

Understanding Risk in Pulp and Paper Industry

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Presented at Sustainable Investments Forum: A risk analysis of the Forestry Sector in Asia, Organized by ASRI, WWF, and Greenpeace, Hong Kong, 17 May 2010

In the pursuit of happiness

“Only companies that share their revenues properly between themselves and others will be sustainable, strong, and prosperous”

Outline of Presentation

- Introduction to money laundering risk framework
- Sources of Money Laundering Risk
- Expansion risk
- Raw material risk
- Revenue risk
- Income risk
- Verification and monitoring

Money Laundering Risk Framework

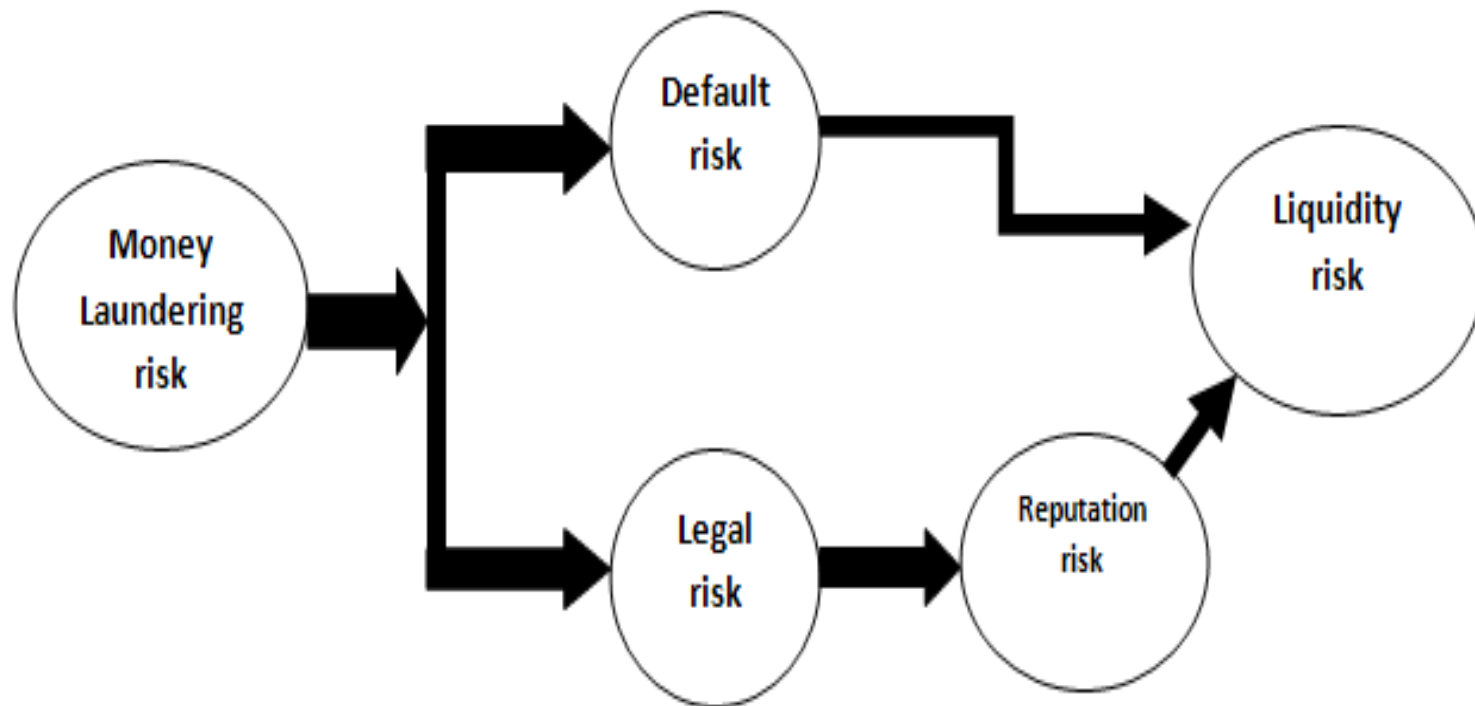


Diagram 1. Predicting other banking risks

Money Laundering Risk

- Risk of doing something with proceeds of crimes.
- Money laundering covers all procedures to change the identity of illegally obtained money so that it appears to have originate from a legitimate source
- For a banker, it is a risk (or possibility) of a bank involves, engages or facilitates financial transactions considered as suspicious financial transactions.

The Crime of Money Laundering

- Any person does something with suspicious assets.
- Offence of dealing with any property, knowing or having reasonable ground to believe it in whole or in part directly or indirectly represents the proceeds of crimes
- a criminal penalty of a minimum imprisonment of 5 (five) years and a maximum of 15 (fifteen) years and a minimum fine of Rp.100,000,000.00 (one hundred million rupiah) and a maximum of Rp.15,000,000,000.00 (fifteen billion rupiah). In HK, 14 years and HK\$ 5 million.
- Financial institution obligation to disclose knowledge or suspicious money laundering transactions. Otherwise, it commits a money laundering crime

Proceeds of Crimes

- Corruption
- Bribery
- Frauds
- Tax Evasion
- Banking crimes
- Forestry crimes
- Environmental crimes

Suspicious Financial Transactions

- **Financial transactions deviating from the profile, characteristics or the usual transaction patterns of the customer concerned;**
- Financial transactions by customers that can be reasonably suspected to be conducted with the purpose of avoiding the reporting of transaction concerned as required for Providers of Financial Services ; or
- Financial transactions conducted or unfinished to conduct financial transactions using assets that have reasonable grounds to be suspected to constitute the proceeds of crime.
- **Transactions requested by PPATK to be reported by reporting parties since there is reasonable grounds to be suspected as proceeds of crime**

HK Suspicious Transaction

- One which is inconsistent with a customer's known, legitimate business or personal activities or with the normal business for that type of account.
- The first key to recognition is knowing enough about the customer's business to recognize that a transaction, or series of transactions, is unusual.

Sources of Money Laundering Risk

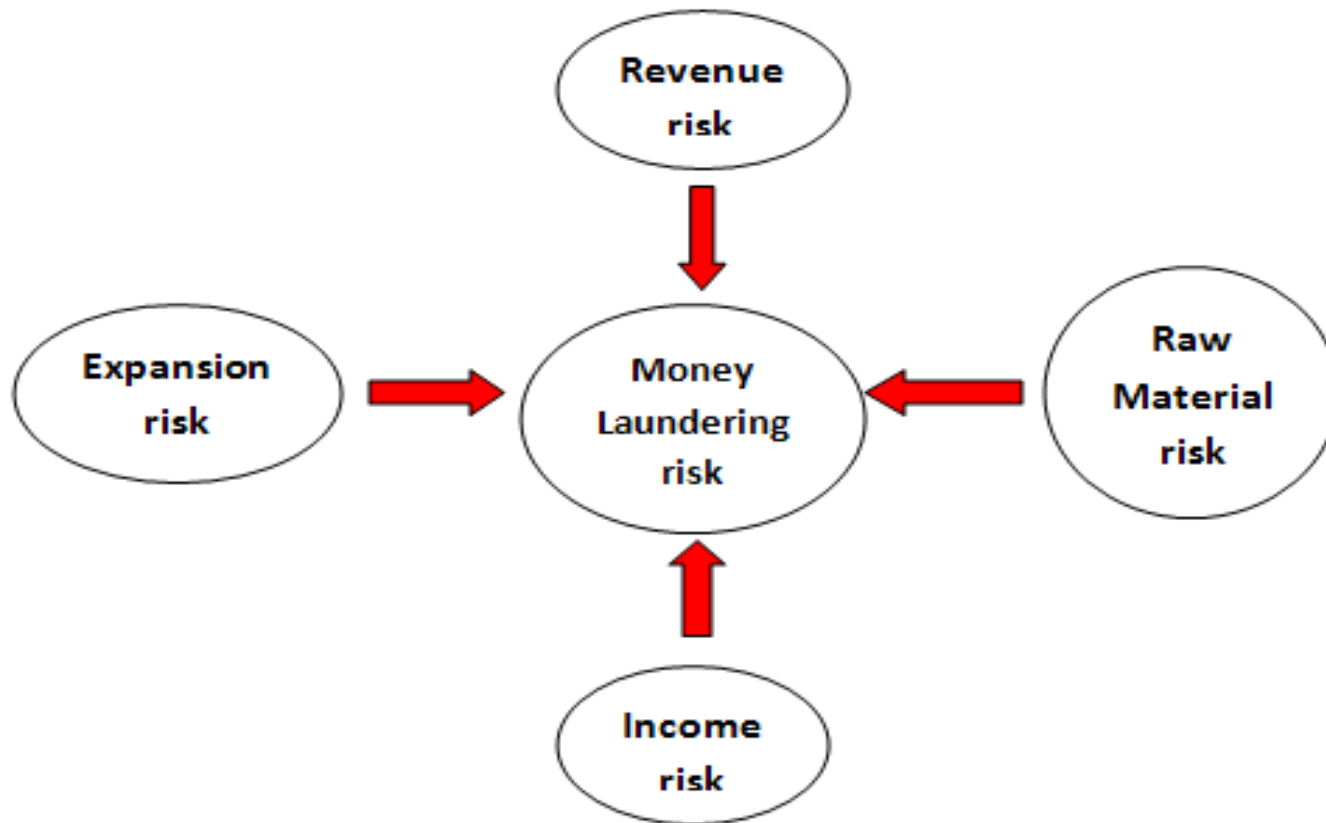
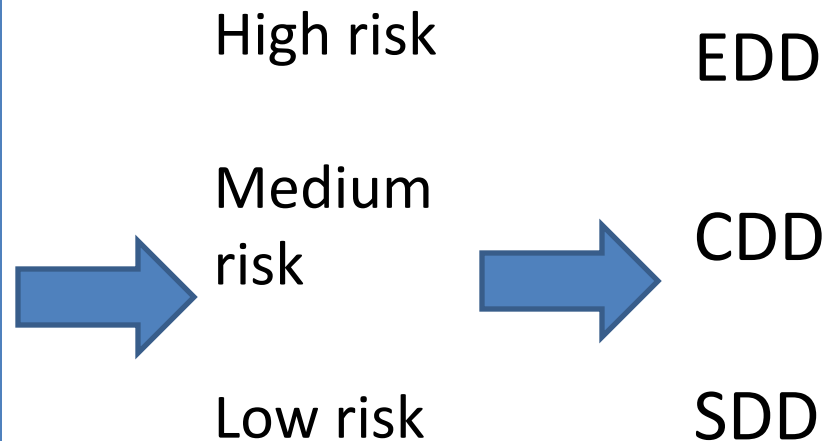


Diagram 2 Money laundering risk profile of natural-resource based industries

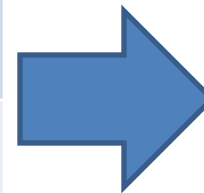
Assessing Customer Risk

- Identity
- Business location
- Customer profile
- Amount of transactions
- Customer business activity
- Ownership structure of corporate customers
- Other information



IKPP Risk Category

Risk Factors	Assessment
Identity	Legal
Business location	Jakarta, Riau, High risk financial jurisdiction
Customer profile	Influential members of Board of Directors and Board of Commissioners
Amount of transaction	USD 2 billion revenues per year
Customer business activity	Converting natural forests into plantation forests
Ownership structure	Companies without public information
Other	Weak website and poor publication



High Risk Customer

Expansion Risk

Source: APKI/Data Consult

No	Company Name	Location	Paper Production (tones)	Pulp Production (tones)
1	PT. Indah Kiat Pulp & Paper	Riau, Serang, Tangerang	2,111,000	2,000,000
2	PT. Lontar Papyrus Pulp & Paper Industry	Jambi	225,500	665,000
3	PT. Pindo Deli Pulp & Paper	Karawang	1,465,000	
4	PT. Pabrik Kertas Tjiwi Kimia	Mojokerto	1.412,000	
	Total		5,213,500	2,665,000

The total investment in earning assets for the period 2002-2008 was about USD2.18 billion. The addition of assets under construction in the amount of USD1.73 billion plus addition of fixed assets not from construction in the amount of USD448.75 million

Raw Material Risk

No	Pulp company	Pulp Production Capacity (tones) by 2006	Timber conversion rate (m3/ton)	Annual Timber demand (m3)
1	RAPP	2,000,000	4.5	9,000,000
2	IKPP	1,820,000	4.5	8,190,000
3	LPPI	665,000	4.5	2,992,500
4	Kiani	525,000	4.5	2,362,500
5	TEL	450,000	4.5	2,025,000
6	Toba	240,000	4.5	1,080,000
7	KKA	165,000	4.5	742,500
8	Pakerin	145,000	4.5	652,500
9	Others	276,600	4.5	1,244.700
	Total	6,286,600	4.5	28,289,700

Source: APKI/Data Consult

IKPP bought approximately 11.92 million m3 and 14.81 million m3 of timbers worth USD1.07 billions and USD1.33 billions in 2007 and 2008 respectively.

Revenue Risk

- IKPP needs to report sales from additional capacity and purchase of timbers in the amount of 14.81 million m³ in 2008
- The uncollectable receivable of affiliated companies in the amount of USD261 million
- Local sales worth more than USD 1 billion is given to affiliated companies.

Income Risk (1)

No	Item	2005	2006	2007	2008
1	Net sales	100	100	100	100
	Cost of product sold (COGS)	(85)	(82)	(78)	(78)
2	Gross Margin	15	18	22	22
	Operating costs	(13)	(11)	(10)	(9)
3	Operating margin	2	7	12	13
	Other income (costs)	5	(3)	(2)	(1)
	Interest expenses, net	(6)	(5)	(4)	(4)
4	Earning(loss) from continuing operations before income taxes, equity earnings, and minority interest	1	(2)	6	9
	Income tax provision	(1)	(10)	(1)	0
	Equity earnings, net of taxes	-	-	-	-
	Minority interest expense, net of taxes	0	(0)	(0)	(0)
5	Earning (loss) from continuing operations	1	(12)	5	9

main production costs (% of COGS)

Items	2005	2006	2007	2008
Raw material	67.71	72.81	71.01	78.32
Wages	1.34	1.54	1.55	1.48
Overhead	30.77	26.26	27.41	22.74

Income Risk (2)

Transactions with affiliated companies (in USA million dollars)

No	Company Name	Products/Services	2005	2006	2007	2008
1	PT Cakrawala Mega Indah	Local sales products	547.16	735.76	833.45	1,009.45
2	IK Import & Export Ltd	Export products	15.37	14.55	19.01	21.43
3	PT Arara Abdi/PT Wirakarya Sakti	Timber supplier	308.00	428.00	389.00	492.00
4	PT Sinarmas Specialy Minerals	Chemical suppliers	7.00	7.20	-	-
5	Linden Trading Company Inc, USA	Chemical suppliers	37.30	18.20	71.60	112.40
6	PT Dian Swastika Sentosa	Energy suppliers	40.30	34.40	44.70	47.00
7	APP Ltd, Singapore	Management fee	21.00	25.10	16.15	22.94
8	PT Royal Oriental Ltd	Office Rental	1.71	1.59	1.43	1.43
	TOTAL		977.84	1,264.80	1,375.34	1,706.65

IKPP's total transaction value with affiliated companies in 2008 was USD1.7 billions or more than 70 percent of net sales in 2008

Income Risk (3)

Year	Sale Cash receipts	Tax payment	%
2002	1,316.65	(6.82)	(0.52)
2003	1,479.95	(6.54)	(0.44)
2004	1,379.04	(11.49)	(0.83)
2005	1,459.76	(41.20)	(2.82)
2006	1,640.23	(27.03)	(1.65)
2007	1,864.13	-	-
2008	2,247.27	(25.62)	(1.14)

Total tax benefits (cash from the government to IKPP) in the period 2002-2007 was USD132.85 million while IKPP only paid USD118.70 million to the government for all taxes obligations.

Verification and Monitoring

- Document to be required
- Capacity to verify document
- Monitoring transactions
- Reporting Suspicious financial transactions

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Thank you

