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Assistance to Free Economy



SOCAR FINANCIAL FLOWS



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This edition comprises the analysis of SOCAR financial flows in 2006-2008, monitoring results of its 2 social projects, summary of problems concerning access to the company-owned information and Policy Paper on the national oil company's transition to disaggregated reporting in the EITI framework. Research and summaries have used official reports of Azerbaijan's Cabinet of Ministers, Chamber of Accounts, Central Bank, SOCAR and SOFAZ, normative legal acts, official web-sites, data obtained during monitoring, interviews with social entities management and related officials, information spread in Mass Media with reference to official establishment, results of research and monitoring previously maintained by NGOs and the PAAFE, and court decisions. The views and conclusions expressed hereby are owned by the author and therefore donor of the project bears no responsibility.

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ACRONYMS

ACG	- Azeri/Chirag/Gunashli
AIOC	- Azerbaijan International Operating Company
CSOF	- Caspian Sea Oil Fleet
DFID	- Great Britain Department for International Development
EITI	- Extractive Industries Transparency Initiatives
IFRS	- International Financial Reporting Standards
ITEI	- Improving Transparency in Extractive Industries
IU	- Industrial Union
JSC	- Joint-Stock Company
NGO	- Non-Governmental Organization
OWRPO	- Oil Workers Rights Protection Organization
OR	- Oil Refinery
OSIAF	- Open Society Institute Assistance Foundation
SC	- State Company
PAAFE	- Public Association for Assistance to Free Economy
PSA	- Production Sharing Agreement
SOCAR	- State Oil Company of Azerbaijan Republic
SOFAZ	- State Oil Fund of Azerbaijan Republic
TDC	- Treatment and Diagnostics Center

INTRODUCTION

4.2% of GDP in Azerbaijan in 2008, 12.6% of state budget incomes fall to SOCAR's share. Number of company's employees as of January 1, 2009 was 65083 and their monthly average wages were 563.7 manats.

Three new departments - Department for Gas Operations, Department for Information Technologies and Communications, and Department for Environment have been established within the SOCAR structure by the presidential Decree dated 14 September 2006. Thus, the number of Company's departments and enterprises has become 18. By the presidential decree dated 27 December 2007 following vice-president positions were established and relevant appointments made in SOCAR on: social issues, ecology, and human resources, routine and information technologies. Thus, the number of vice-president positions within SOCAR has become 8.

Establishment of the Company's Department for Environment and formation of ecological policy could be considered as another change within SOCAR. Following the Department's establishment, the Company adopted Ecological Policy paper in May 2008 and presented it to the public.

"Azerigas" JSC whose shares fully belong to the state was closed down and placed under the control of SOCAR by the presidential Decree "on improvement of Management Mechanisms in Oil and Gas Industry" dated July 1, 2009. In this regard, there have been structural changes at the Company and SOCAR's "Azerigas" Industrial Union has been created on the base of

"Azerigas" JSC. Simultaneously, SOCAR's Department for Gas Operations was renamed to the Department for Gas Exports, "Neftqazlayiha" (Oil and Gas Projecting) and "Elmi Tadgigatlar" (Scientific Research) Institutes have been merged into "Neftgazelmitadgigatlayiha" Institute (Institute of Oil and Gas Researches and Projects).

As of 2007, SOCAR has launched projects with the large finances. The Company has participated in a tender of 2 billion USD and together with its partners has obtained 51% shares of the Petkim Holding, Turkey's biggest petrochemical company. The Company has also expanded its petrol stations set in Georgia and has created Kulevi Black Sea Terminal with transportation capacity of 10 million tons, also has established its representations in Georgia, Romania, Turkey, Great Britain, Switzerland, Iran, Ukraine, Austria, and Kazakhstan. The company has started planning its new 33-floor headquarters worth 1.5 billion manats.

In May 2009, SOCAR Trading Company, 50% of shares owned by SOCAR, has opened its office in Singapore. Previously, it had opened its head office in Geneva.

Financial crisis and falling of oil prices in the world market has significantly impacted SOCAR'S activities in 2009. There have been problems in several investment projects launched by the Company in 2007. The value of the Petkim Holding, whose shares were obtained by the Company together with its partners through participating in June and July of 2007 in the tender worth 2 billion USD has cheapened approximately twice in 2008 - 2009. Furthermore, at the end of 2008, SOCAR has refused from the project of constructing oil processing plant in Ceyhan port and at the end of 2009; it has postponed the transaction to buy 50% of the Tekfen Inshaat Company's shares. Price of the last project equaled to 520 million USD.

SOCAR is still operating as a state enterprise rather than a commercial company. Though the Company possesses 19 large departments and enterprises and its 8 vice presidents are operating, it has no decision-making agency (for instance, Board of Directors). Although the company possesses an agency called the Council, it is intended as a consultative agency under the SOCAR president. And this agency is essentially of formal character. The Company is maintaining its budget, also its expenditures beyond the control of the Parliament. Use of Company's net incomes is defined by the SOCAR president while being agreed with the Government.

After adopting international standards in financial reporting, the Company has first been audited on the outcomes of 2008. Audit was performed by the Ernst & Young". References of the Independent Auditors have been included in the annual 2008 report. SOCAR announced its 2008 report in November of 2009.

SOCAR is the manager of the Azerbaijan's oil and gas reserves and under its status has signed 26 contracts with foreign oil and gas companies, and also participating in these projects as a shareholder. In 2003 - 2008, tripling of oil prices in the world market while SOCAR's production indicators remaining the same, and also due to the profitability obtained by the companies participating in Azeri-Chirag-Gunesli project (SOCAR's share in this project is 10%), total revenues and net profit of the national oil company has increased several times.

Maintaining transparency in the activities of SOCAR, which is one of the key financial resources of Azerbaijan's social and economic development with its ongoing expanding financial possibilities, serves as one of the most vital issues. It goes without saying that SOCAR is not a simple company in Azerbaijan; SOCAR is fully owned by the State and functions as the manager of the oil and gas reserves across the country. Also, its profits are a part of the country's public finance. In this regard, it is very important to track the Company's financial flows and organize public monitoring. The project of "Monitoring of SOCAR financial flows, transparency evaluation, and public discussion of results", which is implemented by the Public Association for Assistance Free Economy with the sponsorship of the U.S. Marshall Fund, is related to this need.

1. SOCAR FINANCIAL FLOWS

The incomes, expenditures, investments, receivables, and payables of the company, its relations with the State Budget have been studied during the examination of company's financial flows. Studies have used the data and indicators of the official reports, as well as the calculations carried out on the basis of those indicators.

Studies begin with the incomes in conformity with the directions of the Company's financial flows and continue through the mutual payables problem. Also, a separate section is dedicated to the EITI report in which both incomes and expenditures are analyzed and additionally this section deals with the issues related to the Company's net incomes. Because the Consolidated Income Statement that was publicized in accordance with the IFRS, finalizes the information on the profits provided by both the Company and the Government in 2007.

It is also worth to mention that despite the fact that information on details of financial flows in SOCAR reports is decreasing from year to year, the report which was publicized in accordance with the IFRS, creates new tracking possibilities.

1.1. Revenues Spectrum

SOCAR has started to disclose its reports on financial indicators as of 2004. The company has specified the volume of incomes and their sources in its Annual Report of the above mentioned year. This tradition has continued through the

2007 Annual Report. However, in the 2008 Report the Company has placed the reports, which it has publicized in accordance with the IFRS, in the "Financial Outcomes" section, but no explanations have been provided there.

The Company's income generating resources in accordance with its ongoing operational profile can be classified in the following way:

Sale of crude oil;

- Sale of oil products;

- Sale of natural gas;

- Sale of SOCAR's share profit hydrocarbons over the PSAs;

- Lease of SOCAR's property;

- Services rendered to foreign oil and gas companies (transportation, geological survey, fleet cargo services and so on.)

- Activities in foreign countries;

Revenues obtained by the Company are formed due to these resources. Information concerning receipts from resources would ensure tracking of the Company's Revenues and perform analysis through separate resources. Although the information concerning the volumes of funds the Company received from sales of crude oil and oil products in 2006 and 2007 was included in both SOCAR's and Cabinet of Minister's annual reports, in 2008 access to this information has also been limited.

Generally, the best possibilities for tracking the Company's Revenues coincide with 2006. This is related to the fact that more information is available in the Company's 2006 Report, on the one hand, and in the announcement made by the Company's Vice-President on economic issues at the EITI Conference held in June 2007 in Baku, on the other.

SOCAR receipts in 2008 yielded from sales and services was 4710,0 million manats. The Company included Azerbaijan Government's receipts obtained from sales of profit hydrocarbons in its reports of previous years as well. This is related to the fact that according to the contracts, SOCAR represents the Government of Azerbaijan and it organizes sales solely. Subsequently these funds are transferred to SOFAZ. However, different numbers in relation with the volume of these funds have been indicated in the reports by SOCAR, SOFAZ, and the Cabinet of Ministers.

SOCAR Revenues structure (million manats)

Sources of Revenues	2006	2007	2008
1. Sale of Oil and Oil Products	2 559,7	3 184,4	N/A ¹
1.1. <i>Oil and Oil Products Exports</i>	1 723,4	1 860,9	N/A
<i>including</i>			
<i>OC and JVs due to export oil</i>	251,4	N/A	N/A
<i>Company's share on PSA</i>	389,2	777,0	859,9
<i>1.2. Sale of oil products in internal market</i>	836,3	1 323,5	N/A
2. Funds generated from natural gas sales	N/A	N/A	N/A
3. Other Revenues	N/A	N/A	N/A
Total Revenues	2 751,7	4 053,3	4 710,0
Azerbaijan's benefit on PSA	924,4	1 860,7	11 633,5
Total financial flows on Revenues	3 676,1	5 914,0	16 343,5

According to the information presented by the Company, 924.4 million manats have been generated from PSAs profit oil sales in 2006.² SOFAZ informs that the receipts on PSAs have been 929.9 million manats in the same year.³ However, the Cabinet of Ministers report reveals that SOCAR has transferred 933.7 million manats to SOFAZ from PSAs to revenues in 2006.⁴ In 2007 these discrepancies have been more obvious. For all that SOCAR has announced 1851.4 million manats and the Cabinet of Ministers 1860.7 million manats to have been transferred, SOFAZ has indicated in its report that it has received 1799.9 million manats on PSAs.⁵ Analogical number has been included neither in SOCAR nor the Government reports. The only available information is the amount of 11633.5 million manats in SOFAZ report.⁶ As obvious it has been decided not to disclose information at all to remove the discrepancies amid reports..

Additionally, SOCAR has removed from its 2008 Annual Report a lot of data which it had made public in previous years. Unlike previous years, the information concerning summaries of incomes generated in 2008, volume of receipts from oil and oil products sales, including the oil and oil commodities exports has been removed from the "Financial Outcomes" section of the Report. Despite that, the IFRS-related reports contain several new data. Also, comparative explanations of these reports with 2007 indicators contradict several

¹ No information is available.

² Presentation by SOCAR Vice-President Suleyman Gasimov at the EITI Conference held in Baku on June 3, 2007

³ 2006 SOFAZ Annual Report, page 8.

⁴ Report on the Cabinet of Minister's 2007 activities, page 79.

⁵ 2007 SOFAZ Annual Report, page 13.

⁶ 2008 SOFAZ Annual Report, page 9.

numbers publicized in the previous year report. Here, the differences created with accounting standards have naturally made its impact, as well. However, it does not seem convincing that there are such big discrepancies between the 2007 revenues and accounting standards. For instance, the Company indicated its revenues as 5914.0 million manats in the 2007 Report. As previously mentioned, in the previous years the Company indicated Azerbaijan Government's revenues on PSAs as a component of its own revenues. If to deduct this indicator concerning 2007 (1860.7 million manats) from the mentioned volume, it becomes obvious that the Company's net revenues in 2007 has been 4053.3 million manats. In the IFRS-related "Consolidated Incomes Statement" 2007 incomes have been indicated as 3820.3 million manats.⁷

If to try classifying the Company's incomes due to financial resources, it will not be possible to obtain this through official disclosures. The Company has disclosed in 2006 and 2007 only the summary of its incomes and the volumes of incomes it obtained from sales of oil and oil products, including from exports of oil and oil products. However, the Company has never disclosed the volume of its incomes which it obtained from other resources - from sales of oil it shared from PSAs, its own produced natural gas, sales of associated gas which it obtains from AIOC, also revenues generated from rendered services. At the same time, the Company has not indicated in its reports separate amounts it obtained from crude oil and oil products exports. Obviously, it is possible to approximately define most of the mentioned indicators by simple calculations. For example, as the amount of the value added tax over the PSA paid to state budget in 2008 is known, it is possible to calculate the total income earned by contractors and to define that SOCAR has earned 859.9 million manats in accordance with its share. At the same time, as the volume of crude oil exported in 2006 and 2007 and SOCAR's average annual sale prices are known, it would be possible to define how much the Company earned from this resource in those years. However, it is interesting that after November 2007, the Company has stopped placing information about average monthly prices for oil and oil products on its web page.⁸

Also, it is not possible to fully define how the financial transactions on crude oil sales in internal market, more precisely, the ways the transactions are carried out in the process of surrendering crude oil from production sector to processing enterprises. Crude oil is produced by the "Azneft" IU (also by SOCAR Joint Ventures and Operation Companies), later a small portion of that oil (1,3

⁷ 2006 SOCAR Annual Report, page 52.

⁸ <http://socar.az/price-az.html>

million tons) goes to exports, while the major part (7,35 million tons) is sent to the two SOCAR enterprises - Baku Oil Refinery and "Aznefttyagh" Oil Refinery.

The approach in accordance with this mechanism is that SOCAR's financial activities are based on centralized accounting (the centralized accounting infers a centralized accounts maintenance in relation with the Company's incomes and expenditures) and compiling a sole balance sheet. According to 4.5 Article of the SOCAR's Charter ratified by the presidential decree dated January 24, 2003, the Company maintains its mutual transactions with its affiliates via its centralized accounting department. At the same time, according to the Charter's Article 1.4, SOCAR compiles to a summary report and a balance sheet for its affiliates. Thus, the common logic is that there are no market sales available; a raw material which belongs to a SOCAR affiliate is used for the production of final goods by another SOCAR affiliate. In 2008, SOCAR's intercompany wholesale price for per ton raw oil was 63.6 manats, the prime cost of 1 ton raw oil of the was 68,26 manats (in 2007, 57.74 manats). It means that by giving the raw oil to oil processing enterprises with lower prices than the prime cost SOCAR ensures the revenues to be concentrated on a sole circle - in the processing process. Taking into consideration all these means that SOCAR's revenues from "receipts of raw oil sales" are limited to revenues from exports.

One of indicators, clarification on which wasn't possible while analyzing, is the amount of funds received from gas production. In 2008, the Company together with JV and OC has produced 7752.6 million cubic meters national gas and 6776.4 million cubic meters of it has been delivered. At the same time, it has received and delivered 2106.8 million cubic meters of associated gas obtained from the ACG project and 2096.7 million cubic meters natural gas from Shahdeniz Project.⁹ So, according to the information provided by SOCAR, in 2008 11956.1 million cubic meters natural gas was extracted and 10979.9 million cubic meters of it was delivered. However in the government provided data, the natural gas delivery from all resources in 2008 is indicated as 11200 million cubic meters.¹⁰ This discrepancy emerges in the international projects. Gas deliveries from ACG and Shahdeniz projects is indicated in the Company's data as 4200 million cubic meters, in the government provided data as 4500 million cubic meters. Also, according to EITI reports the gas deliveries from the Shahdeniz project is 2129.3 million cubic meters.¹¹ 5800 million cubic

⁹ ARDNŞ-nin 2008-ci il üzrə illik hesabatı, səh. 30-31.

¹⁰ Report on Cabinet of Minister's Activities in 2008,page 92.

¹¹ Report of the Government of Azerbaijan on aggregate incomes in Extractive Industry, 2008, annual.

meters of the delivered gas has been sold to "Azerigas" JSC, 4900 million cubic meters to "Azerenerji" JSC, while 500 million cubic meters has been exported. Nevertheless, it has not been possible to define how much funds SOCAR received from those sales. This information is available neither in the Company nor in government reports.

Another issue related to natural gas is the unknown fortune of natural associated gas produced from ACG. According to the PSA, associated gas is given to Azerbaijani side free of any charges. However, as known, PSA has been signed by SOCAR on behalf of the Government, so SOCAR is the Government. Under current circumstances the Company has actually obtained the right to own this gas to be delivered to Azerbaijani side and does not make any related payments to the Government. On other hand, in 2008, SOFAZ has received 131.2 million U.S. dollars from the profit gas delivered to the Government of Azerbaijan from Shahdeniz project, which shows that SOCAR pays only 61.6 U.S. dollars per 1000 cubic meters of natural gas. This is a slightly higher than the lowest sale price of natural gas at that period (42 manats per 1000 cubic meters - "Azerigas" JSC). Nevertheless, natural gas is sold to "Azerenerji" JSC and foreign countries with higher prices.

SOCAR revenues concerning oil, oil products, and natural gas are also important. However, the Company obtains extra revenues through leasing its property and transports means to foreign oil companies and rendering other services. These services are of wide ranges starting from geological surveys to transportation of oil products. One of the institutions which receive significant revenues is the CSOF and it has earned 105.8 million manats in 2008, 21.8% of which (23.0 million manats) came from contracts signed with foreign companies.¹² Information on how much the Company received from the other services is not specified in the reports.

Another resource of revenues which remain unspecified in reports is related to the revenues that SOCAR obtained from its operations in foreign countries. The Company has not provided any explanations on its revenues received through its affiliates - SOCAR Energy Georgia and SOCAR Gas Georgia companies which function in Georgia, Kulevi Terminal, and SOCAR Trading functioning in Switzerland, also the Petkim Holding, a part of shares of which has been obtained.

¹² SOCAR 2008 Annual Report, page 102.

1.2. Where do revenues go?

The detailed identification of financial flows neither in SOCAR expenditures nor in its revenues is possible. One of the reasons is that information regarding the Company's expenditure details in its reports is decreasing from year to year. For example, since 2007 Company has not entered any information related to oil products manufacturing expenditures into its reports. In 2007 and 2008, Company provided information about its expenditures on only three parameters. They are expenditures concerning oil and natural gas production, investments, and payments to the state budget. Volumes of expenditures related to oil and oil products transportation were not previously disclosed. According to unofficial information, SOCAR's expenditures to oil and oil products transportation constitute about 7-8% of their sale prices.

SOCAR expenditures structure (million manats)

Course of Expenditures	2006	2007	2008
1. Product manufacturing	1 059,7	M/Y	M/Y
1.1. <i>Production of raw oil and natural gas</i>	492,0	674,7	714,7
1.2. <i>Production of oil products</i>	567,7	M/Y	M/Y
2. Oil and oil products transportation costs	M/Y	M/Y	M/Y
3. Investments	284,9	768,0	913,9
4. Payments to state budget ¹³¹	564,9	891,2	1052,5
5. Other expenses	M/Y	M/Y	M/Y
Total expenditures	2 751,7	3 888,0	4 223,2
Payments to SOFAZ	924,4	1 860,7	11 633,5
Aggregate financial flows of expenditures	3 676,1	5 748,7	15 856,7

In 2008, 487.0 million manats was spent on oil production and 1 ton oil production cost was 68.26 manats.¹⁴ So, crude oil production cost, if compared to the previous year, has increased 18.2%, which herewith has overrun crude oil's intercompany wholesale prices (63,60 manats) for the first time. This appreciation is justified with raising expenditures of other costs, excluding property, land, and field taxes, which are included in production cost. Totally the appreciation of crude oil production cost has continued in all times, however, it has more sharpened after 2005.

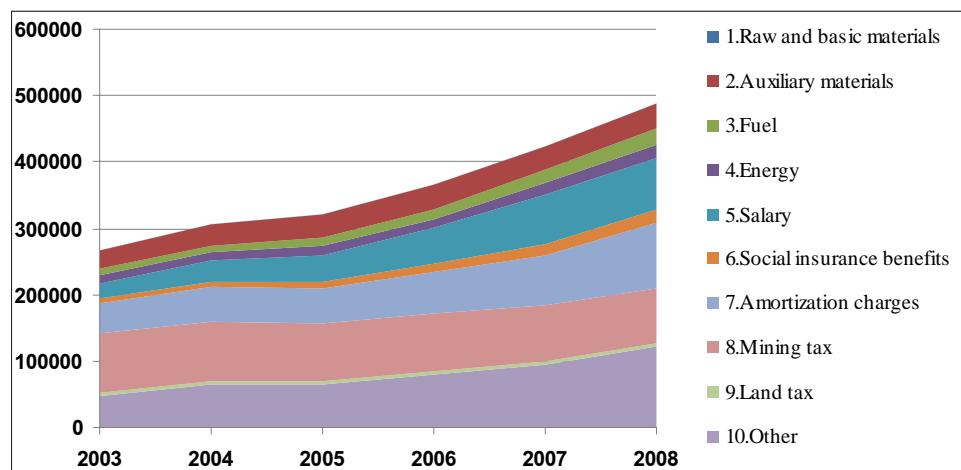
¹³ Budgetary payments considered in material production costs - property, land, royalty, and wage taxes are not included in this amount.

¹⁴ SOCAR Annual Report in 2008, page 45-46.

If compare the components of crude oil production costs in 2003-2008, it is possible to see that material expenses has increased 63.14%, wages and social insurance appropriations 213.43%, depreciation costs 122.91%, and other expenses, structure of which is not disclosed 159.72%. However, during that period oil production has decreased 8.06%, field taxes for oil production 7.94%, and land taxes 11.63%. One of the important moments is that the special share of "other expenses" in production costs is continuously increasing. For example, in 1993, this indicator was 17.6%, however, in 2008, it was 25.2%. The content of other expenditures are also not specified in the Company's reports. It also includes property tax, the value of which is inconsiderable (See: Annex: 1).

Production cost per barrel of oil by SOCAR (9.35 manats) is twice higher than the same indicator in ACG project. Production cost per barrel of oil in ACG is 5-6 U.S. dollars.¹⁵

Structural changes of SOCAR raw oil production cost in 2003-2008 (thousand manats)



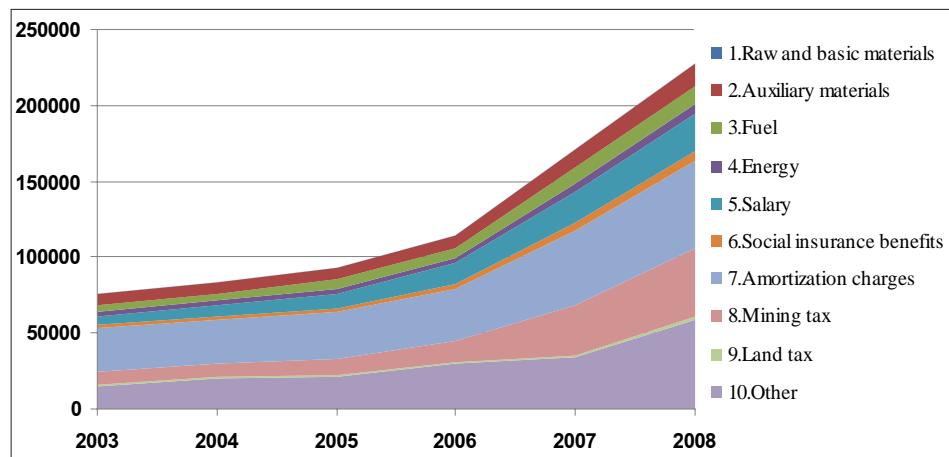
SOCAR's expenses to natural gas production have sharply increased in recent years. Especially, this appreciation has sharpened after 2005. It's true that increase in gas production (2 times) has a role to play in it. However, the production costs of 1000 cubic meters gas has sharply appreciated in the last five years. This indicator in 2008 was 28.89 manats,¹⁶ which is 53.76% higher compared to 2003 and 20.06% compared to 2005. However, when production volume increases, production cost usually decreases.

¹⁵ Industry and energy Minister Natig Aliyev's interview to Public Television, "Carch?" program, 4 February, 2009, http://www.itv.az/04_02_2009/02.php

¹⁶ 2008 SOCAR Annual Report, page 48.

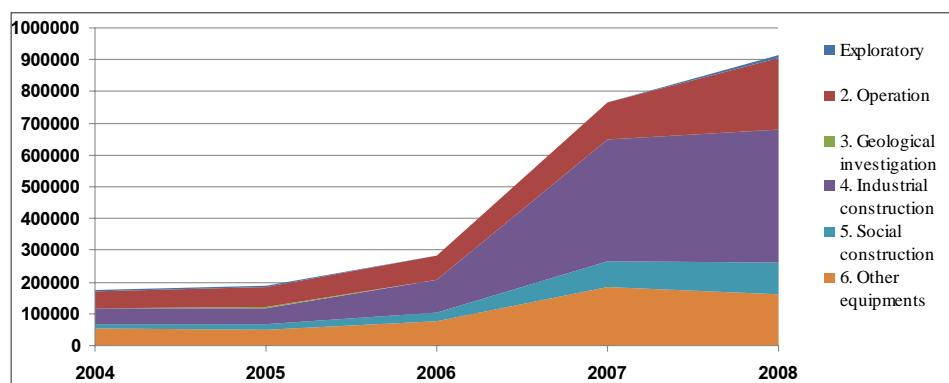
At the same time, one of the factors which increase the production cost of natural gas, as in oil production, is the increase in "other expenses" the structure of which is not specified from 19,6% to 26%.

Structural shifts in SOCAR natural gas production cost in 2003-2008 (thousand manats)



One of the key expense courses of the Company is the investments and from year to year these expenses are increasing countrywide. In 2008, SOCAR's investments have been 913.9 million manats, which is 19% higher than the previous year. At this point only internal investments are intended. It is worth to mention that while SOCAR's operating capabilities during the last 5 years have been dropped, its capital costs have been appreciated 4.2 times.

Structural changes of investments in 2004-2008 (thousand manats)

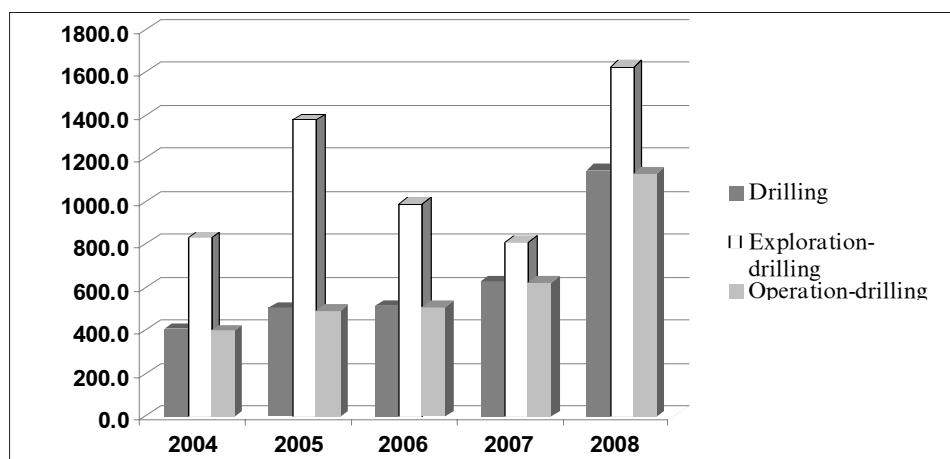


During this period, investments to field operations have been increased 4 times, industrial construction 8.9 times, social investments 7.5 times, funds used for purchase of uninstalling equipment 2.9 times. If all this were an outcome of a

specific investment policy it would be worth to scrutinize the issue in these terms. Still, SOCAR does not possess an open program for the general public in terms of both industrial and social investments. Despite informal news in 2007 about adoption of Social Investment Program at the Company it was later replaced with a list of rapidly shifting projects.

If to analyze SOCAR's capital investments due to several parameters, the ongoing is nothing more than the "real appreciation" and corruption risks in this area are high. For example, if we maintain a relationship between drilling investments and performed drilling operations, we can define one of the reasons for increasing capital investments. In 2008, the Company performed 202.6 thousand meters drilling activity¹⁷ and the capital investments to this area was 231.6 million manats and a capital investment per 1 meter drilling operation was 1144 manats. In 2004, this indicator was only 407 manats. So, during this period the volume of capital investment per 1 meter drilling operation has appreciated 2.8 times (See: Annex 3). It is worth to note that this appreciation has happened at the expense of depreciation of the capital basically invested in production and drilling operations. Capital invested in per 1 meter production and drilling operations appreciated in 2008 and grew to 1130 manats. The capital invested in per 1 meter geological survey and drilling operations in that period appreciated 96% and grew to 1626 manats in 2008.

Capital invested in per 1 meter drilling operations (manats)



Another parameter in evaluation of capital investments can be the value of delivered key funds. It is interesting that in terms of increasing capital invest-

¹⁷ 2008 SOCAR Annual Report, page 25.

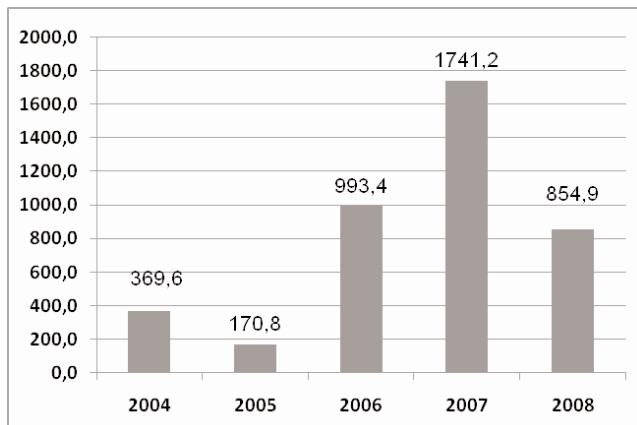
ments in SOCAR, the volumes of key funds delivered against 100-manats capital investments are decreasing every year. This indicator, which was 124.31 manats in 2004, in 2008, it dropped to 69.07 manats.

Ratio of delivered key funds to general capital investments

Directions	2004	2005	2006	2007	2008
Aggregated capital investment, thousand manats	175896	187291,7	284966,5	767699,4	913936,3
Delivered key funds, thousand manats	218652	150156	273029,1	538262,6	631246
Delivered key funds against 100 manats capital, manats	124,31	80,17	95,81	70,11	69,07

In order to assess the efficiency of the Company's social investments, one of the indicators could be volumes of expenses borne to construction of houses. In 2008, SOCAR spent 24665.3 thousand manats to house construction,¹⁸ which is 16.6% higher than the previous year and 3.2 times higher than 2004. At the same time, the total square of flats commissioned in 2008 is 39% more than in 2004. Simultaneously, the capital investment per square meter flat was 369.6 manats in 2004, this indicator turned into 854.9 manats in 2008. This indicator was the highest in 2007 - 1741.2 manats.

Capital investment per square meter flat in 2004-2008 (manats)



In any case, these indicators are significantly higher than real market prices. The Company argues that it performs these constructions without any commercial interests. However, the employees' housing could be realized with lower prices through contracts with construction companies.

It goes without saying that these indicators do not specify the prime cost of per square meter flat in the Company. Because residential buildings with their construction started in a certain year could actually not be commissioned in that same year. Due to this, SOCAR's expenses for per square meter flat area should be scrutinized among these indicators. In any case, these indicators are

¹⁸ 2008 SOCAR Annual Report, page 65.

significantly higher than real market prices. The Company argues that it performs these constructions without any commercial interests. However, the employees' housing could be realized with lower prices through contracts with construction companies. It should be noted that the Company displays photos of its different premises in the reports, however, it does not disclose any housing provided to its employees.

There are discrepancies between the Cabinet of Ministers' reports and the Company reports concerning SOCAR's capital investments. The Cabinet of Ministers' report indicates that in 2007, totally 703.4 million manats capital was invested by the Company.¹⁹ This is 64.3 million manats lesser than the amount the Company has disclosed. According to the Government report, 98 million manats of those funds spent on drilling operations (the difference is 21.4 million manats) and 171.2 million manats on uninstalling equipment (the difference is 14.6 million manats), 436.5 million manats to construction works (the difference is 24.8 million manats).

The Company spent 52.7 million manats on ecological activities in 2008. The spending on ecological activities in the previous year was not disclosed. In 2006, this spending was 23.4 million manats.

1.3. Relations with the State Budget

SOCAR has announced that it paid 1351.49 million manats to the State Budget in 2008, whereas the Cabinet of Ministers indicates this payment as 1351.6 million manats. In the SOCAR's Annual Report, the total of the amounts paid due to separate tax types is 1351.46 million manats. In general, the numbers provided by the Company and the Cabinet of Ministers concerning SOCAR's tax payments have not coincided in previous years, as well. Furthermore, indirect subsidies from the State Budget to the energy sector have been separately indicated by SOCAR as tax payments.

Scope of SOCAR tax payments in 2006-2008 (million manats)

Tax payments	2006	2007	2008
Calculated (SOCAR)	922,1	1158,8	1349,8
Paid (SOCAR)	734,1	1080,7	1351,5
Indirect subsidies	581,4	129,2	-
Paid (Cabinet of Ministers)	700,7	1080,7	1351,6

¹⁹ Report on Cabinet of Minister's Activities in 2007, page 79

If analyze the structure of calculated and paid taxes in 2008, we can witness big discrepancies. Although the difference between the total amounts of calculated and paid taxes is 11.76 million manats, for example, 88.1 million manats less payments have been made on income tax while 118.93 million manats excessive payment have been made on VAT. Or 147.41 million manats less payments have been made on export tax (imposed to the difference between wholesale and world market prices) while excessive tax payments are appears to have been made on excise, property, field and land taxes. What is happening? The reasons for such a chaotic state in a company, which has accepted international accounting standards is not incomprehensible.

There have been serious differences concerning the Company's calculations and payments on separate tax types in 2006 and 2007. It is obvious that SOCAR continues its "old traditions" despite its transfer to the IFRS.

SOCAR's calculations and payments on separate tax types in 2008 (million manats)

Tax kinds	Calculated	Paid	Difference
Profit tax	327,99	239,98	88,01
VAT	94,83	213,76	-118,93
Excise tax	372,26	387,04	-14,77
Property tax	20,31	74,01	-53,70
Royalty	126,41	146,98	-20,57
Land tax	8,28	17,16	-8,88
Salary tax	53,31	60,83	-7,52
Export tax	344,86	197,45	147,41
Other taxes	14,97	14,26	0,71
Total	1363,22	1351,46	11,76

Despite all the above mentioned, Azerbaijan's "generous attitude" towards SOCAR still continues. Although the tradition of indirect subsidies from the State Budget to the energy sector was seized in 2008, SOCAR goes on obtaining benefits from the State and the Budget. In order to increase the Company's charter capital, 400 million manats in 2008,²⁰ and 200 million manats in 2009²¹ was appropriated from the State Budget.

By the presidential decree dated 29 December 2009, the citizens' 327.0 million manats payables to the "Azerigas" Production Union for natural gas consumption till 1 October 2009 were repudiated. At the same time, in 2009 SOCAR received compensation from the State Budget at the rate of the repudiated payables.

²⁰ The Government Report on 2008 State Budget Implementation, page 13-14.

²¹ Appendix to Cabinet of Ministers Order #22s dated 2 February, 2009.

By the presidential decree dated 16 May 2007, 87.6 million manats had been transferred from SOFAZ to SOCAR.²² At that time it was justified so that the Company's incomes from ACG project in 1999-2002 had accumulated at the Fund. However, SOCAR had put no capital in accordance with its participation in that project. The necessary capital was put by foreign companies in return of the Company and its repayment was compensated with Azerbaijan's profit oil.

Furthermore, the Company received a 750 million manats credit from the Central Bank's centralized credit resources under "liquidity support".²³

Obviously, a significant portion of taxes paid by SOCAR to the State Budget is paid back to it in different ways. Without considering the indirect subsidies, the Company has received 1764.6 million manats as financial aid from the State Budget, SOFAZ, and centralized credit resources in 2007-2009, which nearly equals to the aggregate taxes paid by the Company in 2006-2007 (1781.4 million manats).

1.4. The Company's expenses do not cover its payables

On 1 January 2008, SOCAR's receivables were 8111.9 million manats, while its payables were 5780.3 million manats. Without considering intercompany payables, receivables were 3236.3 million manats, payables were 862 million manats. From receivables 1152.7 million manats is to "Azerenerji" JSC, 916 million manats to "Azerigas" JSC, 84.3 million manats to "Azerkimya" State Company, 160.4 million manats to AZAL State Corporation. There is not any information available on which organization the remaining 922.9 million manats receivables belongs to.

Structure of SOCAR's receivables in 2006-2008 (million manats)

Companies	2006	2007	2008
1. Intercompany receivables	4062,2	4875,6	M/Y
2. External receivables	3127,4	3236,3	1666,6
2.1. "Azerenerji" JSC	1328,5	1152,7	M/Y
2.2. "Azerigas" JSC	653,6	916,1	M/Y
2.3. AZAL SC	144,3	160,4	M/Y
2.4. "Azerkimya" SC	-	84,3	M/Y
2.5. Other	1001,0	922,8	M/Y
Total	7189,6	8111,9	M/Y

²² 2007 SOFAZ Annual Report, page 36.

²³ <http://www.cbar.az/> and Central Bank's Statement on its 2010 Monetary Policy's Principal Directions, page 3.

Furthermore, no information is available on causes of 862 million manats receivables and names of organizations to which payables are to be paid.

Structure of SOCAR's payables in 2006-2008 (million manats)

Companies	2006	2007	2008
1. Intercompany payables	4112,1	4918,9	M/Y
2. Payables to State Budget	346	M/Y	366,2
3.External payables	456,9	M/Y	1181,4
Total	4915	5780,9	M/Y

Decision #102 of the Cabinet of Ministers dated 9 June 2005 on "Big State Tax Payers Profit and Cost Budgets" implies that big state tax payers' profit and cost budgets will be approved by the Cabinet of Ministers, however, the budgets for 2007 have not been approved yet. This state leaves no grounds to substantiate and enlarge the Chamber of Accounts' set of analyses on tax payers.

In 2007, the Chamber of Accounts has carried out an analytical analysis of SOCAR's incomes and tax payments related with financial and economic indicators.²⁴ The analysis used the data provided by the Ministry of Taxes and State Statistics Committee and SOCAR's official site resources. Findings of the analysis demonstrated that at the end of 2006, according to SOCAR's Report, the scope of receivables were 7189.6 million manats. From receivables 4062.2 million manats were intercompany payables, while 3127.4 million were external entities payables to SOCAR. From external entities' receivables 42.4% were to "Azerenerji" JSC, 20.9% to "Azerigas" JSC, 1.1% to "Azerkimya" SC, and 4.6% to AZAL SC.

At that period SOCAR's payables were 4915.0 million manats. From the payables 4112.1 million manats were intercompany payables, 802.9 million manats were SOCAR payables to external entities. From the Company's receivables 346 million manats were the debts to the State Budget.

Chamber of Accounts believes that the reasons that turned SOCAR to have big amounts of intercompany receivables and payables, to be an indebted entity against the Budget, also the ongoing differences between SOCAR's Annual Reports and the Ministry of Taxes reports concerning the former's tax payments need to be analyzed.

²⁴ Report on Chamber of Accounts Activities in 2007, page 29.

1.5. SOCAR in Terms of IFRS

In accordance with the IFRS the Company in its annual report has provided: 1) Consolidated Balance Sheet; 2) Consolidated Income Statement; 3) Consolidated Changes in Equity Statement; 4) Consolidated Cash Flow Statement. However, no explanations are provided for these reports. Anyhow, these reports create new possibilities for financial flow tracking.

"Consolidated Balance" enables to get acquainted with data concerning the scopes of the Company's fixed-capital assets, charter capital, receivables and payables, long-term debt instruments, VAT debts, and joint investments and investments related to entities.

The Company's Charter Capital was 422.7 million manats on 31 December, 2008. 400 million manats expansion compared to the previous year was for the account of the State Budget.

It seems that the Company 2008 has partially solved the payables problem. However, this is not more than a technical solution. Furthermore, the data related to 2007 differ from those of the previous year. However, both receivables and payables increased in 2008 according to the IFRS-confirmed reports. Anyhow, the transfer to the IFRS has enabled the debts to the Company to swap and decrease compared to previous years.²⁵

At the same time, the Company's tax debts were 366.2 million manats at the end of 2008. The IFRS confirmed report indicates that the Company had 411.3 million manats debts at the end of 2007. However, the Company had announced that due to its transfer to the IFRS it had paid off all its debts before the end of 2007.

One of SOCAR's controversial financial indicators is concerning its profits. According to the Company reports, the scope of profits made in 2007 was 1537.9 million manats,²⁶ while the calculations by the Cabinet of Ministers declare it as 1700 million manats.²⁷ SOCAR's IFRS confirming 2008 reports indicators were introduced by comparison with the 2007. According to this report, however, the Company made 1841.0 million manats profit in 2007.²⁸ The

²⁵ 2008 SOCAR Annual Report, page 50.

²⁶ 2007 SOCAR Annual Report, page 42.

²⁷ Report on Cabinet of Minister's Activities in 2007, page 79

²⁸ 2008 SOCAR Annual Report, page 52.

2008 indicators differ more sharply: Company's report indicates 814.8 million manats, while the Government shows this amount as 2544.2 million manats.²⁹

All these are not simple discrepancies. The problem is that in 2007 SOCAR was announced to calculate 350.3 million manats income tax and 301.8 million manats were paid as such taxes. However, in the IFRS confirmed report calculated for that year 539.8 million manats as income tax.

The controversy concerning 2008 is that according to the Cabinet of Ministers calculations, SOCAR ended that year with great success. However, from the Company's Consolidated Income Statement it is obvious that 2008 was not so successful for SOCAR. This is proved by the increase of certain expenses. These increases are obvious from social expenses (272.6 million manats), other operation costs (108.4 million manats), financial expenses (147.8 million manats) and net losses from exchange differences (407.7 million manats). The last loses have increased 18 times compared to 2007, which is related to the shifts in exchange rates which resulted from the global economic recession in 2008. In 2008, the SOFAZ losses from exchange differences were 652.6 million manats. This means that the whole energy sector incurred losses of 1060.3 million manats from the shifts in exchange rates within one year (See: Annex 4).

At the same time, at the end of 2008, the Company's undivided profit was 6432.2 million manats and aggregate capital was 7486.3 million manats. The aggregate capital's 90% belongs to the majority (the State). The share of the minority (?) in the aggregate capital was 0,06% in 2007 and 10% in 2008.

The "Consolidated Income Statement" enables to obtain information on SOCAR's administrative costs. In 2008, the Company's total and administrative costs increased 11.9 million manats and amount to 185.4 million manats.

Increases in the Company's social expenses can be regarded as the outcome of chaotic social investments. The problem is that despite previously intended, SOCAR did not wish to give the Treatment and Diagnostics Centers (TDSs) that it constructed in the framework of the "Program for Social and Economic Development of Regions" to the balance of the Ministry of Health and started to manage them itself, which caused social expenses to rise.

²⁹ Report on Cabinet of Minister's Activities in 2008, page 94.

2. MONITORING OF SOCAR'S SOCIAL PROJECTS

In 2006-2008, SOCAR has implemented about 30 social projects.³⁰ Only 22 of these projects were predesigned and their total estimated costs were 160.0 million manats. The construction works were implied to cover 135.7 thousand square meters, including yards of construction facilities. Thus, expenses for per square meters of the total construction area was 1179 manats (See: Annex 5).

The followings are the social projects which were not predesigned but started in 2008: Tovuz TDC and 12 secondary schools (in Goranboy - 3, in Lerik - 3, in Zakhatala - 3, in Agsu - 1, in Balakan -1), Fuzuli district medical center, reconstruction of the stadium in Shirvan town, swimming pool in Goranboy and hotel in Balakan.³¹

SOCAR's social projects are implemented without tendering materials and services.³² Hereby the Company violates the requirements of the Law on "State Purchases" (27 December 2001, # 245 - II) and the Presidential Decree on Implementation of the Law on "State Purchases" (29 January 2002, № 668). According to the requirements of referenced legal instruments, purchases with a

³⁰ OWRPO Report on Results of Monitoring construction of social buildings in regions at the cost of the SOCAR, <http://www.nhmt-az.org>

³¹ <http://www.nhmt-az.org>

³² Final Report by OWRPO and PAAFE on the Project of "Monitoring of the projects on oil revenues use and public discussion of outcomes", page 8.

value of more than 50 000 need to be concluded on a tender basis. Values of social projects implemented by the Company are much higher than this amount.

One of the issues which call attention in the process implementing social projects by the national oil company is the fact that contractors selected on projects are being shifted quickly. Such cases occurred in the projects concerning construction of Ganja and Gazakh diagnostics centers.³³

Impacts of the global financial crisis on SOCAR have been the case in implementation of social projects, as well. The social projects with large amounts, especially construction of most TDCs were not concluded or commissioned even at the end of 2009. They are Guba, Jalilabad, Tovuz and Shamakhi TDMs, Balakan and Yevlakh hospitals, and Fuzuli district medical center.³⁴

2.1. Barda Treatment and Diagnostics Center

Barda TDC was commissioned in March, 2009. The construction area, including the basement is reported to be 16 thousand square meters. Its estimate price was confirmed as 13.9 million manats. However, no information was disclosed on the actual amount of funds spent.

Selection of contractors has not been carried out on the basis of tenders. In the construction process at least 3 companies have been shifted as a contractor. They are "Azerinshaat servis", "Garachay LTD" and "Inshaat avroservis" companies.

Medical equipments have been reported to spend about 2 million manats.³⁵ Predominantly, they are the products of Siemens and Hitachi. There are 10 wards with 2 beds each (one of them is for VIP persons), 4 surgeries, reanimation ward with 6 beds and 2 canteens. The center is supplied with 10 diffusion apparatus.

Although 260 persons were planned to work at the Barda TDC, job cuts have been made due to the economic recession and 180 persons are expected to work in it. The Center is planned to serve to population of Agjabedi, Tartar, Yevlakh, Goranboy, Beylagan and Agdam districts together with Barda residents.

Center's doctors have taken classes in 2-month courses at the Company's Oilmen Hospital in Baku. The medical staff who will work here are implied to receive 3

³³ Final Report by OWRPO and PAAFE on the Project of "Monitoring of the projects on oil revenues use and public discussion of outcomes", page 18.

³⁴ 2008 SOCAR Annual Report, page 109.

³⁵ Interview with Medical Superintendent of the BardaTDC Vagif Huseynov, June 2009.

times higher wages compared to those working in the state health system and 60 manats as premium to those whose working hours will exceed 8 hours.

Although the Center has opened, only its Hemodialysis Unit is currently functioning. The Center is planned to have reception, roentgen diagnostics, hemodialysis, surgical hospital, anesthesiology, reanimation wards, surgery block, and consultative and diagnostic polyclinics. Additionally, the TDC has a conference hall with seating capacity of 150 where it will be possible to watch operations live through the monitor to be installed there.

One of the peculiarities of the TDC is its expensive equipments. The medical superintendent's praises like "this ambulance costs 400 thousand USD", "these flower pots each cost 1000 manats", "all tiles used here have been brought from Spain" indicates that the HDC has cost to the Company more than planned (See: Annex 8).

It is not clear how much the Center is in consistent with medical services requirements of the region. According to the information of Barda Central Hospital cardiovascular, oncologic, neurologic, tuberculosis, and hepatitis diseases appear to be the key health problems in the district. The statistics of diseases in the district registered on 1 June, 2009 is as follows: 1652 persons - diabetes; 765 persons - ophthalmological diseases; 620 persons - tuberculosis; 318 persons - oncologic disease; 28 persons - hemophilia and leukemia; 19 persons - chronologic renal failure.³⁶

However, the Barda TDC's preferred direction is hemodialysis and is aimed at treatment of chronologic renal failure mentioned at the end of the above-mentioned list. It becomes obvious that while designing the TDC the needs of the medical service of the district have not been sufficiently estimated. Otherwise, the TDC's priorities would focus on meeting key medical requirements of the district.

The Barda TDC is located out of the town and no public transport is running to that area. Although the medical service is announced to be free of charges, local residents are skeptic about this.

³⁶ Interview with deputy of head doctor of the Barda District Central Hospital Rana Mustafayeva, June 2009.

2.2. Gusar District Qalajig Village secondary school

Qalajig secondary school was commissioned in September 2008. According to the project, the construction area was implied to be 1650 square meters, number of seats for pupils to be 320, and the project to cost 1.2 million manats (See: Annex 5).

It became obvious from the monitoring of the project that the total square of the school is 923.4 square meters and number of pupil seats is 257.³⁷ The school is two-storied and consists of 16 classrooms, sports and school halls, rooms for director and vice-principal. The ceiling of the school is 3 meters height.

Despite being budgeted, the school has not been supplied with furniture, and working education rooms with equipment and inventories. There is a computer room at the school and it has been supplied with 10 computers. However no telephone circuit and computers access to Internet is available.

The school yard has been repaired and paving stones have been inlaid. However, a part of the yard has subsided and refurbishment has become necessary. This is caused by improper soil fixation while inlaying the paving stones. The emerged problem has not been removed (See: Annex 9).

The name of the company which carried out the construction works is unknown. The school management is also unaware of this.

1.2 million manats have been spent on construction of the school and its per square serviceable area has cost 1300 manats to the Company. The funds spent on per pupil seat is 5058 manats. For comparison, being constructed by the Ministry of Education in the same year the school with 360 seats in Shahagaji village of Agstafa district cost 698 thousand manats (1938 manats per pupil seat) and the school with 360 pupil seats in Pirhasanli Village of Agsu cost 792 thousand manats (2200 manats per pupil seat).³⁸ Such examples could be continued. The comparisons show that the schools constructed by SOCAR are at least twice expensive than the schools built by the Ministry of Education. Although, the schools which have been constructed by the Ministry of Education, are not regarded as inexpensive projects.

³⁷. Interview with Gusar District Galajig secondary school Director Valeh Mirzaliyev, June 2009.

³⁸. Appendix to Cabinet of Ministers Order #44 dated 6 February, 2008.

2.3. Gusar District Ashaghi Leyer Village secondary school

Ashaghi Leyer secondary school was commissioned in November 2008. The construction area, including the school yard is 2198.0 square meters. The school is two-storied and number of seats for pupils is 320, and the estimated costs was planned to be 1.2 million manats.

It became obvious from the monitoring that the number of pupil seats is 304. The school consists of 18 classrooms, sports hall, development, working education, and computer rooms. The computer room has been supplied with 10 computers; however, access to Internet is unavailable.

Only after 8 month it has commissioned, deep breaches have been appeared in the first and second floors of the school. The breaches can be seen in collars as well (See: Annex 10). The school management and the Company's Social Development Department have been informed in this regard.

3. ACCESS TO SOCAR DATA

PAAFE while implementing the project of the "Monitoring over SOCAR's Financial Flow, Assessment of Transparency, and Public Discussion of Outcomes" addressed to the Company with information inquiry on 22 and 23 October, 2008. The information inquiry was included the wholesale oil prices in 2007, scope of profits made internally from the sale of oil and oil products and natural gas, the social projects implemented by the Company and their financial costs, and other information concerning details of SOCAR's other profits and costs. (see: Annex 4 and 5).

In the letter delivered by the Company regarding the first question of the information inquiry it was indicated that internal wholesale price of per ton oil is 53.6 manats. In regard with other questions it was noted that SOCAR is not considered as the information carrier on the specified issues. Furthermore, the reply indicated that lots of information under the information inquiry content is available at SOCAR's official Website and periodically issued Annual Report papers.

However, the questions incorporated into the inquiry had emerged after analyzing SOCAR's Annual Reports and the data at its official Website. Due to this, as the PAAFE was not provided with answers for emerged questions, it has applied to Baku City Sabayil District Court in accordance with the provisions of Article 6.0.7 and Article 49.1 of the Access to Information Law. The action has been justified as follows:

- *SOCAR was incorporated by the State, is owned by the State, its financial assets are state funds, and due to this, the Company is obliged to provide information to the general public on its profits, costs, and implemented projects;*
- *SOCAR represents the interests of the State while implementing oil and gas production and its sale in Azerbaijan and signs international and internal contracts on behalf of the State;*
- *The social projects implemented by this company directly are public functions;*
- *According to Article 9.1.2. of the Access to Information Law, legal entities that implement public functions are information carrier and are obliged to provide to the general the public facts, references, knowledge and all information, which are defined as public information by the laws and other legal acts or created or obtained in the process of performing public duties.³⁹ The Company performs public functions and its importance as the public entity has been confirmed by the Cabinet of Ministers Orders #108 and #140.*

The Sabail District Court has traversed the indictment by its decision dated 19 January, 2009. The decision reads:

As SOCAR is not a municipal or state agency and is not involved in public activities provided in 9.1.2. Article of the Access to Information Law, it is not the information carrier as set in this Article. SOCAR can be an information carrier only under the provisions the mentioned Law's Article 9.3.1 and concerning information which regards to the proviso on supply of the goods and services and their prices, also amendments to those proviso and prices. As the responds by SOCAR as information carrier to questions concerning the wholesale oil prices and its refusal from responding to other questions as being non information carrier is not unlawful, the defendant's decision is legal and valid, which cannot be assessed as the breach of the rights and freedom of a plaintiff.

Later, the PAAFE lodged an appeal from the Sabail district Court's decision. Baku Court of Appeal traversed the appeal application by its decision dated 02 April, 2009. The court has noted:

SOCAR, which was incorporated by the State, is a legal entity involved in trade business and does not perform any public activities. The Company publishes the data and information, which it has to provide to the general public, in a report form at its Website or as a journal. The Annual Report is officially delivered to state agencies, big state corporations, embassies, and foreign com-

³⁹. Law of Azerbaijan Republic on Obtaining Information. 11 December, 2005.

panies. As SOCAR is not a municipal or state agency and is not involved in public activities, it is not the information carrier defined in this article.

PAAFE has given a cassation appeal to the Supreme Court against the decision of Baku Court of Appeal dated 2 April, 2009. The High Court's decision dated 12 August, 2009 decided that there had been no any breaches of material and procedural laws in the process of investigation at the court and did not satisfy the plaintiff's cassation appeal and sustained the decision by the Court of Appeal.

The judicial proceedings showed that SOCAR attempts to conceal details of its activities and financial indicators from the general public. As the Company's financial data details are often contradicting, the Company is beware from its financial flow being tracked and analyzed. Every year number of data disclosed to the general public is reduced, which undermines the monitoring options of the Company's financial flow and increases corruption risks. Taking into consideration all this, in connection with the problem PAAFE has applied to the European Human Rights Court in February, 2010. Although this process will take 2-3 years, solution of the problem concerning access to the Company's information is vital for the Civil Society, expert community, researchers, and Mass Media. Furthermore, it can be regarded as a main key to organize public control over the Company's financial flow.

4. POLICY PAPER ON IMPACTS OF SOCAR'S TRANSITION TO DISAGGREGATED REPORTING WITHIN THE FRAMEWORK OF EITI

This Policy Paper⁴⁰ covers a study on potential impacts of SOCAR's transition to disaggregated reporting through EITI and outlines of relevant advocacy campaign for NGO coalition for ITEI. Disclosure of the document to the public is aimed at the international Executive Board of EITI, its Secretariat, State Commission on EITI and the Secretariat, Multilateral Group, other international agencies which are direct stakeholders in EITI and local organizations. This document would facilitate with exposure of problems related with SOCAR's transparency and advocacy activities that the coalition would implement.

Azerbaijan declared joining EITI as of June 17, 2003. A state commission was established, based on the Decree # 224 of the Cabinet of Ministers issued on November 13, 2003 in regards to implementation of the initiative. On November

⁴⁰. This policy paper was developed through support of OSI-AF and commissioned by the NGO Coalition for ITEI.

2004, a Memorandum of Understanding between the Government, production industry companies and civil society "on Application of Extractive Industries Transparency Initiative in the Republic of Azerbaijan." SOCAR is one of the multilateral extractive industry companies which signed the Memorandum.⁴¹

At the time being, type of accountability on EITI depends on each country's choice. Accountability is implemented by both companies and the government in only three countries (Guinea, Nigeria and Mongolia) where the initiative is implemented.⁴² In remaining countries, including Azerbaijan, EITI reports are of general nature and are not disclosed to the public per each company. However, the first criterion of EITI necessitates this: "Regular publication of all material oil, gas and mining payments by companies to governments ("payments") and all material revenues received by governments from oil, gas and mining companies ("revenues") to a wide audience in a publicly accessible, comprehensive and comprehensible manner."⁴³ This criterion explicitly requires EITI accountability to be observed by both companies and also by the government, as well as disclosure to the general public. In fact, this criterion reflects the philosophy of EITI. In other words, companies should disclose what they have paid and the government what it has received; independent accountants should compare reports; and the civil society would implement public control over all these processes.

NGO Coalition for ITEI has been implementing advocacy activities for the past 4 years for transition of extractive industry companies to disaggregated reporting. As a product of these activities, BP Company started to disclose individual reports on EITI as of 2007 on its operations in Azerbaijan.⁴⁴ Statoil Hydro, Shell, Middle East Petroleum and Binagadioil companies have stated their agreement to disclose individual reports, in response to relevant inquiry by the State Commission on EITI.

Hess Company shares the same position with SOCAR. 14 companies are against disaggregated reporting in general and their list includes influential companies such as ExxonMobile, Chevron and Total.

SOCAR's refusal of disaggregated reporting negatively impacts expansion of disaggregated reporting on EITI. This is due to the fact that all companies

⁴¹. <http://www.oilfund.az/eiti/az/doc/>

⁴². Drilling Down: The Civil Society Guide to Extractive Industry Revenues and the EITI. Revenue Watch Institute, New York, 2008.

⁴³. EITI Source book. DFID, London, 2005.

⁴⁴. BP in Azerbaijan Sustainability Report 2006 and 2007

which have joined the initiative are SOCAR's partners. Also, oil and gas contracts with all these companies have been signed by the SOCAR on behalf of the Government. Under these conditions, it is not unusual that the majority of these companies, especially those which are small and unknown would share SOCAR's position on EITI.

4.1. Accountability situation with SOCAR

The SOCAR has released 10 reports to independent accountants on EITI. The Company's payments to both foreign and also to local companies are included as deposits in the general report on the Initiative, which is disclosed for public. This is not limited to individual payments and taxes. For instance, the company's profits tax per international PSA is included as part of the section for "other deposits from foreign companies;" and the same tax for "Azneft" Industrial Union under the section for "other deposits from local companies."⁴⁵

It is the sixth year that the company publishes annual reports on its operations and uploads these reports on its website. These reports are usually published in July-August and sometimes in November of following years. Annual reports include information on the company's structure, revenues, expenditures, breakdown of its cost price, structure of payments to the state budget, payables and receivables and other data.⁴⁶

The company adopted IFRS as of the beginning of 2008 and the first international audit was carried out on conclusions of that year.

One of the main problems in relation to accountability of the Company is the inconsistency of certain indicators in annual reports with those of the Government's. For instance, the Company states that its revenues for 2007 were 1537.9 million manats.⁴⁷ However, the Government's report indicates that SOCAR's revenues for the same year were 1700 million manats. There are also contradictions in regards to performance of the Company's tax obligations in its report.⁴⁸ The Company's report notes that taxes were calculated at 1158.8 million manats and 1080.7 million manats were paid as taxes during 2007. Further, the Company declares that it has paid off all its debts through an indirect subsidy of 129.2 mil-

⁴⁵. Report of the Government of the Republic of Azerbaijan on total deposits for 2007 from extractive industries, 2007.

⁴⁶. Annual Report of SOCAR 2007.

⁴⁷. Annual Report of SOCAR 2007.

⁴⁸. Report on Performance of the Cabinet of Ministers during 2007.

lion manats.⁴⁹ On the other hand, the annual report of the Chamber of Accounts specifies that for the end of 2006 the Company owed 346 million manats to the state budget.⁵⁰ Accountability of the Company on debt obligations is not at a satisfactory level. The Company does not disclose the structure of its payables and receivables, especially its payables to external bodies (892 million manats).

It is also noteworthy that the amount of Company's payables and receivables is increasing every year. Considering that the SOCAR's financial capabilities are adequately growing, the Chamber of Accounts believes that the following issues must be investigated: causes of large amounts of in-company payables and receivables; the company debtor status for the State Budget; and inconsistencies between annual reports of SOCAR on tax payments and reports of the Ministry of Taxes.⁵¹

SOCAR's accountability before the public is not at a satisfactory level. The Company has not even organized a single discussion with NGOs and external experts on issues of public importance such as social investments or affects on the environment. The Company refuses to reply to inquiries submitted by NGOs and the media and excuses itself with claiming that it is not an information holder identified by the requirements of the law "on Obtaining Information."⁵²

4.2. Potential impacts of SOCAR's transition to disaggregated reporting and increasing transparency

First criterion of EITI necessitates disaggregated reporting of extractive industries. From this point of view, it is important that accountability is based on existing contracts and laws; and balancing⁵³ disclosure of information within the framework of EITI with the need for companies to keep their commercial data confidential.

SOCAR is a state company and its statute is approved by the President of the Republic of Azerbaijan. It maintains seals, stamps, letterheads and other identification signs which include an image of the National Emblem of the Republic of Azerbaijan and the Company's name. Structure of the Company - its management structure and list of subordinate institutions is endorsed by the President of the Republic of Azerbaijan. The Company's President, First

⁴⁹. Annual Report of SOCAR 2007.

⁵⁰. Report on Performance of the Chamber of Accounts during 2007.

⁵¹. Report on Performance of the Chamber of Accounts during 2007.

⁵². SOCAR's letter (# 22/i?-66) to PAAFE, dated January 12, 2009.

⁵³. EITI Source book. DFID, London, 2005.

Vice-President and Vice-President responsible for geology, geophysics and exploitation of deposits are appointed and discharged to position by the President of the Republic of Azerbaijan. The President of the Republic of Azerbaijan has the authority to restructure or abolish the Company.⁵⁴

SOCAR's revenue is one of the sources of oil revenues for the Republic of Azerbaijan. Since the Company is totally owned by the State, its revenues belong to the State as well and such revenues are public funds.

As a major taxpayer, SOCAR is obliged to coordinate with the Ministry of Taxes, Ministry of Economic Development and the Ministry of Finances its quarterly budget estimates which should include revenues and expenditures for following years for and submit such estimates to the Cabinet of Ministers until November 1st of each year for endorsement. Further, the Company is required to submit reports to the Ministry of Finances and the Ministry of Economic Development on quarterly implementation of its endorsed budget for revenues and expenditures until 25th of following months after each quarter.⁵⁵

The SOCAR adopted IFRS as of January 1, 2008. One of the main principles of IFRS is transparency. This includes unilateral complete disclosures by companies. Complete openness is considered to be one of the main factors in establishment of a transparency system which would benefit stakeholders in a common market.⁵⁶

Based on Article 9.1.2 of the Access to Information Law, the Company is an information holder as a legal person fulfilling public functions. Further, it should disclose to the public all information in regards to its functions as well as generated or obtained facts, opinions, and findings produced in the process of fulfilling public duties deemed as public information by the laws or other normative legal acts. Despite the fact that the Company does not consider itself as an information holder in accordance with this Law, Article 9.1.2 of the Law and Resolutions 108 and 140 of Cabinet of Ministers of the Republic of Azerbaijan proves the opposite.⁵⁷ Resolution 108 sets out the criteria for iden-

⁵⁴. SOCAR's Statute, January 24, 2003.

⁵⁵. Resolution 102 of the Cabinet of Ministers on estimates for revenues and expenditures of major taxpayers, June 9, 2005.

⁵⁶. International Financial Reporting Standards. A practical guide. The World Bank.

⁵⁷. Resolution 108 of the Cabinet of Ministers on endorsement of criteria indicators for consideration of commercial enterprises (with the exception of credit entities, insurance companies, investment funds, non-governmental social funds, legal entities with securities in stock market circulation) as entities with public importance. June 20, 2005.

tifying agencies with information that is of public importance. Resolution 140, on the other hand, provides a further confirmation that SOCAR, as well as 5 of its main enterprises (Baku Oil Refinery named after H.Aliyev, "Azneftyagh" Oil Refinery, Department for Oil Pipelines, Department for Marketing and Economic Operations, and "Azneft" Industrial Union) are agencies with public importance.⁵⁸ These documents demonstrate that besides the Company itself, 5 enterprises that it owns are information holders based on the Law "on Obtaining Information."

Hence, impacts of SOCAR's transition to disaggregated reporting within the framework of EITI could be summarized as below:

- *Requirement of the first criterion of EITI;*
- *The fact that the SOCAR is a state company and its resources are public funds and oil revenues of the country;*
- *As a major taxpayer, the requirement for endorsement of the Company's quarterly draft budgets for revenues and expenditures and accordingly its quarterly reports by the Ministry of Finances and the Ministry of Economic Development;*
- *Transition of the Company to IFRS;*
- *The fact that SOCAR is an information holder based on the Access to Information Law;*
- *The fact that the Department of Marketing and Economic Operations of SOCAR and "Azneft" Industrial Union are information holders in accordance with on the Access to Information Law, which is a particularly important part of reporting in terms of EITI.*

4.3. Recommendations for NGO Coalition for ITEI

In accordance with potential impacts of SOCAR's transition to disaggregated reporting implementation of the following are proposed as advocacy activities to be carried out by the NGO Coalition for ITEI:

- *Continuation of activities in regards to disaggregated reporting of companies based on EITI. A) Achieving inauguration of disclosures by companies which have agreed to disaggregated reporting. B) Development of petitions to main offices of influential companies such as Exxon Mobile, Chevron and Total to join this process. The more companies start disaggregated reporting will expose SOCAR to public reproaches;*

⁵⁸. Resolution 140 of the Cabinet of Ministers on endorsement of the list of entities with public importance which are obliged to conduct bookkeeping in accordance with ISFR and submit financial reports. July 18, 2005.

- *Development of a special petition to the International Executive Board of EITI on the fact that as a state company, SOCAR's role prevents disaggregated reporting on EITI;*
- *Filing inquiries to the Ministry of Finances and the Ministry of Economic Development on certain issues not disclosed by SOCAR: for instance, documents that the Company prepared on transition to IFRS, disclosures on IFRS in regards to conclusions of 2008, quarterly budget estimates for incomes and expenditures; and implementation of approved quarterly budget estimates for incomes and expenditures;*
- *Continuing with inquiries for information addressed to SOCAR by members of the Coalition and activities aimed at referring to courts in cases when SOCAR does not respond. More court cases, especially with the European Court of Human Rights would contribute to increased transparency with the Company's functions;*
- *SOCAR is directly related with EITI accountability of "Azneft" IU and the Department for Marketing and Economic Operations. First of all, these enterprises are local production facilities of the Company. Secondly, they are responsible for international oil and gas contracts. It would be appropriate to file information inquiries to these enterprises of the Company on disclosures with respect to EITI reports. This would augment pressures on the Company in regards to its transparency and increased number of court cases if such inquiries are not responded to; expected results of which are mentioned in above mentioned recommendations.*

Annex 1. Oil production cost in SOCAR in 2003-2008 and its structure

Cost items	2003		2004		2005		2006		2007		2008	
	Thousand manats	%										
1. Material costs	49792	18,6	54415	17,7	61206	19,1	65764	17,9	73019	17,3	81229	16,7
1.1. Raw and basic materials	138	0,1	0	0,0	0	0,0	0	0,0	0	0,0	0	0,0
1.2. Auxiliary materials	29143	10,9	33164	10,8	35581	11,1	38025	10,4	33948	8,0	36151	7,4
1.3. Fuel	8277	3,1	9250	3,0	12126	3,8	15196	4,1	19827	4,7	24178	5,0
1.4. Energy	12234	4,6	12001	3,9	13499	4,2	12543	3,4	19244	4,5	20900	4,3
2. Salary	24278	9,1	32448	10,6	41348	12,9	54334	14,8	72576	17,2	76949	15,8
3. Social insurance benefits	6385	2,4	8495	2,8	9238	2,9	12674	3,5	17751	4,2	19159	3,9
4. Amortization charges	44857	16,8	52033	17,0	51346	16,0	63092	17,2	76243	18,0	99990	20,5
5. Miscellaneous expenditures	142103	53,1	159266	52,0	157669	49,1	170599	46,6	183380	43,4	209681	43,1
5.1. Royalty	89038	33,3	88890	29,0	88022	27,4	86650	23,6	84092	19,9	81964	16,8
5.2. Land tax	5898	2,2	5845	1,9	6065	1,9	3774	1,0	5637	1,3	5212	1,1
5.3. Other	47168	17,6	64631	21,1	63382	19,8	80175	21,9	93651	22,1	122505	25,2
6. Costs for total output	267416	100,0	306757	100,0	320807	100,0	366463	100	422969	100	487008	100
7. Costs for non -total output	888	545	0	0	0	0	0	0	0	0	0	0
8. Production costs	3998	4108	4837	4417	5086	4417	5086	5537	5537	5537	5537	5537
9. Unfinished production	-180	878	634	487	345	487	345	-965	-965	-965	-965	-965
10. Costs for commodity production	262710	301226	315337	361559	417538	361559	417538	482436	482436	482436	482436	482436
11. Commercial expenses	207	192	0	16375	18778	16375	18778	21517	21517	21517	21517	21517
12. Overall costs for commodity production	262916	301418	315337	377934	435316	377934	435316	503953	503953	503953	503953	503953
Cost for per ton commodity oil production, manat	32,98	37,86	39,99	48,57	57,74	68,26	68,26					
Total production, ton	8063371	8050108	797329		7606746		7413367					
Commodity production, ton	7969650	7556411	7383338	7780980	7556411	7383338	7383338					

Annex 2. Natural gas production cost in SOCAR in 2003-2008 and its structure

Cost items	2003		2004		2005		2006		2007		2008	
	Thousand manats	%	Thousand manats	%	Thousand manats	%	Thousand manats	%	Thousand manats	%	Thousand manats	%
1. Material costs	14429	19,1	14930	17,9	16347	17,6	17412	15,3	27185	15,9	33049	14,5
1.1.Raw and basic materials	50	0,1	0	0,0	0	0,0	0	0,0	0	0,0	0	0,0
1.2.Auxiliary materials	7408	9,8	7534	9,0	7424	8,0	7923	6,9	11040	6,5	15228	6,7
1.3. Fuel	4377	5,8	4671	5,6	5780	6,2	6638	5,8	10534	6,2	11762	5,2
1.4. Energy	2594	3,4	2725	3,3	3143	3,4	2851	2,5	5611	3,3	6059	2,7
2. Salary	5890	7,8	7360	8,8	9960	10,7	13982	12,3	20942	12,3	24588	10,8
3. Social insurance benefits	1551	2,1	1990	2,4	2178	2,4	3292	2,9	4952	2,9	6226	2,7
4. Amortization charges	29058	38,5	28817	34,6	30675	33,1	35009	30,7	48802	28,6	58617	25,7
5.Miscellaneous expenditures	24562	32,5	30191	36,2	33520	36,2	44354	38,9	68620	40,2	105241	46,2
5.1.Royalty	8447	11,2	8290	10,0	11125	12,0	13093	11,5	32880	19,3	44781	19,7
5.2.Land tax	1308	1,7	1370	1,6	1152	1,2	1049	0,9	1663	1,0	1341	0,6
5.3.Other	14807	19,6	20531	24,7	21243	22,9	30212	26,5	34077	20,0	59119	26,0
6.Costs for total output	75489	100,0	83288	100,0	92680	100,0	114049	100	170501	100	227721	100
7.Costs for non- total output	185	33	0	0	0	0	0	0	0	0	0	0
8.Production costs	3998		10071		13517		15090		22686		31280	
9.Costs for commodity production	64330		73184		79163		98959		147815		196441	
Cost for 1000 m3 commodity gas production, manat	18,14		20,96		23,23		25,5		27,75		27,89	
Total production, 1000 m3	4038228		3880937		3823959				5853534		7646006	
Commodity production, 1000 m3	3544496		3491680		3408243		3880910		5327069		7043397	

Annex 3. Capital investments structure in SOCAR (thousand manat)

Directions	2004	2005	2006	2007	2008
1. Drilling	58637,9	67226,2	77987,7	119427,3	231639,4
<i>1.1. Exploratory</i>	<i>2477,1</i>	<i>2562,8</i>	<i>2188,7</i>	<i>4169,1</i>	<i>7738,8</i>
<i>1.2. Operation</i>	<i>56160,8</i>	<i>64663,4</i>	<i>75799,0</i>	<i>115258,2</i>	<i>223900,6</i>
2. Geological investigation	1397,6	2233,6	1754,4	1457,9	2642,7
3. Construction	59974,5	68163,9	127689,4	461268,5	517552,6
<i>3.1. Social construction</i>	<i>12977,8</i>	<i>19548,2</i>	<i>27867,5</i>	<i>81147,3</i>	<i>97132,1</i>
<i>also</i>					
<i>Buildings</i>	<i>7666,0</i>	<i>7768,8</i>	<i>7971,2</i>	<i>21160,5</i>	<i>24665,3</i>
<i>Communal</i>	<i>949,4</i>	<i>4916</i>	<i>1857,7</i>	<i>2822,0</i>	<i>1362,7</i>
<i>Education</i>	<i>2005,0</i>	<i>1931</i>	<i>1199,7</i>	<i>10147,6</i>	<i>16502,5</i>
<i>Health</i>	<i>2357,4</i>	<i>4932,4</i>	<i>16838,9</i>	<i>47017,6</i>	<i>53655,7</i>
Other equipments	55886,0	49668	77535,0	185545,7	162101,6
Total	175896,0	187291,7	284966,5	767699,4	913936,3

Annex 4. IFRS-related Consolidated Incomes Statement of SOCAR
(thousand manats)

Indicators	2008	2007
Revenues	4 710 845	3 820 275
Cost price of sales	(2 906 918)	(1 539 674)
Total for profit	1 803 927	2 280 601
Distribution costs	(135 147)	(150 334)
Common and administrative costs	(185 376)	(173 466)
Losses related to transfer of assets and other losses, net	(71 515)	(44 338)
Social allowance	(272 557)	(53 338)
Exploration appraisal costs	(6 900)	(9 866)
Survey and development costs	(4 022)	(5 533)
Other operating costs	(108 379)	(31 954)
Other operating incomes	222 294	82 180
Profit gained from operations	1 242 325	1 893 952
Financial income	55 524	15 216
Financial expenses	(147 789)	(91 920)
Net loss on exchange difference	(407 676)	(21 397)
Net financial expenses	(499 941)	(98,101)
Share in financial outcomes of joint ventures	(11 106)	19 038
Share in financial outcomes of associated enterprises	83 523	26 542
Pretax profit	814 801	1 841 431
Expense for profit tax	(327 985)	(539 784)
Profit for financial year	486 816	1 301 647
The profit shall be allocated as follows:		
Equity share	733 545	1 302 262
Minority interest	(246 729)	(615)
Profit for financial year	486 816	1 301 647

Annex 5. Social projects implemented by SOCAR during 2006-2008

N	Name of facility	Total area (m ²)	Value (thousand manats)	Cost for 1 m ² (manats)	Completion date
1	Central hospital with a capacity of 235 beds in Balaken district	20024,0	29400,0	1 468,24	August 2008
2	Secondary school with a capacity of 450 pupils in Ititala village of Balaken district	2463,0	1658,3	673,3	April 2008
3	Construction of a home of culture and a medical point in Ititala village of Balaken district	567,0	475,6	838,8	I Quarter 2008
4	Construction of a library in Balaken district	532,0	334,3	628,4	II Quarter 2008
5	Treatment and Diagnostics Centre in Zagatala	7176,0	9875,4	1376,2	April 2008
6	Lyceum with a capacity of 500 pupils in Zagatala district	2750,0	1945,4	707,4	II Quarter 2008
7	Secondary school with a capacity of 320 pupils in Ashaghi Leyer village of Gusar district	2198,0	1200,0	546,0	II Quarter 2008
8	Secondary school with a capacity of 200 pupils in Suvashal village of Gusar district	1606,0	900,0	560,4	II Quarter 2008
9	Repair of Secondary School # 6 with a capacity of 1176 pupils in Gusar district	-	-	-	November 2007
10	Secondary school with a capacity of 320 pupils in Galajig village in Gusar district	1650,0	1200,0	727,3	III Quarter 2008
11	Treatment and Diagnostics Center in Lenkoran	5842,0	4300,0	736,0	June 2006
12	Treatment and Diagnostics Center in Shirvan	6644,0	7393,3	1112,8	December 2007
13	Treatment and Diagnostics Center in Gabala	7705,0	7800,0	1012,3	March 2008
14	Treatment and Diagnostics Center in Gazakh	7400,9	11920,6	1610,7	April 2008
15	Treatment and Diagnostics Center in Ganja	11069,0	13250,0	1197,0	April 2008
16	Treatment and Diagnostics Center in Barda	12340,0	13856,0	1122,9	June 2008
17	Treatment and Diagnostics Center in Guba	8025,0	9350,0	1165,1	June 2008
18	Treatment and Diagnostics Center in Jalilabad	5500,0	9356,0	1701,1	December 2008
19	Treatment and Diagnostics Center in Shamakhi	7000,0	9356,0	1336,6	2008
20	Central hospital with a capacity of 235 beds in Yevlakh city	15000,0	20470,0	1364,7	October 2009
21	Secondary school with a capacity of 800 pupils in Goygol district	8274,0	4937,2	596,7	2007
22	Secondary school in Chiyni village of Aghsu district	1905,0	1000,0	524,9	IV Quarter 2008
	Total	135670,9	159978,1	1179,2	

Annex 6. Questions included to information inquiry dated October 22, 2008 and addressed to SOCAR

1. Which projects did SOCAR implement during 2007 in the social sphere and what is the financial value of these projects individually?
2. If possible, please provide us with a list of projects implemented by the Company during 2007 and 2008 inclusive of the names of subcontractors and estimated values of the projects.
3. Does SOCAR have a program document on social investment? If possible, please provide us with a document on which the company's social investments are based upon.

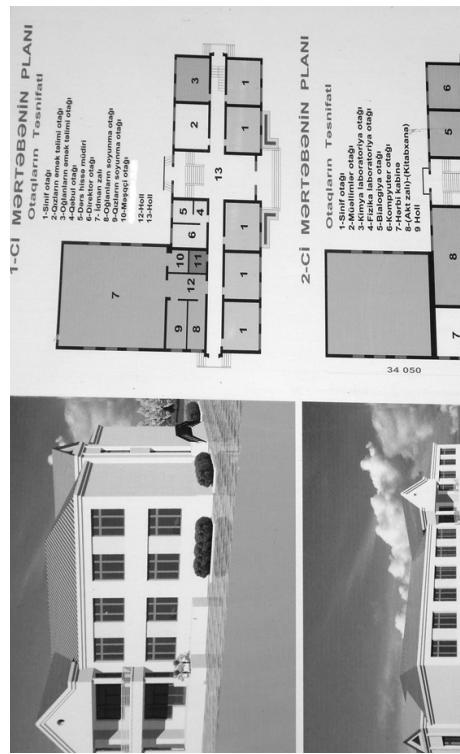
Annex 7 Questions included to information inquiry dated October 23, 2008 and addressed to SOCAR

1. What was the in-company wholesale price for one ton of raw oil in 2007?
2. What is the amount of revenues from export of raw oil in 2007?
3. What was the amount of revenues from sale of oil products within the country during 2007?
4. What was the amount of revenues from export of oil products during 2007?
5. What was the amount of profit oil from revenues as SOCAR's share within the framework of Product Sharing Agreements during 2007?
6. What was the amount of revenues from sale of natural gas during 2007?
7. What was the amount of expenditures on procurement of capital resources, including machinery and equipment for oil and gas production during 2007?
8. What is the amount of expenditures on extraction of raw oil during 2007?
9. What is the amount of expenditures on production of semi-finished products, raw and other materials, and extraction of raw oil for refining purposes during 2007?
10. What is the amount expenditure on wages for oil refinery during 2007?
11. Please provide us with information on structure of payments to the State Budget (including profit tax, VAT, royalty, land tax, property tax, and export tax) exclusive of indirect subsidies.
12. What are the main internal normative documents for conducting bookkeeping and its organization within SOCAR?
13. Please provide us with a copy of normative documents (Bookkeeping Policy and Accounting Directives) that the Company developed in terms of its transition to IFRS (International Financial Reporting Standards).

Annex 8. Images from Treatment and Diagnostics Centre in Barda



Annex 9. Images from Secondary school in Galajig village of Gusar district



Annex 10. Images from Secondary school in Ashaghi Leyer village of Gusar district

