

**Republic of the Philippines
DEPARTMENT OF ENERGY
Taguig City**

ACCOUNTING PROCEDURES

Attached to and made an integral part of the Contract between the DEPARTMENT and the CONTRACTOR dated _____, 200____.

ARTICLE I : GENERAL PROVISIONS

1. Definitions

The Accounting Procedures 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 Procedures is to set out principles and procedures of accounting which will enable the DEPARTMENT to monitor effectively the CONTRACTOR'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 Procedures is to:

- classify costs and expenditures and to define which costs and expenditures shall be allowable for cost recovery, production sharing and participation purposes;
- specify the manner in which the CONTRACTOR's accounts shall be prepared and approved; and
- address numerous other related accounting matters.

For purposes of Article III, the CONTRACTOR herein shall refer to the operator who is designated in accordance with the CONTRACTOR's operating agreement to conduct the Petroleum Operations in the Contract Area for the joint account of the CONTRACTOR except for Article III. 2 L, P and Q.

3. Conflicts

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

4. Working Language and Units of Account

The CONTRACTOR shall maintain all accounts, records, books, reports and statements for the Petroleum Operations in the English language. The amounts shall be recorded both in United States Dollars and Philippine Pesos in accordance with generally accepted international petroleum industry accounting principles and practices.

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 Petroleum Operations 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 Petroleum Operations shall be established and maintained by the operator within the Philippines during the development/production period.

In implementation of Section X of the Contract, the CONTRACTOR shall render to the DEPARTMENT a statement of all charges and credits to the Petroleum Operations summarized by appropriate classifications indicative of the nature thereof.

Notwithstanding the generality of the foregoing, the CONTRACTOR shall make regular statements relating to the Petroleum Operations as follows:

- A. Expenditure Reports
- B. Production Statement
- C. Statement of Revenue and Distribution
- D. Budget Statement

7. Adjustments

Subject to the provisions of Section 18.02 of the Contract, all statements rendered to the DEPARTMENT by the CONTRACTOR 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 CONTRACTOR for adjustment. Failure on the part of the DEPARTMENT to make written claim on the CONTRACTOR 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 CONTRACTOR, 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 CONTRACTOR's accounts, books, records, invoices, cash vouchers, debit notes, price lists or similar documentation with respect to the Petroleum Operations 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 and the costs of such audit shall be borne by the CONTRACTOR as a general and administrative cost. The CONTRACTOR shall not be required to incur any costs and expenses as a consequence of any such access; provided, however, that the CONTRACTOR, 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 CONTRACTOR'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 Petroleum Operations, and to physically examine other properties, facilities and stocks used in Petroleum Operations, wherever located and to question personnel associated with those operations.

10. Revision of the Accounting Procedures

By mutual agreement between the DEPARTMENT and the CONTRACTOR, this Accounting Procedures 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 Petroleum Operations, 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 Oil Field or Gas Field in the event of more than one Oil Field or Gas Field.

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

2. Depreciable/Amortizable Assets

Plant, property and equipment including production, processing, storage, transportation and other facilities and equipment used directly in the Petroleum Operations.

3. Direct Survey Expenditures

- A. Survey expenditures include all geological and geophysical expenditures incurred in performing activities such as geological studies and mapping, and geophysical prospecting, the various phases of which cover data acquisition, data processing, interpretation and restudies.
- B. The costs of contracted and company performed services should be segregated into contracted services and in-house costs. Contracted services, include those, which were supplied by Third Parties and covered by contracts/agreements. In-house costs should include that portion of exploration survey, which are directly performed by the CONTRACTOR.

4. Direct Well Costs

Included are exploration, appraisal and development drilling costs. The following activities are covered:

- A. Exploration and Appraisal – Location of potential oil or gas trap including the drilling of Exploration Well and the examination of specific oil and gas reserves .
- B. Development – Activities needed to obtain access to proved reserves and to provide facilities for extracting, treating, gathering, and storing oil and gas. More specifically, Development Cost and other costs directly identifiable with development activities are costs incurred to:
 - a) Gain access to and prepare well locations for drilling, including surveying well locations for the purpose of determining specific development drilling sites, clearing ground, draining, road building and relocating public roads, gas lines and power lines, to the extent necessary in developing the proved reserves.
 - b) Drill and equip Development Well, including the cost of well equipment such as casing, tubing, pumping equipment and the wellhead assembly.

5. Direct Development Costs

Materials and equipment for the construction of the facilities for extracting, treating, gathering and storing Crude Oil and Natural Gas.

Intangible Development Costs represent development expenditures other than cost of development wells and production facilities such as but not limited to installation costs, mobilization of barges to be used in installation, engineering studies and the like.

6. Direct Production Expenses

Direct production expenses are generally regarded as those expenditures which are absolutely essential to the Production Operations. Indirect production expenses are those which facilitate or are incidental to the Production Operations but do not directly contribute to it.

7. Overhead/Indirect Expenses

A. Expenses incurred 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:

District Office(s) – an office which may be established to serve the Petroleum Operations in the vicinity of the Petroleum Operations.

Principal Office – an office established in Metro Manila which may serve all activities in the Philippines.

Outside the Philippines – the operator’s home office or parent company or Affiliate.

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

1. Revenue definition

A. Gross proceeds shall be valued in accordance with Section 10.01 of the Contract.

B. Other income as enumerated in Article III.5 of this Accounting Procedures

2. Recoverable and Allowable Costs Under the Contract

The costs incurred by the CONTRACTOR on Petroleum Operations 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 Procedures, 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 Petroleum Operations hereunder when paid by the CONTRACTOR in accordance with the provisions of the Contract.

B. Labor and Associated Labor Cost

- 1) Salaries and wages of the CONTRACTOR's employees directly engaged in the conduct of Petroleum Operations of the Contract Area within the Philippines. Salaries and wages shall include everything constituting gross pay to employees as reflected on the CONTRACTOR'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 CONTRACTOR's labor costs or salaries and wages.
- 3) Personal income and fringe benefit taxes where and when they are paid by the CONTRACTOR to the Government of the Philippines for the employee, in accordance with the CONTRACTOR's standard personnel policies.
- 4) The CONTRACTOR's cost of established plans for employee's group life insurance, health insurance, pension retirement, thrift and other benefits of like nature.
- 5) For Home Office based employees, salaries and wages and employees benefits shall be charged to Operating Expenses based on

the percentage of time dedicated to the Petroleum Operations under the Contract.

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 CONTRACTOR for use in the Petroleum Operations 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 Petroleum Operations.

2) Warranty

In the case of defective materials or equipment, any adjustment received by the CONTRACTOR 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 CONTRACTOR for use in the Petroleum Operations 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 CONTRACTOR other than Petroleum Operations 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 CONTRACTOR including those made for travel and relocation of the Expatriate Employees and their families (limited to spouse and dependent children) assigned in the Philippines. Transportation costs for returning Expatriate Employees and their families to their country of origin shall be chargeable to the Operating Expenses provided that Operating Expenses shall not be charged expenses incurred in moving Expatriate Employees beyond their point of origin established at the time of their transfer to the Philippines.
- 2) Reasonable costs of transportation of equipment, materials and supplies for the conduct of Petroleum Operations under the Contract, including directly related costs such as unloading charges, dock fees and inland and ocean freight charges.

E. Services

- 1) Third Parties

The actual costs of contract services, services of professional consultants, utilities and other services necessary for the conduct of Petroleum Operations under the Contract performed by Third Parties other than an Affiliate provided that the corresponding contracts for services are registered with the DEPARTMENT.

2) Affiliate

a) Professional and Administrative Personnel

The costs of professional and administrative services provided by an Affiliate for the direct benefit of Petroleum Operations, including, but not limited to, services provided by the legal, financial, insurance, accounting and computer services. The charges shall be equal to the actual cost of providing their services, but shall not include any element of profit and shall not be any higher than the most favorable prices charged by the Affiliate to third parties for comparable services under similar terms and conditions elsewhere and will be fair and reasonable in the light of prevailing international petroleum industry principles and practices. These expenses shall be considered in the computation under Article III.2.O of this Accounting Procedures.

b) Technical Personnel

The costs of technical personnel services provided by an Affiliate of CONTRACTOR for the direct benefit of Petroleum Operations, which costs shall be charged on a cost of service basis. The charges therefore shall not exceed charges for comparable services currently provided by outside technical service organizations of comparable qualifications.

c) Equipment, facilities and property owned and furnished by the CONTRACTOR's Affiliate, at rates commensurate with the cost of ownership and operation provided, however, that such rates shall not exceed those currently prevailing for the supply of like equipment, facilities and property on comparable rates in the area where the Petroleum Operations are being conducted. The equipment and facilities referred to herein shall exclude major investment items such as (but not limited to) drilling rigs, producing platforms, oil and gas treating facilities, oil and gas loading and transportation systems, storage and terminal facilities and other major facilities, rates for which shall be subject to separate agreement with the DEPARTMENT.

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 CONTRACTOR through the exercise of reasonable diligence. The CONTRACTOR 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 CONTRACTOR.

G. Communication

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

H. Office, Shore Bases and Miscellaneous Facilities

The costs of establishing, maintaining and operating any office, sub-office, shore base facility, warehouse, housing or other facility directly serving the Petroleum Operations. If any such facility serves contract areas other than the Contract Area, or any business other than Petroleum Operations, the costs thereof shall be allocated on an equitable and consistent basis.

I. Environmental Studies and Protection

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

J. Duties, Fees and Other Charges

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

K. Insurance and Claims

- 1) Premium paid for insurance required to be carried for the Petroleum Operations 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 Petroleum Operations incurred and paid by the CONTRACTOR 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.

L. 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 Contract Area and in defending or prosecuting lawsuits involving the Contract Area or any third party claim arising out of Petroleum Operations under the Contract, or sums paid in respect of legal services necessary for the protection of the joint interest of the DEPARTMENT and the CONTRACTOR. 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 Procedures.

M. Training Costs

All costs and expenses of training the CONTRACTOR's personnel for the direct benefit of the Petroleum Operations and the costs of training of the DEPARTMENT's personnel shall be charged as Operating Expenses.

N. Administrative Overhead within the Philippines

The costs and expenses incurred by the CONTRACTOR for an office and staff established in the Philippines which may serve all activities of the Petroleum Operations under the Contract. Allocation of such costs and expenses between the CONTRACTOR's other activities and Petroleum Operations activities hereunder shall be made on actual expenditures or other equitable basis. Examples of such services which are chargeable to the Petroleum Operations include, but are not necessarily limited to the following:

- 1) Administrative and Managerial
- 2) Accounting and Internal Control
- 3) Legal and Tax

- 4) Human Resource and Medical
- 5) Communications
- 6) Purchasing
- 7) Treasury and Financial Services
- 8) Insurance
- 9) Safety and Security
- 10) Budgeting and Planning

O. Administrative Overhead – Outside the Philippines

- 1) Administrative overhead refers to the costs for the managerial and operational services provided by the operator's management organizations for the Petroleum Operations, including management, administration, accounting, treasury, intercompany audit, tax, legal matters, human resources or employee relations, financing, purchasing, medical, the collection of economic data and costs, and related office costs incurred by the parent company or an Affiliate outside the Philippines. The administrative overhead outside the Philippines applicable to Petroleum Operations shall be charged and limited on the following percentages of the adjusted net expenditures:

For first U.S. \$2,000,000 per year 3% but not less than
US\$6,000.00 per year

For next U.S \$1,000,000 per year 2%

Over U.S. \$3,000,000 per year 1%

- 2) Net expenditures for purposes of applying the percentage charges stipulated in sub-paragraph (1) above shall be adjusted to exclude the following:
 - a) Administrative overhead charged under Article III.2.O.1 above;

- b) Nonrecoverable costs as provided in Article III.4 of this Accounting Procedure;
 - c) Surface taxes and rentals;
 - d) Major construction projects covered by Article III.2.O.3 below;
 - e) Settlements of judgments or claims in excess of five thousand United States Dollars (US\$5,000.00) per transaction;
 - f) Proceeds received from sale of assets (including division in kind) amounting to more than five thousand United States Dollars (US\$5,000.00) per transaction;
 - g) Foreign Exchange adjustments; and
 - h) Pipeline tariff costs paid to outsider.
- 3) Administrative overhead for major construction projects such as but not limited to offshore platforms, pipelines, gas and/or water repressuring and processing plants, tanker, loading and terminal facilities, shall be agreed to by the Parties.
- 4) Operator's administrative overhead outside the Philippines shall be reviewed by the Parties periodically upon request of either Party and the future charges adjusted upward or downward as indicated by the operator's cost experience.

P. Interest

Any interest, charges, fees or other consideration paid or suffered in respect of financing the CONTRACTOR's Petroleum Operations 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 to the extent of two-thirds (2/3) of the amount thereof, except interest on loans or indebtedness incurred to finance the Exploration Operations. 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.

Q. Abandonment Costs

The CONTRACTOR shall submit its best estimate of total abandonment cost for its Production Area in accordance with its abandonment program within two (2) years from the Date of Commencement of Commercial Production.

The CONTRACTOR shall charge as Operating Expenses such costs on a per unit or production per quarter basis, commencing with the first quarter of the first Calendar Year of commercial production, calculated as provided below.

At least ninety (90) days prior to each subsequent Calendar Year, the CONTRACTOR shall present to the DEPARTMENT an adjusted estimate of such abandonment costs, which shall be subject to the DEPARTMENT's approval in the same manner as provided above and shall apply as of the commencement of said Calendar Year.

Quarterly Petroleum Produced <hr style="width: 100%;"/> Remaining recoverable reserves at the beginning of the Calendar Year	X	Approved estimate of total abandonment costs Less: cumulative abandonment costs recovered	= quarterly recoverable abandonment cost
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The quarterly recoverable abandonment cost shall be subject to the cost recovery limit contained in Section 10.02 of the Contract and shall be deposited into an interest earning escrow account with a mutually acceptable licensed bank, subject to an escrow agreement between the CONTRACTOR and the DEPARTMENT. An amount equal to the quarterly recoverable abandonment costs, less any interest earned in the escrow account during the applicable Calendar Quarter, shall be paid into the escrow account within thirty (30) days after the end of such Calendar Quarter.

The CONTRACTOR shall give the DEPARTMENT at least twelve (12) months notice prior to the commencement of abandonment operations in respect of any Production Area. Within ninety (90) days from receipt of the abandonment notice, the DEPARTMENT shall notify the CONTRACTOR either:

- 1) That the CONTRACTOR is authorized to abandon the Petroleum Operations in the Production Area, in which event the amount in the escrow account shall be transferred to the CONTRACTOR and the CONTRACTOR shall carry out the abandonment operations in accordance with accepted industry practices for international offshore Petroleum Operations and all applicable Philippine laws, rules and regulations; or

- 2) That the DEPARTMENT desires to take over the responsibility of abandonment of Petroleum Operations in the Production Area, in which event the amount in the escrow account shall be transferred to the DEPARTMENT, and the CONTRACTOR shall be relieved of any further liability for the Petroleum Operations in the Production Area to be abandoned;

Provided, however, that the amount in the escrow account shall be adjusted to be equal to the current approved estimate of total abandonment costs. Any deficiency in the escrow account at that time shall be funded by the CONTRACTOR. Any excess in the escrow account at that time shall be considered as an offset against Operating Expenses.

For purposes of this provision:

“Remaining recoverable reserves” shall mean the estimated proven plus probable volume of Petroleum that can be commercially produced by the CONTRACTOR from the Production Area in question from the beginning of the relevant Calendar Year until the end of the commercial production from the Production Area. A firm of independent reservoir engineers selected by the CONTRACTOR and acceptable to the DEPARTMENT shall determine the estimations referred to in the foregoing definitions.

3. Other Expenditures

Any other costs and expenditures not included in Article III.2 of this Accounting Procedures which have been incurred by the CONTRACTOR for the necessary and proper conduct of Petroleum Operations 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. Expenditures in respect of any financial transaction to negotiate, float or otherwise obtain or secure funds which are not used for Petroleum Operations;
- E. Costs of marketing or transportation of Petroleum beyond Delivery Point;
- F. 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;
- G. Fines and penalties imposed by courts of law of the Republic of the Philippines;
- H. Donations and contributions beyond the limitations set under The Comprehensive Tax Reform Act of 1997;
- I. Costs incurred in the creation of any partnership or joint venture arrangement;
- J. Membership and club dues not related to professional organizations;
- K. Costs incurred as a result of failure to insure where insurance is required pursuant to the Contract, or where the CONTRACTOR has elected to self insure, or has under-insured;
- L. Costs and expenditures incurred as a result of willful misconduct or negligence of the CONTRACTOR; and
- M. Any costs and expenditures which by reference to generally accepted international petroleum industry accounting principles and practices can be shown to be excessive.

5. Incidental Income and Credits

All incidental income and proceeds received from Petroleum Operations 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 sulphur or a by-product of the H₂S extraction process;
- 3) Such other income which is incidental to and/or arising from any Petroleum Operations 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 Petroleum Operations 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 CONTRACTOR from the suppliers/manufacturers or their agents in connection with defective materials, the costs of which was previously charged by the CONTRACTOR to the accounts under the Contract;
- 3) Refunds or other credits received by the CONTRACTOR 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 Petroleum Operations under the Contract;
- 6) Legal costs charged to the accounts and subsequently recovered by the CONTRACTOR; and
- 7) In the event that the proceeds on sale/disposal of assets are less than the acquisition costs.

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, 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 international petroleum industry accounting principles and practices purchased and/or fabricated by the CONTRACTOR, and used by the CONTRACTOR in its Petroleum Operations 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. All tangible investments shall be allocated to Operating Expenses over a five-(5) year period if the Contract qualifies as a Deepwater Contract and a ten-(10) year period for other assets if the Contract is not a Deepwater Contract, beginning in the Calendar Year in which Petroleum production starts or in the Calendar Year in which the costs are incurred, whichever is later. The total cost of the asset shall be allocated to Operating Expenses under either of the following methods, at the option of the CONTRACTOR:

- a) The straight-line method, or
- b) The double declining balance method in the first three (3) years and then straight-line method in the last two (2) years of the five (5) year period.

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 installed on a ship operated under a bareboat charter, etc.

3. Intangible Investments

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