

RULES ON THE PREPARATION AND EXECUTION OF THE ANNUAL PROGRAM OF REVENUES AND EXPENDITURES (BUDGET) OF THE STATE OIL FUND OF THE REPUBLIC OF AZERBAIJAN

Including the addendums and amendments according to the Decrees of the President of the Republic of Azerbaijan № 849 dated February 7, 2003 and № 202 dated March 1, 2005

Approved by the Decree of the
President of the Republic of Azerbaijan
№ 579 dated September 12, 2001

These Rules have been prepared in accordance with the "Regulations (Statute) on the State Oil Fund of the Republic of Azerbaijan" approved by the Decree of the President of the Republic of Azerbaijan № 434 dated December 29, 2000 and determine the arrangements for the preparation, approval and execution of the annual program of revenues and expenditures (hereinafter referred to as a budget) of the State Oil Fund of the Republic of Azerbaijan (hereinafter referred to as the Oil Fund).

1. GENERAL PROVISIONS

- 1.1.** The Oil Fund's budget is an annual financial program prepared in compliance with the legislation of the Republic of Azerbaijan to ensure the implementation of the Oil Fund's objectives and functions and reflects the Oil Fund's revenues and expenditures.
- 1.2.** The Oil Fund budget shall be prepared for each financial year covering the period starting on the first of January and ending on the thirty-first of December.
- 1.3.** The preparation and execution of the Oil Fund's budget shall be based on the principle of the implementation of a coherent macroeconomic policy in the Republic of Azerbaijan and the consolidation of revenues and expenditures of the consolidated government.

- 1.4.** Effecting of any expenditure on Oil Fund's assets extraneous from the Oil Fund's budget by the Oil Fund is inadmissible.
- 1.5.** Expenditures that can arise from the Oil Fund's assets revaluation in the Oil Fund's reported currency (Azerbaijani manat) as well as expenditures in connection with payment of lawfully determined taxes and any other obligatory payments are not being intended in the budget of the Oil Fund and reflected as extra-budgetary expenditures on fact in the balance of the Oil Fund.
- 1.6.** Budget expenditures of the Oil Fund as well as financing lawfully determined taxes and any other extra-budgetary obligatory payments effected on the Oil Fund's assets in the national currency of the Republic of Azerbaijan and foreign currency. Financing the Oil Fund's expenditures and payments in the national currency of the Republic of Azerbaijan is provided in compliance with the legislation of the Republic of Azerbaijan by conversion (selling) of the Oil Fund's foreign currency assets to the national currency of the Republic of Azerbaijan.

2. THE STRUCTURE OF THE OIL FUND'S BUDGET

- 2.1.** The Oil Fund's budget consists of revenue items and expenditure items.
- 2.2.** Grouping of items in the Oil Fund's budget shall be done in compliance with the state budget classification of the Republic of Azerbaijan and international standards.
- 2.3.** The revenue items of the Oil Fund's budget shall comprise the following:
 - 2.3.1.** Revenues generated from implementing agreements on exploration, development and production sharing for oil and gas fields in the territory of the Republic of Azerbaijan including the Azerbaijan's sector of the Caspian Sea (Lake), as well as other agreements on oil and gas exploration, development and transportation entered into between the State Oil Company of the Republic of Azerbaijan or other authorized state body and investors:
 - 2.3.1.1.** Net revenues from the Republic of Azerbaijan's share of the sale of hydrocarbons (after deducting expenditures incurred for hydrocarbons transportation, customs clearance and bank costs, marketing, insurance and independent surveyor fees and not to include revenues falling on a participating interest or investment

of the State Oil Company of the Republic of Azerbaijan in a project if it is an investor, participant or a contracting party of this project);

2.3.1.2. Bonuses paid by investors to the State Oil Company of the Republic of Azerbaijan or an authorized state body in connection with oil and gas agreements signature or performance;

2.3.1.3. Acreage payments due to the State Oil Company or an authorized state body of the Republic of Azerbaijan from investors for the use of a contract area in connection with oil and gas exploration and development;

2.3.1.4. Dividends and profit participation revenues due to the Republic of Azerbaijan in connection with oil and gas agreements implementation (not to include revenues on a participating interest or investment of the State Oil Company of the Republic of Azerbaijan in a project if it is an investor, participant or a contracting party of this project);

2.3.1.5. Revenues generated from oil and gas passing over the territory of the Republic of Azerbaijan by means of the of Baku-Supsa, Baku Tbilisi-Ceyhan and Baku-Tbilisi-Erzurum export pipelines;

2.3.1.6. Revenues generated from transfer of assets from investors to the State Oil Company or an authorized state body within the framework of oil and gas agreements;

2.3.2. Revenues generated from the placement, management, sale, or other utilization or out of sale revenues of the Fund's assets (including financial assets and assets handed over by investors within oil and gas contracts), revenues from asset revaluation in the reported currency (Azerbaijani manat) by the Oil Fund and other;

2.3.3. Grant and other free aid;

2.3.4. Other revenues and receipts in accordance with the legislation.

2.4. The expenditure items of the Oil Fund's budget shall comprise the following:

- expenditures to finance the projects in compliance with the main directions (program) of the Oil Fund's assets utilization;
- the Oil Fund's operational expenditures, including administrative (staffing), involving external consultants and other expenditures.

3. PREPARATION OF THE OIL FUND'S BUDGET

3.1. The process of preparation of the Oil Fund's budget

- 3.1.1.** The process of preparation of the draft Oil Fund's budget shall commence simultaneously with the preparation of the State Budget of the Republic of Azerbaijan 11 months ahead of the next calendar year and shall cover the period until the day of presentation of the draft to the President of the Republic of Azerbaijan for approval.
- 3.1.2.** With a view to ensuring consolidation of the revenues and expenditures of the consolidated government, the Oil Fund's budget and the State Budget of the Republic of Azerbaijan shall be prepared on a consistent basis through close cooperation and coordination between the Ministry of Finance of the Republic of Azerbaijan (hereinafter "Ministry of Finance") and the Oil Fund.
- 3.1.3.** While preparing the Oil Fund's budget the Supervisory Board of the Oil Fund should regularly kept informed about preparation and basic principles of the budget, and its comments are to be studied and taken into consideration.
- 3.1.4.** The preparation of the Oil Fund's budget shall assume medium term (3 years) projections of revenues and expenditures of the Oil Fund. These projections shall be developed by the Oil Fund in close coordination with the Ministry of Finance to ensure consistency with the medium term expenditure framework prepared by the Ministry.
- 3.1.5.** While preparing the draft Oil Fund's revenues and expenditures in the Oil Fund's budget, on the basis of paragraph 1.3 of these Rules, the effects of the Oil Fund's expenditure of foreign currency to finance domestic projects on the macroeconomic situation and the competitiveness of the national economy shall be carefully considered, to this end the Oil Fund shall consult with the state bodies of the Republic of Azerbaijan in charge of financial, monetary, economic, energy and statistical policy, and shall take their opinion into consideration.
- 3.1.6.** In order to enable preparation of the Oil Fund's budget, as well medium term projections of revenues and expenditures as stipulated in paragraph 3.1.4, the Oil Fund has the right to require provision of information from the relevant executive authorities, the authorized state bodies representing the Republic of Azerbaijan in agreements on

exploration, development, production sharing for oil and gas and other relevant agreements (hereinafter “Oil Agreements”) entered into with foreign investors, including these Oil Agreements' contractors.

3.2. Preparation of a forecast for revenue items of the Oil Fund's budget

- 3.2.1.** The forecast of revenue items of the Oil Fund's budget generated from the implementation of the Oil Agreements shall be prepared based upon analysis of global hydrocarbon markets, research, forecasts and estimates of reputable specialized local and international organizations and scientific-research centers, as well as reports and other data to be submitted to the Oil Fund by the state bodies of the Republic of Azerbaijan in charge of energy and economy. To this end the basic oil price indicators shall be coordinated between the Oil Fund and the Ministry of Finance and while preparing the Oil Fund's budget the same figures stipulated in the state budget shall be applied.
- 3.2.2.** The forecast of revenue items of the Oil Fund's budget generated from the Oil Fund's asset management shall be prepared based upon the provisions of the Oil Fund's asset investment policy adopted within the framework of the Fund's assets utilization program.
- 3.2.3.** The investment policy of the Oil Fund shall be prepared in compliance with its assets management rules and be based upon financial market analysis and reports of reputable international rating agencies, and, if necessary, making use of reputable foreign consultants. It shall establish optimum economic return, low risk and conformity to the Oil Fund's constitutional goals as the major guidelines and principles for the Fund's asset management.

3.3. Preparation of expenditures items of the Oil Fund's budget

- 3.3.1.** The expenditure items of the Oil Fund's budget within the Fund's asset utilization program shall envisage only financing of the most important nation-wide projects, construction and reconstruction of strategically significant infrastructure facilities for the purpose of the socio-economic progress of the Republic of Azerbaijan.
- 3.3.2.** The forecast of expenditure items to finance the Oil Fund's assets utilization program shall take into account the necessity to promote the development and increase the competitiveness of the non-oil sector of

the national economy and shall be based on a macroeconomic forecast of the socio-economic development of the Republic of Azerbaijan, an analysis of the performance of different sectors of the economy and the evaluation of project proposals, which shall be submitted within the framework of the State Investment Policy and priorities specified by the President of the Republic of Azerbaijan.

- 3.3.3.** The Oil Fund shall coordinate with the President of the Republic of Azerbaijan the list of projects for consideration within the Oil Fund's asset utilization program not later than May 1 of each year, it shall carry out expert examination of the projects and include approved projects to draft budget of the Oil Fund for the next year. The Oil Fund shall establish criteria for project evaluation and the format for project submissions, including volume of investment, duration of the project and an assessment of the availability of co-financing or other investment sources.
- 3.3.4.** The forecast of expenditure items relating to the Oil Fund's operations shall be prepared based on estimates (calculations) of workload, staffing and other requirements for the next year as well as on the amount of estimate for administrative (staffing) expenditures, expenditures in connection with involving external managers and consultants for assets management actually spent in the preceding financial year.

4. APPROVAL OF THE OIL FUND'S BUDGET

- 4.1.** Every year, by September 5 latest, the draft Oil Fund's budget, having been prepared in coordination and on a consistent basis with the preparation of the draft State Budget of the Republic of Azerbaijan, shall be submitted by the Executive director of the Oil Fund to the Supervisory Board of the Oil Fund for comments along with the following documents:
- the Oil Fund's assets utilization program, including:
 - the Oil Fund's investment policy,
 - an estimate of Oil Fund operational expenditures.
- 4.2.** Every year the Oil Fund's draft budget and the documents stipulated in paragraph 4.1 above, together with the Supervisory Board's comments, shall be submitted to the President of the Republic of Azerbaijan for consideration.

- 4.3.** Final coordination of the Oil Fund's budget with the State Budget and the approval of the Oil Fund's budget shall take place after both documents comprising draft consolidated government revenues and expenditures have been considered by the President of the Republic of Azerbaijan preceding submission of the draft State Budget submission to the Milli Majlis (Parliament).
- 4.4.** The Oil Fund's budget shall be approved not later than December 1 of each year.
- 4.5.** If the Oil Fund's budget is not approved, for whatever reason, by December 31, the Fund's operational expenditures of the next financial year for each month to cover expenditures of the Fund in the amount of 1/12 (one-twelfth) of the Fund's operational expenditures of the previous year can be utilized.
- 4.6.** The Oil Fund's budget shall be published in the press immediately upon approval.

5. EXECUTION OF THE OIL FUND'S BUDGET

5.1. General provisions on the execution of the budget

- 5.1.1.** The execution of the Oil Fund's budget is a mechanism ensuring collection of revenues and their spending in compliance with Oil Fund's budget.
- 5.1.3.** The Oil Fund shall publish reports on its revenues and expenditures on a quarterly basis.
- 5.1.5.** All expenditures shall be executed in accordance with the purpose for which they were approved.
- 5.1.6.** If during the execution of the Oil Fund's budget actual revenues exceed forecast revenues or expenditures have not been executed for whatever reason, the resulting excess amount shall be transferred to the Fund's investment portfolio.

5.2. Execution of expenditure items relating to the Oil Fund's assets utilization program

5.2.1. Expenditure items relating to the Oil Fund's assets utilization program shall be executed through the State Treasury in compliance with the legislation and allowing for certain provisions stipulated in these Rules.

5.2.2. The amounts transferred by the Oil Fund to the State Treasury shall not be used to finance expenditures other than the expenditures for which they were originally allocated.

5.2.3. Procurement of goods (works and services) under the projects financed by the Oil Fund shall be regulated by the corresponding legislation of the Republic of Azerbaijan.

5.2.4. The Oil Fund shall be authorized to exercise supervision over the use of the Oil Fund's project finance related expenditures executed through the State Treasury, including the right to request and receive all requisite data from the Treasury and the entities who are buyers of the financial assets in connection with this.

5.2.5. In order to enable the Oil Fund to produce quarterly and annual reports, the Ministry of Finance shall submit reports on the execution of the Oil Fund's expenditures through the State Treasury to the Oil Fund.

5.3. Execution of expenditures relating to the Oil Fund's operational expenditures

5.3.1. At the execution of expenditures relating to the Oil Fund's operational expenditures, changes can be made in separate items against savings made on other items of expenditures. Reallocation of up to 30% of the total volume of savings on items shall be effected at the discretion of the Executive director of the Oil Fund, changes in excess of this shall only be effected with the consent of the President of the Republic of Azerbaijan.

5.3.2. The amount of once only expenditure of the Oil Fund's operational expenditures shall not exceed the quarterly allocation for operational expenditures.

5.3.3. Information on the Oil Fund's expenditures executed through the State Treasury shall be provided to the Ministry of Finance to enable the Ministry of Finance to incorporate all expenditures of the Oil Fund in its quarterly published report on the consolidated expenditures of the government.

5.4. Amendments to the Oil Fund's budget

5.4.1. In case of a pressing necessity, upon the decision of the President of the Republic of Azerbaijan, the Oil Fund's budget may be amended subject to having allowed for such an amendment in the consolidated government revenues and expenditures.

5.4.2. To make an amendment to the Oil Fund's budget the Executive director of the Oil Fund shall pursue coordination procedures set forth in paragraph 3.1 hereof and submit to the President of the Republic of Azerbaijan an application for the approval of the amendments.

6.REPORTING ON OIL FUND'S BUDGET EXECUTION

6.1. The Oil Fund shall produce quarterly statements and an annual report on the Oil Fund's budget execution and submit them to the Supervisory Board of the Oil Fund and the President of the Republic of Azerbaijan.

6.2. The Oil Fund shall produce an annual report on the Oil Fund's budget execution in coordination with the Ministry of Finance and submit it to the President of the Republic of Azerbaijan along with the comments of the Supervisory Board of the Oil Fund by April 30 latest of the following year.

6.3. The approval by the President of the Republic of Azerbaijan of the annual report on the Oil Fund's budget execution shall take into account the comments of the Supervisory Board of the Oil Fund and the results of the audit carried out by a reputable international audit firm on the Oil Fund's annual financial activity.