

INTERNAL

CONTROL

AND RISK MANAGEMENT



Provision of efficiency and constant perfection of the system of internal control and risk management is one of the Company's priorities. The development of internal control and risk management is primarily aimed at the provision of rational assurance in reaching strategic goals by the most efficient way, asset preservation and investment attractiveness as well as at the maintenance of governance efficiency and at the provision of trouble-free energy supply and energy efficiency.

Our principles of functioning, processes and procedures of internal control and risk management system (hereinafter referred to as the ICRMS) are regulated by the following internal documents:

-The Regulations on the Internal Control Procedures in IDGC of Urals, OAO (approved by a BoD resolution, Protocol #49 dd. 26.12.2008).

-The Risk Management Policy in IDGC of Urals, OAO (approved by a BoD resolution, Protocol #70 dd. 04.06.2010)

-The Internal Control Policy in IDGC of Urals, OAO (approved by a BoD resolution, Protocol #70 dd. 04.06.2010).

-The Regulations on the Arrangement of Inspections held by Internal Control and Audit Department in IDGC of Urals, OAO (approved by IDGCU's Decree #388 dd. 26.10.2009).

ICRMS PARTICIPANTS AND PARTITION OF POWER

According to the approved local regulatory documents on ICRMS perfection, directors and specialists on all management levels (both in our branches and HQ) are involved into risk management and internal control processes. The Board of Directors determines required levels and directions for ICRMS development. The Audit Committee evaluates ICRMS efficiency, including messages and reports of Internal Control and Audit Department, analyses financial (accounting) statements and contributes to the preparation of recommendations on significant financial and operating issues. The General Director arranges efficient ICRMS functioning, ensures internal control procedure implementation and bears responsibility for their completion. Internal Control and Risk Management Department directly evaluates the adequacy, sufficiency and efficiency of internal control procedures, coordinates risk management processes, arranges the implementation of internal control system in business processes and evaluates the compliance of accomplished financial operations to the current legislation and shareholder interests. Structural divisions, within their competence, reveal and evaluate risks, monitor, elaborate and implement measures taken to minimize the risks as well as accomplish control procedures.

KEY RISKS AND MEASURES TAKEN TO MINIMIZE THE RISKS

Due to the fact that IDGCU's operations are influenced by many factors, the key goals of integrated system of risk management and internal control are identification, evaluation and management of financial and operating risks and provision of information on risks while adopting managerial resolutions.

STRATEGIC RISKS

Macroeconomic, political, economic and social changes in Russia may have a negative influence on the Company's operations. A possible decrease in demand and prices on key commodities exported by Russia (oil, gas and metals) due to the recession, possible decrease in demand on goods by internal markets as well as decrease in production rates lead to such strategic risks as significant deviation of real productive supply and energy consumption from targeted ones as well as decrease in connections. To minimize the risks we monitor energy consumption, work hard on forecasts bearing in mind the current dynamics of energy consumption, productive supply and connection applications. To improve mutual interaction we aspire to disseminate information on connection among consumers. We have arranged several Client Support Centers; information on connection is posted on our web-site.

Climatic peculiarities of the Urals may also have a negative impact on our operations. Emergency situations related to rapid changes of temperature, natural disasters (fires, floods) may lead to loss of supply and material impairment. To minimize the risks we conclude insurance contracts compensating damages, create emergency supply of material resources and prepare emergency response teams.

Ill-run retail market mechanisms may lead to risks related to disagreements among grid companies and retail suppliers on consumption volumes, growth of accounts receivable and low consumer payment

discipline. To minimize the risks we aspire to eliminate conflicts with consumers, to decrease receivables on energy transmission as well as to accumulate court practice and positive precedents.

Another important factor is the lack of legal regulation of MRSK-FSK "last mile" relations. Despite the legitimate right to conclude such MRSK-FSK contracts, there are no procedures for contract approval by the Russian Ministry of Energy. Therefore, the appetite of large industrial enterprises to conclude direct transmission contracts with FSK and existing court practice may lead to a possible decrease of the service volume due to cancellation (non-renewal) of "last mile" rental contracts. FSK risk management is aimed at full observance of contract conditions and timely contract prolongation. Court practice is constantly being monitored and analyzed.

At the backdrop of recession, taking into account marginal growth of tariffs in the regions, there is a risk of the increase in economically feasible expenses incurred by allied grids while the growth boiler tariffs is limited. Therefore, under limited growth of final and network tariffs a regional regulator can approve increased tariffs for several grids while our revenues are decreased or left unchanged. Key steps for risk minimization are to submit to regional regulators justifying materials proving required expense gains that are not below the average network tariff growth as well as assertion of required expense growth since we are a regional backbone grid company.

REGULATORY RISKS

Our key business lines are energy transmission and connection. These business lines are regulated by the state (approval of tariffs directly influencing our financial results), and therefore, there is a risk of tariff regulation. The limitation of tariff growth for end users by the state, equivocating interpretation of regulating and methodical documents on tariffs and other factors may lead to a risk of setting tariffs below economically feasible levels. Incorrect planning of energy transmission structure may lead to decreasing revenues or additional expenses. IDGC of Urals constantly works hard over economic grounding for tariff-included expenses as well as controls own expenses and tariff completion. We prepare and submit justifying materials and information to regional regulators as well as work out and approve long-term development programs.

Antimonopoly regulation leads to risks when the Company may be acknowledged as a violator of antimonopoly legislation. These risks may be caused by violation of terms for connection or terms of requesting regulator on connection fee. To minimize risks related to prosecution for antimonopoly violation in terms of connection, our branches have installed software enabling successful control over the terms for application completion processes and approved local regulatory documents determining connection steps.

RAB-tariffs may create risks related to the lack of RAB implementation practices due to the lack of integral regulatory base, including the lack of accumulated practice on tariff component grounding. To minimize these risks the Company actively works out proposals on the introduction of amendments into regulatory documents and grounds for these amendments. We interact with regulators during indicator calculation, approval and update.

IDGC of Urals, like other gridcos, purchases energy for loss compensation at free market prices, dependent on wholesale market fluctuations. Local regulators approve energy transmission revenues without regard to the cost of losses purchased at non-regulated prices, and this causes additional expenses. We minimize the risk by negotiating with local regulators on inclusion of these expenses into RGR during the next regulation period.

FINANCIAL RISKS

When the Company purchases foreign equipment and other produce, a risk of foreign currency change (increase) may lead to the upsurge of purchase prices and our expenses. The risks are minimized by increased volume of equipment and materials purchased from Russian producers. At present the share of foreign equipment and materials are relatively low, therefore, the risk is minimal. Attracted credit resources are in Russian currency.

Instable financial markets, possible growth of the Russian Central Bank refinancing rate, changes in bank policies may determine risks related to interest rate increase that may lead to increasing debt-service expenses. Since the share of credits in our finance structure is insignificant, the risk is viewed as insignificant. To minimize the risk we negotiate with banks over the decrease of current interest rates, conclude agreements to the credit contracts that exclude the unilateral increase of interest rates.

Escalation of inflation has significant effects on our expenses and profitability and may subsequently lead to income decrease. According to official statistics, 2010 inflation totaled 8.8%. According to official forecast made by the Russian Ministry of Economic Development, 2011 inflation will total 7-8%, 2011 forecast (the Russian government used it in the federal budget), will be 6.5%. Still, it should be noted that a possible growth of consumer prices in the beginning of 2011 will lead to a risk of inflation increase in 2011 compared to the forecast. To reduce inflation impact we work out and implement an expense management program. If inflation increases, we will focus on the optimization of receivables and expense management as well as on the increase of current asset turnover.

Mala fide suppliers, specificity of purchased produce and tight working schedule may lead to risks related to defaults on commitments by suppliers and subsequent growth of receivables. Main measures to reduce the risks are aimed at the minimization of advanced payments to suppliers, keeping records of mala fide suppliers, incessant control of terms and cost during purchase planning and arrangement.

Risks, related to defaults to commission objects, are constituent parts of financial risks and may be caused by mistakes in the planning, delays in approval of investment programs by various authorities, long land plot registration and obtainment of a permit for construction as well as refusal of consumers from connection. We take all measures to minimize investment-related risks. The measures are aimed at the observation of investment program approval rules, rules of control over investment program implementation exercised by the Russian Ministry of Energy. We also have a working system of control over investment program implementation and financing, including weekly control. We have worked out local regulatory documents on capital construction and investment program planning. The company implements measures aimed at timely material and technical maintenance and observation of terms and quality of the works done by contractors.

OPERATING AND TECHNOLOGICAL RISKS

Our operations are related to exploitation risks and risks of technological character which are expressed by violations in normal operation mode, incidents, supply disruption, above-level load increase. Main factors for such risks are high depreciation level, impact made by natural disasters and third persons and companies. Erroneous or wrong operations of Company's or outsourced personnel, violations in dispatcher modes are also sources of the risks. To minimize the risks the Company focuses on network renovation, elaboration and implementation of target programs of energy supply reliability increase. We also permanently monitor and diagnose equipment as well as review and analyze incidents. Our personnel undergo training and attestation. At present we implement automated management system of technical exploitation and repairs enabling optimization of exploitation, repair and maintenance processes.

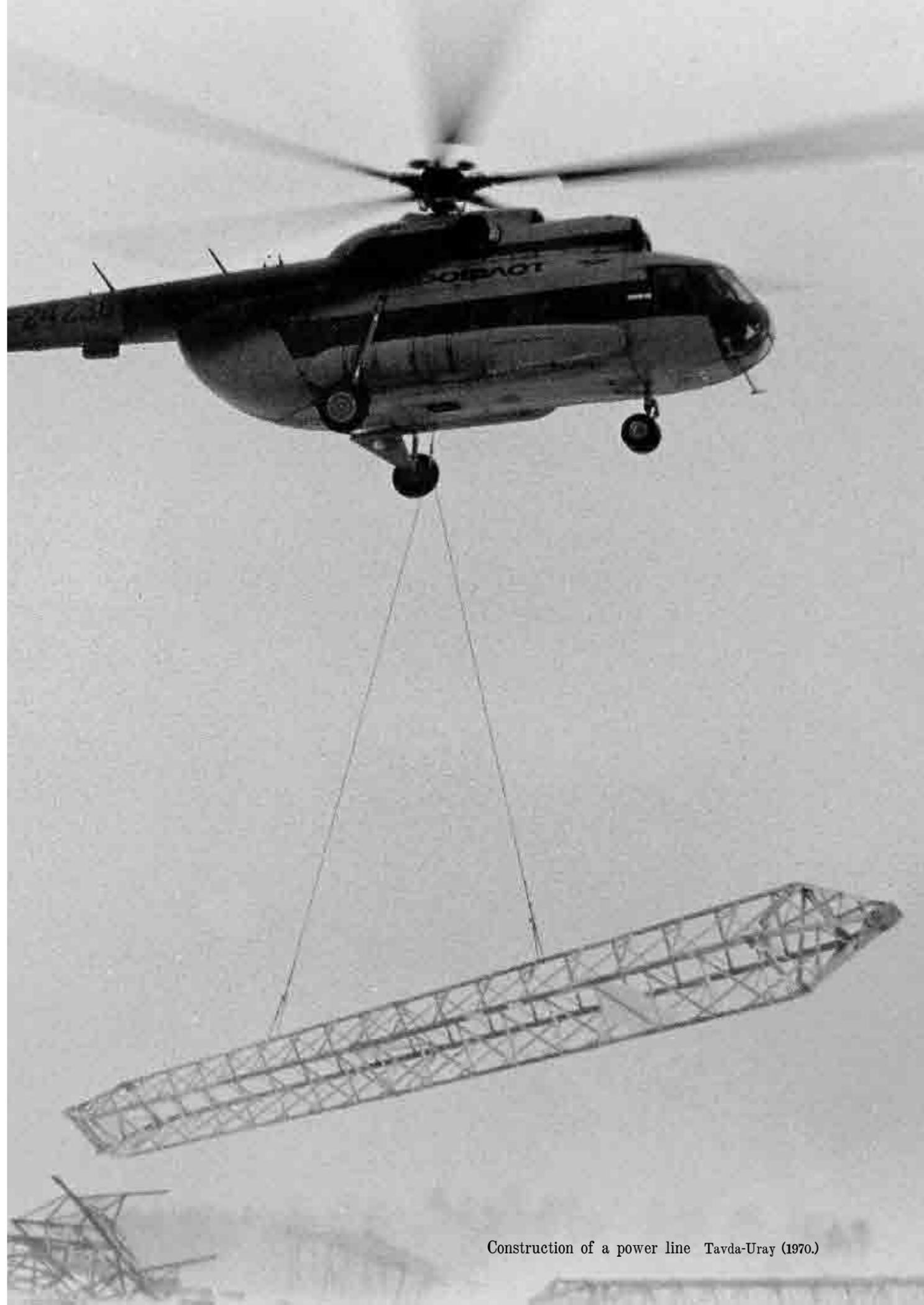
Operating risks also include HR-related risks. Insufficient training of personnel as well as low educational level of college and university graduates, discrepancy of personnel qualifications to new technologies, high staff turnover (especially technical staff) are main factors of such risks. Main risk-minimization measures are aimed at the monitoring of labor market to show employer's attractiveness, close cooperation with colleges and universities on the training of students. The personnel is regularly trained and attested. To increase motivation of personnel during the reported period we elaborated and implemented local regulatory documents stipulating social privileges and guarantees on the service area (Collective agreement and the Regulations on remunerations).

Risks, related to purchasing and logistics, may be caused by planning mistakes, specificity of purchased produce, tight delivery and work schedule, ill-prepared purchase documentation and expertise of participants' offer. The Company controls the preparation of purchase program, and audits timeliness and grounds for purchasing. The market is being monitored with a view to better demand planning.

Operating risks, related to information technologies used by the Company, may be caused by disruptions in server and network operations, information systems and data transmission channels. To minimize the risks we focus on planned preventive repairs, creation of reserved channels, update of computer power, network and technological equipment.

LEGAL RISKS

Legal risks are generic for IDGC of Urals and any other company operating in Russia. Primarily, legal risks are caused by the specificity of the current legislation, its changes, equivocating interpretation of regulatory documents, contradictory court sentences on similar cases. Legal risks, related to equivocating interpretation of legislation on taxes and levies, possible changes in procedure, rates, terms of tax charge and payment, changes in legislation on joint-stock companies as well as corporate governance, are not significant for us. Permanent monitoring of changes in legislation and court practice enables us to plan our financial and economic operations with regard to changes. Accounting and legal departments work together over the methodology of tax base calculation and control their compliance with the current legislation. There is also a legal expertise of corporate procedures, operations and transactions of the Company.



Construction of a power line Tavda-Uray (1970.)