

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

Independent Accountants' Report
For the year ended 31 December 2008

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 on 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 2008 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 (the "MOU") dated 24 November 2004 signed between the National Committee on EITI, the local and foreign Companies specified in Appendix 2, and the non-governmental organizations (the "NGO") specified in Appendix 3. 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 of the Committee based on our examination.

Except as described in the following 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 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 consisted of written 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 would be insufficient to detect them.

Summary of Work Performed

To examine the Assertion of the Committee (Appendix 1) we have compared the schedule of payments/allocations received during the year ended 31 December 2008 by the Government (the "Government's schedule") and the schedules prepared by the Companies party to the MOU (the "Companies' schedule") specified in Appendix 2. We carried out procedures as considered necessary under the circumstances to determine the reasons for the differences between the above schedules. Our findings are presented as follows:

**SUMMARY OF REPORTS BY THE GOVERNMENT AND THE EXTRACTIVE INDUSTRY COMPANIES
FOR THE YEAR ENDED 31 DECEMBER 2008**

Foreign Companies

| Description | Notes | Reported by Government | | | | Reported by foreign Companies | | | | Difference | | | |
|------------------------------------|-------|------------------------|-------------|-----------------------|-----------------------------|-------------------------------|-------------|-----------------------|-----------------------------|-------------|-------------|-----------------------|-----------------------------|
| | | Value | | Volume | | Value | | Volume | | Value | | Volume | |
| | | Million USD | Million AZN | Oil (million Barrels) | Gas (thousand cubic meters) | Million USD | Million AZN | Oil (million barrels) | Gas (thousand cubic meters) | Million USD | Million AZN | Oil (million barrels) | Gas (thousand cubic meters) |
| Monetary inflow for oil production | 1 | 47.4 | - | - | - | 35.3 | - | - | - | 12.1 | - | - | - |
| Monetary inflow for gas production | 2 | 131.2 | - | - | - | 131.2 | - | - | - | - | - | - | - |
| Crude oil | 3 | - | - | 150.2 | - | - | - | 195.6 | - | - | - | (45.4) | - |
| Gas | 4 | - | - | - | 2,129,346.0 | - | - | - | 1,984,569.5 | - | - | - | 144,776.5 |
| Bonuses | 5 | 3.5 | - | - | - | 3.3 | - | - | - | 0.2 | - | - | - |
| Transportation tariff | 6 | 0.2 | - | - | - | 0.1 | - | - | - | 0.1 | - | - | - |
| Acreage fees | 7 | 4.4 | - | - | - | 3.5 | - | - | - | 0.9 | - | - | - |
| Profit tax | 8 | 2,605.9 | - | - | - | 2,605.8 | - | - | - | 0.1 | - | - | - |

Local Companies

| Description | Notes | Reported by Government | | | | Reported by local Companies | | | | Difference | | | |
|-------------|-------|------------------------|-------------|-----------------------|-----------------------------|-----------------------------|-------------|-----------------------|-----------------------------|-------------|-------------|-----------------------|-----------------------------|
| | | Value | | Volume | | Value | | Volume | | Value | | Volume | |
| | | Million USD | Million AZN | Oil (million barrels) | Gas (thousand cubic meters) | Million USD | Million AZN | Oil (million barrels) | Gas (thousand cubic meters) | Million USD | Million AZN | Oil (million barrels) | Gas (thousand cubic meters) |
| Gas | 9 | - | - | - | 9,712.0 | - | - | - | 8,870.7 | - | - | - | 841.3 |
| Royalty | 10 | - | 146.6 | - | - | - | 146.6 | - | - | - | - | - | - |
| Profit tax | 11 | - | 261.6 | - | - | - | 261.6 | - | - | - | - | - | - |
| Other taxes | 12 | - | 437.2 | - | - | - | 437.8 | - | - | - | (0.6) | - | - |

Government's interest in the foreign Companies' extractive output

Note 1. *Monetary inflow as Government's entitlement in foreign Companies' oil production stream*

These figures below represent the Government's entitlement in the foreign Companies' oil production transferred to it as monetary funds. These foreign Companies transfer Government share either in kind or in money terms in accordance with respective Production Sharing Agreements ("PSA").

| | Million USD |
|-----------------------|---------------------------|
| Government's schedule | 47.4 |
| Companies' schedule | <u>35.3</u> |
| Difference | <u><u>12.1</u></u> |

One of the Companies did not report the profit oil payment to the Government in January 2008 giving the above difference.

We confirmed the above difference by receiving a breakdown of payments made by the Companies from State Oil Fund of the Republic of Azerbaijan ("SOFAZ") and obtaining updated confirmation from the respective Company.

Note 2. *Monetary inflow as Government's entitlement in foreign Companies' gas production stream*

These figures below represent the Government's entitlement in the foreign Companies' gas production transferred to it as monetary funds. Extractive Companies transfer Government share in monetary terms in accordance with the relevant PSA.

| | Million USD |
|-----------------------|--------------------------|
| Government's schedule | 131.2 |
| Companies' schedule | <u>131.2</u> |
| Difference | <u><u>0.0</u></u> |

Note 3. *Crude Oil*

These figures below represent the Government's oil production entitlement in the foreign Companies' oil production stream, transferred in kind.

| | Million barrels |
|-----------------------|-----------------------------|
| Government's schedule | 150.2 |
| Companies' schedule | <u>195.6</u> |
| Difference | <u><u>(45.4)</u></u> |

The difference of 45.4 million barrels shown above is the result of typing error on the confirmation provided by one of the foreign Companies.

We verified this difference by obtaining a breakdown of the amount of oil transferred to Government from the operator of Azerbaijan International Operating Company (“AIOC”) and comparing this with the direct confirmation received from the respective Company.

Note 4. Gas

The gas volumes shown below include both natural and associated gas. The associated gas is transferred free of charge as required by the PSAs and natural gas volumes shown below represent the Government’s entitlement in the foreign Companies’ production stream, transferred to the Government in kind.

| | Cubic metres (thousands) |
|-----------------------|---------------------------------|
| Government’s schedule | 2,129,346.0 |
| Companies’ schedule | <u>1,984,569.5</u> |
| Difference | <u><u>144,776.5</u></u> |

The difference amounting to 139,346.5 thousand cubic metres is the result of using different measuring units by parties involved, one of the foreign Company reported the volumes measured in Normal Cubic Meters (Nm³) at 0°C as opposed to the Government where these volumes are reported in Standard Cubic Metres (Sm³) at 20°C degrees.

The remaining difference of 5,430.0 thousand cubic metres is because of errors made in preparation of reports submitted by four of the foreign Companies. We confirmed this difference by receiving additional confirmations from all the Companies concerned.

Other inflows to Government from the foreign Companies

Note 5. Bonuses

Bonuses represent fees paid by Companies to the Government for delegation and transfer of extractive rights. This fee is paid at certain stages of oil and gas field development according to appropriate agreements with the Government.

| | Million USD |
|-----------------------|--------------------------|
| Government’s schedule | 3.5 |
| Companies’ schedule | <u>3.3</u> |
| Difference | <u><u>0.2</u></u> |

The difference of USD 0.2 million is because one of the foreign Companies made payment of bonus in the amount of USD 0.2 million in June 2008 and did not report this payment in the confirmation. We obtained the breakdown from SOFAZ of bonus payments made by the Companies and reconciled this with direct confirmation received from the Company concerned.

Note 6. Transportation tariff

Transportation tariff represents fee paid by the partners of AIOC to Government for oil transportation:

| | Million USD |
|-----------------------|--------------------------|
| Government's schedule | 0.2 |
| Companies' schedule | <u>0.1</u> |
| Difference | <u><u>0.1</u></u> |

The above difference is because an amount of USD 0.1 million is included in the Government's schedule relating to transportation tariff that was paid by the Government itself for the transportation of its own oil entitlement. We confirmed the overall amount allocated to the Government for transportation tariff by obtaining a confirmation from AIOC.

Note 7. Acreage fees

Acreage fee represents fee paid by the foreign Companies to the Government for the use of land/sea acreage during the exploration stage.

| | Million USD |
|-----------------------|--------------------------|
| Government's schedule | 4.4 |
| Companies' schedule | <u>3.5</u> |
| Difference | <u><u>0.9</u></u> |

The difference was caused as one of the foreign Companies did not provide any EITI report as it has ceased operations in Azerbaijan. We received confirmation from the Operator of the project confirming that the Operator made the payment for acreage fee on behalf this foreign Company in the amount of USD 0.9 million.

Note 8. Profit tax

Profit tax is levied on the difference between a taxpayer's income (except for the income which is exempt from tax) and expenses/deductions allowed by the Tax Code of the Republic of Azerbaijan.

| | Million USD |
|-----------------------|--------------------------|
| Government's schedule | 2,605.9 |
| Companies' schedule | <u>2,605.8</u> |
| Difference | <u><u>0.1</u></u> |

This difference arose because one foreign Company omitted to report the profit tax payment made in December 2008 in the amount of USD 0.1 million. We confirmed this difference by obtaining updated confirmation from the foreign Company.

Government's interest in the local Companies' extractive output

Note 9. Gas

The gas volumes shown below include both natural and associated gas. The associated gas is transferred free of charge as required by agreement with the Government. Natural gas volumes shown below represent the Government's entitlement in the local Companies' production stream, transferred to the Government in kind.

| | Cubic metres (thousands) |
|-----------------------|---|
| Government's schedule | 9,712.0 |
| Companies' schedule | <u>8,870.7</u> |
| Difference | <u><u>841.3</u></u> |

The difference of 841.3 thousand cubic metres is because one of the local extractive Companies omitted to report the gas volume transferred free of charge to Government during the year. We confirmed this difference by receiving additional confirmation from the Company concerned and explanation from State Oil Company of the Republic of Azerbaijan ("SOCAR").

Other inflows to Government from the local Companies

Note 10. Royalty

Royalty (mining tax) is paid by Companies for extracting minerals from subsurface strata of the earth on the territory of the Republic of Azerbaijan (including the Caspian Sea sector belonging to the Republic of Azerbaijan).

| | Million AZN |
|-----------------------|--------------------------|
| Government's schedule | 146.6 |
| Companies' schedule | <u>146.6</u> |
| Difference | <u><u>0.0</u></u> |

Note 11. Profit tax

Profit tax is levied on the difference between a taxpayer's income (except for the income which is exempt from tax) and expenses/deductions allowed by the Tax Code of the Republic of Azerbaijan.

| | Million AZN |
|-----------------------|--------------------------|
| Government's schedule | 261.6 |
| Companies' schedule | <u>261.6</u> |
| Difference | <u><u>0.0</u></u> |

Note 12. Other taxes

Other taxes consist of property, land, road fund taxes and Value Added Tax (“VAT”). Withholding, personal income tax and social protection taxes and duties should not be included while reporting other taxes for the purposes of EITI.

| | Million AZN |
|-----------------------|----------------------------|
| Government’s schedule | 437.2 |
| Companies’ schedule | <u>437.8</u> |
| Difference | <u><u>(0.6)</u></u> |

The reason for the difference of AZN 0.6 million is inclusion of withholding taxes payments to the Government in other taxes section by one of the Companies, while according to the guidelines on completion of EITI report the Companies are not required to report on withholding taxes. We confirmed this difference by obtaining an explanatory letter from the Company concerned.

Opinion

In our opinion, based on our work described in this report, except for adjustments, if any, which may have been required had we tested all payments/allocations made by the Companies and all payments/allocations received by the Government, the accompanying Assertion of the Committee, that the schedule of payments/allocations received during the year ended 31 December 2008 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 uses other than as prescribed by the MOU.

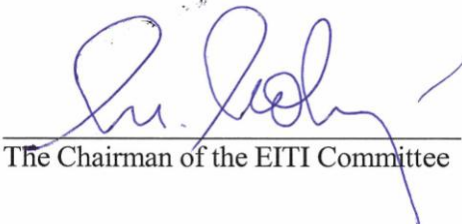
Deloitte Touche LLC

8 June 2009
Baku, the Republic of Azerbaijan

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 OF THE REPUBLIC OF AZERBAIJAN

The schedule of payments/allocations received during the year ended 31 December 2008 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 the 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

Parties to the MOU

1. BP Exploration (Caspian Sea) Limited
2. State Oil Company of the Republic of Azerbaijan
3. Total E&P Azerbaijan B.V.
4. ITOCHU Oil Exploration (Azerbaijan) Inc.
5. Statoil
6. Turkish Petroleum A.O.
7. Commonwealth Oil and Gas
8. Exxon Azerbaijan Limited
9. ConocoPhillips
10. Amerada Hess (ACG) Limited
11. Devon Energy Caspian Corporation
12. Lukoil Overseas
13. Chevron
14. Petro-HongKong-Pirsaat Oil Ltd
15. Salyan Oil
16. Karasu Operating Company
17. Shell Azerbaijan Exploration and Production
18. Middle East Petroleum
19. Anshad Petrol JV
20. Shirvan Oil JV
21. Azgerneft JV
22. Inpex
23. Binagadi Oil Operating Company
24. Rafi Oil F.Z.E.
25. Naftiran Intertrade Co. (NICO) Limited
26. Absheron Investments Ltd

Not Party to the MOU

1. 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 (Chevron Overseas Petroleum Azerbaijan Limited).

APPENDIX 3. LIST OF NON-GOVERNMENTAL ORGANISATIONS AND INDIVIDUALS PARTY TO THE MEMORANDUM OF UNDERSTANDING

NGOs

1. "Development of Society and Civic Relations" Public Union
2. Eco-Renaissance
3. Institute of Democracy and Human Rights
4. Eurasia Lawyers Association
5. "World of Carpet" Association (Guba)
6. "Azeri-Ellada" Intellectual Centre
7. Research Centre of Women's Problems
8. Centre for Caucasus International Strategic Investigations
9. Centre for Economic and Political Researches
10. Centre of Economic and Social Development
11. "Progress" Social Development Public Union
12. Centre of Support to Democratic Elections Public Union
13. Foundation for Protection of Democratic Values
14. Public Finance Monitoring Centre
15. Foundation of Scientific-and-Technical Progress and Education
16. Association of Social Economic Researches
17. International Ecoenergy Academy
18. "Progress" Social Research Centre Public Union (Imishli)
19. "Journalists in Extreme Cases" Public Union
20. Society for Democratic Reforms
21. Multimedia Information Systems and Technologies Centre
22. Institute of Political Pluralism
23. "Region Voice" newspaper
24. Humanitarian Research Society
25. Monitor of Democracy
26. Organization of Mine Victims
27. "For Healthy Life" Public Union
28. Dalga Youth Movement
29. Development of Refugee and Forced Migrant Women
30. "Wave" Ecology and Nature Protection Public Union
31. "Return to Motherland" Public Union
32. Democracy and Women's Initiatives
33. Democratic Progress and Economical Cooperation
34. Socio-Strategic Researches and Analytical Investigations
35. Centre for Development of Democracy and Legal Assistance
36. Regional Development and Human Rights Public Union
37. Institution of Complex Problems of Transportation (transport)
38. Union of Independent Consumers
39. Azerbaijan Construction Association
40. Public Union of "Progress", Ganja
41. Solidarity Among Women
42. Democratic Reformist Young People Public Union
43. Greens' movement
44. Economic Research Centre
45. "Buta" Humanitarian Children Fund
46. Regional Education
47. "Welfare" Social Researches Centre
48. Centre of Islam, Democracy and Human Rights
49. Organization "Ecolex"
50. Friends of the Earth/ Azerbaijan
51. "Umid" Humanitarian and Social Support Centre
52. Azerbaijan Young Lawyers Union

APPENDIX 3. LIST OF NON-GOVERNMENTAL ORGANISATIONS AND INDIVIDUALS PARTY TO THE MEMORANDUM OF UNDERSTANDING (Continued)

53. Centre for Development of Youth
54. "Liberator" Public Union
55. "Finance" Transparent Budget Public Union (Imishli)
56. Media Development Centre
57. Centre of Democratic Reforms
58. Centre of Economic and Social Enlightenment
59. "Echo" International Journalist Investigations Centre
60. "Civilization" Monitoring and Investigations Public Union
61. Political Cultural Centre of Azerbaijan Women
62. "Expert" Economic Journal
63. "Bilik" Ganja
64. "Support to Democratic Initiative" Public Union
65. Public Union for "Citizen Enlightenment"
66. Public Union for "Youth Enlightenment"
67. Citizens' Labour Rights Protection League
68. Democracy and Women Rights Protection Centre
69. Yevlakh district Regional Development Centre Public Union
70. "Ruzgar" Ecological Public Union
71. "Sustainable Development" Educational Centre
72. Centre for Assistance to Young Journalists Public Union
73. "Human Rights – 2003" Public Union
74. Centre for Economic and Legal Enlightenment of Journalists
75. "Women's World" Public Union
76. Ganja Children Fund
77. Fund of Constitution
78. "Care for Aged Intelligentsia" Public Union
79. Society for Democratic Reforms
80. "XXI Century Education Center" Public Union
81. Caucasus Media Investigations Centre
82. "Free Person" Organization for Human Rights Protection
83. Institute of Economical Technologies
84. Centre for Support of Democratic Initiatives
85. Committee for Oil Industry Workers Rights' Protection
86. Centre for Assistance to Democratic Elections
87. Centre for the Development of Azerbaijan Football Public Union
88. Democracy and Ecological Balance
89. Centre for Election Researches Public Union
90. Centre for Legal Assistance to Oil Industry Workers
91. Association of Traders and Producers
92. Foundation of Legal Initiatives
93. Business Research Centre, Khazar University
94. Centre of Oil Researches
95. Union of Garabagh Migrants
96. "Saniye" Humanitarian Information Analytical Agency
97. "Electronic" Elections Public Union
98. Economic Innovations Centre
99. Centre for Equal Opportunities
100. Centre of Pluralism "Inam"
101. Centre of Support to Civil Society Building (Regional NGO, Agstafa)
102. HVA Regional Branch (Ganja)
103. Azerbaijan Public Union for Healthy Evolution
104. Educational- Monitoring Centre on Socio-Economical Rights
105. Independent Research Centre "ELS"
106. Baku Aquarians Club

APPENDIX 3. LIST OF NON-GOVERNMENTAL ORGANISATIONS AND INDIVIDUALS PARTY TO THE MEMORANDUM OF UNDERSTANDING (Continued)

107. Society for Caring of Garabagh War-Disabled People
108. Eco-World Public Union
109. “Human Rights XXI century” Azerbaijan Fund
110. “Youth Club” Public Union
111. Centre of National Ecological Forecasts
112. Free Economy Centre

Individuals:

1. Arzu Soltan
2. Bakirzade Shabnem
3. Dunya Sakit
4. Aliyev Elmidar
5. Hamidova Hijran
6. Huseynli Fikret
7. Ibrahimov Zaur
8. Isayev Samir
9. Movsumov Shamil
10. Musayev Jeyhun
11. Pashayeva Sedaget
12. Safarov Afig
13. Seyidova Suheylyla
14. Khalilov Ruslan