

**The Committee on the
Extractive Industries
Transparency Initiative of
the Republic of Azerbaijan**

Independent Accountants' Report

For the year ended 31 December 2004

THE COMMITTEE ON THE EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE OF THE REPUBLIC OF AZERBAIJAN

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INDEPENDENT ACCOUNTANTS' REPORT

To the Committee on the Extractive Industries Transparency Initiative (“EITI”) of the Republic of Azerbaijan:

We have examined the accompanying Assertion of the Committee of the EITI of the Republic of Azerbaijan (the “Committee”) shown in Appendix 1, that the schedule of payments/allocations received during the year ended 31 December 2004 by the government of the Republic of Azerbaijan (the “Government”) from the extractive industry companies (the “Companies”) is prepared in accordance with the Memorandum of Understanding dated 24 November 2004 signed between the National Committee on EITI, the local and foreign companies operating in the Extractive Industries of Republic of Azerbaijan, specified in Appendix 2, and the non-governmental organizations specified in Appendix 3 (the “MOU”). The Committee on the EITI of the Republic of Azerbaijan is responsible for the assertion. Our responsibility is to express an opinion on the assertion based on our examination.

Except as described in the next paragraph, our examination was conducted in accordance with the International Standard on Assurance Engagements and, accordingly, included examining, on a test basis, evidence supporting the assertion of the Committee on the EITI of the Republic of Azerbaijan and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

The information available to test the Assertion of the Committee was submissions by the Companies party to the MOU and the supporting details of payments/allocations received by the Government that were provided by the Committee. Our work did not extend to reviewing all payments/allocations received by the government nor all payments/allocations made by the Companies. If payments/allocations were made by the Companies but omitted from both the Companies’ and Government’s submissions, our work was insufficient to detect them.

Summary of Work Performed

To examine the Assertion of the Committee on the EITI of the Republic of Azerbaijan (Appendix 1) we have compared the schedule of payments/allocations received during the year ended 31 December 2004 by the Government (the “Government’s schedule”) and the schedules prepared by the Companies (parties to the MOU) (the “Companies’ schedule”) specified in Appendix 2. We have carried out procedures as considered necessary under the circumstances to verify the differences between the above schedules. Our findings are presented below.

The government interest in the foreign companies' extractive output (crude oil)

Government's schedule	6.7 mln barrels
Companies' schedule	6.0 mln barrels

0.7 million barrels not included in the Companies' schedule relate to the amount transferred to the Government by an extractive industry company which was not a party to the MOU. We confirmed the overall amount allocated to the government by receiving a confirmation from Azerbaijan International Operating Company ("AIOC") ("BP"), who is the operator of this oilfield, of the total amount allocated to the government.

The government interest in the foreign companies' extractive output (gas)

Government's schedule	1,050,000 thousand cubic meters
Companies' schedule	955,726 thousand cubic meters

An amount of 57,924 thousand cubic meters of gas included in the Government's schedule relates to the use of different measurement units of the volume of gas received from one extractive company which is a party to the MOU.

The Companies' schedule did not include 28,500 thousand cubic meters of gas transferred to the Government by one local extractive company which is a party to the MOU. This company omitted to report this amount as it was unaware that this was a reportable item under the terms of the MOU.

The Government's and the Companies' schedule include 13,900 thousand cubic meters of gas and 6,090 thousand cubic meters of gas respectively which relate to commercial activities which are not reportable under the MOU.

The Government's schedule includes 40 thousand cubic meters of gas which has been reconciled as a rounding difference.

Other inflows to government from the foreign extractive industry companies

Transit duties

Government's schedule	12.2 mln USD
Companies' schedule	10.6 mln USD

Transit duties relating to the Northern Route of 0.2 mln USD were not included in the Government's Schedule but reported by the Companies. We confirmed these amounts by obtaining a confirmation from AIOC on the details of transit fees. These amounts were not included in the Government's schedule because they were paid to SOCAR as part of commercial activities and are not reportable under the terms of the MOU.

A payment of 1.3 mln USD was not included in the Government Schedule as it was received in 2005 but included by the Companies in their returns. The Government did not include this amount in its return as the returns are prepared on a cash basis under the terms of the MOU and this represents a timing difference at 31 December 2004. We confirmed this amount by reference to the SWIFT documents relating to the transaction.

An amount of 3.1 mln USD relates to amount of transit fees that was paid by two Companies which are not parties to the MOU. We confirmed the overall amount allocated to the government by receiving a confirmation from AIOC.

Compensation on the non-performance of the contract terms

Government's schedule	3.8 mln USD
Companies' schedule	Nil

The difference of 3.8 mln USD relates to the amount paid by an extractive company who was not a party to the MOU. We verified this payment to the bank confirmations received from SOCAR.

The government interest in the local companies' extractive output (crude oil)

Government's schedule	Nil
Companies' schedule	1.3 mln barrels

Local companies' extractive output of 1.3 million barrels relates to incorrect reporting under the MOU by two local extractive industry companies of crude oil sold to SOCAR per local market prices. This is a commercial activity and is not reportable under the MOU.

Other inflows to government from the local companies

Profit tax

Government's schedule	333.7 bln AzM
Companies' schedule	334.9 bln AzM

The difference of 1.2 bln AzM arose due to the fact that one local company reported the profit tax on an accrual basis rather than a cash basis as required under the terms of the MOU. This company subsequently submitted a revised return prepared on a cash basis resulting in the company's reported amount agreeing to the Government's. We confirmed the initial difference by inspecting the company's records.

Dividends

Government's schedule	Nil
Companies' schedule	0.005 bln AzM

Local companies' dividends of 0.005 bln AzM relates to incorrect reporting under the MOU by one local company of dividends paid to its shareholders. The company concerned subsequently submitted a revised return which excluded this amount.

Royalties (Mining tax)

Government's schedule	1,961.2 bln AzM
Companies' schedule	1,842.5 bln AzM

0.6 bln AzM of the difference relates to reporting by one local company of royalties on an accrual basis rather than a cash basis as required under the terms of the MOU. We confirmed this by inspecting the company's records.

118.1 bln AzM of the difference represents the amount of other taxes (see also “Other taxes” category) paid by one local extractive company which in accordance with the Tax Code was reallocated by the Ministry of Taxes of the Republic of Azerbaijan as royalties.

Other taxes

Government’s schedule	820.3 bln AZM
Companies’ schedule	941.1 bln AZM

0.7 bln AzM of the difference was due to two local extractive industry companies initially reporting other taxes on an accrual basis rather than a cash basis as required under the terms of the MOU. One local extractive industry company included 2.0 bln AzM of payroll related and withholding taxes in their return and these not reportable under the terms of the MOU. We confirmed these differences by inspecting the companies’ records. These companies subsequently submitted revised returns which eliminated the differences mentioned above.

118.1 bln AzM of the difference represents the amount of other taxes (see also “Royalties” category) paid by one local extractive company which in accordance with the Tax Code was subsequently reallocated by the Ministry of Taxes of the Republic of Azerbaijan as royalties.

Opinion

In our opinion, based on our work described in this report, and except for an adjustment, if any, which may have been required if we had tested all payments/allocations made by the Companies and all payments/allocations received by the Government, the accompanying Assertion of the Committee on the EITI of the Republic of Azerbaijan, that the schedule of payments/allocations received during the year ended 31 December 2004 is prepared in accordance with the aforementioned requirements, is fairly stated in all material respects.

This report is intended for the use of the signatory parties to the MOU and should not be used by other parties or for other uses than as prescribed by the MOU.



20 July 2005

APPENDIX 1. ASSERTION OF THE COMMITTEE ON THE EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE OF THE REPUBLIC OF AZERBAIJAN

ASSERTION OF THE COMMITTEE ON THE EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE (“EITI”) OF THE REPUBLIC OF AZERBAIJAN

The schedule of payments/allocations received during the year ended 31 December 2004 by the government of the Republic of Azerbaijan (the “Government”) from the local and foreign companies operating in the Extractive Industries of the Republic of Azerbaijan, specified in Appendix 2 (collectively - the “Companies”) is prepared in accordance with the Memorandum of Understanding dated 24 November 2004 signed between the National Committee on EITI, the local and foreign companies operating in the Extractive Industries of Republic of Azerbaijan and the non-governmental organizations detailed in Appendix 3.

The Chairman of the EITI Committee

APPENDIX 2. LIST OF EXTRACTIVE INDUSTRIES COMPANIES PARTY AND NOT PARTY TO THE MEMORANDUM OF UNDERSTANDING

Companies – Parties to the MOU

BP Exploration (Caspian Sea) Limited,
State Oil Company of the Republic of Azerbaijan,
Total E&P Azerbaijan B.V,
ITOCHU Oil Exploration (Azerbaijan) Inc.,
Statoil,
Turkish Petroleum A.O.,
Commonwealth Oil and Gas,
Exxon Azerbaijan Limited,
ConocoPhillips,
Amerada Hess (ACG) Limited,
Devon Energy Caspian Corporation,
Lukoil Overseas,
Unocal Khazar,
Shengli Oil,
Salyan Oil Limited,
Karasu Operating Company,
Shell Azerbaijan Exploration and Production,
Middle East Petroleum,
Anshad Petrol JV,
Shirvan Oil JV,
Azgerneft JV

Companies – Not Parties to the MOU

Chevron Overseas Petroleum Azerbaijan Limited,
Agip,
Inpex,
Japan Azerbaijan Oil Co. Ltd (“JAOC”),
Azerbaijan International Operating Company (“AIOC”)¹

¹ AIOC is the operating company of the ACG oilfield. The partners of AIOC are BP Exploration (Caspian Sea) Limited, Exxon Azerbaijan Limited, Statoil, Inpex, SOCAR, Devon Energy Caspian Corporation, ITOCHU Oil Exploration (Azerbaijan) Inc., Amerada Hess (ACG) Limited, Turkish Petroleum A.O., Unocal Khazar.

APPENDIX 3. LIST OF NON-GOVERNMENTAL AGENCIES PARTY TO THE MEMORANDUM OF UNDERSTANDING

Community of the Young Lawyers
Economic and Political Research Center
National Group for International Human Rights
Gandja Kepez Municipality
International Ecoenergy Academy
Public Finance Monitoring Center
Citizen Initiative Center
Humanitarian Research Center
Agroeco Consulting Center
Green Movement
Economic Research Center
“Buta” Humanitarian Children Fund
Ecolecs Organization
Assistance to continuing development “Chevre” Social Community
Committee on the protection of the oilmen’s rights
Multimedia Information and Technology Center
“Expert” Economic Journal
“Knowledge” Gandja
League on the protection of the citizens’ labor rights
Gandja Children’s Fund
Azerbaijan Educational Youth Organization-Sabunchu department
Democratic Reform Society
Merchant and Reformists’ Community
“Sponsor”
Association of the “Participators of the Venchur Projects”
IHQMB
HVA Regional zone (Gandja)
Azerbaijan Fund of XXI century Human Rights
National Ecological Forecasting Center