



HYDRO

The Journey to Sustainable Sox Compliance

“ A short 45 minutes recap of a 4 year journey that have just started... “

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Why SOX Was Issued



- Largely in response to major corporate and accounting scandals involving several prominent companies in the US
- The most extensive reform that the US financial markets have seen since the enactment of the Securities Act of 1933 and the Securities and Exchange Act of 1934
- Most will agree that the law was needed to restore investor confidence. But few will acknowledge that they themselves need it. Or can benefit from it

Background: US companies, financial scandals, fraud and mistrust

- Enron
- WorldCom
- Adelphia
- Health South
- Tyco
- Global Crossing
- Cendant



Department of Justice

**U.S. CHARGES EX-WORLDCOM CEO BERNARD EBBERS;
FORMER WORLDCOM CFO SCOTT SULLIVAN PLEADS GUILTY**

Convicted by a jury last month of spearheading an \$11 billion accounting fraud that led to the biggest bankruptcy in U.S. history, the 63-year-old Ebbers could spend the rest of his life behind bars. He faces up to 85 years in prison.



Bernard Ebbers, CEO WorldCom

Scandals also in non-US companies



Norway: Finance Credit

- Founder sentenced to 9 years and repay USD 180 million (mill NOK 1178)
- Auditors KPMG has made an out-of-court settlement of USD 55 million (mill NOK 347)



Scandals also in non-US companies



Why Good People Do Bad Things ...



- Sociological studies show that even those with scruples of steel will buckle and make bad decisions when put in an environment that encourages them to do so
- So, when it comes people's conduct, the company culture is a great asset, or the biggest threat
- It boils down to creating an environment where good people make good decisions when faced with conflict

To Avoid Management Override...



Sox Regulations in Brief

” Fear – should you be afraid ? ”

Sox in Brief ...

1. Accounting scandals



3. Interpretation guidance



4. Corporate guidelines defined by:

Hydro management

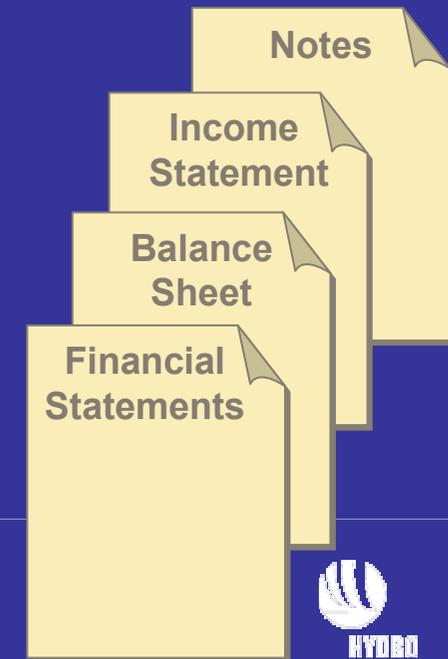


2. Law sanctioned in 2002: The Act encompasses provisions designed to strengthen corporate governance, ensure transparent financial reporting and restore public trust in capital markets



Sarbanes at White House ceremony as the Public Company Accounting Reform and Investor Protection Act of 2002 becomes law of the land. Law now known as Sarbanes-Oxley.

5. Internal Controls Over Financial Reporting (404)



Sarbanes-Oxleys Act 2002

- **The Sarbanes-Oxleys Act section 404 requires the CEO and the CFO of Hydro ASA to:**
 - ✓ Accept responsibility of internal control over financial reporting (ICOFR);
 - ✓ Evaluate the effectiveness of ICOFR using a suitable control criteria;
 - ✓ Support evaluation with sufficient evidence, including documentation; and
 - ✓ Present a written assessment regarding effectiveness of ICOFR
- **So, what's in it for Hydro Oil & Energy:**
 - ✓ We must prove/document that we have sufficient ICOFR to reduce the risk for material errors in the financial statement to an adequate level
 - ✓ The way we continuously operate our processes and controls will prevent and detect all material errors before reporting deadline
- **The Sarbanes-Oxleys Act requires the external auditor to attest to managements written assessment**

Purpose of the Sarbanes-Oxley Act

- Restore public trust and confidence in the public securities market
- Improve corporate governance and promote ethical business practices
- Enhance transparency and completeness of financial statements and disclosures
- Ensure that company executives are aware of material information emanating from a well-controlled environment
- Hold company management accountable for material information that is filed with the SEC and released to investors

Criminal Penalty

Escaping from prison	1 to 2 years
Kidnapping involving ransom	3 to 5 years
Second degree murder	11 to 14 years
Sarbanes-Oxley Certification	10 to 20 years
Hijacking	20 to 25 years

Jail Time



"To make a story short the generally accepted accounting practises weren't as generally accepted as I thought"

Sarbanes-Oxley Act

Key sections

-
- Section 106 : Foreign Public Accounting Firms registration with the PCAOB
- Section 201 : Prohibited external audit services
- Section 202 : Pre approval of external audit services
- Section 203 : External audit partner rotation
- Section 301 : Audit Committee
- Section 302 : CEO & CFO Certification of SEC Filings
- Section 404 : Internal Control reporting
- Section 406 : Code of Ethics
- Section 407 : Audit Committee Financial Expert
- Section 409 : Real-time Disclosure of Material Changes
- Section 802 : Retention and Protection of Records
- Section 806 : Whistle Blower Communication and Responses
- Section 906 : Corporate responsibility for financial reports
-

More than Section 404

Message from the Capital Markets

”They are rewarding companies that have good governance and high financial information quality”

The Carrot of Good Internal Controls



- Average premium on share price investors are willing to pay for good governance:
 - ✓ 20% - Japan
 - ✓ 14% - U.S.
 - ✓ 13% - Germany
 - ✓ 13% - France
 - ✓ 12% - U.K.
 - ✓ 11% - Canada

Data source: McKinsey & Co; Global Investor Opinion Survey

The Hammer of Bad Internal Controls



- The markets are hammering those that don't...
- The incredible shrinking market cap. – Average market capitalization lost due to financial restatements:
 - ✓ -9,5% loss (\$ 139 million) – One day after restatement
 - ✓ -18,2 loss (\$ 327 million) – 60 days after restatement
- **AIG down 26%**

Message From The Capital Markets

- They are rewarding companies that have good governance and high financial IQ – Share premium
- Financial IQ (Information Quality = Transparency, Timeliness, Accuracy and Reliability), and they are hammering those that don't
- Average market capitalization lost to financial restatements are 18,2% or on average \$ 327 million

”There is no way to measure how many reporting failures will be averted and how many investment dollars will be saved because of the increased attention to effective internal control systems. Strong controls are vital to high-quality financial reporting and essential to timely analysis. To achieve the goals of Section 404 (of the Sarbanes-Oxley Act), all participants in the financial reporting process – investors, management, audit committees, auditors, lawyers and regulators – must make the development of and adherence to these systems a priority in our daily work.”

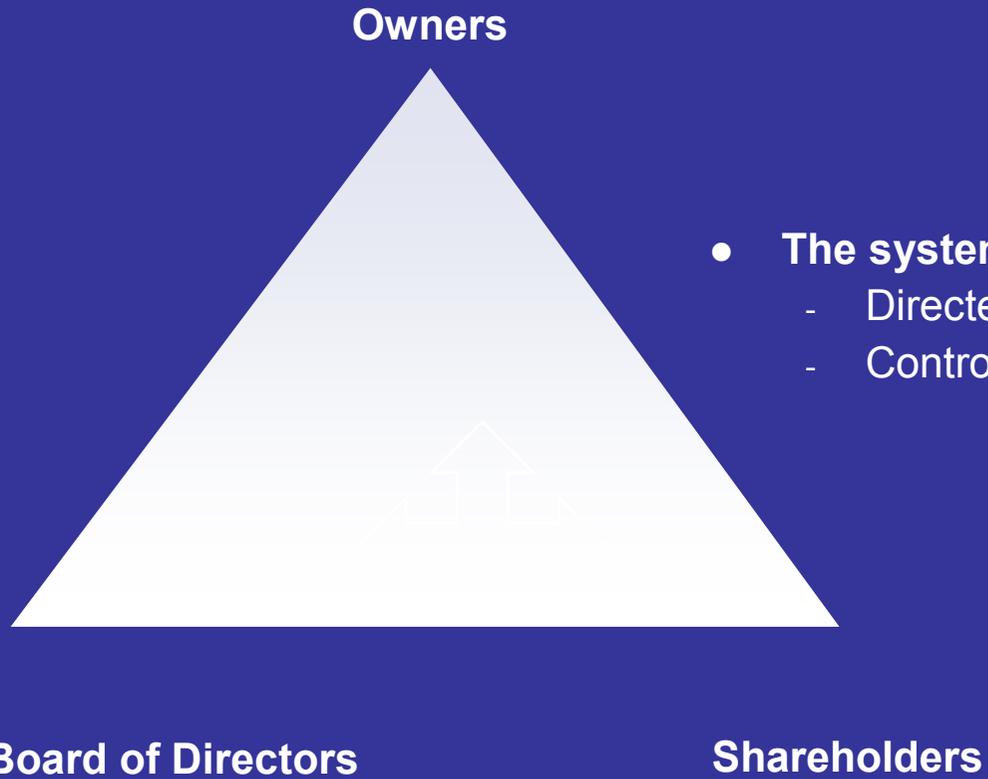
*Donald T. Nicolaisen
Chief Accountant
U.S. Securities and Exchange Commission
October 7, 2004*



Internal Controls Framework

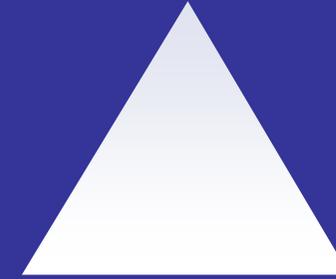
” Not One-Size-Fits-All”

Corporate Governance



- The system by which Hydro are
 - Directed
 - Controlled

Internal Control Responsibility

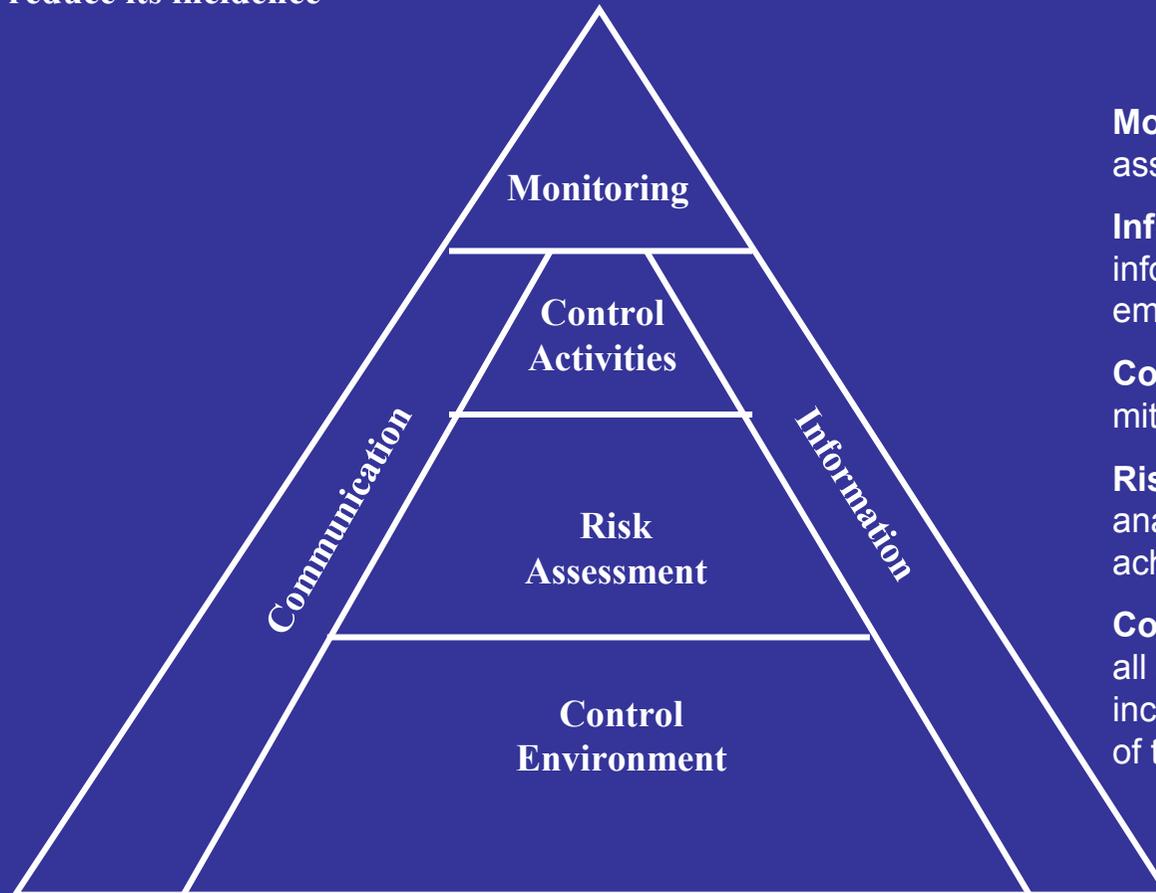


- Typically when you think about internal controls, you think of a dusty policy & procedure manual written and enforced by the accountants
- Management are responsible for designing control processes that provide reasonable assurance that the following objectives can be achieved:
 - Effective and efficient operations
 - Compliance with laws and regulations
 - Reliable financial reporting
- Internal controls are owned by management and staff and it's more about having a well run-organization

*"Improving Corporate Governance
through Effective Internal Controls"*

COSO

”Committee of Sponsoring Organizations of the Treadway Commission (COSO), is a U.S. private-sector initiative, formed in 1985. Its major objective is to identify the factors that cause fraudulent financial reporting and to make recommendations to reduce its incidence”



Monitoring - the evaluation and assessment of internal control

Information and Communication - information pathways from management to employees and vice versa

Control Activities – specific tasks to mitigate each of the risks identified below

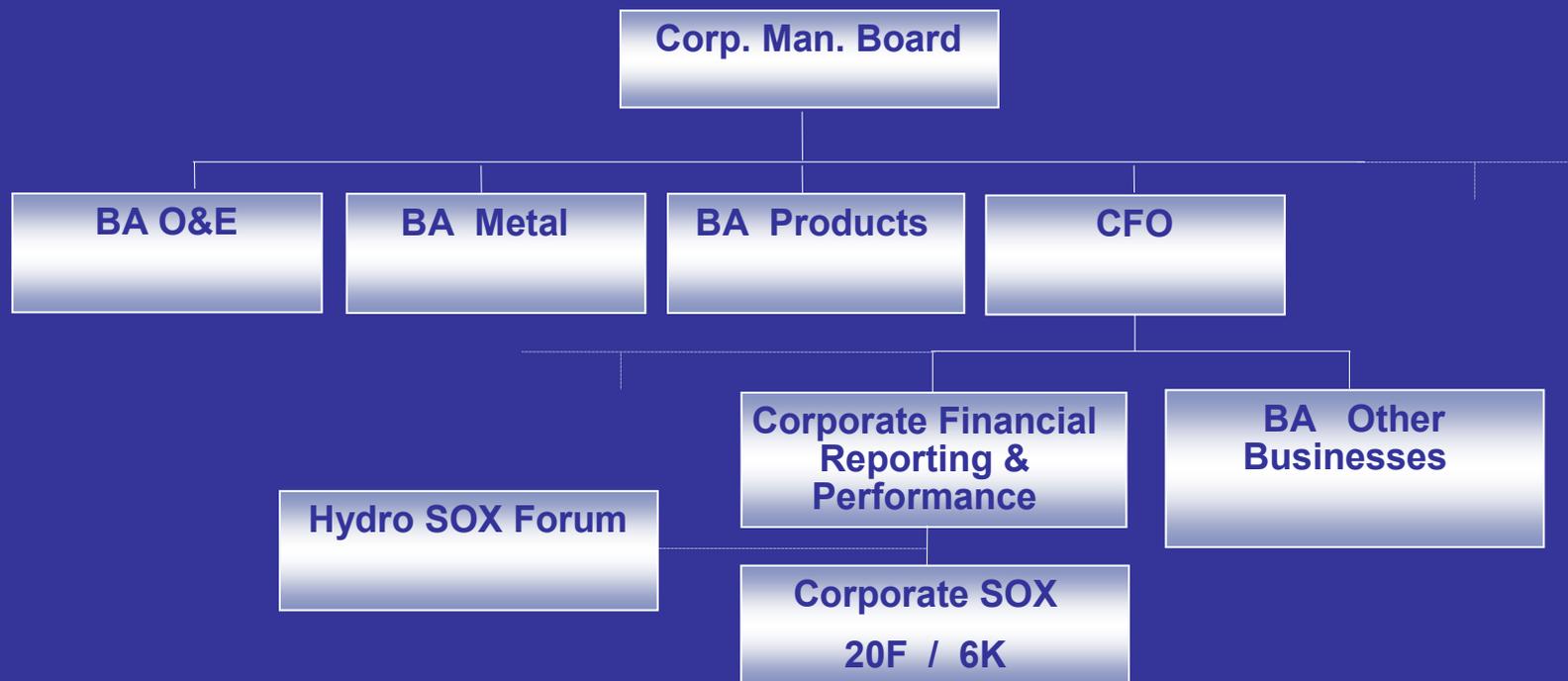
Risk Assessment – the identification and analysis of relevant risk that can hinder the achievement of business objectives

Control Environment – the foundation for all other elements of internal control, which includes the ethical values and competence of the company’s employees.

Hydro Sox Responsibility & Process

” A major change management process”

Norsk Hydro organisation SOX Responsibility



Responsibility Corporate & BA / Sectors

- **Corporate SOX team**

- Overall schedule and progress of work (Yearly SOX process)
- Guidelines, methods and SOX tool
- Define “Hydro Financial Reporting Risks” (HFRR)
- Hydro Wide Controls (Internal Control Environment)
- Common processes and interfaces between processes
- Standardisation of processes and controls
- Quality Assurance of SOX work

- **BA & Sector SOX managers**

(17 sub SOX projects)

- Carry out the SOX activity for their BA / Sector
- Follow-up of the HFRR
- Define scope:
 - Describe material accounts, material units, processes, controls
- Self-testing (Internal Control Assessment and Review)
- Populate the SOX tool

Managements SOX activity

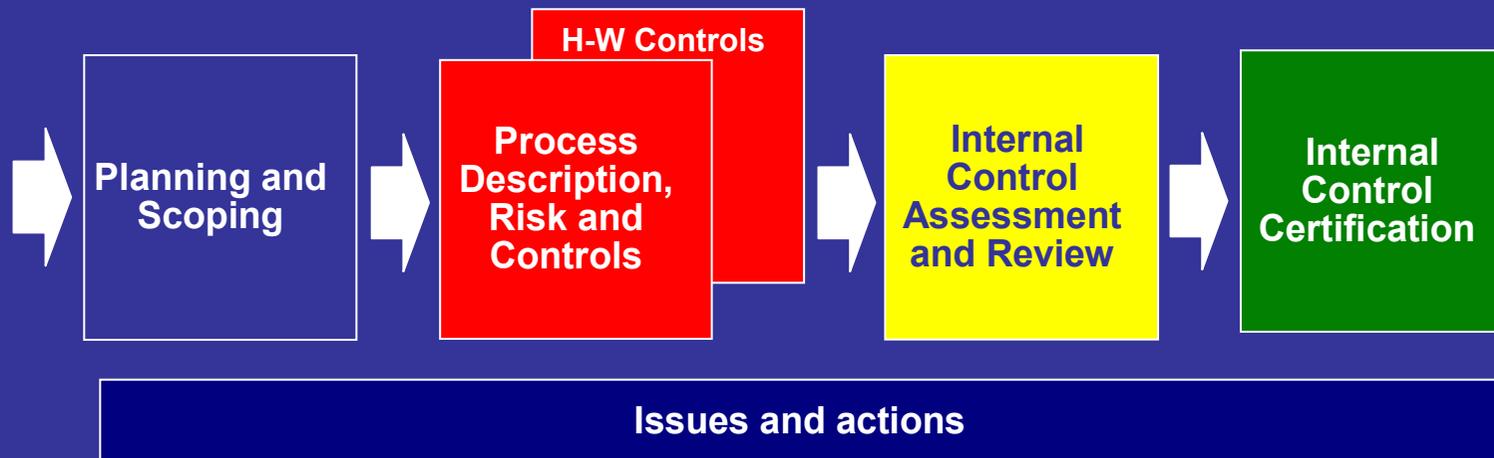
- **Generally, management must:**

- Evaluate the risk for misstatements of the financial statements
(Fraud = managements manipulation of the financial statements)
- Determine the key controls in the processes supporting the significant financial statement accounts and disclosures
- Document these key controls and assess their design effectiveness
- Test these key controls and self-test their operating effectiveness
- Remediation of control deficiencies
- Report in accordance with Section 404

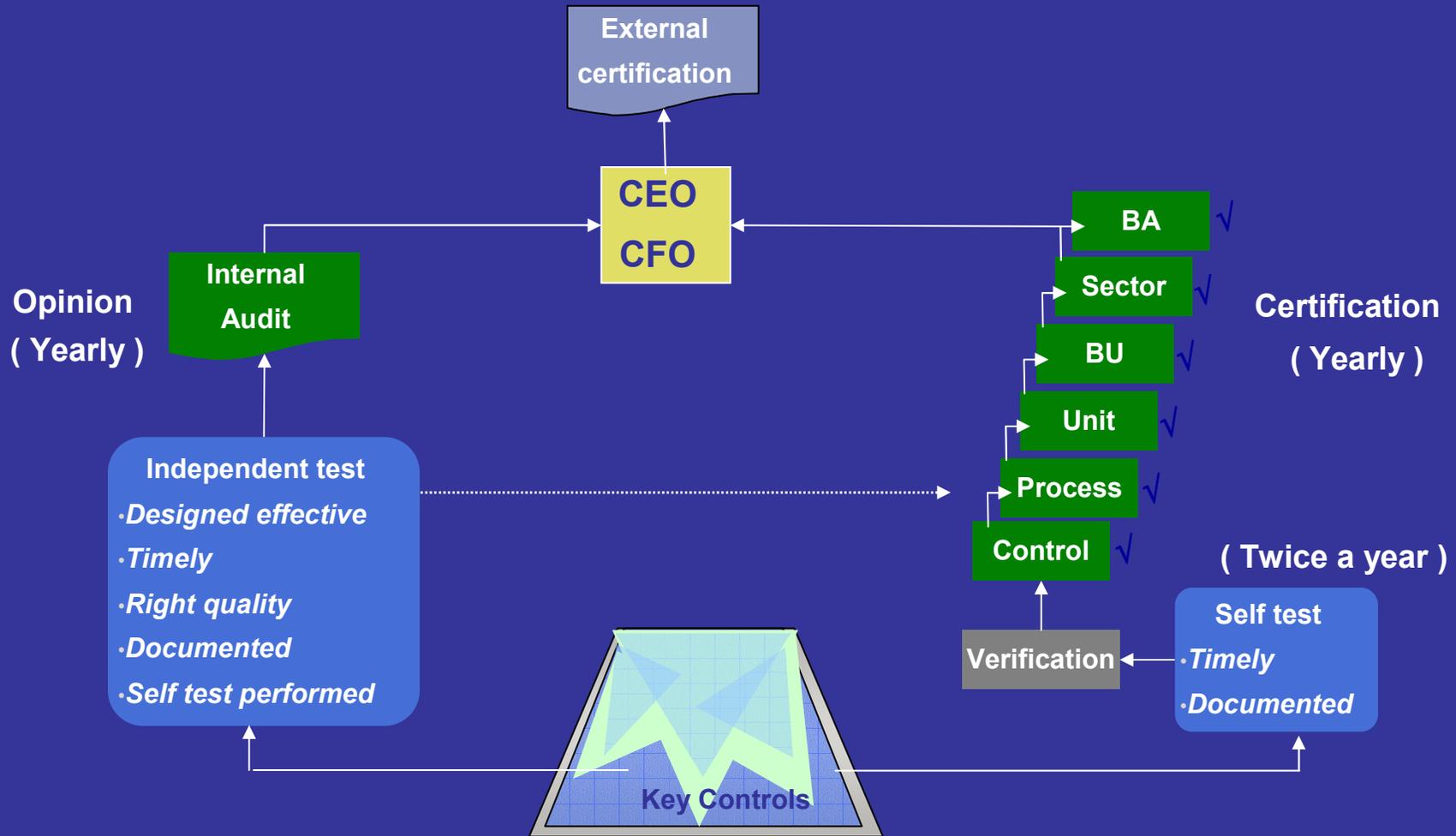
- **Instructions from US**

- Extremely limited guidance is available for management and hence the PCAOB auditing standard (no 2) will drive both management and the work of the auditors'
- SEC - Round table conferences

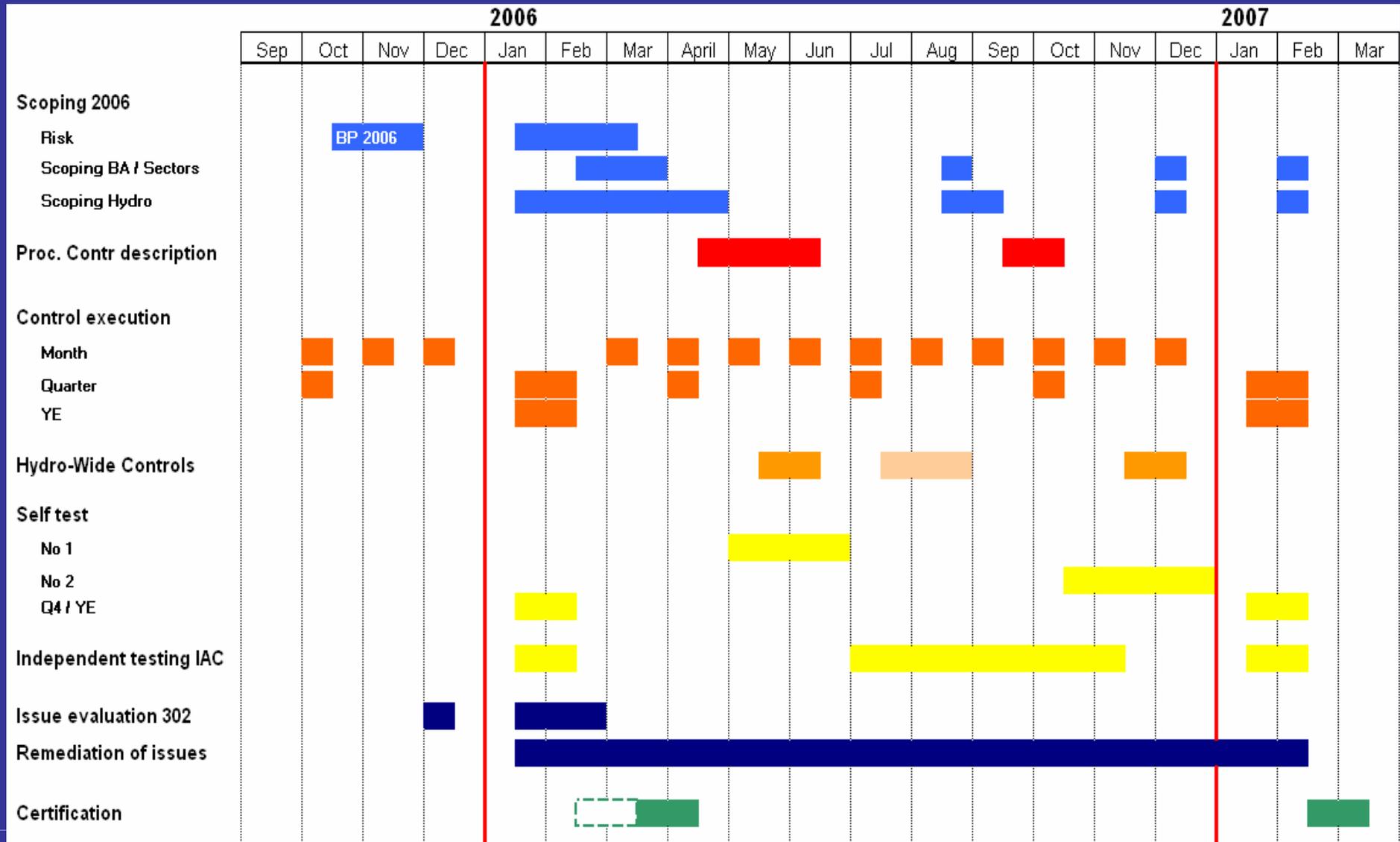
Hydro SOX process



Testing (assessment and review) and Certification

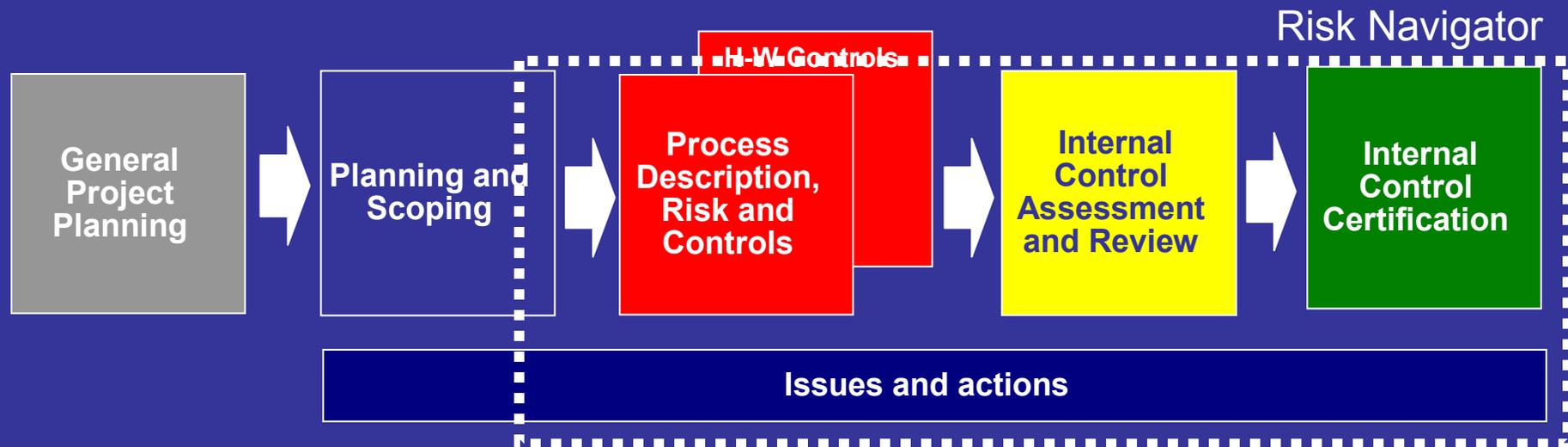


Time Table SOX activity



Hydro SOX process

- Risk Navigator SOX tool



- Monitoring of total SOX activity
- Links to existing process description
- Reporting of various dimensions / roles
- Follow-up of issue handling
- Formal certification made through the system



Learning Experiences & Key Messages

” From tell me to prove to me”

The Five Stages of the SOX 404 Experience

#1 – Innocence

“We’ve got the best Controls on the Planet – I can sleep at night !”

#2 – Skepticism

“This shouldn’t be a big project, we have tons of policies & our external auditors found only minor adjustments last year.”

#3 – Anger

“The amount of documentation required is ridiculous. This entire exercise is form over substance.”

#4 – Fear

“500 control deficiencies ! Are we going to get a clean opinion?”

#5 – Value Awakening

“As a result of this process we are now much more efficient because we make fewer errors and have fewer last minute surprises.” **COMPETITIVE ADVANTAGE!**

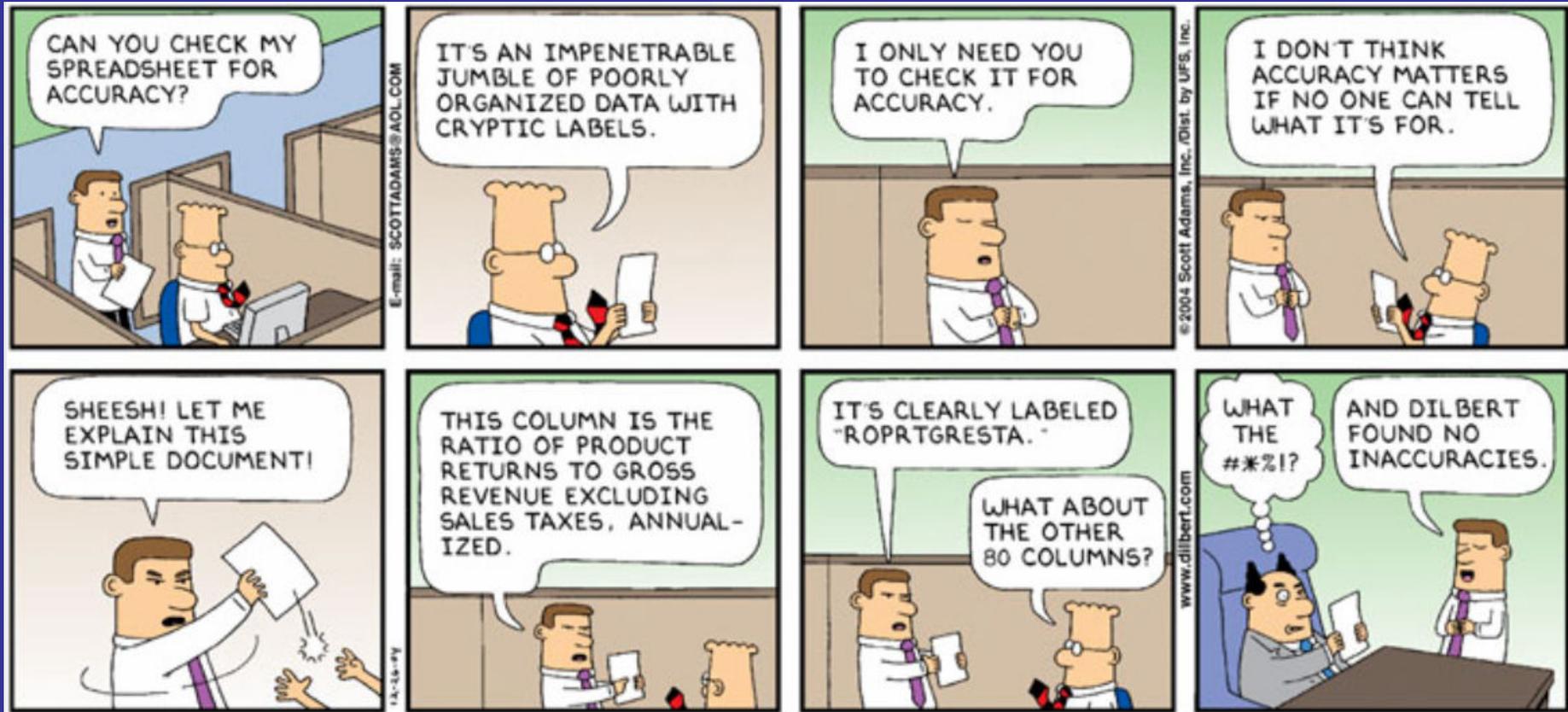
Documentation ...



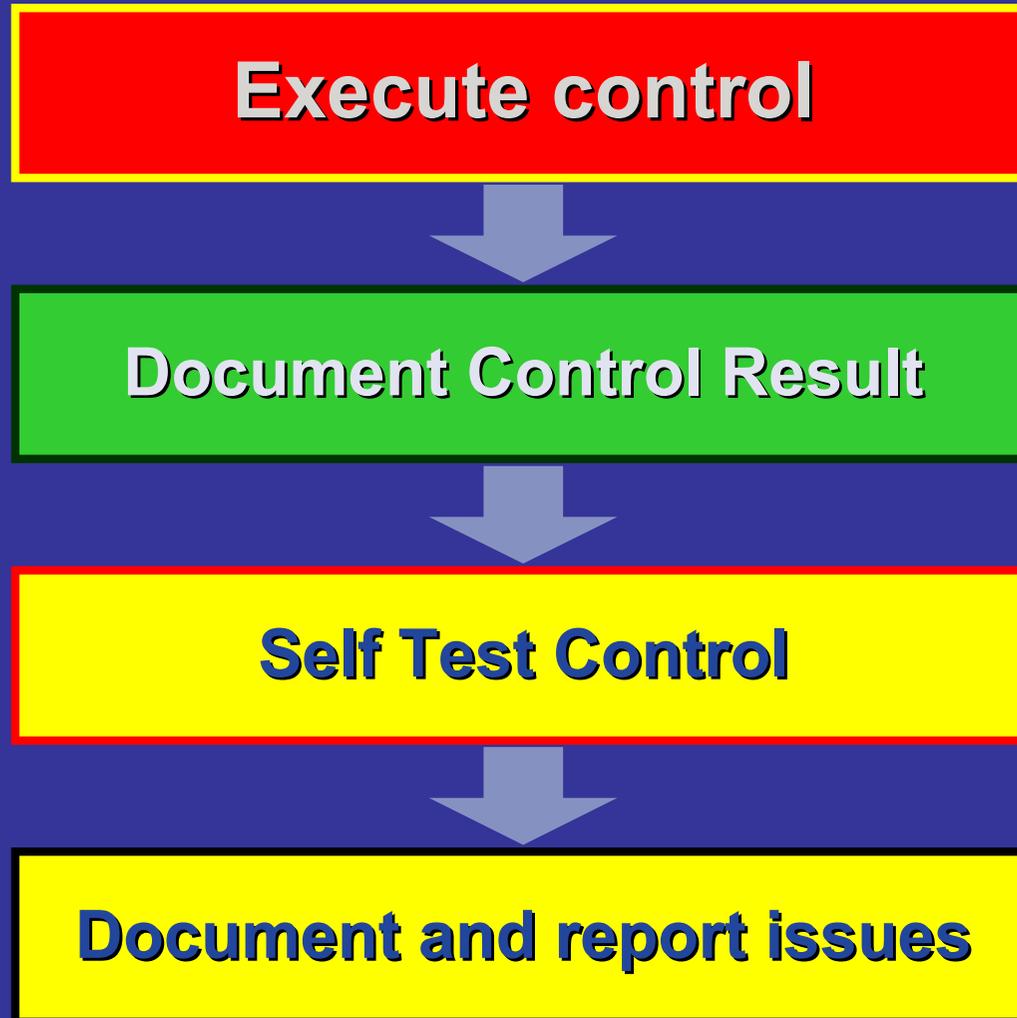
Norske Skog–Share Development in 2006-2007



Spreadsheets...



Key Messages



New guidance from the SEC

“More business and risk oriented”

New guidance from the SEC

- **Affecting the 2007 management assessment process and auditing cycle**
- **New interpretive guidance from the SEC to company management (Securities and Exchange Commission May 23, 2007)**
 - Strengthen public companies internal control over financial reporting while reducing unnecessary costs
 - Focusing company management on the internal controls that best protect against the risk of a material financial misstatement
 - Reduce uncertainty of what constitutes a reasonable approach while maintaining flexibility for companies that have already developed a well functioned assessment process

New guidance from the PCAOB

- **New Audit Standard For Internal Control Over Financial reporting from the PCAOB (The Public Company Accounting Oversight Board Auditing standard No. 5, approved by the board May 24, 2007)**
 - The board worked closely with the SEC to coordinate with the SEC guidance
 - The new standard is more “risk-based and scalable”
 - Fulfilling the objectives that a properly performed walkthrough achieves rather than requiring performance of a walkthrough for all MCOTs
 - Simplify the text of the standard:
 - Align key terms and concepts with terms used in SEC rules and guidance
 - Clarifying that the materiality of an internal control audit is the same as for the long-standing principles applicable for financial statement audits
 - Audit standard No. 5 supersedes No. 2. Reduction from 200 to 100 pages

The background is a solid dark blue color with several lighter blue, curved, overlapping shapes that create a sense of depth and movement, resembling stylized waves or abstract architectural forms.

hydro.com