

How financial reporting is controlled

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According to the Swedish corporate governance council's statement on the transitional solution for 2005, this Report is limited to a statement on how internal controls are organised. Accordingly, the Board is not making any statement on how well internal controls functioned in the year.

In 2005, the group began activities intended to increase the integration and systematisation of the group's risk management. This will have future implications including forming the foundation of the Board's report on internal controls of financial reporting.

Framework of internal controls

COSO is the internal control framework with the broadest acceptance and international proliferation, and states the guidelines for what should be considered good internal controls. Thus, the group has chosen the COSO framework for reporting on how internal control of the financial reporting is organised. Because the framework is extensive, and because the company has not previously documented its internal controls according to COSO, initial mapping and documentation processes are necessary. This encompasses mapping of how internal control is designed at an overall company level, which controls are embedded in the operation's significant processes, and how general IT controls are modified to the needs of operations.

Current activities and planned initiatives

In autumn 2005, the company analysed how the COSO framework would be practically applied within the company. A structured methodology was prepared, including an unequivocal standard on structuring and documenting internal controls consistently within the group.

An initial risk analysis was conducted, preceding from the Consolidated Balance Sheet and Income State-

ment and associated note disclosures in the Annual Report. The assessment of risks is based on the complexity of the relevant balance sheet and income statement items, and underlying assessment of the complexity of the operational processes indirectly affecting each balance sheet and income statement item. The inherent risk of material mis-statement relating to the impact of fraud and exogenous factors on various accounts was evaluated.

A number of significant transactions, business events and flows were identified on the basis of this initial risk analysis. A review of the company's related controls will be conducted in 2006.

An evaluation of how internal controls function operationally will be conducted in the year. These evaluations will be conducted through a combination of self-assessment and testing.

The evaluations will constitute the foundation for the Board's statement on how internal controls have functioned through forthcoming financial years.

The following review of how internal controls are currently organised regarding the financial reporting conforms to the structure stated in the Confederation of Swedish Enterprise's/FAR's (Swedish Institute of Authorised Public Accountants) guidance:

- Control environment
- Risk assessment
- Control structures
- Information and communication
- Updates

Review

Control environment

Effective Board activities are the foundation for good internal controls. The company's board has formulated unequivocal working processes and procedural rules for its activities and the Board's committees including instructions for financial reporting to the Board. Other frameworks, such as the Code of Conduct and Finance Policy, which contribute to enhancing internal controls, are additional. These Policies are updated and reformulated on an ongoing basis.

The Board evaluates the performance and results of operating activities continuously through an expedient reporting package including operational and profit figures, analyzing key indicators and other significant operational and financial information.

In 2005, the Board resolved to maintain its previous approach, where the whole Board acts as an audit committee. Thus in 2005, the whole Board monitored internal control and risk management systems. These systems are intended to ensure that operations are conducted pursuant to laws and ordinances and are efficient, and that financial reporting is reliable. The Board has reviewed and evaluated routines for accounting and financial reporting, and updated and evaluated external auditors' activities, qualifications and independence. The Board reviewed and received reports from the company's external auditors on two occasions in 2005.

Risk assessment

In autumn 2005, the company initiated a formal risk analysis for evaluating the risk of mis-statement in financial reporting as stated in a previous section. From 2006, this process will be annual, which the Board will evaluate and adopt.

A number of income statement and balance sheet items, subject to increased risk of material mis-statement, were identified coincident with the risk analysis. In the company's operations, these risks mainly relate to the valuation of inventories, the valuation of fixed assets, the valuation of accounts receivable and revenue recognition, tax, provisions and hedging financial instruments.

The company has had a number of risk management processes with a significant influence on the company's capacity to ensure accurate financial reporting for some time. Primarily, these procedures encompass the following segments:

- Risk assessments for purposes such as identifying events on the market or operations that can result in changes to financial reporting.
- Processes to capture changes in accounting standards and recommendations that ensure that these changes are accurately reflected in the company's financial reporting.

Control activities

Control structures are designed to manage those risks considered significant to the internal control of financial reporting. These control structures partly comprises an organisation with clearly defined roles enabling an effective division of responsibility that is suitable from an internal controls perspective, and partly from specific control activities intended to discover, or prevent the risks of, reporting mis-statement in advance. Examples of control activities are unequivocal decision-making processes for significant decisions (investments, contracts, divestments, provisions, etc.), profit analysis and other analytical updates, reconciliation, stock-taking and automated controls in IT systems.

Information and communication

To the extent that they relate to financial reporting, the company's significant control documents, its policies, guidelines and manuals, are kept continuously updated and communicated through relevant channels such as the intranet and internal meetings.

A clearly stated corporate communication policy, stating the guidelines for this communication, is applied for communicating with external parties.

Updates

Höganäs does not intend to create a separate internal audit function, because the company's group accounting function has overall responsibility for updating and monitoring internal control issues within the group. Moreover, this function has a close collaboration with subsidiary controllers and accounting managers regarding reporting financial statements.

The group also has an integrated bookkeeping and accounting system with shared accounting instructions. To some extent, Höganäs intends to utilise external expertise to further ensure the high quality of its monitoring.