

**REPUBLIC OF THE PHILIPPINES
DEPARTMENT OF ENERGY
Taguig City
Metro Manila, Philippines**

ACCOUNTING PROCEDURE

Attached to and made an integral part of the Contract between the DEPARTMENT and the OPERATOR dated _____, 20 ____.

ARTICLE I : GENERAL PROVISIONS

1. Definitions

The Accounting Procedure herein provided for is to be followed and observed in the performance of all obligations under the Contract. Unless otherwise specified, the terms used herein shall have the same meaning as those defined in the Contract.

2. Purpose

Generally, the purpose of this Accounting Procedure is to set out principles and procedures of accounting which will enable the DEPARTMENT to monitor effectively the OPERATOR's costs, expenditures, production and income as well as Government's entitlement to Net Proceeds pursuant to the terms of the Contract. More specifically, the purpose of this Accounting Procedure is to:

- a) classify costs and expenditures and to define which costs and expenditure shall be allowable for cost recovery purposes;
- b) specify the manner in which the OPERATOR's accounts shall be prepared and approved; and
- c) address numerous other related accounting matters.

For purposes of Article III, the OPERATOR herein shall refer to the party designated in accordance with the operating agreement to conduct the Coal Operation in the Coal Contract Area.

3. Conflicts

If there should be any conflict between the provisions of this Accounting Procedure and the Contract, the provisions of the Contract shall prevail.

4. Working Language and Units of Account

The OPERATOR shall maintain all accounts, records, books, reports and statements for the Coal Operation in the English language. The amounts shall be recorded in Philippine Pesos in accordance with generally accepted accounting principles and practices in the coal industry.

5. Currency Translation

For conversion purposes for transactions between United States Dollars and Philippine Pesos or any other currency, the applicable exchange rate shall be the exchange rate as quoted by the Philippine Dealing System at the close of business on the last banking day of the same month of disbursement or receipt, or if there were no such quotations on that day, then such rates on the most recent day in such preceding month during which were such quotations or on such other basis as may be agreed upon by the Parties. Provided, however, that in the event of a significant change in the rate of exchange after the end of the preceding month, then all transactions after such re-evaluations until the end of that month shall be translated at the rates in effect on the day of the transactions.

It is agreed, however, that any adjustment resulting from the exchange of currency required for the use of this Coal Operation or from the translation above mentioned, shall be charged or credited to the Operating Expenses. The matter of translation rates will be reconsidered if it is determined that the above methods result in inequities.

6. Accounting Records and Statements

All accounting records related to the Coal Operation shall be established and maintained by the OPERATOR within the Philippines.

In implementation of Section VI of the Contract, the OPERATOR shall render to the DEPARTMENT a statement of all charges and credits to the Coal Operation summarized by appropriate classifications indicative of the nature thereof.

Notwithstanding the generality of the foregoing, the OPERATOR shall make regular statements relating to the Coal Operation as follows:

- a) Coal Operations Return
- b) Coal Production/Sales/Inventory Report
- c) Coal Purchased from Small Scale Coal Mining Permittee
- d) Expenditures Report

7. Adjustments

Subject to the provisions of Section 11.2 of the Contract, all statements rendered to the DEPARTMENT by the OPERATOR during any Calendar Year shall conclusively be presumed to be true and correct and reasonable unless within the period provided in said section, the DEPARTMENT takes written exception thereto and makes claim on the OPERATOR for adjustment. Failure on the part of the DEPARTMENT to make written claim on the OPERATOR for adjustment within such period shall establish the correctness and reasonableness thereof and preclude the filing of exceptions thereto or making claims for adjustment thereon.

8. Arm's Length Transactions

Unless otherwise specifically provided for in the Contract, all transactions giving rise to revenues or expenditures which will be credited or charged to the accounts prepared, maintained or submitted hereunder shall be conducted at arm's length or on such a basis as will assure that all such revenues or expenditures

will not be lower or higher, as the case may be, than would result from a transaction conducted at arm's length on a competitive basis with Third Parties.

9. Audit and Inspection

Without prejudice to statutory rights, the DEPARTMENT, upon at least fifteen (15) days advance written notice to the OPERATOR, shall have the right to inspect and audit, during normal business hours, all records and documents supporting costs, expenditures, receipts and income, such as the OPERATOR's accounts, books, records, invoices, cash vouchers, debit notes, price lists or similar documentation with respect to the Coal Operation conducted in each Calendar Year, within two (2) years (or such longer period as may be required in exceptional circumstances) from the end of such Calendar Year.

The DEPARTMENT shall undertake the conduct of the audit through its own representatives. The OPERATOR shall not be required to incur any costs and expenses as a consequence of any such access; provided, however, that the OPERATOR, if requested by the DEPARTMENT, shall provide reasonable assistance and logistical support (including without limitation, suitable office space, equipment, stationery, local area transportation, and other like resources) to the representatives authorized by the DEPARTMENT using its existing resources.

In conducting the audit, the auditors shall be entitled to examine and verify, at reasonable times, all charges and credits relating to the OPERATOR's activities under the Contract and all books of accounts, accounting entries, material records and inventories, vouchers, payrolls, invoices and any other documents, correspondences and records considered necessary by the DEPARTMENT to audit and verify the charges and credits. The auditors shall also have the right, in connection with such audit, to visit and inspect, at reasonable times, all sites, plants, facilities, warehouses and offices of the OPERATOR directly or indirectly serving the Coal Operation, and to physically examine other properties, facilities and stocks used in Coal Operation, wherever located and to question personnel associated with those operations.

10. Revision of the Accounting Procedure

By mutual agreement between the DEPARTMENT and the OPERATOR, this Accounting Procedure may be revised from time to time, in writing, signed by the Parties, stating the date upon which the amendments shall become effective.

ARTICLE II : CLASSIFICATION, DEFINITION AND ALLOCATION OF COSTS AND EXPENDITURES

1. Segregation of Costs

The costs shall be segregated in accordance with the purposes for which such expenditures are made. All costs and expenditures allowable under Article III, relating to Coal Operation, shall be classified, defined and allocated as set out below in this Article. Expenditure records shall be maintained in such a way as to enable proper allocation to each Contract.

The report to be submitted by the OPERATOR to the DEPARTMENT in this regard shall be in the form required by the DEPARTMENT.

2. Depreciable/Amortizable Assets

Capital expenditures defined under the Contract. This includes the acquisition cost of machinery and equipment, construction cost of infrastructures, expenditures incurred for construction in progress, and incidental costs related to such purchase or construction of machinery and equipment with estimated useful life longer than the immediate years of Coal Operation.

3. Exploration Costs

Exploration costs generally comprise the cost incurred in prospecting, sampling or testing for the presence of Coal and subdivided into:

- a) Survey costs and expenses related to the preliminary evaluation of the Coal Contract Area and includes the following activities:

- 1) Geological Mapping
 - 2) Geochemical / Geophysical survey
 - 3) Geodetic engineering and topographic survey
 - 4) Others
- b) Exploration drilling representing costs incurred in sampling the Coal Contract Area for the presence of Coal deposits after the survey works and the determination of the estimated reserves therein. The related activities are as follows:
- 1) Diamond drilling
 - 2) Pits Testing
 - 3) Site clearing
 - 4) Other related expenses

4. Development Costs

Development costs comprise the expenditures incurred in developing the Coal Contract Area which is usually characterized by the following activities:

- a) Development drilling
- b) Tunneling
- c) Pre-stripping
- d) Others

5. Marketing Expenses

Marketing expenses comprise the expenditures directly associated with the marketing of Coal produced in the Coal Contract Area which shall be limited and sub-classified as:

- a) Delivery expense – hauling and/or freight costs incurred in transporting Coal produced to the consumer.
- b) Reasonable commission or brokerage fees paid to third parties in connection with Coal sold.

Unless otherwise provided for in the Contract, marketing expenses shall form part of the Operating Expenses and subject to the percentage limitation of the cost recovery.

6. Production Costs

Production costs refer to the expenditures incurred which are absolutely essential to the Coal Operation during the production phase.

7. General and Administrative Costs

- a) Expenses incurred during the year in operating one or more administrative levels in exploration, development and production activities are to be included herein.
- b) Overhead/indirect expenses shall include expenses incurred in the following:
 - 1) Principal Office – an office established in Metro Manila which may serve all activities in the Philippines.
 - 2) District Office(s) – an office which may be established to serve the Coal Operation in the vicinity of the Coal Operation.

ARTICLE III: REVENUES, COSTS, EXPENDITURES AND INCIDENTAL INCOME OF THE CONTRACTOR

1. Revenue definition

- a) Gross proceeds from the domestic sale of Coal
- b) Gross proceeds from the sale of Coal which are to be exported from the Philippines
- c) Other income as enumerated in Article III.5 of this Accounting Procedure.

2. **Recoverable and Allowable Costs Under the Contract**

The costs incurred by the OPERATOR on Coal Operation pursuant to the Contract as classified under the headings referred to in Article II shall be allowable for purposes of the Contract except to the extent provided in Article III.4 or elsewhere in this Accounting Procedure, subject to audit as provided for herein.

a) **Surface Rights**

All direct costs attributed to the acquisition, renewal or relinquishment of surface rights acquired and maintained in force for the Coal Operation hereunder when paid by the OPERATOR in accordance with the provisions of the Contract. All direct costs attributable to the entry, use or acquisition of private lands, timber and water when paid by the OPERATOR in accordance with the contract and the governing law(s) thereof including bid monies, rentals and other rentals made by the OPERATOR to the private landowner, timber or concessionaires and/or government agencies for the entry, use and/or acquisition of the said surface, water and timber rights.

b) **Labor and Associated Labor Cost**

- 1) Salaries and wages of the OPERATOR's employees directly engaged in the conduct of Coal Operation of the Coal Contract Area. Salaries and wages shall include everything constituting gross pay to employees as reflected on the OPERATOR's payroll. To the extent not included in the salaries and wages, the Operating Expenses shall also be charged with overtime pay, rest day pay, holiday pay, vacation pay, and vacation travel pay, sickness and disability benefits, bonuses and customary allowances.
- 2) The costs of expenditures or contributions made pursuant to obligations imposed by the governmental authority which are applicable to the OPERATOR's labor costs or salaries and wages.
- 3) Personal income and fringe benefit taxes where and when they are paid by the OPERATOR to the Government of the Philippines for

the employee, in accordance with the OPERATOR's standard personnel policies.

- 4) The OPERATOR's cost of established plans for employee's group life insurance, health insurance, pension retirement, thrift and other benefits of like nature.

c) Materials and equipment

1) General

So far as it is reasonable, practicable and consistent with efficient and economical operation, only such materials shall be purchased or furnished by the OPERATOR for use in the Coal Operation as may be required for use in the reasonably foreseeable future and the accumulation of surplus stocks shall be avoided. Materials and equipment held in inventory shall only be charged to Operating Expenses when such materials and equipment are removed from inventory and used in Coal Operation.

2) Warranty

In the case of defective materials or equipment, any adjustment received by the OPERATOR from the suppliers or manufacturers or their agents in respect of any warranty on materials or equipment shall be credited to the accounts under the Contract.

3) Value of materials charged to the account under the Contract

- a) Except as otherwise provided in subparagraph (b) below, materials purchased by the OPERATOR for use in the Coal Operation shall be valued to include invoice price less trade and cash discounts, if any, purchase and procurement fees plus freight and forwarding charges between point of supply and point of shipment, freight to port of destination, insurance, taxes, custom duties, consular fees, other items chargeable against imported material and, where applicable, handling and transportation costs from point of importation to warehouse or operating site, and these costs shall not exceed

those currently prevailing in normal arm's length transactions in the open market.

b) Materials purchased from or sold to Affiliates or transferred to or from activities of the OPERATOR other than Coal Operation under the Contract:

1. New materials (hereinafter referred to as condition A) shall be valued at the price prevailing in normal arm's length transactions in the open market;

2. The cost of inventories shall comprise all cost of purchase, cost of conversion and other costs incurred in bringing the inventories to their present locations and condition. The cost of purchase of inventories comprise the purchase price, import duties and other taxes, and transport, handling and other costs directly attributable to the acquisition of finished goods, material and services. Trade discounts, rebates and other similar items are deducted in determining the cost of purchase.

d) Transportation Costs

1) Reasonable transportation and travel expenses of employees of the OPERATOR including those made for travel and relocation of the employees and their families (limited to spouse and dependent children) to or from their place of origin.

2) Reasonable costs of transportation of equipment, materials, and supplies for the conduct of Coal Operation under the Contract, including directly related costs such as unloading charges, dock fees and inland and ocean freight charges.

e) Services

- 1) The actual costs of contract services, services of professional consultants, utilities and other services necessary for the conduct of Coal Operation under the Contract performed by third parties.
- 2) In the event the OPERATOR, from time to time, utilizes skilled personnel not regularly residing in the Philippines for performance of services either in the Philippines or elsewhere for the benefit of the Coal Operation, whose time in full or in part is not otherwise charged hereunder, a proportion of the direct and indirect salary and travel expenses of such personnel (including reasonable living expenses while in the Philippines) together with any tax on such salaries or otherwise imposed upon the employees' service in the Philippines which are comparable to the Philippine Government and for which the OPERATOR assumed responsibility, and any accident or sickness compensation and/or hospitalization cost incurred shall be charged to Operating Expenses.
- 3) Data processing and computer services acquired for the benefit of the Coal Operation may be contracted through third parties or by arrangement for time rental of computer services from the OPERATOR's affiliates even though such computer facilities are physically located outside the country. The contract for computer services must be competitively priced.

4) Use of Exclusively Owned Facilities

Equipment owned by the second party/parties, or any affiliate or either of them, and not previously charged to the Operating Expenses, either directly or indirectly, may be utilized in the Coal Operation. For the use of any such wholly-owned equipment, the Operating Expenses shall be charged a rental rate commensurate with the cost of ownership and operation, but not to exceed commercial rates for the use of like equipment.

A fair rate shall be charged for laboratory services performed by the second party/parties or their affiliates for the benefit of the Coal Operation, such as but not limited to gas, water, core and any other

analyses and test provided such charges shall not exceed those currently prevailing if performed by outside technical service companies.

f) Damages and Losses

All costs or expenses necessary to replace or repair damages or losses not recovered from insurance incurred by fire, flood, storm, theft, accident or any other cause not controllable by the OPERATOR through the exercise of reasonable diligence. The OPERATOR shall furnish the DEPARTMENT written notice of damages or losses incurred as soon as practicable after report of the same has been received by the OPERATOR.

g) Communication

The costs of acquiring, leasing, installing, operating, repairing and maintaining communication systems including radio and satellite communication facilities between the Coal Contract Area and the OPERATOR's nearest base facility.

h) Environmental Studies and Protection

The costs incurred in conducting the environmental impact studies for the Coal Contract Area, and in taking environmental protection measures pursuant to the terms of the Contract.

i) Duties, Fees and Other Charges

Any duties, levies, fees and charges imposed by any governmental or taxing authority in connection with the OPERATOR's activities under the Contract and paid directly by the OPERATOR except those charges and assessments for which the OPERATOR is solely liable under the terms of the Contract.

j) Insurance and Claims

- 1) Premium paid for insurance required to be carried for the Coal Operation conducted under the Contract, together with all the expenditures incurred and paid in settlement of any and all losses, claims, damages, judgments, and other expenses, including legal services not recovered from the insurer.
- 2) All actual expenditures relative to the Coal Operation incurred and paid by the OPERATOR in settlement of any and all losses, claims, damages, judgments and any other expenses not covered by insurance, including legal services shall be charged to the Operating Expenses.

k) Legal Expenses

All reasonable costs and expenses resulting from the handling, investigating, asserting, defending or settling of any claim or legal action necessary or expedient for the procuring, perfecting, retention and protection of the Coal Contract Area and in defending or prosecuting lawsuits involving the Coal Contract Area or any third party claim arising out of Coal Operation under the Contract, or sums paid in respect of legal services necessary for the protection of the joint interest of the DEPARTMENT and the OPERATOR. Such expenditures shall include attorney's fees, court costs, costs of investigation and procurement of evidence and amounts paid in settlement or satisfaction of any such litigation and claims provided such costs are not covered elsewhere in the Accounting Procedure.

l) Training Costs

All costs and expenses of training the OPERATOR's personnel for the direct benefit of the Coal Operation and the costs of training of the DEPARTMENT's personnel shall be charged as Operating Expenses.

m) Administrative Overhead within the Philippines

- 1) Principal office as used herein means the costs and expenses incurred by the OPERATOR for an office and staff established in Metro Manila which may serve all activities of the Coal Operation under the Contract.

Allocation of such costs and expenses between the OPERATOR's other activities and Coal Operation activities hereunder shall be made on actual expenditures or other equitable basis. Examples of such services which are chargeable to the Coal Operation include, but are not necessarily limited to the following:

- a) Administrative and Managerial
- b) Accounting and Internal Control
- c) Legal and Tax
- d) Human Resource and Medical
- e) Communications
- f) Purchasing
- g) Treasury and Financial Services
- h) Insurance
- i) Safety and Security
- j) Budgeting and Planning

2) District office(s) as used herein means the cost and expenses incurred by the OPERATOR for an office(s) which may be established to serve the Coal Operation in the vicinity of the Coal Operation. Allocation of such costs and expenses between the OPERATOR's other activities and Coal Operation activities hereunder shall be made on actual expenditures or other equitable basis. Examples of such district office(s) services which are chargeable to Coal Operation include, but not necessarily limited to the following:

- a) Field or district superintendent and staff
- b) Geological and geophysical staff
- c) Engineering and production staff
- d) Communication
- e) Camp and commissary facilities
- f) Clerical staff

n) Interest

Any interest, charges, fees or other consideration paid or suffered in respect of financing the Coal Operation including but not limited to, financial

advisor fees, investment banker fees, registration and stamp fees and all closing costs, as approved by the Government, shall be considered Operating Expenses except interest on loans or indebtedness incurred to finance the Exploration Phase. The DEPARTMENT's approval of such interest, charges, fees or other considerations shall not be withheld if reflective of prevailing conditions in the international capital market.

3. Other Expenditures

Any other costs and expenditures not included in Article III.2 of this Accounting Procedure which have been incurred by the OPERATOR for the necessary and proper conduct of Coal Operation shall be allowed to be recovered.

4. Costs not recoverable and not allowed under the Contract

The following costs and expenditures shall not be recoverable nor allowed for cost recovery and production sharing purposes under the Contract:

- a) Processing/application fees, bonuses, rentals and other payments made to the DEPARTMENT such as but not limited to the payments for signature bonus, discovery bonus, production bonus and tax exemption certificates;
- b) Costs attributed to posting the performance guaranty deposits required under this Contract;
- c) Costs and charges incurred before the Effective Date including costs in respect of preparation, signature or ratification of this Contract;
- d) Royalties/fees paid to original claimholder/leasehold/assignor and assignee;
- e) Expenditures in respect of any financial transaction to negotiate, float or otherwise obtain or secure funds which are not used for Coal Operation;
- f) Costs of marketing or transportation of Coal beyond Delivery Point;

- g) Expenditures incurred in obtaining, furnishing and maintaining the guarantees required under the Contract and any other amounts spent on indemnities with regard to non-fulfillment of contractual obligations;
- h) Fines and penalties imposed by courts of law of the Republic of the Philippines;
- i) Donations and contributions beyond the limitations set under The Comprehensive Tax Reform Act of 1997;
- j) Costs incurred in the creation of any partnership or joint venture arrangement;
- k) Membership and club dues not related to professional organizations;
- l) Costs incurred as a result of failure to insure where insurance is required pursuant to the Contract, or where the OPERATOR has elected to self-insure, or has under-insured;
- m) Costs and expenditures incurred as a result of willful misconduct or negligence of the OPERATOR; and
- n) Any costs and expenditures which by reference to generally accepted accounting principles and practices in the coal industry can be shown to be excessive.

5. Incidental Income and Credits

All incidental income and proceeds received from Coal Operation under the Contract, including but not limited to the items listed below, shall be credited to the accounts under the Contract and shall be treated as follows:

a) As part of Gross Income

- 1) Revenue received from third parties for the use of property or assets, the cost of which has been charged to the accounts under the Contract;

- 2) Proceeds from sale of Coal by-products;
- 3) Such other income which is incidental to and/or arising from any Coal Operation or other aspects of the Contract.

b) As offset against Operating Expenses

- 1) Proceeds of any insurance or claim or judicial awards in connection with Coal Operation under the Contract or any assets charged to the accounts under the Contract where such operations or assets have been insured and the premiums charged to the accounts under the Contract;
- 2) Any adjustment received by the OPERATOR from the suppliers/manufacturers or their agents in connection with defective materials, the costs of which was previously charged by the OPERATOR to the accounts under the Contract;
- 3) Refunds or other credits received by the OPERATOR which apply to any charge which has been made to the accounts under the Contract;
- 4) Net dividends received from utilities and dividends received from investments;
- 5) Costs originally charged to the accounts under the Contract for materials subsequently exported from the Republic of the Philippines without being used in Coal Operation under the Contract;
- 6) Legal costs charged to the accounts and subsequently recovered by the OPERATOR; and
- 7) In the event that the proceeds on sale/disposal of assets are less than the acquisition costs/ net book value.

c) As hundred percent (100%) revenue for the DEPARTMENT

In the event the proceeds on sale/disposal of assets are more than the acquisition costs/ net book value, the excess shall be 100% revenue for the DEPARTMENT.

ARTICLE IV : RECOVERY OF EXPENDITURES

1. Tangible Investments

The initial costs of physical assets classified as depreciable in accordance with the generally accepted accounting principles and practices in the coal industry purchased and/or fabricated by the OPERATOR, and used by the OPERATOR in its Coal Operation shall include such costs as export broker's fees, purchasing agent's fees, transportation charges, loading and unloading fees, license fees associated with the procurement of materials and equipment, duties and customs fees, in-transit losses not recovered through insurance and installation costs necessary to put the asset ready for use. The total cost of the assets shall be allocated to the Operating Expenses in accordance with the provision of P.D. 972.

2. Leasehold Improvements

Improvements and betterments on leasehold which can be capitalized in accordance with generally accepted international petroleum industry accounting principles and practices shall be allocated to Operating Expenses in accordance with depreciation principles established in Article IV.1 above. Such improvements shall include but not be limited to office improvements, additional equipment and other improvements.

3. Intangible Investments

Notwithstanding any other provision of this Accounting Procedure, all intangible investments shall be recoverable in full in the Calendar Year in which these are incurred.