

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

Independent Accountants' Report
For the 6 months ended 30 June 2006

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 6 months ended 30 June 2006 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 the 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 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 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 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 on the EITI of the Republic of Azerbaijan (Appendix 1) we have compared the schedule of payments/allocations received during the 6 months ended 30 June 2006 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 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.

Government's interest in the foreign companies' extractive output***Crude oil***

Government's schedule	8.78 mln barrels
Companies' schedule	8.65 mln barrels

The Government's schedule which was initially submitted to us by the EITI Committee on 31 October 2006 did not include 1.37 million barrels of oil which AIOC transferred to the Baku-Tbilisi-Ceyhan Pipeline Company ("BTC Company") as the Government's share in the BTC pipeline linefill. The Government did not initially report this amount as the amount had not been reported to the Government by both AIOC and BTC Company. On 7 December 2006 the Baku-Tbilisi-Ceyhan Pipeline Company officially reported this amount to the EITI Committee and the EITI Committee submitted a revised consolidated Government's schedule on 11 December 2006 which included this volume of oil as part of the allocations received by the Government.

0.13 million barrels not included in the Companies' schedule relates to the amount not reported by one extractive company which is a party to the MOU. We confirmed this difference by receiving an additional confirmation from AIOC and the Baku-Tbilisi-Ceyhan Pipeline Company. This company omitted to report this amount as it was unaware that this was a reportable item under the terms of the MOU.

Gas

Government's schedule	1,408,371 thousand cubic meters
Companies' schedule	1,414,390 thousand cubic meters

The Companies' schedule included 20,245 thousand cubic meters of gas produced and incorrectly reported as delivered to the Government by one foreign extractive industry company which is a party to the MOU. The actual volume of gas delivered to the Government by this Company was 7,034 thousand cubic meters. We confirmed this difference by receiving an additional confirmation and explanation from SOCAR and the extractive company concerned.

The Government's schedule includes 5,250 thousand cubic meters of gas more than the Companies' schedule. This relates to the difference in measurement data of the volume of gas received from one extractive company which is a party to the MOU. We confirmed this difference by receiving an additional confirmation and explanation from SOCAR and the extractive company concerned.

The Companies' schedule did not include 1,942 thousand cubic meters of gas transferred to the Government by one foreign 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. We confirmed this difference by receiving an additional confirmation and explanation from SOCAR and the foreign extractive company concerned.

Other inflows to Government from the foreign extractive industry companies

Transit duties

Government's schedule	7.9 mln USD
Companies' schedule	6.9 mln USD

An amount of 1 mln USD included in the Government's schedule relates to transit fees that were paid by the Government itself for the transit of its own oil entitlement. We confirmed the overall amount allocated to the Government by receiving a confirmation from AIOC.

Profit tax

Government's schedule	213.0 mln AZN
Companies' schedule	201.8 mln AZN

An amount of 11.6 mln AZN not included in the Companies' schedule relates to profit tax paid which was excluded from the report submitted by one foreign extractive company. We confirmed this amount by receiving a confirmation from this foreign extractive company.

An amount of 0.4 mln AZN relates to incorrect reporting under the MOU by one foreign extractive company due to technical errors. We confirmed the correct amount by examining profit tax payment documents received from this foreign extractive company.

The Government interest in the local companies' extractive output

Gas

Government's schedule	3,460 thousand cubic meters
Companies' schedule	4,000 thousand cubic meters

540 thousand cubic meters were incorrectly included in the Companies' schedule and represented by one local extractive company's gas delivered under commercial terms which is not reportable under the terms of the MOU. We confirmed this difference by receiving an additional confirmation and explanation from SOCAR and this local extractive company.

Other inflows to Government from the local companies

Profit tax

Government's schedule	11.6 mln AZN
Companies' schedule	12.7 mln AZN

The difference of 1.1 mln AZN arose due to the fact that two local extractive companies reported profit tax payments covering the wrong period. We confirmed the difference by inspecting the bank statements obtained from these two local extractive companies.

Other taxes

Government's schedule	136.1 mln AZN
Companies' schedule	135.8 mln AZN

The Government's schedule includes other taxes amounting to 0.3 mln AZN which represents tax on a dividend paid but not reported under the MOU by one local extractive company. We confirmed the difference by inspecting the payment documents obtained from this local extractive company.

Opinion

In our opinion, based on our work described in this report, except for an adjustment, if any, which may have been required had 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 6 months ended 30 June 2006 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.



14 December 2006

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 6 months ended 30 June 2006 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

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. Shengli Oil,
14. Salyan Oil Limited,
15. Karasu Operating Company,
16. Shell Azerbaijan Exploration and Production,
17. Middle East Petroleum,
18. Anshad Petrol JV,
19. Shirvan Oil JV,
20. Azgerneft JV,
21. Inpex,
22. Chevron Overseas Petroleum Azerbaijan Limited
23. Binegedi Oil Operating Company
24. Royal Association of Finance Investors (RAFI OIL FZE)

Not Parties to the MOU

1. The Baku-Tbilisi-Ceyhan Pipeline Company
2. 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 AGENCIES PARTY TO THE MEMORANDUM OF UNDERSTANDING

1. Eurasia Lawyers Association
2. Democracy and Women's Researches Center
3. Economic and Political Research Center
4. Economic and Social Development Center
5. National Group for International Human Rights
6. Society for Protection Azerbaijan Women's Rights
7. Public union for Assistance to Democratic Elections
8. Social-economic Research Center
9. Social-technical Progress and Education Fund
10. International Eco-energy Academy
11. Fund for Protection of Democratic Values
12. Public Finance Monitoring Center
13. Citizen Initiative Center
14. Democratic Reforms Society
15. Multimedia Information and Technology Center
16. Humanitarian Researches Committee
17. Society of Mina victims
18. Democratic Growth and Economic Co-operation
19. Society for social strategic researches and analytic investigations
20. Center for Development of Democracy and Legal Assistance
21. Institute of Complex Problems of Transportation
22. Independent Consumers Union
23. Agroeco Consulting Center
24. "Progress" public union
25. Azerbaijan Construction Association
26. Green Movement
27. Women solidarity
28. Public society for sound growth and education
29. Training and monitoring center on social-economic rights
30. Economic Research Center
31. "Buta" Humanitarian Children Fund
32. Ecolecs Organization
33. Friends of Earth/Azerbaijan
34. "Umid" Humanitarian and Social Support Center
35. Community of Young Lawyers
36. "Xilaskar" Public Union
37. "Finance" Transparent Budget Public Union
38. Independent economy center
39. Centre of Pluralism "Inam"
40. Institute of Economical Technologies
41. "Free Person" Human Rights Protection Center
42. Committee on the protection of the oilmen's rights
43. Center for Support of Democratic Initiatives
44. Bureau of Defense of Human rights and Legality
45. Assistance to democratic elections center
46. Center for Democratic reforms
47. "Eks-seda" International Journalists' Research Center
48. "Expert" Economic Journal
49. "Bilik" Gandja
50. "Inkishaf" Legal Assistance to Young People Public Union
51. League on the protection of the citizens' labor rights
52. Center for Democracy and protection of Women's rights
53. "Ruzgar" Ecological Public Union
54. "Human Rights-2003" Public Union
55. "Women's World" Public Union

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

56. Gandja Children's Fund
57. Constitution Fund
58. Society for Democratic Reforms
59. Caucasus Media Investigations Center
60. Merchant and Reformists' Community
61. Fund for Legal Initiatives
62. Business Researches Centre at Khazar University
63. "Sponsor"
64. Crude Accountability
65. Fund for Protection of Civil Rights in Media
66. "Elektronic Elections" Public Union
67. Center for Economic Innovation
68. HVA Regional zone (Gandja)
69. Center for Assistance to Civil Society Association (Regional NGO district of Agstafa)
70. Political Culture Center of Azerbaijan Women
71. Center for Monitoring of Ecological Standards, Azerbaijan
72. Institute of Peace and Democracy
73. Eco-Alem Public Union
74. Azerbaijan Fund of XXI century Human Rights
75. National Ecological Forecasting Center