

Governance

The Heineken risk management and control system encompass policies, processes, tasks, behaviours and other aspects of the company, which, taken together, are aimed at a reasonable level of assurance, that the risks of the Company are identified and managed and that the operational and financial objectives are met, where relevant in compliance with applicable laws and regulations. Embedded in these processes is a system of controls over financial reporting in order to provide reasonable assurance regarding the reliability of the Company's financial reporting. Heineken's internal control system is based on the COSO Internal Control Framework.

Considering Heineken's overall risk profile, and based on the activities described below and the assessments provided from these, we have no indication that current risk management and control systems were not adequate nor effectively working in the year under review. The risk management and control systems are considered to be in balance with Heineken's risk profile, although such systems can never provide absolute assurance.

Following Heineken's continuing growth and changing risk profile, the Company's risk management and control systems are subject to continuous review and adaptations. Currently, Heineken is further structuring and formalising its risk governance activities, appropriate to the evolving structure and needs of the group.

Risk management and control system

Overall Risk Profile

Heineken's operations and related risks are widely spread. The worldwide activities are exposed to varying degrees of risk and uncertainty, some of which, if not identified and managed, may result in a material impact on a particular operating company, but may not materially affect the group as a whole.

Heineken's operating companies work in many different markets, environments and cultures. However, Heineken is a single-product company, with a high level of commonality in its worldwide business operations. This allows for the development of best-practice driven processes and systems worldwide which has a positive impact on Heineken's overall operational risks and controls.

Overall, Heineken's risk profile is considered relatively low. However, due to continuous growth and increasing complexity, the risk profile is changing.

Risk Management

Doing business inherently involves taking risks, and by managing these risks Heineken strives to be a sustainable and performance driven company. This calls for a proper balance between entrepreneurial attitudes and the control levels associated with exploiting business opportunities.

In the year under review, Corporate departments carried-out a structured integrated risk assessment. On a process level, structured risk identification and management activities are partly established in various operating companies, mainly driven by Heineken common systems. In 2005 risk management will be further enhanced.

Responsibilities

The Executive Board, under the supervision of the Supervisory Board, is overall responsible for the design and functioning of Heineken's risk management and control systems. Operating company management teams are accountable for managing performance, underlying risks and effectiveness of operations, within the boundaries set by the Executive Board. They are responsible for implementing, operating and monitoring an effective risk management and internal control system in their operations, optimising the use of Heineken common processes, systems and other best practices, supported and supervised by Corporate departments and the Executive Board.

In 2004, the Heineken Code of Business Conduct and Code of Whistle Blowing were issued. Various policies and procedures have been updated, including Fraud Reporting procedure, the Funds Planning & Application procedure, the Heineken Brand Policy and the Crisis Management Manual.

Corporate role

The commonality of Heineken's operations, the development of Heineken common processes, systems, and definitions and related performance benchmarking opportunities, facilitate Corporate departments on setting directives and ensuring monitoring. In addition, Corporate departments are contributing to competence development in operating companies by sharing of best practices, common system and tool developments and training programmes. With the growth of the company and evolving business needs, corporate departments are reviewing and adapting their activities towards operating companies.

Shared services

Heineken is further developing shared services, mainly driven by synergies, but also strengthening risk management and internal control. Main examples of Heineken's shared services are world-wide technical services to breweries, contracting of raw and packaging materials by Corporate Purchasing, back office activities with regard to Heineken's export businesses, and shared IT services for all common system operations. Also within various operating companies, there is a movement towards shared services, like in the widely spread wholesale businesses in Western Europe, and various supportive processes in regional operating companies, managing many mid-sized and smaller market operations.

Business planning and performance monitoring

The main pillar of Heineken's internal governance activities is the business planning and performance monitoring process. Operating companies strategy, business plan and quarterly performance reporting are discussed with the responsible Executive Board member, taking into account the comments from corporate function's reviews, which may include internal control issues. The approved business plans include clear objectives, performance indicators and target setting, which provide the basis for monitoring performance compared to plan. Heineken's regional operating companies, responsible for managing mid-sized and smaller companies in a region, cascade the business planning and performance monitoring cycle down to their management structures. Currently, further enhancements to Heineken's performance management system are progressing.

Internal control in operating companies

Heineken is progressing the group-wide development and implementation of uniform processes and common IT systems based on best practices. At the end of 2004 the main part of the operating companies work in accordance with the evolving Heineken common system.

In developing and implementing common systems, structured risk assessments were included and controls established or adjusted. These internal controls ensure the integrity of the information processing in its support of the day-to-day transaction processing, financial and management reporting, decision-making and overall monitoring. Internal Audit reviewed the redesign and implementation of internal control during and after the common system implementation projects.

Based on these reviews, the level of internal control of the majority of operating companies working with Heineken common processes and systems is satisfactory. However, most of these operating companies are still in a phase of optimising their internal control systems. For a few operating companies, where the level of controls is not yet satisfactory, improvement plans and strong progress monitoring are in place.

Various – smaller and mid-sized – Heineken operating companies, that have not yet adopted common systems, showed progress on improving and monitoring internal control, following reports from internal and external auditors.

Supervision

The Executive Board oversees the adequacy and functioning of the entire system of risk management internal control. Corporate departments assist the Executive Board by providing analyses, appraisals and recommendations, raising the level of risk awareness, and promoting effective and efficient internal control best practices. Group Internal Audit provides overall independent challenge and assurance on risk management and internal control system.

Main operating companies and joint ventures do have their statutory obligations, including their own Supervisory Boards and Audit Committees. Various Heineken senior executives are member of these boards and committees.

Early 2004, an Assurance Meeting has been introduced in the operating companies. The Assurance Meeting oversees, at operating company level, the adequacy and operating effectiveness of the entire internal control system. These meetings, which are in principle held twice a year, and agreed action plans are an integral aspect of the internal governance structure of operating companies and ensure transparency within the Heineken group.

Group Internal Audit is organised close to the business, with internal auditors having a good understanding of the process and culture and speaking the local language. Group Internal Audit has stimulated the establishment of Local Internal Audit departments and is continuously working on standardisation and ensuring their quality and independence governed by a functional relationship. Group Internal Audit plays a critical role in the objective and independent assessment of risk management activities and the effectiveness of internal control. Group Internal Audit regularly meets with the Chairman of the Executive Board and the Member of the Executive Board responsible for Finance to discuss the main observations. Quarterly summary reports are issued to the Executive Board and the Audit Committee.

External parties also provide assurance on Heineken's risk management and control system. The worldwide external audit activities – which are based on local statutory requirements, and therefore broader in scope than necessary for the Heineken N.V. consolidated figures – provide assurance on reliability of financial reporting on operating company level.

Main risks and responses

Under the explicit understanding that this is not an exhaustive list, Heineken's major risk factors and responses are listed below.

Strategic risks*Heineken brand perception and company reputation*

As both the group and its most valuable brand carry the same name, reputation management is of utmost importance. Heineken enjoys a positive corporate reputation and our operating companies are well respected in their region. Constant management attention is directed towards enhancing Heineken's social, environmental and financial reputation. The Heineken brand is key to Heineken's growth strategy and is the most valuable asset of the company. Anything that adversely affects consumer and stakeholder confidence in the Heineken brand or company could have a negative impact on the overall business.

The Company reputation and sales could be damaged by product integrity issues. Therefore, production and logistics are subject to rigorous quality standards and monitoring procedures. Brand perception is managed by strict marketing control procedures. Any (perceived) socially irresponsible behaviour of the Company and its employees is managed via the issue and implementation of a Code of Business Conduct and Whistle Blowing Procedure.

Pressure on alcohol

An increasingly negative perception towards alcohol could lead to a decrease in sales and damage the industry in general. If the social acceptability of alcoholic beverage were to decline significantly

from current levels, sales of Heineken products could materially decrease.

Heineken's Alcohol Policy is based on the principle to produce, market, and sell beer in ways that have a positive impact on society at large. With this policy, Heineken promotes awareness of the advantages and disadvantages of alcohol, encouraging informed consumers to be accountable for their own actions.

Attractiveness of Beer Category under pressure

Heineken has many operations in mature Western European beer markets where the attractiveness of the beer category is being challenged by other beverage categories.

In these markets, management focus is on product innovation and portfolio management in order to secure market position and profitability. Since Heineken is acquiring new businesses in emerging markets, the relative dependency on profitability from mature markets will decline.

Operational risks

Growth in emerging markets and business integration

In the pursuit of further expansion, Heineken seeks to strike a balance between organic and acquired growth within the limit of a conservative financing structure. Following its expansion in emerging markets, Heineken will be faced with different cultures, business principles and political environments, which may affect corporate values, image and quality standards. It may also impact the realisation of long-term business plans including synergy objectives, underlying the valuation of new acquired companies.

Heineken is strengthening its business development and integration processes, which includes significant involvement from relevant corporate departments and regional management in carrying out effective due diligences and preparing integration plans. Timely and sound integration of acquired businesses should ensure control and the realisation of synergies.

Business continuity

Business interruptions could affect sales and market shares. These are not considered a major risk due to the relative size and spread operations. An exception is the supply of beer products from the Netherlands to the USA, one of Heineken's most profitable markets.

Contingency measures, involving multi-sourcing locations in Europe are in place and Heineken's central purchasing department manages long-term contracts with preferred suppliers in order to secure supply of critical raw and packaging materials.

IT security

IT has a growing impact on Heineken's worldwide business operations, and connectivity in the company and with outside partners is increasing.

Heineken has a strict IT security policy to ensure confidentiality, integrity and availability of information and data. Support and monitoring activities towards operating companies are being strengthened. IT contingency measures with regard to the partly outsourced IT shared service centre are under review and will be further strengthened.

Financial risks

Currency risks

Heineken operates internationally and reports in euros. Currency fluctuations, especially relating to the US dollar, materially affect overall Company results.

Heineken has a clear policy on hedging transactional exchange risks, which postpones the impact on financial results. Translation exchange risks are not hedged. The sensitivity on the financial results with regard to US dollar positions are explained on page 95.

Capital availability

Sufficient generated capital is needed to finance long-term growth and to keep pace with the consolidation of the global beer market.

Strong cost and cash management and strong controls over fund applications are in place to ensure effective and efficient allocation of resources. Financing strategies are under continuous evaluation.

Tax

Heineken and its operating companies are subject to a variety of local excise and other tax regulations. In principle, Heineken's sales prices are adjusted to reflect changes in the rate of excise duty, but increased rates may have a negative impact on sales volume.

Compliance risks

Emerging legislation

Due to increasing legislation, supervision and claim culture, both international as local, there is a growing possibility of non-compliance, which could result in claims or penalties and could have a negative effect on the Company's reputation.

Relevant corporate departments and operating companies have put strong policies and procedures in place, or these are being established.

There may be current risks that the Company has not fully assessed, and are currently identified as not having a significant impact on the business but which could – in a later stage – develop a material impact on the Company's business. The Company's risk management systems are focused on timely discovery of such incidents.