

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

Independent Accountants' Report

For the six months ended 30 June 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 six months ended 30 June 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 six months ended 30 June 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	2.8 mln barrels
Companies' schedule	2.5 mln barrels

0.3 million barrels not included in the Companies' schedule related to the amount transferred to the Government by an extractive 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	453,521.0 thousand cubic meters
Companies' schedule	Nil

Included in 453,521 thousand cubic meters of associated gas above is 441,920 thousand cubic meters transferred to the State Oil Company of the Republic of Azerbaijan ("SOCAR") by two foreign extractive companies, one a non party to the MOU and one a party to the MOU. We obtained a confirmation of the amounts from these companies and SOCAR which verified that these companies transferred 511,573 thousand cubic meters of associated gas to SOCAR. The difference of 69,653 thousand cubic meters is explained by SOCAR as gas used for its own consumption and technical losses during the production process.

The Companies' schedule did not include the gas transferred due to the fact that this was transferred by one extractive company which was a non party to the MOU, and the extractive company which was a party to the MOU omitted to report this amount, since it was unaware that this was a reportable item to the MOU. We are informed that this amount will be included in the Companies' schedule in future reporting periods.

Other inflows to government from the extractive industry companies

Transit duties

Government's schedule	6.6 mln USD
Companies' schedule	5.2 mln USD

Transit duties of 1.4 mln USD not included in the Companies' schedule relates to the amount paid by two extractive companies who were not parties to the MOU. We confirmed these amounts by obtaining a confirmation from AIOC who is the operator of this oilfield.

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	0.1 mln barrels

Local companies' extractive output of 0.1 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.

Other inflows to government from the local companies

Other taxes

Government's schedule	449.2 bln AZM
Companies' schedule	713.5 bln AZM

The difference of 264.3 billion AZM was mainly due to errors in the reporting by two local extractive industry Companies. One company mistakenly reported the amount of taxes offset against its other receivables from the Ministry of Taxes of the Republic of Azerbaijan.

The other company included the amount of individual income tax paid in their report. According to the EITI reporting requirements the companies should not include in their reports non-cash movements and the amounts of individual income tax paid to the Ministry of Taxes of the Republic of Azerbaijan.

Opinion

Included in the volume of associated gas of 453,521 thousand cubic meters reported by the Government as received, is 441,920 thousand cubic meters of associated gas received from two foreign extractive Companies. As noted above, according to the confirmations received from the State Oil Company of the Republic of Azerbaijan ("SOCAR"), and the extractive companies themselves, the Government received 511,573 thousand cubic meters of associated gas from these two companies.

In our opinion, based on our work described in this report, except as for the effect of the matters disclosed in the preceding paragraph had the Government reported the volume of associated gas received from the above mentioned companies as 511,573 thousand cubic meters, 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 assertion of the Committee on the EITI of the Republic of Azerbaijan, that the schedule of payments/allocations received during the six months ended 30 June 2004 is prepared in accordance with the aforementioned requirements, referred to above in all material respects is fairly stated.

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 prescribed by the MOU.

Deloitte & Touche

15 March 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 six months ended 30 June 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 "MOU").


The Chairman of the EITI Committee 15.03.05

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