



APPROVED

by the Decision of the Board of Directors of
Mechel Open Joint-Stock Company

Minutes No. _____ dated _____

Chairman of the Board of Directors

_____ / _____ /

Annex
on internal control
over financial and economic activities
of Mechel OAO

Moscow, 2013

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1. General Regulations

- 1.1. These Regulations are made on the basis of the existing statutory and internal regulatory and administrative documents of Mechel OAO taking the law of the Russian Federation "On accounting" and other regulations and acts of supervisory bodies into account.
- 1.2. These regulations determine the tasks, objectives and procedures for internal control over financial and economic activities of Mechel OAO and its purpose is to provide information on the procedure for organization of internal control to all interested persons.

2. Abbreviations and definitions

- 2.1. **Company** is Mechel Open Joint-Stock Company.
- 2.2. **Regulations** are the regulations on internal control over financial and economic activities.
- 2.3. **SVK** is a system of internal control of the Company.
- 2.4. **ICAD** is the Internal Control and Audit Division of the Company. The ICAD consists of the following subdivisions:
 - 2.4.1. **DVA** is the Internal Audit Department of the Company.
 - 2.4.2. **DVK** is the Internal Control Department of the Company.
- 2.5. **General Director** is the sole executive body of the Company.
- 2.6. **Audit Committee** is the Committee of the Board of Directors for audit.
- 2.7. **Internal Control Object** is financial and economic activities of Society.
- 2.8. **Internal Control Entities** are the Board of Directors, Audit Committee, Auditing Commission of the Company, General Director, ICAD, structural units of the Company that ensure internal control.
- 2.9. **Internal Control** is a continuous integrated process carried out at all levels of the Company in order to provide reasonable confidence that the following objectives shall be achieved:
 - efficiency and effectiveness of financial and economic activities, asset management, liability management and risk management;
 - accuracy, completeness, objectivity and timeliness of preparation and submission of financial, accounting, statistical and other reports;
 - compliance with the requirements of the existing legislation of the Russian Federation, internal documents and other applicable regulatory requirements.
- 2.10. **Internal Control System** is a set of organizational measures, internal control methods and procedures used by the management of the Company as a means:
 - to conduct of financial and economic activities in an ordered and effective manner;
 - to ensure the safekeeping of assets;
 - to detect, correct and prevent errors and misrepresentation of information;
 - to prepare reliable financial (accounting) statements in a timely manner.
- 2.11. **Internal Control Procedures** is a set of measures implemented by the internal control entities designed to evaluate whether the Company achieves its objectives in the course of financial and economic activities effectively.
- 2.12. **Risk** is the probability of adverse events that can be assessed in terms of quantity and quality.
- 2.13. **Conflict of Interest** is any relationship that actually is or may be perceived as not complying with the interests of the Company and may impair the person's ability to perform its duties objectively.
- 2.14. **GAAP** are the generally accepted accounting principles.

3. Tasks and objectives of the internal control

- 3.1. The main purpose of internal control is to obtain reasonable confidence that the Company shall achieve its goals in the most efficient way.
- 3.2. The internal control is designed:

- to provide assistance to the management of the Company as relates to the effective fulfillment of administrative functions, preventing and resolving conflicts of interest;
- to ensure analysis of risks that may have a significant negative impact on the achievement of the objectives of the Company relating to its financial and economic activities, measures to mitigate these risks taken in a timely manner;
- to identify and mobilize internal business capacity and reserves to obtain profit;
- to ensure investor confidence in the Company and its managerial bodies, protection of the shareholders' investments and assets of the Company;
- to create conditions for preparation and submission of reliable financial, accounting, statistical, administrative and other reports for internal and external users in a timely manner, to ensure its completeness, reliability and accuracy;
- to comply with regulations of the Russian Federation, decisions of the managerial bodies and internal documents of the Company;
- to ensure safety of assets, effective use of resources and the potential of the Company.

4. Principles of the internal control system functioning

4.1. The Company's internal control is organized with regard to the following principles:

- participation of each employee. The internal control process involves the staff of all subdivisions of the Company;
- comprehensive nature of functioning. The internal control covers all activities and processes of the Company. Procedures and means of the internal control are governed by internal regulations and administrative documents of the Company;
- continuity. Implementation of the Company's internal control is carried out on an ongoing basis.

5. Procedures and methods of the internal control

5.1. Procedures of the internal control of the Company shall include:

- independent assessment and analysis of the financial status of the Company;
- control of generation and performance of the audit plan approved by the Board of Directors;
- detection of violations by means of audits, monitoring and analysis of the results of audits carried out in the structural subdivisions;
- prevention of violations by informing the relevant structures of the Company on identified significant violations and shortcomings;
- control over elimination of the identified shortcomings;
- identification and analysis of risks relating to the financial and economic activities of the Company;
- monitoring and development of measures to minimize the risks relating to the financial and economic activities;
- arrangement for collection, processing and transfer of operating, financial and other information, including reports containing operating, financial and other information on the Company as well as establishment of effective channels and means of communication, providing vertical and horizontal communication within the Company;
- informing the members of the Company on their duties in the area of the internal control;
- proper documenting of the internal control procedures;
- regular assessments of the quality of the internal control system;
- assessment of compliance of actions of the officers of the Company with the accepted standards of corporate and business ethics, strategic goals of the Company, interests of the shareholders;
- other procedures necessary to achieve the objectives of the internal control.

5.2. When performing internal control procedures the methods of inspection, survey, analysis, supervision, monitoring, auditing, and other methods required to implement internal control procedures shall be applied.

6. Internal control entities

The internal control entities in accordance with these Regulations shall include:

- 6.1. **Board of Directors** that determines the general trends in arrangement of SIC in the Company and assesses the effectiveness of the internal control procedures regarding the nature, scope and conditions of the activities of the Company.
- 6.2. **Audit Committee** that assesses compliance with the internal control principles, risk management principles and overall efficiency of the SIC in the Company (particularly, on the basis of reports and ICAD records), provides recommendations for improvement of SIC.
- 6.3. **General Director** that introduces SIC procedures and ensures its efficient functioning, by informing the Board of Directors in a timely manner on all significant risks of the Company, significant SIC shortcomings, and on plans and results of the activities for their elimination.
- 6.4. **Auditing Commission** that exercises control over financial and economic activities of the Company and its separate subdivisions.
- 6.5. **Managers and employees of structural subdivisions** of the Company responsible for the creation, maintenance and continuous monitoring of SIC regarding the relevant functional areas of activities throughout the entire chain of command as well as implementation of control procedures depending on the official duties assigned to the same.
- 6.6. **ICAD** that carries out an independent evaluation of the effectiveness of individual components of SIC, SIC over the audited entities and SIC over the Company as a whole and develops recommendations to improve its reliability and efficiency.

7. The internal control procedures in the course of financial and economic activities

- 7.1. To ensure systematic control over financial and economic activities of the Company the internal control procedures shall be carried out by ICAD in cooperation with other bodies and subdivisions of the Company.
- 7.2. The purpose of the ICAD activities is to provide to the Audit Committee, Board of Directors and management of the Company reasonable and well-grounded safeguards that SIC and the risk management system of the Company is duly formed and functions effectively.
- 7.3. In its activities the ICAD shall be guided by the following documents:
 - the Charter of the Company;
 - these Regulations;
 - the Regulations on the Board of Directors of the Company;
 - the Regulations on the Audit Committee of the Board of Directors;
 - the Regulations on the Auditing Commission of the Company;
 - the Regulations on the sole executive body (General Director) of the Company;
 - the Regulations on the directorate for internal control and audit of the Company.
 - the Rules for internal audit of the Company;
 - the Rules for the internal certification of SIC in the Company in accordance with the requirements of Section 404 of the Sarbanes-Oxley Act.
- 7.4. The ICAD shall be functionally subordinated to the Audit Committee and administratively subordinated to the General Director.
- 7.5. The ICAD Manager shall be accountable to the Audit Committee and the management of the Company for the arrangement of the ICAD work and completion of its tasks.
- 7.6. The ICAD Manager shall regularly report to the Audit Committee and management of the Company on the achievements of the ICAD, providing information on significant risks, SIC shortcomings and corporate governance as well as other information necessary to the Audit Committee and the management of the Company to carry out their responsibilities.
- 7.7. The ICAD Manager shall:
 - provide the annual program of the ICAD activities to the Audit Committee and the management of the Company for agreement upon and approval, and shall also regularly provide information on its implementation;

- provide information on significant risks, SIC shortcomings and corporate governance to the Audit Committee and management of the Company in a timely manner, as well as recommendations for their improvement;
 - inform the Audit Committee and the management of the Company on the results and quality of the corrective measures developed by the management (or responsible employees) of the audited entities based on the results of conducted internal audits;
 - inform the Audit Committee and the management of the Company on detected violations, significant constraints that prevents ICAD from effective fulfillment of its tasks;
 - initiate attraction of third-party experts on a contractual basis to perform the inspections if necessary.
- 7.8. The ICAD manager and staff shall have the following rights upon instruction of the manager:
- to plan activities, identify objects and volumes of audit, to decide on the frequency of internal audits;
 - to collect information needed to assess the effectiveness of the internal control system, risk management and corporate governance, particularly, by visiting and inspecting structural subdivisions of the company;
 - to request and receive unrestricted access to all records, documents, accounting records and other information on the activities of the Company, to make copies of documents within the framework of and relating to the internal audit;
 - to examine and evaluate any documents and information that are requested in the course of internal audits and send these documents and/or the relevant information to the Audit Committee and the management of the Company;
 - to obtain the necessary assistance of personnel of the subdivisions subject to internal audits as well as the assistance provided by the staff of other subdivisions of the Company;
 - to inform the Audit Committee and the management of the Company on any proposals to improve the existing systems, processes, policies, procedures, methods of operation;
- 7.9. A shareholder (member), official or other employee of a legal entity that competes with the Company cannot be the ICAD Manager, its deputy manager or employee of the ICAD.
- 7.10. The employees of the ICAD shall be impartial as relates to their work and shall avoid conflicts of interest of any kind.
- 7.11. The organizational structure of the ICAD comprises the Internal Audit Department and Internal Control Department.
- 7.12. In the course of internal control procedures DVA shall take the following measures:
- risk-based audits and other audits to evaluate the effectiveness of SIC business processes and compliance with regulations and administrative documents accepted by the Company and its affiliated and dependent companies, existing legislation, regulatory requirements, best world practices, decisions of the management of the Company, strategic goals of Company, interests of shareholders, including detection of features (signs) of corruption and evaluation of the effectiveness of SIC in the area of fraud prevention;
 - consulting and provision of recommendations to the management of the Company in relation to the corporate governance, improvement of SIC and risk management system efficiency;
 - assisting the management of the Company in development of measures (agreed actions of the management) to improve the SIC efficiency and eliminate violations detected in the course audits and other control measures. Further control over agreed management actions based on the results of audits and other control activities;
 - coordination and methodological support of the activities of the regional divisions of the ICAD relating to the internal audit and control in the following areas:
 - ✓ development of local regulations that govern the activities of the ICAD and its structural subdivisions;
 - ✓ development and updating of instructions, regulations, methodological recommendations for the performance of an audit, individual audit procedures and other controls, templates of reports, working papers and other documents used by the ICAD in its operations;

- ✓ preparation of information material summarizing the most risky activities of the Company, typical SIC shortcomings and recommendations for their elimination, including the best practices.
- 7.13. DVA shall ensure planned projects relating to business processes audit in compliance with the following procedure:
- shall carry out preparation of audits in accordance with the annual ICAD action plans approved by the Audit Committee;
 - shall verify and document the results of audits;
 - shall issue an audit report following the audit and communicate the results to the management of the Company;
 - shall produce and coordinate the plan for elimination of the detected violations, shortcomings and improvement of SIC business processes;
 - shall monitor the implementation of action plan and measures to eliminate violations and shortcomings identified as a result of audits.
- 7.14. In the course of internal control procedures DVK shall take the following measures:
- promotion of the objectives of the Community relating to creation and improvement of the internal control system in accordance with the requirements of the Sarbanes-Oxley Act;
 - identification and analysis of risks of misinterpretation of financial statements that may occur at any business process level, significant influence on financial statements of the Company and its subsidiaries and affiliates in a timely manner;
 - development, improvement and evaluation of effectiveness of control procedures to cover risks of misinterpretation of the financial statements of the Company and its subsidiaries and affiliates;
 - evaluation of the effectiveness of compliance by the Company with policies, procedures, regulations and legislation relating to SIC applicable to the Company;
 - development of recommendations for the managers of structural subdivisions of the Company as regards to the effectiveness of SIC;
 - provision to the Board of Directors, management of the Company on demand reports on the status of accounting systems and the SIC in areas essential for the US GAAP reporting;
 - analysis and evaluation of the effectiveness of the procedures established by the management of the Company to eliminate the existing shortcomings in the accounting system and SIC;
 - preparation of detailed recommendations to eliminate the existing shortcomings in the accounting system and SIC in areas essential for the US GAAP reporting;
 - assessment of the potential risks of financial reporting and preparation of recommendations to respond to these risks;
 - coordination and methodological support of the activities of the regional subdivisions of the ICAD for the internal control relating to testing of control procedures, classification and evaluation of shortcomings identified in the internal certification of SIC.
- 7.15. DVK shall control reliability and annual internal certification of SIC over the preparation of financial statements of the Company, including:
- annual planning of the internal certification of SIC over the preparation of financial statements of the Company;
 - methodological support and testing of design and operating efficiency of the enterprise-level controls and general computer controls;
 - methodological support and testing of design and operating efficiency of the business process and economic controls;
 - methodological support and actualization of SIC over the preparation of the financial statements of the Company;
 - methodological support and evaluation of the detected shortages of SIC over the preparation of the financial statements of the Company;
 - generation of a consolidated report on the detected shortcomings of SIC over the preparation of the financial statements of the Company;
 - creation of a performance report regarding SIC over the preparation of the financial statements of the Company;

- methodological support relating to the development of measures for elimination of the detected shortcomings of SIC over the preparation of the financial statements of the Company;
- monitoring over implementation of measures for elimination of the detected shortages of SIC over the preparation of the financial statements of the Company;
- planning of assessment of accounting systems and the SIC effectiveness in the areas essential for the US GAAP reporting;
- assessment of accounting systems and effectiveness of SIC in areas essential for the US GAAP reporting;
- methodological support relating to the development of measures (agreed actions of the management) to improve the SIC efficiency and eliminate violations detected in the course of audits and other control measures;
- further control over agreed management actions based on the results of audits and other control activities.

8. Final provisions

- 8.1. In case of amendment of legal acts, regulatory requirements and regulations that govern the functioning of the Company's internal control system, changes in and amendments to the present Regulations may be approved only by properly made decisions of the Board of Directors. The Board of Directors may also decide to adopt a new version of these Regulations.
- 8.2. Amendments to the present regulations may be made upon the proposal of the members of the Board of Directors, Audit Commission, General Director and ICAD Manager.
- 8.3. If as a result of changes in the laws of the Russian Federation certain articles of these Regulations contradict to the above, these articles become invalid and prior to the amendment of the Regulations the Company shall be guided by the relevant legal acts and regulations of the Russian Federation.
- 8.4. All other regulatory documents of the Company directly or indirectly affecting the internal control issues shall not contradict to these Regulations.