

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

Independent Accountants' Report
For the year ended 31 December 2005

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

TABLE OF CONTENTS

	Page
INDEPENDENT ACCOUNTANTS' REPORT	1
APPENDIX 1. ASSERTION OF THE COMMITTEE ON THE EXTRACTIVE INDUSTRIES TRANSPARENCY INITIATIVE OF THE REPUBLIC OF AZERBAIJAN	5
APPENDIX 2. LIST OF EXTRACTIVE INDUSTRIES COMPANIES PARTY AND NOT PARTY TO THE MEMORANDUM OF UNDERSTANDING	6
APPENDIX 3. LIST OF NON-GOVERNMENTAL AGENCIES PARTY TO THE MEMORANDUM OF UNDERSTANDING	7

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 2005 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 year ended 31 December 2005 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 below.

Government's interest in the foreign companies' extractive output

Crude oil

Government's schedule	14.3 mln barrels
Companies' schedule	13.1 mln barrels

1.4 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.

0.2 million barrels were incorrectly included in the Companies' schedule and relate to the amount reported by two foreign extractive companies as profit oil payable and local market oil disposed of to SOCAR under commercial terms. We confirmed this amount by receiving additional confirmations from these two foreign extractive companies.

Gas

Government's schedule	1,919,709 thousand cubic meters
Companies' schedule	1,779,652 thousand cubic meters

An amount of 109,179 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. We confirmed this difference by receiving additional confirmation and explanation from SOCAR.

The Companies' schedule did not include 21,371 thousand cubic meters of gas transferred to the Government by one 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 amount by receiving an additional confirmation from this foreign extractive company.

The Companies' schedule did not include 3,077 thousand cubic meters of gas transferred to the Government by one extractive company which is not a party to the MOU. We confirmed this amount by receiving an additional confirmation from this foreign extractive company.

The Government's schedule includes 6,430 thousand cubic meters of gas which relates to one local extractive company which is a party to the MOU. See below "The Government interest in the local companies' extractive output". We confirmed this amount by receiving an additional confirmation from this local extractive company.

Other inflows to Government from the foreign extractive industry companies

Transit duties

Government's schedule	16.5 mln USD
Companies' schedule	12.9 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. We understand from this confirmation that these amounts were not included in the Government's schedule because they were paid to SOCAR as part of commercial activities and as such are not reportable under the terms of the MOU.

A payment of 1.3 mln USD was included in the Government's schedule but it was accrued in 2004 and included by the Companies in their payments to the Government in 2004. The Government included this amount in the current period 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.

An amount of 2.7 mln USD included in the Government's schedule relates to transit fees that were paid by two extractive companies which are not parties to the MOU. We confirmed the overall amount allocated to the Government by receiving a confirmation from AIOC.

The Companies' schedule includes transit duties amounting to 0.2 mln USD which represents a rounding difference. It arises due to Companies reporting rounded figures in their returns submitted to us.

Compensation on the non-performance of the contract terms

The Government's schedule which was initially submitted to us by the EITI Committee had been incorrectly consolidated by the EITI Committee from the information submitted by the Government, due to the omission of 50 mln USD paid by two extractive companies who are parties to the MOU. The EITI Committee realized that they had made this error in the consolidation of the Government's schedule and that they had omitted this amount which had been reported to them by the Government. The EITI Committee submitted a revised consolidated Government's schedule which was corrected for this omission.

Bonus on signing and other bonuses

Government's schedule	1 mln USD
Companies' schedule	Nil

The difference of 1 mln USD relates to the amount paid to SOCAR by an extractive company who was not a party to the MOU. We confirmed this amount by reference to the bank statements and contractual terms related to this transaction.

The Government interest in the local companies' extractive output

Crude oil

Government's schedule	Nil
Companies' schedule	1 mln barrel

Local companies' extractive output of 1 million barrels relates to incorrect reporting under the MOU by one local extractive industry company of crude oil sold to SOCAR per local market prices. This is a commercial activity and is not reportable under the terms of the MOU. We confirmed this amount by receiving an additional confirmation from this local extractive company.

Gas

Government's schedule	Nil
Companies' schedule	6,430 thousand cubic meters

Local companies' extractive output of 6,430 thousand cubic meters relates to one local extractive company which is included in the Government's schedule as the Government's interest in the foreign companies' extractive output. See above "The Government interest in the foreign companies' extractive output".

Other inflows to Government from the local companies

Profit tax

Government's schedule	46.9 bln AzM
Companies' schedule	43.4 bln AzM

The difference of 3.5 bln AzM arose due to the fact that one local extractive company reported only the 2005 profit tax and not the 2004 profit tax paid during 2005 as required under the MOU. We confirmed the difference by inspecting the bank statements obtained from this company.

Other taxes

Government's schedule	400.3 bln AZM
Companies' schedule	400.5 bln AZM

The Companies' schedule includes other taxes amounting to 0.2 bln AzM which represents a rounding difference. It arises due to Companies reporting rounded figures in their returns submitted to us.

Opinion

In our opinion, based on our work described in this report, and 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 year ended 31 December 2005 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.

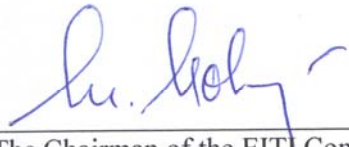


31 July 2006

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 year ended 31 December 2005 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,
Shengli Oil,
Salyan Oil Limited,
Karasu Operating Company,
Shell Azerbaijan Exploration and Production,
Middle East Petroleum,
Anshad Petrol JV,
Shirvan Oil JV,
Azgerneft JV,
Inpex,
Chevron Overseas Petroleum Azerbaijan Limited

Companies – Not Parties to the MOU

State Oil Fund of the Republic of Azerbaijan
Binegedi Oil Operating Company
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

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
Eurasia Lawyers Association
Democracy and Women Researches Center
Economic and Social Development Center
Society for Protection of Azeri Women Rights
Centre for Assistance to Democratic Elections
Socio-Economic Researches Public Union
Technological Progress and Education Fund
Fund for Protection of Democratic Values
Democratic Development and Economic Co-operation
Center for Social, Strategic and Analytical Researches
Center for Development of Democracy and Legal Assistance
Institute of Complex Problems of Transportation
Union of Independent Consumers
“Progress” Public Union, Ganja
Azerbaijan Construction Association
Women Solidarity
Azerbaijan Sound Development Public Union
Training and Monitoring Center for Social and Economic Rights
Friends of the Earth / Azerbaijan
“Umid” Humanitarian və Social Support Center
“Hilaskar” Public Union
“Finance” Transparent Budget Public Union (district of Imishli)
Centre of Pluralism “Inam”
Institute of Economical Technologies
“Free Person” Human Rights Protection Center
Center for Support of Democratic Initiatives

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

Centre for Assistance to Democratic Elections
Society for Democratic Reforms
“Eks-seda” International Journalist Researches Center
“İnkishaf” Legal Assistance to Young People Public Union
Center for Democracy and Protection of Women Rights
“Ruzgar” Ecological Public Union
“Human Rights-2003” Public Union
“Women's World” Public Union
Fund of Constitution
Caucasus Media Investigations Center
Fund for Legal Initiatives
Business Researches Centre at Khazar University
Crude Accountability
Fund for Protection of Civil Rights in Media
“Elektronic Elections” Public Union
Center for Assistance to Civil Society Assosiation (Regional NGO district of Agstafa)
Political Culture Center of Azeri Women
Azerbaijan Fund of Monitoring of Ecological Standarts
Institute of Peace and Democracy
Eco-Alem Public Union