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Power Plant: A lease or not a lease?

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On 16 September 2008, Financial Accounting Standard Board – Indonesia Institute of Accountants (DSAK – IAI) approved and subsequently published its Interpretation on Financial Accounting Standard 8 ("ISAK 8") "Determining whether an Arrangement contains a Lease and further Stipulation on the Transitional Provision of PSAK 30 (revised 2007)". ISAK 8 basically extends the definition of a lease to contracts that are not formally designated as leases. In other words, lease accounting would be applicable to a contract - whether or not it is formally titled as a lease contract - when such a contract in substance meets the definition of a lease. This new standard will likely impact the contractual arrangements related to Independent Power Producers ("IPP").

Perusahaan Listrik Negara ("PLN"), the Indonesian state-owned power company, has monopoly rights to sell electricity to end consumers in Indonesia and therefore IPPs are required to sell electricity solely to PLN under either a Power Purchase Agreement ("PPA") or an Energy Sales Contract ("ESC")

Accounting treatment on IPPs: Pre and post ISAK 8

Prior to ISAK 8, Power plant costs were usually recognized as fixed assets whilst income from actual electricity delivery was recognized as revenue in the financial statements.

Under ISAK 8, an arrangement is considered to contain a lease if it meets two conditions: (a) fulfilment of the arrangement is dependent on the use of a specific asset or assets and (b) the arrangement conveys a right to use the asset. ISAK 8 also includes some examples of contracts that in substance may contain a lease which includes supply contracts and take or pay contracts.

If IPP concludes that such arrangement meets the definition of a lease under ISAK 8, then IPP will need to follow lease accounting under Statement of Financial Accounting Standard 30 (PSAK 30 (Revised 2007)) "Leases", which may differ from how the Company previously accounted for these transactions.

Implementation issues

There are several issues related to the implementation of ISAK 8 to IPPs, such as (but not limited to) the following:

1. ISAK 8 scoped out any arrangement that is considered to be "Public to Private Service Concession Arrangement" since these sort of arrangements will be ruled under separate accounting guidance. It is as yet unclear how to determine the arrangement since the regulation has not been issued.
2. It is debatable whether the agreed price between IPP and PLN is considered as market price or not. This drives the conclusion whether the arrangement conveys a right to use asset.
3. Some IPP's assets are collateralized and as such there is the possibility that loan covenants will be breached if IPP following the lease accounting guidance, derecognizes some of their assets under finance lease arrangements
4. Sales of electricity are not subject to VAT and WHT. There is an issue as to whether interest income/ rental income will be subjected to VAT and/or WHT. Potential issues also arise in the different treatment of corporate income tax.
5. A practical difficulty arises in classifying leases (finance lease vs. operating lease) since PSAK 30 (revised 2007) only provides principal guidance and some examples.
6. Other practical difficulties such as net investment recognition, determining future lease payments, treatment on critical spare parts/overhauls/make up wells (for geothermal power plants), depreciation method, dismantling obligations etc.

Recent Progress

Recently, the Capital Markets and Financial Institutions Supervisory Board ("BAPEPAM & LK") issued a letter to PLN clarifying that IPP arrangements with PLN are exempted from the requirement to apply ISAK 8. BAPEPAM & LK has the authority to set Indonesia GAAP for listed companies, and therefore listed companies are exempted from the application of ISAK 8. However we believe that ISAK 8 is still applicable for non listed companies which is consistent with the view's of DSAK-IAI who has higher hierarchy than BAPEPAM-LK in Indonesia GAAP for non public entities.

Way Forward

It appears unlikely that DSAK – IAI will defer the adoption of ISAK 8 following its plan to fully converge Indonesia GAAP with International Financial Reporting Standard ("IFRS") by 2012. ISAK 8 is basically an adoption of IFRIC 4 of IFRS.

As ISAK 8 involves a complicated assessment which requires significant judgment, IPPs are encouraged to start the assessment process early. Below are our recommendations for this process:

- Identify lease contracts
- Assess potential magnitude
- Involve high level management and non-finance management in the assessment
- Document the assessment in the formal accounting policy

In addition, IFRS has issued IFRIC 12 "Service Concession Arrangement" which contain certain criteria used to determine whether or not arrangements fall into a Service Concession Arrangement. It is likely that DSAK – IAI will adopt this standard in the medium future. As such it is worthwhile to consider IFRIC 12 while performing your assessment of ISAK 8. ■

2009 Tax Audit Plan and Strategy

Ali Mardi /Anthony J. Anderson

The Director General of Tax issued a Circular Letter No.SE-02/PJ.04/2009 dated 24 February 2009 regarding the 2009 tax audit plan and strategy.

The letter confirms that the 2009 tax audit focus will be divided into two categories, i.e. National audits and Regional audits.

National audits

Business sectors covered under the National audit focus include:

a) oil and gas and oil services;
b) construction.

Regional audits

In addition to the sectors covered under the National audit focus above, the regional tax office should also focus on certain sectors that are considered important to each of the regional tax offices. For example:

a) the coal mining sector is an audit focus of the tax offices covering South Sumatra and East Kalimantan;
b) the mineral mining sector is an audit focus of the tax offices covering Sulawesi; and

c) group taxpayers and taxpayers with indication of tax evasion through transfer pricing are a focus of the Large Tax Payer Offices and the Directorate of Audit and Collection.

Pre-emptive actions

Taxpayers covered by the National audit or Regional audit focus may wish to consider pre-emptive action to anticipate the tax audits. These may include:

a) a review of financial/tax records and documentation on file to ensure all documents supporting significant transactions are available;
b) a review of documentation of transfer pricing policies
c) preparing reconciliations of taxes, e.g. reconciliation between sales reported in the corporate income tax return with those reported under the Value Added Tax returns, etc.; and
d) reviewing of any aggressive tax positions taken and preparation of arguments supporting the positions adopted.

Please call your PricewaterhouseCoopers Indonesia contact to discuss any preparatory actions that you may wish to pre-emptively take to anticipate the tax audits.

2009 VAT Refunds

Service companies to the oil/gas and mining sectors are often in a VAT overpayment position, mainly due to VAT "collector" status of their customers and/or limited Input VAT paid to sub-contractors and other vendors.

The same circumstances are also faced by mining companies who export the majority of their mining products (which is subject to zero percent (0%) Output VAT).

The Director General of Tax recently issued new regulations in respect of VAT audits. The key features of these regulations are as follows:

a) VAT invoices (Faktur Pajak) must be delivered within one month of the refund application filing date. Failure to deliver the VAT invoice within this period will result in the rejection of VAT refund;
b) the Indonesian Tax Office (ITO) must issue a decision within twelve months of the application filing date. However, depending on the applicant's risk profile, completion within three to eight months is possible;
c) risk profile of a taxpayer will determine the type and scope of audit and (other) documents required. More lenient document requirements are applicable on audits of "very low risk" taxpayers;
d) a taxpayer is considered as "very low risk" if:
   - it is not an user/issuer of fictitious tax invoices;
   - refund application does not include VAT "compensation" from more than three previous months;
   - at least one of the three conditions below must prevail:
     - at least one of the last three years financial statements have been audited by public accountants; or
     - exporter producer whose Corporate Income Tax Returns has been tax audited (in at least one of the two previous years); or
     - major shareholder is the central government.

On this basis, a company with frequent VAT overpayment positions may wish to try and be included in the "very low risk" category to shorten the VAT refund period.

Please call your PricewaterhouseCoopers Indonesia contact for further information on the new 2009 VAT audit procedures.

Total Tax Contribution Study

PricewaterhouseCoopers LLP of the United Kingdom recently issued PricewaterhouseCoopers' Total Tax Contribution Study of the Global Mining Industry.

This is the first ever total tax contribution study for the global mining sector that reveals the total taxes of fourteen of the world's largest mining companies, focusing on their largest operations in various countries.

The results show that mining companies pay many other taxes and payments to government, as well as corporate income tax. The full extent of this contribution is not always recognised, because sometimes only corporate income tax is separately disclosed in the financial statements. Despite the substantial fiscal contributions (direct and indirect) by mining companies, this limited focus on corporate tax collections, sometimes diminishes the public's perception of mining companies, as good corporate citizens.

Please call your PricewaterhouseCoopers Indonesia contact to obtain a copy of the report or visit our website (www.pwc.com) to access the full report of the study. ■

Revised Minister of Trade Regulation of the Republic of Indonesia Concerning Goods Export Requiring Letter of Credit

Paul van der Aa /William Deertz

In our previous newsflash we reported that the minister of Trade of the Republic of Indonesia issued Regulation No. 01/M-DAG/PER/1/2009 regarding Export of Goods Requiring Letters of Credit on 5 January 2009.

Under this regulation, Indonesian exporters are required to use a Letter of Credit ("L/C") issued by domestic foreign exchange banks. Both L/C payments and receipt of proceeds need to be routed through a domestic foreign exchange bank. The regulation is applicable for certain goods, including coffee, crude palm oil, cocoa, iron ore, nickel, alumina, coal, rubber and tin. The Director General of International Trade Cooperation has recently clarified that domestic foreign exchange banks referred to in the aforementioned regulation are banks operating in Indonesia, either foreign or local banks, possessing a permit to operate as domestic foreign exchange banks in accordance with prevailing banking laws in Indonesia.

The Director General of International Trade Cooperation stated that to alleviate difficulties faced by small and medium sized exporters in fulfilling the L/C requirement, and in an attempt to minimize the change in export policy, the Government of Indonesia ("GOI") has revised the application of commodities export obligated to use the L/C through Ministry of Trade ("MOT") regulation No. 10/M-DAG/PER/3/2009 on Export Proceed through L/C dated 5 March 2009.

Under this new regulation, effective as of 1 April 2009, the L/C application is only mandatory for mining, tin and CPO products, with export value above US$ 1 million. The L/C requirement for the other commodities (i.e. cocoa, rubber, coffee, etc) will be postponed until 31 August 2009 using the same US$ 1 million threshold. However, as of 1 April 2009, exporters of all of the aforementioned commodities are required to report L/C payments or other payments used in international trade as well as the number and the date of the payment document in the PEB (Pemberitahuan Ekspor or Product Export Notice). In addition, these exporters are also required to send monthly reports to the Minister of Trade (i.e. the Director General of International Trade Cooperation) through export realization reports, which include the method of payment, the name of the foreign exchange bank and the exporters' bank account number.

The MOT stressed that the GOI will continue its reform process to create more trade and investment opportunities and intends to increase the overall economic competitiveness through simplification of regulations. While this latest regulatory change is a "step in the right direction", any policy which inhibits exports can not be viewed favorably particularly in the current economic environment and it seems that the objectives of the above regulations could have been achieved without requiring the use of a L/C. Hopefully the additional costs and administrative burdens will not lead to an unnecessary decline in exports. ■

Update on PSC cost recovery (Regulation No.22/2008)

Daniel Kohar /William Deertz

In June 2008 the Minister of Energy and Mineral Resources issued Ministerial Regulation No. 22/2008 (Regulation No. 22/2008) in an attempt to clarify the Government's position on certain activities eligibility for cost recovery, however, the regulation lacked clarity on several issues or contradicted public statements made by officials on several matters.

There have been on-going discussions between BP Migas and various players in the upstream oil and gas industry to create implementation guidelines on the Regulation No. 22/2008. In January 2009, the industry group, Indonesia Petroleum Association ("IPA"), proposed a modification to the implementation guidelines. In March 2009, there have been discussions with BP Migas on the implementation guidelines and we understand that there is already a draft of the implementation guidelines. Based on the draft implementation regulations seen by PricewaterhouseCoopers Indonesia ("PwC"), we understand that the implementation guidelines will be applied retroactively effective June 30, 2008, however, the costs incurred for non-cost recoverable activities (e.g., community development) will be considered for cost recovery provided the Contractors have received approval from BP Migas prior to the stipulation date of Regulation No.22/2008.

Our below observations are prepared based on discussions with various industry players and to the extent possible incorporating the latest status based on the draft of the implementation guidelines.

Types of costs of upstream oil and gas business activities which are non-recoverable to Contractor of Production Sharing Contract based on Regulation No. 22/2008	IPA's proposed modification to the implementation guidelines for the types of costs of upstream oil and gas business activities which are non-recoverable to Contractor of PSC	PwC Observations
1. Costs related to the private/personal interest of the PSC employee's including: personal income tax, losses due to the sale of private cars and houses.	Charging of costs related to the following matters: a. PSC employee's personal interest except as provided in Work Procedure Manual No. 018/PTK/X/2008 (PTK 018). b. Employee income tax except as provided to the contrary in the provisions of PSC and/or applicable taxation regulation	In today's environment where there is a shortage of skilled workers available in the industry, it is important to provide "benefits in-kind" to attract and retain personnel. The proposed modification provides leeway for Contractors to accomplish the above objective because employment benefit policies in PTK 018 ask the Contractors to provide a competitive remuneration package to its employees to foster productivity. On July 18, 2008, BP Migas issued letter No. 701/ BPD000/2008/S8 to all PSCs Contractors which disallow cost recovery of (1) income tax for personal interest outside service of the employee, and (2) loss on sale of personal property and car. A question that needs to be resolved relates to the 'gross-up' method for employee income tax calculation (point b). The current practice is for the Contractors to bear the employee income tax and no 'gross-up' is needed. If Contractors have to follow the current tax practice like in other industries, the Contractors will need to 'gross-up' the income tax amount to the employee's basic salary so it can be cost recovered or tax deductible. As a result, the employee's basic salary will be substantially increased by the employee income tax amount. This ultimately will increase the post-retirement benefits (i.e. Big Table or equivalent benefit) to be paid to the retirees, which is not favorable for the overall cost recovery amount.

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		Based on discussions with industry participants, we understand that the specific wordings relating to the employee income tax has been removed from the latest draft of the implementation guidelines.
2. Incentives granted for the employees of PSC contractors constituting a Long-Term Incentive Plan ("LTIP") or other similar incentives.	Award of bonus or LTIP and share ownership program: a. which uses company performance achievement outside PSC Contractor's work area in Indonesia, based on corporate performance; and/or b. based on employees' term of service outside PSC Contractor's work area in Indonesia.	The proposed modification is consistent with BP Migas' letter No. 701/BPD000/ 2008/S8 dated July 18, 2008 to all PSC Contractors as well as PTK 018. Based on discussions with industry participants, we understand that the latest draft of the implementation guidelines only refer to PTK 018. However, PTK 018 is pretty general with regard to long-term incentive plan. PTK 018 does require the cost of expatriate's severance payment to be prorated based on the length of work for cost recovery purposes if such payment is made while the expatriate is working in a PSC. There are questions that need further guidance from BP Migas, for example: - PTK 018 is silent about the cost recovery mechanism for expatriate's severance payment who has moved on to other project or country. - PTK 018 does not discuss incentives or bonuses paid by the Contractors for meeting head office's key performance indicators set at the business unit level but ultimately beneficial to the PSC operations. For example, Contractor's head office often set key performance indicators for HSE and internal control compliance (SOX 404) for specific business units. - PTK 018 does not discuss the cost recovery mechanism for severance payments to employees when the Contractor has set aside a specific fund. - PTK 018 does not discuss the cost recovery mechanism or allocation for employees who work in various work areas in Indonesia.
3. Employment of foreign employees/expatriates not in compliance with the Expatriate Manpower Utilization Plan Procedures ("RPTKA") and without being furnished with Expatriates Work Permit ("IKTA") in oil and gas sector issued by BP Migas and/or the Directorate General of Oil and Natural Gas.	Employment of foreign employees/ expatriates for PSC work in Indonesia conducted without BP Migas approval and inconsistent with PTK 018. This provision shall also apply to foreign employees/ expatriates employed through third party. [Note : Currently manpower contract for expatriates conducted through third parties only require work permits from Director General of Oil and Gas and do not require BP Migas approval]	According to BP Migas letter No. 701/ BPD000/2008/S8 dated July 18, 2008 to all PSCs, the cost of expatriate is not cost recoverable if (1) a proposed role has been denied by BP Migas but the Contractor is still hiring an expatriate through a third party to fill the proposed role; or (2) a proposal to hire an expatriate has been rejected by BP Migas but the expatriate is still hired through a third party. Based on discussions with industry participants, we understand that the latest draft of the implementation guidelines only refer to PTK 018 and do not mention the above situation. It remains uncertain whether a contractor that "acts in good faith" to obtain the needed work permits be disallowed these costs if caused by delays in the Indonesian bureaucracy.

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4. Legal consultant fees that are not related to PSC contractor's operation.	Cost sharing of legal consultant irrelevant to petroleum operations as referred to in PSC and not implemented according to the Work Procedure Manual No. 028/PTK/XII/2007 (PTK 028)	Based on discussions with industry participants, we understand that the latest draft of the implementation guidelines will only refer to PTK 028. In principle, we do not believe most investors will take exception to this item. PTK 028 defines non-cost recoverable legal consultant fees as legal consultant fees incurred in relation to the rights and/or obligation of Contractors under the PSC or existing regulation vis-à-vis BP Migas and/or the Government of Indonesia. PTK 028 does not provide specific examples of legal consultant fees irrelevant to petroleum operations. However, it is generally understood that legal consultant fees in connection with merger and acquisition and FCPA matters are non-cost recoverable.
5. Tax consultancy fees.	Cost charging of tax consultant fees including tax consultant fees for administrative matters, calculation and reporting of entity income tax article 25 and article 29, unless : a. related to the obligation of expatriate in Indonesia and in home country ; or b. concerning tax dispute with tax office in Indonesia and Contractor wins the dispute.	Based on discussions with industry participants, we understand that the latest draft of the implementation guidelines prohibits cost recovery for the use of tax consultants (including tax consultant fees for administration, calculation and reporting of Article 25 and Article 29 Corporate Income Tax), except for tax consultancy fees incurred in relation to a dispute with the Indonesian tax office and the decision is in favor of the Contractor. The prohibition to engage tax consultant for administrative matters means Contractors cannot engage tax consultant for purposes of tax compliance. This may be burdensome to smaller Contractors as they will need to have a reliable tax department or person for each company. Another concern is the cost of tax administrative assistance for purposes of expatriate income tax calculation and reporting in Indonesia. From the employee and/or head office perspective, the tax administrative assistance in the host country is generally part of the employment package (benefit in-kind) when the employee works abroad. This matter needs to be clarified.

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6. Charges of oil and natural gas marketing costs borne by the PSC contractors and costs arising from intended mistakes, related to oil and natural gas marketing activities.	Marketing costs for PSC Contractor's oil and gas share and costs arising due to willful mistake, related to oil and gas marketing, unless: • Contractor and BP Migas make joint lifting (or that the oil/gas is not distributed in-kind); • Contractor has been appointed by BP Migas as seller of state's share oil/gas; • Costs related to oil and gas marketing activities inside or outside Indonesia which has been included in WP&B approved by BP Migas; • Cost for Indonesian employees and/or expatriate supported by the Expatriate Manpower Utilization Plan Procedures ("RPTKA") already approved by BP Migas. Other than the exception of costs referenced above, the following costs can be included in operating costs with prior approval of BP Migas; • cost for marketing study for supporting commerciality process of a project; • cost for marketing activities conducted upon BP Migas request and/or seller appointed by BP Migas.	In principle, most investors should not take exception to the proposed modification to the implementation guideline. Based on discussions with industry participants, we understand that the latest draft of the implementation guidelines will remove all the exception points proposed by the IPA. However, it is understood that BP Migas accepts the cost recovery of such costs provided BP Migas requested such activity or the Contractor obtains approval from BP Migas prior to incurring such costs. The remaining uncertainty relates to defining 'willful mistake'. There are many ways to justify that marketing activities are not 'willful mistakes' and vice versa. PwC Indonesia understands that the phrase is intended to protect the Government of Indonesia from potential liabilities which could arise on missed LNG cargoes. Another unresolved question is the cost recoverability of using established corporate group marketing at the exports destination which does not require RPTKA.
7. Charges of unlimited Public Relations costs for any type and amounts in the absence of the nominative list of beneficiaries as stipulated under the tax regulations, including costs related to: golf, bowling, credit cards, membership fees, family gatherings, farewell parties, contribution to the PSC contractor's educational institutions, the PSC contractor's anniversary, contributions to the association of employee's wives, nutrition and fitness.	Charging of public relation cost with no limit, both in type and amount without accompanied with nominative list of beneficiary, except: a. Cost for internal relation such as sport, family gathering, farewell party, can be conducted with the limitations as set forth in PTK 018. b. Cost for external relations such as: i. use of facilities (operated by) contractor by stakeholders with no request and with no approval in writing from BP Migas; ii. external publications (advertorial, booklet, brochure poster, etc.) not requested by BP Migas/government; iii. exhibitions and other events (inauguration) not coordinated with BP Migas; c. sponsorship in coordination with BP Migas; d. other donations (such as natural disaster) in coordination with BP Migas	The proposed modification appears consistent with the general practice outside the oil and gas industries, i.e. a company must prepare a nominative list for meals and entertainment provided to third parties so it is qualified for deduction for corporate income tax calculation purposes. Based on discussions with industry participants, we understand that all the exceptions points have been removed from the latest draft of the implementation guidelines. Instead it reverts to PTK 018 for internal relations and PTK 017 for external relations. It should also be noted that BP Migas, through its letter to all Contractors on July 18, 2008 No. 701/ BPD000/2008/S8, has asked all Contractors to save 30% from the Contractors' original budget for sport, social and cultural activities provided to Contractors' employees. Employers should carefully communicate BP Migas' instruction to the employees as it may have detrimental impact to employees' work motivation. Additionally, there may need to be a resolution for projects that are halfway or already committed to local governments or communities.

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8. Environmental and community development costs during the exploitation stage.	Charging of cost for environmental and local community development in exploitation period, as follows: a. surrounding community economic development program; b. surrounding community educational and cultural development program; c. surrounding community health development program; d. social and/or general facilities development; e. environmental development program Excluded from provision of point 8 herein is for Work Program and Budget ("WP&B") which is part of operating cost (operation supporting costs) already included in the WP&B approved by BP Migas, like: a. costs for operation infrastructure development; b. compensation and indemnity to community; c. expense related to permits; d. costs related to regulation compliance (for example: fulfillment of environmental impact ("AMDAL") commitment) e. community development program already included in WP&B which has been approved by BP Migas	Based on discussions with industry participants, we understand that support activities should not be considered as community development activities. Further, Contractors generally have obtained BP Migas approval on the support activities spending through WP&B process. We understand that in the latest draft of implementation guidance, the following costs or activities are no longer considered as community development: - costs for the construction of operational infrastructure. - compensation and indemnity to society - expenses related to permits and licenses - costs related to compliance with regulation (e.g. fulfilling AMDAL commitment). Contractors may consider to setup different account codes in its general ledger to differentiate community development and support activities. Contractors should carefully convey the message to local communities and/or local governments as cut down in community development activities may diminish support from local communities and eventually be detrimental to the Contractor's operations.
9. The management and depositing of reserve funds for abandonment and site restoration under the PSC contractor's account.	Management and saving of reserve fund for abandonment and site restoration in PSC contractor's account, unless : a. such fund is saved in an account in government bank, jointly controlled by contractor and BP Migas. The ministry will provide further details on accounts to be used; b. the saving and management of such fund must be in compliance with work procedure manual issued by BP Migas.	There are outstanding questions that need clarification from BP Migas, such as: (1) what is the extent of the release of liability once the funds are transferred to the account? (2) if there are remaining funds after all the abandonment and site restoration have been completed, can the Contractor share in the excess funds? After all, the Contractor generally only recovers 85% (for oil lifting) of funds through cost recovery and corporate and dividend tax deduction. (3) who bears the foreign currency risk once the cash is deposited into the designated bank account? The general consensus is the interest income from the reserve funds should be part of the fund, i.e. reduce Contractors' obligation to fund the abandonment and site restoration activities.
10. Costs related to all types of technical training activities for foreign employees/expatriates	Charging of all types of technical training for foreign employees/expatriate unless : a. training which is conducted to meet his or her professional permit requirements b. obligatory training which is also participated by national employees.	Based on discussions with industry participants, we understand that the latest draft of the implementation guidelines reverts to PTK 018 with respect to technical trainings for expatriates. In principle, most investors should not take exception to the proposed modification to the implementation guideline. Contractors may need to setup, if they have not done so already, different accounts or cost centers to capture the sole costs related to training activities for expatriates.

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11. Costs related to merger and acquisition.	Costs related to merger and acquisition including: a. cost for personnel and consultant related to due diligence; b. external costs for press release, promotion, change of company logo; c. costs related to separation program and retention program, cost related to change of information technology system (to the extent the previous system has not been fully depreciated), costs related to the removal of office, costs incurred due to the change in the policy concerning the on-going projects, except such costs have been previously approved by BP Migas.	In principle, most investors should not take exception to the proposed modification to the implementation guideline. With respect to point (c), there needs to be a consideration of cost vs. benefit of changing IT systems, office relocation, efficiency from less support staff for administrative matters (e.g. HR, finance and accounting, SCM, etc.). Nevertheless, these costs may be recoverable as long as BP Migas approves these costs in advance.
12. Costs for loan interest of Petroleum Operation Activities.	Cost recovery for loan interest related to Petroleum operation activities except which is related to on going projects pursuant to relevant PSC.	Based on discussions with industry participants, we understand that in the latest draft of the implementation guidelines, BP Migas does not elaborate the interest expense that can be cost recovered. Further, there is no clear rule for the existing projects that have been approved to receive interest recovery by BP Migas. PwC Indonesia understands that investors generally ask for interest recovery from BP Migas to increase the rate of return on certain projects that would otherwise be uneconomically feasible. From talking with industry participants, we understand that BP Migas wants to avoid deemed costs and it will provide incentives instead of interest recovery in order to make a project more attractive to develop. However, we are not aware of the new mechanism being introduced other than the existing investment credit mechanism based on capital spending.
13. Costs for third party income tax.	Charging of income tax of third party (all contracts with third party may not include reimbursement components of income tax of goods and services provider).	In an umbrella service contract, the vendor generally can use sub-contractors to complete the work. In certain situations, the vendor passes through the VAT paid to sub-contractors as a cost to the PSC Contractor instead of following through the VAT-In and Out mechanism. We understand that BP Migas intention is to avoid a vendor to charge VAT-In from its subcontractors as part of the costs of umbrella service contracts. In some situations, manpower contracts can also contain a tax stabilization clause where the hourly rate will be adjusted if there is a change in tax rates (e.g. withholding tax article 23). This tax stabilization clause might be prohibited under Regulation No. 22/2008 subject to BP Migas or government auditors interpretation.
14. Procurement of goods and services as well as other activities which exceed the Authorization for Expenditure ("AFE") approval by more than 10% and are not completed by sufficient justification.	Procurement of goods and services as well as other activities exceeding the approved amount of AFE over 10% (ten percent) of AFE value and with no clear justification as provided in Work Procedure Manual No. 007/PTK/VI/2004 (PTK 007) and WP&B-AFE-POD implementing procedure guidelines.	It is a long standing requirement that Contractors need to obtain supplemental approvals from BP Migas when they exceed an AFE by 10% or more. It should be noted that in practice this supplemental approval is often not obtained on a timely basis or before incurring the additional expenditures which may be what this exclusion is targeting.

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		Generally AFE overruns are uncontrollable and exceed 10% of the budget when it comes to issues during drilling activities, such as fishing, drill bit jamming, lost tool, etc. There is a need for differentiation in the process to request AFE supplement for long-term or construction projects and short-term or drilling projects. Contractors and BP Migas may wish to develop emergency procedures when it comes to operational or drilling problems.
15. Excess material surplus due to improper/ mistaken planning and purchase.	Excess non-capital material surplus due to mistaken plan and purchase. To determine excess non-capital material surplus, PSC contractor will propose minimum stock levels for each stock material based on applicable industry standards and obtain BP Migas approval; What is meant as negligent planning is any act or omission by Contractor's senior management or senior supervisory personnel which : (i) was intended to cause or which was in reckless disregard of , or wanton in indifference to, the harmful consequences such person, knew or should have known, such act or omission would have on the safety or property of another person or entity or (ii) seriously deviates from a dilligent course of action and which is in reckless disregard of or indifference to harmful consequences.	In principle, most investors should not take exception to the proposed modification to the implementation guideline. It should be understood that BP Migas' intention is to avoid excessive obsolete materials. Based on discussions with industry participants, we understand that in the latest draft of the implementation guidelines, BP Migas does not discuss how to set minimum level of non-capital material surplus. Therefore, Contractors should establish a robust planning and approval process for purchases of non-capital material surplus to be able to prove no negligent planning.
16. The establishment and operation of Placed into Service ("PIS") Projects/ facilities that are not able to operate in accordance with the economic life due the PSC contractor's negligence	Project / facilities development and operations which have been Placed Into Service and cannot be operated pursuant to economic age due to negligence of Contractors. Definition of negligence is the same as definition of gross negligence/ willful misconduct above. PIS is defined as the time when certain facility/ equipment has met the following requirements: a. operable pursuant to the planned capacity and economic age of production as approved by BP Migas; b. operator has obtained permits for operations and certifications pursuant to the prevailing regulations. Economic age is defined as projection of usable term of the intended facilities based on project approval.	Based on discussions with industry participants, we understand that in addition to points (a) and (b) proposed by the association, there are more clarification points added to the latest draft of the implementation guidelines as follow: - It has been proven that performance of the constructed production facilities has met the criteria stipulated in reference to BP Migas approval. In case of the characteristic of hydrocarbon is different with the agreed assumption, it can be shown by the result of performance test of each equipment to the assumption of characteristic approved/agreed by BP Migas in the process of project proposal evaluation. - All spare parts agreed in the existing contract are stored at a warehouse, in a good condition and ready to use. - All surplus materials have been recorded and reported to BP Migas. - A handover certificate has been issued from the person-in-charge ("PIC") of the project to PIC of the operations. - The start up of equipment/asset is witnessed by BP Migas, and a handover certificate is made. In principle, most investors should not take exception to the proposed modification and/or the latest draft of implementation guidelines.

Types of costs of upstream oil and gas business activities which are non-recoverable to Contractor of Production Sharing Contract based on Regulation No. 22/2008	IPA's proposed modification to the implementation guidelines for the types of costs of upstream oil and gas business activities which are non-recoverable to Contractor of PSC	PwC Observations
17. Transaction with affiliated parties that cause losses to the Government, without tender, or contradictory to Law No. 5 of 1999 concerning Anti-Monopoly Practice and Unfair Business Competition as well as tax regulations.	Transactions with the affiliated parties if conducted without tender that will create losses to the government and not in compliance with PTK 007; or contrary to Law number 5 of 1999 on Prohibition to monopolistic and Unfair Business Competition Practices; or Laws and Regulations in Taxation Sector. Exempted from the transactions meant hereunder are PSC transactions with affiliates through Technical Service Agreement ("TSA") or Parent Company Overhead ("PCO").	Based on discussions with industry participants, we understand that the latest draft of the implementation guidelines removed the exemption for TSA and PCO although TSA and PCO are common business practices in the upstream industry. It is unclear whether BP Migas will address TSA and PCO through a different regulation or Contractors will need to provide support that its PCO and TSA benefit the PSC operations (e.g. more efficient) and there is no profit component embedded in the PCO or TSA's rates.

From the above observations, there are still various questions or significant matters that BP Migas needs to address to make the implementation guidelines to Regulation No.22/2008 more effective. We understand that the draft is currently being reviewed by high ranking officers within BP Migas and is expected to be issued shortly.

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Code of conduct
The way we do business*

Putting our values in action

Excellence

Delivering what we promise and adding value beyond what is expected.

We achieve excellence through **innovation, learning and agility.**

Teamwork

The best solutions come from working together with colleagues and clients.

Effective teamwork requires **relationships, respects and sharing.**

Leadership

Leading with clients, leading with people and thought leadership.

Leadership demands **courage, vision and integrity.**