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# **The Internal Control Policy of OAO “IDGC of Urals”**

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# 1. Basic concepts, definitions and abbreviations

**Internal Control System (ICS)** is a whole range of procedures, methods and mechanisms of control, elaborated by the Company's BoD and management to ensure proper financial and economic performance. Internal control procedures are an integral part of the Company's business processes. They are performed either during the business process or prior or following an operation.

## **Internal Control System enables to:**

- Ensure performance during efficient management of the company;
- Ensure observation of legal and regulatory requirements;
- Ensure asset safety;
- Prevent mistakes and violations, reveal them and decrease their quantity;
- Ensure accounting relevance, authenticity, integrity and correctness;
- Ensure preparation of timely and authentic financials.

**Internal control (IC)** is a process aimed at ensuring reasonable guarantee of pursuing the aims of efficient and resultative usage of the Company's resources, asset safety, observance of legal requirements and submission of authentic financials.

**Internal audit (IA)** is a range of activities in evaluating ICS reliability and efficiency, risk management system, efficiency and economy of business process management as well as consulting the Company's management during elaboration of ICS systems and procedures.

**Risk management (RM)** is a process performed by the Board of Directors, senior officers and other employees aimed at revelation, management and control of events that may have a negative influence on the company's objectives.

**Risk Management System (RMS)** is a totality of processes, methods, information systems aimed at the achievement of risk management goals and objectives.

**Risk** is a combination of event occurrence probability and consequences (ISO/IEC Guide 73:2002). For the purpose hereof, a risk (a risk event) is a possible event that may have an influence on the achievement of the Company's strategic and operating objectives in the long run. Risk influence is divided into negative and positive.

**Risk appetite** is the amount of risk that a company can undergo to achieve the aim of increasing its value.

**Risk factor** is an occasion or surroundings bearing a possibility of risk occurrence.

**Risk consequences** are events that are most likely to happen after risk occurrence. Risk consequences are expressed by the influence on efficiency and objective deadlines, financial

result, reputation, reliability of services, human resources and other factors of achieving the Company's strategic and operating goals.

**Probability of risk** is a measure for a possibility of risk occurrence.

**Substantiality of risk** is a measure of risk consequences.

**Risk management** is a process performed by officers and clerks on every management level of the Company and its structural subdivisions, including:

- Risk identification and evaluation,
- Risk ranking,
- Influencing risk within risk appetite

to ensure reasonable guarantee of achieving the Company's strategic and operating goals (COSO ERM).

**Risk owner** is a head of a subdivision which strategic or operating goals are influenced by the risk. A risk owner is responsible for identification, evaluation and monitoring of risk management and is appointed by the Company's CEO.

**Guarantor** is a person responsible for the arrangement of risk management.

**Risk passport** is a document containing all information on a risk.

**Risk register** is a data base containing key information on the Company's risks.

**Key Risk Indicators (KRI)** are quantitative indices of risk (factors).

**Risk coordinator** is a person responsible for coordinating risk management processes within one structural subdivision, in particular, collection and update of information on risk, consulting risk owners on risk management methodology, provision of information to the parties concerned.

**ISO/IEC Guide 73:2002** is a standard of the International Organization for Standardization and International Electrotechnical Commission "Risk Management. Glossary".

**COSO ERM** is a model for risk management in a company of Sponsoring Organizations of the Treadway Commission, widely used in global risk management practices.

**Control procedures** are a range of measures enabling to exclude (decrease) a possibility of risk or to prevent its consequences.

**Internal Control Subjects – the Board of Directors** (Audit BoD Committee), CEO, Department (Directorate) for Internal Control, Audit and Risk Management as well as subdivisions and personnel of the Company and its branches, responsible for internal control, audit and risk management, formalized for them by the Company's internal documents.

**Inspection (audit)** is a controlling activity or research of a situation in certain Company's activities.

**Audit of the Company's business process ICS** is an activity lying in collection, evaluation and analysis of audit evidence, in relation to the ICS of a business process, subject to audit, and resulting in an auditor opinion on the reliability level of process ICS.

**Structural subdivision** is a subdivision of the approved organizational structure of the **Executive Office of the Company (EO)**.

## **2. General provisions**

Internal Control Policy of OAO “IDGC of Urals” (hereinafter referred to as the Policy) determines basic principles for the arrangement of the internal control system in OAO “IDGC of Urals” (hereinafter referred to as the Company), obligatory for execution, and shaping of the single approach to the implementation of internal control processes in the Company’s activities.

The Policy is elaborated to develop and improve the Company’s internal control systems and risk management.

The document was prepared for officers and clerks on all management levels of the Company, its structural subdivisions as well as other participants of RM processes and the parties concerned.

The Company’s internal control policy is based on the recommendations proposed by the best global practices and does not contradict the requirements set forth by the Russian legislation.

The present document covers the following spheres:

- The strategy for ICS development;
- IC principles;
- IC goals and directions;
- IC processes;
- ICS architecture.

### **3. The strategy for ICS development**

The Company is focused on the development of a process approach to management and ICS building with a view to implement possibilities in:

- Determination and management of the Company's key processes and performance results,
- Integration and coordination of uncoordinated activities of structural subdivisions,
- Efforts to achieve single result.

ICS of the Company is arranged according to the following "maturity" levels:

#### **Level 1. Standardized ICS:**

- Basic guiding principles have been set;
- Control environment and business processes (control procedures and mechanisms) are well documented;
- Control procedures are supervised;
- Control procedures are regularly adjusted to risk changes;
- Internal audit inspects separate business processes;
- Non-stop experience exchange is on among all subdivisions and management levels;
- The personnel undergo target training in IC sphere.

#### **Level 2. Guided ICS:**

- Guiding principles have a detailed description;
- Execution of control procedures undergo a regular monitoring available for analysis;
- Control procedures are constantly adjusted to risk changes and are regularly documented;
- Standardized procedure for control procedures record;
- Internal audit monitors ICS.

#### **Level 3. Optimized ICS:**

- Control procedures are fully coordinated with other control and audit functions;
- RM and ICS operate as a single integrated system;
- Constant ICS perfection;
- Control procedures are automated.

## 4. The IC fundamentals

### 4.1 IC principles

ICS is based on the following principles:

- Performance continuity;
- Responsibility of all IC subjects for proper performance of control functions;
- Clear separation of duties and responsibilities of the Company's subdivisions and directorates during internal control;
- Complexity. Coverage of all the Company's business processes on all management levels;
- Unity in methodological base. IC processes are implemented on the basis of common approaches and standards for all structural units of the Company;
- Transparency. Required information disclosure for the parties concerned;
- Balance. Control functions should be provided with proper means and powers for execution;
- Priority. Control procedures are launched at the Company's business segments in accordance with their importance for further successful performance of the Company;
- Timely information on the execution status of control procedures and functions submitted to persons authorized to take management decisions;
- Constant development and perfection.

### 4.2 IC Goals and Directions

#### 4.2.1 ICS Goals

ICS pursues the following goals:

- Most efficient provision of credible administration and achievement of strategic goals;
- Provision of the observance of the Russian legislation, regulatory documents and internal procedures established in the Company;
- Timely risk revelation and analysis;
- Provision of authenticity, correctness, integrity and relevance of financial and management information and reporting;
- Provision of achievement of Company's financial and economic plans;
- Provision of high confidence of investors to the Company and its management bodies;
- Protection of the investments made by shareholders and investors;
- Provision of the Company's asset safety and efficient usage of the Company's resources;
- Assistance in arranging optimal organizational structure.

#### **4.2.2 IC Directions:**

- Control over the observance of authority matrix and responsibility distribution among subdivisions and management of the Company and its structural units;
- Control over the efficiency of the Company's business segments and analysis of performance results;
- Control over investments and proper application of shareholder investments;
- Control over the arrangement of efficient information channels on the activities of the Company's structural units ensuring internal vertical and horizontal links;
- Control over the execution of resolutions adopted by the Company's management bodies and executives as well as elimination of revealed violations;
- Provision of proper confidence in Company's financials and observance of financials preparation procedures as well as observance of accounting requirements set forth by the Company;
- Control over the budget completion of Company and its structural units;
- Control over the compliance of agreements between the Company and third parties with financial and economic interests of the Company;
- Control over the compliance of internal documents and resolution drafts of the management bodies with financial and economic interests of the Company.

#### **4.2.3 IC processes:**

Integrated internal control framework COSO determines five IC components according to which IC processes are classified:

**Table 4.3 IC processes**

| Component                                  | IC processes  |
|--|---|
| <p><b>Control environment</b></p>          | <p><b>Evaluation of the internal environment of the Company and its structural units.</b></p> <ul style="list-style-type: none"> <li>○ Corporate Behavior Code: <ul style="list-style-type: none"> <li>-ethic principles;</li> <li>- internal policy and procedures.</li> </ul> </li> <li>○ Organizational structure: <ul style="list-style-type: none"> <li>- identification of mutually related and non-contradicting goals and objectives on various management levels;</li> <li>- distribution and delegacy of key authorities and responsibilities in the Company, provision of efficient interaction of structural units and personnel;</li> </ul> </li> <li>○ Distribution of authorities and duties: <ul style="list-style-type: none"> <li>- distribution of key duties between Company’s employees (including duties on approval of operations, distribution, storage and obtainment of resources, analysis and audit of operations);</li> <li>- dissemination of information on internal control duties to all employees;</li> </ul> </li> <li>○ HR: <ul style="list-style-type: none"> <li>- employee competence;</li> <li>- hiring procedures;</li> <li>- evaluation of employee performance;</li> <li>- training.</li> </ul> </li> <li>○ Measures to prevent fraud</li> </ul> |
| <p><b>Risk evaluation and analysis</b></p> | <p><b>Revelation and analysis of potential risks that may hinder the achievement of the Company’s goals.</b></p> <p>Processes are determined by the Risk Management Policy</p>  |
| <p><b>Control procedures</b></p>           | <p><b>Evaluation of presence and efficiency of policies and procedures ensuring correct and full execution of management instructions, ensuring the coverage of all levels and functions of the Company by control procedures.</b></p> <p>Control procedures:</p> <p><b>Detective procedures</b> are procedures aimed at revealing disadvantages of processes and negative events following their occurrence (data reconciliation, report analysis, etc.).</p> <p><b>Directive procedures</b> are procedures aimed at operational procedure for personnel and outsiders (regulations, decrees, etc.).</p> <p><b>Remedial procedures</b> are procedures aimed at remedial actions prior or following occurrence of negative events (for instance, blocking authentication after several attempts to obtain access to information system).</p> <p><b>Preventive procedures</b> are procedures aimed at exclusion or strident decrease of the possibility of negative event occurrence (access limitation, access authentication, etc.).</p> <p><b>Compensating procedures</b> are procedures aimed at compensation of disadvantages of current controls (for instance, additional to current authentication procedures).</p>  |

| Component   | IC processes  |
|---|---|
| <p style="text-align: center;"><b>Information and communication</b></p> | <p><b>Evaluation of reliability and relevancy of information and communications:</b></p> <ul style="list-style-type: none"> <li>- arrangement of information collection, processing and transfer system, including arrangement of reports and messages, containing operating, financial and other information on the Company's activities as well as arrangement of efficient channels and means of communication ensuring internal vertical and horizontal communicative links;</li> <li>- arrangement of efficient relations between the Company and third parties;</li> <li>- access and safety of information obtained from internal and external sources;</li> <li>- revelation, registration and dissemination of required management information to the parties concerned;</li> <li>- dissemination of the current policies, plans and instructions, etc. to the personnel.</li> </ul> |
| <p style="text-align: center;"><b>Monitoring</b></p>                    | <p><b>Evaluation of ICS performance efficiency:</b></p> <ul style="list-style-type: none"> <li>- evaluation and determination of performance efficiency criteria for structural units, executives and other personnel;</li> <li>- risk-oriented auditing of business processes;</li> <li>- audit inspections on asset safety;</li> <li>- regular evaluation of ICS quality by subdivisions (control self-assessment).</li> </ul>  |

## 5. ICS architecture

### 5.1 ICS levels

The Company's internal control is multilevel and is divided into two categories:

**Multilevel in corporate governance** corresponding to the Company's corporate structure. There are 2 management levels:

- The Executive Office.
- Branches.

**Multilevel in organizational governance** corresponding to the goals of operating management/ There are 3 levels:

- The BoD (control procedures are performed by the BoD)
- The Management Board (internal control is performed by the Management Board or any other consultative body);
- Middle management (internal control is performed by heads of subdivisions).

### 5.2 Subdivisions and participants

Internal control system is based on the basic principle – application of **common standards** for business processes and control procedures on all management levels. This means that common process standards contain control procedures performed by the Executive Office and branches in accordance with functional vertical lines.

Process owners are designated on the Company level. Their basic function is to interact with structural units, participants of a business process, on all management levels.

In the Company's branches process standardization coordinators can be certain persons (being members of functional directorate or executives or specialists, partially involved for executing the function).

All structural units should perform their functions basing on single standards and methods stipulating internal control both within one management level and through links between Executive Office subdivisions and branches.

### 5.3 Roles and Responsibilities of the ICS participants

Roles and responsibilities are distributed according to the following principles:

- The BoD approves the Internal Control Policy and evaluates its efficiency, is responsible for approval and periodic review of overall IC strategy.
- Audit Committee (BoD) evaluates overall efficiency of IC procedures (incl. based on messages and reports of ICARM Department (Directorate)).

- The CEO is responsible for the implementation of the Policy approved by the BoD as well as for functioning and efficiency of IC procedures. The regional branch directors are responsible for functioning and efficiency of IC procedures on lower management levels.
- Internal audit subdivision directly evaluates adequacy, sufficiency and efficiency of control procedures as well as evaluates observance of control procedures by process participants on the corresponding management level. Besides, it gives an overall evaluation of the ICS, levels of its standardization and optimization on all management levels.
- Subdivisions executing functions on RM and IC arrangement (RMS and ICS coordinators) are responsible for arrangement and coordination of process standardization and methodological support of control establishment process and interact with the ICS branch coordinators.
- Heads of structural subdivisions and other employees, according to their duties, perform internal control by using formal standards and regulating documents. Structural subdivisions monitor and are responsible for control procedures according to the standards.
- Heads of structural subdivisions and other branch employees are responsible for establishment and performance of control procedures as well as evaluate efficiency and improvement of control procedures.

Table 5.1 gives a short description of roles and responsibilities distributed between ICS participants.

**Table 5.1 Roles and responsibilities distributed between ICS participants.**

| <b>Participant</b>           | <b>Role</b>       | <b>Functions and duties</b>   |
|------------------------------|-------------------|---|
| <b>Board of Directors</b>    | <b>Sponsor</b>    | <ul style="list-style-type: none"> <li>○ Determines a required ICS development level;</li> <li>○ Responsible for approval and periodic review of the overall strategy on various aspects of the policy;</li> <li>○ Entrusts the CEO to arrange inspection within IC procedures;</li> <li>○ Reviews IC results (reports and other materials of the subsidiary responsible for internal control and audit).</li> </ul>  |
| <b>Audit Committee (BoD)</b> | <b>Controller</b> | <ul style="list-style-type: none"> <li>○ Controls the efficiency of internal control and audit;</li> <li>○ Supervises control procedures and observance of legislative and regulating acts;</li> <li>○ Supervises timely preparation of financials by the executive bodies and the authenticity of the financials;</li> <li>○ Reviews information on the results of inspections carried out during the year submitted by the subdivision responsible for internal control/ audit;</li> <li>○ Analyze annual financials prior to introducing it for the BoD review and interim financials prior to its disclosure;</li> <li>○ Interacts with the Audit Commission on the elaboration of joint recommendations on significant financial and economic issues;</li> <li>○ Interacts with external auditor.</li> </ul> |

| Participant  | Role   | Functions and duties  |
|--|--|---|
| <b>The CEO (the Management Board)</b>  | <b>Guarantor</b>                                     | <ul style="list-style-type: none"> <li>○ Arranges efficient functioning of internal control and audit;</li> <li>○ Ensures arrangement and implementation of internal control procedures;</li> <li>○ Approves the schedule of inspections held by the subdivision responsible for IC/audit (entrusts it to other persons);</li> <li>○ Initiates non-scheduled inspections by the subdivision responsible for IC, audit and RM;</li> <li>○ Reviews reports, prepared by the subdivision responsible for IC/audit, and information on inspection results;</li> <li>○ Reports to the BoD on elimination of violations revealed during IC procedures;</li> <li>○ Introduces proposals on the improvement of IC procedures for the BoD review.</li> </ul>   |
| <b>Department (Directorate) of internal control, audit and risk management</b> | <b>Expert-Controller<br/>Coordinator<sup>1</sup></b> | <ul style="list-style-type: none"> <li>○ Evaluates the ICS and RMS;</li> <li>○ Monitors control procedures completion;</li> <li>○ Coordinates inspection of the efficiency of IC procedures;</li> <li>○ Controls elimination of violations revealed during inspections and official investigations;</li> <li>○ Prepares proposals on the improvement of IC procedures;</li> <li>○ Evaluates the level of process regulation and presence of control procedures in regulations;</li> <li>○ Evaluates the correspondence of completed financial and economic operations with shareholder interests;</li> <li>○ Elaborates documents regulating internal audit;</li> <li>○ Examines authenticity and integrity of operating, financial, tax and management reporting, accounting methods and reporting;</li> <li>○ Supports and develops methodological and regulating ICS environment;</li> <li>○ Arranges special inspections (including abuse and fraud investigations) on the request of the Executive Office, Audit Committee.</li> </ul> |
| <b>RMS and ICS Coordinator</b>   | <b>Methodologist</b>                                 | <ul style="list-style-type: none"> <li>○ Chooses methodology and instruments for performing control procedures (CP);</li> <li>○ Coordinates CP standardization process;</li> <li>○ Integrates CP into business processes, including the forming of CP common data base, ensures dialogue between executive office and branches for build-up of standardized ICS;</li> <li>○ Controls quality of process description and its standardization;</li> <li>○ Develops CP common rules and standards;</li> <li>○ Monitors ICS efficiency (timely implementation and performance);</li> <li>○ Trains and consults on ICS methodology;</li> <li>○ Supports and develops methodological and normative ICS environment;</li> <li>○ Provides interested persons with information on ICS.</li> </ul>  |
| <b>Heads of Divisions</b>  | <b>Principals</b>                                    | <ul style="list-style-type: none"> <li>○ Develop CP basing on IC standards and regulations;</li> <li>○ Ensure the compliance of process efficiency parameters to the set parameters;</li> <li>○ Perform ICS procedures according to the regulating documents;</li> <li>○ Perform own evaluation of efficiency and CP improvement;</li> <li>○ Timely submit information on CP completion status.</li> </ul>  |

## 5.4 Regulating documents and standards

ICS normative environment is based, complies with and does not contradict the statements hereof.

ICS normative environment is formed for every management level on the basis of common standards.

Table 5.2 demonstrates an obligatory list of ICS documentation and its purpose.

<sup>1</sup> During standardized ICS build-up

**Table 5.2. The list of normative documents**

| <b>Document</b>   | <b>Purpose</b>  |
|---|---|
| <b>ICS Policy</b>   | Basic strategies and principles for IC arrangement and realization.   |
| <b>Process classifier</b>   | Key standard processes and their level decomposition.   |
| <b>Process description standard</b>   | Process documentation formats: form for describing business process (flow-process diagram), common requirements, etc.   |
| <b>Methodological recommendation on process regulation</b>  | Description of approaches and methods of process description, control and identification procedures.  |
| <b>Regulations, instructions, reference materials</b>   | Common standardized regulating documents, obligatory for execution by all subdivisions, enabling to make the process more controlled and transparent on all process levels.   |
| <b>CP report forms</b>  | Forms for ICS information submission from subdivisions.   |
| <b>Standard regulations on process is a main document appeared as a result of implementing standardized ICS, uniting requirements on build-up of control environment, performing all control procedures, RM and responsibility area determination</b> | <p>Standard regulations contain:</p> <ul style="list-style-type: none"> <li>Common classifier of process elements, notions and terminology with a view to conformity and elaboration of common approaches to process arrangement;</li> <li>Process description (from “input” to “output”);</li> <li>Revealed responsibility areas in the course of the process, performance and control functions divided (creation of responsibility matrix);</li> <li>Established control procedures and instruments;</li> <li>RM elements in the course of the process;</li> <li>Revelation of junction points between various functional directions, while performing through business process, that demand coordinated actions and responsibility distribution;</li> <li>Operating control elements, ensuring timely transmission of required information for management and control.</li> </ul> |

## **6. Sequence of actions on standardized ICS build-up**

### **6.1 Standardized ICS Build-Up (Phase I)**

While building up standardized ICS the following actions should be performed during Phase 1:

- Analysis of the current control environment and control procedures on the Company's business processes:
  - Business process analysis;
  - Evaluation of the current control procedures;
  - Risk identification.
- Documentation of business processes, control environment (control procedures and mechanisms):
  - Business process documentation;
  - Establishing transparent scheme of process management arrangement in corporate terms: interaction of structural subdivisions throughout the process according to approved common standards, rules and methodologies;
  - Monitoring of control procedures (clear separation of control and performance functions, transparency and responsibility);
  - Elaboration of standard regulations on business processes (according to the list approved by the Management Board);
- Training and development of the personnel.

#### **6.1.1 Analysis of the current control environment and process control procedures**

To record business processes and control environment the analysis of the following spheres is performed:

- Current status of control environment;
- Current local documents regulating process operations (regulations, provisions and instructions);
- Presence of control procedures
- Efficiency of control on all management levels;

##### **6.1.1.1 Process analysis**

Process standardization is arranged by RMS and ICS coordinator (specialized internal control subdivision within ICARM Department (Directorate) or a separate specialist responsible for executing the functions), that acts as a methodologist and coordinates elaboration and implementation of process standardization.

RMS and ICS coordinator elaborates methodology, forms and patterns on process description as such (or uses the ones proposed by the BoD) and forwards them to branch RMS and ICS coordinators.

Processes are analyzed in terms of process chains portraying sequence of functions within the process, links between events and reflection of participant functions and responsible process owners.

Process owners are assigned on the Company level. Their basic function is interaction between structural subdivisions, participants of the process, and RMS and ICS coordinator, performing methodological functions. The goal of such interaction lies in creation of efficient communications between all participants of process standardization and its further coordination.

Therefore, processes as such are described by process owners jointly with process participants – functional subdivisions (Departments) according to unified methodology elaborated by the RMS and ICS coordinator (or proposed by the BoD), with a view to:

- Determine the efficiency of the present ICS;
- Reveal key process points which are or should be controlled;
- Evaluate control adequacy judging the fullness of control procedure description, responsible principals and controllers, list of guiding normative and regulating documents, regulations and duty instructions;

Process owners collect and submit the materials to the RMS and ICS coordinator for ranking and analysis.

#### **6.1.1.2 Evaluation of the current control procedures**

A RMS and ICS coordinator ranks and analyzes the materials submitted by the process owners. For analysis purposes the RMS and ICS coordinator compares them to the best IC and RM practices applied both globally and domestically as well as within the industry.

During analysis the coordinator:

- Identifies the most efficient procedures for process control;
- Reveals instruments used for control – standards, etc.;
- Evaluates normative documents used for control (compilations, standards, calculations, equivalents, legal acts, etc.) and enabling efficient control and RM as well as compiles the register.

Analysis results are reconciled with the process owners and participants. Later, the results, including comments, recommendations and amendments, are **forwarded to Internal Audit subdivision** for evaluation of ICS efficiency.

Such approach will enable to use leading industry practices in terms of their internal implementation as well as increase the independency of process efficiency evaluation.

**The Company's Internal Audit subdivision:**

- Classifies the analysis results produced by the RMS and ICS coordinator, taking into account comments and amendments submitted by functional subdivisions as well as evaluates the efficiency of the current control procedures;
- Reveals weak and missing control procedures, lack of which results in risk occurrence;
- Forms:
  - the register of missing control procedures;
  - control procedures, requiring processing or reprocessing to exclude the possibility of risk occurrence;
  - the list of legal acts used as a control instrument recommended for usage

The efficiency of control procedures is evaluated in terms of provisioning reasonable guarantee for reaching goals of the process under review.

Evaluation results, produced by **Internal Audit section**, are forwarded to the RMS and ICS coordinator for usage while elaborating methodological and normative environment for arranging RMS and ICS standardized level and dissemination of efficient control procedures and instruments (standards, compilations, etc.). The coordinator reports the analysis results to the Audit Committee (The Board of Directors).

### **6.1.1.3 Risk identification and evaluation**

Risks are identified on all management levels of the Company by functional subdivisions (risk owners) according to a single risk classifier approved by the BoD.

The risk classifier, basing on main functions of the Company and branch management, determines risk areas that can be specified by detailed information on objects subject to risks, subjects-at-risk, terms and other required information providing full comprehension of the risk area under review.

During risk identification the following information is determined:

- Risk name;
- Risk description;
- Risk sources;
- Risk owner and person providing information on risk;
- Subdivision of the Company;
- Key risk indicators.

**Risks are evaluated** by a unified method in accordance with the following scales: stochastic, material, reputational and reliability ones.

The algorithm of risk calculation is developed by **RMS and ICS coordinator** jointly with functional subdivisions.

Methodological local documents used for monitoring the process of RM standardization are approved by the BoD.

Methodical recommendations on RM, regulations, report forms are elaborated to:

- Establish unified view and standards for approaches and methods of risk revelation, evaluation and minimization on all levels of the Company's corporate governance.
- Establish unified scale of risk measurement on all levels of corporate governance.
- Establish unified approaches to the implementation of the RM system
- Refer a risk to a decision-taking level (risk review and decision-taking), that depends on all risk evaluation indicators and established level of the risk appetite.

Main goal is to imbed RM elements while recording the business process, establishing control procedures and elaborating key risk indicators.

## **6.1.2 Documentary recording of the current control environment and procedures on business procedures**

### **6.1.2.1 Documentary recording of the processes**

The Company's BoD approves the list of processes, subject to standardization and regulation.

**The RMS and ICS coordinator** is an owner of standardization process with built-in RM elements. The main functions include elaboration of unified standards and requirements, methodological guidance of process recording.

**Process recording** includes the elaboration of various documents:

- Process guidance,
- Process models (standards),
- Duty instructions and subdivision regulations,
- Regulations and other internal documents.

Business processes are recorded by the **functional subdivisions** of the Company, involving the RMS and ICS coordinator that elaborates methodological environment for process regulation, approved by the BoD using main ICS methods and observance of internal control and risk management principles.

Methodological environment on process description is created in compliance with the following requirements:

- All-round process coverage includes description of both horizontal control and risk management (input-output) and vertical management control as well as description of control exercised by interested parties (coordination, approval, limitation, etc.).
- Application of risk-oriented approach: risk identification during the process and on all management levels will enable, during process standardization, to set a required control to ensure efficient risk management;
- Application of unified methodology and normative environment;

- Revelation of control and decision-taking points and saturation with required control instruments. Any decision-taking, coordination and approval should be performed on the basis of justifying documents and calculations (standards). Information for decision-taking should be reliable and correspond to normative documents of the Company, legal and local acts, be supported by calculations, protocol resolutions, reports and acts, etc.;
- Elaboration of an indicator for IC and RM efficiency by calculating key risk indicators, established at the process “input”.

Graphic description of a process is given on Diagram 6.1

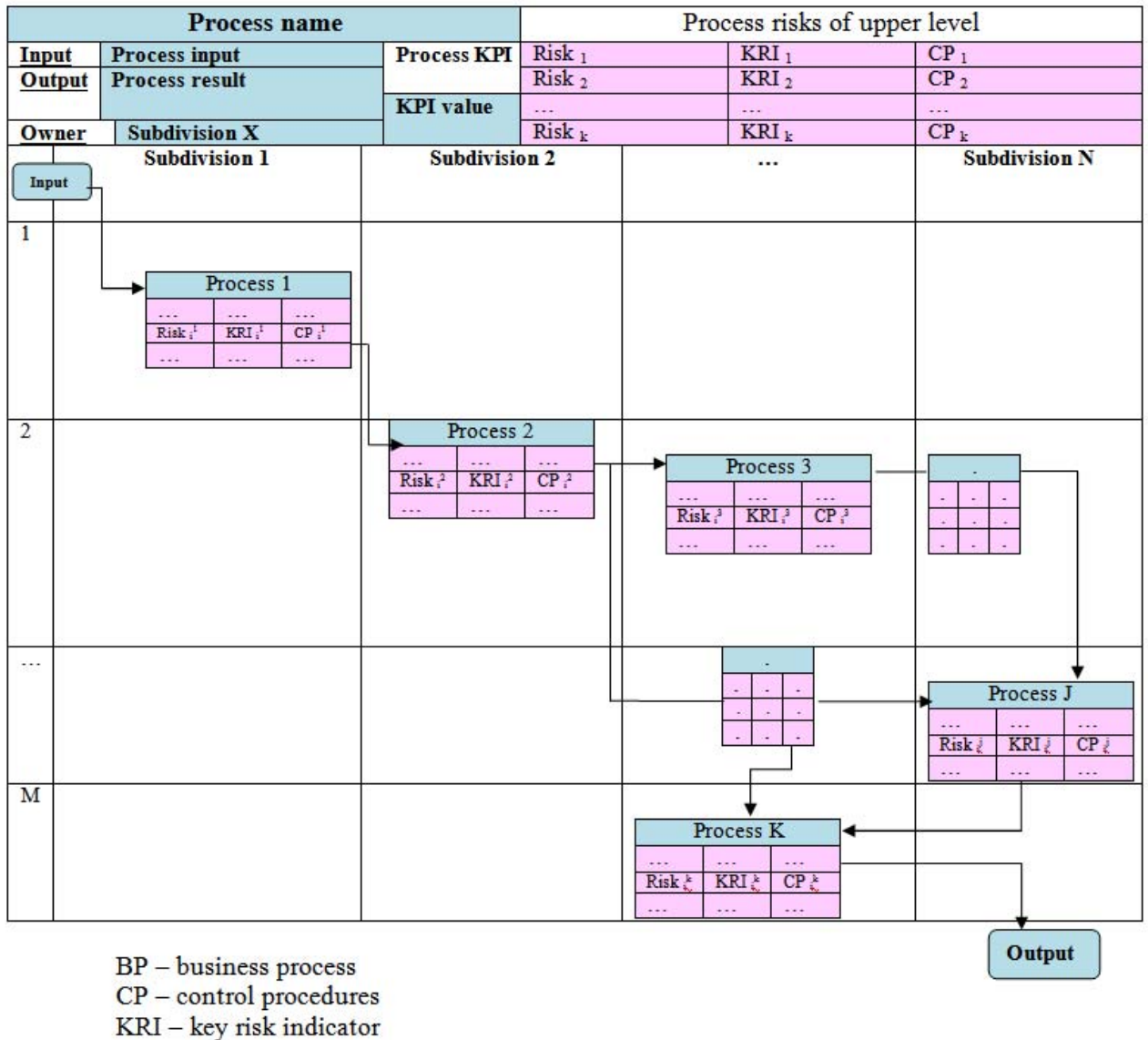


Diagram 6.1. Graphic description of a process

### 6.1.2.2 Establishing a transparent scheme for arranging process management according to a corporate vertical line

Build-up of standardized ICS and RMS means that common process standards contain risks and control procedures performed both by the Company and its branches according to functional

vertical lines, responsibility levels and interest in efficient business management, preservation of grid reliability, transparency observance, asset preservation and income making.

Guidelines are determined by the decrees on separation of powers, build-up of ICS matrix, adoption of interaction regulations, provisions, rules and methods.

### **6.1.2.3 Monitoring control procedures (clear separation of control and execution functions, transparency and responsibility)**

To ensure separation of control and execution functions the process standards are analyzed by **the Company's Internal Audit subdivision** in terms of efficiency and sufficiency of control procedures, observance of IC requirements and principles. After analysis the subdivision provides its recommendations on improvement of standardized processes.

Control procedures should cover risks identified during process description and provide opportunities for monitoring control execution during ICS audit. Besides, in future (during 2<sup>nd</sup> phase of building-up a **guided ICS**) to motivate officers and clerks, basing on evaluation of function execution (including controlling functions), KPIs will be elaborated.

### **6.1.2.4 Elaboration of standard regulations on business process.**

Building-up a standardized ICS during 1<sup>st</sup> phase results in elaboration of a process description standard as well as unified standard **Regulations on main business processes**.

**Standard regulations on business process are a main document describing results of implementing a standardized ICS and uniting requirements on:**

- Building-up a control environment,
- Performance of all control procedures
- Measures on RM
- Determination of responsibility area.

Standard regulations on business process should contain:

- Unified classifier of process elements, notions and terms with a view to uniformity and elaboration of common approaches for process arrangement;
- Description of a process from input to output, including from planning to reporting (i.e. a process is “through” or multifunctional) as well as process efficiency evaluation;
- Revealed responsibility areas during the whole process, execution and control functions separated (creation of responsibility matrix);
- Established control procedures and instruments using unified standards, protocol resolutions (important issues should be approved collegiately, obligatory documentary record) to ultimately decrease a subjectivity factor;
- Risk management elements during the whole process (risk should be identified, sources should be determined, evaluation of risk and demining measures, risk indicators – key risk indicators);

- The list of justifying documents and obligatory requirements on information disclosure, calculation of decision-taking consequences when coordination or approval of decisions by management bodies (including BoD) is required;
- Revelation of junction points between various functional directions during through processes requiring coordinated actions and responsibility distribution. To ensure integrity (continuity) of a process and internal control at junction points recorded procedures should be determined;
- Provision of timely transmission of required information for management (operating reporting forms: coordination list, dispatcher and conference calls).

Standard regulations on business process should guarantee process transparency and ensure preventive control by RM, instant reaction to incorrect or non-agreed actions, establishment of control procedures as well as exclude the possibilities of fraud, adoption of non-efficient and illegal resolutions.

Elaboration and implementation of standard regulations on key business processes shall enable to control execution management bona fides and decrease possibilities of fraud and distortion of activity results, increase efficiency and transparency.

**Standard regulations on main processes** are elaborated by functional subdivisions (performing process management and control) in accordance with standards on key processes, approved by the BoD, involving the Company's RMS and ICS coordinator.

Evaluation of observance of RMS and ICS requirements by elaborated standard regulations on business processes and proposals are submitted by internal audit. After reprocessing these standard regulations are approved by the Company's BoD.

### **6.1.3 Personnel training and development in RMS and ICS**

To implement planned activities the personnel is trained in accordance with approved plans in every subdivision, including postgraduate courses, trainings and workshops on implementation of RMS and ICS. This, in its turn, will enable to increase the personnel competence while building-up standardized ICS.

External consultants or highly-skilled workers will be involved to train and form required skills. The training program includes a workshop for top-managers as well as low and middle management, coordinators and personnel of specialized directorates.

## **6.2 Building-up ICS and RMS during 2<sup>nd</sup> phase – building-up guided ICS**

Building-up of ICS and RMS during the 2<sup>nd</sup> phase lies in reaching the next level of ICS maturity that includes:

- Detailed description of guidelines (elaboration of process regulations, revealing key risk indicators and coordinating the minimization results with KPIs);
- Regular and analysis-available monitoring of control procedures;

- Constant adaption and regular update and record of control procedures to internal and external environment changes, business processes;
- Standardized order of documentary record of control procedures;
- ICS monitoring by Internal Audit function

I.e. at the background of analysis and monitoring of the ICS built up on the basis of process management principle there is:

Follow-on revision of regulating documents;

Detailed and concrete actions of principals and controllers by studying regulations, methods, normative documents;

Build-up of risk-control matrix on the basis of “not as is” but “as required”.

Amendments to regulations on structural subdivisions and duty instructions are introduced in accordance with adopted regulations on processes and requirements, stemming from them, on performing functions by process participants.

Internal audit function constantly monitors ICS, provides evaluation and proposals on follow-on revisions or change of control procedures. Detailed description and sequence of actions will be adjusted when ICS reaches 1 maturity level and is arranged by the plan on reaching 2 maturity level.

### ***6.3 Building-up ICS and RMS during Phase 3 – building-up of optimized IC system***

**Phase 3 – building-up optimized IC system characterized by the following principles:**

- Control procedures are fully coordinated with other control and audit functions;
- RM and ICS work as an integrated system;
- Constant ICS improvement;
- Control procedures are automated.

Main focus of phase 3 will be concentrated on automation of control procedures, creation of automated program and integration of all ICS and RMS. A detailed plan will be developed when ICS and RMS reach maturity level 2.