

4 Corporate Governance

**Report of the Chairman of the Board
of Directors** 146

1

**Composition of the Board of Directors
during the year 2007** 157

2

3

**Statutory Auditors' report on the report
of the Chairman of the Board of Directors** 160

4

5

6

Report of the Chairman of the Board of Directors relating to the conditions of preparation and organization of the Board's work, the possible limitations to the powers of the Chief Executive Officer and the internal control procedures put in place by the Valeo Group

This report of the Chairman of the Board of Directors was presented to the Audit Committee.

The Board of Directors was subsequently informed of the Audit Committee's and the Statutory Auditors' findings, and the final

version of the Chairman's report was presented to the Board on February 12, 2008, the issue date of the 2007 financial statements.

1

2

3

4

5

6

1. Preparation and organization of the work of the Board of Directors

On March 31, 2003, the Board of Directors adopted Internal Rules of Operation in line with the recommendations of the Bouton Report on corporate governance, aimed at precisely defining the operating procedures of the Board, in addition to legal and regulatory requirements and the provisions of the Company's bylaws. These Internal Rules were amended on July 24, 2006 in order to authorize Directors to participate in Board meetings by videoconference, or by any other telecommunication means that enables them to be identified and ensures that they actually participate in the meeting. On December 14, 2006, the Internal Rules were further amended following the merger of the Nomination and Remuneration Committees, and the dissolution of the Strategy Committee (see "Committees created by the Board" below). The Internal Rules were not otherwise amended by the Board of Directors in 2007.

The Internal Rules can be accessed on the Company's website.

1.1. Rules specific to the functioning and organization of the Board and their application

1.1.1. Composition of the Board of Directors

The bylaws provide that the Board of Directors must have between 3 and 18 members. At the beginning of 2007, the Board had 11 members. Following the resignation of Véronique Morali and Yves-André Istel, the Board appointed Helle Kristoffersen on March 22, 2007 and Georges Pauget on April 10, 2007 as Directors to serve the unexpired terms of office of their predecessors, i.e., until the close of the General Shareholders' Meeting of May 21, 2007. The Combined Annual and Extraordinary Shareholders' Meeting of May 21, 2007 ratified the appointment of both Helle Kristoffersen and Georges Pauget, and renewed Helle Kristoffersen's, Thierry Morin's, Pierre-Alain De Smedt's, Philippe Guédon's, Georges Pauget's and Erich Spitz's terms of office until the close of the Annual Shareholders' Meeting called to approve the 2010 financial statements and

< Contents >

appointed Gérard Blanc, Pascal Colombani and Lord Jay of Ewelme as new Directors for four-year terms, which expire at the close of the Annual Shareholders' Meeting called to approve the 2010 financial statements, to fill the seats left vacant by François Grappotte, Jean-Bernard Lafonta and Alain Minc, whose terms of office expired on May 21, 2007. The Board of Directors therefore still has 11 members at the present date.

Details concerning the composition of the Board of Directors are set out in the appendix to this report.

In accordance with the independence criteria set out in the Board's Internal Rules of Operation, the Board of Directors has reviewed whether or not its members can still be classified as independent. Under these Rules, an independent Director is one who does not have any relations whatsoever with the Company, the Group or the Group's management that may compromise his or her ability to exercise freedom of judgment.

In particular, independence is presumed to exist when a Director:

- is not an employee or a corporate officer of the Company, or an employee or a Director of one of its consolidated subsidiaries, and has not been in such a position for the previous five years;
- is not a corporate officer of a company in which the Company holds a directorship, either directly or indirectly, or in which an employee appointed in that role, or a corporate officer of the Company (currently in office or having held such office in the past five years), is a Director;
- is not a customer, supplier, investment banker or commercial banker that is material for the Company or Group, or for which the Company or Group represents a significant portion of the business of the Director concerned;
- is not related by close family ties to a corporate officer;
- has not been an auditor of the Company in the past five years;
- has not been a Director of the Company for more than twelve years on the date when he/she was appointed to his/her current term of office.

For Directors holding at least 10% of the Company's capital or voting rights, or representing a legal entity that holds such a stake, the classification as independent takes into account the Company's ownership structure and any potential conflict of interests.

In application of these criteria, the Board of Directors noted that:

- one Director holds the positions of Chairman and Chief Executive Officer of the Company, and therefore cannot be considered independent: Thierry Morin;
- one Director has been a member of the Board of Directors (and previously the Supervisory Board) for over twelve years, and therefore cannot be considered independent: Erich Spitz;

- nine Directors are independent with respect to the criteria set forth in the Internal Rules and in accordance with the recommendations set out in the Bouton Report on corporate governance: Gérard Blanc, Daniel Camus, Pascal Colombani, Jérôme Contamine, Pierre-Alain De Smedt, Helle Kristoffersen, Lord Jay of Ewelme, Philippe Guédon, Georges Pauget.

1.1.2. Average period of notice for calling Board meetings

In accordance with the Internal Rules, each Director is notified of the dates of Board meetings at the beginning of each fiscal year at the latest. The average period of notice for calling Board of Directors' meetings is approximately eight days.

1.1.3. Representation of Directors

A Director may be represented at meetings of the Board of Directors by another Director. The proxy must be given in writing. During the 2007 fiscal year, four Directors used the possibility of being represented at Board meetings.

1.1.4. Chairman of Board meetings

The Board meetings are chaired by the Chairman of the Board or, in his/her absence, by a Vice-Chairman or a Director designated by the Board of Directors. All sixteen Board meetings held during the 2007 fiscal year were chaired by the Chairman.

1.1.5. Directors' participation in Board meetings

Following the General Shareholders' Meeting held on May 17, 2006, article 16 of the Company's bylaws and the Board's Internal Rules of Operation were amended in order to authorize Directors to participate in Board meetings by any telecommunication technology that enables them to be identified and ensures that they actually participate in the meeting. Accordingly, Directors who take part in Board meetings through such means are deemed to be present for the purposes of calculating the quorum and majority, except at meetings dedicated to the preparation of the annual Company and consolidated financial statements and the related management reports (as provided for in articles L. 232-1 and L. 233-16 of the French Commercial Code). The Chairman is required to state in the relevant notice of meeting if these methods can be used for certain meetings. Directors wishing to participate in a Board meeting by these methods must contact the Board Secretary at least 2 (two) working days before the meeting date (except in an emergency situation) in order to ensure that the relevant technical information can be exchanged and tests performed before the meeting takes place.

1
2
3
4
5
6

1.2. Directors' access to information

1.2.1. Directors' access to information

Each Director is given all the information required to perform his or her duties. The agenda for any upcoming Board meeting is provided within a sufficient timeframe, as well as the fullest possible set of relevant materials.

1.2.2. Guests of the Board

During the year, the Group Financial Controller attended all Board meetings except the one held on May 21, 2007 prior to the Annual General Shareholders' Meeting and the one held on April 10, 2007, which were attended by the Vice-President, Financial Affairs and Strategic Operations. The Group General Counsel attended all Board meetings, acting as Board Secretary. The lawyers and bankers representing Valeo as well as the Vice-President, Financial Affairs and Strategic Operations, attended those Board meetings held to review the Group's strategic options and the notices of interest received in the first half of 2007 from investors targeting the Company's capital.

1.3. Frequency of Board meetings and average attendance rates of the Directors

In accordance with the Internal Rules of the Board, the Board of Directors meets at least four times a year. The Board of Directors met on sixteen occasions in 2007.

The average attendance rate of the members of the Board of Directors (in person or via proxy) during 2007 was 93%. The average attendance rate of the members of the Board of Directors in person during 2007 was 89%.

1.4. Role of the Board

The principal role of the Board of Directors is to determine the business strategies of the Company and oversee their implementation.

In 2007, the Board of Directors analyzed the 2006 financial statements of the Company and the Group, proposed payment of a dividend, assessed the performance of the Board, reviewed whether the Directors could still be classified as independent in accordance with the criteria set out in the Board's Internal Rules, examined the management forecasts and budget for 2007, reviewed the Group's strategic transactions (particularly disposals and acquisitions), its strategic options and the notices of interest received from investors

targeting the Company's capital, analyzed the Company's ownership structure, granted stock options and consideration-free shares to the employees and corporate officers who had been the most directly involved in the Group's development, reviewed the composition of the Board and the various Board Committees, appointed two new Directors, called a Combined Annual and Extraordinary Shareholders' Meeting, decided to initiate a share buyback program, authorized the Chairman to issue sureties, endorsements and guarantees, heard the reports on the work carried out by the various Board Committees, renewed the Chairman's term of office and approved the compensation paid to him, and authorized the Chairman to issue bonds (either under a renewed EMTN program or otherwise).

1.5. Committees created by the Board

In 2003, the Board created four committees to improve its functioning and provide effective assistance for preparing its decisions: the Strategy Committee, the Audit Committee, the Remuneration Committee and the Nomination Committee.

At the Board meeting of December 14, 2006, the Nomination Committee was merged with the Remuneration Committee and the Strategy Committee was dissolved. The Board therefore currently has two standing committees – the Audit Committee and the Nomination and Remuneration Committee.

The work of the Audit Committee and the Nomination and Remuneration Committee in 2007 was presented to the Board of Directors throughout the year in the form of reports and is summarized below.

1.5.1. Audit Committee

The Audit Committee has three members including a Chairman, appointed by the Board of Directors. All members of the Audit Committee are independent Directors as defined by the criteria in the Internal Rules.

The members of the Audit Committee are Pierre-Alain De Smedt, Daniel Camus and Gérard Blanc (since June 13, 2007). The Audit Committee is chaired by Pierre-Alain De Smedt. The Chairman and Chief Executive Officer is not a member of the Committee but may attend its meetings as a guest.

The Committee's roles and responsibilities are:

- to ensure the relevance and due application of the accounting and financial methods adopted to prepare the consolidated financial statements, as well as the appropriate accounting treatment of transactions at both Product-Family and Group level;

1

2

3

4

5

6

< Contents >

- to check that internal procedures are defined for compiling and controlling financial and accounting information in order to ensure its reliability and guarantee rapid reporting, to review the Group's internal audit plan and management's related comments, and to keep informed of the Group's internal and external audits and management's related comments;
- to express an opinion on the choice of Statutory Auditors or the renewal of their terms of office;
- to review any financial or accounting matter referred to it by the Chairman of the Board of Directors as well as any conflict of interest issue of which it is aware.

The Audit Committee met four times in 2007 with a 79% attendance rate. During these meetings, the Committee reviewed the consolidated financial statements for the year ended December 31, 2006 and the interim financial statements for first-half 2007. In connection with the updated EMTN program, the Committee reviewed the first-quarter 2007 accounts and the Statutory Auditors' opinion as to the fairness of the presentation of those accounts. The Committee was informed that the new IFRS 8 standard would become effective as from the beginning of 2009, deemed the internal controls self-assessment system to be satisfactory, and noted the application of internal control procedures in line with those defined by the COSO (Committee of Sponsoring Organizations of the Treadway Commission) in the United States. The members of the Audit Committee also reviewed the methodology used for risk mapping and the internal audit work schedule for 2008.

The Audit Committee's work was conducted in line with its objectives. The Statutory Auditors, the Group Financial Controller and the Group Accounting Director attended all the meetings (with the exception of the Group Accounting Director who did not attend the meeting of November 12, 2007 held to review the work of the Internal Audit Department in 2007). The Committee was also assisted by the work carried out by the Internal Audit Department. The presentations made by the Statutory Auditors mainly related to the findings of their audit of the annual financial statements of the Company and the Group and their limited review of the interim financial statements. The Audit Committee did not have any reservations concerning the annual consolidated and Company financial statements or the interim financial statements presented to it.

1.5.2. Nomination and Remuneration Committee

The Nomination and Remuneration Committee has three members including a Chairman, appointed by the Board of Directors.

The majority of the Committee's members are independent Directors as defined by the criteria in the Internal Rules. The Chairman and Chief Executive Officer also takes part in the work of the Committee, except when it convenes to discuss the compensation to be paid to him or renewal of his term of office.

The members of the Nomination and Remuneration Committee are Jérôme Contamine, Georges Pauget and Philippe Guédon (since June 13, 2007). The Committee is chaired by Jérôme Contamine.

According to the Internal Rules, the roles and responsibilities of the Nomination and Remuneration Committee include the following:

- concerning compensation:
 - studying and making recommendations concerning the compensation paid to corporate officers (particularly in relation to the variable portion of their compensation),
 - recommending to the Board an aggregate amount of attendance fees payable to Directors and the individual amounts payable to each Director,
 - providing recommendations to the Board of Directors on the Group's general stock option policy and specific stock option grants;
- concerning selections and nominations:
 - preparing the composition of the Company's management bodies by making recommendations for the appointment of corporate officers and Directors,
 - reviewing the status of each Director in relation to the independence criteria set out in paragraph 1.2 (b) of the Board's Internal Rules.

The Nomination and Remuneration Committee met four times in 2007 with a 79% attendance rate. During its meetings, the Committee drew up proposals relating to the compensation to be paid to the Chairman and Chief Executive Officer and recommended to the Board that Thierry Morin should be granted 350,000 stock options (see "Compensation paid to the Chairman and Chief Executive Officer"). These recommendations were approved by the Board of Directors on March 7, 2007 and November 15, 2007. During its meeting of March 7, 2007, the Board also approved the proposal by the Nomination and Remuneration Committee to grant a total of 100,000 consideration-free shares to high potential junior managers, and at its meeting of November 15, 2007, the Board likewise approved the Committee's proposal to grant a total of 1,527,000 stock options to the employees and corporate officers who had been the most directly involved in the Group's development.



1.6. Evaluation of the Board of Directors

In accordance with the Internal Rules, the Board carries out a self-assessment to review its *modus operandi* and to ensure that its meetings are properly organized.

At the Board meeting of November 15, 2007, the Nomination and Remuneration Committee recommended that the assessment of the Board of Directors' work in 2007 should be performed with the assistance of an external firm.

A detailed questionnaire was sent to all Directors concerning their assessment of the way in which the Board operates and suggestions for improvement. The topics covered included the operation and composition of the Board, Directors' access to information, the choice of issues discussed, as well as the quality of the discussions and the general functioning of the Board Committees.

The Directors' replies were analyzed and the findings presented at the Board meeting held on February 12, 2008. The Directors indicated that they saw steady improvement in the way the Board operates, exemplified by a strategy seminar and a general review of the Group's businesses. They put forward a number of recommendations on how to achieve further improvement.

1.7. Shareholdings and securities transactions

Each Director must hold at least 100 Valeo shares during his or her entire term of office.

On accepting their position, members of the Board of Directors and the Executive Management of the Group agreed to a Code of Conduct in relation to trading in the Company's securities. Under the terms of the Code, Directors must declare to the Group's General Counsel any transactions that they have entered into involving the Company's securities, within a maximum of five trading days following the transaction. In accordance with applicable regulations, this information must then be disclosed to the French securities regulator (Autorité des marchés financiers – AMF) and subsequently made public in accordance with the provisions of the AMF's General Regulations.

1.8. Agreements governed by Article L. 225-38 of the French Commercial Code

The following agreements entered into in previous years remained in force during 2007:

- the agreements authorized by the Board of Directors at its meeting of October 18, 2004 and entered into between the Company and its Spanish subsidiaries as part of the implementation of the 2004 Valeorizon international employee stock ownership plan;

- the agreements authorized by the Board of Directors at its meeting of December 15, 2005 and entered into between the Company and the Group's operating subsidiaries in connection with trademark royalties agreements.

The Board of Directors authorized two further agreements during 2007:

- the signing of a mandate with the bank Calyon following the Board's analysis of the notices of interest received from several investment funds during the first half of 2007. Considering that this bank is a Crédit Agricole subsidiary, the proposed mandate was submitted for approval at the Board meeting of April 24, 2007 and the agreement was unanimously approved by the Board members, with Georges Pauget abstaining;
- the compensation and benefits owed or likely to be owed to Thierry Morin as a result of his leaving his position as Chairman and Chief Executive Officer or subsequent thereto, which represent a renewal of the compensation and benefits authorized by the Board of Directors at its meeting of March 21, 2001, were authorized by the Board at its meeting of May 21, 2007, which renewed Thierry Morin's term of office as Chairman and Chief Executive Officer, and were unanimously approved; Thierry Morin did not take part in the vote. The terms and conditions applicable to the payment of termination benefits to Thierry Morin were approved by the Board of Directors as a related party agreement on March 20, 2008. At that meeting, the Board also brought the compensation and benefits payable to Thierry Morin and contingent on certain criteria into compliance with the provisions of French Act 2007-1223 of August 21, 2007 (see Chapter 5, page 176). For more details on the above information, see chapter 6, "General information about the issuer", section 3.1.1.

A special report by the Statutory Auditors will be devoted to these agreements.

1.9. Authorization granted regarding sureties, endorsements and guarantees governed by Article L. 225-35 of the French Commercial Code

During the year, the Board of Directors authorized the Chairman, who is entitled to delegate this authority, to issue sureties, endorsements and guarantees in the Company's name up to a maximum amount of 23 million euros, and to maintain in effect the sureties, endorsements and guarantees previously issued.

This authorization was granted by the Board of Directors for a 12-month period as from February 12, 2007. No new commitments were given by the Chairman under this authorization during the year.

1

2

3

4

5

6

< Contents >

1.10. General Management of the Company and limitations on the powers of the Chief Executive Officer

The Company's Board of Directors has chosen to combine the positions of Chairman of the Board of Directors and Chief Executive Officer. This choice was reaffirmed during the year when Thierry Morin's term of office as Chairman and Chief Executive Officer was renewed.

The Board of Directors has not imposed any specific limits on the powers of the Chief Executive Officer. The Chairman and Chief Executive Officer therefore has the widest possible powers to act in any circumstances in the Company's name. He exercises his powers within the scope of the Company's corporate purpose and subject to the powers that the law specifically grants to Shareholders' Meetings or the Board of Directors. The Chairman and Chief Executive Officer represents the Company in its relations with third parties.

1.11. Compensation paid to the Directors

Since 2006, attendance fees have been allocated among the Directors on the following basis:

- 20,000 euros to each Director;
- an additional 15,000 euros for each Director who is a member of one or more Board Committees;
- Directors receive the aggregate amount of attendance fees provided that their average attendance rate at Board meetings or, where applicable, at Committee meetings has been equal to or greater than 50% during the preceding half-year. Directors whose attendance rate has been lower than 50% during the preceding half-year receive no attendance fees.

In accordance with these rules, the Directors were paid the following attendance fees in 2007:

- Gérard Blanc 20,000 euros;
- Daniel Camus 35,000 euros;
- Pascal Colombani 12,500 euros;
- Jérôme Contamine 27,500 euros;
- Pierre-Alain De Smedt 35,000 euros;
- François Grappotte 17,500 euros;
- Philippe Guédon 35,000 euros;
- Yves-André Istel (Company Director until April 10, 2007): 0 euro;
- Lord Jay of Ewelme 12,500 euros;
- Helle Kristoffersen 20,000 euros;
- Jean-Bernard Lafonta 10,000 euros;
- Alain Minc 17,500 euros;
- Véronique Morali (Company Director until March 22, 2007): 0 euro;

- Thierry Morin 20,000 euros;
- Georges Pauget 27,500 euros;
- Erich Spitz 20,000 euros.

Apart from Thierry Morin, no other compensation or benefits were paid to members of the Board of Directors during the year. Other than Thierry Morin, no Directors hold stock options or were awarded shares free of compensation during the year.

1.12. Compensation paid to the Chairman and Chief Executive Officer

1.12.1. Compensation paid during 2007

Acting on the recommendation of the Nomination and Remuneration Committee, at its meeting of March 7, 2007, the Board of Directors approved the principles for calculating the compensation and benefits of any nature granted to the Chairman and Chief Executive Officer. At its meeting of May 21, 2007 at which Thierry Morin's term of office as Chairman and Chief Executive Officer was renewed, the Board also unanimously voted (with Thierry Morin abstaining) to maintain his compensation both as Chairman of the Board of Directors and as Chief Executive Officer.

Fixed compensation

The total gross fixed compensation paid to Thierry Morin for 2007 was set at 1,577,590 euros (including travel expenses) and 19,543 euros in benefits-in-kind.

Exceptional bonus

Thierry Morin did not receive any exceptional compensation in 2007 for 2006.

At its meeting of March 7, 2007, the Board of Directors decided, as recommended by the Nomination and Remuneration Committee, that any exceptional bonus to be awarded to the Chairman and Chief Executive Officer for 2007 would be exclusively contingent on the level of gross margin and operating margin achieved by the Group, and would be subject to a ceiling set by the Board on the basis of the Nomination and Remuneration Committee's recommendation.

Attendance fees

In 2007, Thierry Morin received 20,000 euros in attendance fees in his capacity as a Director of Valeo.

Compensation paid by companies controlled by Valeo

In 2007, Thierry Morin received total gross compensation of 45,750 euros in attendance fees from companies controlled by Valeo (as defined in article L. 233-16 of the French Commercial Code).

1
2
3
4
5
6

Stock options and shares awarded free of consideration (share awards)

During 2007, the Board of Directors granted stock options to Thierry Morin. 200,000 stock options were granted at the Board meeting of March 7, 2007 and 150,000 at the Board meeting of November 15, 2007, in accordance with the following terms and conditions:

- at its March 7, 2007 meeting, the Board set the purchase price of the shares to be issued on exercise of the 200,000 options at 36.97 euros. Half of the options granted may be exercised as from March 7, 2009 and all of the options may be exercised as from March 7, 2010. The shares obtained on exercise of the options may not be sold before March 7, 2011. If the options are not exercised, they will be forfeited on March 6, 2015. If Thierry Morin does exercise the stock options granted to him, he will be required to hold, in registered form, at least 75% of the number of shares issued on exercise of said options until such time as he leaves his position. The calculation of this 75% holding will be made after the sale of the number of shares necessary to finance the exercise of the options and pay the related taxes and transaction costs. In addition, Thierry Morin must still hold an employment contract or a corporate officer's position within the Valeo Group at the date on which the options are exercised, in accordance with the provisions of the stock option plan;
- at its November 15, 2007 meeting, the Board set the purchase price of the shares to be issued on exercise of the 150,000 options at 36.82 euros. Half of the options granted may be exercised as from November 15, 2010. With respect to the remainder, the number of options that may be exercised will depend on the operating margin achieved in 2008 and will increase or decrease on a linear basis in proportion to the operating margin achieved within a range set by the Board. The shares obtained on exercise of the options may not be sold before November 15, 2011. If the options are not exercised, they will be forfeited on November 14, 2015. If Thierry Morin does exercise the stock options granted to him, he will be required to hold, in registered form, at least 50% of the number of shares issued on exercise of said options until such time as he leaves his position. The calculation of this 50% holding will be made after the sale of the number of shares necessary to finance the exercise of the options and pay the related taxes and transaction costs. In addition, Thierry Morin must still hold an employment contract or a corporate officer's position within the Valeo Group at the date on which the options are exercised, in accordance with the provisions of the stock option plan.

In 2007, Thierry Morin did not exercise any options granted in previous years.

1.12.2. Pension scheme

Thierry Morin is still a member of the supplementary pension scheme set up for members of the former Management Board, as approved by the Supervisory Board on October 17, 2002. This system is designed to top up existing pensions benefits (statutory pension, ARRCO, AGIRC, etc.) to enable beneficiaries to acquire benefits representing 2% of their final salary per year of service with the Group. The total amount of pension benefits may not exceed 60% of a beneficiary's final salary. The scheme only applies to beneficiaries who have a minimum of 15 years' service in the Valeo Group when they retire and for whom Valeo or one of its subsidiaries was their last employer at their retirement date.

Thierry Morin has also benefited from a pension plan held with Valeo (UK) Limited since his nomination as Chairman, and which will be paid when he leaves his post as corporate officer. This supplementary pension provides an additional annual pension entitlement set at 60,980 euros when he took up his corporate office in March 2001, and which is linked to the annual benchmark salary index of the mechanical and electrical industries. The expense recorded by Valeo (UK) Limited in respect of this pension plan for 2007 amounted to 76,364 euros. Compensation and benefits payable to Thierry Morin on termination of his corporate duties and contingent on certain criteria have been brought into compliance with the provisions of French Act 2007-1223 of August 21, 2007 (see Chapter 5, page 176).

1.12.3. Termination benefits

In the event that Thierry Morin leaves the Company, either at his own initiative following a difference of opinion concerning the strategy implemented by the Board further to a public tender offer, or by way of a decision of the Board of Directors, the amount of his termination benefits will represent three times his last annual compensation, excluding bonuses. Such termination benefits will not be payable in the event of gross misconduct (*faute grave*). At its May 21, 2007 meeting, the Board renewed its approval of these termination benefits under a regulated agreement. The terms and conditions applicable to the payment of the termination benefits were amended by the Board of Directors on March 20, 2008 (see Chapter 5, "General information about the issuer", section 3.1.1.).

1

2

3

4

5

6

2. Internal control procedures

2.1. Definition and aims of internal control procedures

Internal control as defined by the Valeo Group is the process implemented by Management and employees to provide reasonable assurance regarding the achievement of objectives in the following categories:

- reliability of financial and management data;
- compliance with laws and regulations;
- safeguarding of assets;
- effectiveness and efficiency of operations.

Valeo has adopted a definition of internal control in line with that provided by the COSO (Committee of Sponsoring of the Treadway Commission), the findings of which were published in 1992 in the United States.

As with any control system, Valeo's internal control procedures can only provide reasonable assurance – and not an absolute guarantee – that the Group's objectives will be achieved and that risks will be avoided. The purpose of the system put in place by Valeo is to reduce the probability of risks occurring and their potential impact.

The Valeo Group has become acquainted with the Reference Framework established by the Autorité des marchés financiers in its report dated January 22, 2007 (supplemented by an Application Guide). The Group has judged its own internal control procedures against the general principles of internal control and the Application Guide set forth in the Reference Framework. To reflect the findings of this benchmarking study, Valeo has adapted its approach and above all the outlook presented in section 2.6 of this report.

2.2. Scope of internal control

Valeo's internal control procedures are applied to the entire Valeo Group, defined as Valeo SA and all of its fully consolidated subsidiaries.

2.3. The components of Valeo's internal control procedures

Valeo's internal control procedures are based on the following five interrelated components defined in the COSO framework.

Control Environment

The control environment sets the tone of an organization, influencing the level of awareness of its people to the need for controls. Valeo's decentralized structure enables it to respond swiftly and locally to customer needs, which in turn enables the Group to expand in its markets. Against this backdrop, the Group has set up operating principles and rules that are applied in all of its companies through appropriate delegation of responsibility.

A Code of Ethics forms the basis of detailed procedures which must be applied by all of the Group's companies. The Code places major emphasis on upholding fundamental rights with respect to child labor, employment of the disabled, discrimination and harassment, and health and safety at work. It also highlights the Group's commitment to sustainable development. Finally, the Code of Ethics deals with societal issues and business conduct. Available on the Intranet and translated into 19 languages, the Code has been sent out to all of the Group's managers. It was updated in 2004 to include new processes relating to human resources management.

Risk Assessment

Risk assessment is the ongoing identification and analysis of risks that may impact the objectives set by the Group, forming a basis for determining how the risks should be managed. By identifying possible risk factors, the Group can more accurately define what control activities are appropriate.

The Group's main risks are described in the section "Risks and uncertainties" of the Management Report.

Control Activities

Control activities are the policies and procedures that help ensure Management directives are carried out. They occur throughout the organization, at all levels and in all functions. In this context, the Group's Administrative and Financial Manual serves as the benchmark for Valeo's financial and management operations. The Manual is used on a daily basis by all operational staff and comprises two parts:

- part one concerns the rules governing management and internal control;
- part two defines how the main items of the balance sheet and statement of income should be measured and presented.

Every year, the Director and Financial Controller of each Product Family and each Division sign a letter of representation in which they undertake to ensure compliance with the financial, internal control and management rules contained in the Manual.



Specific rules and procedures have also been put in place by the Group's various corporate divisions, in line with the Administrative and Financial Manual. These include:

- the Constant Innovation Charter, which provides a strict definition of the management principles applicable to development projects;
- marketing procedures and sales practices;
- human resources procedures;
- purchasing procedures, aimed at reducing the number of listed suppliers in order to facilitate quality control;
- the Risk Management Manual and implementation guides in relation to security, safety and the environment, together with the Insurance Manual. Valeo has undertaken to comply with local regulations concerning safety and the environment at a minimum and, in certain cases, to comply with even higher standards;
- legal procedures that set down the principles with which the Group must comply. These mainly concern the laws and regulations applicable in the countries where the Group operates as well as respecting contractual obligations and protecting the Group's intellectual property.

The information on these rules and procedures is accessible on the Group's Intranet by the staff concerned.

In terms of quality, Valeo has set its own benchmarks – Valeo 1000 and Valeo 5000. In addition, the QRQC (Quick Response Quality Control) method ensures the prompt implementation of corrective action, and the Lesson Learned Card (LLC) process enables the Group to monitor best practices and explore avenues for improvement.

Since September 2000, the Group has been organizing Valeo Finance Academy seminars with the aim of developing internal control and financial management skills. By combining modules (on accounting, cash flow, management control and internal control) with case studies and simulations, these yearly training sessions help the Group's younger financial managers to get better acquainted with the methods and tools used in financial control.

Information and Communication

Pertinent information must be identified, captured and communicated in a form and timeframe that enable all of the Group's people to carry out their responsibilities and perform the controls required of them.

Group Financial Control is responsible for preparing the financial statements of the Company and the Group, and reports to the Chairman and Product Family Directors on this process. The budget

and monthly reporting procedure is a critical tool for Valeo in managing its operations. Any variances can be identified, analyzed and dealt with during the year, thereby increasing the reliability of the interim and annual accounts closing process. The same information system is used for the consolidation and reporting processes, thus ensuring that the Group has constant control over the preparation and processing of financial information. The Group has put in place an integrated software application, which is being rolled out to all of its operating units. As well as providing a structured framework, this software application enables user profiles to be defined and access controls to be monitored, enabling the Group to comply with regulations concerning the segregation of tasks.

Finally, an annual Medium-Term Plan examines the Group's competitive position, possible levers for driving growth and profitability, and the action plans to be implemented to meet the Group's three-year performance objectives and forecasts (in terms of income statement, balance sheet and operating cash flows).

Monitoring internal control procedures

The Group's General Management team oversees the internal control system and delegates responsibility to the Financial Control, and Risk Insurance Environment Departments as well as to the individual Product Families for the management of issues within their remit. The internal control system is audited by the Valeo Internal Audit Department, whose task is to carry out assignments within the Group to ensure that the procedures set up function properly. Based on observations made during these assignments, recommendations are put forward to the audited operating units, which are subsequently required to implement appropriate action plans. The Internal Audit team is also called upon at regular intervals to carry out audits of performance indicators at various manufacturing sites and Divisions, and to coordinate the updates to the Group's financial and management procedures. The Internal Audit Department's work and findings are presented each year to the Audit Committee.

The application of Valeo's quality standards is regularly checked via VAQ (*Valeo Audit Qualité*) audits, and the environmental and safety aspects are overseen by the Risk Insurance Environment Department. Valeo has launched a certification program for its manufacturing sites in accordance with the ISO 14001 standard relating to environmental management and the OHSAS 18001 standard concerning occupational health and safety. At December 31, 2007, these two standards had been awarded to 117 and 93 sites respectively, out of a total of 125 sites.

1

2

3

4

5

6

< Contents >

2.4. Review of work carried out in previous years

Valeo carried out the following tasks at Group level in previous years:

- an analysis of the existing internal control procedures in light of the five main components defined in the COSO Framework (control environment, risk assessment, control activities, information and communication, and monitoring);
- the mapping of major risks and processes based on interviews with the Group’s main operational and administrative managers; risk mapping is now updated each year;
- the identification of material accounts and their interaction with the processes, as well as an inventory of existing internal control procedures relating to the preparation of the financial statements.

The Group has put in place a specific project designed to improve internal control in relation to the reliability of financial information. As a result, Valeo now has reliable information for monitoring, measuring and assessing the relevance and correct implementation of existing internal control procedures in relation to the reliability of financial information from all of its operating units.

In order to achieve this, 131 key control points have been identified in relation to the 7 processes set out below:

- sales, receivables management and payments received;
- procurement, payables management and payments made;
- monitoring of assets;
- monitoring of inventory;
- payroll;
- cash flow;
- accounts closing policies.

Rules relating to documentation and testing – particularly regarding the size of the sample used – have been defined to ensure uniformity between the sites. The process was initially implemented at a number of pilot sites in order to enable the approach to be validated, forecasts of required resources to be finetuned, and documentation and testing for all the sites to be standardized. The approach was then rolled out to the Group’s other operating units. A specific database of best internal control practices has been posted on the Group’s Intranet. In addition, Valeo leverages a tool for reporting the findings of its internal control self-assessment procedures to centralize documentation relating to the controls and tests performed in connection with the French Financial Security Act (LSF project). This tool, which is overseen by the Internal Audit team, is also used by the Group’s financial controllers to monitor in real time the action plans implemented to enhance the internal control system.

In parallel, Valeo has set up a procedure aimed at reviewing the user profiles and access controls for the integrated business software package deployed at all of the Group’s main sites. The underlying aim of this process is to establish consistent internal control practices across all of the operating units. On the basis of matrices showing incompatibilities for each of the processes, optimized standard user profiles have been identified. With each new deployment of the software package, manuals are provided and incompatibility matrices are tracked by the Internal Audit team in liaison with each Division. The Group also carried out a centralized review of the automatic and manual controls in the integrated business software package, as well as of the security of its information systems. To supplement this effort, a review was conducted within each operating unit that included an analysis of how the centrally defined key controls are applied at a local level and a verification of the manual controls performed by local users.

The LSF project also included the “Corporate” functions, and the internal control procedures for the Valeo Internal Bank were documented as part of this process.

2.5. Work carried out in 2007

As part of its risk assessment process, the Group updated and enriched its risk mapping process. The risks concerned were assessed by combining a scenario-based approach with probability of occurrence and impact evaluations. The risk mapping process formed a major component of the work undertaken to prepare the audit plan, which was presented to the Audit Committee in November 2007. During 2007, the Internal Audit team also carried out assignments on research and development costs, the reliability of order backlog figures, goodwill impairment testing and the Group’s retirement commitments in North America.

With respect to internal control procedures used to monitor the reliability of financial information, specific key controls and the related operating procedures were defined and deployed at Valeo Service in order to deal with the risks related to selling universal market spares to the independent aftermarket. For smaller start-up units, the Group also produced a simplified self-assessment questionnaire that includes 68 key control points in relation to the seven processes listed above.

Under a new process, the Internal Audit team now reviews integrated business software package access twice a year. Access to the system and to sensitive transactions, key users who provide first-level support to other users, analysis of incompatibilities and action plans implemented to eliminate them are the main areas of focus in these reviews.

1
 2
 3
 4
 5
 6

< Contents >

2.6. Outlook for 2008 and 2009

A two-year audit plan has been drawn up for the Group's main risks, based on the updated findings from the risk mapping process, the work conducted by the Internal Audit team and a summary of the internal control self-assessments performed by the operating units. The plan covers both cross-business and technical risks.

A special review of access controls and user profiles at Valeo Service sites will be conducted once the integrated business software package has been deployed. A pilot site has been selected with the aim of establishing operating procedures that can gradually be rolled out to all Valeo Service divisions.

A documentation plan will be drawn up for the "Corporate" functions, together with a definition of the applicable key controls and a test plan based on defined samples, notably for specific holding company processes, financial consolidation procedures and tax processes.

The risk mapping summary will provide the basis for establishing a formal risk monitoring system, one of whose key functions will be to ensure that there are adequate risk management procedures.

During 2008, the Internal Audit Department will be given an audit charter which sets out its role, its responsibilities, and the policies and procedures under which it operates.

On a general level, the Group will pursue its ongoing efforts to improve its internal control procedures, with the underpinning aim of constantly adapting its management and control tools in line with changes in the Group's structure and its objectives.

These efforts are wholly supported by the Group's General Management team.

Thierry Morin

Chairman of the Board of Directors

1

2

3

4

5

6

< Contents >

Composition of the Board of Directors during the year 2007

| Name | First appointed | End of term of office | Main position held within the Company | Main position held outside the Company | Other directorships and positions held in all companies in 2007 |
|-------------------------|-----------------|---|---------------------------------------|---|--|
| Thierry Morin | March 21, 2001 | General Shareholders' Meeting to be called to approve the 2010 financial statements | Chairman and Chief Executive Officer | | Valeo Group <ul style="list-style-type: none"> ■ Chairman of Société de Participations Valeo (until November 15, 2007), Valeo Bayen (until November 16, 2007), Valeo Service, Valeo Finance, Valeo Thermique Habitacle, Valeo España SA, Valeo SpA, Valeo Japan Co. Ltd, and Valeo (UK) Limited ■ Legal Manager of Valeo Management Services, Valeo Auto-Electric Beteiligungs GmbH, Valeo Germany Holding GmbH, Valeo Grundvermögen Verwaltung GmbH, and Valeo Holding Deutschland GmbH ■ Director of Valeo Systèmes de Liaison (until January 2, 2008), Valeo Service España SA, Valeo Iluminacion, SA, and Valeo Termico SA Outside the Valeo Group <ul style="list-style-type: none"> ■ Director of CEDEP and Arkema |
| Gérard Blanc | May 21, 2007 | General Shareholders' Meeting to be called to approve the 2010 financial statements | | | <ul style="list-style-type: none"> ■ Director of Sogeclair |
| Daniel Camus | May 17, 2006 | General Shareholders' Meeting to be called to approve the 2009 financial statements | | Chief Operating Officer in charge of finance and international development in the EDF Group | EDF Group <ul style="list-style-type: none"> ■ Chairman of the Board of Directors of EDF Energy (United Kingdom) and EDF International ■ Director of Edison (Italy) and Transalpina di Energia (Italy) ■ Member of the Supervisory Board of EnBW (Germany) Outside the EDF Group <ul style="list-style-type: none"> ■ Member of the Supervisory Board of Dalkia SA and Morphosys (Germany) |
| Pascal Colombani | May 21, 2007 | General Shareholders' Meeting to be called to approve the 2010 financial statements | | Associate Director and Senior Advisor of AT Kearney | <ul style="list-style-type: none"> ■ Director of British Energy Group Plc., Alstom SA, Rhodia SA and Technip SA ■ Member of the Académie des Technologies |

1

2

3

4

5

6

< Contents >

| Name | First appointed | End of term of office | Main position held within the Company | Main position held outside the Company | Other directorships and positions held in all companies in 2007 |
|---|------------------|---|---------------------------------------|---|---|
| Jérôme Contamine | May 17, 2006 | General Shareholders' Meeting to be called to approve the 2009 financial statements | | Senior Executive Vice-President of Veolia Environnement | Veolia Group <ul style="list-style-type: none"> ■ Director of VE Services-Ré, Veolia Transport, Veolia Propreté, Veolia Environmental Services Plc (United Kingdom), Veetra, and Veolia ES Holdings Plc (United Kingdom) ■ Chairman of Venao (United States) ■ Managing Director and Director of Veolia UK (United Kingdom) ■ Chairman of VE IT ■ Member of the Supervisory Board of Veolia Eau and Dalkia France ■ Member of Dalkia's A and B Supervisory Boards Outside the Veolia Group <ul style="list-style-type: none"> ■ Director of Rhodia |
| Pierre-Alain De Smedt | March 7, 2005 | General Shareholders' Meeting to be called to approve the 2010 financial statements | | Chairman of FEBIAC (the Belgian Federation of the Car and Two-wheeler Industries) and director of various companies | <ul style="list-style-type: none"> ■ Director of Belgacom, CNP (Compagnie Nationale à Portefeuille/Albert Frère Group), Deceuninck Plastics, Alcopa, and Avis Europe Plc ■ Member of the Executive Committee and Director of FEBIAC (Belgian Federation of the Car and Two-wheeler Industries) |
| Lord Jay of Ewelme | May 21, 2007 | General Shareholders' Meeting to be called to approve the 2010 financial statements | | Member of the House of Lords | <ul style="list-style-type: none"> ■ Director of Crédit Agricole ■ Non-Executive Director of Associated British Food (ABF) and Candover Investments Plc ■ Independent member of the House of Lords ■ Member of House of Lords sub-committee on EU law & institutions ■ Member of the House of Lords select committee on international institutions ■ Member of GLOBE, an interparliamentary group on climate change ■ Vice-Chairman of Business for New Europe ■ Chairman of Merlin (international medical charity) |
| François Grappotte (until May 21, 2007) | March 31, 2003 | May 21, 2007 | | Honorary Chairman of Legrand SA | Legrand Group <ul style="list-style-type: none"> ■ Director of Legrand SA and Legrand France Outside the Legrand Group <ul style="list-style-type: none"> ■ Director of BNP Paribas ■ Member of the Supervisory Board of Michelin ■ Member of the Banque de France Consultative Committee |
| Philippe Guédon | March 31, 2003 | General Shareholders' Meeting to be called to approve the 2010 financial statements | | Managing Partner of Espace Développement | |
| Yves-André Istel (until April 10, 2007) | January 29, 1992 | April 10, 2007 | | Senior Advisor to Rothschild, Inc. | <ul style="list-style-type: none"> ■ Director of Compagnie Financière Richemont AG and Imperial Sugar Company |

1

2

3

4

5

6

< Contents >

| Name | First appointed | End of term of office | Main position held within the Company | Main position held outside the Company | Other directorships and positions held in all companies in 2007 |
|--|------------------|---|---------------------------------------|---|---|
| Helle Kristoffersen | March 22, 2007 | General Shareholders' Meeting to be called to approve the 2010 financial statements | | Vice President of Corporate Strategy Alcatel-Lucent | |
| Jean-Bernard Lafonta (until May 21, 2007) | December 7, 2001 | May 21, 2007 | | Chairman of the Management Board of Wendel Investissement | Wendel Group <ul style="list-style-type: none"> ■ Chairman of the Supervisory Board of Editis Holding ■ Chairman of the Supervisory Board of Bureau Veritas ■ Member of the Supervisory Board of Oranje-Nassau Groep BV ■ Director of Legrand Holding and Legrand SA Outside the Wendel Group <ul style="list-style-type: none"> ■ Chairman of the Board of Directors of Winvest SA (Luxembourg) ■ Legal Manager of Granit (SARL), JBMN (Luxembourg), and Winvest Conseil (Luxembourg) |
| Alain Minc (until May 21, 2007) | July 4, 1986 | May 21, 2007 | | Chairman of AM Conseil | <ul style="list-style-type: none"> ■ Chairman of the Supervisory Board of Le Monde ■ Director of FNAC and Vinci |
| Véronique Morali (until March 22, 2007) | March 31, 2003 | March 22, 2007 | | Director and Chief Operating Officer of Fimalac | Fimalac Group <ul style="list-style-type: none"> ■ Sole Director of FCBS GIE ■ Member of the Board of Fimalac, Inc., Fitch Ratings, Inc., and Fitch Risk Management, Inc. Outside the Fimalac Group <ul style="list-style-type: none"> ■ Director of Eiffage, Club Méditerranée, and Algorithmics (Canada) |
| Georges Pauget | April 10, 2007 | General Shareholders' Meeting to be called to approve the 2010 financial statements | | Chief Executive Officer of Crédit Agricole SA | Crédit Agricole Group <ul style="list-style-type: none"> ■ Chairman of the Board of Directors and of the Remuneration Committee of Calyon ■ Chairman of the Executive Committee of Crédit Agricole SA ■ Chairman of the Board of Directors of LCL – Le Crédit Lyonnais Outside the Crédit Agricole Group <ul style="list-style-type: none"> ■ Vice-Chairman and member of the Executive Committee of the Fédération Bancaire Française (FBF) ■ Permanent representative of LCL – Le Crédit Lyonnais as a Director of the Fondation de France |
| Erich Spitz | June 24, 1987 | General Shareholders' Meeting to be called to approve the 2010 financial statements | | Advisor | Thales Group <ul style="list-style-type: none"> ■ Chairman of Thales Avionics Lcd ■ Director of Thales Corporate Ventures Outside the Thales Group <ul style="list-style-type: none"> ■ Member of the Supervisory Board of Novaled and Riber ■ Correspondent member of the Académie des Sciences ■ Member of the Académie des Technologies ■ Honorary Chairman of European Industrial Research Management Association (EIRMA) |

1

2

3

4

5

6

Statutory Auditors' report on the report of the Chairman of the Board of Directors on internal control procedures relating to the preparation and processing of financial and accounting information

Year ended December 31, 2007

This is a free translation into English of the Statutory Auditors' report issued in the French language and is provided solely for the convenience of English speaking readers. This report should be read in conjunction with, and construed in accordance with, French law and professional auditing standards applicable in France.

In our capacity as Statutory Auditors of Valeo, and in accordance with article L. 225-235 of the French Commercial Code, we hereby report to you on the report prepared by the Chairman of your Company in accordance with article L. 225-37 of the French Commercial Code for the year ended December 31, 2007.

It is for the Chairman to give an account, in his report, notably of the conditions in which the duties of the Board of Directors are prepared and organized and of the internal control procedures in place within the Company. It is our responsibility to report to you our observations on the information set out in the Chairman's report on the internal control procedures relating to the preparation and processing of financial and accounting information.

We performed our procedures in accordance with professional standards applicable in France. These standards require us to perform procedures to assess the fairness of the information set out in the Chairman's report on the internal control procedures relating to the preparation and processing of financial and accounting information. The procedures we performed notably consisted of:

- obtaining an understanding of the internal control procedures relating to the preparation and processing of the financial and accounting information supporting the information set out in the Chairman's report as well as the existing documentation;
- obtaining an understanding of the work performed to support the information given in the report, as well as of the existing documentation;
- determining if the material internal control weaknesses relating to the preparation and processing of the financial and accounting information that we may have identified in the course of our audit are properly described in the Chairman's report.

On the basis of these procedures, we have no matters to report in connection with the information given on the internal control procedures relating to the preparation and processing of financial and accounting information, contained in the report of the Chairman of the Board of Directors, prepared in accordance with article L. 225-37 of the French Commercial Code.

Paris and Neuilly-sur-Seine, February 12, 2008

The Statutory Auditors

Salustro Reydel

Member of KPMG International

PricewaterhouseCoopers Audit

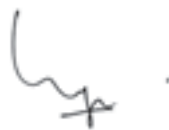
Jean-Pierre Crouzet



Emmanuel Paret



Serge Villepelet



Jean-Christophe Georghiou

