



3. INTERNAL CONTROLS AND RISK MANAGEMENT SYSTEMS

The Board of Directors of D'leteren S.A. performs its control duties on the Group entities (Automobile distribution and Corporate, Avis Europe and Belron, hereafter collectively "the Group") by (i) ensuring that these entities' bodies correctly perform their own control duties and that committees entrusted with special survey and control tasks (such as an Audit Committee and a Remuneration Committee) are put in place and function properly and (ii) ensuring that reporting procedures are implemented to allow the Board to follow up at regular intervals the Group entities' businesses, notably regarding the risks they are facing, and to acknowledge the decisions taken by the entities' bodies.

The Board of Directors is assisted by the Group's Audit Committee (hereafter "the Audit Committee") in the exercise of its control responsibilities on the Company's entities, in particular as regards the financial information distributed to shareholders and to third parties and in monitoring the mechanisms for risk management and internal control.

Against this background, the effectiveness of the Group's system of controls, including operational and compliance controls, risk management and the Group's internal control arrangements, has been reviewed. Such a system is designed to manage, rather than eliminate, the risk of failure to achieve business objectives, and can only provide reasonable, and not absolute, assurance against material misstatement or loss.

These reviews have included an assessment of both financial and operational internal controls by the internal audit of each entity and reports from the external auditor on matters identified in the

course of its statutory audit work.

3.1. INTERNAL CONTROL ENVIRONMENT

3.1.1. The system of internal control includes but is not limited to:

- > clear definition of the organisation structure and the appropriate delegation of authorities to management;
- > maintenance of appropriate separation of duties together with other procedural controls;
- > strategic planning and the related annual budgeting and regular review process;
- > monthly reporting and review of financial results and key performance statistics;
- > adoption of accounting policies to help ensure the consistency, integrity and accuracy of the Group's financial records;
- > specific treasury policies and the regular reporting and review of all significant treasury transactions and financing activities;
- > procedures for the authorisation of capital expenditure;
- > internal audit reviews;
- > policies and business standards.

3.1.2. The effectiveness of the system of internal control has been reviewed through the following processes:

- > review of internal and external audit plans;
- > review of any significant reported unsatisfactory control matters;
- > review of any control issues that arise from internal and external audits together with any additional matters brought to its attention;
- > review of any significant risks identified by the Group's risk management process;
- > discussions with management on any significant new risk areas identified

by management and the internal and external audit processes.

The Audit Committee receives a regular report on the work carried out by the Audit Committee of each entity and makes in turn its own reporting to the Board.

3.2. ASSESSMENT OF BUSINESS RISK

3.2.1. The Group ensures that business risks, whether strategic, operational, reputational, financial, legal or environmental, are both understood and visible as far as practicable. The Group's policy is to ensure that risk is taken on an informed rather than unintentional basis.

3.2.2. Each entity conducts an annual risk review and updates its risk register with each risk's impact, probability and mitigation actions. This approach forms the cornerstone of the risk management activities of the Group, the aim of which is to provide the assurance that the major risks the Group faces have been identified and assessed, and that there are controls either in place or planned to manage these risks.

A summary of the main risks the Group faces is provided hereafter.

3.3. INTERNAL AUDIT

3.3.1. Each entity has its own internal audit and risk management function, which is independent of its external auditors and which may work in partnership with an outsourced provider, where specialist skills are required. The review ensures that these functions are appropriately staffed, that their scope of work is adequate in the light of the key identified risks the en-

tity faces and that the annual internal audit plan is properly approved.

3.3.2. The Audit Committee of each entity ratifies the appointment and dismissal of its internal audit manager and assesses his independence and objectivity and helps ensure that he has unfettered access to management and to the Audit Committee.

3.3.3. The role of internal audit of each entity is to:

- > assess the design and operating effectiveness of controls governing key operational processes and business risks;
- > provide with an assessment, independent of management, as to the adequacy of the entity's internal operating and financial controls, systems and practices;
- > provide advisory services to management in order to enhance the control environment and improve business performance.

3.4. KEY RISKS

3.4.1. Business risks

3.4.1.1. Industry risk

The automobile distribution business may be impacted by several factors relating to the car industry and the volume of cars sold on the Belgian market. Overall demand and mix may be affected by factors including general economic conditions, availability of credit to potential buyers, the tax treatment of company cars or CO₂ emissions. Specific demand for the distributed makes depends on the success of models developed by their automotive suppliers (VW, Porsche, Yamaha) and their adequate pricing on the Belgian market.

In addition to general economic con-

ditions which affect demand from corporations or individuals, disruptions in air travel patterns or a general decrease in air travel as a result of a significant event such as a terrorist incident or as a consequence of increased security measures being taken by the authorities in anticipation of such a threat may specifically affect the demand in the car rental activity.

In the vehicle glass repair and replacement business, mild weather conditions, reduction in number of miles driven (e.g. as a result of an increase in fuel prices) or reduction of average speed on roads as a result of speed limit enforcements are unfavourable factors as they tend to reduce the frequency of glass breakage. Changes in insurance policies regarding glass breakage, such as increase of deductibles may reduce demand or increase price pressure.

Disruptions in the recent used car market as a result of economic conditions or intense price competition in the new car market may affect residual values on risk fleet of Avis Europe or buyback cars repurchased from car rental companies at D'leteren Auto.

These developments are actively monitored by each entity and fed in a planning process including strategic planning, long term financial planning, budgets and monthly reporting. This process allows a good anticipation of these trends or quick reaction to sudden events and provide management with a base for decisions regarding the range of products or services offered, their pricing and the sizing of the organisation.

Where business is by essence subject to rapid changes in demand, structures have been adapted to provide the maximum flexibility.

3.4.1.2. Sourcing risk

D'leteren Auto imports and distributes new cars and spare parts of the makes of the Volkswagen group. The relationship with Volkswagen has been built over the last 60 years and is formalised in wholesale agreements with each of the makes with no specified end dates. Any adverse changes to the terms of the agreements, any deterioration in the relationship with the Volkswagen group or any significant change in policy towards independent importers is likely to have an adverse effect on the financial condition and the results of the entity.

The key defence against this risk resides in the company's ability to demonstrate to the Volkswagen group its added value through the management of the Belgian network of distributors. The company is strictly aligned to the commercial, marketing and services policies of the Volkswagen group.

Avis Europe purchases its fleet from all major OEM's. Collapse of one OEM may result in loss of fleet availability, buy-back exposure and poor residual performance. This risk is mitigated by a diversified fleet supplier mix, monitoring of OEM credit ratings, frequent book value to residual assessment, and netting arrangements where appropriate.

VGRR business is critically dependent on the supply of vehicle glass, polyurethane and repair resin. The loss of a key supplier in any of these areas would significantly disrupt its operation. As a result, purchasing teams have developed a strategy to diversify sourcing and actively allocate volumes in order to ensure that there remains viable competition in supply with global diversification of suppliers.

3.4.1.3. Key account risk

In the three entities, a significant part of the business is transacted with large key accounts such as corporates, fleet leasing companies or insurers. Any loss of one or several major key account(s) could have an adverse effect on the financial condition and the results of the Group.

Each entity undertakes many activities to ensure that its relationship with key accounts remains strong. Every major account will have a clear owner who will develop a key account plan with clear objectives on how to develop the relationship further. Each entity ensures that its customer portfolio remains sufficiently balanced.

3.4.1.4. Partnering Risk

In the car rental activity, Avis Budget Group, Inc. (ABG) licenses the Avis and Budget brands to Avis Europe for operation in specified territories through master licensing agreements which expire in 2036. Avis Europe does not have any cross-shareholdings with ABG, yet through the close contractual and business relationship the two companies work together to provide a seamless service to customers of both the Avis and Budget networks. Avis Europe relies on ABG to operate its own business in a manner that both upholds the value of the global brands and allows the group to provide a similar service in all locations in which it operates. Avis Europe has joint marketing initiatives with ABG and share market and customer information where appropriate. It also provides joint services and cross-refers customers through a formalised agreement. The maintenance of a good management relationship with ABG is therefore important to Avis Europe.

Avis Europe uses the Wizard rental

and reservation system under license from ABG, pursuant to a long-term computer services agreement, which is subject to a five-year notice period. Wizard has been operational since 1972, and has been continuously enhanced and expanded since that time. It is a fully integrated reservation, rental and management information system that is used by Avis Europe and ABG worldwide. Avis Europe is obliged to contribute to the cost of upgrading and enhancing Wizard and, therefore, unanticipated costs could adversely affect its results. Should Wizard need to be replaced, process and execution issues could present a substantial risk to Avis Europe's operations. Any adverse changes to the terms of the agreements or any deterioration in ABG or its business or in the relationship with ABG are likely to have an adverse effect on the financial condition and the results of the group.

3.4.1.5. Product/service failure risk

Vehicles or spare parts distributed by D'leteren Auto may be subject to a major default. In this case, all the technical and PR response to such failure would be organised by the Volkswagen group.

In the vehicle glass repair and replacement business, as the windscreen is an important part of the safety of a vehicle, particularly with regards to the deployment of the airbag and the strength of the roof, any badly fitted windscreen could adversely impact the safety of the vehicle and have a legal, financial and reputational impact.

In order to minimise this risk, Belron develops clear fitting standards, rolls them out throughout the organisation, and regularly monitors compliance through technical teams in every

business unit. In addition, events such as the "Best of Belron", a worldwide competition to elect the best fitter of the group, based on observation of standards and quality of execution, reinforce the importance of the highest fitting standards.

3.4.1.6. Loss of key Personnel

Continuity of the business may be impaired by the loss of personnel responsible for key business processes, for physical reasons or as a result of their decision to leave the organisation.

Personnel retention is managed through the offering of a competitive compensation, regularly benchmarked against market practice, good career perspectives, regular feedback and employee satisfaction surveys. Succession planning of key personnel is regularly reviewed by the top management of each entity.

3.4.2. Finance and IT risks

3.4.2.1. Catastrophic loss risk

The Group's entities are heavily dependant on key resources such as IT systems, call centers and distribution centers. Major disaster affecting these resources may result in the inability of the entity to provide essential products or services either locally or globally. Absent mitigating actions, operating costs resulting from the occurrence of a disaster may not be recovered.

Management regularly reviews the underlying potential causes of loss and implements protective measures. In addition, Business Continuity Plans are designed to ensure continuity of the entities should a disaster occur. More specifically for IT systems, dupli-

cation of key data and systems mitigate the impact of a potential major system failure. Residual risk may be covered by appropriate insurance policies.

3.4.2.2. Liquidity risk

Some of the Group's operations are by their nature very capital intensive and are dependent on its various sources of funding. A substantial proportion of the Group's entities are funded with borrowings, including both on and off balance sheet leasing arrangements and, as such, depend on access to the debt markets and other forms of financing to fund the Group's fleet, such as securitisation. Lack of availability of funds or a breach of financial covenant could result in the inability of all or part of the Group to operate or may lead to a significant increase of the cost of funding.

Each entity seeks to ensure that it has a core level of long-term committed funding in place with maturities spread over a number of years.

This core funding is supplemented with shorter-term committed and uncommitted facilities particularly to cover seasonal debt requirements. All funding is arranged with a wide range of providers, on both a public and private basis. Each entity maintains a regular dialogue with debt providers to keep them updated on the trading performance and prospects of the business.

3.4.2.3. Interest rate and currency risk

The Group's international operations expose it to foreign currency and interest rate risks. The majority of the business carried out by the Group is transacted in euro, pounds and US dollars. In each country where the

Group has a subsidiary, revenue generated and costs incurred are primarily denominated in the relevant local currency, thereby providing a natural currency hedge. With regard to translation exposures in the car rental activity, the policy is to match where possible the average assets of the Group to the equivalent average liabilities in each major currency and thus minimise any impact to the Group. To the extent that this does not occur, both foreign currency borrowings and forward exchange contracts are used. In the vehicle glass repair and replacement activity, the policy is, whenever possible, to hedge the value of foreign currency denominated investment with an equivalent amount of debt in the same currency to protect their value in euro.

Interest rate risk arises from the borrowings of the Issuer and its affiliates which, after foreign currency risk hedging, principally arise in euro and pound. Borrowings issued at variable rates expose the Group to cash flow interest rate risk whereas borrowings issued at fixed rates expose the Group to fair value interest rate risk. To manage these risks, the Group is financed through a combination of both fixed and floating rate facilities and enters into various derivatives. As present debt facilities mature, the Group is exposed to higher credit spreads on its borrowings.

3.4.3. Other risks

3.4.3.1. Compliance risk

In geographies where the Group's businesses have significant market shares and/or are governed by vertical agreements falling in the scope of Block Exemption regulations, the key legislative risk relates to Competition Law. Any competition law breach could result in significant fines. In addition to this, there has recently been significant development in Data Protection legislation with similar punitive fines being introduced.

In order to mitigate these risks, clear policies and legal monitoring have been put in place and widely communicated. Their application is audited on a regular basis.

3.4.3.2. Integrity risk

The reputation or the assets of the Group may be affected if unethical or fraudulent activities were perpetrated by employees, customers, suppliers or agents against the Group for personal gains, or if the Group was considered jointly responsible for such acts perpetrated by third parties.

The Group is putting in place a series of measures in order to avoid these risks to the maximum extent possible, including established policies and procedures, ethics policy or code of conduct applicable to all staff, appropriate training of the staff, delegation of authority in place with separation of duties, management information, internal audit, finance reviews and accounting reconciliation.