



## **Conclusion of "Increasing Transparency in Extractive Industries" NGO Coalition on the 2015 EITI report of the Republic of Azerbaijan**

*This opinion document was prepared, in line with article 2.4.9 of Memorandum of understanding by the Analytical Group with arelevant decision of the ITEI NGO Coalition Council adopted at the 166<sup>th</sup> meeting on December 28, 2016.*

*An opinion of Increasing Transparency in Extractive Industries (ITEI) NGO Coalition over the 2015 EITI report of Azerbaijan Republic was adopted through discussions at the meeting of Coalition Council held on January 31, 2017.*

*The development of the Opinion was carried out on compliance with the requirements of EITI standards. Reconciliation, comparative, structural and trend analysis methods were applied while preparing this document. Along with this, general and specific driven recommendations were suggested based on the outcomes of conducted evaluation for improvement of the report in the upcoming years.*

### **EITI requirement I: Oversight by the multi-stakeholder group**

#### **1.1 Government engagement**

According to the paragraph a) of 1.1 standard under this requirement, the government is required to issue an unequivocal public statement of its intention to implement the EITI. Furthermore, paragraph b) of 1.1 standard lays out that the government is required to appoint a senior individual to lead the implementation of the EITI. A new composition of the previous EITI Commission established with last order was comprised of representatives from relevant state agencies aligned with 11 directions. Six of them are regularly involved in the work of multi-stakeholder group (MSG) as its members. Due to the fact that principles and criterions on representation of EITI Commission members within the MSG are not incorporated in the Ordinance and reports, therefore, there is uncertainty over the selection process of 6 members out of 11.

As coming to the paragraph d) of 1.1 standard, it highlights that the government must ensure senior government officials are represented on the multi-stakeholder group. Currently, the governmental officials member to the MSG are represented on the level of heads of department and their deputies. Despite the fact that the 2015 EITI report describes the roles and objectives of 11 state agencies of Azerbaijan Republic, however, their functions related to the engagement in the EITI process are not specified accurately. Although data in the current report meets requirements of the Standard, but it is recommended to describe it more broadly in the next reports. It should be noted that the findings of the assessment have come to the conclusion that the data in the 2015 report are meeting the requirements of the Standard and it could be considered promising.

## **1.2. Production industry companies**

The report lays out that over 30 Production Sharing Agreements (PSA) were inked since the signing of Azeri-Chirag-Gunashli PSA in 20 September of 1994 until 2016. Nevertheless, the exact number of signed PSAs is not specified in the report. Despite the fact that the data on PSAs were provided in the course of the 2015 reporting period, however, information related to the accountability of "Zenith Energy Ltd" company newly involved into the process was not covered. The section of the report on "Reconciliation results" shows that 29 foreign extractive companies and 2 local extractive companies are involved into the process. These companies have reported the total payments made to the government. Additionally, it should be noted that in spite of the fact that the issue of Azerbaijan President's the decree on the establishment of "AzerGold" Ltd dates back to February 11 of 2015, however, the EITI report covering 2015 period does not contain any data about this company.

In general, compliance of data with the requirements of the Standard reflected in the report can be considered as satisfactory - although there is scarcity of information in this direction.

## **1.3. Civil society engagement**

As paragraph 1.3 of this Standard sets out that civil society must be fully, actively and effectively engaged in the EITI process. According to the appendix to the report, 134 NGOs and in addition this, 9 civil society and media representatives were engaged in the process at the end of previous year. Moreover, "Registration of agreements (decisions) on receiving (awarding) grants" approved with #27 decree of the President of Azerbaijan Republic on February 12, 2004 as well as "Rules on obtaining the right to give a grant by foreign donors in the territory of Azerbaijan" ratified with #339 decision of Cabinet of Ministers of Azerbaijan Republic on 22 October of 2015 which were adopted during the reporting period have severely endangered and worsened the situation to comply with the requirements of this Standard. Nevertheless, the solution of practical problems of numerous NGOs was launched during the reporting period. The bank accounts of all NGOs member to ITEI Coalition are freed from arrests, tax debts of some organizations were removed, their representatives are not subject to border inspections anymore, and interrogations led by prosecutor general office were suspended. According to the paragraph b) of Standard 1.3, the government must ensure that there is an enabling environment for civil society participation with regard to relevant laws, regulations, and administrative rules as well as actual practice in implementation of the EITI. It further emphasizes that the fundamental rights of civil society substantively engaged in the EITI, including but not restricted to members of the multi-stakeholder group, must be respected. As a result of restrictive amendments made to the NGO legislation in 2013-2015 there are still problems existing in the fields of registration of NGO grants, registration of foreign donors as well as state registration of organizations. It should be mentioned that positive steps were enacted for simplification of afore-mentioned Rules following the reporting year - 2016 and 2017, however, these policy actions did not eliminate fully registration requirement associated with grants and foreign donors.

The paragraph c) of the Standard outlines that the government must ensure there are no obstacles to civil society participation in the EITI process. Currently, main barrier on participation of ITEI Coalition members in this process is lack of access to financial resources. This is due to the fact that as a key local donor the Council of State Support to Non-Governmental Organizations has even suspended implementation of its grant project allocated for the ITEI Coalition that was totally deprived from any financial support. Along with this, the Council has removed the EITI, it was a special direction in 2016 and 2016 years, from its calls for bids in 2017.

As coming to paragraph d) of 1.3 Standard, it mentions the government must refrain from actions which result in narrowing or restricting public debate in relation to implementation of the EITI. However, an assessment of the EITI Work Plan implementation for the period 2016 has shown that the failure to execute majority of activities falling under the obligations of ITEI Coalition members in the Work Plan are associated with restrictions imposed over their actions. Thus, the members of ITEI Coalition are still encountering with administrative hurdles on arrangement of debates in central televisions, including seminars in universities and round tables in the regions.

The observations proves that in spite of the fact that civil society, including multi-stakeholder group members could exercise their rights in the field of transparency and natural resource governance, however; they are unable to share their thoughts in broad audiences due to restrictions over EITI related public debates. At the same time, civil society, especially a group represented within the MSG is unable to participate and contribute effectively to this process regardless of their close engagement, implementation, monitoring and evaluation of the EITI due to narrowing access to financial resources. In a nutshell, information described under this section of the report could be estimated as unsatisfactory.

#### **1.4. Multi-stakeholder group**

In 2015, there have been overall 7 meetings of MSG dedicated to the implementation of Extractive Industries Transparency Initiative (EITI) in Azerbaijan. According to this requirement, in establishing the multi-stakeholder group, the government must ensure that the invitation to participate in the group is open and transparent. Each stakeholder group must have the right to appoint its own representatives, bearing in mind the desirability of pluralistic and diverse representation. Civil society groups involved in the EITI as members of the multi-stakeholder group must be operationally, and in policy terms, independent of government and/or companies. The civil society groups involved in the EITI as members of the multi-stakeholder group had not adopted relevant rules during the reporting period that makes them operationally, and in policy terms, independent of government and/or companies.

As underlined in the paragraph b) of 1.4 Standard, the multi-stakeholder group has agreed clear public Terms of Reference (ToRs) for its work, and the role, responsibilities and rights of the multi-stakeholder group have been developed. Nevertheless, the multi-stakeholder group did not undertake effective outreach activities with civil society groups and companies, including through media,informing stakeholders of the government's commitment to implement the EITI, and the central role of companies and civil society. Additionally, the multi-stakeholder group has failed to widely disseminate the public information that results from the EITI process such as the EITI Report. However, information incorporated into the report is considered satisfactory.

#### **1.5. Work Plan**

The 2015 Work Plan was approved after 3 months since the beginning of the current year at the meeting of multi-stakeholder group dating back to 03.04.2015.

According to paragraph a) of 1.5 Standard, the Plan should set EITI implementation objectives that are linked to the EITI Principles and reflect national priorities for the extractive industries. Multi-stakeholder groups are encouraged to explore innovative approaches to extending EITI

implementation to increase the comprehensiveness of EITI reporting and public understanding of revenues and encourage high standards of transparency and accountability in public life, government operations and in business.

This requirement is partially met in the 2015 Work Plan. Thus, while preparing the work plan an alignment between the objectives and national priorities was subtly achieved, and innovative methods are not applied broadly.

Additionally, it did not assess and outline plans to address any potential capacity constraints in government agencies, companies and civil society that may be an obstacle to effective EITI implementation. Despite the fact that the main obstacle on implementation of EITI during this year was related to creating an enabling environment for free and effective participation of civil society in this process, however, the Work Plan do not address relevant activities in this direction.

It is worth highlighting that the 2015 Work Plan address the scope of EITI reporting, including technical aspects of reporting, but there are delays on its implementation. Therefore, planned activities for 2015 were executed in the year of 2016.

As paragraph d) of 1.5 Standard outlines that the Plan should identify domestic and external sources of funding and technical assistance where appropriate in order to ensure timely implementation of the agreed work plan. Furthermore, paragraph e) of the same Standard requires making the Plan widely available to the public and publishing on the national EITI website. The paragraph f) of this Standard also outlines that the Work Plan should be reviewed and updated annually. This requirement was met. Eventually, paragraph g) of 1.5 Standard outlines a necessity to include a timetable for implementation that is aligned with the reporting and Validation deadlines established by the EITI Board and that takes into account administrative requirements such as procurement processes and funding.

The 2015 EITI report mentions that MSG is fulfilling its activities in accordance to the Work Plan on EITI implementation. The objectives of the 2015 EITI annual Work Plan were defined in line with the national priorities on extractive industries by complying with the requirements of the Standard. Besides, the report does not contain any other evaluations associated with the Work Plan. Thus, we consider reflected data within the report as adequate

As a result of evaluation of first requirement of the Standard, the following recommendations are provided for improving the current situation:

- *Multi-stakeholder group should continue upholding its initiatives on improvement of laws that regulate activities of the civil society and create an enabling environment aimed at free and effective participation of civil society members in the EITI process.*
- *The government should double its efforts to lift current obstacles through enhancing the laws that regulate NGO activities, especially to eliminate the existing barriers associated to the state registration, grant registration of NGOs as well as entrusting them rights to operate with foreign donors.*
- *Legal and administrative hurdles should be removed in funding of institutional and program activities of ITEI Coalition as a party to the Memorandum of Understanding on EITI implementation in the Republic of Azerbaijan.*

- *Enabling environment should be created for representatives of the ITEI Coalition in order to organize public debates of the EITI reports at the central televisions, Universities, including regions and Baku through conduction of round tables and press conferences.*
- *Communication opportunities of the ITEI Coalition members with each others, especially between MSG members and the Coalition Council should be intensified and broadened.*
- *A broad coverage of current situation in accordance to the requirement of 1.3 paragraph of the Standard in the EITI progress report should be ensured.*
- *Rules or regulations ensuring a good rapport between the EITI and MSG members, and overseeing periodical replacements aiming to achieve full, active and effective involvement of the government in the EITI process should be developed.*
- *EITI Commission should be comprised of senior persons from relevant state agencies in order to ensure representation of high-ranking governmental officials within the multi-stakeholder group, and a renewal of their composition should be processed on an operative and flexible manner.*
- *The government in the MSG should be represented by members of the EITI Commission. Their replacement with low-ranking officials should be prevented.*
- *Extractive industry companies in the MSG should be represented with high-ranking officials.*
- *Rules and procedures on sources of funding, work programme, duties, including transparent and accountable operation of civil society members in the multi-stakeholder group should be adopted.*
- *Number of public affiliated events organized on behalf of multi-stakeholder group should not be only limited with presentation of the EITI report in media outlets, but it should be expanded beyond this.*
- *Minutes of multi-stakeholder group should be widely published and its public accessibility/availability should be ensured.*
- *Annual work plans prepared by the multi-stakeholder group should be adopted at the end of the previous year and before the start of current year.*
- *Objectives of the Work Plan should be aligned closely with national priorities.*
- *Work Plan should be renewed and updated on quarterly basis at the meetings of multi-stakeholder group.*
- *The EITI requirements should be assessed in the course of preparation of Work Plan, and the Plan should be enriched with proposals related to resolution of existing issues.*

As a result of assessment of the first requirement of the Standard, the following recommendations are provided for improving the current situation:

- *Roles and responsibilities of state agencies of Azerbaijan Republic should be accurately and clearly described in the report and their EITI driven functions and responsibilities should be underscored.*
- *Number of signed PSAs, genuine PSAs, including registered and currently operational companies in production industries should be accurately recorded in the report.*
- *The procedures in regard to the involvement of companies in the EITI process and their rights of representation in the MSG should be clarified in the report.*
- *The report also should include information about “AzerGold” Closed Joint-Stock Company*

## **EITI requirement II: Licenses and contracts**

### **2.1. Legal framework**

According to this requirement, implementing countries must disclose a description of the legal framework and fiscal regime governing the extractive industries. This information must include a summary description of the fiscal regime, including the level of fiscal devolution, an overview of the relevant laws and regulations, and information on the roles and responsibilities of the relevant government agencies. In comparison to the Reports of previous years, there is progress in this specific section of the 2015 report:

The list of international contracts having regulatory role is expanded; the list of legal-normative documents includes laws along with 2 decrees of the President of Azerbaijan Republic and 1 decision of the Cabinet of Ministers; and unlike to previous years, the framework of relationships regulated by each legal-normative documents were generally presented; describes relationships between extractive industries and state budget on fiscal regime; general description of interrelation between relevant state agencies and extractive industries.

Besides, relations on mining industries regulated by each legal norms named above are of general character. It is necessary to describe this information more in detail in the upcoming reports and include a summary description of relations on extractive sector regulated by normative documents. At the same time, efforts should be continued to incorporate all legal-normative documents that oversee the activities regarding extractive industries. For example, decree of President of Azerbaijan Republic dating back to July 22 of 2011 was not included to the report, and in fact this decree is one of the normative documents regulating fiscal relations related to BTC Main Export Oil Pipeline. Nevertheless, it would be useful to reflect the impact of implemented changes over regulation of extractive sector in the legal-normative documents.

A description of relationship of different state agencies with extractive companies in the Report is of general character. It would be relevant to provide the interaction between state agencies and extractive companies more in detail. ( For instance, Does the Ministry of Ecology and Natural Resources is entitled to make any decision on ecological activities of extractive companies? and other such matters)

In general, information reflected in the Report meets the requirements of the Standard.

### **2.2. License allocations**

As it is known, the exploration and exploitation of natural resource deposits (mines) in Azerbaijan falls under licensable activities. Additionally, this does not contain any special licensing rules, and therefore, it is not possible to award any new licenses in the extractive sector throughout a year.

The activities of extractive industry companies are not established through licensing process in Azerbaijan, but it is realized based on production sharing agreements. It is clear that there should be essential rules for signing the production sharing agreements. Due to absence of a special law that oversees issues and procedures concerning PSAs, each agreement becomes as a legal document after being ratified at the Parliament of Azerbaijan Republic. The PSAs reflect itself stipulations related to all activities (including exploration and production of deposits) carried out by contractors within the Agreement.

The 2015 EITI Report touches upon procedures related to the PSA practices implemented in Azerbaijan, including information on new PSAs during the reporting period (page 22). Besides,

despite the fact that the report include establishment procedures of PSAs, however, it does not contain any information that would explain ways of engagement of various extractive industry companies in this process, access to data on deposits (mines) which exploration and development works are already launched, and also to what extent the engagement process of companies are meeting competitive standards. It is highly recommended to enrich the next report with above mentioned matters

In general, information in the Report is evaluated as satisfactory.

### **2.3. Register of licenses**

In line with definition of "license" term in paragraph a) of this requirement as well as considering the full list of information, the register of all PSAs operating in Azerbaijan was prepared and posted in the open source.

The Report fully complies with this requirement of the Standard.

### **2.4. Contracts**

The requirement of the Standard encourages implementing countries to publicly disclose any contracts and licenses. Moreover, it also makes clear it is a requirement that the EITI Report documents the government's policy on disclosure of contracts and licenses that govern the exploration and exploitation of oil, gas and minerals.

The 2015 Report mentions that 6 oil-gas contracts currently operational in Azerbaijan are posted at the website of EITI. The report further outlines that the incumbent government does not have a special policy in the field of disclosure of contracts and licenses that govern the exploration and exploitation of oil, gas and minerals.

The Coalition believes that it is expedient that MSG continues its efforts in the direction of achieving a disclosure of other contracts.

The Report fully complies with this requirement of the Standard.

### **2.5. Beneficial ownership**

The government has not undertaken any steps in regard to beneficial ownership in 2015 and therefore, it is not the subject of the Report so far.

### **2.6. State participation**

The report indicates that currently the state is engaged in the oil-gas industry through State Oil Company of Azerbaijan Republic (SOCAR), whereas the extractive sector (exploitation of gold deposits) is represented by "AzeriGold" LTD.

Besides, the report includes background information on establishment of SOCAR, its relationship with different state owned enterprises, the practices governing transfers of funds between the state-owned enterprises and the state, financial indicators and data on production, including a level of beneficial ownership within SOCAR's joint ventures, associates and subsidiaries and emerging changes, loan and loan guarantees, and information related to activities of the company in foreign markets. In comparison with the report of previous year, the progress is recorded in this specific section of the 2015 Report: contents of given data and its coverage. Additionally, the Report does not comprehensively address the relationship between government agencies and the SOCAR. For example, the Report lists the names of government agencies that the Company has submitted its

annual reports (page 25), nevertheless, it does not disclose the issues covered within the annual reports submitted to the government agencies.

The information given in the Report about the legal regulation of SOCAR's activities is over generalized (page 25). It would have been significant to provide a list of key legal-normative documents directly overseeing the activity of the Company and a brief summary of each act that regulates relationships. Moreover, the Report talks about neither appointment nor dismissal of president and vice-president of SOCAR by the President of Azerbaijan Republic. Similarly, it does not address to the question on formation of the supreme governing bodies of the Company.

The information on annual reporting system on the activity of SOCAR in the Report is incomplete and vague (page 26). In fact, the Report should contain 3 reports (financial, general activities and sustainable development) related to the annual activity of SOCAR. A summary information about the coverage and content of each report and hyperlinks as footnotes of these reports should be included to the Report. In return, this would demonstrate SOCAR's intention being openness and accountable to the public about its activities.

In general, information in the Report is evaluated as satisfactory.

As a result of evaluation of second requirement of the Standard, the following recommendations are provided for improving the current situation:

- *MSG should continue its efforts on disclosure of PSAs that have been blocked until now from public access;*
- *MSG should address to the government on development of a special policy regarding disclosure of information regulating exploration and exploitation of oil, gas and minerals.*

As a result of evaluation of second requirement of the Standard, the following recommendations are provided for improving the current situation:

- *The Report should provide full list of legal-normative documents that regulate the activities of extractive sector;*
- *The Report should include a summary (description) on tangible (concrete) relationships overseeing each legal-normative document in association with extractive industry;*
- *The Report should reflect an impact of implemented changes during the accounting year to regulation of extractive industries.*
- *The Report should contain detailed information in regard to the relationships between state agencies and extractive companies.*
- *The Report in line with requirement of " License allocations" should explain the way of how companies access to information on exploration and the fields (mines) ready for exploitation, including engagement of different extractive companies to this process and to what extent the process meets competitive pre-conditions for its implementation.*
- *The Report should provide more detailed and comprehensive information in relation to SOCAR's relationship with state agencies, all state agencies should be included to this component and submitted data should correspond with characteristics of relationships (What report does the Company submit to these agencies, what are the characteristics of fiscal relationships ( payments, taxes, fines, dividends, etc), non-financial relationships and so on)*
- *The Report should contain a list of important legal-normative documents that directly manage the activities of SOCAR and a short summary for each act should be provided;*

- *The Report should include information on direct appointment and dismissal of president and vice-president of SOCAR by the President of Azerbaijan Republic. Similarly, it should address to the question on formation of the supreme governing bodies of the Company;*
- *The Report should cover 3 reports ( financial, general activities and sustainable development) related to the annual activity of SOCAR, including an overview information about the coverage and content of each report should be disclosed and it is sufficient to include a reference or link in the EITI Report;*

### **EITI Requirement 3: Exploration and Production**

#### **3.1. Exploration**

The 2015 Report addresses the third EITI Requirement based on three directions - overview of the mining industry, production volume and the share of the export in the extractive industry. Initially, "Overview of the mining industry" is described under 3.1 paragraph and this section covers mainly the areas like the volume of oil-gas reserves, their geographical locations, contracts regarding oil-gas fields on the onshore and offshore, including contractors and their participating interests, gold and silver extraction, and significant exploration activities. Virtually, the data given under this paragraph are identical with information provided in 2013 and 2014 Reports. There are minor changes made in the composition of participants in Shahdeniz PSA in 2014 and 2015 years, including new participants over the agreement signed between BP Exploration (Caspian Sea) Limited and SOCAR Commercial Affiliate on April 14 of 2015 regarding the exploration of Absheron Peninsula shallow part, and the participating interests of each of this company put as 50 percent.

The 2015 report reflects generally covers the approved amounts of oil and gas reserves of Azerbaijan. It should be noted that an opinion of the Coalition provided for the 2013 Report strongly recommends to incorporate the volume of resources on all fields and product types (oil, gas, condensate, gold, silver and etc.) in the next reports, including to adopt decision on implementation of this recommendation during the discussions at MSG, and execute necessary deeds by the Working Group. In spite of these advices, none of the above mentioned information was included into the 2015 Report either.

In addition to this, it should be mentioned that information given under this paragraph of the report in regard to significant exploration activities does not fully reflect the carried out exploration operations and it is too succinct. We believe that this information is not sufficient for the report. Also, the given information should be described in a comprehensive and clear form.

Along with this, there is a huge extractive industry potential in the occupied territories of Azerbaijan, especially in Kalbajar region situated at the Lesser Caucasus Mountains. These areas have 112,5 ton industrial resources and exploitable Soyudulu (Zod) reserves as well as Agduzdag and Tutkhun gold fields amounting more than 13 ton resources; industrial driven three Agyataq, Levchay, Chorbulag fields having in total 850 reserves, and Gamishli and Aggayaciva deposits holding more than 200 ton reserves. Some of these fields (Zod and others) have gone through exploration and exploitation stages back in Soviet period. Currently, those deposits are exploited by the companies of Armenia who occupied the territories of Azerbaijan.

Certainly, there are significant mining potential in other regions under the occupation. It is recommended to give coverage on mining industry, reserves, exact geography of the occupied territories in the EITI report, particularly under "Overview of the mining industry" section.

In general, information in the Report is assessed as satisfactory.

### **3.2. Production**

The paragraph 3.2 under EITI Requirement 3 embodies production data of a country submitted the report. This mainly requires implementing countries to disclose production data for the fiscal year, including total production volumes and the value of production by commodity, and, when relevant, by state/region. This could include sources of the production data and information on how the production volumes and values disclosed in the EITI Report have been calculated.

Additionally, the requirement of 3.2 paragraph of the EITI Standard was evaluated against the 2015 Report and information described in here. The section 3.2 of the report focuses mainly on production volume (in-kind) and amount (price, mln. US dollars) of extraction by foreign and local extractive companies in 2015. More importantly, it is a positive sign to denote the results by using two different in-kind units of measurement (ton/barrel, cubic meter/MMBTU, kg/ounces) as well as show correlation between the them. However, it would have added more value if it explained the calculation of a "special formula".

Moreover, due to absence of disclosure of the total production volumes and the value of production by commodity as required by the Standard, including sources of the production data by companies and information on how the production volumes and values have been calculated, this section of the report was evaluated as insufficient.

The "Production volume" section of the 2015 report is fully relevant in terms of format and content with the 2014 Report. Also, compliance of given data in the report with the requirement of the Standard could be assessed as satisfactory.

### **3.3 Export**

The 2015 Report regards to oil and gas as the main export products of Azerbaijan, and along with this, it also presents section under finished and semi-finished silver, and other products. This section also gives information about the products exported as in-kind and value (amount) forms.

In accordance to the requirement of the Standard, the share of the export in the regions, including extractive industry is denoted neither in absolute terms nor in relative values. Along with this, presentation of dynamic in the share of exports in terms of value and in-kind in the last three years should be considered as a positive step. Nevertheless, the occurring changes, especially rationale behind the reduction of export in two times in 2015 compared to previous years were not analyzed.

Additionally, it is worth highlighting that summarizing total exports (11,4 bln.US dollars) on extractive industry for 2015 under "other products" sub-section which amount roughly 21 percent is raising questions. Thus, compliance of given data in the report with the requirement of the Standard could be assessed as satisfactory.

As a result of evaluation of third requirement of the Standard, the following recommendations are provided for improving the current situation:

- *The data on illegal exploitation of fields by Armenian at the occupied territories of Azerbaijan Republic should be incorporated into the EITI report.*
- *Information associated with exploration activities in the EITI report should be expanded.*

- *The volume of reserves on all fields and product types (oil, gas, condensate, gold, silver and so on) should be included to the EITI report.*

## **EITI Requirement 4: Revenue collection**

### **4.1 Comprehensive disclosure**

The requirement on comprehensive disclosure in the EITI report usually evaluated as satisfactory. As the main extractive industry of the country is considered oil-gas production, involvement of companies into accountability does not create any obstacles. Even the revenues from a relatively new area - mining industry are regulated through PSA, and therefore, chasing them and demanding accountability do not yield any difficulties. Certainly, the representation of leading foreign companies within the PSA positively impact to the quality of accountability. Given this, setting up a level of significance is logical and in a sense, it is considered one of the factors simplifying the accountability.

Furthermore, it is surprising to see an absence of dividend transfers from listed revenue sources. The payment of dividends to the government for operation of BTC pipeline had been suspended since 2013 and currently, the Report does not provide any explanation on this matter. It is not sufficient to make reference to a relevant decision of MSG in the Report. Therefore, it is required to provide additional comments on this.

In general, the EITI report meets the Standard's relevant requirement.

### **4.2. Sale of the state's share of production or other revenues collected in kind.**

The main revenues from extractive industry of the country are paid to the government, in compliance with PSA's stipulations, in the form of in-kind. This include carbohydrogen products and non-ferrous metals transferred to the government in the form of oil-gas, gold, silver and copper

During the reporting period, the figures related to crude oil, natural gas, associated gas, including gold, silver, gold concentrate, silver concentrate, and copper concentrate transferred to the government are overlapping. However, there is a critical difference ( 181 346 mln. cubic meter) on transfers of associated gas, and this can be explained as an application of different unites of measurement in the report.

A positive side of reflection of in-kind revenues in the report is the sale of crude oil and gas as the state's share (including SOCAR) in later stage ( whom, volume, and value).

Thus, this information is relatively filling gaps in the report and it clarifies the fate of crude oil that falls under the state's share. Along with this, although it underlines the non-export of gold, silver and copper products in the reporting period, however, it neither explains how government utilized the above mentioned products nor indicates to the end-user. Therefore, it is required to provide additional comments on this.

In general, the EITI report meets the Standard's relevant requirement.

### **4.3 Infrastructure provisions and barter arrangements.**

Information regarding infrastructure provisions and barter arrangements was not included in EITI report for the year ended 2015. This is due to the decision made by EITI Multi Stakeholder Group on

34th meeting dated 10 December 2014 to eliminate the information which is not relevant in Azerbaijan Republic.

As a matter of principle, the report mentions that there have not been barter arrangements and this is justified by referring to the relevant minutes of the MSG.

#### **4.4. Transportation revenues**

The data provided in the report should not be considered as satisfactory. In spite of giving detailed technical information regarding 4 oil and gas pipelines, but the listed data on revenues are incomplete and vague. Besides pointing out to different status of pipelines, however, it is still unclear through what means each of them are generating revenues (or why not generating) to the state budget. Additionally, it fails to explain the reasons behind international investment company, formed by virtue of investors of BTC and South Caucasus Pipeline (SCP), "Azeri-Chirag-Guneshli" and "Shah-Deniz" projects, evading to pay transit fees to Azerbaijan government. Moreover, it raises questions as to whom the Baku-Novorossiysk oil pipeline belongs and why it does not contribute to the transit fees. More importantly, the Report does not contain any information about the owner (government, SOCAR or investors) of this pipeline.

It is worth mentioning that "Baku-Supsa" is the only pipeline that currently government gains transit fees. In 2015, the government received 11,6 million dollar transit fee for transportation of crude oil via the pipeline. Nevertheless, an ever growing difference regarding entangled financial relationships between SOCAR and operators are common in the EITI reports. Regardless of repeated pretensions and feedbacks made by the NGO Coalition, the issues are not addressed properly and the administrator relates it to objective factors.

The data in the 2015 Report is assessed as satisfactory.

In general, compliance of the 2015 EITI report with the Standard's relevant requirement could be regarded satisfactory.

#### **4.5. Transactions related to state-owned enterprises.**

SOCAR acting on behalf of the Azerbaijan Republic within the PSA Framework obtains state's share of oil and gas in-kind from the participant of PSAs, and thus, making the Company as a central "player" in terms of chasing the transactions. Therefore, SOCAR's financial interactions with other enterprises are of vital importance. It could be lauded that the report is enriched with such information along with the sale of crude oil and gas in foreign market. The current practice meets requirement of the Standard that ensuring the reporting process comprehensively addresses the role of state-owned enterprises (SOEs), including material payments to SOEs. The situation related to this requirement is satisfactory and therefore, no recommendations are offered.

#### **4.6. Sub-national payments.**

This requirement is not implemented in Azerbaijan and given this, it is not part of the report.

#### **4.7. Level of disaggregation**

The payments in the Report are presented as a form revenue streams, different individual companies, and concentration of revenues in a government entity and even different agreements. The main pretension related to this requirement is that payment data is given in a vague and unclear manner. The positioning of reconciliation timetable on one part of the report, and amendments on the

part prevents the Report to be user-friendly. This section of the Report meets 4.7 requirement of the Standard.

#### **4.8. Data timeliness**

As a general rule, there is adherence to the set timeline of the EITI Standard. The report prepared at the end of 2006 is reflecting the data given for 2005 and this should be considered an exemplary aspect.

#### **4.9. Data quality and assurance**

A key criterion on data assurance is meeting with international auditing standards. From this point of view, it is essential that the report contains the document, belonging to EITI companies, approving international auditing standards. Besides SOCAR, this requirement is relevant for other subsidiary enterprises. At the same time, state agencies (SOCAR, Ministry of Taxes, Ministry of Ecology and Natural Resources) accumulating revenues should not limit themselves with auditing procedures conducted by Chamber of Accounts. There should be a special plan that complies with international auditing standards.

In general, this requirement is considered as satisfactory.

As a result of evaluation of fourth requirement of the Standard, the following recommendations are provided for improving the current situation:

- *The Work Plan on transit of state agencies to international auditing standards should be developed and information on gained results should be noted in the next report*

As a result of evaluation of fourth requirement of the Standard, the following recommendations are provided for improving the current situation:

- *Transportation statistics of pipelines should be studied seriously, transportation tariffs of each pipeline should be shown in the report separately, and regardless of tariffs, payments should be indicated clearly.*
- *Considering Azerbaijan's role as a transit country ( A part of Kazakhstan and Turkmenistan oil is transported through sea, pipelines and railways over Azerbaijan to the work market), transit revenues should be separated from overall transportation proceeds as well as along with pipelines, volume of sea and railway transportations and gained transit fees should be covered in the next report.*
- *The payment statistics should be given based on 3 stages: 1. Provide general numbers as an infographic format at the beginning of the Report 2. Prepare aggregative (synthetic) timetable in required part of the Report. 3. Separate payments by companies as an addendum to the Report (together with amendments).*

#### **EITI Requirement 5: Revenue allocations**

Section 5 of the Report requires disclosures of information related to revenue allocations, enabling stakeholders to understand how revenues are recorded in the national and where applicable, sub-national budgets. The EITI Requirements related to revenue allocations include: (5.1) distribution of revenues; (5.2) sub-national transfers; and (5.3) revenue management and expenditures. Since (5.2)

sub-national transfers are not applied in Azerbaijan, 5.1 and 5.2 requirements of the Standard were evaluated by the EITI Coalition in the 2015 Report.

### **5.1 Distribution of extractive industry revenues.**

According to this requirement of the Standard, EITI implementing countries must disclose a description of the distribution of revenues from the extractive industries. Thus, paragraph a) of the 5.1 Standard outlines that an implementing country should indicate which extractive industry revenues, whether cash or in kind, are recorded in the national budget. Where revenues are not recorded in the national budget, the allocation of these revenues must be explained, with links provided to relevant financial reports as applicable, e.g., sovereign wealth and development funds, sub-national governments, state-owned enterprises, and other extra-budgetary entities. From Azerbaijan's practice, this function falls under the subordinate of State Oil Fund. The report mentions that during 2015, the amount of receipt from the mining industry to the state budget was 8,7 billion manat. The amount of 8,7 billion manat includes the transfers made by the State Oil Fund. The amount transferred from the State Oil Fund to the state budget estimated 8,1 billion AZN in 2015. Furthermore, the report outlines that in 2015, the flow of the funds to the State Oil Fund amounted to AZN 7,799 billion manat. The Oil Fund's income sources have been formed from Azerbaijan's share of the proceeds from the sale of hydrocarbons, transit fees, bonus payments, acreage payments, revenues from Fund's assets management and income from other sources. Nevertheless, in spite of the fact that this section of the Report notes that information on transfers of funds by the PSA contractor companies to the state budget in 2015 has been presented in more details in "Reconciliation of the results" section of the report, however, it does not specify how much funds were channeled to the state budget by subcontracts in 2015. Similarly, this section does not talk about the proceeds from the State Oil Fund of Azerbaijan to the state budget, but it only touches upon the state budget of State Oil Fund. At the same time, the timetable shown in the report reflects only proceeds from taxes to the state budget. Table 25 gives transfers from SOCAR to the state budget under "Other receipts" and its accurate amount is not shown.

According to paragraph b) of 5.1 Standard, Multi-stakeholder groups are encouraged to reference national revenue classification systems, and international standards such as the IMF Government Finance Statistics Manual. Given this paragraph is of recommendation character, multi-stakeholder group did not conduct discussions over it. This section of the report meets 5.1 requirement of the Standard.

### **5.2. Sub-national transfers**

This requirement of the Standard is not applicable for Azerbaijan.

### **5.3. Revenue management and expenditures**

The multi-stakeholder group is encouraged to disclose further information on revenue management and expenditures, including:

- a) A description of any extractive revenues earmarked for specific programme or geographic regions. This should include a description of the methods for ensuring accountability and efficiency in their use.
- b) A description of the country's budget and audit processes and links to the publicly available information on budgeting, expenditures and audit reports.

c) Timely information from the government that will further public understanding and debate around issues of revenue sustainability and resource dependence. This may include the assumptions underpinning forthcoming years in the budget cycle and relating to projected production, commodity prices and revenue forecasts arising from the extractive industries and the proportion of future fiscal revenues expected to come from the extractive sector.

The issues recommended under the paragraph a) of 5.3 Standard was not described in the report, whereas paragraph b) of this Standard is partially met. Although a description of the country's budget and sources of funding are included to the report, coverage of audit processes are not mentioned. Similarly, the report does not touch upon links to the publicly available information. Besides, the points mentioned under paragraph c) of this Standard which encourages revenue forecasts and the assumptions on expected future fiscal revenues are not noted in the report as well. Nevertheless, the report contains Table 26 that describes sources of revenues of SOCAR in the last 3 years, whereas Table 27 highlights allocation of expenditures.

Besides, the report talks about the applied unified budget classification and it further mentions that the classification includes all types of direct payments from extractive industry to the budget, including proceeds from SOCAR to the state budget. The report also highlights that the state budget is formed of all types of income and expenses which are related to the government agencies and is confirmed as a law by the President of the Republic of Azerbaijan. Chamber of Accounts of the Republic of Azerbaijan gives its opinion on the draft state budget and budget of extra-budgetary funds, annual report on state budget execution and appropriate law projects. In accordance with the legislation, Chamber of Accounts conducts an audit of income and expenses of state, including extra-budgetary funds and consolidated budget. Additionally, the report contains important data in regard to budgetary calendar. However, this information provides commentary over current legal situation and does not offer evidence-based analysis. In general, this section of the Report meets requirement of the Standard.

As a result of evaluation of fifth requirement of the Standard, the following recommendations are provided for improving the current situation:

- *Multi-stakeholder groups should debate the current state of classification system of national revenues and the classification should be conducted in line with international standards*

As a result of evaluation of fifth requirement of the Standard, the following recommendations are provided for improving the current situation:

- *The Report should not limit itself to include information only from SOCAR, but it should simultaneously refer to payments made to the state budget by subcontractor companies on PSA as well as proceeds from SOCAR to the state budget. In this case, the report could present information on aggregate sum of both in-kind and value terms of extractive revenues*
- *Table 25 in the report that describes transfers from SOCAR to the state budget under "Other receipts" should be elaborated more in detail.*
- *The programs funded at the expense of extractive revenues, including social-economic development programme of the regions and their allocations by the regions should be incorporated into the report.*
- *Auditing process over state budget should be described more in detail, and references should be made to current public data on funding, expenditures and auditing reports*

- *Forecast revenues of extractive industries for upcoming period and expected revenues from this sector should be posted in the report.*

## **EITI Requirement 6: Social and economic spending**

### **6.1. Social expenditures by extractive companies**

According to this requirement of the Standard, Where material social expenditures by companies are mandated by law or the contract with the government that governs the extractive investment, implementing countries must disclose and, where possible, reconcile these transactions. The 2015 Report contains social spending of SOCAR. However, this information is incomplete: social expenditures were shown as 12.166 thousand manat in reference to SOCAR's "Report about the Sustainable Development". In fact, SOCAR's Consolidated Financial report for 2015 "social expenditures" was amounted 143 mln. AZN<sup>1</sup>. This matter should be clarified.

The requirement of the Standard requires publishing the social expenditures not only of national oil company, but all extractive companies. It would be expedient to reflect the social expenditures of foreign oil companies operating in Azerbaijan in the next reports. It is possible to access some of this information (for example, BP company and others) through their report on sustainable development.

During the implementation of this requirement of the Standard, it would be useful to make references Guide on accountability in the field of sustainable development of the Global Initiative.

The Report partially meets the requirement of the Standard.

### **6.2. Quasi-fiscal expenditures**

This requirement requires including disclosures from state-owned enterprises on their quasi-fiscal expenditures. According to this requirement, MSG is required to develop a reporting process with a view to achieving a level of transparency commensurate with other payments and revenue streams, and should include state-owned enterprise subsidiaries and joint ventures. As it can be seen from the report, the MSG has determined the types of quasi-fiscal activities in the extractive industry and in accordance with the "Guide on Resource Revenue Transparency" of IMF, it has decided, to include in the EITI report the information on two types of quasi-fiscal expenditures: 1) Energy Quasi-fiscal activities, and 2) Public expenditure Quasi-fiscal activities.

In the report it mentions that the wholesale and retail domestic prices for oil and gas products are subject to the state regulation and this regulation is a responsibility of Tariff (Price) Council, however; it does not address to quantitative dimension of quasi-fiscal expenditures that SOCAR was subject to.

Additionally, the Report provides general overview on allocated funds for different state projects of the Company by referring to the financial report of SOCAR. Nevertheless, there is not any information in regard to the structure and contents of those projects.

In fact, insufficiency of this data is mainly related to preparation of reports on quasi-fiscal expenditures of state companies operating in the country. It is highly recommended to prepare thereport on quasi-fiscal expenditures of state-owned enterprises in IMF's "Guide on ensuring transparency in budgetary-tax sphere" (2007) by central ministry responsible for state budget and also, include it to the budgetary documents. Given this, it is necessary that MSG makes an appeal to

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<sup>1</sup> SOCAR, "Maliyyəhesabatı 2015-ci il", səh. 3, <http://www.socar.az/socar/assets/documents/az/socar-financial-reports/Maliyy%C9%99%20hesabat%C4%B1%202015.pdf>

the Ministry of Finance and SOCAR on preparation of detailed quasi-fiscal expenditure reports, including reflect justification about each of quasi-fiscal operations, and reflect quantitative dimension in the document. Also, this could be part of the EITI Mainstreaming process.

The Report partially meets the requirement of the Standard.

### **6.3. The contribution of the extractive sector to the economy.**

According to the requirement of this Standard, implementing countries must disclose, when available, information about the contribution of the extractive industries to the economy for the fiscal year covered by the EITI Report. Moreover, it is required that this information includes the size of the extractive industries in absolute terms and as a percentage of Gross Domestic Product as well as an estimate of informal sector activity.

As it was in the 2013 and 2014 reports, this Report also contains some information related to contribution of the extractive sector to the economy, including graphics.

In general, compliance of information in the Report with the requirement of the Standard is estimated as satisfactory.

As a result of evaluation of sixth requirement of the Standard, the following recommendations are provided for improving the current situation:

- MSG should make an appeal to the Ministry of Finance and SOCAR on preparation of detailed quasi-fiscal expenditure reports, including reflect justification about each of quasi-fiscal operations, and reflect quantitative dimension in the document.
- *MSG and Independent Administrator should refer to a guidance document on “Options for data reporting – EITI standard, 2016: the good, the better and the best” (WB, august 2016). prepared by the World Bank amid preparations of the EITI report.*

As a result of evaluation of sixth requirement of the Standard, the following recommendations are provided for improving the current situation:

- *The report should present data on social expenditures of SOCAR in clear manner*
- *The report should include data on social expenditures (voluntary and compulsory) of other extractive companies operating in the country*
- *MSG should continue its efforts to encourage SOCAR to present the content and quantitative dimensions of its quasi-fiscal expenditures.*

## **EITI Requirement 7: Outcomes and impact**

### **7.1 Public debate.**

This is not directly linked to the theme of report.

### **7.2 Data accessibility**

In general, the report meets the requirement; nevertheless, there are some drawbacks. Thus, the process on transition to the machine readable and to code or tag EITI Reports already applied by several counties has been started in Azerbaijan. A practical importance of massive data is primarily related to following it online regime, collate it with other relevant statistical information and automated update on a continuous basis. Therefore, Work Plan should be prepared and tangible progress should be made at the next reporting period. In general, compliance of information with the requirement of the Standard is satisfactory.

### **7.3. Discrepancies and recommendations from EITI Reports**

It is a good practice to publish an opinion and recommendation of the NGO Coalition at the end of each report resulting from the previous report. With a view steps to act upon lessons learnt, an independent administrator and MSG demonstrate being open to a criticism and more importantly, they are striving in order to make EITI function uninterruptedly.

Actually, a subtle approach taken against recommendations casts shadow on this work. Thus, authors of the report have considered more of easily handled and cosmetic character recommendations. In other words, they have avoided adopting fundamental changes in this regard. The issues related to accessing all PSAs, integration of all data related to the activities of SOCAR into report, clear classification of transportation revenues and other serious setbacks are still remaining unresolved.

In general, this requirement partially can be assessed as satisfactory.

### **7.4. Review the outcomes and impact of EITI implementation**

Currently, the development of EITI does not limited with publication of report on timely manner though the Standard does not concretely specify this. The main target is integration of EITI mainstreaming into the governance system of government. Therefore, an end goal of the recommendations and overall EITI is related to governance of extractive industry. Currently, several EITI countries (Afghanistan, Iraq, US and others) have gained interesting outcomes on change of governance system in line with different requirements of the Standard. Azerbaijan could build a good practice through choosing certain direction and thus, achieving tangible improvements in governance. The country has sufficient potential to attain this goal.

In general, this requirement partially can be assessed as satisfactory.

As a result of evaluation of seventh requirement of the Standard, the following recommendations are provided for improving the current situation:

- *A short summary of the report, including infographic description and other similar products should be more frequently published by the EITI Secretariat and NGO Coalition*
- *The EITI Secretariat should publish a full list of previous recommendations, and in the next report, reasons for non-compliance with recommendations should be clarified during the MSG meeting*