

# Report of the chairwoman of the supervisory board on organising the work of the supervisory board and on the internal control and risk management systems

## Report of the chairwoman of the supervisory board on the conditions for preparing and organising the work of the supervisory board



*Article 117 of the French financial security act - article L225-68 of the French commercial code*

The contents of this report are based on an analysis of the Group's position and organisation primarily carried out through a series of meetings with Virbac's executive board.

A draft report was subsequently submitted to the audit committee and its recommendations taken into account.

In line with the provisions set forth by the act of 3 July 2008, this report was submitted to the supervisory board at its 11 March 2011 meeting and was unanimously approved.

### Preparation and organisation of the work of the supervisory board and executive board

#### **Responsibilities and membership of the supervisory board**

The supervisory board is responsible for supervising the management activities of the executive board. It exercises its supervisory powers by meeting every quarter in order to, in particular, review the company's and Group's performance indicators and the annual and interim financial statements presented to it by the executive board. It carries out its responsibilities by, where necessary, getting information from the statutory auditors. It also reviews in more detail any proposed acquisitions on the basis of analyses drawn up by the executive board. The supervisory board has five members, two of whom are independent. The criterion used to define independence is wholly in line with Afep-Medef recommendations.

The terms of office of the supervisory board were renewed for a period of three years by the shareholders' meeting of 15 June 2010. The supervisory board is made up of two women and three men. The chair is a woman. The offices held by supervisory board members are listed on page 42 of the annual report.

#### **Meetings of the supervisory board**

The statutory auditors are invited to all supervisory board meetings. The documents, technical material and information necessary for the performance of the duties of board members relating to items on the agenda are sent out, by courier, as early as possible prior to the meeting. Supervisory board meetings are generally held at the head office. Minutes of supervisory board meetings are drawn up at the end of each meeting and submitted for the approval of supervisory board members at the subsequent meeting. In accordance with the articles of association, the supervisory board meets at least once a quarter. During the past year, the supervisory board met five times. All supervisory board members attended all meetings with the exception of Xavier Yon who was at four of the five meetings. Supervisory board members also met informally several times during the year for work and discussion sessions. At the 2010 financial year meetings, the supervisory board notably reviewed the annual and interim financial statements, quarterly sales, the budget, the reports of the executive board on the Group's business activities, results, performance and outlook as well as developments in each of the Group's major functional areas and its strategic outlook and plans and proposed acquisitions.

## Following Afep-Medef recommendations

The supervisory board resolved to adopt as its reference the corporate governance code for listed companies drawn up and put together by Afep-Medef ([www.medef.fr](http://www.medef.fr)) in December 2008, with a large majority of these recommendations already being followed.

At its 13 March 2009 meeting, the supervisory board approved its internal bylaws covering its membership, running, responsibilities, the board's reporting procedures as well as the membership, running and responsibilities of the special committees. The supervisory board must do an annual review of these rules and operating methods and a formal assessment must be carried out every three years. The supervisory board performed its first review in March 2010.

## Corporate governance

In order to comply with Afep-Medef recommendations, the terms of office of the members of the supervisory board was reduced from six to three years by the shareholders' meeting on 15 June 2010.

In addition, given the special manner in which it is run, namely on the one hand a limited liability company governed by both an executive board and a supervisory board (the responsibilities of directors differing from those of supervisory board members) and on the other hand given the family nature of its shareholder base, the company has elected not to implement the following Afep-Medef recommendation, which requires the company to have a selection or appointment committee: the size of the company and the stability of its management and supervisory bodies mean that there is no need to set up a selection or appointment committee. The supervisory board assumes this responsibility itself.

## Compensation

In terms of compensation of members of the executive board, the company follows the vast majority of provisions of the Afep-Medef recommendations (see letter of 23 December 2008 to the AMF published on the company's website). At its 22 December 2008 and 13 March 2009 meetings the supervisory board set the terms of payment for severance pay as well as a few items associated with bonus share grants and the supplementary pension scheme. The ordinary and extraordinary shareholders' meeting of 19 June 2009 approved the performance criteria associated with severance pay. Severance pay is only paid in the event of dismissal, whether associated with a change in strategy or control or otherwise, and is subject to demanding performance criteria: operating profit ratio from ordinary activities/sales over the twelve months prior to the departure of the senior manager equal to or greater than 7%.

There is a slight difference remaining on two points:

- Stock grants: the stock grants assigned to executive board members are not subject to the purchase of a specific number

of shares upon vesting of the shares granted but 35% of the shares acquired by the chairman of the executive board and 25% by other corporate officers may not be transferred whilst they work for the Group. In addition, the supervisory board felt it was more appropriate to link the performance criteria to be satisfied for the assignment of stock grants to the final year prior to the grant and not, as recommended by the Afep-Medef, to a performance assessed over a number of consecutive years. Moreover, the performances looked at are not linked to the performance of other companies or a benchmark sector as a result of a lack of reliable comparisons, with companies having similar operations to Virbac either being unlisted or divisions of major listed pharmaceutical groups;

- pensions: the supervisory board does not wish to apply the recommendations regarding the supplementary pension scheme. Virbac's policy is to only grant supplementary pensions to executive board members for two reasons: firstly the supplementary pensions granted this way are of a controlled size and subject to the potential beneficiaries meeting several conditions, and secondly Virbac has established a well-balanced social policy for all employees in terms of welfare, voluntary profit sharing and savings (company savings plan, collective retirement savings plan, employer contribution, etc.). In addition, the company goes beyond the Afep-Medef recommendations as regards the increase in potential rights since they only represent a limited percentage of the beneficiary's compensation including the variable component.

## Special committees

### Compensation committee

The membership and responsibilities of the compensation committee are set out on page 11 of the annual report. The compensation committee, chaired by an independent member of the supervisory board, met twice during 2010. Its meetings mainly dealt with the compensation of the executive board (fixed and variable components) and the granting of bonus shares to executive board members and to certain managerial personnel within the company.

### Audit committee

The membership and responsibilities of the audit committee are set out on page 11 of the annual report. The audit committee, chaired by an independent member of the supervisory board, met twice during 2010 with the chairman of the executive board, the chief financial officer and the statutory auditors in attendance. During 2010, it examined the 2009 financial statements and the 2010 interim financial statements.

It checked the financial information and decided upon the accounting treatment for the year's major transactions, in particular the acquisition completed in Australia at the start of the year. It also noted the efforts made by the executive board to ensure the establishment and effectiveness of risk management and internal control procedures. In the first quarter of 2011, the audit committee met to confirm the financial information related to the 2010 annual financial statements.

## Executive board membership

The executive board has five members. At its 22 December 2008 meeting, the supervisory board reappointed all executive board members for three years:

- Éric Marée became chairman of the executive board in December 1999. He directly supervises human resources, communications and information systems;
- Pierre Pagès supervises international operations, manufacturing and quality assurance;
- Christian Karst supervises research and development, R&D quality assurance, marketing and strategic monitoring, licensing and acquisitions;
- Michel Garaudet supervises financial and legal activities;
- Jean-Pierre Dick is responsible for special projects.

Executive board members meet, in line with the law, in order to report quarterly to the supervisory board and whenever business so requires. In line with act 2006-1770 of 30 December 2006 on the development of profit sharing and employee shareholding, the policies and rules for determining compensation and benefits of all kinds granted to executive board members are set out on page 44 of the annual report.

## Special procedures regarding shareholder participation at the shareholders' meetings

Shareholders' meetings are called and deliberate in the legally required manner. Meetings are either held at the head office or at any other place specified in the meeting notice. Meetings are chaired by the chairwoman of the supervisory board. The roles of scrutineers are filled by the two members of the meeting with the highest number of votes and accepting this position. The meeting's board appoints the secretary, who need not be a shareholder.

The main powers of the ordinary shareholders' meeting consist of the right to approve or reject the statutory financial statements and the consolidated financial statements, to allocate earnings, pay out a dividend, appoint or dismiss supervisory board members and appoint the statutory auditors. Decisions of the ordinary shareholders' meeting are taken by a majority of the votes of shareholders present or represented.

The extraordinary shareholders' meeting may take decisions such as amending the articles of association, authorising financial transactions that may change the share capital, approving or rejecting mergers or spin-offs, and granting or refusing stock options or stock grants. Decisions of the extraordinary shareholders' meeting are taken by two thirds of the votes of shareholders present or represented.

Irrespective of the number of shares owned, any shareholder is entitled to take part in the shareholders' meeting or to be represented by another shareholder, a spouse, the partner with whom they have entered into a civil solidarity pact under French law as well as any other individual person or legal entity of their

choice, or alternatively to vote by post. Legal entity shareholders participate at meetings through their legal representatives or via any person they appoint for the purposes thereof. In line with the law, the entitlement of shareholders to attend in person, by proxy or by post at shareholders' meetings is subject to the registration of the shares in the name of the shareholder or in the name of the intermediary acting on its behalf, on the third business day prior to the meeting, at midnight Paris time, either in the registered share accounts administered for the company by its agent or in the bearer share accounts held by the authorised banking or financial intermediary, acting as security custodian.

The registration of shares in the bearer share accounts held by the authorised intermediary must be confirmed by a certificate issued by the latter, adjoining the postal voting or proxy form or admission card request filled out in the name of the shareholder or on behalf of the shareholder represented by the registered intermediary. To be valid, postal voting or proxy forms must have been effectively received at the company's registered office or the location specified in the meeting notice at the latest three days prior to the date set for the shareholders' meeting, except where a shorter period is specified in the meeting notice.

Each shareholder is entitled to exercise as many votes as the shares they hold or represent without limitation. Nevertheless, a double voting right is granted to all fully paid up shares that have been registered in the name of the same shareholder for at least two years.

## Report of the chairwoman of the supervisory board on the internal control and risk management systems



In accordance with article L225-68 paragraph 7 of the French commercial code, amended by the ordinance of 22 January 2009, the chairwoman of the supervisory board has drawn up her report on the internal control and risk management procedures defined and implemented by the Virbac group.

This report has been drawn up based on contributions from several departments, in particular the Financial Affairs, Legal and Human Resources departments as well as the Group Risk Management department, and has been reviewed by the executive board which has confirmed the validity of its contents. The entire report has subsequently been communicated to the statutory auditors for discussion by them and to the audit committee for review before final approval by the supervisory board.

This report was approved by the supervisory board at its meeting on 11 March 2011.

## Internal control definition and goals

### Framework

The Group has drawn on the reference framework and its application guide first published in January 2007 and updated on 22 July 2010 by the AMF (French financial markets authority) in order to define its internal control and risk management framework so as to structure its approach. In accordance with a recommendation from AMF report 2010-15 dated 7 December 2010, the Virbac group decided to present the different information requested pursuant to the plan specified in the reference framework.

### Perimeter

The perimeter for internal control and risk management includes the parent company and the companies included in the Group's consolidated financial statements.

### Aims and principles of internal control

The internal control implemented at Virbac is aimed at ensuring that:

- economic and financial objectives are achieved in compliance with applicable laws and regulations;
- direction determined by the executive board is implemented;
- company's capital is developed and its assets are protected;
- and that the Group's financial and accounting information depicts a true and fair view.

The internal control system must promote and secure the Group's industrial and economic development by helping to prevent and control the risks to which it is exposed, all within an environment of control which is suited to its business areas and their respective issues.

In line with the fixed objectives, the internal control and risk management system of the Virbac Group is based on the following structuring elements:

- appropriate and sustainable organisation;
- internal distribution of reliable and targeted information;
- implementation of this system;
- suitable control activities that aid in the process of preparing and processing accounting and financial information;
- continuous management and formalisation of the areas of improvement.

### Limits

An internal control system can only provide a reasonable assurance and never an absolute one as regards overall risk control and limitation of obstacles to achieving the Group's objectives. The probability of actually achieving these is subject to the limits inherent in any internal control system, whether this concerns potential failings in the decision-making process, the need for reviewing the cost/profit ratio before implementing controls, or the malfunctions that may occur on account of a failure or human error.

## A sustainable organisation which is fit for purpose

### System components

The control environment which is essential for the internal control system, for good risk management and for the application of procedures, is based on a specific organisation as well as on behavioural and human aspects.

### Organisation

The internal control organisation is based first of all on key factors that are anchored deep within the company's culture and which have formed the basis of its success, such as taking initiative, placing trust in the Group's workers and providing them with a sense of responsibility. The operational organisation of internal control is structured around three levels: Group, areas and subsidiaries. Each level is directly involved and is given responsibility for designing and implementing the control in accordance with the level of centralisation desired by the executive board. At each of these three levels the internal control is broken down into specific organisational procedures, delegation of responsibilities, raising awareness and training of staff which are consistent with the Group's general framework. It requires heavy involvement on the part of each operational or functional manager by expecting them to adapt the policies and procedures defined at Group level, play a role in implementing and complying with them and finalise them via measures that are adapted to the special nature of the business activities or the areas under their responsibility.

The control system implemented within the Group is also based on a stronger governance structure which guarantees that decisions are transparent and traceable, whilst still preserving the principles of subsidiarity and decentralisation that are viewed as essential and necessary for optimum management of industrial and commercial activities in the Group.

### Delegations of powers

The subsidiaries are almost all directly or indirectly wholly owned by Virbac. This way the parent company is represented directly or indirectly (via an intermediary subsidiary) on the boards of directors at the subsidiaries. Special attention is paid to the composition and operations of the boards of directors at the Virbac subsidiaries. Each appointment or change of a director must be validated by the members of the Virbac executive board.

In addition, a Group procedure describes the rules on delegation of powers and authority to sign for the company. This was published to all subsidiaries for them to verify and, where necessary, to adapt their procedures in accordance with these instructions. Delegations of power are established, managed and updated with the aid of the Group Legal department.

## Values

The values and principles of behaviour in the Group have been formalised and published to all employees via the Group code of ethics. This code stated the Group values and reveals its principles for action and behaviour in relation to employees, shareholders, customers, suppliers and competitors. It states the principles for individual behaviour that all employees must respect, as well as the demeanour that must be observed in the countries where the Group has a presence. Adopted in 2004 as an initiative of the executive board and distributed to all employees, this code is a framework guiding people in their work, in line with the Group's values and principles.

## Codes

The Virbac Group has provided employees with other codes that allow the internal control environment to be structured and promoted. All codes are available on the Intranet.

### ■ Group code of ethics

The Group code of ethics is described in the previous section.

### ■ Purchasing code of ethics

A code of ethics specific to purchasing was also drawn up for professional and occasional buyers. It sets out the guidelines for the function within the Group, defines the roles and responsibilities of each party in their job and thereby represents a guide to the performance of each person's duties.

### ■ Stock market code of ethics

A stock market code of ethics was drawn up and distributed to all Group employees in 2005. This code sets out the applicable rules within Virbac and all its subsidiaries regarding trading in listed shares in the company and, as the case may be, its subsidiaries. It is designed both to serve as a reminder of the key principles of stock market regulations regarding trading in listed shares and to lay down some internal rules of conduct designed to ensure the correctness and transparency of transactions carried out by Group employees.

### ■ Information systems user code

An information systems user code sets out the usage methods of the different tools made available to Group employees.

## Procedures and standards governing activities

Group policies have been defined by the functional departments for all processes supplying the financial statements, in particular sales, purchases and stock and property management. These departments lay down Group policies which define the organisation, responsibilities and particular operating and reporting principles in the respective area of expertise under their responsibility. These policies are then broken down into specific procedures for monitoring, rule validation, authorisation and accounting.

As an example the Group has implemented the following policies:

- a purchasing policy which determines the rules, aims and best practices related to purchasing and ethics;
- a policy for securing payment methods which defines the methods that must be implemented in order to limit the risks of fraud;

- a policy for protecting individuals aimed at providing the same level of protection to all Group employees, whether they are expatriates, local or on special assignments;
- a safety and environmental policy which lays down the rules of conduct for a permanent reduction in the risks inherent in any industrial activity;
- an investment policy which is validated by the executive board when the strategic plans and budgets have been drawn up. Any major investment foreseen in these budgets is still subject to a further validation by the International Operations department or by the executive board. Any change that may occur during the year that relates to projects that have been budgeted is subject to special prior authorisation.

In parallel with this *body* of procedures on internal bylaws, the Group complies with the different frames of reference that apply within the pharmaceutical industry. These texts outline the management operations for each stage, whether this is at the research and development method level or at the medicine and vaccine manufacturing standards, packaging, distribution, sales and marketing and promotion levels.

## Human resources management policy

Human resources management plays a part in the Virbac internal control system by allowing the Group to ensure that its employees have a suitable skills level in relation to the roles and responsibilities entrusted to them, and that they are aware of their responsibilities and their limits, in addition to being aware of and complying with Group rules.

### ■ Recruitment and development policy

The Group recruits in all countries and for all roles in order to support its growth. The Human Resources department defines standards and verifies practices in order to ensure the consistency and relevance of the recruitment process.

In parallel, an employee performance and development management process known as Perf (covering performance, evaluation, compensation and training) has been deployed; it is made up of several different parts which include setting individual objectives and annual achievements assessed by line managers with the situation examined on an individual basis.

Within the annual performance committee the executive board shares the assessments, remuneration and professional development possibilities of the 60 key individuals in the Group as well as the potential top performers identified through the Perf process.

### ■ Compensation policy

Compensation is reviewed annually. The review covers the base salary and individual and collective bonuses. The salary review is carried out in accordance with an overall policy aimed at strengthening the competitiveness, consistency and development of compensation within the Group. The aim is also to remunerate individual performance pursuant to objective criteria and criteria shared between all roles. The bonus practices applicable in the Group are otherwise consistent and are based mainly on comparable criteria in terms of value and type. The compensation committee also reviews the overall remuneration policy for members of the executive board.



## Main players

### Supervisory board and its special committees

The supervisory board operates a constant control over the Group management led by the executive board. Within this framework, it ensures in particular that the internal control systems are actually implemented within the Group.

The board has set up two special committees to aid it in its task: the compensation and the audit committees. The members of these committees are shown on page 11 of the annual report.

The role of the compensation committee is to determine the compensation of the members of the executive board.

The audit committee is responsible for:

- ensuring the relevance, consistency and reliability of accounting methods;
- ensuring the existence and effectiveness of the internal control and risk management systems;
- examining the statutory inspection of the annual financial statements and the consolidated financial statements by the statutory auditors;
- making a statement on the accounting process for significant transactions;
- and ensuring the independence of the statutory auditors.

### Executive board

The executive board has operational and functional responsibility in all Group activities for implementing the strategy decided upon by the supervisory board. In particular, it is responsible for actual implementation of the internal control systems within the Group.

The members of the executive board are shown on page 10 of the annual report.

Its members have divided responsibilities as follows.

The chairman of the executive board is responsible for supervising and coordinating the activities of all executive board members. He performs all the legal functions of a company head and takes responsibility for this. He represents the company and acts on its behalf in all circumstances and particularly before the courts. For the purposes of the company's internal organisation, he is, moreover and more particularly, responsible for the following corporate departments: the Group Human Resources department; the Group Information Systems department; the Group Communications department including financial communication in collaboration with the chief financial officer.

The chief operating officer supports the chairman with his work and stands in for him upon request, exercising the same powers pursuant to the law. He holds the position of qualified person of Virbac in line with articles L5142-1 *et seq.* of the French public health code. For the purposes of the company's internal organisation, he supervises the following departments: the International Operations department, responsible operationally for the subsidiaries and export activities spread across four areas: Europe, North America, Latin America, Apisa (Asia, Pacific, India, South Africa); the Group Industrial Operations department,

responsible in particular for drawing up and managing the Group's industrial strategy, coordination of production sites with the main sites being based in France, and coordination of actions for ensuring strict compliance with the regulatory framework; and the Industrial Quality Insurance department.

The Development director supervises the following departments: the Group Products Innovation department, responsible for laying out the Group's R&D strategy, carrying out projects and coordinating research centres spread across the various geographic regions, as well as for marketing and strategic monitoring; the R&D Quality Assurance department; the Business Development department, which is responsible for licensing (an activity that mainly consists of acquiring or disposing of rights to active ingredients of finished products or products in development in line with Group strategy) and acquisitions.

The chief financial officer is responsible for Group financial policy and supervises: the cash situation and financing, drawing up the consolidated financial and accounting information, the budgetary and financial planning processes and management control; the Legal department, responsible for corporate law, insurance policy, negotiations, drawing up and managing contracts and disputes, and the Risk Management department shown on page 68 of the annual report.

The head of special projects is the president of the Fondation d'Entreprise Virbac (a corporate foundation), and ensures the communication and development of Virbac's corporate reputation through sponsoring initiatives.

### Strategic committee

The Strategic committee is chaired by the chairman of the executive board and comprises the following departments, represented as follows:

- executive board members;
- area directors: Europe, North America, Latin America, Apisa;
- Group Human Resources department;
- Group Industrial Operations department;
- Group Product Innovation department.

The Strategic committee gives its view on the Group's major strategic decisions: strategy by business, function and major project.

### Executive committee France

The executive committee France is chaired by the chairman of the executive board and comprises the following departments, represented as follows:

- executive board members;
- Group Human Resources department;
- French Industrial department;
- Group Product Innovation department;
- Group Communications department;
- Group Information Systems department;
- Europe department;
- Legal department.

The executive committee France is primarily responsible for decision-making, coordination and reporting on all issues affecting the group of French companies and represents a platform from which to disseminate information to the various departments.

### Operational departments

In accordance with the operational decentralisation principles within the Group, the managers of each business activity have the necessary powers for organising, directing, managing and delegating the operations for which they are responsible.

Each activity favours the organisation which is best suited to its markets, taking into account its particular sales, industrial and geographic features. The managers are responsible for adopting internal control systems consistent with their organisations as well as with Group principles and rules.

### Functional departments

The central functional departments (finance, legal, human resources, product innovation, communications, information systems, health, safety and environment and purchasing) have a dual task: organisation and control of Group operations falling within their respective skills area and technical assistance with operational activities in these areas where required.

The presence of the central functions and their organisation play a significant role in Group internal control systems. The managers of these roles have in particular functional authority over all managers who carry out tasks falling within their skills area in the operational activities.

### Risk Management department

Since its creation at the end of 2009, this department has become a full participant in the Group risk management and internal control system. Reporting directly to the chief financial officer (member of the executive board) with a dotted line to the executive board, the Risk Management director takes part in and coordinates risk analysis, makes a contribution across the organisation and aids in sharing best practices between Group entities and departments. His roles and responsibilities are shown in detail on page 69 of the annual report.

## Internal distribution of reliable and targeted information

Information and communication are connected with the information flows which support the internal control procedures, from the orientations expressed by management through to action plans. They contribute to the control environment being implemented as well as to the distribution of an internal culture and the promotion of relevant control activities that play a part in risk control.

There are different aims:

- informing all Group employees and making them aware of the implementation of best practices;

- sharing experiences so as to promote the use of these best practices, including internal control and risk management systems.

Special communication tools deployed by the Group encourage the achievement of these aims: the internal publication *Virbaction* presents Virbac's general direction, its organisation, activities and projects. Other tools such as the Intranet allow Group policies and procedures to be distributed. Virbac also strives to provide each of its newly recruited managers with a view over the entire Group and its organisation, main business areas and strategy. Induction sessions for new recruits, either organised locally or at head office, are part of this effort. Finally, in addition to the training sessions organised by the operational divisions, Group seminars allow employees to improve certain professional skills (finance, marketing, human resources, project management, etc.) and encourage an exchange of best practices.

The information and the communication channels also rely on the information systems. The Group Information Systems department is responsible for all Group information systems. It is made up of departments that are the direct responsibility of the Group Information Systems department and of decentralised departments within the operational divisions. The departments within the overall Group Information Systems department define information system policies, coordinate the processes for managing the information systems role and manage global IT infrastructures and services in line with Group priorities. The decentralised departments develop and manage the specific applications within their divisions, as well as the dedicated IT infrastructures and services.

Upward and downward information channels have been defined so as to allow the timely transmission of relevant and reliable information.

In terms of information feedback, accounting and financial information is processed in accordance with processes and with collaborative reporting and control tools (collaborative reporting and consolidations software shared throughout the Group under the authority of the Financial Affairs department).

For downward information flows, resolutions from the decision-making bodies are relayed via the relevant departments. Any change in the regulatory framework relating to any matter whatsoever is communicated to the relevant entities and departments in an appropriate manner.

Finally, communication aimed at stakeholders is governed by the appropriate systems for the sake of guaranteeing the quality of the information.

In addition, the Group distributed a crisis management procedure the objective of which as far as possible is to anticipate the potential occurrence of any crises through deployment of management and alert principles covering all Group areas and activities.

## Implementation of the risk management system

### Aims

The Group Risks Management department was set up at the end of 2009 in order to strengthen the Group's ability to forecast, analyse and prioritise risks of any kind and to ensure the suitability of the Group's development in relation to these risks.

This department has structured its methodological framework in line with best practices and recognised professional standards such as, in particular, ISO 31000, Federation of European risk management associations (FERMA), Committee of sponsoring organisation (COSO II).

The aims of the Risks Management department are to ensure that the following functions in relation to risk management are actually in place within the Group:

- know and anticipate: ensure that there is constant monitoring of Group risks in order to guarantee that none of these is forgotten or underestimated and to forecast any development in their nature or intensity;
- organise: ensure that the main risks identified are actually taken into account by the organisation, at the most appropriate level within the Group. Numerous operational risks are managed by the subsidiaries; head office takes charge of other risks which require special skills or that have an essentially cross-organisational or strategic component;
- control: ensure that the organisations and methods in place are effective in reducing the risks identified;
- inform: implement a coordinated risk management system is an important factor in the system as a whole. This is how overall risk management plays a role in supporting sustainable and responsible growth and predictability of results.

### Regular structured analysis of the main Group risks

The internal control system is based on the internal control environment and is part of a continuous process for identifying, assessing and managing risk factors that are likely to have an impact on the aims being achieved and the opportunities that could improve performance. Providing an awareness of the responsibilities related to identifying, assessing and managing risks should be spread out through all appropriate levels of the organisation.

A formal and more accurate report of the main risks for the Group and the methods of management and control of these is shown on page 50 of the annual report.

Thanks to a structured process aimed at understanding and analysing the main risks for the Group, Virbac is able to appreciate the adequacy of the existing internal control systems, implement relevant action plans for their improvement and, more generally, to provide increased protection for the Group's corporate value in the area of compliance with applicable laws and regulations.

### Organisation of the risk management system

The main committees helping with the process of identification, assessment and management of risks and opportunities are the executive board, the strategic committee and the executive committee France. The members of these committees rely on their experience in anticipating risks and opportunities associated with the developments in the pharmaceutical sector and in the company itself.

The risk concept is consistently taken into account as part of the company's decision-making processes, such as during the budgetary process, monthly reviews of results and monthly management reporting.

In addition, the Group embarked on a formal and recurrent process of analysing its main risks through completion of a mapping of its major risks. This process was started in 2010 at the Group level. The process was implemented between April and November 2010 and it allowed for detailed reporting on Group risks along with an assessment of these. It was carried out via interviews with around 80 executives representing different levels in this panel (head office, area directors and subsidiaries) as well as the different roles and business areas in the Group. Each of the risks identified was assessed in terms of impact and frequency after taking into account the risk reduction factors already implemented.

The results of this process were reviewed by the members of the executive board and presented to the audit committee. These reviews caused new actions to be determined or led to existing actions being reinforced in order to improve the control level of certain risks identified within the Group.

The risk mapping will be updated on a regular basis in collaboration with the managers of the central functions and the main operational players in the Group.

Each of the major risks has been analysed and prioritised. For each of them, risk owners are responsible for designing and implementing action plans in coordination with the different operational and functional departments, in order to limit any exposure to risk. The director for Risk Management coordinates the whole process and reports to the executive board who monitors the implementation of the action plans directly.

The mapping of the major risks in the Group and the associated action plans were presented at the Group audit committee on 10 March 2011.

The risk management process has contributed to the following initial results:

- a general view of Group risks with priorities;
- a dynamic caused by significant mobilisation with this project which encourages practices and experiences to be shared between the departments themselves (cross-functional approach);
- an organisation set up to capitalise on current risk management mechanisms (for example, financial and legal and those related to environmental risk assurances and management) and to implement action plans and additional controls;
- the strengthening of company controls over cross-functional risks.



For Virbac, risk management forms part of a continuous improvement cycle of the overall risk management system by becoming engrained in company processes and consistently taking the fundamental issues into account that can be found in the organisation, whether operational, legal, regulatory or related to governance. Areas for improvements are planned for 2011 aimed at extending this system shown on page 72 of the annual report.

## Suitable control activities that aid in the process of preparing and processing accounting and financial information

This system does not only cover the processes for preparing financial information, it also covers all the upstream operational processes that help to produce this information. Internal control in all its forms but especially that related to finance and operations is essential for Virbac. The Group's ongoing aim is to maintain the balance between the decentralisation required for its activities, better operational and financial control and the dissemination of skills and best practices.

### Dedicated financial organisation

The control system and the procedures for producing accounting and financial information are consistent within the Group. This system is made up of a cross-functional accounting organisation, uniform accounting standards, one single consolidated reporting system and quality control of the financial and accounting information produced.

Accounting and financial operations are managed by the Group Financial Affairs department. Its central organisation includes:

- the Corporate Control department which supervises all functions related to the preparation and analysis of financial information. This set is made up of:
  - the Accounting and Consolidation department, which is responsible for preparing and presenting the financial accounts of the Virbac entity and the Group consolidated accounts. It is also responsible for monitoring tax affairs within the Group;
  - Management Control department, which is responsible for preparing and consolidating budget data and for monthly management reporting which includes an analysis of Group results both compared with budgetary objectives and with the previous year;
- a corporate Treasury and Financing department which is responsible mainly for coordinating and monitoring the reporting related to the Group's financial debt and financial results. With regard to exposure to exchange rate risks in particular, the guidelines of the Financial Affairs department forbid speculation and only allow for the hedging of positions that, whether current or future, are certain.

The financial directors of each subsidiary exercise a key role on account of the decentralised organisation of the accounting and finance functions. They are mainly responsible

for ensuring that all internal accounting and finance control procedures are applied correctly on the ground. Each subsidiary financial director reports functionally to an area management controller who operates at the area level. The controller reports functionally to the Group chief financial officer.

### Suitable tools: procedures and reference frameworks

The accounting and finance rules set out in the special instructions drafted by the Group Financial Affairs department apply to all operational and legal entities in the Group. In compliance with the IFRS standards adopted in the European Union, they include the following factors:

- a reminder of the general accounting principles and instructions that must be followed;
- a detailed chart of accounts;
- a confirmation of the Group accounting methods applicable for the most significant items and/or transactions;
- control procedures for the largest account categories, and in particular the main reconciliations to be carried out for controlling the information produced;
- rules defining the framework of the management information known as Group financial reporting guidelines;
- rules to be followed in order to manage cash flow requirements and financing thereof, investments of cash surpluses, hedging of exchange-rate risks.

These documents are updated on a regular basis, upon each change or application of new accounting standards, under the responsibility of the Corporate Control department. Virbac has set up a reporting system, which has been deployed in all entities within the Group, in order to ensure the quality and reliability of its financial information. It is supplied via the local accounting data, either by an interface, by drawing the required data from the ERP financial modules that these entities have, or by manual entry.

Special procedures have been defined for off-balance sheet commitments. These latter items stem from guarantees provided by the company. The provision of securities, deposits and guarantees are subject to the following controls:

- for the parent company: special authorisations from the supervisory board whenever such guarantees exceed the permanent authorisation given to the executive board;
- for the subsidiaries: material off-balance sheet commitments must be approved in advance by the parent company.

### Formal processes

The financial processes implemented contribute to the quality and reliability of the accounting and financial information.

### Accounting and consolidation process

The generation of information is achieved via the half-yearly consolidation process supervised by a dedicated unit within the Financial Affairs department and underpinned by accounting principles applicable to all subsidiaries, thereby ensuring methodological consistency.

### **Budgetary and management reporting process**

Management Control coordinates the monthly budgetary consolidation and reporting process within the Group, using information transmitted by the different operational departments and by the subsidiaries. Concordance between the management information from reporting and the accounting data constitutes the key principle of control for ensuring the reliability of accounting and financial information. The management reporting system is used for monitoring the monthly results and the main management indicators, and for comparing them with the budget and with the results from the previous year. The management indicators are explained and analysed by Management Control in collaboration with the local financial directors.

Each month the executive board examines the summaries from the management reporting, analyses the significant variations and decides on any corrective actions to be implemented where necessary.

### **Treasury process**

A process for establishing an annual treasury plan was also implemented across the Group, making it possible to control and consolidate the forecasting of cash movements of subsidiaries, a sign of the accuracy of sales and expenditure forecasts and of operating capital requirement management, customer collection, stock management and supplier payment terms.

A policy of pooling excess cash and financing requirements daily in the eurozone means that the Group's net positions can be reduced and the management of its deposits or financings optimised. Outside Europe, a policy of cash pooling was also implemented in order to limit counterparty risks and to optimise the use of lines of credit.

### **Items likely to have an impact in the event of a public offer**

Pursuant to article L225-100-3 of the French commercial code, the items likely to have an impact in the event of a public offer, *i.e.* shares with a double voting right, are set out in the annual report on page 49. As such Virbac's main shareholder, the Dick family Group, holds 47.7% of shares and 63.9% of voting rights.

### **Management of systems and areas for improvement**

#### **Actions for monitoring and improving systems**

The Virbac group is implementing continuous improvement actions for its internal control systems under the supervision of the executive board and the executive committee France, as well as under the supervision of the audit committee of the supervisory board.

#### **Supervisory board**

The role of the supervisory board and its special committees was described on page 67 of the annual report.

### **Executive board**

The executive board is responsible for defining and managing the approach to internal control and risk management, relying on the operational departments to implement these (see page 67 of the annual report). The functional departments carry out investigations into operations in their respective areas through their network of experts or via regular audits (see page 68 of the annual report).

### **Statutory auditors**

All the accounting and financial elements prepared by the consolidated subsidiaries are subject to at least a limited audit during half-yearly closing for the most significant entities, and to an audit carried out by external auditors when the year closes. The audit tasks in the different countries are given to the members of the network of statutory auditors of the Group. They certify the consistency, reliability and a fair view of the consolidated statements and of the individual company statements. They are informed of the key factors in the year upstream of the process of preparing the financial statements and they present a summary of their work to the Group accounting and financial managers and to the audit committee at the half-yearly stage and when the year closes.

### **Financial communication**

#### **Annual report**

The Financial Affairs department is responsible for preparing the annual report, which involves in particular:

- defining the feedback and validation process for the information appearing in the annual document;
- supervising the work carried out by the annual report steering committee;
- applying the AMF regulations and managing relations with the AMF.

#### **Press releases**

The increasing importance of financial communication and the need to deliver quality financial information have led the Virbac group to acquire the functions and skills required to present reliable quality information and to control risks to the corporate image. The Group Communications department is responsible in particular for actions taken which could have an impact on the image, reputation and integrity of the brand name or Virbac's share price. To achieve this, it works very closely with the Financial Affairs department.

#### **Improvement plan for the internal control and risk management system**

The Virbac group embarked on a process improvement project for its internal control and risk management system in line with the general directions and priorities fixed by the chairman of the executive board. The actions implemented are the responsibility of the functional and operational departments. They are presented at the audit committee.

### Monitoring of 2009 commitments

Setting up the risk management functions within the Group materialised through the completion of a mapping of the Group's major risks and of a programme for implementing action plans for the risks considered to be priorities by the executive board.

### Outlook for 2011

The outlook for the coming year includes the following:

- monitoring of the implementation of action plans related to the mapping of risks completed in 2010;
- progressive deployment of the risk management process within the organisation with an initial desire to focus on the Group's main subsidiaries;
- setting up a network of contacts for risks within the subsidiaries.

## Financial report

# Statutory auditors' report prepared in accordance with article L225 235 of the French commercial code (*Code de commerce*), on the report prepared by the chairwoman of the supervisory board

Year ended 31 December 2010

This is a free translation into English of the statutory auditors' report issued in French prepared in accordance with article L225-235 of the French commercial code on the report prepared by the chairwoman of the supervisory board of Virbac on the internal control procedures relating to the preparation and processing of accounting and financial information issued in French and is provided solely for the convenience of English-speaking users.

This report should be read in conjunction with, and construed in accordance with, French law and the relevant professional standards applicable in France.

To the shareholders,

In our capacity as statutory auditors of Virbac and in accordance with article L225 235 of the French commercial code (*Code de commerce*), we hereby report to you on the report prepared by the chairwoman of your Company in accordance with article L225 68 of the French commercial code for the year ended 31 December 2010.

It is the chairwoman's responsibility to prepare, and submit to the supervisory board for approval, a report on the internal control and risk management procedures implemented by the Company and containing the other disclosures required by article L225-68 of the French commercial code, particularly in terms of corporate governance.

It is our responsibility:

- to report to you on the information contained in the chairwoman's report in respect of the internal control and risk management procedures relating to the preparation and processing of accounting and financial information, and
- to attest that this report contains the other disclosures required by article L225-68 of the French commercial code, it being specified that we are not responsible for verifying the fairness of these disclosures.

We conducted our work in accordance with professional standards applicable in France.

## Information on the internal control and risk management procedures relating to the preparation and processing of accounting and financial information

The professional standards require that we perform the necessary procedures to assess the fairness of the information provided in the chairwoman's report in respect of the internal control and risk management procedures relating to the preparation and processing of the accounting and financial information. These procedures mainly consisted in:

- obtaining an understanding of the internal control and risk management procedures relating to the preparation and processing of the accounting and financial information on which the information presented in the chairwoman's report is based and the existing documentation;
- obtaining an understanding of the work involved in the preparation of this information and the existing documentation;
- determining if any significant weaknesses in the internal control

procedures relating to the preparation and processing of the accounting and financial information that we would have noted in the course of our engagement are properly disclosed in the chairwoman's report.

On the basis of our work, we have nothing to report on the information in respect of the Company's internal control and risk management procedures relating to the preparation and processing of the accounting and financial information contained in the report prepared by the chairwoman of the supervisory board in accordance with article L225-68 of the French commercial code.

## Other disclosures

We hereby attest that the chairwoman's report includes the other disclosures required by article L225 68 of the French commercial code.

Nice and Marseille, 28 March 2011

The statutory auditors

**Novances-David & Associés**

Jean-Pierre Giraud

**Deloitte & Associés**

Vincent Gros

