in order to control risks that could affect the company's ability to achieve its objectives**
Control activities can be found everywhere in the organisation, at every level, and in every function. They include controls focusing on prevention or detection, manual or computerised controls, and controls built into the reporting structure.
In any event, control activities are determined in the light of the nature of the objectives with which they are associated and are proportionate to the implications of each process. In this context, particular attention should be paid to the controls over the processes involved in the organisational, human and technical aspects of designing and running information systems.

5) On-going monitoring of the internal control system together with regular review its operation

As for any system, the internal control system requires on-going monitoring. The aim is to verify its relevance and appropriateness to the company's objectives.
Implemented by management, with oversight by the executive management or the executive board, this monitoring consists mainly of analysis of the main incidents that have been recorded, the result of controls performed, together with work carried out by the internal audit team, when there is one. This monitoring also takes into consideration the observations made by the statutory auditors and by regulatory supervisory bodies.

Keeping an active watch on internal control best practices can be another useful complement to the monitoring tools.
Monitoring, together with the best practices watch, culminate, where required, in the implementation of corrective actions and adjustments to the internal control system.

Executive management or the executive board should assess the parameters for informing the board of the main results of the monitoring and reviews thus performed.

4. Scope of risk management and internal control

It is up to each company to implement risk management and internal control systems that are appropriate for its situation.
In a group, the parent company shall ensure that its subsidiaries have risk management and internal control systems. These systems must be adapted to the subsidiaries' specific characteristics and to the relations between them and the parent company.
When a parent company has a substantial equity interest and significant influence over an affiliate, it should take care to assess the possibility of acquainting itself with and examining its affiliate's measures with regard to risk management and internal control.

5. Risk management and internal control players

Risk management and internal control are the business of entire company, from the governing bodies to employees.

a) Executive management or the executive board

Executive management is responsible for the quality of internal control and risk management systems, whether it acts directly or delegates its tasks. It is also responsible for designing and implementing internal control and risk management systems that are appropriate for the size of the company, its business and its organisational structure. This task includes defining the relevant roles and responsibilities within the company.

Executive management ensures constant monitoring of internal control and risk management systems with the aim of ensuring their integrity and improving them through adaptations to changes in the organisation and environment of the company. It initiates any remedial measures that become necessary to correct problems identified and to stay within accepted risk limits. It also ensures that these measures are carried out.

Executive management ensures that appropriate information is reported in a timely manner to the board of directors or the supervisory board and to the audit committee.

b) Board of directors or the supervisory board

The board's involvement in internal control and risk management varies from one company to the next. However, Article L. 225-100 of the Commercial Code requires the board of directors to give an account of risks in its management report, which must include:

- a description of the main risks and uncertainties facing the company,
- a description of the main risks and uncertainties facing the companies included in the consolidated financial statements,
- information about the company's use of financial instruments. This information must deal with the company's objectives and policies regarding financial risk management. It must also address the company's exposure to price risk, credit risk, liquidity risk and cash flow risk.

In practice, the board is informed of the key characteristics of the internal control and risk management systems chosen and implemented by executive management: organisational structure, roles and functions of the main players, procedures, risk reporting and control system monitoring structure. More specifically, it obtains a comprehensive overview of financial reporting procedures.

Basically, the board ensures that the major risks incurred by the company are in line with its strategies and its objectives and that these major risks are given due consideration in the management of the company.

Under these circumstances, the board is periodically informed of the operating results of these systems, the main problems detected during the previous period and the plans of action decided by executive management.

More specifically, the board checks with executive management to ensure that the monitoring, internal control and risk management systems are adequate to ensure the reliability of the company's financial reporting and to provide a fair view of the company's and the group's earnings and financial situations.

The board may use its general powers as needed to have any audits or verifications that it deems timely carried out or to take any other action that it deems appropriate in this regard.

c) Audit committee

The audit committee's role and duties are dealt with in detail in the document entitled "Audit Committees: Working Group Report".

d) Risk manager

When the position exists, the risk manager, or the person in charge of risk management, is responsible for deploying and implementing the overall risk management process as defined by executive management. For this purpose, the risk manager establishes a structured system that is both permanent and adaptable for the purpose of identifying, analysing and managing the main risks. The risk manager runs the risk management system and provides methodological support to the company's line and staff divisions.

e) Internal audit

When there is one, the internal audit department is responsible, within the scope of its duties, for assessing the operation of the internal control system and for making recommendations to improve it.

It helps raise awareness and train management personnel in internal control, but is not directly involved in the design or the day-to-day running of the system.

As part of its work plan approved by executive management, it examines compliance with laws and regulations, ensures that executive management's instructions are properly carried out and verifies the proper functioning of the company's internal processes relating to the reliability of reporting channels and information systems.

The internal audit manager draws up a work programme in light of the main risks incurred by the company and reports the significant findings of work carried out to executive management and, in accordance with the procedures defined by each company, to the board.

f) Employees

Management in each entity ensures that the company's risk management policy is applied. It is responsible for applying this policy and ensures that exposure to these risks complies with the executive management's risk management policy.

Risk management is the operational expression of the risk oversight system: it involves the implementation of the system for identifying, analysing and managing risks at the business line level by the division managers, major functions and by all employees.

All employees concerned should possess the knowledge and information required for creating, operating and monitoring risk management and internal control systems in light of the objectives assigned to them. This is particularly true of line managers dealing directly with the risk management and internal control systems, as well as with the internal controllers.

6. Statutory auditors' role

Statutory auditors' legal duties do not include participation in risk management and internal control systems. They learn about the systems, rely on internal audit work, when internal audit exists, to obtain a better understanding and formulate an opinion about the appropriateness of this work completely independently.

They certify the financial statements and, as part of their task, they may identify material risks and major internal control weaknesses that could have a significant impact on financial disclosures.

They present their observations about the chairman's report and about internal control procedures relating to financial reporting, and they certify that other information required by law has been produced.

7. Limitations of risk management and internal control

No matter how well-conceived and rigorously applied risk management and internal control systems are, they cannot provide an absolute guarantee that the company's objectives will be reached.
The probability of reaching these goals depends on more than just the company's will. Every system and process has its limitations. These limitations stem from many factors, such as uncertainty about the outside world, the use of sound judgment or problems that may arise from technical and human failures or from ordinary errors.
Risk management choices are made by weighing the opportunities against the cost of risk management measures, with due consideration of their potential effects on the occurrence and/or consequences of the risk in order to avoid taking needlessly expensive actions.

III. QUESTIONNAIRES ON GENERAL PRINCIPLES

The questionnaires are a helpful addition to the general document derived from the reference framework. In view of the specific features of each company, their presentation in no way suggests that all of the questions that they contain need to be considered when examining the risk management and internal control systems, or that all of the elements mentioned need to be present, or that the lack of any element needs to be explained.

1. Risk management questionnaire

If the board of directors has set up an audit committee, then the role attributed to the board in the following questions could just as easily be played by the audit committee.

Organisational framework for risk management

- *Has the company established risk management objectives?*
- *Have risk management responsibilities been defined and notified to the people concerned?*
- *Is the person in charge of risk management adequately qualified and does he have the support and confidence of managers to perform his duties with regard to line and staff managers?*
- *Have policies and procedures for managing the main risks been defined, approved by executive management and implemented in the company?*
- *Have the company's acceptable risk limits (risk tolerance) been defined, by executive management, where appropriate, and disseminated?*
- *Does the company have a "common language" for dealing with risk (uniform definitions, criteria for risk identification, analysis and monitoring, etc.)?*
- *Has the company identified its legal and regulatory obligations with regard to risk disclosure?*
- *Does the company provide internal information to the people concerned:*
    - *about risk factors?*
    - *about risk management systems?*
    - *about current actions and the people in charge of them?*

Risk identification

- *Is there a process for identifying risks that threaten attainment of the company's objectives? Has an appropriate structure been set up for this purpose?*
- *Have potential opportunity costs also been considered?*
- *Have systems been established to identify the main risks affecting the process of preparing the financial statements?*
- *Has the correlation of potential knock-on risks been considered?*

Risk analysis

- *Does the company analyse the potential impact of the main risks identified (quantified or not, financial or non-financial impact) and the estimated degree of risk control?*
- *Has the company's past experience with risks or that of similar entities been taken into consideration?*
- *Are several functions in the company involved in analysing the potential consequences and probabilities?*
- *Does executive management share risk analysis with the persons concerned?*
- *Does the risk analysis consider internal and external changes affecting the company?*

Managing the main risks

- *Are risks that exceed the acceptable limits defined by the company dealt with first? Has a residual risk level been defined?*
- *Do major risks give rise to specific actions? Has the responsibility for such actions been defined? Where appropriate, is implementation of these actions monitored?*
- *Does the company have a crisis management plan?*

Oversight and review of risk management

- *Does management receive information about the key characteristics of actions taken to manage the company's main risks (type of actions taken or hedges established, insurance, exclusions and the amount of coverage, etc.)?*
- *Have specific resources been allocated to implementation and supervision of the risk management procedures?*
- *Is there a mechanism that makes it possible, when necessary, to adapt risk management procedures to changes in risks and the external environment, as well as to changes in the company's objectives and business activities?*
- *Is there a system for identifying and correcting the main weaknesses in the risk management system used by the company?*
- *Has the board of directors or, where appropriate, the supervisory board, been informed of the main thrust of the risk management policies? Is the Board updated periodically on the main risks identified and the key characteristics of the risk management system, including the resources allocated and ongoing improvements?*

Accounting and financial disclosure

- *Has a schedule been established that summarises the group's periodic market disclosure requirements for accounting and financial information? Does this schedule specify:*
    - o *the nature and deadline for each periodic disclosure requirement,*
    - o *the people responsible for preparing the disclosures.*
- *Are there people responsible and procedures in place for identifying and meeting market disclosure requirements?*
- *Has a procedure been established for checking information prior to disclosure?*

2. Internal control questionnaire

Role of governance bodies[4]

If the board of directors has set up an audit committee, then the role attributed to the board in the following questions could just as easily be played by the audit committee.

- *Have the accounting principles that have a material impact on the presentation of the company's financial statements been formally validated by executive management, reviewed by the statutory auditors and presented to the board of directors or the supervisory board?*
- *Has executive management explained and substantiated the main accounting options and choices made to the board and have they been reviewed by the statutory auditors?*
- *Has a process been established for validating planned changes in accounting principles with due consideration of the economic aspects of the transactions? Does this process call for consultation with the statutory auditors and notification of the board?*
- *Does the board receive the statutory auditors' assurance that they had be given access to all the information necessary for the performance of their duties, especially in the case of consolidated companies?*
- *Does the Board receive the statutory auditors' assurance that they have made enough progress on their work at the cut-off date to be able to present all their material observations?*
- *Are the earnings components, balance-sheet presentation, financial position presentation and the notes to the financial statements explained to the board each time the published financial statements are prepared?*
- *Has the Board been informed of the existence of a management control function, which produces data that are periodically reconciled with the published financial information?*
- *Has management periodically informed the board of cash position monitoring, especially at times of major tension?*
- *Are any restrictions on cash flows within the group stemming from special clauses or the percentage of equity held clearly stipulated to the board?*

[4] Governance bodies, in the context of the questionnaire, means the board of directors or the supervisory board.

Accounting and financial reporting structure

- *Does the accounting and financial reporting function have access to the information needed to prepare the financial statements from the entities covered by the statements?*
- *Does the group have an accounting principles manual that specifies the accounting treatment for the most significant transactions?*
- *If financial statements are published in accordance with several sets of accounting standards at the individual company or consolidated level, have procedures been established for explaining the main restatements?*
- *Are there accounting procedures manuals and instructions describing the division of responsibilities for execution and control of accounting tasks, as well timetables for execution? As part of the preparation of the consolidated financial statements, are there dissemination procedures to ensure that the manuals and instructions are followed by subsidiaries?*
- *Have the people responsible for preparing the financial statements and financial information, and the various players who participate in the preparation of the financial statements been identified?*
- *Has a process been established to identify the resources required for the smooth operation of the accounting function? Does it give due consideration to foreseeable developments?*

Information system

- *Have information procedures and systems been developed to meet requirements with regard to the security, reliability, availability and relevance of accounting and financial information? Have the roles and responsibilities of the players been defined?*
- *Are line functions adequately involved in defining new data processing tools? Before, during and after the project?*
- *Are dealings with IT providers covered by a contract? Have performance and quality indicators been defined and are they reviewed regularly? Has the company's dependence on IT providers been analysed? Does the contract provide for on-site inspections of providers by the company and have they been carried out?*
- *Are information systems used for accounting and financial information adapted as the company's needs change? Has request and incident management been implemented?*
- *Are indicators used to measure quality of service (e.g. rejected data, abnormal response times, service interruptions, etc.)? Are there plans for analysis and implementation of remedial actions?*
- *Do authorisations and access rights to systems, as well as the environments hosting these systems, give due consideration to the segregation of duties?*
- *Have user security principles been defined and disseminated (e.g. password management, data transfers, Internet access, etc.)? Have physical security principles been defined and disseminated? Have logical security principles been defined and disseminated? Have access to data and software been protected by user profiles? Can transactions be traced, analysed and verified? Are there plans for an anti-virus system to protect against attacks and intruders?*
- *Have data back-up systems been established? Are they tested periodically?*
- *Have continuity of service measures been established in conjunction with users' needs? Are they tested periodically?*
- *Are record retention requirements with respect to information, data and computer processing used directly or indirectly to prepare accounting records and financial statements met?*

Control activities

- *Are regular audits and spot checks conducted to ensure compliance in practice with the manual of accounting principles and the manual of accounting procedures?*
- *Have procedures been established to identify and resolve new and unforeseen accounting problems in the accounting principles manual and/or the accounting procedures manual?*
- *Do internal control activities for accounting and financial reporting include procedures to protect assets (risk of negligence, errors and internal or external fraud)?*
- *Does the internal control system for accounting and financial reporting include specific audits of accounting aspects that are identified as critical, such as recognition of assets, recognition of earnings, accruals and inventory valuation?*
- *Are the procedures for preparing the group's financial statements applied in every consolidated entity? If there are exceptions, are there adequate procedures for dealing with them?*

APPLICATION GUIDE FOR INTERNAL CONTROL PROCEDURES RELATED TO THE ACCOUNTING AND FINANCIAL INFORMATION PUBLISHED BY THE ISSUERS

IV. APPLICATION GUIDE FOR INTERNAL CONTROL PROCEDURES RELATED TO THE ACCOUNTING AND FINANCIAL INFORMATION PUBLISHED BY THE ISSUERS

Preamble

This is an Application Guide to the general principles governing internal control procedures related to the preparation and processing of accounting and financial information for publication.

The guide is not a binding set of rules or standards; it is a tool to enable management bodies (senior management, management boards, financial departments, etc) and decision-making bodies (boards of directors, supervisory board) to understand and improve their internal control system for accounting and financial reporting.

It is designed to help companies and entities, especially those that are publicly listed, that wish to analyse their accounting and financial internal control procedures.

This Application Guide covers the principles and key analytical points that apply in all business sectors, except those sectors covered by specific rules, such as banking and insurance.

In view of the specific characteristics of each company and the need for internal control arrangements to be flexible and tailored to existing organisational structures, this presentation does not claim to be exhaustive. Neither does it insinuate that all the points it covers are applicable, that all of them need to be included, or that their absence must be explained. Possible discrepancies between a company's practices and these principles do not necessarily indicate inadequate internal control of accounting and financial reporting.

The approach focuses on the factors that contribute to the preparing and processing of accounting and financial information for publication.

Definitions

Internal control of accounting and financial information is effected through a system designed and implemented by a company to ensure, as far as possible, that the accounting and financial aspects of its business are rigorously managed and monitored so as to meet the objectives set out below.

Internal control of accounting and financial information is a key component of internal control. It covers the processes for producing and disseminating companies' accounting and financial information and contributes to the production of reliable information that complies with legal and regulatory requirements.

As for general internal control, it relies on an overall system that includes the design and implementation of the company's information system, as well as the policies and procedures for monitoring, supervision and control.

Objectives

Internal control of accounting and financial reporting is intended to ensure that:

- accounting and financial information complies with applicable rules;
- the instructions and guidelines given by senior management or the Management Board on the strength of this information are properly implemented;
- the company's assets are safeguarded;
- fraud and accounting and financial reporting problems can be detected or prevented as far as possible;
- the information disseminated and used internally for the purposes of monitoring and control is reliable, insofar as it is used in the preparation and processing of published accounting and financial information;
- the financial statements and other information provided to the market are reliable.

Scope

Internal control of accounting and financial information covers the parent company and consolidated companies ("the group"), if consolidated financial statements are produced.

Persons and bodies concerned

Internal control of accounting and financial information involves most of the key players in the company, who have different responsibilities and roles depending on the subjects being dealt with. Three corporate governance players are particularly closely involved:

- Senior management (or the Management Board) is responsible for organising and implementing internal control of accounting and financial information, as well as for compiling financial statements for each accounting period. To simplify matters, the term “senior management” will be used in the rest of this document to mean “senior management or the Management Board,”

- The Board of Directors, or the Management Board, which compiles the financial statements, and the Supervisory Board, which, like the Board of Directors, carries out such audits and verifications of the financial statements as it deems appropriate. To simplify matters, only the term “Board of Directors” will be used hereafter. Preparations for these tasks can be made by the Audit Committee, if the company has one;

- The Chairman of the Board of Directors (or the Chairman of the Supervisory Board), who is responsible for compiling the report on internal control procedures, including those relating to the preparation and processing of accounting and financial information.

The internal audit function, if one exists, can help these players by making proposals to improve the quality of internal control processes for published accounting and financial information.

Statutory auditors are not part of the internal control system. They certify the financial statements and, as part of their task, they review internal control procedures to identify and assess the risk of material discrepancies in the financial statements, in order to design and implement their audit procedures. They present their remarks about the Chairman’s report on internal control. In this area, they do not replace the company and their work does not replace the work carried out by the company.

Control environment

The internal control system for accounting and financial information must be more than just a set of procedural manuals and documents. The organisation and implementation of internal control hinges on the awareness and participation of the people concerned. The control environment thus encompasses the actions of the people and bodies involved in the internal control of accounting and financial information.

In this respect, consideration of the players’ ethical values, integrity and competence (see reference framework)[5]is critical in the more specific area of internal control of accounting and financial information.

Accounting processes

The accounting processes at the heart of internal control of accounting and financial information are a set of uniform activities that transform business transactions – all the basic events that make up the company's business – into accounting and financial information by putting them through the “accounting mechanism”, composed of accounting policies and ground rules. They include an accounting production system, preparation of financial statements and communications.
The diagram below shows that the processes involved in producing the information are not solely within the “conventional scope” of the Accounts and Financial Reporting Department.

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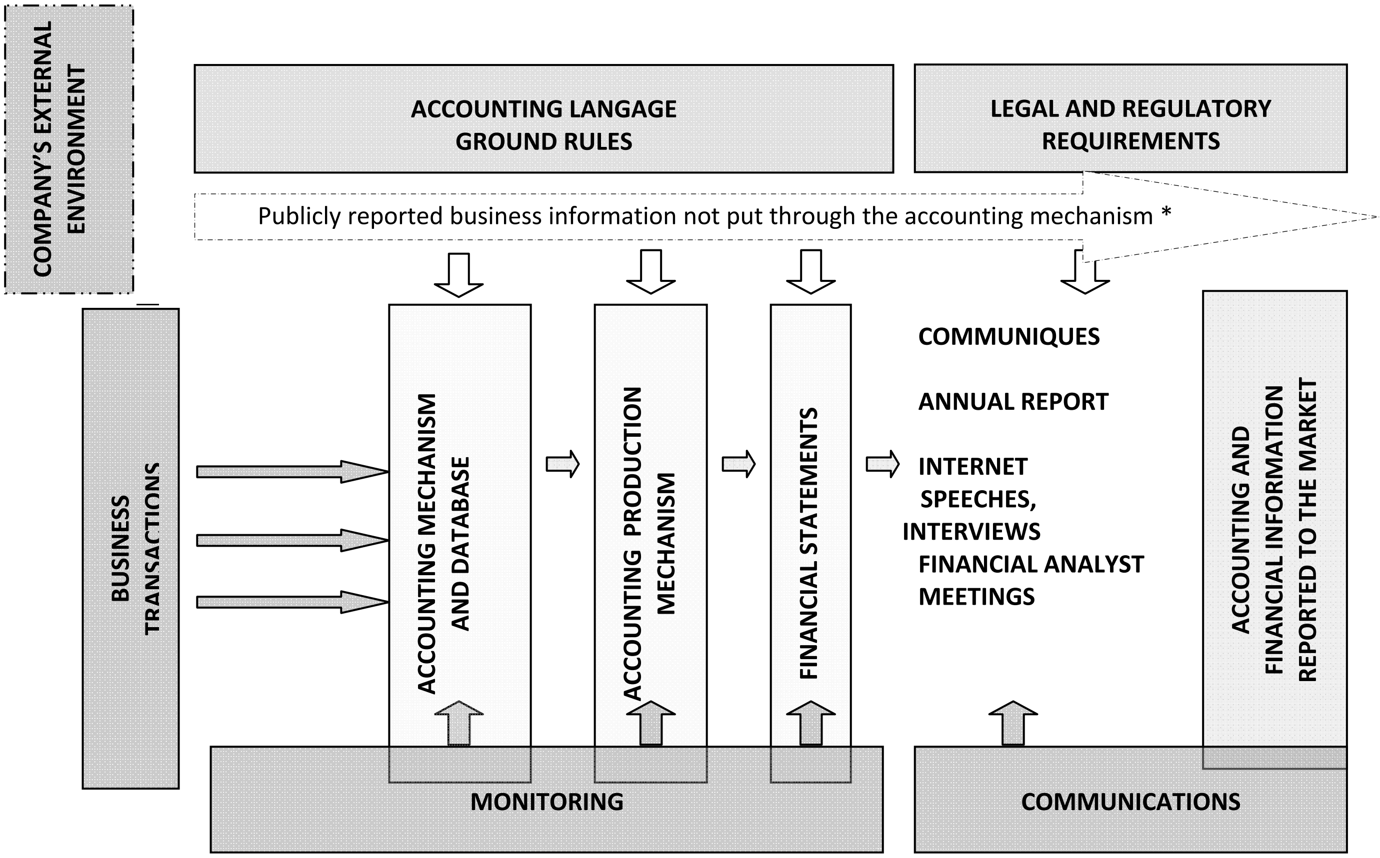
[5] *In view of the requirement in the Financial Security Act (Article 225-37 of the Commercial Code) that the Chairman of the Board of Directors or the Supervisory Board draft a report on internal control procedures, the AMF set up a Working Group in April 2005 to choose or adapt an Application Guide for internal control. The Working Group presented a reference framework on 9 May 2006 that takes into account French and European legal and regulatory provisions, as well as accepted good governance practices in France.*



** Publicly reported business information that is not put through the "accounting mechanism" is separate from published accounting and financial information. Such information is not addressed in this Application Guide.*

The accounting processes presented in this Application Guide exist in all companies. However, the approach used here is deliberately independent of organisational characteristics, such as:

- Whether the information systems are integrated or not (in an Enterprise Resource Planning application, for example);
- Whether accounting is centralised, decentralised or outsourced;
- The players' identities and functions.

Application Guide outline

The "accounting processes" discussed in this Application Guide can be broken down into two major groups:

- **Monitoring processes for the accounting and financial reporting structure;**
- **Processes involved in preparing published accounting and financial information. These are further broken down into:**
    - **Upstream processes (purchasing, sales, cash management, etc.) that provide the information for the accounting database and for the accounting and financial information production processes;**
    - **Financial statement preparation and financial communication processes.**

This Application Guide presents the internal control components for accounting and financial reporting that ensure effective control of these three groups of processes.

1. Monitoring processes for the accounting and financial reporting structure

The objectives of the monitoring processes for the accounting and financial reporting structure are to define and implement accounting policies and to manage resources and constraints in order to meet senior management's objectives. Monitoring of the accounting and financial reporting structure is based on the principles and key analytical points discussed in detail below. This monitoring is the task of the Accounts and Financial Reporting Departments, as well as senior management.

1.1. Principles and key analytical points

To ensure the overall coherence of this process, it is important to make sure that:

- Functions are separated in such a way as to ensure that the control process is independent. This functional separation is appropriate to the company's circumstances and an effort is made to segregate tasks and functions relating to operational factors, the protection of assets and their recognition in the accounts;

- The names of the persons with power of signature and the various levels of approval required, according to the type of obligations entered into, are defined and made available to the persons responsible for recording them so that they can ensure that the transactions have received proper approval.

When consolidated financial statements are produced, it is important to ensure that an organised and documented arrangement exists to ensure the uniformity of published consolidated accounting and financial information.

1.1.1. General organisation

- Internal documentation sets out and explains the principles for recognising and controlling transactions and the related financial flows.

- Information channels must be set up to:

  - Ensure comprehensive capture of business events for each upstream process (purchasing, sales, personnel, legal affairs, obligations, events after the cut-off date, etc.);

  - Provide rapid and periodic centralisation of data for the accounts department;

  - Ensure the uniformity of accounting data.

- Controls must be established to ensure implementation of information circuits.

- A timetable must govern the preparation of accounting and financial information disseminated within the group for the purposes of the parent company's published financial statements.

- The people responsible for preparing published accounting and financial information and the various players contributing to the financial statements must be clearly identified.

- Each employee involved in the process of preparing accounting and financial information must have access to the information needed to apply, operate and/or supervise the internal control system.

- Senior management must set up a structure that is responsible for ensuring that the controls are applied.

- The Accounts Department must have the authority to enforce accounting rules.

- Procedures must be established to verify that controls have been implemented, to identify any deviations from the rules and to remedy them if necessary.

1.1.2. Resources management

- A process has been established to identify the resources required for the smooth operation of the accounting function.

- Monitoring has been established to adjust manpower and skills to the scale and the complexity of transactions and to adapt to changing needs and constraints.

1.1.3. Enforcement of accounting rules

- A manual of accounting principles and/or procedures must set forth the accounting concepts used within the group and identify the treatment for the largest transactions and complex accounting treatments specific to the business sector of the group.

- A procedure has been established for updating the manual of accounting principles and/or procedures to cover complex new accounting issues.

- If financial statements are published in accordance with several sets of accounting standards at individual company or consolidated level, procedures must be established for explaining the main restatements.

- Information needed for the consolidation of the financial statements must be produced at the most appropriate place within the group.

- A regulatory watch procedure must be established to identify and anticipate changes in the company's environment (management of different accounting standards and divergences between them, changes in accounting doctrine and tax rules. Specialists should be called in as appropriate).

1.1.4. Control of accounting rules

- The processing and production of consolidated and subsidiaries' accounting and financial information (schedule of cut-off dates, adjustment of parent company accounts, etc.) must be controlled.

- Rules of conduct and ethics must be established to deal with accounting issues.

- Regular audits must be carried out to ensure compliance with the manual of accounting principles and the manual of accounting procedures.

- Specific audits must be conducted with regard to accounting aspects that are identified as business-critical, such as recognition of assets, recognition of earnings, matching of revenues and expenses, inventory valuation, etc.)

- Mechanisms must be established to identify, trace and deal with incidents and problems systematically.

1.1.5. Organisation and security of information systems

The following processes must be used to control the components of the accounting information production tool:

- The use of computerised accounting systems calls for a clear and formalised organisational structure, and measures to ensure the physical security of computer systems and data integrity;

- Information systems have been developed to meet requirements with regard to the security, reliability, availability and relevance of accounting and financial information;

- Overall information system organisation and operations must be governed by specific rules on system access, validation of processing, cut-off procedures, record keeping and verification;

- Procedures and controls must be established for quality assurance and operational security, for maintenance and development (or parameterisation) of accounting and management systems[6], along with other systems that provide data directly or indirectly to accounting and management systems;

- Critical information system controls must be established (preventing duplicate entries, thresholds for entries, limited access for critical transactions, automated reconciliations, etc.);

- Information systems used for accounting and financial information must be adapted as the company's needs change;

[6] *In this case, management systems that contribute to the preparation and processing of published accounting and financial information.*

- The company must be capable of meeting the specific requirements of the tax authorities:
    - Storage of data processed by computer applications that prepare accounting records or substantiate transactions recorded in the documents filed with the tax administration;
    - Documentation: Data and file management rules implemented by computer programs that contribute to the determination of book income, taxable income and tax returns must be described;

1.2. Role of senior management

1.2.1. Organisation, powers and resources

Senior management must ensure that an internal control system for accounting and financial reporting is in place and must organise supervision of the system. The system must be aimed at producing reliable accounting and financial information and providing a true and fair view of the company's earnings and financial situation in a timely manner. To this end, senior management must ensure that the system addresses the following points:

- The organisational structure and scope of responsibilities of the accounting and financial reporting functions ensure that the group has appropriate risk identification and control systems to ensure that the accounting and financial information published by the parent company is reliable;
- Incentive and compensation arrangements within the accounting and financial reporting functions are compatible with the internal control objectives;
- Accounting rules and procedures are formalised and disseminated (standards and procedural manuals);
- Record keeping requirements for information, data and processing routines used directly or indirectly to prepare accounting records and financial statements;
- Measures taken to ensure the retention and security of information, data and processing routines that contribute directly or indirectly to the preparation of financial statements (business continuity plans, especially for computer operations, archiving systems that comply with regulatory requirements, etc.);
- Periodic review of the suitability of the systems cited above and the resources made available to the accounting and financial reporting functions (e.g. human resources, data processing tools, etc.)

1.2.2. Monitoring and control

Senior management must ensure that a monitoring system is established to analyse and control the main identifiable risks that could potentially have an impact on the preparation of the accounting and financial information that the company publishes.

- More specifically, senior management must ensure that the standards and procedures disseminated within the company give due consideration to changes in the group's needs and in its environment (especially the regulatory environment). For this purpose, senior management must ensure that an appropriate process is established for identifying, explaining and validating changes in accounting principles.
- It must ensure that a management control system is established to meet the reliability requirements for published accounting and financial information:
    - Senior management must ensure that any non-compatible information system that might be used for monitoring business activities is reconciled with the accounting information system;
    - It must also provide quality assurance for forecasts that are published or used to measure the value of assets and liabilities, or for any other published accounting and financial information.

  This means that the management control system must be organised to ensure that the quality of information and forecasting is fit for this purpose (appropriate schedule for updating information, indicators and tracked information, suitable standard of variance analyses and the budget and forecasting process).

- When an internal audit structure is in place, senior management must ensure:
    - The suitability of the accounting and financial audit structure's organisation, powers, methods and tools;
    - The relevance of internal audit plans.

  It must also be informed of the internal audit function's findings and ensure that adequate remedial plans of action are implemented.

- Senior management must conduct a formal review of the accounting principles that have a material impact on the presentation of financial statements.

- Senior management must ensure that the internal control system for accounting and financial reporting is supervised. It must be informed periodically of malfunctions, shortcomings and enforcement problems, and ensure that remedial action is taken. It could be helpful to base this supervision process on the internal audit function, if one exists.

1.2.3. Preparing financial statements

- Senior management must ensure that a recording process has been established for major transactions, such as business acquisitions or disposals, restructuring and closing of key contracts, and that there is a validation process for these records.

- Senior management must obtain appropriate information about unconsolidated entities and examine the grounds for excluding them from the consolidation.

- Senior management must ensure that cut-off procedures are established for accounts that are deemed to be critical (revenue recognition, valuation of key assets, etc.)

- It must ensure that processes for determining and validating estimates, included in the published statements or financial information, are defined and implemented to ensure the quality of such estimates (information used, departments or persons involved, technical competence, etc.)

- It must ensure that the Accounts and Financial Reporting Department has compatible quality control systems (identification of suspense items, unanalysed accounts, unreconciled items or unapproved items, etc.) so that it can take remedial measures.

- If there are any exceptions to the procedures for preparing consolidated financial statements applying to consolidated subsidiaries, senior management must ensure that procedures have been implemented to compensate for non-compliance with the group's rules.

Senior management must prepare the financial statements, including the notes. For this purpose:

- They must specify and explain the main options and estimates that are based on their own judgment;

- They must highlight any changes in accounting principles and notify the Board;

- They must ensure that the major financial ratios (debt ratio, quick ratio, interest rate cover ratio, etc.) are analysed, and identify and explain the factors responsible for changes in earnings (current year versus previous year);

- They must prepare financial statements for cut-off dates and include the Accounts and Financial Reporting Department's comments and analysis;

- They must define the investor relations strategy (indicators, procedures, etc.) and propose or draft financial news releases.

1.2.4. Consideration of the statutory auditors' work

As part of its responsibility for preparing the financial statements and implementing internal control systems for accounting and financial reporting, senior management must hold discussions with the statutory auditors.

- They must ensure that the statutory auditors have reviewed the accounting principles and options that have a material impact on the presentation of the financial statements.

- They must ask the statutory auditors about the scope of their work and procedures. They must also read the findings of the statutory auditors' work on the financial statements.

- They must ensure that the statutory auditors are notified of any major shortcomings in internal control identified in the course of the financial year that are likely to have a material impact on the published accounting and financial information.

- They must ensure that any major internal control problems or shortcomings pointed out by the statutory auditors are given due consideration in the company's remedial measures.

1.3. Role of the Board or Directors or the Supervisory Board

1.3.1. Control and verification

As part of its preparation and supervision of accounting and financial information and the communication of such information, it is critical for the Board to be informed of any major aspects that are likely to jeopardise business continuity.

As in all other areas, the law gives the Board the right to carry out any controls and audits that it deems necessary. This means it can check with senior management that the monitoring and control systems are capable of ensuring that the financial information published by the company is reliable and provides a fair view of the company's and the group's earnings and financial situations.

To exercise this control:

- The audit committee, if the company has one, can carry out preparatory work.

- They must be notified of the key characteristics of the company's and the group's monitoring systems and, more specifically, the risk monitoring, management control, finance and cash monitoring systems, as well as controls carried out by the internal audit function or any other functions;

- They can ask to be informed of the main processes for collating and communicating accounting and financial information;

- As appropriate, they must be informed of any changes in accounting methods and accounting options used by the company that have a material impact on the presentation of financial statements;

- They must provide quality assurance for the process of selecting statutory auditors, especially with regard to the competence and independence criteria applied;

- They must be informed of key events in the company's business and its cash position if they are likely to jeopardise business continuity (in the second case, the cash flow considered in the analysis presented to the Board must indicate the components that cannot be used unrestrictedly).

- Furthermore, the Board must be informed of:

    - publicly reported earnings projections, when it deems such information appropriate;

    - major investment, disposal or financing plans;

- As appropriate, the Board must also be informed of the material facts regarding acts of fraud, violations of laws and regulations, and major internal control shortcomings that are likely to be taken into account when preparing the financial statements;

1.3.2. Approving financial statements

The Board of Directors or the Executive Board must approve the annual financial statements and examine the interim financial statements. For this purpose, it must obtain any information that it deems necessary, such as information about cut-off options, estimates, changes in accounting methods and explanations about earnings components and the presentation of the balance sheet, the financial position and notes to the financial statements.

1.3.3. Relations with statutory auditors

- The statutory auditors must confirm to the Board that they have had access to all the information needed to carry out their duties, especially in the case of consolidated companies.
- The Board must be informed of the statutory auditors' scope of action and working procedures, as well as their findings.
- They must ensure that any major internal control problems or shortcomings pointed out by the statutory auditors are given due consideration in the company's remedial measures.
- The Board must be given the statutory auditors' assurance that they have made enough progress on their work at the cut-off date to be able to present all their material observations.

2. Processes involved in preparing published accounting and financial information

2.1. Quality criteria

The quality of accounting and financial information also depends on proper identification of the risk of error inherent in accounting processes. This identification may be based on various criteria and compliance with such criteria should be the goal, so that the information in the financial statements presents a true and fair view. These criteria, which are explained below, have been taken from the Decree of 19 July 2006 on the professional code of practice for statutory auditors with regard to the probative value of evidence gathered.

Upstream processes and accounting production processes

1. Materiality: The recorded transactions and events actually took place and are related to the entity;
2. Exhaustiveness: All of the transactions and events that should have been recorded have been recorded;
3. Measurement: The amounts and other data relating to transactions and events must have been recorded correctly;
4. Accrual basis: Transactions and events have been recorded in the right period;
5. Classification: Transactions and events have been recorded in the relevant accounts;

Financial statement preparation process

1. Existence: the assets and liabilities truly exist;
2. Rights and obligations: The entity owns and controls the rights to the assets and the liabilities correspond to the entity's obligations;
3. Exhaustiveness: All assets and liabilities that should have been recorded have actually been recorded;
4. Valuation and allocation: Assets and liabilities are recorded in the financial statements with appropriate amounts and all the adjustments resulting from their valuation or allocation are recorded correctly;

5. Presentation and comprehension: Financial information is presented and described appropriately, and the information provided in the notes to the financial statements is presented clearly.

6. Materiality/Rights and obligations: The events, transactions and other elements provided actually took place and are related to the entity;

7. Exhaustiveness: The notes to the financial statements present all of the information required by accounting standards;

8. Measurement and valuation: Financial and other information is presented fairly and the amounts given are reliable.

2.2. Identifying risks affecting the preparation of published accounting and financial information

The quality of published accounting and financial information depends heavily on the reliability, regularity of dissemination and exhaustiveness of information from the “upstream processes,” as well as on accounting production and financial statement preparations. Accordingly, quality depends on a proper command of the processes discussed below.

Upstream processes and accounting production processes

- Identifying upstream processes/significant transaction categories and the relevant accounts or groups of accounts.
- Defining control activities to be implemented to prevent, detect or remedy risk areas, irregularities and inaccuracies, as well as fraud and error prevention procedures.
- Identifying applicable legal and regulatory provisions relating to accounting, tax and financial reporting.
- Safeguarding assets to ensure the protection of the company’s assets and means of production, etc.
- Traceability of information (audit trail) and adequate documentation to ensure that accounting events occurring in the company are properly identified and documented.
- Compliance with processes aimed at ensuring the reliability of the information needed to produce the published financial statements.
- Accuracy and exhaustiveness of accounting records.
- Compliance with accounting rules.

Financial statement preparation process

- Neutrality, objectivity and relevance of the published accounting and financial information with regard to the users’ needs, the timeliness and the comprehension of such information.
- Definition and dissemination to all integrated entities of the procedures for preparing consolidated financial statements that comply with these criteria.
- Traceability of accounting entries within information systems.
- Verification before compiling the consolidated financial statements (compliance with accounting standards and the group’s practices, tests of reasonableness, etc.)
- Financial statement analysis systems (control methodology, identification of the persons in charge of analysis and supervision, nature of analyses and documentation).

2.3. Principles and key analytical points

Accounting processes are often set up to deal with flows of uniform or similar transactions (e.g. structure by categories of transactions). This Application Guide proposes adaptations of quality criteria for each transaction category (sales, purchasing, etc.) that can be applied to each of the accounting processes.

The following principles and key analytical points have been formulated in affirmative, rather than interrogative form. They can be used to identify the main risks that might affect the processes involved in preparing accounting and financial information.

Control of accounting processes is the responsibility of the Accounts and Financial Reporting Department, senior management and the Board of Directors, according to their respective areas of competence.

For all transaction categories discussed below, the company may ensure that organised and documented systems are established to provide uniform accounting and financial information for consolidated financial statements.

2.3.1. Investment / Divestment / research and development

Control of the upstream processes and accounting production processes

- Investment and divestment are covered by an organised and documented process that calls for notification of the accounts department.
- Regarding research and development expenditure:
    - The research and development phases of projects are defined clearly and are distinct;
    - The accounting rules used by the company define the requirements for capitalising development costs.

Control of the financial statement preparation process

- A verification conducted on the cut-off date confirms that the requirements for capitalising development costs are still being met.

2.3.2. Tangible and intangible assets, and goodwill

Control of the upstream processes and accounting production processes

- The accounting rules used by the company define:
    - Identification criteria for fixed assets, including the rules for distinguishing between current costs (maintenance and repairs) and capitalised costs;
    - Recognition criteria for fixed assets that deal with the following questions:
        a. The items that constitute capital costs for fixed assets, including procedures for determining and monitoring the cost of rehabilitating sites in the case of tangible assets;
        b. Depreciation and amortisation methods and start dates. This item includes procedures for applying the component-based approach and the procedures used to determine residual values;
        c. The criteria for determining impairment losses and, more specifically, the procedure for determining the discount rate and the level (sectors, for example) at which cash generating units are defined and rates are calculated;
        d. Held-for-sale classification criteria;
        e. Categories of revalued assets and the revaluation method used (fair value or index).

- These rules are reviewed periodically.
- Movements of fixed assets are tracked for recognition purposes.
- Commitments for fixed asset purchases are tracked so that they can be included when preparing the notes to the financial statements.
- The classification of financial and operating leases is set out clearly for the purposes of accounting treatment.
- Tangible fixed assets are verified periodically by taking inventory. Write-offs or disposals of assets are subject to a manager's approval and the necessary accounting adjustments are made.
- Title documents are properly protected (minimum compliance with legal obligations, for example).
- Disposals of assets are subject to an authorisation procedure that is disseminated within the entity.
- A process for identifying, recognising and tracking intangible assets and goodwill has been established, especially for goodwill and the cost of acquiring brands, licences, patents, business, customer files, other contractual rights, etc.
- Legal and software protection of intangible assets is monitored regularly and measures are taken to secure the resources that the company may derive from such assets (brand protection, domain names, etc.)

Control of the financial statement preparation process

- If the fair value method is used, valuations are made by specialists or on the basis of regularly updated market data.
- A procedure for identification of impairment loss indices is implemented at least once a year and systematically on each cut-off date for unamortisable intangible assets, intangible assets in progress and goodwill.

2.3.3. Long-term investments

Control of the upstream processes and accounting production processes

- Securities transactions (acquisitions, disposals, price supplements, asset and liability guarantees) are tracked for recognition.
- Outright and optional obligations of all kinds (commitments, calls, puts, etc.) are identified for the purposes of recognition or inclusion in the notes to the financial statements.
- Loans granted, especially to subsidiaries, are subject to an organised process.
- Title documents and loan contracts are properly protected.
- If consolidated financial statements are drawn up under IFRS, the classification rules for the various financial instrument categories defined in IAS 39 have been clearly established and a procedure is used to verify that the classification decision has been duly authorised, from the inception of the transaction.

Control of the financial statement preparation process

- Earnings from long-term investments are valued on each cut-off date.
- At each cut-off date, an objective indicator of impairment of financial instruments is assessed. The impairment losses to be recognised are determined, as appropriate.

2.3.4. Purchases / Trade payables

Control of the upstream processes and accounting production processes

- The purchasing process has been organised with formal procedures to be applied by all the players concerned.
- The functions for ordering and authorising orders are separated, as are the functions for receiving and recording purchases and for paying suppliers.
- Major purchases are subject to an official purchase order that has been validated by a duly authorised person.
- Purchase orders are tracked and reconciled with receiving reports and invoices (quantities, prices, payment terms). Any discrepancies found are analysed and monitored.
- A system has been established to prevent double recording or double payment of suppliers' invoices.
- Prepayments of suppliers' invoices are controlled (authorisation, tracking, accounting entries).
- Rejected deliveries and disputes are monitored, along with the recognition of supplier credit notes corresponding to discounts and rebates.
- An independent and duly authorised person controls the management of supplier payments.
- Suppliers' accounts are examined and substantiated periodically (exhaustiveness, accuracy).

Control of the financial statement preparation process

- A procedure has been established to ensure that income and expenses are recorded in the correct period.
- A system has been established for complete and accurate recording of provisions for invoices to be received or prepaid expenses.

2.3.5. Costs / Inventories and works in progress / Long-term or construction contracts

Control of the upstream processes and accounting production processes

- Physical inventory is taken (at least one a year or, in the case of perpetual inventories, during cycle counts).

The processes may concentrate on ensuring that:

- Physical deliveries of commodities or components are entered in inventory and recorded in the accounting systems;
- Inventory disbursements to production are recorded in the accounting system;
- Production costs are calculated appropriately and the relevant expenses are recognised fully and accurately (if such costs are used for inventory valuation);
- The calculation of production costs is consistent with real accounting items;
- Other items that can be used to value inventories, such as net cost of purchases, entries and disbursements, are duly recorded, retained and updated.
- Margins are monitored in order to ensure correct tracking of inventory impairment;
- The accounting rules that the company applies to long-term contracts or construction contracts (IAS 11) define a reliable procedure for measuring stages of completion and correctly identify losses on completion;

- All recorded inventory is adequately protected, owned by the company and/or fits the definition of an asset.

Control of the financial statement preparation process

- A procedure has been established to ensure accruals are correctly recorded.
- A system has been established for ensuring that work-in-process inventory is consistent with orders received and work in progress.
- A process has been established to ensure that impairment provisions are estimated and booked as appropriate.

2.3.6. Ordinary income / Trade receivables

Control of the upstream processes and accounting production processes

The processes may be aimed at ensuring that:

- The company's accounting rules make a clear distinction between sales and the provision of services, and describe the procedures used to decompose contracts with multiple components, when necessary;
- Ordinary sales income is recognised if all of the following conditions have been met:
  - The company has transferred the major risks and benefits inherent in ownership of the goods to the purchaser;
  - The company is no longer involved in the management usually incumbent upon the owner of the goods, or in the actual control of the goods sold;
  - The amount of ordinary sales income can be reliably determined;
  - The economic benefits associated with the transactions are likely to accrue to the company, and;
  - The costs incurred or to be incurred in the transaction can be determined reliably.
- All of the deliveries made (or services rendered) have been invoiced during the appropriate period;
- All sequentially numbered invoices have been recorded in the customer accounts or directly as sales revenue;
- Issuance of credit notes is substantiated and verified. Only verified credit notes are recorded in the accounts;
- A genuine separation has been established between invoicing and collection functions;
- A genuine separation has been established between the collection and customer account management functions;
- All customer accounts correspond to actual customers;
- The account balances are correctly substantiated periodically;
- Delinquent accounts are correctly identified and insolvency risks are recorded in the accounts in compliance with the applicable rules.

A system has been established to exclude income that has been invoiced or is to be invoiced on behalf of other parties from ordinary sales income.

Control of the financial statement preparation process

- A procedure has been established to ensure that income and expenses are recorded in the correct period.

- A system has been established to record invoices to be issued or prepaid income completely and accurately.

- Impairment loss provisions are reviewed for re-measurement, as appropriate (for example, on the basis of an aged trial balance, or on the basis of the latest developments in disputes with customers).

2.3.7. Cash / Financing and financial instruments

Control of the upstream processes and accounting production processes

- Financing and cash are subject to organised processes (procedures, assignment of powers, etc.) and formal criteria.

The processes may be aimed at ensuring that:

- The cash plan can be used to monitor foreseeable developments in the company's own cash holdings and, where appropriate, the cash holdings of subsidiaries that the company has a contractual right to use;

- Cash and cash equivalents, subject to restrictions on their use over 12 months or more, are identified and given special accounting treatment;

- Cash transactions are recognised on a daily basis;

- Bank accounts are reconciled periodically with the data received from banks and subjected to periodic reviews using procedures that comply with the principle of separation of functions. Physical records are made of reconcilations and used to explain any discrepancies;

- Expenditures are authorised, paid and recognised by different people;

- Loan accounts are periodically reconciled with the contractual data, the repayment schedules and the data received from financial institutions;

- Repayment schedules are calculated using the depreciated cost method (at the effective interest rate) and drawn up when the loan is activated;

- Hedging transactions are adequately documented and procedures have been established to ensure that, when hedge accounting is chosen, the choice is made at the inception of the hedge;

- Loan guarantees received or given are clearly identified and recognised in the financial statements and/or in the notes to the financial statements.

Finally:

- A procedure has been established to identify complex financial instruments so that they can receive prior approval (under the company's rules) and accounting treatment that complies with the applicable standards (IAS 39, for example);

- An inventory is taken of other commitments given or received in relation to cash and financial instruments for their recognition or inclusion in the notes to the financial statements.

Control of the financial statement preparation process

The processes may be aimed at ensuring that:

- Financial expenses and income calculated using the effective interest rate method are correctly valued and recognised;

- Foreign currency cash and loans are correctly valued;

- Interest rate and currency derivatives are correctly valued.

2.3.8. Employee benefits

Control of the upstream processes and accounting production processes

- “Payroll” activities are subject to procedures that are known and adapted to the organisational choices made (in-house or outsourced processing).
- A separation has been established between the functions for calculating, recording, auditing, making payments and issuing payslips.
- A system has been established to ensure complete, accurate and timely transmission of the data needed to calculate pay (hours worked, overtime, wage increases, bonuses, new hires and departing employees, etc.)
- A process has been established to ensure clear information about employee benefits, especially post-employment benefits that are subject to complex actuarial calculations and nonmonetary benefits or other benefits that can be subject to valuation.
- Payroll entries are audited by a person with an appropriate level of responsibility.
- The accuracy of wage payments is subject to audits.
- The company’s accounting rules specify the accounting treatment for shares and options attributed to directors and employees.
- Payroll and social security contribution accounts are examined and substantiated periodically.

Control of the financial statement preparation process

A system has been established to ensure proper counting, valuation and verification of proper accounting of:

- Provisions for paid holidays;
- Obligations related to employee saving schemes;
- Long-term employee benefit obligations;
- Obligations for pensions and other post-employment benefits.

The company must call on actuaries, when necessary, to value its retirement pension obligations and other employee benefits.

2.3.9. Taxes

Control of the upstream processes and accounting production processes

- A process has been established for monitoring obligations stemming from tax laws, regulations and instructions.
- Current year transactions, contracts, agreements, transfer pricing structures, etc. are analysed periodically from the tax perspective.
- A process has been established to ensure that the processing, preparation and filing of tax documents, and tax payments are carried out correctly and on time.
- A process has been established to ensure retention of the information needed to record taxes and business events relating to taxes, especially for the validation of effective tax rates and for determining deferred tax liabilities.
- An accounting system has been established to monitor the company’s deferred tax position.
- Total tax expense, as shown in the consolidated income statement, is reconciled with the theoretical tax expense (tax proof).

2.3.10. Equity transactions

- A process has been established to ensure that the necessary authorisations have been given for all transactions involving the company's capital.

- A procedure has been established for tracking stock options (documentation of attribution dates, monitoring of options attributed and expired options, etc.)

- A procedure has been established to specify accounting regulations on advances on dividends.

2.3.11. Provisions and obligations

Control of the upstream processes and accounting production processes

- Obligations are identified using an organised process and established criteria.

- The company provides a clear definition of obligations and notifies the staff concerned.

- Obligations are identified periodically and covered by centralised reporting.

- The company ensures that commitments given and received, and reciprocal commitments are duly authorised.

- A process has been established to ensure that the company provides information about its obligations in the notes to its financial statements, in compliance with applicable accounting principles.

Control of the financial statement preparation process

- The company periodically accounts for its obligations and risks and determines, in collaboration with its experts and advisers, whether provisions or information in the notes to the financial statements are required. The company sets aside a provision whenever it has a legal or implicit obligation arising from past events and this obligation is likely to result in the disbursement of funds to third parties with no equivalent consideration expected in return and when a reliable estimate of the amount can be made.

- It analyses provision allocations and write-backs (distinguishing the proportion used) in order to assess the reliability of its risk measurement and analysis.

- More specifically, the company reviews and values the expenses and risks relating to:

    - Sales (rebates, price reductions, coupons, gifts, guarantees, etc.);

    - Requirements for bringing sites into compliance, rehabilitating sites, pollution clean-up and similar obligations;

    - Restructuring (indemnities, moving expenses, etc.);

    - Losses on contracts or financial instruments.

2.3.12. Consolidation

Control of the upstream processes and accounting production processes

Processes have been established to ensure that:

- The scope of consolidation is kept up to date and documented;

- Consolidation statements are drawn up in accordance with uniform accounting rules and principles by consolidated companies;

- Intercompany transactions are identified and eliminated, especially financial transactions and intercompany income (margin on inventories, dividends, income from the disposal of assets, etc.)

Furthermore:

- Consolidation entries are recorded and tracked in a special ledger;
- Variations in controlling shares of subsidiaries and investments are tracked in real time to ensure appropriate treatment at the cut-off date (scope of consolidation, changes in the consolidation method, etc.);
- Organisational measures ensure access to the information required for the treatment of companies consolidated by the equity method in the consolidated financial statements.

Control of the financial statement preparation process

- Uniform accounting principles are applied in consolidated financial statements.
- The accounting rules used define the consolidation criteria for subsidiaries and the methods applied.
- The percentage of holdings and the control situation of subsidiaries, investments and controlled entities are analysed to ensure the appropriate consolidation method is used for each one.
- Subsidiaries' individual financial statements are compared to the consolidated financial statements to analyse and track discrepancies and deferred taxes.
- The difference between the net consolidated closing position and the net consolidated opening position is analysed and explained.
- Variations stemming from the cash flow statement are analysed and explained.

2.3.13. Management information required for preparing accounting and financial information for publication

Control of the upstream processes and accounting production processes

- Management data (cost accounting, reporting, budgeting, etc.) required for preparing published accounting and financial information are reconciled periodically with the relevant accounting data (especially for the substantiation of the values of goodwill and recognised unamortisable intangible assets).
- Any discrepancies are analysed in compliance with the principle of separation of functions.

Control of the financial statement preparation process

- Published data are reconciled with internal data.
- The value of certain assets is validated by comparison to management data when required by accounting principles and rules (calculating impairment losses on intangible and tangible assets as appropriate).

2.3.14. Management of external financial information

Control of the upstream processes and accounting production processes

- Compliance and officers and processes have been established to identify and meet financial market disclosure requirements.
- A process has been established to monitor financial disclosure requirements.
- A schedule has been established that summarises the group's periodic disclosure requirements for accounting and financial information. The schedule specifies:
    - The nature and deadline for each periodic disclosure requirement;
    - The people responsible for preparing disclosures.

- A process has been established to ensure that external information:
    - Is disclosed on time;
    - Is in compliance with laws and regulations.
- A process has been established to ensure the reliability of non-accounting business information disclosed along with accounting and financial information (for example staffing and volume figures).
- A process has been established to ensure the protection of confidential information, in compliance with the rules set out in the AMF General Regulation.
- A process has been established to ensure that information fitting the definition of inside information is disclosed to the market in a timely manner, in compliance with the applicable rules. For this purpose, the company has an information system that enables it to monitor material events and transactions taking place during different accounting periods, as well as outcomes that are materially different from the objectives disclosed to the market.

  A process has been established for checking information prior to disclosure.

APPENDICES

Annex 1

Lists of participants in the Working Group's work

Members of the working group

Chairman: Olivier Poupart-Lafarge, member of the AMF Board

Chairmen of the sub-groups

- Patrice Marteau, Chairman, ACTEO
- Didier Martin, Attorney, BREDIN PRAT
- Gérard Lancner, Chairman, AMRAE

Members of the working group

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- Philippe Christelle, Internal Audit Director, CAP GEMINI
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- Philippe Jeunet, Member of the Executive Committee in charge of Audit and Risk Management, GDF-SUEZ
- Dominique Laboureix, Director of Research and International Relations, SGACP
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- Michel Léger, Chairman, BDO
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- Charles Paris de Bollardière, Chairman of the Audit Committee, STERIA
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- Philippe Santi, Deputy Chief Executive Officer, INTER PARFUMS
- Patrick Sayer, Chairman, EURAZEO
- Louis Vaurs, Chief Executive Officer, IFACI
- Caroline Weber, Chief Operating Officer, MIDDLENEXT

- Daniel Barlow, Representative, Central Administration of the Ministry of Justice (DACS)
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- Emmanuel Susset, Representative, Directorate General of the Treasury and Economic Policy (DGTPE)
- Edouard Vieillefond, Deputy Secretary General, Regulation Policy and International Affairs Division, AMF
- Sophie Baranger, Director of Accounting Affairs Division, AMF

Working group rapporteurs

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- Patricia Choquet, Legal Affairs Division, AMF
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Michel Léger	Auditor
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Non-voting members

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	Christophe Izard
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Banking federation	Jean Tricou
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Hubert Reynier: Secretary General’s Deputy
Philippe Danjou: Accounting and Auditing’s Director
Maryline Dutreuil-Boulignac: Regulatory Policy and International Affairs’s officer
Etienne Cunin: Accounting and Auditing’s Officer

Participants in the Technical Group's work on drafting the Application Guide for internal control of accounting and financial information published by issuers

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Michel Léger	Chair, Technical Group	Member of the Working Group	Auditor
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François Dugit-Pinat	AFEP	Alcatel	Consolidation and Accounting Procedures Director
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AMF Group Secretariat

Patrick Parent: Accounting and Auditing Department
Florence Tiberini: Accounting and Auditing Department
Etienne Cunin: Accounting and Auditing Department

Annex 2

Leading publications on risk management and internal control

- ***AMRAE publications on risk management:***

- La cartographie : un outil de gestion des risques, nouvelle édition - janvier 2010 (Collection Maîtrise des risques)
- Comparatif des référentiels de gestion des risques, janvier 2010

- ***IFACI publications on risk management procedures:***

- La cartographie des risques, groupe professionnel Assurances, juillet 06 (cahier de la recherche –guide d'audit-) ;
- Etude du processus de management et de cartographie des risques, janvier 2004 (cahier de la recherche – guide d'audit-) ;
- Risk Management, 2001 (translation of a book in English)

- ***IFACI publications on internal control:***

- Commentaires relatifs à la transposition des 4ème,7ème et 8ème directives européennes (Groupe professionnel « contrôle interne de l'IFACI), juin 09 ;
- Le contrôle interne du système d'information des organisations, février 09 (Guide opérationnel d'application du cadre de référence AMF relatif au contrôle interne, élaboré par un groupe de travail mixte IFACI/CIGREF) ;
- Contrôle interne et qualité, pour un management intégré de la performance, mai 08 (cahier de la recherche-notes professionnelles-) ;
- Des clés pour la mise en œuvre du CI, avril 08 (cahier de la recherche- meilleures pratiques-) ;
- L'auto-évaluation du contrôle interne, oct.05 (cahier de la recherche-guide d'audit-).

- ***AFEP, ANSA, MEDEF and MiddleNext publications:***

- Systèmes de contrôle interne et de gestion des risques (« CIGR ») Principes communs pour les sociétés européennes AFEP ANSA MEDEF Middlenext (Mars 2010)

- ***- European Issuers Document:***

- Position paper, "Towards Common Principles for Internal Control & Risk Management Systems at Listed Companies in Europe", January 2010