

APPROVED  
by the Board of Directors of  
IDGC of the North-West, JSC  
on 27.08.2012 (Minutes No 109/7)

**Internal Control Policy of  
IDGC of the North-West, JSC**

**(Restated)**

**Gatchina,  
2012**

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## 1. General Provisions

1.1. The Internal Control Policy of IDGC of the North-West, JSC (hereinafter referred to as the “Policy”) has been elaborated in accordance with the Russian Federation legislation, the Charter of IDGC of the North-West, JSC (hereinafter referred to as the “Company”), the Corporate Governance Code of the Company, other in-house documents of the Company and is based on recommendations of the world best practices in the field of internal control system organization.

1.2. The Policy is an in-house document of the Company and determines the proceedings, aims and principles of organization of an internal control system, roles, responsibilities and interaction of such system participants, types and levels of internal control over the Company’s financial and business activities.

1.3. The Policy provisions are mandatory for application for all structural subdivisions of the Company.

## 2. Core terms and Definitions

**Internal Control** is the process aimed to provide for reasonable assuredness of achievement of strategic and operational aims of the Company, efficient and effective utilization of the Company resources, safekeeping of assets, the Company’s compliance with the requirements of the Russian Federation legislation, branch standards, in-house regulatory documents of the Company and provision of credible statements.

**The Internal Control System (ICS)** is the complete range of control proceedings, methods and mechanisms created by executive bodies and the Board of Directors of the Company to provide for internal control over the Company’s financial and business activities.

**The Risk Management System (RMS)** is the combination of proceedings, techniques, IT systems directed at achievement of risk management aims and tasks.

**Control Proceedings** are the combination of actions and measures directed at exclusion (reduction) of the probability of actual occurrence of the risks run by the Company. Control Proceedings are an integral part of the business-processes of the Company.

**Control Points** are control criteria relating business-process risk factors to strategic aims of the Company and the business-process aims.

**Internal Control System (ICS) Participants** are represented by the Board of Directors, the Auditing Commission, the Audit Committee under the Board of Directors, General Director, the Management Board of the Company, the Internal Audit and Risk Management Subdivision as well as the Company officials and workers responsible for execution of control proceedings allocated to them by in-house documents of the Company.

**The Company** is IDGC of the North-West, JSC.

**The Structural Subdivision** is a subdivision within the organizational structure of the Company.

**SDC** is a Subsidiary Dependent Company of IDGC of the North-West, JSC carrying out activities for electric energy transmission, technological connection as well as retail energy sale, repair and energy service activities.

**IARMS** is the Internal Audit and Risk Management Subdivision.

**The Business-Process** is a stable, purposeful, controllable combination of interrelated operations, ordered in time and per executor and with an accurate definition of the Business-Process input and output.

**The Risk** is an uncertainty with regard to the Company's aim achievement. Within the framework of this document we understand the "Risk" ("Risk Event") as a probable event that may affect achievement of strategic and operational aims of the Company.

**The Matrix of Risks and Control Proceedings** is the document describing the control environment of process in the form of a table containing a description of the process steps, a description of the process risks and a description of the control proceedings.

**COSO, Committee of Sponsoring Organizations of the Treadway Commission**, is a voluntary private organization established in the US and intended for elaboration of corresponding recommendations for corporate management on critical facets of organizational management, business ethics, financial reporting, internal control, company risk management and fraud suppression.

**COSO Internal Control Conceptual Framework:** the COSO model determines the internal control as a process implemented by the Board of Directors, management and the rest of the Company personnel and intended to provide for "reasonable assuredness" of achievement of strategic and operational aims of the Company.

**COSO ERM** is the enterprise risk management model of the Committee of Sponsoring Organizations of the Treadway Commission, widely used in the world practice of risk management.

**The Internal Audit (IA)** is the activity directed at evaluation of reliability and efficiency of ICS and RMS within the Company.

### **3. Internal Control System Aims**

The internal control system of the Company (hereinafter referred to as ICS) is the complete range of control proceedings, methods and mechanisms created by executive bodies and the Board of Directors of the Company to provide for internal control over the Company's financial and business activities. ICS is an element of the Corporate Governance System of the Company.

The main aims of ICS are:

1. Improvement of the System of Corporate Governance of the Company and SDCs to provide for reasonable assuredness in terms of observance of interests and rights of shareholders and investors of the Company and SDCs to the extent concerning:
  - efficient and effective utilization of the Company and SDC resources;
  - the Company and SDC assets safekeeping;
  - compliance with the requirements of the legislation of the Russian Federation, local regulatory instruments of the Company and SDCs (compliance control);
  - credibility, objectivity of managerial and accounting (financial) statements and their preparation system reliability.
2. Enhancement of the Company and SDCs activities efficiency and effectiveness due to risk management processes improvement and efficient control proceedings adoption.
3. Assistance in the Company activities timely adaptation to external and internal environment changes.

## **4. Internal Control System Organization Fundamentals**

### **4.1. ICS in the Corporate Governance System**

ICS is one of the elements of the Corporate Governance System of the Company, ensuring the Company management bodies taking well-substantiated decisions directed at increase of the Company shareholder value due to raising the degree of the Corporate Governance System participants' responsibility and accountability at all levels of the Company governance.

ICS improvement is implemented by the Company in SDCs by way of corporate governance methods within the frameworks of SDCs shareholder's rights exercise and is based on principles described herein.

Control over the SDCs' financial and business activities is performed by the Company in accordance with the Charter of the Company, the Corporate Governance Code of the Company and other in-house documents of the Company.

### **4.2. Internal Control System Organization Principles**

The framework of efficient and reliable operation of the internal control system of the Company is based on compliance with the following ICS principles:

- Integrity: ICS is an integral component of the governance system of the Company at all its levels;
- Complexity: ICS covers all the aspects of the Company's activities with control proceedings performed within all the business-processes of the Company at all the levels of the governance system;
- Functioning continuity: continuous efficient functioning of the internal control system enables timely prevention of violations and risks occurrence possibilities and their timely detection;
- Responsibility: all ICS participants are responsible for proper performance of control proceedings within the ambit of their authorities as set forth in in-house regulatory documents of the Company;
- Responsibility indivisibility: responsibility for each specific control proceeding is allocated to but a single ICS participant in accordance with segregation of functional duties within the Company;
- Segregation of duties: duties are segregated on the basis of delimitation authorities for exercise of the following function: initiation, authorization, execution, accounting and control over financial and business operations being effected;

- Methodological framework unification: the internal control system functioning is performed based on unified approaches and standards at all the levels of corporate governance of the Company;
- Transparency: disclosure of information to parties concerned in full;
- Regulation: at all governance levels and within all business-processes, control proceedings are formalized by in-house regulatory documents of the Company;
- Documentarization: results of financial and business operations performance and control proceedings within the Company are properly documented and stored;
- Authorization: all financial and business operations within the Company shall be sanctioned (endorsed) or approved (permitted) by officials within the ambit of their competence;
- Resource provision: control proceedings are provide with the resources required and authorities for their execution;
- Expedience: control proceedings are carried out with account for their expedience and economic efficiency i.e. expenditures on carrying out control proceedings are not in excess of their implementation effect manifested in risk reduction;
- Constant development and improvement: control proceedings are constantly improved and adapted to changes in the internal and external environment;
- Agreement and interaction: control proceedings execution and ICS improvement are based on efficient and coordinated interaction of all ICS participants at all levels of the Company governance.

### 4.3. Internal Control System Components

In accordance with COSO ICS model, the internal control system of the Company is composed of five interrelated components. Those components provide an efficient base for description and analysis of the internal control system implemented within the Company. The five components include:

1. Control environment;
2. Evaluation of risks;
3. Control proceedings;
4. Information and communication;
5. Monitoring.

See Table 1 for description of each ICS component.

Table 1. Internal control components

ICS component	Elements of the internal control system within the Company
Control environment	<p>Corporate Governance Code of the Company approved by the Board of Directors of the Company (IDGC of the North-West, JSC dated 22.08.2008 (Minutes No 35/3)).</p> <ul style="list-style-type: none"> <li>– Ethical principles;</li> <li>– Internal policy and proceedings.</li> </ul> <p>Organizational structure:</p> <ul style="list-style-type: none"> <li>– Identification of interrelated and non-contradictory aims and tasks at different levels of the Company governance;</li> <li>– Distribution and delegation of key authorities and responsibilities within the Company, provision for efficient interaction of structural subdivisions and workers of the Company.</li> </ul> <p>Distribution of authorities and responsibilities:</p> <ul style="list-style-type: none"> <li>– System for confirmation of authorities within the ambit whereof workers act while performing their duties;</li> <li>– Segregation of key duties between the Company workers (including duties dealing with endorsement (permission) and approval of financial and business operations, issues, storage and receipt of resources, analysis and review of operations);</li> <li>– Conveyance of details of their internal control duties and responsibilities to all the workers of the Company.</li> </ul> <p>HR policy:</p> <ul style="list-style-type: none"> <li>– Workers’ professional qualities and competence;</li> <li>– Recruitment proceedings;</li> <li>– Evaluation of workers’ activities efficiency;</li> <li>– Training.</li> </ul> <p>Documenting financial and business operations and their reflection in the accounting records system.</p> <p>Local and regulatory documents of the Company.</p>
Risk evaluation and analysis	<p>The risk management cycle is determined by the Risk Management Policy of IDGC of the North-West, JSC as approved of by decision of the Board of Directors of the Company dated 23.06.2010 (Minutes No 60/15).</p>
Control proceedings	<p>Auditing (follow-up) proceedings: those directed at detection of deficiencies in processes and negative events</p>

ICS component	Elements of the internal control system within the Company
	<p>triggered by their occurrence.</p> <p>Directive proceedings: those aim whereof consists in pointing out the due procedure of actions for the Company workers.</p> <p>Corrective proceedings: those directed at corrective actions prior to or upon occurrence of negative events.</p> <p>Preventive proceedings: those directed at exclusion or a critical reduction of probability of negative events.</p> <p>Compensatory proceedings: those directed at compensation for current control deficiencies.</p>
Information and communication	<ul style="list-style-type: none"> <li>– Organization of a system for information collection, processing and transmission including generation of reports and messages containing information on the Company’s financial and business and other activities as well as establishment of efficient communication channels and means providing for vertical and horizontal communication relations within the Company;</li> <li>– Company establishing efficient relations with third parties;</li> <li>– Access to information obtained from internal and external sources;</li> <li>– Managerial information detection, registration and conveyance to the parties concerned;</li> <li>– Bringing the effective policies of the Company, plans, guidelines etc. to the notice of employees.</li> </ul>
Monitoring	<ul style="list-style-type: none"> <li>– Determination of criteria and evaluation of efficiency of activities of structural subdivisions, officials and workers of the Company;</li> <li>– Risk-oriented audit carries of business-processes;</li> <li>– Auditor reviews;</li> <li>– Analysis of actual performance indicators of financial and business activities to those planned;</li> <li>– Regular self-evaluation of the internal control system quality.</li> </ul>

#### 4.4. Distribution of Roles and Responsibilities between the Internal Control System Participants

See table 2 for distribution of roles and responsibilities between the internal control system participants.



**Table 2. Distribution of roles and responsibilities between the internal control system 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 the required level of ICS development;</li> <li>– Approves and introduces amendments to the Internal Control Policy;</li> <li>– Gives instructions to executive bodies of the Company concerning ICS improvement and development aspects.</li> </ul>
<b>Audit Committee under the Board of Directors of the Company</b>	<b>Controller</b>	<ul style="list-style-type: none"> <li>– Carries out surveillance over ICS efficiency including ICS efficiency evaluation;</li> <li>– Carries out surveillance over compliance with the Russian Federation legislation and in-house regulatory documents;</li> <li>– Performs analysis of annual financial (accounting) statements including evaluation of Auditor’s conclusion prior to their submittal for consideration to the Board of directors of the Company and of intermediate (quarterly) financial (accounting) statements prior to their disclosure;</li> <li>– Considers the IARMS report on the results of control measures and control proceedings undertaken within the framework of ICS and RMS efficiency evaluation;</li> <li>– Prepares proposals (recommendations) on ICS improvement in interaction with the Auditing Commission.</li> </ul>
<b>General Director (Management Board)</b>	<b>Guarantor</b>	<ul style="list-style-type: none"> <li>– Organizes and bears responsibility for ICS efficient functioning within the Company.</li> </ul>
<b>Officials</b>	<b>Managers</b>	<ul style="list-style-type: none"> <li>– Provide for ICS principles implementation;</li> <li>– Manage and own business processes;</li> <li>– Bear responsibility for efficiency of achievement of business-processes operational aims;</li> <li>– Organize an efficient business-process control environment including provision for efficient control proceedings in place and control proceedings “embedding” into the Company’s business-processes as well as exercise of preliminary current control;</li> <li>– Provide for timely inclusion of elaborated IARMS control proceedings into local regulatory documents of the Company regulating the activities of the accountable subdivision / business-process and accountable employees’ job descriptions;</li> <li>– Manage business-process risks and organize execution of business-process control proceedings.</li> </ul>
<b>Internal Audit and Risk Management Subdivision</b>	<b>Controller Expert, Coordinator Methodologist</b>	<ul style="list-style-type: none"> <li>– Carries out follow-up control within the Company;</li> <li>– Takes measures for immediate evaluation of ICS and RMS efficiency, detects violations during control proceedings execution with the results presented to the Audit Committee for the latter to exercise ICS proceedings efficiency evaluation functions;</li> <li>– Evaluates business-processes regulation quality;</li> </ul>

Participant	Role	Functions and duties
		<ul style="list-style-type: none"> <li>– Exercises control over compliance with ICS internal control proceedings and communicates violations as may be detected to the Audit Committee;</li> <li>– Exercises monitoring of removal of violations detected following risk-oriented audits results;</li> <li>– Controls documentarization of financial and business operations and their reflection in the accounting records system;</li> <li>– Maintains and develops the ICS methodological and regulatory framework as well as its efficiency evaluation approaches and criteria;</li> <li>– At the adoption stage – controls standardization of the Company’s business-processes control environment and evaluates control proceedings regulation quality;</li> <li>– Provides information on ICS top parties concerned.</li> </ul>
<p style="text-align: center;"><b>Workers of Structural Subdivisions</b></p>	<p style="text-align: center;"><b>Executors</b></p>	<ul style="list-style-type: none"> <li>– Execute control proceedings within the framework of ICS functioning in accordance with job descriptions and local regulatory documents established;</li> <li>– Exercise monitoring of control proceedings execution;</li> <li>– Exercise self-evaluation of efficiency of control proceedings executed and participate in ICS improvement;</li> <li>– Inform officials and IARMS of risks and violations detected in business-processes functioning.</li> </ul>

## 5. ICS Control Proceedings

### 5.1. Types of Control within the Framework of ICS

Within the framework of ICS the following types of control are carried out:

- 1) **Preliminary** (preventive) control, executed prior to commencement of effecting business operations and directed at prevention and restriction of negative impact of events and factors that may affect achievement of strategic and operational aims of the Company and SDCs; preventive control procedures carried out within the framework of the Company’s and SDCs’ risk management system;
- 2) **Current** control carried out immediately in the process of effecting business operations and aimed at achievement of the business-process aims and provision for efficient usage of resources during business-processes execution;
- 3) **Follow-up** control carried out after the business operations have been effected; is aimed at establishment of credibility of reporting data, detection of violations, deficiencies or positive experience, evaluation of the activities results conformity to the established target performance indicators.

### 5.2. Core Control Proceedings

Within the framework of **preliminary control** the following control proceedings are carried out:

- Control over the external auditor selection proceedings with a view of provision for the auditor’s independence and evaluation of the external auditor’s work plan;

– Analysis of business-process with a view of detecting “bottlenecks”, evaluation of the existing control procedures as well as detection of control proceedings not in place, absence whereof leads to occurrence of risk events;

– Measures for management of risks run by the Company and RMS efficiency evaluation.

Control proceedings of preliminary control are detailed in the Risk Management Policy of the Company approved by the Board of Directors of the Company.

Carried out within the framework of **current control** are control proceedings “embedded” in the Company’s business-processes and described in the Regulations on the Control Environment and Risks of the Company’s Business-Processes approved by the Board of Directors of the Company.

Detailization of control proceedings of current control is performed in Matrixes of Business-Process Risks and Control Proceedings representing appendices to the Regulations on the Control Environment and Risks of the Company’s Business-Processes approved by the Board of Directors of the Company.

Within the framework of **follow-up control** the following control proceedings are carried out:

– Analysis and evaluation of credibility and objectivity of managerial and accounting (financial) statements of the Company;

– Control and documenting of financial and business operations and their reflection in the accounting records system;

– Analysis (monitoring) and evaluation of efficiency (reliability) of the internal control system. Control proceedings testing for availability, documentarization and performance quality;

– Compliance-control directed to provide for the Company’s activities conformity to the requirements of the Russian Federation legislation, branch standards, in-house regulatory documents including those dealing with suppression of unlawful usage of insider information and market manipulation;

– Consideration of the results of investigations and arrangements undertaken by the Company to prevent occurrence of corporate fraud facts and suppress corruption practices.

Control proceedings of **follow-up control** are detailed in internal audit standards approved by the Board of Directors of the Company.

## **6. Internal Control Regulatory Framework and Standards of the Company**

In-house documents of the Company regulating ICS are elaborated with account for the provisions hereof.

See Table 3 for the required<sup>1</sup> list of ICS documentation with indication of the documents purpose.

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<sup>1</sup> Whenever required, the ICS regulatory documents may be supplemented with other documents.

**Table 3. List of regulatory documents**

<b>Document</b>	<b>Purpose of document</b>
<b>Internal Control Policy</b>	In-house document of the Company determining the core principles of ICS organization and development strategy
<b>Regulations on the Control Environment and Risks of the Company's Business-Process (including the Risks and control Proceedings Matrix)</b>	In-house document describing the control environment and risks of the Company's business-process
<b>Unified regulations, procedural rules, guidelines and regulatory reference materials</b>	In-house documents regulating ICS and binding on all ICS participants
<b>Control proceedings reporting forms</b>	Forms for structural subdivisions of the Company to report on performance of control proceedings
<b>Internal audit standards</b>	In-house documents regulating the internal audit procedure and methods applied by IARMS in the course of audit proceedings

## **7. Internal Control System Development Strategy**

### **7.1. ICS Development Strategy**

Development and improvement of ICS within the Company is directed at:

- Provision for ICS conformity to the scale of the Company's activities and complicity of financial and business operations carried out;
- Provision for a proper level of protection of the interests of shareholders, investors and other parties concerned of the Company's activities;
- Application of best international and domestic internal control and risk management practices.

### **7.2. Process Approach to ICS**

The Company is oriented at development of a process approach to management of activities and ICS building to achieve:

- Unification, optimization and efficiency of business-processes and the organizational structure;
- Balances actions of structural subdivisions;
- Synergetic effect of joint, agreed activities of structural subdivisions and control bodies of the Company.

### **7.3. ICS Development Levels**

The level of development of the internal control system within the Company is determined in accordance with the following criteria:

#### **Level 1. Standardized internal control system:**

- Simple governing principles are established;
- Control environment and business-processes (control proceedings and mechanisms) are documentarily formalized;
- Control proceedings are performed and tracked;

- Control proceedings are adapted to changes in the internal and external environment;
- Internal audit carries out risk-oriented audit of individual business-processes;
- Best practices are propagated within the Company;
- Personnel are trained in ICS improvement.

**Level 2. Optimized internal control system:**

- Governing principles described in detail;
- Regular and traceable monitoring of control proceedings execution is in place as well as control proceedings improvement following the results of risk-oriented audits of business-processes;
- Control proceedings are constantly adapted to changes of risks and documented;
- Standardized documented procedure of control proceedings formalization;
- ICS risk-oriented audit and monitoring carried out on a regular basis.

**Level 3. Automated internal control system:**

- Control proceedings fully agreed with other control and auditor functions;
- RMS and ICS act as an integrated system;
- Constant improvement of ICS;
- Automated execution of control proceedings;
- Automated monitoring of control proceedings execution;
- Monitoring of risks and control proceedings efficiency carried out based on automated means for monitoring key risk indicators in a constant mode.

With SDCs the Internal Control System Development Strategy and process approaches to ICS are implemented by the Company via corporate governance methods within the framework of exercise of the SCD shareholder's rights.

## **8. Final Provisions**

8.1. This Policy as well as any supplements and amendments hereto are approved by the Board of Directors of the Company in accordance with in-house documents of the Company.

8.2. Issues unsettled hereby are settled by the effective legislation, decisions of the Board of Directors of the Company, in-house regulatory documents of the Company.

8.3. If, as a result of amendments to the legislation or regulatory legal instruments of the Russian Federation, certain provisions hereof come in conflict therewith, the articles concerned become invalidated with the Company following the effective legislation and sublegislative regulatory legal instruments of the Russian Federation until introduction of amendments hereto.