

Changes of Employment Regulations and Their Impacts on Financial Reporting

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Omnibus Employment Cluster: How might it support the investment environment? What are the potential impacts on Financial Reporting?

Indonesia's current demographic profile presents a substantial pool of labour resources, which if effectively engaged can help drive economic growth and increase Indonesia's competitiveness.

However, labour force productivity in Indonesia is still viewed by investors as a potential stumbling block to the attractiveness of Indonesia in terms of an investment destination. This is particularly the case when compared to some neighbouring countries in South East Asia that typically compete for those investment dollars. It is for this reason that the Indonesian government recognises the need to focus on creating an environment, including regulatory framework, that can support the improvement of labour force productivity.

With such objective in mind, Law No. 11/2020 concerning Job Creation ("Omnibus Law") makes some important changes to the Indonesian labour law and regulations. These changes are expected to support the improvement of labour force productivity and competitiveness while also providing protections to employees. The hope is that this in turn will create increased job opportunities and further development of the Indonesian workforce.

We acknowledge there has been some debate that the changes might have a negative impact on the local labour force. This Omnibus Flash will not address those debates but rather seeks to highlight some significant changes introduced by the Omnibus Law which are expected to support labour productivity and improve the investment climate in Indonesia. It is also critical to understand how some of these changes might impact the financial statements position of companies with a significant workforce.

What are the significant upcoming changes on Employment Regulations?

Expatriate work permit

Foreign investment is still one of the engines of economic growth and it is normal that it involves the employment of foreign workers in Indonesia. Therefore, simplification of permits to employ foreign workers is seen as a factor which can attract more foreign investment.

Recently, there has been some simplification of the expatriate work permit introduced in the various Government and Ministry of Manpower Regulations. Omnibus Law regulates this simplification in the following provisions:

- a. The employer is only required to obtain an Expatriate Manpower Plan (*Rencana Penggunaan Tenaga Kerja Asing/RPTKA*) approval to employ foreign workers as compared to the provision in Law No. 13/2003 concerning Labour ("Labour Law") which required the employer to obtain a permit in addition to an RPTKA approval. The permit is now simply replaced by a notification only;
- b. A foreign investment company that has foreign directors and foreign commissioners who are at the same time investing by holding certain number of shares in the company is exempted from the obligation to obtain the RPTKA approval for such foreign directors and commissioners; and
- c. Exemption to obtain RPTKA approval is also granted to some businesses to attract more foreign investment which include vocational programs and technology-based start-up business.

At the same time, Omnibus Law maintains some provisions which can protect local labour forces, such as the obligation to appoint and provide training and education to Indonesian employees as counterpart for expatriate employees. This is part of the transfer of knowledge and technology program. There are also provisions that only permit foreign workers to assume certain positions for a certain period and the requirement that foreign workers must have competencies relevant to the position assumed in Indonesia.

Definite period employment contract

There are some important changes to the status of definite period employment contract. The most significant changes relate to the allowable duration of a definite period employment contract and the introduction of obligations for compensatory payments upon completion of the contract. Labour Law, in principle, stipulated that a definite period employment contract could have a maximum total duration of up to five years. In order to provide more flexibility to businesses, as well as to increase job opportunities, under the Omnibus Law, both employer and employees will be able to determine the period of a definite period employment contract based on their mutual agreement.

Meanwhile, in order to protect the employees under a definite period employment contract, and to balance the flexibility to mutually agree the period of the contract, Omnibus Law requires the employer to provide compensation payment to the employees upon completion of the contract period or completion of the job specified in the contract. Such compensation payment was not required under Labour Law.

In addition, under the Omnibus Law, although a definite period employment contract must still be drawn up in writing, failure to do so will not result in it being regarded as a permanent employment contract unlike as previously stipulated in the Labour Law. Nevertheless, having a written definite period



employment contract is better to avoid any potential dispute between the employee and employer.

Businesses may expect more clarity on the type, nature, activities and period of duration of a definite period employment contract and the amount of compensation payment which will be issued in a form of a Government Regulation following the issuance of Omnibus Law.

Outsourcing of works

The Omnibus Law deletes the provisions in the Labour Law which stipulate the possibility for a company to outsource works to a job or labour outsourcing company, as well as the type of works that can be outsourced. This is with a consideration that these provisions must be regulated in the business sector regulations rather than in the Labour Law.

The deletion of provision on type of works that can be outsourced can be interpreted to mean that all work can now be outsourced.

We understand that on this point, the government believes that a work outsourcing arrangement can refer to the relevant provisions under the Indonesian Civil Code, including to the sectoral regulations. This means that businesses will need to monitor the sectoral regulations that stipulate the types of jobs that can or cannot be outsourced.

The amendment in the Omnibus Law focuses on the provisions related to the employment relationship between the employees and the outsourcing company and also protection to employees considering that there will be more outsourcing arrangements expected in the future.

The Omnibus Law emphasises that the responsibility for the protection of the outsourced workers falls upon the outsourcing company, including transfer of protection for outsourced workers based on a definite period employment contract in the case of change of the outsourcing provider. In relation to this, the Omnibus Law also removes provision that the employment relationship of the outsourced workers will be legally transferred from the outsourcing company to the employers in case it does not meet certain requirements.

The Government will issue further Government Regulation on detail provisions regarding protection of outsourced workers and licensing requirements for the outsourcing company.

Working hours and rest period

The Omnibus Law does not amend the provision on the number of working hours i.e. 40 hours a week, which consists of 7 hours/day for 6 working day or 8 hours/day for 5 working days.

However, to accommodate some of the business needs, the Omnibus Law stipulates the following provisions:

- a. A company can stipulate the implementation of working hours in the employment contract, company regulation or Collective Labour Agreement (CLA);
- b. The maximum overtime working hours is increased from maximum 3 hours in one day and 16 hours in one week to maximum 4 hours in one day and 18 hours in one week, with a note that this does not apply to certain business sectors or jobs; and
- c. Removal of the provision in the Labour Law which stipulates a long leave period of minimum 2 months and specifies that long leave is to be regulated by company in the employment contract, company regulation or CLA. It does not provide any minimum period of long leave anymore and we understand that this is to align with each company's business needs and capability.

Wages and minimum wages

Some of the provisions under the Omnibus Law adopt those that have already been stipulated under Government Regulation No. 78/2015 concerning Wages.

The Omnibus Law does mention the determination of minimum wages at provincial as well as regency/city level, but it is silent on the sectoral minimum wages.

To provide support, the Omnibus Law provides exemption for micro and small enterprises to follow the provision on minimum wages and allow the minimum wages to be mutually agreed with the employees within certain minimum requirements as set out in the Omnibus Law. This will also be further clarified in a forthcoming Government Regulation.

The Omnibus Law no longer includes a provision on the possibility for a business to postpone the payment of minimum wages.

The Omnibus Law includes additional provisions granting further protections to employees, which include priority rights for employees to receive unpaid wages before payment to all creditors, in the case of bankruptcy or liquidation. It also removes the provisions which stipulate that any claim for payment of wages or other payments related to an employment relation expires after the lapse of 2 years which provides rights to workers to claim for the fulfilment of the payment even after 2 years.

Employment termination

Although the Omnibus Law in substance stipulates similar provisions on the employment termination process, with the objective to shorten the process, the Omnibus Law stipulates that the process starts with informing the employee of the objectives and reasons for terminations. Only if the employee rejects this, then bipartite negotiation is required. The Omnibus Law also stipulates that the mechanism of industrial relationship dispute settlement must be conducted in cases where the mutual agreement based on bipartite negotiation cannot be reached.

On the reasons for termination, the Omnibus Law mainly adopts those already in the Labour Law with some changes. The Omnibus Law does not include change of company status as a reason for termination since we understand it was not clear what exactly constitutes a change of company

status that can lead to a termination. It also specifies acquisition instead of change of ownership as stipulated in the Labour Law to emphasise that only a change in ownership that leads to change of controlling shareholder can be one of the reasons for termination. On termination due to efficiency reason because the company is experiencing loss, the Omnibus Law stipulates that such efficiency reason does not need to be followed by the closure of the company. The Omnibus Law also includes suspension of debt payment as a reason for termination.

On the component of termination package, the Omnibus Law maintains the three components i.e. severance pay, service year pay and compensation of rights. However, for the severance pay, the Omnibus Law no longer defines the said amount as the floor threshold so the amount can now be interpreted as fixed amounts. For the compensation of rights, the Omnibus Law also removes the compensation for housing allowance, medical and health care allowance at 15% of the severance pay and/or service pay as one of its components. We noted that this is based on the argument that housing and medical/healthcare benefit for the employees has been covered under the existing old age security program and health program under the Social Security Administrator Agency (*Badan Pengelola Jaminan Sosial/BPJS*). The Omnibus Law removes provisions under Labour Law related to the formula of termination package based on the reason of termination as this will be further stipulated in a Government Regulation.

Unemployment insurance

The Omnibus Law introduces a new insurance program i.e. Unemployment Insurance to provide further protection to employees impacted by employment termination.

Under this insurance program, which will likely be managed by BPJS, the Government will provide benefit to the impacted employees in the form of cash, access to job market information and training.

The insurance program will be financed by the government and by contributions from the participants, which will also be borne by the government.

The Omnibus Law does not provide the details including criteria of employees that can be covered under this insurance, including the implementation of the insurance program, as this will be further regulated in a forthcoming Government Regulation.

Other than the above changes, the Omnibus Law stipulates other provisions such as on job training institution, work placement agencies, Indonesian migrant worker as well as provision on criminal and administrative sanctions.



What do these changes mean for Financial Reporting?

One of the most notable changes that may have immediate impact on the financial statements of a company is related to the minimum benefits that should be provided by employers to employees. Companies need to consider whether amendments to their CLA are needed following the issuance of the new regulations under the Omnibus Law. A CLA usually covers both benefits for employees during the employment period (an employment benefit plan) as well as benefits provided after the employment period ends (a post-employment benefit plan). Several changes to employee benefits provided under the Omnibus Law, as compared to the previous Labour Law, could have an impact on the company's financial statements.

Amendment of the employment benefits

The employment benefits consist of short-term benefits (i.e. wages, annual bonus, annual leave, etc) and long-term benefits (i.e. long-term incentive, long-service award, long service leave, etc). These items are accounted for in the financial statements and thus if there are any changes in the obligations the employers need to reassess their related balances on provisions for employment benefits. Changes in the amount of benefits to be paid by employers to employees during the employment periods, as regulated in the Omnibus Law might trigger constructive obligations. This needs to be included in the employers' current provision for employment benefits such as, but not limited to, bonus accruals, long service leave accruals, etc.

Further consultation with legal counsel is needed to determine the timing when the constructive obligation has arisen.

Amendment of the post-employment benefits

Some provisions in the Omnibus Law indicate potential changes in the amount of benefits that will be paid by employers to employees after the employment period ends, such as compensation payments to contract employees upon completion of the contract period, changes in the compensation for employee termination, etc. As outlined in Indonesian Financial Accounting Standards (*Pernyataan Standar Akuntansi Keuangan/PSAK*) 24 "Employee Benefits", in a situation when an employer introduces new, withdraws changes, and/or significantly reduces the benefits payable under an existing defined post-employment benefit plan, such changes should be treated as a plan amendment in the eyes of PSAK 24 "Employee Benefits" and remeasurement of the net defined benefit obligation (assets) will need to be performed.

Here are several quick reminders about key accounting principles related to post-employment benefit plan amendment.

A. Accounting for plan amendments

Remeasurement of the net defined benefit obligation (assets) caused by the benefit change should not only portray future impact but also should reflect the past period portion (if any) called "past service costs". Past service costs result from a change in the present value of the defined benefit obligation for employee service in prior periods, resulting from a plan amendment or a curtailment. The remeasurement result might produce an increase in the cost of future service relating to active members (reflected in a higher annual current service cost) and/or an increased liability for past service relating to current and ex-employees.

The gain or loss relating to a past service cost adjustment is calculated by remeasuring the net defined benefit liability (asset), using the current fair value of plan assets and current actuarial assumptions (including current

market interest rates and other current market prices). This calculation should reflect the benefits offered under the plan before the amendment. This remeasured net defined benefit liability (asset) is compared to the new net defined benefit liability (asset) immediately after the amendment. The difference is the gain or loss on plan amendment.

For further guidance on past service cost, please refer to Manual of Accounting (MoA) Chapter 12 section 12.85-12.91.

B. When should the plan amendment effectively be recognised in the financial statements?

PSAK 24.102 clarifies that past service costs should be recognised in the income statement at the earlier of (a) when the plan amendment or curtailment occurs; and (b) when the employer recognises related restructuring costs or termination benefits.

The plan amendment occurs when an employer introduces or withdraws a defined benefit plan or changes the plan. Plan amendments might arise from a constructive obligation. Informal communications made to employees might result in the employer having no choice but to pay the benefits. Further consultation with legal counsel is needed to determine the timing when the constructive obligations has arisen.

For further guidance on the timing of past service cost due to plan amendment, please refer to MoA Chapter 12 FAQ 12.87.1.

Information to be disclosed in financial statements for the period ended 30 September 2020

If employers have not issued their financial statements for the period ended 30 September 2020 (or any other interim period), as required by PSAK 8 para 21 – 22, disclosure about the potential impact of the Omnibus Law should be added to the financial statements if the impact is material. The disclosure should not only provide descriptive information about the nature but also should provide an estimation of the financial effects resulting from such plan amendment, if the employer can reliably estimate such effects as of the reporting date.

What's next for the business?

In addition to the above outlined changes, there are some other provisions covering areas such as on the job training, work placement agencies, Indonesian migrant worker rules as well as provisions on criminal and administrative sanctions.

Many of the detail changes and provisions in the employment cluster of the Omnibus Law require issuance of further implementing regulations to be effective. We understand that the Government is targeting the issuance of those implementing regulations within a three months period since the enactment of the Omnibus Law.

Following the issuance of the detailed regulations, companies will need to identify any impact on their employment terms and conditions, including changes to the current employment contract, company regulation and CLA, and formulate the necessary plan and steps to adopt such changes. Financial accounting impacts will also need to be assessed and to be reported in the financial statements.

In the interim, if there will be any actions related to the areas changed under the Omnibus Law, in the absence of the detailed regulations, consultation

with the authorities and legal counsel may be needed to ensure that any such contemplated actions comply with the law and forthcoming regulations. We also highly suggest you start a discussion with your actuary consultant, to further understand and project any potential impact of the Omnibus Law to your financial figures.

PwC professionals will continuously monitor this evolving situation and provide relevant and timely insights. We remain ready to advise you on the detail of the Omnibus Law and its upcoming implementing regulations and help you work through the impact and future planning!



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