

Board paper 35-5-A

Validation of Azerbaijan

For discussion and possibly decision

The Validation Committee provides the following update to the Board. Pending further review of the [Validation Report](#) and any comments on the Report from the Multi-Stakeholder Group in Azerbaijan, the Validation Committee will make a recommendation to the Board. The Committee will meet and continue to discuss the options and possible recommendations based on this paper after it is submitted to the Board and the Committee will report any further findings and possible recommendations at the Board table. The recommendation will include:

1. In accordance with Requirement 8.3.a.ii, an overall assessment of adherence to the EITI Standard. Given that this is a second Validation, the options and implications are as follows:

Option A – The Board agrees that Azerbaijan has made “no progress”. Azerbaijan would be delisted.

Option B - The Board agrees that Azerbaijan has made “inadequate progress”. Azerbaijan would be delisted.

Option C - The Board agrees that Azerbaijan has made “meaningful progress overall ... but with no improvements on individual requirements”. Azerbaijan would be suspended and requested to undertake corrective actions until the third Validation.

Option D - The Board agrees that Azerbaijan has made “meaningful progress overall in the second Validation, and with considerable improvements across several individual requirements”. Azerbaijan would not be suspended and requested to undertake corrective actions until the third Validation.

2. In accordance with Requirement 8.3.a.i, an assessment of Azerbaijan’s adherence to the EITI’s requirements with corrective actions with respect to requirements [1.3, 1.4, 1.5, 2.3, 4.1, 4.9, 6.2, 7.1 and 7.4] and additional recommendations to further strengthen EITI implementation (see Annex A). In

accordance with Requirement 8.3.c, if the Board finds that Azerbaijan has not achieved satisfactory progress on requirements 1.1, 1.2, 1.3 or 4.8, the implication is that Azerbaijan should be suspended.

VALIDATION OF AZERBAIJAN

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1 Recommendation

A recommendation from the Validation Committee is subject to further review of the [Validation Report](#) and any comments on the Report from the Multi-Stakeholder Group in Azerbaijan.

2 Background

Azerbaijan was accepted as an EITI Candidate in 2007 and was the first country to become EITI compliant with the EITI Rules in 2009. It has produced EITI reports in a timely fashion since 2005, however, concerns surrounding civil society participation prompted the EITI Board to request the country to undergo early Validation in 2015 against the EITI Standard. The Board found that Azerbaijan was not compliant but had made meaningful progress in implementing the EITI, thus designating it a Candidate rather than Compliant country. The Board established corrective actions for Azerbaijan to be completed by 15 April 2016 regarding civil society engagement, the work plan, public debate, and impact, adding that it was not possible to assess compliance with requirements 2, 3, 4, and 5 on EITI disclosures in the absence of an approved 2013 EITI Report.

On 2 June 2016, the Board agreed that Azerbaijan’s second Validation would commence on 1 July 2016. In accordance with the 2016 EITI Standard:

1. An initial assessment was undertaken by the International Secretariat. The findings are available [here](#).
2. The Multi-Stakeholder Group was invited to comment on the Secretariat’s assessment. Their comments are available [here](#). CSO representatives on the MSG did not endorse these comments, and provided their own comments ([here](#)).
3. The Secretariat’s initial assessment was reviewed by the Independent Validator, who prepared the Validation Report ([here](#)).
4. The Azerbaijan Multi-Stakeholder Group will be invited to comment on the Validation Report. The Validation Committee will review these comments before finalising its recommendation.

In accordance with the 2016 EITI Standard, the final step in the validation process is Board review:

The Validation Committee will review the Validator's assessment and any feedback from the multi-stakeholder group. The Validation Committee will then make a recommendation to the EITI Board on the country's compliance with the EITI Requirements. The EITI Board will make the final determination of whether the requirements are met or unmet, and on the country's overall compliance in accordance with provision 8.3.a.ii of the EITI Standard.

3 Impact of EITI implementation

The Independent Validator reports the following:

Positive impacts of EITI implementation were noted by stakeholders consulted for the Assessment who had varying levels of familiarity with EITI. These include, but are not limited to: EITI has stressed the importance of accountability especially on the part of government and industry; it can facilitate trust and dialogue among stakeholders; it has contributed to greater understanding of, and technical knowledge about, the extractive sector; participation in the EITI can lend credibility to and support an environment for investments. At the same time, however, awareness about EITI appears to still be quite limited although the MSG, and more so civil society, have undertaken public information events around the 2014 EITI Report. The Assessment provides important insights with statements such as "EITI appears to have played a limited role in stimulating national debate about sector management and spending of oil revenues," "EITI reports do not appear to have played any significant role in stimulating government reforms in the extractive sector," and "there is insufficient evidence to demonstrate these efforts (on EITI) have had an impact on NR governance." The MSG should more rigorously analyse impacts, or the lack thereof. Contributing factors may include stakeholders' uncertainty in designing measurable objectives, in applying appropriate methodologies for assessing impact, and the lack of sustained outreach information efforts across the country. EITI does not appear to have had genuine, demonstrable impact on the day-to-day lives of people and communities. In other words, there is little evidence of a "human face" to the positive experience of EITI in Azerbaijan.

4 Assessment of progress with EITI implementation

Requirement 8.3 states:

- a) *Assessment of progress with EITI implementation*
- i. *Assessment of each EITI Requirement. The Validation process will assess the country's progress in complying with each of the EITI Requirements. Detailed guidance on the types of evidence that are required in order to make an assessment on individual requirements is set out in the Validation Guide available at www.eiti.org. The level of progress and compliance with each individual EITI Requirement shall be indicated by applying one of the following designations:*

Satisfactory progress. In order for the EITI Board to conclude that a country has made satisfactory progress, Validation needs to demonstrate that all aspects of the

requirement have been implemented and that the broader objective of the requirement has been fulfilled.

Meaningful progress. In order for the EITI Board to conclude that a country has made meaningful progress, Validation needs to demonstrate that significant aspects of the requirement have being implemented and that the broader objective of the requirement is being fulfilled.

Inadequate progress. In order for the EITI Board to conclude that a country has made inadequate progress, Validation needs to demonstrate that significant aspects of the requirement have not been implemented and that the broader objective of the requirement is far from fulfilled.

No progress. In order for the EITI Board to conclude that a country has made no progress, Validation needs to demonstrate that all or nearly all aspects of the requirement remain outstanding, and that the broader objective of the requirement is not fulfilled.

For information purposes, the findings from the Validator are presented in Annex A. A recommendation from the Validation Committee is subject to further review of the [Validation Report](#) and any comments on the Report from the Multi-Stakeholder Group in Azerbaijan. In accordance with Requirement 8.3.c, if the Board finds that Azerbaijan has not achieved satisfactory progress on requirements 1.1, 1.2, 1.3 or 4.8, the implication is that Azerbaijan should be suspended (see below).

5 Overall assessment

Requirement 8.3 states:

Pursuant to the Validation Process, the EITI Board will make an assessment of overall compliance with all requirements in the EITI Standard.

In determining a country's overall assessment, the EITI Board will apply the same minimum threshold tests for the overall assessment as used for the assessment of the individual requirements outlined in provision 8.3(i) above. The Board will also take into account provision 8.3(c)(i) below, as well as the following factors:

- *the advice and recommendations of Validators and the Validation Committee;*
- *the nature of the outstanding requirements and how close the requirements are to being met;*
- *the magnitude and complexity of the extractive sector of the country;*
- *other barriers to meeting requirements such as but not limited to state fragility and recent or ongoing political change, and the extent to which the multi-stakeholder group has undertaken actions to resolve barriers encountered;*
- *the good faith efforts undertaken by the multi-stakeholder group to comply with the requirements;*
- *the reasons and justifications for not complying with the requirements; and*
- *any plans agreed by the multi-stakeholder group to address the requirements in the future.*

Requirement 8.3(c) states:

i. A country must achieve satisfactory progress on the following four requirements in order to avoid suspension: government engagement (1.1), company engagement (1.2), civil society engagement (1.3) and timely EITI reporting (4.8). Where a country achieves less than meaningful progress on data quality (4.9) and data comprehensiveness (4.1), the MSG will be required to disclose a time-bound action plans for addressing weaknesses in data reliability and comprehensiveness. Progress with implementation of this plan will be taken into account in subsequent Validations.

With regards to the other EITI Requirements, the consequences of non- compliance depend on the Board's assessment of overall progress:

ii. No progress. The country will be delisted.

iii. Inadequate progress. The country will be suspended and requested to undertake corrective actions until the second Validation. For the suspension to be lifted, the country must in its second Validation demonstrate at least meaningful progress.

If a country achieves meaningful progress in the second Validation, the procedure in provision (iv)(2) below applies. If the country achieves inadequate progress, in the second Validation the procedure in provision (ii) above applies.

iv. Meaningful progress. The country will be considered an EITI candidate and requested to undertake corrective actions until the second Validation.

- 1. If the country achieves meaningful progress overall in the second Validation, but with no improvements on individual requirements, the country will be suspended and requested to undertake corrective actions until the third Validation. If the country achieves meaningful progress overall in the third Validation but with no improvements on individual requirements, the country will be delisted. If the country achieves meaningful progress overall in the third Validation, but with considerable improvements across several individual requirements (i.e. several but not all requirements that were previously unmet have been met), the country will remain suspended. The Board will establish new corrective actions. Failure to meet all requirements in the fourth Validation will result in delisting.*
- 2. If the country achieves meaningful progress overall in the second Validation, and with considerable improvements across several individual requirements (i.e. several but not all requirements that were previously unmet have been met), the country will be considered an EITI candidate whilst undertaking corrective actions. If the country achieves meaningful progress overall in the third Validation, the country will be suspended. The Board will establish new corrective actions. Failure to meet all requirements in the fourth Validation will result in suspension or delisting.*
- 3. If the country achieves inadequate progress in the second or subsequent Validations,*

the procedure in point (ii) above applies.

iv. Meaningful progress. The country will be considered an EITI candidate and requested to undertake corrective actions until the second Validation.

In accordance with Requirement 8.3.a.ii, the Board should agree an overall assessment of adherence to the EITI Standard. Given that this is a second Validation, the options and implications are as follows:

Option A – The Board agrees that Azerbaijan has made “no progress”. Azerbaijan would be delisted.

Option B - The Board agrees that Azerbaijan has made “inadequate progress”. Azerbaijan would be delisted.

Option C - The Board agrees that Azerbaijan has made “meaningful progress overall ... but with no improvements on individual requirements”. Azerbaijan would be suspended and requested to undertake corrective actions until the third Validation.

Option D - The Board agrees that Azerbaijan has made “meaningful progress overall in the second Validation, and with considerable improvements across several individual requirements”. Azerbaijan would not be suspended and requested to undertake corrective actions until the third Validation.

If the Board adopts option C or D, Requirement 8.3(d)(ii) states:

Where Validation verifies that a country has not achieved compliance, the EITI Board will establish the corrective actions that the country is required to undertake and a timeframe of 3-18 months for the next Validation where progress with the corrective actions will be assessed. In establishing the timeframe for completing the corrective actions, the EITI Board will consider the nature of the corrective actions and local circumstances. The Board retains the right to establish shorter or longer timeframes. In accordance with provision 8.5, a country may request an extension of this timeframe. A country may also request to commence Validation earlier than scheduled by the EITI Board.

Annex A – Assessment card and corrective actions

Assessment card

The table below is based on the Validation Report. The Validation Committee has not yet discussed the findings.

<i>Figure 1 – Validator's assessment EITI Requirements</i>		LEVEL OF PROGRESS				
		No Progress	Inadequate	Meaningful	Satisfactory	Beyond
Categories	Requirements					
MSG oversight	Government engagement (#1.1)				Green	
	Industry engagement (#1.2)				Green	
	Civil society engagement (#1.3)		Orange			
	MSG governance (#1.4)			Yellow		
	Work plan (#1.5)			Yellow		
Licenses and contracts	Legal framework (#2.1)				Green	
	License allocations (#2.2)					
	License register (#2.3)			Yellow		
	Policy on contract disclosure (#2.4)				Green	
	Beneficial ownership (#2.5)		Grey			Grey
State participation (#2.6)			Yellow			
Monitoring production	Exploration data (#3.1)				Green	
	Production data (#3.2)				Green	
	Export data (#3.3)				Green	
Revenue collection	Comprehensiveness (#4.1)			Yellow		
	In-kind revenues (#4.2)				Green	
	Barter agreements (#4.3)	Grey	Grey			Grey
	Transportation revenues (#4.4)				Green	
	SOE transactions (#4.5)				Green	
	Direct subnational payments (#4.6)	Grey	Grey			Grey
	Disaggregation (#4.7)				Green	
	Data timeliness (#4.8)				Green	
Data quality (#4.9)			Yellow			
Revenue allocation	Revenue management & expenditures (#5.1)				Green	
	Subnational transfers (#5.2)	Grey	Grey			Grey
	Distribution of revenues (#5.3)	Grey	Grey			Grey
Socio-economic contribution	Mandatory social expenditures (#6.1.a)	Grey	Grey			Grey
	Discretionary social expenditures (#6.1.b)	Grey	Grey			Grey
	SOE quasi-fiscal expenditures (#6.2)			Yellow		
	Economic contribution (#6.3)				Green	
Outcomes and impact	Public debate (#7.1)			Yellow		
	Data accessibility (#7.2)	Grey	Grey			Grey
	Follow up on recommendations (#7.3)				Green	
	Outcomes & impact of implementation (#7.4)			Yellow		

Corrective Actions

The list below is based on the Validation Report, which the Validation Committee has not yet discussed. The text is based on recommendations from the Secretariat's initial assessment, with additions (in italics) by the Independent Validator. Further edits to clarify the corrective actions may be needed.

1. *Azerbaijan has taken positive steps to ease the situation for NGOs involved in the EITI, however, further progress is needed to meet the different aspects of Requirements 1.3b-d, 1.3.e.i, 1.3.e.iv, and 1.4.a.ii. Specifically, the government should address the remaining issues related to the environment for civil society participating in the EITI, notably legal and practical obstacles related to registration of NGOs, accessibility of registration extracts, registration of grants and any other obstacles affecting the ability of NGOs to operate. The government should ensure that there is an enabling environment for civil society to express their views and debate on natural resource governance issues. Civil society should take steps to agree a policy for political and operational independence, and consider issues affecting coalition governance.*
2. The MSG should *articulate*: a clearer explanation of the links between the work plan objectives, the extractive sector, *and national priorities*; and the rationale behind the selected objectives. The MSG is encouraged to expand the consultation on the work plan objectives to include key stakeholders beyond MSG members. *Moreover, the MSG should ensure that activities in the work plan can be monitored effectively, which requires measurable, goals, and timetables.*
3. The MSG is encouraged to consider more timely reporting on license allocation, i.e. when they occur, and is advised to update the license register to include all active contracts, including contracts pertaining to companies not covered in the scope of the EITI Report. *The MSG should ensure the maintenance of a publicly available register of licenses that will be updated with time and comprehensive information. It is encouraged to consider commenting on the efficiency and effectiveness of the ad hoc approach to awarding licenses, and to provide an overview of the contracts and licenses that are publicly available.*
4. *The MSG should work on obtaining more comprehensive data regarding the mining sector, including the number of operating companies and permits issued, including on the local level.* The MSG should clarify the terms attached to the government's share in the two active mining PSAs.
5. *The MSG should agree on a clear policy on the access, release, and re-use of EITI data (7.1.b). It is encouraged to ensure outreach events by and for all the stakeholder groups, and take efforts to clarify their roles, expectations, and responsibilities.*
6. *In view of Azerbaijan's disclosure of contracts, the EITI Report should provide an overview of these contracts and licenses.* Future EITI reports should include commentary confirming whether there are any ongoing reforms related to contract transparency. Given that all PSAs in Azerbaijan are ratified by Parliament, the MSG should consider increasing its efforts to make the remaining PSAs available on the EITI Azerbaijan website.
7. *The MSG is encouraged to ensure that future EITI Reports summarize the legal framework, fiscal regime, the applicable rates, and how the various taxes and payments are calculated, so that stakeholders can gain an understanding of how the extractive sector is managed. With regard to reforms listed in future EITI Reports, it is recommended that these be described in a way that stakeholders can understand the nature of the change, its magnitude, and its potential impact.*
8. The MSG should ensure that SOCAR discloses all details regarding its equity stake and changes in

ownership. The MSG could consider extending this to SOCAR subsidiaries operating in the downstream sector. *In future reports, the MSG may wish to consider requiring a table that ties the payment and revenue amounts set forth in section 1.4 to the allocation numbers set forth in section 3.6 and including a discussion of the amounts transferred by SOFAZ to the national budget (how determined) and retained by SOFAZ.*

9. *In order to promote a better understanding of the potential of the extractive sector in Azerbaijan, the MSG is encouraged to include information regarding the value of total reserves (by commodity) that are economically recoverable. It is further recommended that the MSG discuss how to address concerns regarding the reliability of data from the mining sector. The MSG should consider including sources of data on how export volumes and values are calculated.*
10. The MSG is encouraged to consider expanding the reporting on sales of in-kind revenue to include additional information such as the type of product, price, market and sale volume.
11. The MSG is encouraged to expand the reporting on transportation to include a full description of the transportation arrangements including the products transported, transportation route(s), disclosure of tariff rates and the methodologies used to calculate them, and disclosure of volume of the transported commodities.
12. The MSG is encouraged to ensure that the Independent Administrator include an overview of companies and government agencies that have published their audited financial statements online, and how these can be accessed. *In the future, the MSG is encouraged to ensure that reconciliation is conducted in accordance with proper audit standards.*
13. The MSG may wish to consider extending EITI Reporting to include information on revenue management and expenditures. It is encouraged to explore opportunities to report on discretionary social expenditures in future EITI reports.
14. The MSG is encouraged to undertake an analysis of the impact of EITI implementation with a view to identifying weaknesses and opportunities for increasing impact. It is recommended that broader stakeholders have an opportunity to contribute to such an analysis.