



CONCLUSION
by the ITEI Coalition of civil society institutions
on the (7th) Independent Accountant's Report
for the six-month period ending on June 30th, 2007
in the framework of the Extractive Industries Transparency Initiative
in the Azerbaijan Republic

The ITEI Coalition of civil society institutions considers the release of the results of the audit on the 7th report an important development and an essential step, which the Government of Azerbaijan and the country-active oil & gas companies have jointly taken forward to increase transparency in the extractive industry. Meanwhile, The ITEI Commission, as a party to the memorandum which had been signed along with the Government Commission and oil companies, has arrived at the following conclusions upon an independent analysis of the results of the audit concerning the 7th report.

The results have been divided in two separate sections; the first directly involves the findings with respect to the 7th report, while the latter part has incorporated the outcomes of the analyses of the latest three reports.

Findings of the analysis of the 7th report:

1.1. Delayed disclosure of the report gives rise to concern. In accordance with paragraph (f) of Article 5 of the Memorandum of Understanding, dated November 24th, 2004, involving the Government Committee on EITI, local and foreign companies active in the production of mineral resources, and the ITEI Coalition, the final “Independent Accountant’s Report” shall be “submitted to all the Parties to this Memorandum within 30 days after the deadline for the submission of all reports to the auditor, proviso that any inconsistencies have been either resolved or agreed to be insignificant.” In the meantime, paragraph (c) of Article 5 of the Memorandum sets out that the half-year reports shall be submitted to the audit company by August 15th. As a matter of fact, independent accountants (the auditor) received the report thereof at the end of December. In other words, three months later than the deadline stipulated in the Memorandum. On the same point, in the Independent Accountant’s Report, there isn’t any information on whether the EITI report by the Government Committee on EITI and the foreign and local companies’ reports have been submitted

on time (August 15th as is stipulated for half-year reports) or with delay. In the case in question, the spending of such a long time on the resolution of inconsistencies in the report(s) and the inconsistencies that have been agreed to be “insignificant” is unclear. The independent audit company must pay more attention to the shortening of the period of time for the resolution of inconsistencies and to the timely submission of the final EITI Report (by the Government Committee on EITI).

1.2. A great number and repetition of inconsistencies gives rise to concern. The audit company has disclosed 12 inconsistencies following the reconciliation between the reports on the half year, ending on June 30th, 2007, by the Government, on the one side, and local and foreign companies, on the other side. Of the total number, eight inconsistencies have been revealed while harmonizing the reports by the Government and foreign companies, and the remaining four mismatches have been disclosed between the reports by the Government and local companies. The previous, 6th Independent Accountant’s Report has disclosed 12 – the same number of – inconsistencies for the reporting period ending on December 31st, 2006, with nine mismatches between the reports by the Government and foreign companies and the remaining three ups and downs with respect to the reports by the Government and local companies. A majority of these inconsistencies was similar to the mismatches, disclosed in the latest auditor’s report, in terms of content too. Notwithstanding the experience in the field of the preparation and submission of the corresponding reports, such a big number of “errors” and their repetition in terms of content is unacceptable, given that the latest audit was the seventh in succession. Despite this issue has been brought by the previous conclusions by the Coalition up for consideration to the parties, the corresponding problem, however, still exists. Therefore, the Coalition assesses the situation in the way that the parties who do prepare the reports fail to pay due attention to the issue in question.

1.3. Units of measurement and different terminology in the reports, submitted by companies lead to misunderstanding, thereby giving rise to concern. While analyzing the inconsistencies that have been disclosed in the Independent Accountant’s Report, different amounts of gas in the reports by the Government and foreign companies have been explained by different units of measurement. In the same reports, the terms “income tax” and “profit tax” are used in parallel to each other, thereby causing new controversies. The problems of this kind have been repeated in all the previously disclosed reports. Consequently, the Coalition is concerned with the fact that so far no progress has been made in this respect.

In the report, which has been submitted by the Government to the auditor, the amount of the profit, paid by foreign companies had been expressed in U.S. dollars, while the same figure had been shown in manats in the respective statement to the public. It is our opinion that in order to remove any room for inconsistency and ensure the accuracy of the information presented, it would

be more expedient to state the corresponding amount in U.S. dollars – the currency in which the foreign companies had made relevant payments.

1.4. With respect to the analysis of the reports presented by companies, access to the information on their activities remains a problem. The disclosure of company reports on an individual basis is a matter of difficulty in identifying the company which has been at fault for variances in the audit report. On the other side, the fact that the inquiries, which the Coalition of civil society institutions For Improving Transparency in Extractive Industries had made to BP and SOCAR for information, have left unanswered by the recipients is another addition to the concern thereof. The failure of the above-mentioned companies to provide the answers, requested in the inquiries, is considered and submitted to the consideration of the public as the breach of the Azerbaijan Republic law “On the access to information.”

On findings from the analysis of the latest three reports:

2.1. The changes, which have been planned in favor of Azerbaijan, have not been taken into account as expected.

ACG project expenses surged as compared with what was planned for the first half of 2007, thereby depriving the Azerbaijani side of the high rate of profitability that befits contractors. In its previous conclusion, the Coalition expressed its opinion towards this issue. As to the present report, the Coalition announces that given the consequences for the established situation and prevalent tendencies and proceeding from the results of the analysis of the latest report, yet no significant increase has taken place in the share of the profit oil of Azerbaijan, despite the change of the overall environment for the better. As a matter of fact, since January through June 2007, some 20 percent of the total crude production of the Azerbaijan International Operating Company (AIOC) has fallen to the share of the Government. That has constituted 11.8 percent for the half of 2006 and has advanced slightly up to 13 percent at as of the end of the same year. The following statistical data can be used as confirmation of the performance mentioned above. In its respective report, BP stated the overall capital expenditures and operating expenses of AIOC at 1,337 and 180 million U.S. dollars over the first half of 2007. Also well-know is that some 14,877,266.75 tons of crude oil have been shipped during the period under consideration. Given that the price of Brent Mediterranean crude oil has averaged at 63.31 U.S. dollars per barrel, the total revenues have reached 6.952 billion U.S. dollars. After the deduction of capital expenditures and operating expenses out of that amount, there is left the remainder of 5.435 billion U.S. dollars. It seems that the Government of Azerbaijan should have received a total of 1.63 billion U.S. dollars in return for its share of profit oil. As is shown in the report, the Government has received 16 million barrels of crude oil in kind plus the monetary benefit of 23.2 million U.S. dollars. This means that the monetary equivalent of the share

of the profit oil of the Government has made up 1.035 billion U.S. dollars or roughly 20 percent of the profit to be distributed among ACG project partners.

2.2. Of contradictory natures are the reporting system of and payments to the Government by local companies and SOCAR in particular. The analysis of the audit report on latest statements shows that the information on Government's receipts from local companies remains contradictory. On this point, it has been said in the 7th report that throughout the six months since the very outset of 2007 the total amount of receipts from local companies – the transfers by SOCAR and the joint ventures, in which SOCAR has an interest and who are a party to the Memorandum of Understanding, to the Government in the framework of hydrocarbons production activities only – has constituted 179.9 million manats (roughly 213 U.S. dollars). The same showing for the corresponding period of 2006 has been measured at 403.6 million manats (roughly 478 million U.S. dollars), significantly above the year of 2005 performance of 119 million manats (141 million U.S. dollars).

Specifically, the concern of the Coalition over the amount of profit tax paid by local companies has been clearly expressed in previous conclusions, precisely the conclusion on the 5th report. The amount of profit tax, paid by local companies had aggregated at 8.5 million manats (slightly less than 10 million U.S. dollars) for January through June 2005, while the comparative performance for the correspondig periods of 2006 and 2007 had been measured at 11.6 and 15.7 million manats, or roughly 13.7 and 18.7 million U.S. dollars respectively.

Causing misunderstanding are slight changes which have been observed in the amount of profit tax payments to the Government by local companies over the first six months of each of the last three years. The expansion of crude oil production and benign conditions on the petroleum market should have set the trend in payments significantly upwards.

2.3. Definite clarifications are required with respect to the difference between the market sale price of crude oil and the price stated in the report(s). Another concern expresses itself in the difference between the sale price of crude oil on the world market and the price which is stated in the report(s). The logical question arises to what degree the price, set by the Government on the sale of the profit oil of separate contractors, is realistic and to what degree the Government's being in control of this process is effective.

The ITEI coalition of civil society institutions recommends the following action be taken into consideration under the 7th EITI report by the Government:

1. *With respect to the Independent Accountant's Report, it is expedient to provide an explanation for any case of the failure of the Government, as well as local and foreign companies to submit their respective reports on the time stipulated in the Memorandum or any case of delay in the submission of relevant reports;*

2. *The independent audit company needs to reinforce its efforts to shorten the period for the removal of inconsistencies (in the reports which are submitted to it by parties to the Memorandum) and submit the final Report on time;*
3. *Proceeding from the Memorandum of Understanding, new discussions need to be launched among the parties (to the Memorandum) in order to improve the existing reporting system;*
4. *Necessary work needs to be accelerated towards the harmonization of the units of measurement and terminology in the reports submitted by the Government, as well as local and foreign companies;*
5. *With the purpose of settling the unintentional problems of the companies in the reporting system, training courses need to be provided to the company staff who are responsible for the corresponding error;*
6. *New companies and SOCAR in particular need to clarify contradictions in their respective reports on payments to the Government, and make necessary disclosures to the public.*

Besides, the ITEI Coalition of civil society institutions brings to the notice of the Government the importance of reinforcing the attention to the recommendations, which have been made in the previous conclusions by the ITEI Coalition of civil society institutions on respective reports, but still remain unconsidered.