



**12**

# Report of the Chairman **of the** **Supervisory Board**

on the preparation and organization  
of Supervisory Board meetings  
and on Internal Control

## 1. Preparation and organization of Supervisory Board meetings

### 1.1. Supervisory Board membership, role and responsibilities

The Peugeot S.A. Supervisory Board has twelve members and three non-voting advisors. No member of the Board exercises any executive responsibilities or is a salaried employee of a Group company.

The Supervisory Board appoints members of the Managing Board and can remove them from office. According to the law, it is responsible for overseeing the Managing Board's management of the business. The Company's bylaws also attribute to the Supervisory Board sole authority to approve corporate actions, bond issues, the signature or termination of agreements with other companies operating in the same industry that will have a decisive impact on the Group's future development, and any major transaction that substantially alters the business or financial structure of the Company or the Group. In addition, the Supervisory Board ensures that the strategy implemented by the Managing Board is consistent with the Group's long-term vision, as defined by the Supervisory Board.

### 1.2. Supervisory Board practices

The Supervisory Board meets at least once every quarter; the agenda of each meeting is drawn up by the Chairman. It met five times in 2006, with an average attendance rate of 90%.

Board members are provided with detailed information about all material transactions. Guarantees given on behalf of subsidiaries are submitted for Supervisory Board approval when the amount involved exceeds €25 million or the cumulative amount of guarantees given during the year exceeds €125 million (excluding customs and tax bonds).

At the beginning of 2006, the Supervisory Board performed a self-assessment of its organization and procedures.

### 1.3. Committees of the Board

The Supervisory Board has set up three committees, each of which has its own internal rules.

#### The Compensation and Appointments Committee

Set up in 1998, the Compensation and Appointments Committee is responsible for preparing Supervisory Board decisions regarding compensation for members of the Managing Board, the Supervisory Board and the Board committees, as well as stock option grants to members of the Managing Board. It also stays informed of the compensation and stock option grants for other Group executives.

In February 2003, the Committee's terms of reference were broadened to include preparing Supervisory Board decisions concerning the appointment of new members of the Supervisory Board and Managing Board, by proposing selection criteria, organizing the selection process and recommending candidates for appointment or re-appointment. It is also informed of appointments and compensation of members of the Executive Committee.

The Committee comprises two members, appointed in their own name and not as representatives of corporate Supervisory Board members. It met three times in 2006, to review the base salary and bonuses of Managing Board members and the granting of stock options to Managing Board members. In July 2006, the Committee was expanded to five members as part of process of selecting, assessing and recommending a new Chairman of the Managing Board to the Supervisory Board. The expanded Committee met five times during the selection process.

#### The Strategy Committee

The Strategy Committee, set up in 1998, is responsible for considering the Group's long-term growth trajectory and strategic direction. It reviews the Managing Board's long-term strategic plan and is consulted about proposed major transactions. It also prepares Supervisory Board decisions on strategic projects submitted for the Board's approval in accordance with Article 9 of the bylaws.

The Committee comprises six members, appointed in their own name and not as representatives of corporate Supervisory Board members. The Strategy Committee met twice in 2006, once without the Managing Board in attendance to assess Committee procedures and once with the Managing Board in attendance to review the manufacturing and marketing strategy of the Group and its marques in Asia.

## The Finance Committee

The Finance Committee, set up in 2002, is responsible for informing the Board of its opinion on the interim and annual financial statements of the company and the Group, and it may also be asked to review any corporate actions and other projects requiring prior approval by the Board. To this end, the Committee reviews in detail the interim and annual financial statements, the most significant financial transactions and the management reporting schedules. It also monitors off-balance sheet commitments and data to assess the Group's risk exposure.

The Finance Committee, which enjoys free access to all the information it needs, can, like the Chairman of the Supervisory Board, meet with the persons responsible for internal control and with the auditors, with or without line management attending. It comprises three members, appointed in their own name and not as representatives of corporate Supervisory Board members. In 2006, it met four times, in particular to review the Group's internal control and risk management processes, the internal audit plan and Group tax planning policy. In February 2007, it met with the Statutory Auditors to review the procedures for closing the Group's 2006 accounts, prior to their presentation to the Supervisory Board on February 6, 2007.

## 2. Internal Control procedures

### 2.1. Organization of Internal Control

Since 1972, Peugeot S.A. has had a two-tier management structure, with a Supervisory Board and a Managing Board. This structure guarantees a clear separation between the Managing Board's day-to-day management of the business and the Supervisory Board's oversight, exercised with the support of three committees of the Board (see section 1.3). It represents an effective corporate governance model, by maintaining an appropriate balance of powers between the executive and control functions. As part of this organization, internal control is the responsibility of senior management, represented by the Managing Board.

The overall structure of delegations of authority down the chain of command reflects the Group's internal organization. Account is taken of each manager's job as well as of his or her position in the chain of command, in order to grant powers to individuals who have the necessary authority, resources and competence in the area concerned. Each delegation of authority describes the individual's role and responsibilities, the rules and regulations to be complied with and the practices to be followed.

A Code of Ethics setting out the standards of conduct and behavior to be met by all employees has been available for consultation on the Group Intranet by all employees since March 2003.

Since early 2007, internal control has been the responsibility of the Vice-President, Legal Affairs, Institutional Relations and Internal Audit, who reports directly to the Chairman of the Managing Board. In addition, the head of internal control has direct access to the Chairman of the Managing Board, which means that he or she is completely independent from all other departments and

divisions. The Vice-President, Internal Audit has direct authority over the corporate-level internal auditors and has a dotted-line reporting relationship with the internal auditors working in various departments of the Automobile Division (platforms, technical affairs, purchasing, manufacturing, the marques and information systems) and the other Group companies (Banque PSA Finance and Gefco). He or she reports on all of the internal auditors' work twice a year to the Executive Committee, as well as to the Finance Committee.

In accordance with French company law, the financial statements of Peugeot S.A. and the consolidated financial statements are audited by two firms of auditors. The two firms jointly audit all of the accounts and examine the processes used to prepare the financial statements, as well as the Group's internal control processes and procedures. Through the members of their networks in all the countries where the Group operates, they act as contractual auditors of all the Group's fully consolidated subsidiaries, with the exception of the companies in the Faurecia sub-group. Effective from 2003, they perform continuous audits of the main Automobile Division companies and finance companies in France, in order to improve the overall quality of their audit.

Faurecia is listed on the Euronext Paris market and its statutory auditors are appointed by its stockholders in General Meeting. The auditors of joint ventures set up with other automakers, which are accounted for by the equity method, are appointed by the joint venture partners.

The internal and external auditors work closely together and exchange information about their respective audits of the system of internal control, while respecting each other's independence.

As a credit institution, Banque PSA Finance is required to comply with French banking regulations and is supervised by the French Banking Commission, the supervisory arm of the Bank of France. The Banking Commission is responsible for verifying compliance with the laws and regulations applicable to credit institutions, reviewing business practices and ensuring that capital adequacy requirements are met. Banque PSA Finance also complies with all banking laws and regulations in the other countries where it has operations.

### 2.2. Internal Control systems in the corporate departments and the subsidiaries

Internal control is assessed based on the Group's operational organization as well as its legal structure.

#### 2.2.1. Procedures for the preparation and processing of financial and accounting information

The consolidated financial statements are prepared by the consolidation department, which is also responsible for establishing and updating Group accounting policies. The Department's teams visit Group subsidiaries (at least once every five years for Automobile Division entities and once every three years for Banque PSA Finance entities) to audit their consolidated reporting procedures and provide related assistance where necessary.

A full set of consolidated financial statements is produced each month, for both internal management and external reporting purposes.

Off-balance sheet commitments are recorded, tracked and validated according to the same process.

Management controls within the Group are organized around an integrated three-tier structure:

- a corporate department is responsible for the entire system and for issuing finance and management standards and procedures, describing the methods to be used, the related software applications and the timelines for the various tasks;
- the second tier consists of management control structures at divisional level, with Automobile Division controls organized around the main entities (the marques, production, R&D);
- the third tier corresponds to management control structures in each operating unit, such as a plant or a distribution subsidiary for the Automobile Division.

Capital expenditure is managed according to a similar process, based on Group strategy and, for the Automobile Division, manufacturing and product-plan strategies.

The management control entities produce monthly management reporting packages for submission to the Executive Committee, based on the full monthly consolidation packages.

The management control system also includes detailed automobile costing analyses, including analyses of variances and product margins, for use by line management.

Published financial information is based on the consolidated financial statements approved by the Managing Board and presented to the Supervisory Board, as well as on analyses of consolidated data. The annual and interim information is audited or reviewed by the statutory auditors prior to being published.

#### 2.2.2. Divisional operating procedures

##### Automobile Division

Development and process engineering work for each new vehicle or component requires extensive resources, the cost of which has an impact on the Group's future profitability. Implementation of each project is based on a comprehensive design process – known as the operational development plan – defining product features, profitability, quality and time-to-market objectives. Progress in meeting these objectives is tracked by a system of project milestones, corresponding to the various stages at which the financial and technical indicators are reviewed.

In light of the very significant contribution of suppliers, the purchasing function applies highly disciplined processes that guarantee the delivery of the requisite performance in terms of innovation, development, quality and competitive prices. The function leverages extensive expertise in product costing and commodity price management, as well as in-depth understanding of global markets, which enable it to manage the competitive bidding process and supplier relationships as part of its purchasing strategy. Close attention is paid to supplier risk, particularly the risk of supply chain disruption or of supplier bankruptcy.

Contractual commitments to suppliers are strictly adhered to. Orders, inward deliveries and invoices are systemati-

cally recorded. Supplier payments are made only when the invoices have been checked for compliance with the order and the applicable regulations, and when they correspond to the goods actually received.

In manufacturing, the assembly plants have been ISO 9001:2000 quality-certified by UTAC, to comply with the requirements of European Directive 2001/116, Appendix X. Most of the manufacturing plants' environmental management systems are ISO 14001-certified. All employees are trained in safety and workplace procedures and a constant focus is maintained on improving plant safety. Ergonomic considerations are taken into account in the design of products and the related plant and equipment in order to improve working conditions in the production shops.

In marketing and sales, internal control for the two marques, Peugeot and Citroën, is based on descriptions of operating processes and procedures applicable at corporate level and by the import subsidiaries and dealerships. Senior management provides the leadership and impetus for operational management in each department, subsidiary and dealership, backed by a system of controls and a continuous improvement process. Led by Corporate Management Control, management control teams at each marque monitor compliance with Group management rules and standards, produce management reporting schedules and guarantee transparency and cooperation among the various participants.

Automobile Division vehicle and replacement part sales in the countries where Banque PSA Finance has operations are carried out on a cash basis, with any financing requested by customers being provided by Banque PSA Finance. For sales in other countries, a standard has been issued stipulating payment and credit terms to be applied by the Automobile Division to customers according to the product (new vehicles, used vehicles, replacement parts, spare parts or components). A secure payments policy has been drawn up to avoid credit risks, supported by a monthly reporting system that ensures compliance.

Programmed and manual controls are performed to ensure that customer invoices comply with local customs, tax and other regulations in both the shipping country and the delivery country, as well as with the terms of the order or contract covering the price, incoterms, transfer of title and other matters. Periodic and continuous physical inventories are performed to ensure that all delivered goods have been duly invoiced.

Financing decisions and banking relationships are managed at corporate level. Cash management transactions for Eurozone subsidiaries, foreign currency cash flows and related transactions on the currency markets, and financial market transactions related to interest rates are managed by specialist teams based at Group headquarters. Back-up trading rooms have been set up to avoid the risk of any interruption of trading following a major incident. For entities outside the Eurozone, locally managed cash flows and cash balances are closely tracked at corporate level. Investment and financing strategies and strategies for managing counterparty risks arising from financial market transactions are approved at the monthly Finance Committee meetings chaired by the Chairman of the Managing Board.

The quality department authorizes the sale of each vehicle that leaves the production line and organizes any necessary recalls of faulty vehicles delivered to the dealers or to customers.

Human resources management and development procedures are designed to ensure that the Group has constant access to the skills needed to run the business. Regulatory changes are closely monitored to ensure that the Group is viewed at all times as a benchmark employer.

The Risk Prevention and Management Department is responsible for ensuring that the Group is in a position to effectively manage any risk that could affect earnings, by implementing appropriate risk prevention and management methods and policies and assisting the various entities in prioritizing the action to be taken in this area. The Department identifies insurable risks, negotiates insurance cover and monitors the effectiveness of preventive and remedial action plans.

Information system development projects are approved by a specialized committee and are conducted using project management techniques. IT resources are managed in-house and consist mainly of large-scale processing centers meeting the highest standards of security. Procedures are in place to prevent unauthorized access and system downtime, as well as to protect data, programs and IT infrastructure.

Local internal audit teams check that rules and standards are consistent with Group strategy and ensure compliance. Where necessary, improvements are recommended and follow-up checks are performed to ensure that these recommendations are implemented.

### Banque PSA Finance

To cover all of the risks inherent in its business, Banque PSA Finance has set up an internal control system which checks:

- that the Bank's transactions, internal organization and procedures comply with the applicable regulations, professional standards and codes of practice;
- that decision-making procedures are strictly followed, whatever the nature of the decision;
- the quality of accounting and financial information;
- the existence of an audit trail guaranteeing data traceability;
- the quality of information and communication systems.

The Bank's internal control unit, which is independent from the line units, comprises all the internal control teams based at Bank headquarters and in the subsidiaries. Regular controls are performed at the various levels of the Bank's operating structures, within a framework defined by a series of cross-functional and local procedures. Ex-ante controls performed by headquarters teams mainly concern significant lending decisions made by the Banque PSA Finance Group Credit Committee under the system of discretionary lending limits, new products and services that are submitted to the New Products Committee for approval, and pricing decisions.

The headquarters Risk Committee monitors trends in retail financing credit losses, as well as changes in lending margins and competitive positioning indicators. The headquarters team also closely tracks the performance of the operating entities, through a standard management reporting system, for both budgetary control and risk monitoring purposes.

In 2005, the Bank's Board of Directors set up an Audit Committee to monitor internal control structures and procedures and to report its findings to the Board. It met three times in 2006.

The internal control system has been modified to comply with the new provisions of standard CRBF 97-02, applicable as from January 1, 2006. It is now built around a headquarters-based internal control unit that performs internal audits of Banque PSA Finance, its subsidiaries and branches and the Group entities responsible for

supplying essential services (IT, Accounting and Cash Management/Financing). The unit is supported by the Compliance, Risk Management and Operational Risk Control departments, which are completely independent from the line units. Transactions carried out by the line units are controlled by a series of procedures, formal authorizations, commitment limits and programmed controls. The new system was approved by the Bank's senior management and Board of Directors in December 2005.

### Transportation and Logistics: Gefco

Gefco operates integrated agency networks that all apply the same operating and service quality standards and use the same information system. In the finance area, the Gefco companies apply PSA Peugeot Citroën Group standards and policies and participate in the Group cash pool. The networks are ISO 19001-certified.

The system of internal control comprises three tiers. Headquarters internal control teams check the quality of the monthly statutory and management reporting packages submitted by the subsidiaries, the national accounting departments ensure that financial flows comply with Group procedures, while the branches check that all services performed are accounted for and billed at the agreed price.

### Automotive Equipment: Faurecia

The Faurecia Board of Directors, whose Chairman is also the sub-group's Chief Executive Officer, has set up a Finance Committee and a Compensation and Appointments Committee.

Internal control is based on a set of procedures available for consultation by all employees via the Faurecia Intranet. The procedures mainly concern controls over programs, in order to track the execution of complex contracts for the design, production and supply of complex equipment to automakers, and financial and accounting controls designed to ensure that financial and accounting information is properly processed, thereby underpinning the company's responsiveness.

Faurecia has its own internal audit department, responsible for assessing the effectiveness of internal financial control systems.

### **2.2.3. Internal Control procedures and processes**

The internal control system is managed by a headquarters team reporting to the Vice President, Internal Audit. The team defines and updates internal control procedures, checks that the system complies with the applicable laws and good practice recommendations, and ensure that procedures are consistent and appropriate and address all identified risks. It also performs various tests and checks, oversees implementation of recommended improvements and reports on the effectiveness of internal control.

The overall quality of the Group's system of internal control is assessed annually based on assessments performed by all the significant units, in France and abroad, of the different departments of the Automobile Division and the non-Automobile subsidiaries (except Faurecia and its subsidiaries, which have their own system). These units include corporate departments, plants, import subsidiaries, captive dealerships, finance companies, local finance departments, facility accounting departments, etc.).

The assessment is based on definitions of processes, the related risks and the measures taken to manage them. It covers all action taken or overseen by the various functions to help prevent risks. For example, the Legal Department assesses legal risks, business interruption risks, safety risks and the risk of damage to or loss of assets. The Quality Department assesses quality risks affecting products and services. The Human Resources Department assesses employee-related and labor law compliance risks. The Engineering, Methods and Purchasing Department assesses automobile regulations compliance risks and the Finance Department assesses compliance risks related to accounting, tax and financial regulations and guidelines.

The 2007 internal audit plan includes a certain number of specific audits of areas identified as giving rise to significant risks, whatever the quality of the related internal controls as determined by the assessment process.