Palm oil plantation

Industry lanscape, regulatory and financial overview

Plantation
Indonesia

- Overview of palm oil industry landscape in Indonesia
- A highlight on regulatory issues
- Taxation for the oil palm plantation industry
- Plasma and its accounting implications
- A highlight of challenges on fair value accounting for oil palm plantation
- RSPO, catalyst for Improvement?

Overview of palm oil industry landscape in Indonesia

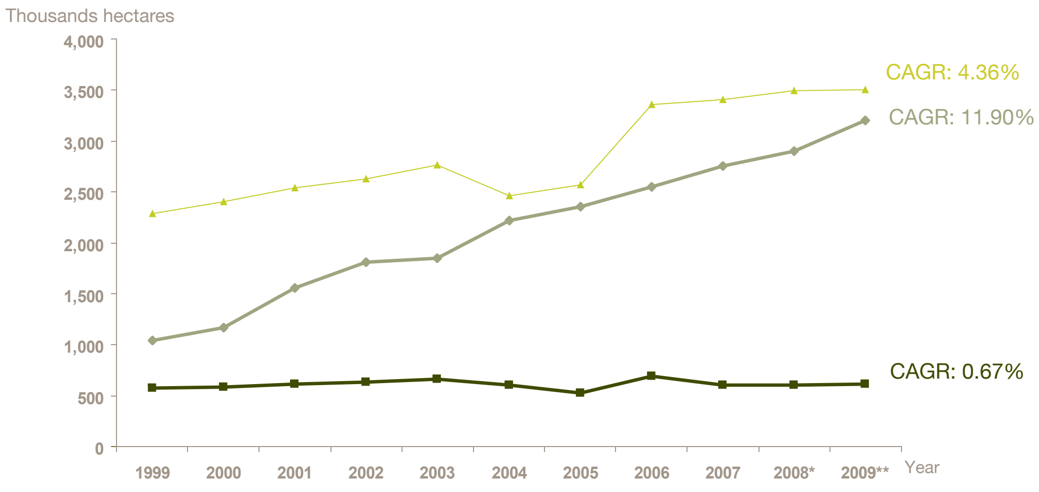
Buntoro Rianto

Crude palm oil (CPO) industry grows increasingly important for Indonesia, the world's largest CPO producer, given its enormous contribution for the country's export and employment rate. In Indonesia, the industry is focused on the upstream sector, or CPO production. This sector is dominated by private enterprises, followed by small planters, which include plasma farmers.

Oil palm plantations are currently concentrated in the Island of Sumatra, and historically are dated back to the Dutch colonial era. The development of the plantation and the related infrastructure in the island's provinces, therefore, is relatively more advanced than those in other parts of Indonesia.

The followings are several tables that show the historical development of CPO industry, as well as the snapshots of the current situation.

Developments of oil palm plantation areas in Indonesia during the last decade.

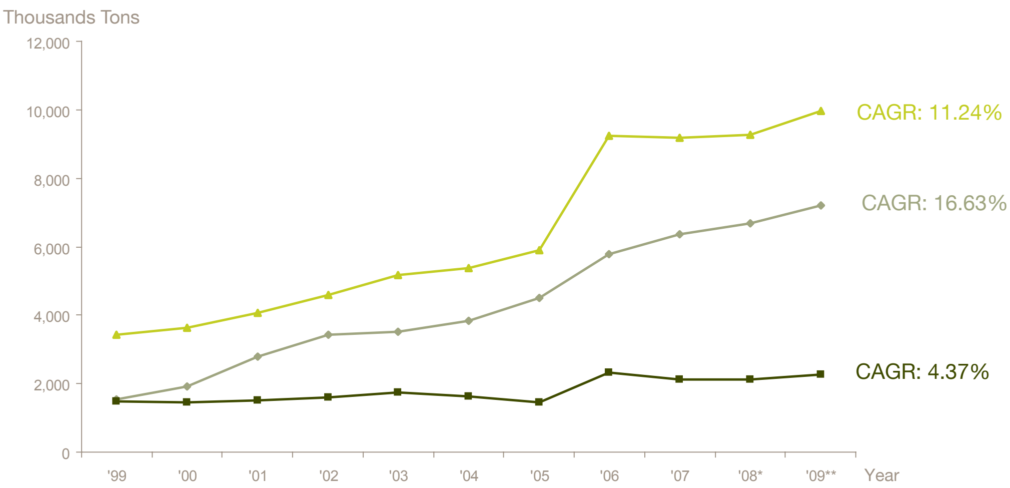


Smallholders
State-owned enterprises
Private enterprises

Source (raw data) :
Directorate General of Estate Crops

* Preliminary
** Estimation

Developments of CPO production in Indonesia during the last decade.



Smallholders
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Source (raw data) :
Directorate General of Estate Crops

* Preliminary
** Estimation

The compounding annual growth rate (CAGR) of CPO production contributed by private enterprises during the last decade has been significantly higher than their compounding growth of plantation areas, which indicate higher productivity. The higher productivity of plantations owned by private enterprises is attributed to various factors, including those that relate to maturity ages, plantation and mill processing management.

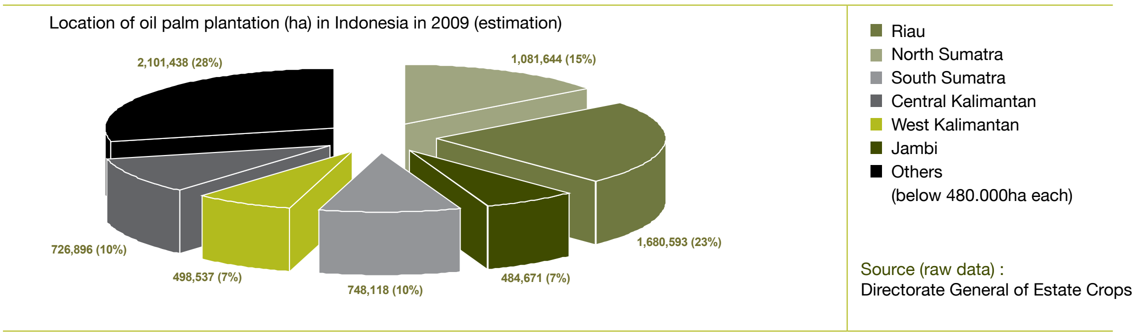
During the last decade, oil palm industry in Indonesia has been developing rapidly. In 1999, the total area of palm oil plantation was approximately 3.9 million hectare and it has grown into a whopping 7.3 million hectare in 2009.

In line with the development of the plantation areas, the volume of CPO production also increased significantly during the period, whereby it was approximately 6.5 million tons in total in 1999 and it reached 19 million ton a decade later.

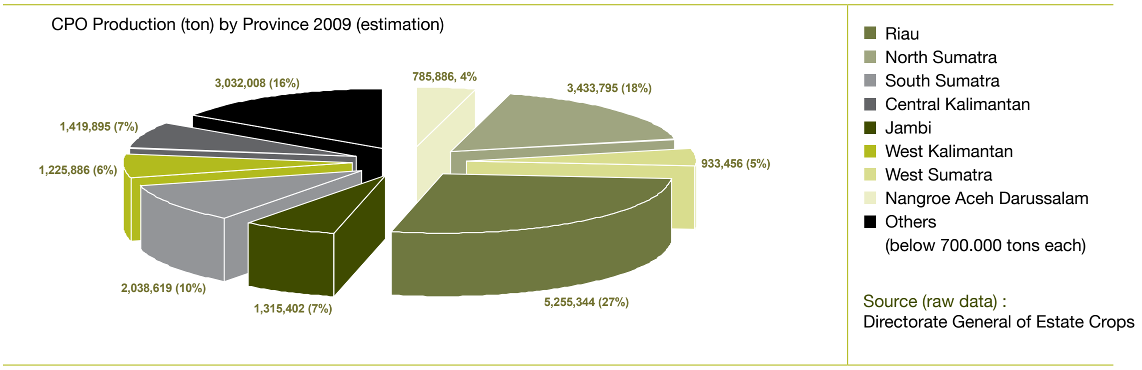
There has also been a significant change in terms of business players in the past decade. From the domination of big players, small planters emerged later on and get a hold of about 43.76% of the plantation areas, while 48% others are managed by private enterprises and the rest is by state-owned enterprises.

The 2009 data showed that 65% of the plantation areas were located in Sumatera, 26% in Kalimantan, 3% in Sulawesi and the rest sprawls in other parts of Indonesia, including Java and Papua.

The following charts depict the detail plantation areas as well as the CPO productions by each province in 2009.

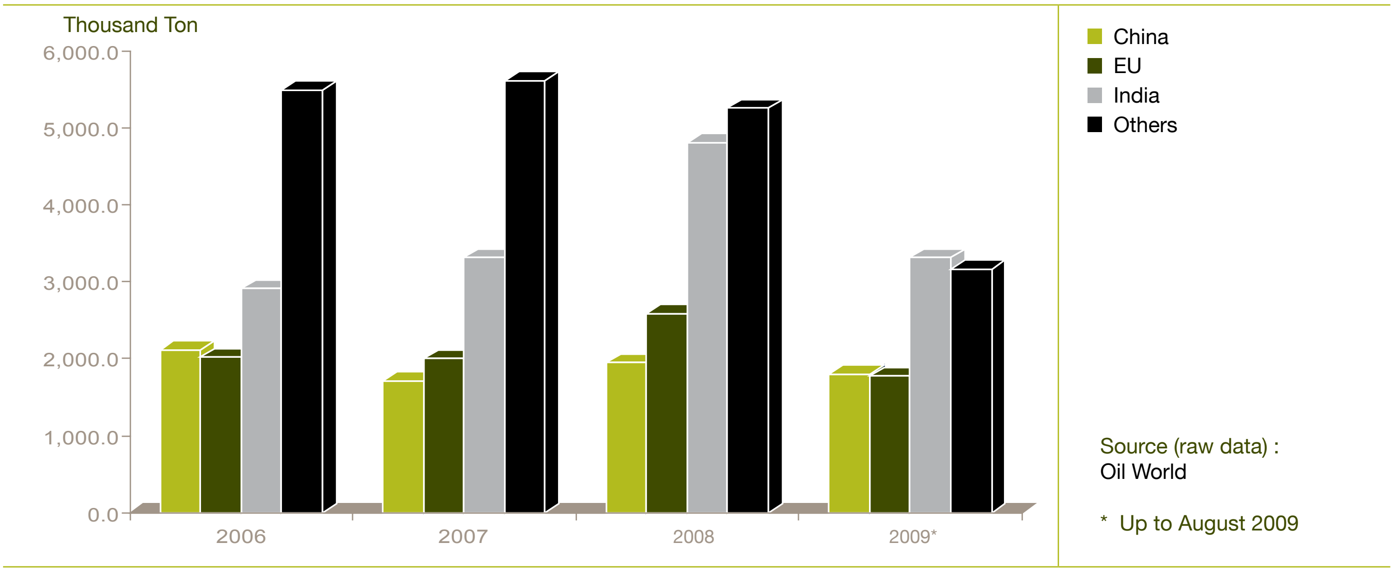


The CPO production capacity per province is in line with the concentration of plantation shown in the following table.



Export Market

The following chart shows the destination countries of Indonesian CPO's export destination in the past decade.



The majority of CPO production in Indonesia at the moment serves foreign market. The domestic market mainly needs it for cooking oil, which causes the price of cooking oil to move in line with the CPO supply to domestic market. There have been precedents in the past where the price soared due to the limited supply. The Government of Indonesia has imposed export duty on palm oil products to protect domestic CPO supply and thus to keep cooking oil price from soaring. The export duty is imposed at the pre-determined progressive rates based on the type of product on the standard export price. The standard price is determined by Directorate General of Custom and Duty periodically using the CIF Rotterdam CPO price as the reference.

The export duty rates for CPO and Crude Palm Kernel Oil (PKO) as of 1 January 2009 are as followed:

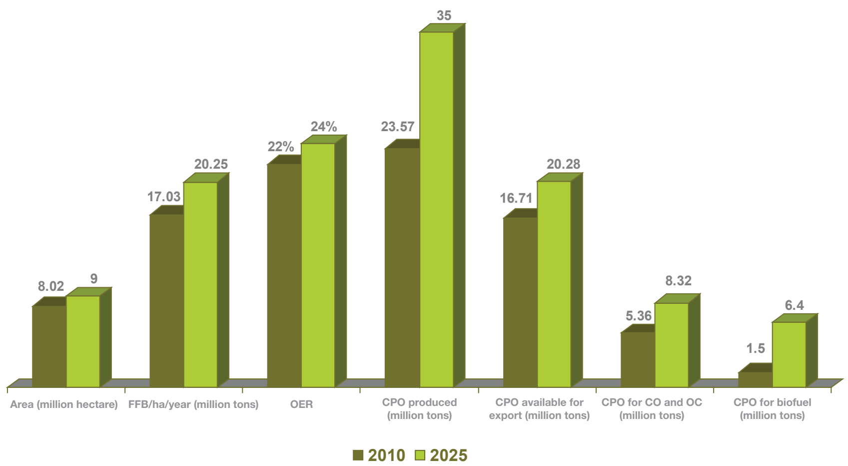
Standard export price (in US$)	CPO	PKO
<=700	0%	0%
701-750	1.5%	0%
751-800	3%	1.5%
801-850	4.5%	3.%
851-900	6%	4.5%
901-950	7.5%	6%
951-1,000	10%	8.5%
1,001-1,050	12.5%	11%
1,051-1,100	15%	13.5%
1,101-1,150	17.5%	16%
1,151-1,200	20%	18.5%
1,201-1,250	22.5%	21%
>=1,251	25%	23%

Source: Minister of Finance Regulation No. 223/PMK.011/2008

Prospects of palm oil industry in Indonesia

In the short run, it seems that land expansion will remain the main strategy to increase CPO production capacity. Within the medium term, the trend of industry integration will increase, along with the growth of downstream industry for ole-chemical and biofuel. As for the medium and long term period, the development will emphasize on the efficiency and effectiveness of plantation management as well as refinery management processes to increase productivity.

The following chart features key metrics of palm oil industry development targets in Indonesia:



Source (raw data) :
R&D-Ministry of Agriculture (2007)

OER: Oil Extraction Rate
CO: Cooking Oil
OC: Oleo-Chemical

SWOT Overview

Strengths
- High availability of land
- The right to land that is valid for up to 90 years
- Availability of low cost manpower

Weaknesses
- Lengthy procedure to obtain land permits
- Lack of infrastructures in certain prospective locations

Opportunities
- Increasing demand for CPO
- Favorable regulations for foreign investors, such as the one that allows foreign investors to hold 95 percent shares
- Sustainable palm oil-based management
- Newly established CPO commodity market

Threats
- Better performance of substitute products
- Limited supply of high quality seed
- Issues with surrounding communities
- Environmental issues

A highlight on regulatory issues

Adi Pratikto

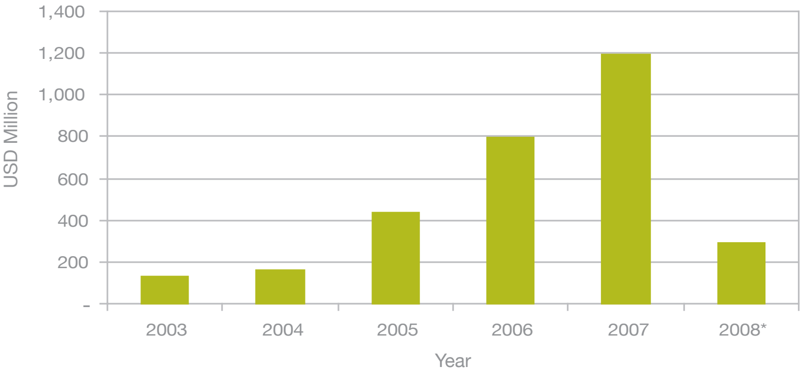
Investment in the Palm Oil Plantation Industry

The plantation sector in Indonesia is a large contributor to national income and at the same time maintains quite a large sector of employment.

In particular for palm plantations, the continued growth in demand for palm oil over the past few decades has resulted in rapid expansion in the production of palm oil around the world. Lead by the potential economic benefits from this increase in palm oil demand, palm oil plantations, in particular in tropical areas where the palm tree grows such as Indonesia, have also been expanding and attracting investors to invest their capital in this industry.

In view of the above, the GOI has been putting efforts into improving the investment climate to attract more foreign investors into Indonesia, which among other things has included issuance of new investment regulations. There are several basic regulatory issues which investors should be aware of which are described in the following section.

Foreign Investment Planning Approvals in Food Crops and Plantation Sector



Source :
www.bi.go.id

* Upto March 2008

Land Issue

One main issue in relation to plantation area in Indonesia is conflict with local communities with regard to the ownership of the land caused by lack of clarity as to land status and the legal ownership of land. Despite efforts taken by the government, communities and other stakeholders, this land problem has been a classic issue for years in Indonesia. Investors, therefore, need to perform a careful check on land status prior to acquiring a piece of land to avoid possible land problems in the future.

Another land issue is the limitation on the ownership of land area by a plantation company.

The Ministry of Agriculture through Article 12 of its Regulation No. 26/Permentan/OT.140/2/2007 regarding Guidance on Licensing Plantation Business stipulates that a plantation company can have a maximum of 100,000 hectares in plantation area or twice that if the plantation area is located in Papua.

In practice, however, the limit is subject to conditions, especially in the case of a new plantation company needing to acquire a piece of land for its plantation area. This is due to another regulation issued by the State Minister of Agriculture/National Land Agency, No. 2/1999 in year 1999, regarding Location Licenses.

Based on the above National Land Agency regulation, a plantation company must obtain a Location License from the Land Office prior to acquiring land for the plantation area. This regulation, however, stipulates that a palm plantation company can only own/control a maximum of 20,000 hectares in one province or twice that in Papua province and 100,000 hectares throughout Indonesia.

Consequently, a plantation company that operates in one province can only have a maximum 20,000 hectares based on regulation No. 2/1999 instead of 100,000 hectares area based on regulation No. 26/Permentan/OT.140/2/2007.

Furthermore, the limitation in regulation No. 2/1999 applies not only to individual palm plantation companies but also to other palm plantation companies which constitute a group of companies.

Licensing Process

The World Bank in its Doing Business 2010 ranked Indonesia at 122 out of 183 countries on ease of doing business. One factor considered in making the ranking was the average number of procedures and average number of days required by entrepreneurs to start a business, which in the case of Indonesia consists of nine procedures that taking 60 days in average.

In the plantation industry, the licensing process has also been an issue. There are various permits/licenses/approvals to be obtained from various government authorities which relate to the incorporation of the company, land ownership and plantation company operational licensing.

Investors may need to follow a quite lengthy and costly process, which may take some months, to obtain complete licenses for a palm plantation company.

Foreign investors may also consider acquiring a local plantation company in order to avoid the long route of getting the permits/licenses/approvals required, assuming that the local plantation company has already obtained such permits/licenses/approvals.

Foreign Shareholding

In particular for foreign investment, another issue is the limitation on foreign shareholding in a plantation company.

Presidential Decree Nos. 77/2007 and 111/2007 regarding Lines of Business Closed and Open with Requirements for Investment stipulate that foreign investors can have up to a 95% shareholding in a plantation company, including palm plantation companies. The remaining 5% shares must be allocated to an Indonesian shareholder.

Like any other lines of business in Indonesia which is subject to a minimum percentage of local shareholding, in the plantation sector, even though the 95% shares would form a majority in the company, foreign investors often would like to ensure that they fully control the management of company. In the past this could be done through an arrangement called a “nominee” arrangement where there would be an agreement between the shareholders which said that the Indonesian shareholder agreed to hold the 5% shares on behalf and in the interest of the foreign shareholder.

However, on 26 April 2007, by the issuance of Investment Law No. 25/2007, the government in principle stated its intention to avoid the existence of a company which is legally owned by a party but materially and substantially owned by another party as resulted from nominee arrangements. Therefore, in Article 33 of the Investment Law, the government decided to prohibit parties from entering into such nominee agreements. Such an agreement would be considered null and void by law. Share ownership and control through a nominee arrangement is now risky under this Investment Law.

Taxation for the oil palm plantation industry

Antonius Sanyojaya / Yunita Wahadaniah / Ay Tjhing Phan

The plantation industry is unique, with its own characteristics and complexities in terms of managing tax strategy, tax compliance and tax risk. Investors should be aware of the taxation aspects at every life cycle stage from start-up through development to commercial production in order to minimise the tax risk and optimise the bottom line. To a large extent, the discussion below focuses on oil palm plantations.

Start-up

At a very early stage, investors should identify the most tax-efficient shareholding structure for the purposes of profit repatriation, funding and exit strategies. They should also start to determine how to integrate the downstream and upstream activities if they consider that integration is necessary. Furthermore, investors should be aware of any income tax incentives available.

Shareholding

Shareholding structure is one of the most important considerations when investing in Indonesia. This applies to both foreign and local investors. Some key tax issues to be considered when structuring an investment in Indonesia for foreign and local investors are outlined in Table 1 and Table 2, respectively. Re-structuring the shareholding later in the life cycle of the investment could be costly and involve regulatory hurdles.

Investors should also be aware of the Controlled Foreign Corporation ("CFC") rules and the anti tax-abuse rules on the effective sale of shares in Indonesia i.e. the sale of shares in an Indonesian entity through an offshore vehicle that has a special relationship with the Indonesian entity is deemed as the sale of shares in the Indonesian entity. These rules will impact on the sustainability and effectiveness of the shareholding structure.

Shareholding structure will generally impact on tax efficiency (effective tax rate) when distributing the profits from the operating unit back to the shareholder and when the investment in Indonesia is exited. Please refer to Table 3 for the key tax issues for exit strategies.

Table 1

Structuring issues for foreign investors

- selection of the shareholder jurisdiction that provides the most tax efficiency for profit repatriation (via dividends) and shareholder funding. The use of a treaty country is generally preferable. The Indonesian withholding tax ("WHT") rate on dividends and interest is 20% unless if there is tax treaty relief;
- new rules in accessing tax treaty benefits should be observed and complied with. Broadly, the Certificate of Domicile ("CoD") Form-DGT 1 for foreign shareholders, in a format designed by the Indonesian Tax Office ("ITO"), should be made available to Indonesian subsidiaries when receiving dividend income, on an annual basis. The foreign shareholders should also be the "beneficial owners" subject to certain administrative requirements to be satisfied by the foreign shareholders; and
- the taxation regime in the foreign shareholder jurisdiction for the income received (typically dividend and interest).

Table 2

Structuring issues for local investors

- dividend income is tax exempt if paid to a domestic-entity shareholder (i.e. a PT) provided it holds 25% or more of the entity paying the dividend. Multiple layers of local shareholdings generally may not provide any tax benefits to the group companies;
- dividend income is subject to 10% final tax in the hands of the individual shareholder; and
- dividend income from offshore subsidiaries is taxed at the normal corporate income tax rate. WHT paid offshore is generally allowed for credit (subject to the prescribed calculation formulae).

Table 3

Exit strategies

- gains derived from the transfer of shares by corporate tax residents are subject to 25% headline tax rate in 2010 onwards;
- the sale of listed shares through an Indonesian stock exchange is subject to final WHT at 0.1% of the gross transaction value. Exemptions may arguably be available under relevant tax treaties;
- the sale of non-listed shares in an Indonesia entity by a foreign investor (a non-tax resident) is subject to final WHT at 5% of the gross proceeds. Exemption may be available under relevant tax treaties; and
- under the Income Tax Law No.36/2008, which took effect from 1 January 2009, the sale of special purpose vehicle entities established in "tax haven" countries that have a special relationship with an Indonesian entity through shareholding is subject to tax at 5% of gross proceeds. Exemption may be available under relevant tax treaties.

Financing

The funding for plantation operations is generally sourced from either equity or loans. Some cases may involve hybrid financing (e.g. preference shares, convertible notes etc.). Each form of funding has its specific features.

Dividends can only be distributed when the company is in a profit position. There is also a statutory requirement that the company should not distribute all profits as dividends. The company should retain 20% of paid-up capital as a reserve.

Loan financing provides flexibility for repatriation. Interest and principle can be paid at any time before profits as agreed. Interest on the loan is tax deductible unless the loan is used to produce non-taxable income. The interest is subject to withholding tax at 20% or reduced treaty rate for foreign loan and 15% for domestic loan (unless paid to domestic bank).

Thin capitalisation rules may be adopted by the Indonesian tax authorities and therefore this should be closely monitored.

Upstream/Downstream Integration

The palm oil industry provides a variable supply chain from upstream to downstream. This may include research and development, seed gardens, plantations, Crude Palm Oil ('CPO") mills, refineries and bio-diesel plants.

This is another consideration at the start-up stage, where investors have to determine whether to operate the plantation as part of an integrated project (i.e. one company is engaged in all processes from plantation to refinery) or as a stand-alone project (separate companies run each business unit). Indonesia does not recognise grouping for income tax purposes.

An integrated project may technically provide more tax advantages than a stand-alone. This is because the delivery of goods will not be subject to transactional taxes (VAT etc.) and there is the opportunity to benefit from the cross-use of deductions amongst business units. The integrated project may also minimize "shared services" transactions and their associated tax implications as otherwise occur in a stand-alone project scenario.

The business case above is however subject to regulatory/licence permits.

Tax Incentives

Bio-diesel production may be eligible for investment facilities in respect of income tax incentives. Plantations and refineries are however unlikely be entitled to these incentives.

The incentives consist of a reduction in net income of up to 30% of the amount invested (prorated for six years), accelerated fiscal depreciation (double the standard rates), extension of tax loss carry-forward (up to ten years) and 10% WHT on dividend payments to offshore shareholders (reduced from the 20% non-treaty rate).

Development / Planting

The development (or planting) stage is a period where there will be significant investment spending. Cash efficiency becomes a key success factor. Accordingly, taxation also comes into play in this development period. Typical tax issues at this stage are the capitalisation of plantation assets, intra-group funding and VAT management, which are discussed below.

Capitalisation of Plantation Assets

The tax loss carried forward period is five years. To minimise the expiration of tax loss, the plantation company should properly recognise the costs incurred during the development/planting stage. Capitalisation, to the extent allowed, should generally reduce the risk of the tax loss expiring before it can be used.

Most expenses incurred during the development/planting stage are capitalised as "immature plantation" for accounting purposes. For fiscal purposes, only expenses with useful lives of more than a year can be capitalised. Expenses with useful lives of less than one year should be treated as expenses.

Before 2009, the tax rules required that fixed assets (arguably including plantation assets) be depreciated when the assets are acquired or at the time the expenditures for planting the trees are incurred. A deferment for claiming depreciation (up to the period when commercial production starts) is allowed, however it is subject to the ITO's approval.

From 2009 onwards, the depreciation of plantation trees is automatically allowed to be deferred until the plantation trees have matured (i.e. no approval from the ITO is required).

For tax purposes, the original acquisition cost of land titles, land/building use rights, business use rights etc. are not allowed to be capitalised and amortised along the useful life. The cost for applying for an extension of such rights is however allowed for capitalisation and amortisation.

Intra-group Funding

Intra-group lending would normally be the main source of funding at this stage (as the project may not yet be bankable). The tax issues associated with inter-company loans need to be well understood and the Indonesian transfer pricing rules should not be infringed. Essentially under the transfer pricing rules, loan terms and conditions must be on arm-length terms. A market interest rate should apply.

VAT Management

The company should ensure that the VAT prepayment will be recoverable.

The VAT system adopts a credit mechanism. A company pays input VAT when purchasing and charges output VAT when selling. The input VAT can be claimed as credit against the output VAT. As no selling will have occurred in the development stage, the company will typically be in a VAT overpayment position. Claiming VAT refunds (and possibly VAT compensation (i.e. carry-forward) under VAT Law No.42/2009) will attract a tax audit. Investors should be aware that a tax audit may be time consuming and therefore the related tax audit must be properly managed.

The VAT Law No.42/2009, which have been effective from 1 April 2010, limits eligibility for VAT credit during the development/pre-operating stage (i.e. VAT credit is restricted to capital goods only). The VAT Law also limits the VAT refund frequency (this will be available once a year at the end of the relevant book year instead of monthly as previously allowed).

Commercial Production

The commerciality stage is the period where the transaction volume becomes significant and the cash flow becomes positive. Tax compliance again plays an important role for tax efficiency.

Below are the typical tax issues at this stage.

Commencement of Depreciation

When the plantation starts to be harvested (in the fourth or fifth year of operation), the immature plantation will be reclassified as a mature plantation. The company will start to depreciate the mature plantation.

It appears that the tax rules on depreciation do not specifically cover or include plantation assets/trees. Based on the prevailing fiscal depreciation rules, assets that are not listed under a specified grouping (categories 1 to 4) should be classified as category 3 (with a useful life of 16 years using the depreciation rate of 12.5% for the declining balance method or 6.25% for the straight line method).

Cooperation of Plasma Scheme

Plasma is a typical feature of oil palm plantations. Some tax issues relating to plasma include the following:

- provision for accounting losses in respect of plasma conversion (i.e. the hand-over to plasma farmers) is not allowed for tax deduction;
- actual conversion loss, if any, for tax purposes is acceptable only when the plasma trees are officially handed over to the plasma farmers. Third party confirmation/calculation supporting the loss on plasma conversion should be prepared; and
- services provided by the plantation company to Plasma farmers (e.g. management, technical support, loans, fertilizer and pesticide lending, etc.), if any, are arguably subject to VAT.

Construction of CPO Mill

The plantation company may apply for tax incentives when importing capital goods for CPO mill construction. The incentives may include VAT and Income Tax Article 22 prepayment exemption on the importation of the capital goods (i.e. machinery, equipment etc.). The tax exemptions are subject to the ITO's approval.

The plantation company may also apply for import duty exemption under the Badan Koordinasi Penanaman Modal/BKPM facility (i.e. through a "master list").

VAT on Fresh Fruit Bunch ("FFB") and CPO

FFB is not subject to VAT. Consequently, input VAT relating to the production of FFB is non-creditable. The input VAT is however treated as a tax deduction. CPO is a form of VAT-able goods. Input VAT relating to the production of CPO is creditable. If the end product is in the form of CPO (where the plantation company owns its CPO mill), it can be argued that all input VAT paid in respect of plantation and CPO mill operations are creditable.

The ITO in some cases has adopted different views and argued that the plantation and CPO mill are two separate business units, and therefore only allowed input VAT incurred in respect of the CPO mill operation as creditable.

VAT is normally due on a location-by-location basis unless the company obtains VAT centralisation approval. In this case, the VAT invoice should be issued and reported at the location of the plantation estate. Companies that are registered with certain tax offices (e.g. foreign investment/PMA, Large Tax Office/LTO, etc.) are deemed to have VAT centralisation and therefore no approval is required.

Others

Transfer Pricing

The ITO has increased the level of focus on enforcing compliance with transfer pricing rules. The steps the ITO has taken include:

- increasing the focus on transfer pricing issues in tax audits and non-audit questionnaires issued to taxpayers; and
- requiring related party disclosure form to be filed with corporate income tax returns, which now requires the disclosure of a taxpayer's related party transactions and confirmation of whether transfer pricing documentation is available to test whether those transactions have been done at arm's length.

These latest developments in transfer pricing compliance reinforce the ITO's continued focus in this area after introducing mandatory documentation rules in December 2007 and formally adopting the OECD pricing methods as the only acceptable methods by which to accept or review transfer prices into Indonesian taxation law.

In light of the ITO's current level of focus on transfer pricing, group plantation companies, including multinationals with operations in Indonesia, should review their preparedness to respond to a transfer pricing audit. In line with this, it is critical to prepare robust transfer pricing documentation to support the contention that the company's related party transactions meet the arm's length principle.

Taxes related to Land and Building

There are three types of taxes in respect of the use and/or transfer of land and buildings i.e. land and building tax, land and building transfer duty and income tax on the transfer of land and building.

The land and building tax is levied on any holdings of land and/or buildings. The tax is due on annual basis and calculated at 0.5% of 20% (for government designated price (known as NJOP up to IDR1 billion) or 40% (for NJOP above IDR1 billion)).

Land and building transfer duty is levied upon the acquisition of any rights over the land and buildings (e.g. land and/or buildings rights, business use rights etc.). The duty is payable by the buyer and calculated at 5% of the actual purchase price or NJOP, whichever is higher.

In addition to the transfer duty, the transfer of rights is also subject to final income tax payable by seller. The tax is calculated at 5% on the actual selling price or NJOP, whichever is higher.

Regional Tax

Plantation company is liable to a number of regional taxes and retribution at the rates currently ranging from 1.5% to 35% of a wide number of reference values determined by the relevant regional government.

Export Duty

Export of FFB, CPO and refined products are subject to export duty calculated at progressive rates (currently ranging from 0% to 25% for CPO) of a predetermined statutory value set out by the Central Government.

Plasma and its accounting implications

Andy Santoso

Background

In line with the effort in developing the plantation sector to increase the income of farmers, the GoI has introduced several cooperative programs of plantation development which involve main plantation companies called nucleus ("Inti") and individual farmers called plasma farmers. Principally in the plasma scheme, the Inti assists the plasma farmers to develop and manage their plasma plantations up to a predetermined physical condition at which time the plasma plantation is ready to be transferred to the plasma farmers.

The development and management of the plasma lands usually requires financing as plasma farmers generally do not have adequate capital resources. In practice, such financing can be either provided by a bank (bank financing) or by the Inti (self-financing).

Some of the key prevailing laws and regulations governing the implementation of the plasma scheme are as follows:

- Plantation Law No. 18 year 2004;
- Minister of Agriculture No. 333/Kpts/KB.510/6/1986 regarding the "Perkebunan Inti Rakyat ("PIR – Trans")"; and
- Collective decision amongst Minister of Agriculture and Minister of Cooperative and Management of Small Entrepreneurs No. 73/Kpts/OT.210/2/98 regarding "Pola Kemitraan Melalui Pemanfaatan Kredit Kepada Koperasi Primer untuk Anggotanya ("KKPA")".

Type of plasma schemes

Nowadays, there are two main types of plasma schemes:

1) PIR Trans, and
2) KKPA.

The KKPA is being widely implemented nowadays because the productivity of plasma plantations can be maintained and in turn guarantee a future income stream for the plantations in paying off the loan. In addition, it is expected that there is an effective transfer of knowledge and skills from the Inti to the plasma farmers.

Presented below is the summary of the main features of the two types of plasma schemes:

Main features	PIR Trans	KKPA
Participants	Individual farmer who are appointed by regional government or transmigration minister.	Farmers who are united under a cooperative (KUD).
Development of plantation through government/bank financing and/or self-financing. Development costs include direct development costs from preparation stage up to transfer stage including interest.	Yes	Yes

Main features	PIR Trans	KKPA
Financing arrangement with bank.	A direct loan agreement between the Inti and the bank up to conversion of the plasma plantation. Immediately after the conversion, the agreement is terminated and a new agreement between the plasma farmers and the bank is established, and a corporate guarantee is provided by the Inti to the bank.	A loan agreement between the KUD and the bank with a corporate guarantee provided by the Inti to the bank from the day one.
Obligation of the farmers to sell FFB to the Inti once the plasma plantation becomes mature.	Yes	Yes
The Inti keeps assisting farmers in managing their plantation after transfer of plasma plantation with management fee earned.	No	Yes
The conversion price during the transfer is detemined by the GoI.	Yes	Yes

Common issues in the plasma plantation scheme

The plasma plantation schemes are not without problems such as:

- Late transfer of the plasma plantation because the Inti does not meet the physical standard set by the GoI.
- Long delays in receiving allotted land and loan financing.
- Low productivity of the harvest especially due to the lack of skills possessed by the management of PIR Trans subsequent to the transfer.
- Uncompetitive selling price of the FFB sold to the Inti because of low quality.

Accounting for plasma plantation

Does the arrangement contain a lease?

In a plasma plantation, all the costs during the development phase up to conversion are accumulated as development costs. These costs are financed first by the Inti if the bank has not yet been appointed. The conversion price, which is determined by the GoI, forms the basis for determining the outstanding loan to be settled by the plasma farmers over a certain period.

In the case of the PIR Trans arrangement, there is an arrangement whereby the plasma farmers are required to sell the FFB to the Inti for a period until the loan is repaid. Whilst, in the case of KKPA, there is an arrangement whereby the Inti manages the plantation and deducts fees for the works undertaken from the FFB sale proceeds. In the same way as PIR Trans, there is also an arrangement whereby the FFB produced is sold to the Inti. Either under PIR Trans or KKPA, the Inti is committed to buy the FFB from the plasma farmers.

Albeit further analysis is required, the above tends to suggest that the arrangements contain lease in accordance with ISAK 8/IFRIC 4. If the arrangements contain lease, a further analysis is required to determine whether the lease feature is a finance or operating lease.

Is the corporate guarantee provided by the Inti an "on-balance sheet" or "off-balance sheet" item?

PIR Trans

Under PIR Trans, there is a loan agreement between the Inti and the bank. This therefore sets up a contractual obligation that leads to a financial liability. In this case, it shall be presented as a liability in the Inti's balance sheet.

As the Inti keeps providing a guarantee to the bank subsequent to the transfer in relation to the settlement of loan, this preserves the initial contractual basis between the Inti and the bank even though a new agreement between the plasma farmers and the bank has been established. This condition tends to suggest that the Inti should not derecognise the liability until the loan is repaid. However, a further analysis on the whole arrangement is required.

KKPA

Under KKPA, there is no contractual obligation during the development phase and this does not change once the plantation becomes mature and is transferred to the cooperative. However, the Inti still has to provide a guarantee to the bank in the event of default by the cooperative and this arrangement creates a contractual basis between the Inti and the bank.

This contractual basis does not necessarily lead to the recognition of a liability in the Inti's balance sheet because it is usually impracticable to determine the outstanding amount that the cooperative is unable to settle with the bank.

A highlight of challenges on fair value accounting for oil palm plantation

Buntoro Rianto/Andy Santoso

Background

International Accounting Standard ("IAS") 41, "Agriculture" requires that biological asset be carried at fair value less costs to sell and the agriculture produce harvested be carried at fair value less costs to sell at the point of harvest. The exception to this requirement is that if on the initial recognition of a biological asset, fair value cannot be determined reliably, the biological asset shall be measured at its cost less any accumulated depreciation and any accumulated impairment loss. A gain or loss arising from change in fair value is included in the profit or loss for the period in which it arises.

IAS 41 is applied to account for biological assets and agricultural produce when they relate to agricultural activity. The accounting treatment is applicable for the biological assets during the period of growth, degeneration, production, procreation and for the initial measurement of agricultural produce at the point of harvest. Oil palm plantation activity is an example of agricultural activity as defined under IAS 41.
The fair value model prescribed in IAS 41 is a major shift from the historical cost that was traditionally used for agriculture activities. Indonesian Financial Accounting Standards Board ("DSAK") plans to fully adopt the IFRS in 2012, without exception for the IAS 41. Given this, it is worthwhile to know the overview of the fair value measurement and the challenges relating to the application of the fair value accounting for biological assets and agricultural produce in an oil palm plantation business.

Fair value measurement and its challenges

A major part of measurement activity in an oil palm plantation is measurement of palm trees as biological assets. Whilst for FFB as the agriculture produce, normally oil palm plantation companies do not maintain FFB as inventory because FFB should be delivered to the mill within 24 hours of being harvested; otherwise, the monetary value of the FFB at the balance sheet is usually insignificant. Given this, we focus discussion on the measurement of biological assets.

Market-determined prices or values are usually not available for oil palm trees at their present condition and location, therefore the lower fair value hierarchy, i.e. discounted cash flows based valuation, is used. Complexity arises from using this valuation model because determination of key assumptions underlying the discounted cash flows is inherently highly subjective, in particular for an oil palm plantation business. In addition, in determining the present value of expected net cash flows, the entity should include the net cash flows that market participants would expect that asset to generate in its most relevant market.

Subjective key assumptions include, but are not limited to, CPO prices, productivity metrics both at mill and estate, and maintenance costs from the operational aspect; and discount rate from the financial aspect.

Given the complexities of the exercise, involvement of a valuation expert is usually necessary.

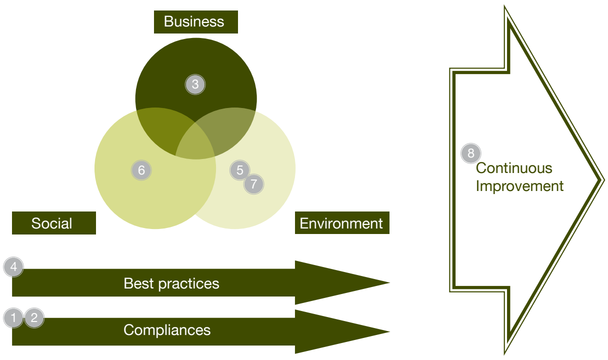
RSPO, catalyst for Improvement?

Premala Ponnusamy

The Roundtable on Sustainable Palm Oil ("RSPO") is an association focusing on the issues surrounding palm oil production and its negative impact on the environment and social welfare. Palm oil is unarguably an important source of oil in the global market and has many positive characteristics. With RSPO's efforts, the world will be able to enjoy the benefits of palm oil whilst minimising its negative impact on the environment and the people affected by production. The RSPO certification is one immediate and important step in the right direction for the future of crude palm oil ("CPO") production.

It is not only the environment and society that stands to gain from sustainable palm oil practices. With the RSPO certification, palm oil suppliers in Indonesia can improve their standing as it increases access to global markets. This also provides opportunities for palm oil suppliers to market their brand using the RSPO certification and other related initiatives, creating a reputation of an "environmentally-friendly" company. In the future, sustainable production of CPO can be used as a competitive advantage and in mature markets, priced at a premium. Another advantage towards embracing sustainability includes gaining trust from markets and Governments, which can provide expansion opportunities locally or internationally as the preferred supplier of CPO.

The RSPO certification is based on 8 core principles providing a holistic perspective towards sustainable CPO production, namely sustainable practices from the business, environmental and social aspects. Although a significant investment will be required as suppliers will have to embed changes in the organisation including processes, operations and communications, but if used to its advantage, suppliers stand to benefit from the certification process. With the appropriate monitoring mechanism in place, continuous improvement of sustainability practices, audit activities and certification renewals can be easily performed with minimal effort in the future.



RSPO Certification Principles:
1. Commitment to transparency
2. Compliance with applicable laws and regulations
3. Commitment to long term economic and financial viability
4. Use of appropriate best practices by growers and millers
5. Environment responsibility and conservation of natural resources and biodiversity
6. Responsible consideration of employees and individuals and communities affected by growers and mills
7. Responsible development of new plantings
8. Commitment to continuous improvement in key areas of activity

Mapping of RSPO certification principles against PwC's approach

We at PwC can assist you through this process ensuring the tools you require for certification today, and in future are put in place. We will look at certification needs from the business, social and environment perspectives, whilst taking into account best practices and compliance to requirements. Our sustainability practice can assist you in identifying the gaps between your organisation today against the RSPO certification criteria. We will then determine and implement quick fixes, followed by the development of a detailed implementation plan for the resolution of all gaps as well as mediation between your organisation and the certification body. We at PwC are committed towards assisting organisations become sustainable.

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.**

This summary is not intended as professional advice. It is suggested to always consult with your usual PwC contact.

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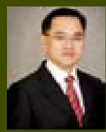
Your PricewaterhouseCoopers Indonesia contacts

For further information on how PricewaterhouseCoopers Indonesia can assist you, please contact one of the following specialists based in our Jakarta office: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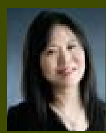
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