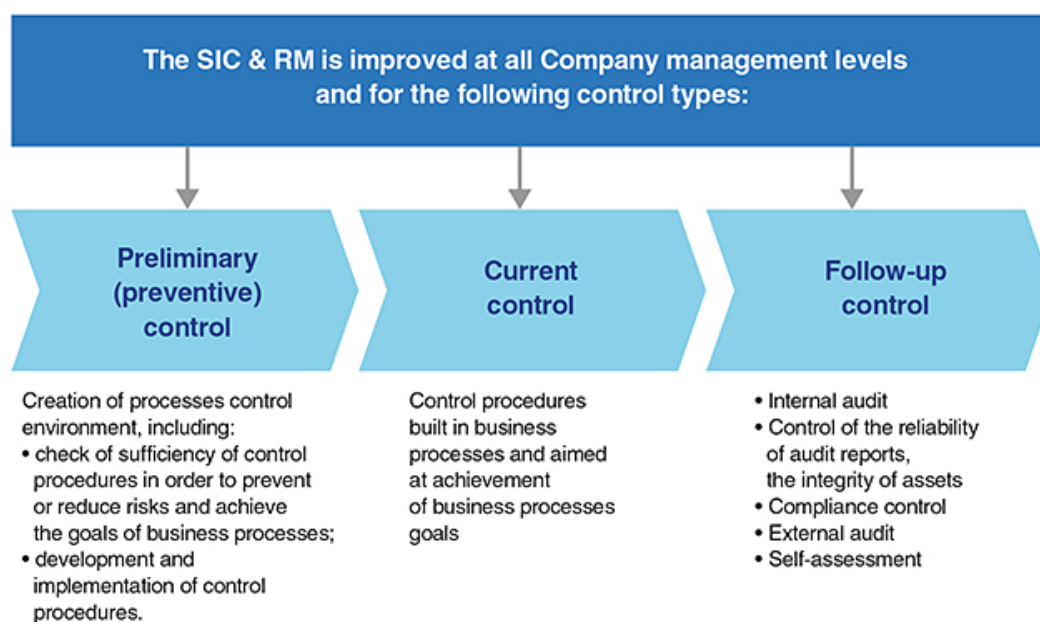


Internal Control and Internal Audit

System of Internal Control

Company System of Internal Control (the “SIC”) is an element of integrated Company governance system. SIC covers all areas of Company activities; control procedures are implemented continuously in all Company processes (areas of activity), at all management levels in order to ensure reasonable guarantees as to the achievement of goals in the following areas:

- efficiency and effectiveness of activity arrangement;
- compliance with the applicable laws, as well as with the requirements of the Company local regulations;
- prevention of misconduct of Company employees and third parties with respect to the Company assets;
- ensuring reliability and timeliness of accounting (financial) and other types of statements.



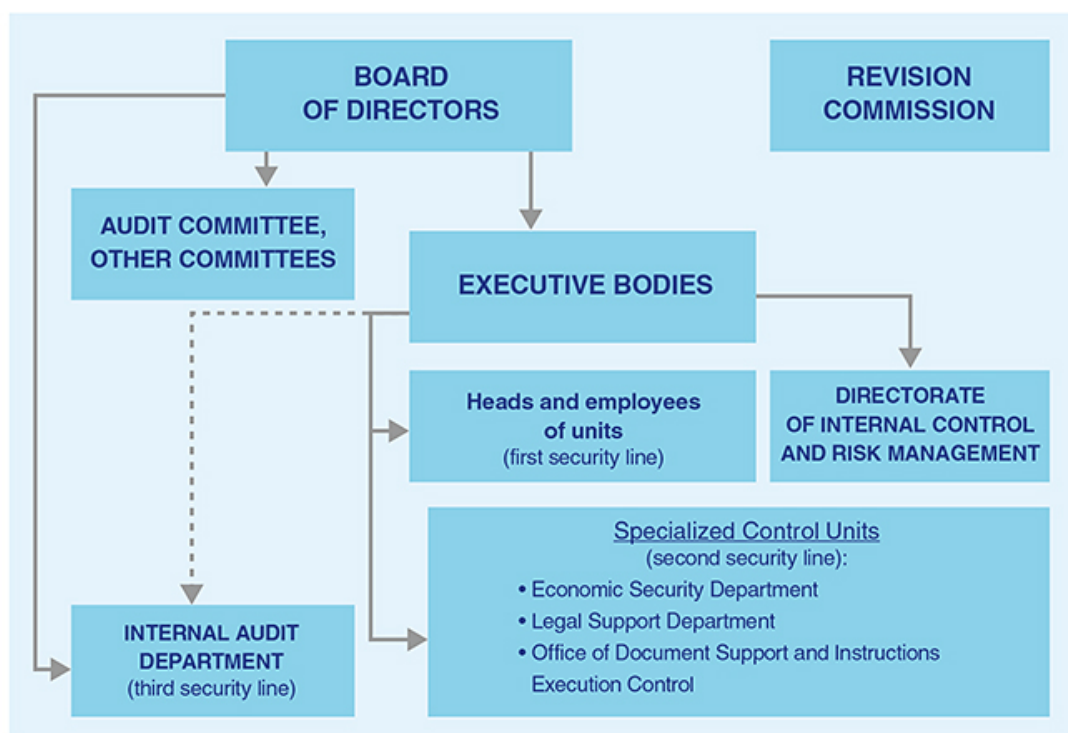
For the implementation of SIC Development and Improvement Strategy of PJSC ROSSETI and its S&A approved by the Decision of the Board of Directors of PJSC ROSSETI of 2/10/2014 (Minutes No. 143), Internal Control Policy of Kubanenergo PJSC approved by the amended Decision of the Board of Directors (Minutes No. 233-2016 of 3/18/2016) was in force in the Company in 2016. The Internal Control Policy determines objectives, principles of functioning and the Company SIC elements, main functions and responsibility of SIC participants, procedure for assessment of SIC efficiency.

Company SIC issues are also regulated by the following documents:

Item No.	Name of the document	Company Management Body that approved the document (latest revision)	Details of the Company management body decision by which the document was approved
1.	Company Articles of Association;	General Meeting of Shareholders	Minutes No. 36 of 6/11/2015
	Regulation on the Audit Committee of the Board of Directors	Board of Directors	Minutes No. 233/2016 of 3/18/2016, No. 253/2016 of 10/28/2016
	Procedure for Evaluation of Efficiency of the System of Internal Control and the System of Risk Management of ROSSETI Group of Companies	Director General	Order No. 6 of 1/12/2016
	Distribution of duties between the Deputy Director General and other managers subordinated to the Director General	Director General	Order No. 146 of 2/25/2015
	Procedure for functioning of the System of Internal Control over the intended, efficient and timely use of funds, raised through additional issue of shares of Kubanenergo PJSC for implementation of Kubanenergo PJSC Development Plan	Director General	Order No. 1185 of 12/30/2016
	Plan of measures on the Development and Improvement of the Systems of Internal Control and Risk Management of Kubanenergo PJSC for 2016–2018;	Board of Directors, Director General	Minutes No. 256/2016 of 12/2/2016, Order No. 1122 of 12/19/2016
	Regulation on Procedure for Implementation of Requirements of the Company Internal Control Policy	Director General	Order No. 45 of 1/27/2017

Moreover, to improve the Company management system aimed at the efficient and appropriate allocation of the Company resources with simultaneous implementation of elements of strategic management, advanced management technologies and methodological tools, IT technologies, the set of measures on development and improvement of the Company management system was developed and approved (Order No. 1114 of 12/16/2016).

Members of the Internal Control System



Powers and Responsibilities of Main SIC Members

Name of member	Main functions in the field of SIC
Revision Commission	<ul style="list-style-type: none"> controls the Company financial and economic activities following the results of which it prepares proposals/recommendations to improve the SIC; performs independent assessment of reliability of the information included in the Company annual report and annual accounting statements.
Board of Directors	<ul style="list-style-type: none"> specifies principles and approaches to arrangement of Company SIC, including approval of the Company internal documents that stipulate organization and strategy for the SIC development and improvement, approves the Company Internal Control Policy; implements control over the work of the Company executive bodies in main (priority) business areas; considers the report of the Management Board on arrangement and functioning of the SIC; considers reports of the internal auditor on the SIC efficiency every year; considers the results of external independent assessment of the SIC efficiency.
Audit Committee of the Board of Directors	<ul style="list-style-type: none"> implements a preliminary review prior to approval of internal documents by the Board of Directors, defining arrangement and strategy for development and improvement of the SIC, Internal Control Policy and further amendments to them; implements a preliminary review prior to the Board of Director's approval of the results of the assessment of SIC efficiency according to the information of reports of the internal auditor on the SIC efficiency, as well as information on the results of the external independent assessment of the SIC efficiency, elaborates proposals/recommendations on improvement of the SIC; implements supervision of the SIC in terms of considering issues related to the control over reliability of Company accounting (financial) statements, selection of external auditor and carrying out external audits, compliance with the regulatory and legal requirements, in part of considering reports of the Management Board on arrangement and functioning of the SIC, as well as in terms of considering issues related to the analysis and assessment of the Internal Control Policy observance.
Other Committees of the Board of Directors	<ul style="list-style-type: none"> exercise supervision of performance of the established financial and operational indices, observance of the applicable laws, rules and procedures established by the local regulations, as well as reliability and timely manner of statements prepared by the Company (within their competences established by the Board of Directors).
Director General, Management Board	<ul style="list-style-type: none"> ensure creation and efficient functioning of SIC; have responsible for implementation of decisions of the Board of Directors related to the SIC
Company Management Board	<ul style="list-style-type: none"> sets trends and plans of SIC development and improvement; prepares reports on the Company financial and economic activities, on arrangement and functioning of the Company SIC; considers results of the external independent assessment of the SIC efficiency, specifies measures on development and improvement of the SIC.
Director General	<ul style="list-style-type: none"> approves regulatory and methodological documents of the Company related to arrangement and functioning of the SIC, excluding documents the approval of which is attributed to exclusive competence of the Company Board of Directors; ensures implementation of plans of the Company activities required to achieve the set objectives; arranges maintenance of accounting records and management accounting records, prepares accounting (financial) and other statements; submits reports on the Company financial and economic activities and on the arrangement and functioning of the Company System of Internal Control to the Board of Directors for approval.
Heads of Units And Divisions	<ul style="list-style-type: none"> exercise functions on elaboration, documenting, implementation, monitoring and development of the System of Internal Control in the Company functional areas of activity, responsibility for arrangement and coordination / implementation of which is allocated to them by the Company regulatory documents / Regulations on Divisions, including: ensure implementation of the internal control principles; arrange creation of efficient processes (areas of activities), including their development and implementation regard to identified risks of new or amended current control procedures; ensure regulation of supervised processes (areas of activity); arrange implementation of control procedures;

Name of member	Main functions in the field of SIC
	<ul style="list-style-type: none"> • carry out assessment (monitoring) of implementation of the control procedures; • carry out assessment of the supervised processes (areas of activities) for required optimization in order to improve efficiency and compliance with variable external and internal environment conditions, arrange development of proposals on the control procedures improvement; • ensure elimination of identified failures in control procedures and processes (areas of activities)
Collective Working Bodies Established by the Company Executive Bodies for Execution of Specific Functions (Commissions, Working groups, etc.)	<ul style="list-style-type: none"> • implementation of control procedures and/or development of recommendations on improvement of control procedures, certain components (elements) of internal control and SIC;
Employees of Company Divisions Performing Control Procedures as Part of Their Official Duties	<ul style="list-style-type: none"> • implement control procedures; • ensure timely notification of direct supervisors if the performance of control procedures is rendered impossible for some reason and/or requires changes in the design of control procedures due to the changes in internal and/or external conditions of functioning of the Company. • submit to direct supervisors proposals on implementation of control procedures in the respective areas of activities for consideration.
Specialized Control Units: - Economic Security Department - Office of Document Support and Instructions Execution Control - Legal Support Department	<ul style="list-style-type: none"> • counteracts to the facts of unfair competition; • carries out investigations on the facts (prerequisites) of causing damage to interests of economic security of the Company; • organizes protection from theft of electric power, financial and real assets, intellectual property, prevention of other crimes against the Company property; • participates in joint checks of financial and economic activity of Company divisions for the purpose of preparation of own opinion on the facts of violations and formation of evidential base in the interests of the Company; • ensures the unified record keeping system in the Company branches and executive office; • organizes control of document execution; • organizes control of document execution with regard to activities of Deputy Director General. • carries out control of observance of legislation by the Company by way of legal review and coordination in accordance with the procedure stipulated by Company regulatory and administrative documents, as well as approval of draft contracts and agreements, draft regulatory and administrative documents, draft powers of attorney for representation of Company interests before third parties, draft applications, letters, requests, claims submitted on behalf of the Company to the legislative and executive authorities, legal authorities, law enforcement agencies; • controls and reports to the Company management of all adopted laws and regulations of the Russian Federation that influence significantly Company activities mitigating risks of failure to comply with the legislation and meet Company interests.
Directorate of Internal Control and Risk Management	<ul style="list-style-type: none"> • develops and ensures implementation of basic and methodological documents related to creation and improvement of SIC; • assists the management in development of control environment, elaboration of recommendations on description and implementation of control procedures in the processes (areas of activities) and assignment of responsibility to the officers; • coordinates activities for maintenance and monitoring of the SIC target status; • prepares information about the SIC status for interested parties; • cooperates with the state regulatory authorities on issues related to the internal control.
Internal Audit Department	<ul style="list-style-type: none"> • following the results of internal audit, develops recommendations on improvement of control procedures, certain components (elements) of the internal control and the SIC; • carries out internal independent assessment of the SIC efficiency and provides recommendations on increase of the SIC efficiency and performance.

To ensure efficiency of the SIC and compliance with the objectively changing requirements and conditions, the Company performs assessment of the SIC efficiency in relation to its compliance with the target status and maturity level.

The Internal Control System Development and Improvement Strategy of PJSC ROSSETI and its S&A approved by the Decision of the Board of Directors of PJSC ROSSETI of 2/10/2014 (Minutes No. 143) (hereinafter referred to as the “SIC Development Strategy”) determines 6 levels of the SIC maturity (from 1 (“zero”) to 6 (“high”).

In the reporting year, the Company implemented the following key measures aimed at the SIC improvement:

- Regulation on the Audit Committee of the Board of Directors of Kubanenergo PJSC was approved as amended;

- amendments were introduced to the Regulation on Strategy, Investments and Restructuring Committee of the Board of Directors of Kubanenergo PJSC;

- the Board of Directors approved and amended Company Internal Control Policy, Risk Management Policy and Internal Audit Policy;

- for splitting current and preventive control and the subsequent control functions, the Company Board of Directors approved a new Company organizational structure introducing the position of Deputy Director General for Controlling and newly created Directorate of the Internal Control and Risk Management, Internal Audit Department and Controlling Department;

- for the purpose of implementation of the current control the documents securing the SIC functioning (see to the table above for the documents regulating SIC) were approved (put in force) and executed;

- self-training of employees of specialized services on the subject “System of Internal Control. Process Control Updates” was organized;

- within a certain period of 2016, 33 activities were carried out and a Report on Implementation of the Plan of Activities on Development and Improvement of Internal Control and Risk Management Systems of Kubanenergo PJSC for 2016–2018 was considered by the Management Body;

- amendments were introduced to the regulations on Company divisions and in job descriptions of the officers of the Company Executive Bodies in part related to the addition of competences in the area of functioning of the System of Internal Control;

- employees of the Internal Audit Department and Directorate of the Internal Control and Risk Management were additionally trained in the area of Internal Control and Internal Audit.

Implementation of the specified measures made it possible to increase the SIC maturity level from the intermediate between “satisfactory” and “moderate” to “moderate”.

Internal independent assessment of the SIC and Risk Management System efficiency for 2016 was carried out by the Company Internal Auditor: According to the Audit Committee of the Company Board of Directors the SIC and SRM maturity level in 2016 corresponds to level 4 (“moderate”) (Minutes No. 51/2017 of 3/20/2017; the Board of Directors considered the issue of the SIC efficiency in 2016 (Minutes No. 271/2017 of 4/28/2017). No external independent assessment was carried out.

Implementation of the following measures on the SIC improvement is scheduled for 2017:

- implementation of the control matrices in Company business processes;
- development of the SIC for accounting and tax records maintenance and for preparation of statements, including the statements made in accordance with international standards;

- implementation of the Company integrated safety policy;
- development of a regulatory document on the functioning of the “second line of defense”, development of “horizontal” and “vertical” interaction patterns of divisions of the “second line of defense”;

- development of the SIC and SRM participants interaction pattern and its implementation in the Company;
- Development of interaction pattern for the Directorate of Internal Control and Risk Management, Controlling Department, Internal Audit Department in the Controlling Unit, and its approval by the Company regulatory and administrative document;
- Implementation of the set of activities on improvement of Kubanenergo PJSC management system (in accordance with Order No. 1114 of 12/16/2016).

Internal Audit

Objective of the internal audit is to assist the Board of Directors and the Executive Bodies of the Company in enhancing the Company management efficiency, improving its financial and economics activities, specifically through systems and sequential approach to the analysis and assessment of the Systems of Risk Management, Internal Control and Corporate Governance, as tools to provide reasonable assurance of achievement of the Company objectives.

The division responsible for implementation of internal audit function in the Company is the Internal Audit Department.

Internal audit is functionally accountable to the Company Board of Directors, which means that the Board of Directors shall implement control and organization of internal audit division activity, including:

- approval of the Plan and Report on its implementation;
- approval of the budget;
- Approval of the Decisions on appointment, dismissal of the head of internal audit division, and definition of his/her remuneration.

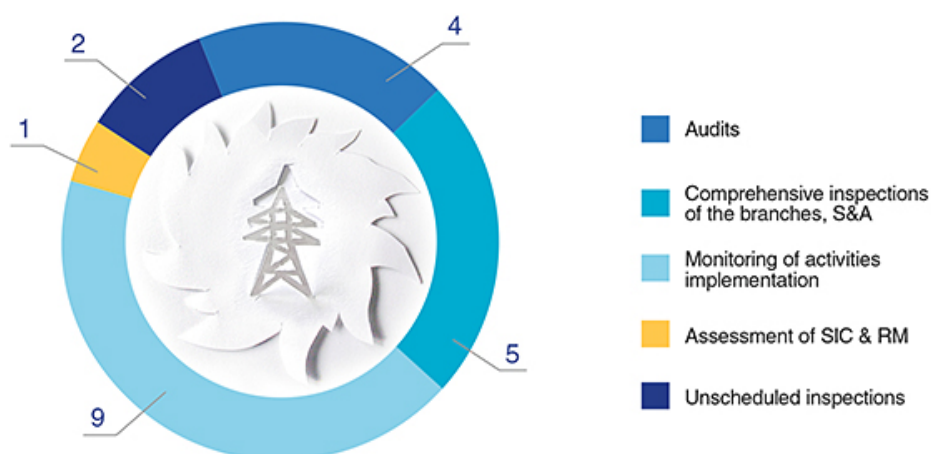
The goals and objectives, functions, basic principles of arrangement and functioning, powers of internal audit are stated in the Internal Audit Policy of Kubanenergo PJSC approved as amended by the Decision of the Board of Directors (Minutes No. 233/2016 of 3/17/2016).

Internal documents of the Company, regulating Internal Audit functions:

Name of the Document	Company Management Body that approved the document (latest revision)	Details of the Company management body decision, by which the document was approved
Guidelines on Internal Auditing and Glossary of Internal Audit	Director General	Order No. 56 of 1/27/2016
Guidelines on Monitoring of Implementation of Plans of Corrective Actions for Elimination of Violations and Faults Detected during Internal Audits	Director General	Order No. 651 of 7/27/2016
Regulation on Internal Audit Department	Board of Directors	Minutes No. 251/2016 of 9/23/2016
Program of Internal Audit Quality Assurance and Improvement	Board of Directors	Minutes No. 257/2016 of 12/6/2016
Regulations on Cooperation of the Internal Audit and Control Department with other Company Divisions during Audits and Monitoring of Implementation of the Plans of Corrective Actions	Director General	Order No. 346 of 4/26/2016
Regulations on Organizing Activities of the Internal Audit and Control Department	Director General	Order No. 511 of 6/23/2015
Instruction on Development and Use of the Unified Classifier of Violations and Faults	Director General	Order No. 600 of 7/20/2015
Unified List of Network Reports	Director General	Order No. 89 of 5/25/2016
Procedure for Evaluation of Efficiency of the System of Internal Control and the System of Risk Management of ROSSETI Group of Companies	Director General	Order No. 6 of 1/12/2016

In 2016, the number of Company employees carrying out internal audit function amounted to 5 persons.

In 2016, the internal auditor carried out 21 control activities, including:



Following the results of the control activities carried out by internal audit in 2016, 115 corrective actions aimed at elimination and further prevention of identified violations and deficiencies are to be implemented.

All 82 corrective actions with the term of implementation maturing in the reporting year, were executed.

Corrective Actions implemented in 2016:



Implementation of the corrective actions is controlled by the Audit Committee of the Board of Directors by hearing of the regular quarterly reports of the Company management on implementation of corrective action plans for elimination of deficiencies detected by the Company Revision Commission, the internal auditor, and external control bodies.