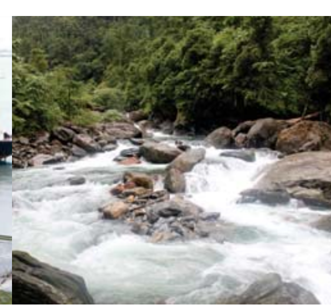
PHILIPPINE NATIONAL OIL COMPANY

PNOC
The Energy Company

2009 Annual Report




VISION

To be a world-class
Philippine energy enterprise

MISSION

To develope and implement projects and programs
in a financially prudent and responsible manner
aimed at: Increasing self-sufficiency in oil, gas
and other energy sources;
Ensuring security of supply; and
Maintaining energy price stability.

CORE VALUES

Professional Integrity
Professional Excellence
Company Loyalty
Teamwork

PHILIPPINE NATIONAL OIL COMPANY

2009

Annual Report

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PNOC Highlights in 2009

- Highlighting PNOC's 36th Anniversary celebration was the inauguration/switching ceremony of the "Energy Center Solar Streetlight Conversion Project"

- PAFC's Industrial Park obtained three prestigious certifications from the International Organization for Standardization (ISO) that boosted its status as a globally-competitive industrial estate since September 2008.

- PNOC'S Solar Home Systems Project was awarded as one of the winners in the 1st GawadPampublikongKorporasyon by the OGCC, one from 35 entries submitted by government corporations which hasan impact on national development.

- PNOC assumed the post as the Secretariat of ASEAN Council on Petroleum (ASCOPE) for the next 5 years effective, lending pride and prestige not only to PNOC but to the Philippines.

Oil and Gas

PNOC Exploration Corporation (PNOC EC) as the upstream oil and gas subsidiary of the Philippine National Oil Company (PNOC) continued to actively engage in the country's search for indigenous sources of energy. Since its establishment, it has been into various onshore and offshore oil and gas exploration activities in many parts of the country.

Petroleum Exploration

As in the past years, PNOC-EC implemented an aggressive petroleum exploration program around the country with their interests in seven exploration Service Contracts including Ragay Gulf, Offshore Mindoro, Calamian, West Calamian, West Balabac East Sabina and Isabela. Activities covered mostly data acquisition, processing and interpretation, geological and geophysical studies, all in preparation for well drilling activities. A total of 1,455 line kms of 2D and 1,151 line kms of 3D seismic data were acquired and interpretation of data was conducted separately by the participants.

Natural Gas Development and Production

Total natural gas produced from the Malampaya Deepwater Gas-to-Power Project reached 133.9 billion cubic feet, providing for the fuel requirements of its three power plant customers in Batangas. Condensate production from the project reached 5.47 million barrels and was shipped to buyers in Singapore, Thailand and China during the year.

On the Batman project, consultants were engaged to assist PNOC EC and PNOC in the bid for 149PJ gas in SC 38 and feasibility study on greenfield power plant. Route verification for the proposed sub-transmission and distribution lines is ongoing and the preparation of TOR for Front End Engineering Design already started.

During the year, PNOC and PNOC EC discussed/negotiated the transfer of project ownership to PNOC. The company is just waiting for the signing of the Memorandum of Understanding.

Coal

PNOC EC's coal businessserved the requirements of the cement manufacturing and the power production industries with its own production from the Zamboanga Sibugay Coal Project (COC 41) and other local mine sources such as Semirara coal and imported coal from Indonesia.

Coal production stood at 18,600 metric tons which was below target due to various rehabilitation and repair activities in the area including the delay in the procurement of steel arches. During the year, the company was able to trade 582,000 metric tons of

Indonesian Coal to China but this was lower compared to the previous year due to low demand and stiff competition of coal from other cheaper sources.

The Environmental Impact Statement (EIS) for theIsabela Coal Project was already submitted and PNOC EC is just awaiting the approval of the ECC. Study on Mine Optimization, Design and Cost was also conducted parallel to the preparation for Right of Way acquisition and Terms of Reference (TOR) for the FEED. Corporate Social Responsibility (CSR) activities were also done in the area in order to as part of soliciting the support of the local government unit on mining activities.

Alternative Fuels

The PNOC Alternative Fuels Corporation (PAFC) which was created in 2006 pushed its mandate to explore, develop, and accelerate the utilization and commercialization of alternative fuels in the country. True to its secondary mandate, PAFC still pursued the development, operation and management of the530-hectarepetrochemical industrial estate in Limay and Mariveles, Bataan.

Jatropha Development

With its focus was the development and production of jatropha as a source of alternative fuel, PAFC targeted the production of seedlings that will be sufficient planting materials for at least 15,000 hectares of commercial jatropha plantations. The development and establishment of jatropha plantations have also been undertaken throughout the country. PAFC established 6,653 hectares of plantations in Luzon, Visayas and Mindanao regions at the end of the year. In addition, land preparation was donein two (2) additional sites in Cagayan de Oro and Sarangani.

The Company also entered into various contracts/legal agreements with LGUs, farmers' cooperatives, private entities and State Universities and Colleges to further promote and expand useof alternative fuels. The agreements covered nursery and plantation development and jatropha seeds off-take agreement, among others. Research and development (R&D) collaborations with various research institutions and the academe to study the agronomy of the *Jatrophacurcas*, and to develop advanced, efficient and cost-effective methods of jatropha oil extraction and refining were part of the agreements.

Petrochemicals

PNOC Alternative Fuels Corporation's (PAFC) was created in 2006 from the defunct PNOC Petrochemical Development Corporation (PDMC) and up to this day continues to pursue its mandate to explore, develop, and accelerate the utilization and commercialization of alternative fuels in the country.

Todate, the operations of PAFC is focused on the use of alternative fuels both developmental and commercial in nature. Biofuels production and utilization is in support of the governmentinitiative to introduce more environment-friendly alternative fuels.

However, PAFC still pursues the development, operation and management of a petrochemical industrial estate which is part of their holdings. The complex, located in Limay and Mariveles, Bataan, is approximately 530 hectares and about 80 hectares have been fully developed.PAFC maintained its operations through provision of raw and fire water, power supply within the Petrochemical Park and other commercial areas, as well as jetty services to its existing and newly commissioned locators. These services provided the bulk of revenues for the Park.

As part of the CSR Program of the PNOC-AFC's Industrial Park, health, safety, security and environment programs were implemented last year. Environmental regular water and ambient air quality monitoring was part of its environmental quality monitoring activities. Strict implementation of the solid and hazardous waste management in the Park was also undertaken. A joint effort with the existing locators saw the motion of the preparatory activities in putting up funds to cover the implementation of various environmental projects in the Park.

In October 2009, three certifications from the International Organization for Standardization (ISO) for Quality Management System, Environmental Management System and Occupational Health and Safety Management System were issued to the Industrial Park.

The untiring efforts of the company led to the awarding of the ISO 9001:2008 distinguishing the company as the first government-owned and –controlled corporation in the country to do so and the first to have obtained three certifications at the same time.

Renewables

PNOC Renewables Corporation (PRC) wastasked to promote the development and implementation of new and renewable energy sources in the country.

Solar and Wind

The *PNOC Solar Home Systems (SHS) Distribution Project II* was a continuation of the successful project, which installed 15,000 solar homes in different barangays all over the country and was completed in 2007. In coordination the Department of Energy (DOE), PNOC RC continued the rural electrification activities of the PNOC. It was able to energize 92 barangays or 3,680 households along with 45 schools, 92 barangay halls and provided streetlights to the 92 identified barangays.

Hydropower, Tidal and Wave

DOE awarded eleven (11) hydropower service contracts to PNOC RC drawing several joint development or partnership for the development proposals from private companies, both local and foreign.

Geothermal

PNOC RC looked into the possibility of developing three (3) frontier geothermal projects. Two projects were set to be developed by private sector consortium and PNOC RC was keen on taking a minority position. A MOA with Magma Energy Resources, Inc. for the development of the Mainit-Sadanga and Buguias-Tinoc Geothermal fields were in the final stages.

Shipping and Transport

The PNOC Shipping and Transport Corporation (PSTC) acting as the shipping and transport arm of PNOC continued its engagement in the business of transporting petroleum products in all parts of the country. Four (4) company-owned vessels provided services inshipping, tinkering, lighterage, barging, towing, and shipment of goods, chattels, and other products, marine and maritime commerce.The tankers completed 161 voyages transporting about 602,689 metric tons of petroleum cargo to various parts of the country. MT Lapu-lapu carried on its 10-year contract with Petron while MT Jacinto continuously traded with Petron under a Time Charter Arrangement. Average fleet utilization level reached 84.22 percent for the year.

Estate Management

The PNOC Development and Management Corporation (PDMC) still managed a 123-hectare property in Rosario, Cavite as part of its industrial estate development and management mandate. Since the extension of PDMC's corporate life in March 2008, PDMC's activities were mainly on the sale of assets based on its Privatization Plan, as approved by the PDMC and PNOC Boards as well as by the Privatization Council of the Department of Finance dating back to September 2006.Its properties were mostly re-appraised for purposes of offering these through public bidding as part of the privatization plan. Some of the properties have already been sold while some properties still have to be re-bid as these resulted to failed bids.

PDMC sold 54 lots of the Socialized Housing Project which was created under Executive Order No. 59 for the entire year. The remaining inventories for sale are those classified as prospective ejectment cases.

The Costa Verde Estate Project- an upscale residential and commercial real estate development located in Rosario, Cavite, fronting General Trias Drive with its execution of a Joint Venture (JVA) with Sta. Lucia Realty and Development Corporation (PDMC) has sold 94 lots in the period. The exemplary performance was due to the growing interests of buyers on the PDMC lots brought about by the construction of the SM City Rosario within the Costa Verde area.

For the sale of El Pueblo units, PDMC sold 9 units. There was a delay in the marketing of the units to the public since the PDMC Board gave priority to the sale of the units to the Energy Family and other government employees at a discounted rate. So far, only 10 units were sold out of the 87 units of inventory. The expectation was for the units to be sold in the upcoming year. A marketing strategy was also in the drawing boards with the help of a real estate consultant.

2009 Consolidated Audited Financial Statements

Republic of the Philippines
COMMISSION ON AUDIT
Commonwealth Avenue, Quezon City

INDEPENDENT AUDITOR'S REPORT

THE BOARD OF DIRECTORS
Philippine National Oil Company
Energy Center, Fort Bonifacio
Taguig City, Metro Manila

We have audited the accompanying consolidated financial statements of the **Philippine National Oil Company and Subsidiaries** (a Corporation wholly-owned by the Government of the Republic of the Philippines), which comprise the consolidated balance sheet as at December 31, 2009, and the consolidated statement of income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Philippine Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Philippine Standards on Auditing. These standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

Our audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making these risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

In our last year's report, we rendered a qualified opinion on the fairness of presentation of the Company's consolidated financial statements because the appraisal increment for investment property was not recognized through profit and loss but in the equity statement. For 2009, the Company made the necessary adjustments to conform with Philippine Accounting Standard No. 40 and Philippine Financial Reporting Standard No. 1. Accordingly, our present opinion is different from that of last year's.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the **Philippine National Oil Company and Subsidiaries** as of December 31, 2009 and its financial performance and its cash flows for the year then ended in accordance with Philippine Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 13 to the financial statements regarding the investment in preferred shares of the National Development Company wherein dividends receivable for the period 1984 to 2009 totaling P620.173 million are not recorded in the books of accounts.

Further, Note 8 on land inventory includes reserve for development cost of P222.517 million on PAFC saleable land which has not been appraised or evaluated to determine the actual and estimated costs incurred.

COMMISSION ON AUDIT

JOSE DENNIS G. ISIP
State Auditor V

December 14, 2010

PHILIPPINE NATIONAL OIL COMPANY AND SUBSIDIARIES
(A Corporation Wholly-Owned by the Government of the Republic of the Philippines)
CONSOLIDATED STATEMENT OF FINANCIAL POSITION
December 31, 2009
(In Philippine Peso)

	Notes	2009	As restated 2008
ASSETS			
Current assets			
Cash and cash equivalents	5	**5,471,259,855**	9,382,809,499
Short-term investments	6	**1,603,223,754**	15,153,340,796
Trade and other receivables - net	7	**2,832,675,001**	3,067,897,002
Inventories - net	8	**1,327,856,420**	1,076,450,222
Prepaid expenses and other current assets	9	**1,075,718,012**	1,501,352,783
Total current assets		**12,310,733,042**	30,181,850,302
Assets held for sale - net	10	**507,185,257**	505,011,522
Non-current assets			
Long-term receivables - net	11	**3,437,968,480**	4,767,582,935
Investment in available for sale securities	12	**2,942,367,723**	2,859,161,755
Investments	13	**780,432,438**	782,309,775
Property, plant and equipment - net	14	**11,191,450,855**	11,416,411,862
Investment property	15	**11,556,398,334**	9,707,422,216
Exploratory and development cost	16	**507,096,764**	391,687,766
Deferred tax assets	31	**728,784,738**	611,433,112
Deferred charges and other assets	17	**15,616,068,169**	1,320,375,801
Total Non-current assets		**46,760,567,501**	31,856,385,222
TOTAL ASSETS		**59,578,485,800**	62,543,247,046
LIABILITIES AND EQUITY			
LIABILITIES			
Current liabilities			
Trade and other payables	18	**1,032,010,894**	949,863,202
Dividends payable	25	**469,411,779**	653,960,725
Current portion of long-term loans	20	**1,103,229,930**	1,426,798,246
Total current liabilities		**2,604,652,603**	3,030,622,173
Non-current liabilities			
Long-term loans - net of current portion	20	**3,357,326,062**	4,736,411,539
Deferred tax liabilities	31	**3,311,070,582**	3,106,073,281
Other long-term liabilities	21	**160,893,000**	141,442,960
Other credits	19	**5,589,984,669**	7,128,539,046
Total non-current liabilities		**12,419,274,313**	15,112,466,826
TOTAL LIABILITIES		**15,023,926,916**	18,143,088,999
EQUITY		**44,554,558,884**	44,400,158,047
TOTAL LIABILITIES AND EQUITY		**59,578,485,800**	62,543,247,046

See accompanying Notes to Financial Statements

PHILIPPINE NATIONAL OIL COMPANY AND SUBSIDIARIES
(A Corporation Wholly-Owned by the Government of the Republic of the Philippines)
CONSOLIDATED STATEMENTS OF INCOME
For the Year Ended December 31, 2009
(In Philippine Peso)

	Notes	2009	As restated 2008
NET SALES	26	**7,285,656,306**	9,094,023,792
COST OF SALES	27	**3,860,439,310**	3,949,556,318
GROSS MARGIN		**3,425,216,996**	5,144,467,474
UNREALIZED GROSS PROFIT FROM INSTALLMENT SALES		**36,867,174**	26,513,668
REALIZED GROSS PROFIT		**3,388,349,822**	5,117,953,806
REALIZED GROSS PROFIT FROM PREVIOUS YEAR'S INSTALLMENT SALES		**25,304,959**	26,174,892
TOTAL REALIZED GROSS PROFIT		**3,413,654,781**	5,144,128,698
GENERAL AND ADMINISTRATIVE EXPENSES	28	**1,035,673,621**	850,460,583
INCOME FROM OPERATIONS		**2,377,981,160**	4,293,668,115
OTHER INCOME - NET	29	**1,391,210,604**	22,657,588,103
INCOME BEFORE INCOME TAX		**3,769,191,764**	26,951,256,218
INCOME TAX	30		
Current		**(954,916,937)**	(1,713,671,440)
Deferred		**(34,954,302)**	(414,020,682)
NET INCOME		**2,779,320,525**	24,823,564,096
Attributable to:			
Equity holder		**2,775,095,216**	24,816,688,886
Minority interest		**4,225,309**	6,875,210
		2,779,320,525	24,823,564,096
EARNINGS PER SHARE			
Attributable to equity holder Company - basic	32	**346**	3,091

See accompanying Notes to Financial Statements.

PHILIPPINE NATIONAL OIL COMPANY AND SUBSIDIARIES
(A Corporation Wholly-Owned by the Government of the Republic of the Philippines)
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the year ended December 31, 2009
(In Philippine Peso)

	2009	As restated 2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash receipts from customers	**20,522,782,675**	17,552,029,867
Cash paid to suppliers and employees	**(18,194,954,972)**	(11,583,622,565)
Interest income received	**1,345,233,427**	1,100,405,250
Interest expenses paid	**(22,827,433)**	(46,854,944)
Income taxes paid	**(1,051,437,102)**	(1,728,258,433)
Net cash from operating activities	**2,598,796,595**	5,293,699,175
CASH FLOWS FROM INVESTING ACTIVITIES		
Short-term investment	**14,127,111,605**	2,086,824,998
Long-term investment	**163,603,653**	(96,240,001)
Cash dividends	**2,153,709**	375,801,032
Proceeds from disposal of assets	**65,034**	250,854,451
Purchase of banked gas	**(14,400,000,000)**	-
Capital expenditures	**(1,767,023,103)**	(815,141,470)
Exploratory and development costs	**(77,073,014)**	(40,662,401)
Investment in available for sale securities	**(85,993,359)**	490,245,463
Drydocking costs	**(48,311,094)**	(37,402,638)
Net proceeds from PNOC-EDC's privatization	**-**	25,360,668,041
Share of National Government in PNOC-EDC's privatization	**-**	(20,912,223,854)
Net cash from investing activities	**(2,085,466,569)**	6,662,723,621
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of long-term debt	**(1,567,273,454)**	(3,526,589,424)
Principal payment on finance lease	**(421,154)**	(373,754)
Payment of cash dividends	**(2,921,865,185)**	(2,317,305,586)
Cash collateral for bond conversion	**42,147,409**	-
Share buyback program	**-**	(4,115)
Net cash used in financing activities	**(4,447,412,384)**	(5,844,272,879)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(3,934,082,358)**	6,112,149,917
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	**22,532,714**	(18,771,454)
CASH & CASH EQUIVALENTS AT BEGINNING OF YEAR	**9,382,809,499**	3,289,431,036
CASH & CASH EQUIVALENTS AT END OF YEAR	**5,471,259,855**	9,382,809,499

See accompanying Notes to Financial Statements

PHILIPPINE NATIONAL OIL COMPANY AND SUBSIDIARIES
(A Corporation Wholly Owned by the Government of the Republic of the Philippines)
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
For the year ended December 31, 2009
(In Philippine Peso)

	Attributable to Equity Holder of Parent						Minority Interest	Total Equity
	Capital Stock (Note 22)	Donated Capital (Note 23)	Appropriated Retained Earnings (Note 25)	Unappropriated Retained Earnings (Note 25)	Revaluation Surplus (Note 24)	Total		
Balance at January 1, 2008	**3,114,595,519**	**89,308,406**	**9,900,000,000**	**21,848,438,260**	**8,305,196,739**	**43,257,538,924**	**32,756,469**	**43,290,295,393**
Net Income for 2008				24,859,552,540		24,859,552,540	6,875,210	24,866,427,750
Share of National Government from sale of 40% Petron shares				(20,912,223,854)		(20,912,223,854)		(20,912,223,854)
Appropriation for investment projects & capital requirements			2,968,400,000	(2,968,400,000)		-		-
Reversal of appropriated retained earnings			(6,750,000,000)	6,750,000,000		-		-
Cash dividends for 2008 net earnings				(867,863,681)		(867,863,681)	(3,722,865)	(871,586,546)
Additional cash dividends for 2007 net earnings				(1,306,326,753)		(1,306,326,753)		(1,306,326,753)
Appraisal of investment property				1,062,373,880	268,313,989	1,330,687,869		1,330,687,869
Reversal of appraisal increment					(398,000)	(398,000)		(398,000)
Reclass of appraisal increment to retained earnings				8,262,230,217	(8,262,230,217)	-		-
Adjustment on deferred tax liability				(2,478,669,065)		(2,478,669,065)		(2,478,669,065)
Adjustment on deferred tax assets				(8,543,013)		(8,543,013)		(8,543,013)
Prior period adjustment				388,738,447		388,738,447		388,738,447
Settlement of case against Lusteveco				(599,634)		(599,634)		(599,634)
PCC's winding-up expenses				(494,174)		(494,174)		(494,174)
PDMC's share buy back program				(3,002)		(3,002)	(1,113)	(4,115)
Balance at December 31, 2008	**3,114,595,519**	**89,308,406**	**6,118,400,000**	**34,628,210,168**	**310,882,511**	**44,261,396,604**	**35,907,701**	**44,297,304,305**
Adjustment/reclass of revaluation surplus				(753,833,116)	673,338,919	(80,494,197)		(80,494,197)
Adjustment on deferred tax assets				1,911,515		1,911,515		1,911,515
Adjustment on deferred tax liabilities				(100,737,794)		(100,737,794)		(100,737,794)
Prior period adjustment				325,037,872		325,037,872		325,037,872
Adjustment in net income for 2008				(42,863,654)		(42,863,654)		(42,863,654)
						-		-
Balance at December 31, 2008 - as restated	**3,114,595,519**	**89,308,406**	**6,118,400,000**	**34,057,724,991**	**984,221,430**	**44,364,250,346**	**35,907,701**	**44,400,158,047**
Balance at January 1, 2009	3,114,595,519	89,308,406	6,118,400,000	34,057,724,990	984,221,430	44,364,250,345	35,907,702	44,400,158,047
PNOC EC's appropriation of retained earnings			400,000,000	(400,000,000)		-		-
Net Income for 2009				2,775,095,216		2,775,095,216	4,225,309	2,779,320,525
Cash dividends				(1,967,351,021)		(1,967,351,021)	(3,167,597)	(1,970,518,618)
Additional cash dividends for 2008 net earnings				(766,797,621)		(766,797,621)		(766,797,621)
Adjustment on revaluation surplus				(22,587,697)		(22,587,697)		(22,587,697)
Appraisal increase of land and improvements					254,074,596	254,074,596		254,074,596
Prior period adjustments				(119,044,359)		(119,044,359)	65	(119,044,294)
PCC's winding-up expenses				(46,054)		(46,054)		(46,054)
						-		-
Balance at December 31, 2009	**3,114,595,519**	**89,308,406**	**6,518,400,000**	**33,556,993,454**	**1,238,296,026**	**44,517,593,405**	**36,965,479**	**44,554,558,884**

See accompanying Notes to Consolidated Financial Statements.

1. CORPORATE INFORMATION

The Philippine National Oil Company (the Parent Company or PNOC) was created under Presidential Decree No. 334 on November 9, 1973 to provide and maintain an adequate and stable supply of oil in the country. Its charter was amended to include energy exploration and development. Thirty six years after its creation, the Parent Company serves as the key institution in the exploration, development and utilization of indigenous energy sources. Development in the country, as well as the global front, makes it imperative for the Parent Company to get more involved in new and renewable energy activities and projects. It has ventured into several projects carried out by its following subsidiaries:

a) **PNOC Exploration Corporation (PNOC EC)** was incorporated under Philippine laws and was registered with the Securities and Exchange Commission under Registration Certificate Number 67111 on April 20, 1976. The Company's common shares are listed in the Philippine Stock Exchange (PSE).

   The registered office address and principal place of business of PNOC EC is at Building 1, Energy Center, Merritt Road, Global City, Taguig City, Philippines.

   In line with PNOC's mandate to provide and maintain an adequate supply of energy, the Company takes the lead in energy exploration and development. It has entered into service contracts with the Department of Energy on oil, gas, and coal exploration projects where the Company has either 100% ownership or is in joint venture with other partners.

   PNOC EC has a wholly-owned subsidiary, the PNOC Malampaya Production Corporation which, as of December 31, 2009, has not yet started its operations. PNOC owns 99.79% of the Company's outstanding shares of stocks while .21% is owned by the public.

b) **PNOC Alternative Fuels Corporation (PAFC)** was formerly known as PNOC Petrochemical Development Corporation (PPDC). The amended Articles of Incorporation of the PPDC was approved by the SEC on July 13, 2006, reflecting its new name as PNOC Alternative Fuels Corporation. Its mandate is to explore, develop and accelerate the utilization and commercialization of existing and emerging alternative sources of energy and technologies, and carry on the business of alternative fuels and other related activities thereto to enhance the energy security and promote sustainable energy development; to develop projects for implementation of alternative fuel sources which shall include but not limited to bio-fuels, bio-diesel, bio-mass, bio-gas and such other energy systems that support environmental sustainability and energy consumption efficiency; to purchase, acquire, own, hold, lease, develop, sell construct, maintain and operate production plants, refineries, factories, equipment, pipelines, transportation facilities, patent rights, technical and engineering know-how, appliances, industrial sites, storage, warehouses, offsite and industrial utilities which are used or incidental to production, manufacturing, processing, converting, fabricating, storage, trading, marketing, distributing, beneficiating, disposing, buying, selling, bartering, transporting, importing, exporting, or making of alternative fuels; to advance energy research development of alternative energy sources through technical, financial and institutional arrangements as well as venture into financing and operating of energy projects, utilizing alternative fuels through innovating schemes such as but not limited to joint ventures and other sharing arrangements.

The President of the Philippines, in a Joint National Economic and Development Authority (NEDA) Board and National Anti-Poverty commission (NAPC) Cabinet Group Meeting held at the Malacañang Palace on August 8, 2006, issued her directives that the Company has primarily responsibility over the Bio-Fuel Project and be responsible for the coordination with concerned agencies.

PAFC retained its secondary purpose to manage, operate, and develop some 530 hectares of land in Bataan as a petrochemical industrial estate, known as Petrochemical Park. The Company was also mandated to cause the establishment of petrochemical and related industries thereat either by itself or in joint venture with private investors.

The Company initially developed about 85 hectares of the Petrochem Park for the midstream plants. Facilities, such as raw and firewater distribution systems, road network and drainage system, a power distribution system, and a 1.3 kilometer feedstock pier, are in place.

The park is located in two barangays within two adjacent municipalities of Bataan: Barangay Lamao in the municipality of Limay and Barangay Dos in the municipality of Mariveles.

c) **PNOC Shipping and Transport Corporation (PSTC)** is engaged in the business of shipping, tankering, lighterage, barging, towing, transport and shipment of goods, chattels, petroleum and other products, marine and maritime commerce in general. The Company continued to build upon its reputation of providing efficient services. To maintain its competitive edge, it embarked on a fleet modernization program that will ensure more competence in delivering services to their customers. The modernization program, which included the replacement of its ageing tankers with younger vessels and the computerization of its business processes, were considered as its most significant undertakings.

The Company was incorporated on December 27, 1978 and was registered with the Securities and Exchange Commission under SEC Registration Certificate No. 83659. The registered office address of the Company is 7th Floor S & L Building, 1500 Roxas Boulevard, Ermita, Manila.

d) **PNOC Development and Management Corporation (PDMC),** formerly Filoil Development and Management Corporation (FDMC), is the estate development and management arm of PNOC which owns about 98% of its Class "B" Common Shares. The remaining 2% is owned by private stockholders. Its assets consist mainly of landholdings in Rosario, General Trias and Noveleta, Cavite.

   Pursuant to Executive Order No. 59 dated December 10, 2001, PDMC started in 2002 the development of its real estate properties consisting of twenty five (25) hectares and disposed them to bona-fide informal dwellers under the socialized housing program of the government through installment sales contracts ranging from one (1) to twenty-five (25) years.

   The extension of the corporate life of PDMC was unanimously approved by the PDMC Board of Directors at a meeting held on March 28, 2008 at its principal office. The amendment of the Articles of Incorporation was endorsed by the Department of Energy on September 1, 2008 to the Securities and Exchange Commission and was duly approved by the latter on March 4, 2009.

   The principal office of PDMC is at PNOC Building 6, Energy Center, Merritt Road, Fort Bonifacio, Taguig City.

e) **PNOC Renewables Corporation i**s the newest PNOC subsidiary established last February 2008. The PNOC Board through Board Resolution No. 1706, S'2007, approved the recommendation on October 17, 2007 to pursue the reactivation of PNOC Dockyard and Engineering Corporation (PDEC) for the purpose of reorganizing it into PNOC Renewables Corporation (PNOC-RC). The amended Articles of Incorporation was approved by the Securities and Exchange Commission on March 7, 2008.

   The Company will be the primary vehicle of PNOC and the government in promoting, developing and implementing new and renewable energy sources in the country. Through renewable energy, the country would be able to reduce its dependence on imported oil while mitigating climate change. Renewable energy is an important component in the country's drive towards self-sufficiency, security and independence.

   The registered office address is PNOC Building 6, Energy Center, Merritt Road, Fort Bonifacio, Taguig, Philippines.

f) **PNOC Coal Corporation (PCC)** was organized in 1981 to serve as a coal trading arm of the Parent Company. Its objective was to provide a steady supply of good quality and low-priced coal in the country through expansion and diversification of existing supply sources and ensuring coal price stability in the market.

   On May 31, 2002, the PCC ceased to operate and its coal trading activities were absorbed by PNOC EC. The PCC is still on its winding-up process which is administered by the Parent Company as its Trustee-Receiver.

g) **Tanker Companies** namely PNOC Tankers, Petron Tankers, Petrophil Tankers and PNOC Oil Carriers, Inc. ceased operations in 1995 due to continued losses. The Commission on Audit (COA) issued final audit reports of the tanker companies for the period ended June 1996. In 2003, the SEC issued a certificate for the revocation of registration of these four (4) tanker companies. Likewise, the Bureau of Internal Revenue (BIR) issued a certificate of no outstanding liability to Petron Tankers Corporation and Petrophil Tankers Corporation on June 29, 2005 and July 2, 2005, respectively.

2. STATUS OF OPERATIONS

a) PNOC Exploration Corporation

OIL and GAS Exploration and Production

The Malampaya Project

PNOC EC owns a 10% stake in the upstream component of the Malampaya Deepwater Gas-to-Power Project (SC 38), together with Shell Philippines Exploration B.V., the Operator (20%), Shell Philippines LLC (25%), and Chevron (45%). Commercial gas production from Malampaya commenced on January 1, 2002. The Malampaya Project provides the gas fuel requirements of its three power plant customers in Batangas, namely Sta. Rita (1,000 MW), San Lorenzo (500 MW) and Ilijan (1,200 MW), as well as the gas requirements of Pilipinas Shell Petroleum Corporation (PSPC) in Tabangao. In 2009, the Project produced 133.88 billion cubic feet (BCF) of gas and P5.47 million barrels of condensate. The condensate produced was shipped to buyers in Singapore, Thailand and China during the year.

San Antonio Gas Project (SAGP)

The Company operated the country's first natural gas power plant facility, a 3-megawatt pilot plant in San Antonio, Isabela under SC 37 that was commissioned in 1994. The plant supplied the electricity requirements of some 10,000 households via Isabela-I Electric Cooperative, Inc (ISELCO-I). Operations of the San Antonio Gas Project was officially shut down on July 31, 2008 as gas pressure dropped below the required inlet pressure of the power plant's gas turbine on said date due to the declining well head pressure of the SA-IA well.

Other Pre-operating Projects

Downstream Natural Gas Infrastructure Development Projects

The Batangas to Manila Natural Gas Pipeline Project (BATMAN-1), and the Integrated Bataan Liquefied Natural Gas Terminal, Power Plants and Bataan to Manila Pipeline Project (BATMAN-2) represent the overall downstream natural gas infrastructure development program of the National Government, as conceptualized by the Department of Energy (DOE). The setting up of these vital energy infrastructures will expand the use of natural gas beyond the power sector, making the environment-friendly, competitively-priced and efficient fuel available to the industrial, commercial and transport sectors, and eventually to households.

The PNOC is spearheading the development of these natural gas infrastructure projects. The Company engaged the services of PNOC EC as project implementor for the BATMAN Projects.

In 2009, PNOC EC engaged the services of consultants for the natural gas supply, Greenfield power plant in Southern Tagalog Area and for the validation of the PNOC's bid proposal for the 149PJ Malampaya New Gas. Parallel to this, PNOC EC prepared PNOC's bid for the 149PJ New Gas and lead the eventual negotiations with the S38 Consortium. Also, the Company assisted PNOC in its successful acquisition of the Ilijan Banked Gas from National Power Corporation (NPC), Power Sector Assets & Liabilities Management Corporation (PSALM) and the DOE.

Also in 2009, PNOC EC commenced its gas marketing efforts, renewed the ECC and continued coordination with the tollway operators and LGUs affected by the project for the Right-of-Way (ROW) acquisition.

As for BATMAN-2. PNOC EC continued to explore possible joint venture partnerships with entities (i.e. PTT of Thailand, Mitsubishi of Japan and XinAo of China) interested in the various value chain of the project. Preliminary survey of proposed sites for the LNG Terminal and Greenfield Power Plant, and potential gas markets in Bataan, Zambales and Pampanga were also conducted.

Cagayan (SC 37)

PNOC EC continued its re-assessment of the block as part of its renewed exploration efforts in SC 37 where it holds 100% equity. Preparations are on-going for the conduct of a land gravity survey on one of the prospective areas in the block. A Certificate of Non-Coverage from the Environmental Management Bureau was already acquired for the survey.

Ragay Gulf (SC 43)

PNOC EC has a 15% participating interest in SC-43 in the Ragay Gulf, between Bicol and the Bondoc Peninsula, which was granted by the DOE on January 14, 2004. Its partners in SC 43 are Pearl Energy Philippines ("Pearl") and Premier Oil Philippines BV ("Premier") which has 64% and 21% participating interests, respectively. Pearl replaced Premier Oil as operator of SC 43 when it acquired 21.5% of the latter's original 42.5% participating interest.

PNOC EC assisted the SC 43 operator, Pearl, in acquiring 1,925 line kilometer (km) aerogravimetric/magnetic survey. Pearl has also completed reprocessing of 345 km 2D seismic data and acquisition of 272 km2 3D seismic. During the year, the Company conducted the geologic fieldwork for the consortium in the Southwest Bondoc Peninsula.

Offshore Mindoro (SC47)

With the withdrawal of Petronas Carigali Overseas Sdn Bhd ("Petronas Carigali") on January 10, 2008, PNOC EC now has a 97% participating interest. Its other partners are PetroEnergy Resources Corporation and Basic Energy Corporation with 2% and 1% participating interest, respectively. During the year, PNOC EC acquired 1,091.60 km of 2D seismic data and completed post well evaluation of Kamia I well.

Calamian (SC 57)

PNOC EC has a 100% participating interest in SC-57 when the DOE granted it on September 15, 2005. The Company subsequently entered into joint venture arrangements for the exploration of SC 57 in 2006 with China National Offshore Oil Corporation (CNOOC) acquiring 51% participating interests and operatorship of the block and Mitra Energy Inc. ("Mitra Energy") getting 21%, leaving the Company with the remaining 28%. However, the DOE has yet to approve their entry and transfer of participating interests of the Company to CNOOC and Mitra Energy.

Approximately 2,268 km. of new 2D seismic data has already been acquired in August-September 2006. The results of the interpretation showed several prospects that need to be fully evaluated before they are tested. However, future exploration plans in SC 57 will hinge on the DOE's approval of the Company's joint venture partners.

West Calamian (SC58)

SC 58 was awarded to PNOC EC by DOE on January 12, 2006. The Company later entered into a joint venture arrangement for exploration with Nido Petroleum Philippines Pty. Ltd. (Nido Petroleum") in July 2006 to acquire a 50% participating interest. Under the agreement, Nido Petroleum will be the operator and will fund the work program which includes 2D and 3D seismic surveys and the drilling of the first well. Results of the seismic interpretation are encouraging and the first well is expected to be drilled in 2010. During the year, PNOC EC assisted the operator, Nido Petroleum, in its preparation for seabed coring. The Company also conducted in-house interpretation and validation of the operator's interpretation of seismic data.

West Balabac (SC59)

SC 59 was awarded to PNOC EC by the DOE on January 13, 2006. It is located in Southwest Palawan along the trend of the offshore oil and gas fields in Malaysia and interpreted to share a common petroleum system. On November 2009, PNOC EC has successfully farmed-out 75% of its interest to BHP Billiton. With Billiton's participation, the Company will be able to have free carry on the acquisition and processing cost of 2D and 3D seismic data and the drilling of 3 wells. In December 2009, 363 line kilometers of 2D seismic data was acquired.

East Sabina (SC 63)

PNOC EC and Nido Petroleum jointly entered into SC-63 with the former as Operator on November 24, 2006. Each of the company has 50% participating interests in SC 63 and equally share the exploration costs. The block is located south of the oil and gas fields in offshore Palawan, including Malampaya. During the year, PNOC EC acquired 754 km2 of 3D seismic data. The Department of Energy's Geoscientific Research and Testing Laboratory through a DOE-PNOC EC Memorandum of Understanding conducted the evaluation of selected SC 63 wells. The Company also reprocessed 867 km old 2D seismic data.

Domestic

PNOC EC has completed the seismic interpretation of data in open areas in West Palawan. It has also conducted the technical and economic evaluation of SC 52 (Northern Cagayan) and SC 54 (Northwest Palawan) areas as part of the review of farm-out offers of other petroleum operators.

Overseas

PNOC EC has completed the reviews of an investment opportunity in West Papua (Indonesia), and a report on investment climates in Latin America. It has likewise completed the technical evaluation on a regional scale of petroleum blocks offered in Peru and Myanmar. The Company has also completed the preliminary evaluation of four blocks being offered under the 2010 Colombia Open Round.

Coal Operations

PNOC EC holds five (5) coal-operating contract (COCs) with the DOE under which it conducts activities for coal exploration or development and production of coal resources. While currently mining coal reserves in the contract area of COC 41 (known as the Malangas Coal Project) within the Malangas Coal Reservation located in Zamboanga Sibugay, PNOC EC is preparing to develop the coal reserves located in two other coal areas in Isabela (covered by COC-141 and COC-122) in connection with the objective of establishing a mine-mouth power plant project.

Coal Operating Contract (COC) No. 41 – Malangas Coal Project

PNOC EC operates Coal Operating Contract (COC) No. 41 within the Malangas Coal Reservation in Zamboanga Sibugay straddling portions of the municipalities of Malangas, Diplahan and Imelda. The rehabilitation and repair of Mines 1 & 2 main and ventilation shafts in the Integrated Little Baguio colliery is almost complete following the take-over of PNOC EC of the operations left by Taiwan Overseas Mining Co., Phils., Inc. (TOMC). Development of the underground roadway of production panels is on-going. The ILB Colliery is the largest semi-mechanized underground coal mine in the country. PNOC EC also supervises mining operations of various small-scale coal miners.

Coal Exploration

Coal Operating Contract (COC) No. 41 – Exploration Projects (Other Areas)

PNOC EC has completed the Phase 2 drilling program with a total depth of 3,600 meters for Lumbog area in July 2009. Evaluation of the drilling data indicates recoverable coal resources of 2.1 million metric tons (MT) of coal. Mine engineering and development plans for Lumbog are being updated based on the recent drilling data.

Core drilling of exploration holes with 3,750 meters aggregate depth was started in December 2009 in the Malongon area.

Also in 2009, development of the Lalat area is still on-going. The project is in joint venture with Blackstone Energy Corporation. PNOC EC's joint venture partner completed the development of the 400-meter access road to the mine offices and the sites of the main and ventilation shaft portals. Construction of the mine/engineering office has been completed while the construction of the field staff's living quarters is 55% complete. In addition, the concreting of the main shaft portal and excavation for the ventilation shaft portal has been completed during the year.

Coal Operating Contract (COC) No. 140 - Surigao Coal Exploration

COC No. 140 was awarded to PNOC EC by the DOE on July 5, 2005. The coal contract area with a total of 3,000 hectares is located in the Municipality of Tago, Surigao del Sur. The COC will allow PNOC EC to conduct exploration activities within the coal concession for two (2) years.

The DOE approved two applications for contract moratorium since 2006 due to the heightened insurgency and subsequent military alert in the area. The first moratorium covered the period from October 12, 2006 until July 5, 2007; and the second was for a one-year term from June 19, 2007 to July 5, 2008. Subsequently, the DOE approved the two-year extension of the COC to enable the Company to conduct exploration activities until July 5, 2009. The contract to conduct the core drilling of at least 15 exploration holes for an aggregate depth of 3,000 meters was awarded to Construction & Drilling Specialists, Inc. (CDSI) in June 2008. CDSI has mobilized to the site the drilling equipment and is still awaiting the local leaders' permission to commence drilling.

PNOC EC applied for a Certificate of Non-Coverage (CNC) from the Environmental Management Bureau (EMB) covering its exploration activities at the COC No. 140 project area and received approval in July 2008 while the Pre-condition Certificate from the National Commission on Indigenous Peoples (NCIP) was issued on April 29, 2008.

Despite the prevailing threat of insurgency in the area, PNOC EC conducted and completed the block boundary survey for the project area in December 2008. The objective of the survey was to delineate on the ground the actual location of the boundaries of the 3,000 hectares project area. The programmed activities for the year were not pursued due to the unstable peace and order situation in the area. Only reconnaissance mapping and field verification survey were accomplished in COC 140.

The exploration period of COC No. 140 expired in July 2009. PNOC EC has requested the DOE for the extension of the COC's exploration phase and is still waiting approval.

Coal Operating Contract (COC) No. 122 – Isabela Coal Mine-mouth Power Plant Project

PNOC EC is the holder of COC No. 122 which straddles portions of Cauayan City and the municipalities of Naguillian and Benito Soliven in Isabela. The estimated P5.0 billion project involves putting up a power plant with a generating capacity of 30-100 MW that will utilize the low-rank coal in the province. The project was shelved in July 2006.

Efforts to renew the project were started in 2007. While the technical and economic studies on the project are continuing, attention was also given to Social Development Projects (SDP) in June 2008 after consultations with concerned LGUs early in the year. SDPs include a medical mission, a supplemental feeding program, several health-related seminars and other activities that target the youth.

The Environmental Impact Statement was submitted to the DENR-EMB and the ECC was issued in February 2010. Studies on the Mine and Power Plant Design and Costs Optimization were conducted. CSR activities were also implemented in the area in order to have the LGU's involvement and support on the various project activities. The preparation of Terms of Reference (TOR) for the Grid Impact Study (GIS), Mining Plan, Front End Engineering Design (FEED), and the Land Acquisition and Relocation Plan (LARP) is on-going.

Coal Operating Contract 141 – Isabela Coal Project

On July 5, 2005, the DOE awarded the COC No. 141 to PNOC EC for the two-year exploration of Coal Blocks 14-G-77, 78 and 79 covering an area of approximately 3,000 hectares in the Municipality of Benito Soliven, Province of Isabela, in the Cagayan Valley of Northern Luzon.

The three coal blocks under COC No. 141 are located north and adjacent to the coal blocks of PNOC EC's COC No. 122. The preliminary geologic assessments indicate that the mineable coal seams at the adjacent COC No. 122 blocks may extend northward into the COC No. 141 project area.

In December 2008, PNOC EC initiated the application for a Certificate of Non-Coverage (CNC) from the Environmental Management Bureau (EMB) covering its exploration activities at the COC No. 141 project area which was subsequently issued on January 6, 2009. The contract for the block boundary survey was awarded to H.O. Noveloso in March 2009. The additional coal reserves that will be delineated from this activity are intended to increase the already established economic viability of the Isabela Integrated Coal Mine Mouth Power Plant Project (COC No. 122).

PNOC EC conducted coordination activities with local government unit (LGU) officials, both at the municipal and barangay levels, of Benito Soliven for the conduct of the boundary survey. However, three of the six barangay chairpersons did not attend the scheduled briefing on the survey activity. The exploration period of COC No. 141 expired in July 2009. PNOC EC has already requested the Department of Energy (DOE) for the extension of the COC's exploration phase and is still waiting for its approval.

Coal Operating Contract (COC) No. 152 – Siay Coal Exploration Project

In November 2008, COC No. 152 was awarded to both PNOC EC and Agusan Petroleum and Minerals Corporation (APMC), the winning bidders for six coal blocks located in Siay, Zamboanga Sibugay that were offered during the 2006 Philippine Energy Contracting Round (PECR 2006). The new contract, which designates PNOC EC as the Operator, grants the two companies a minimum of two years to conduct joint exploration activities in Coal Blocks 41-H-315, 316, 355, 356, 357 and 395.

In June 2009, the joint venture acquired the Certificate of Non-Coverage from the Environmental Management Bureau (EMB) of the Department of Environment and Natural Resources (DENR). During the year, geologic mapping of the contract area, which includes test pitting, trenching and rock sampling, was completed. The block boundary survey conducted by H.O. Noveloso is still on-going. The Terms of Reference (TOR) and the Scope of Work (SOW) for the planned core drilling of 3,600 meters aggregate depth of stratigraphic holes was finalized with APMC and the public bidding for the Phase I exploration drilling contract is also in progress.

Indonesian Coal Projects

PNOC EC intends to establish strategic alliance and venture into coal mining business in Indonesia in order to ensure a stable and competitive supply of coal for the Philippine market.

Definitive agreements between PNOC EC and Putra Asyano Mutiara Timur (PT PAMT) were initially pursued in 2007. Following PT PAMT's acquisition of the requisite KP for Exploration in July 2008, PNOC EC commenced the conduct of legal, technical and financial due diligence in Indonesia.

In 2009, PNOC EC completed the block boundary survey, aerial topographic survey of the concession area, proposed route haul and access roads, and the proposed location of the river load-out port/jetty. Geologic evaluations and core drilling of exploration holes are still on-going. After the completion of the drilling activity as well as the legal and financial due diligence, the Company will evaluate whether to pursue the buy-in and develop the area.

Coal Trading

Aside from coal exploration and production, the Company also engages in coal trading activities. PNOC EC continued to cater to the coal requirements of the cement industry and the Naga power plant located in Cebu with coal production from COC no. 41 and from other coal sources, both local and foreign.

Aside from coal sales, PNOCEC also offers integrated services consisting of discharging foreign and local coal shipments, stockpiling, screening, blending and hauling of coal to various cement plants in the Philippines.

Energy Supply Base (ESB)

PNOC EC operates the Energy Supply Base (ESB) located in Mabini, Batangas which has excellent berthing, cargo handling, storage and warehousing facilities that continue to serve the needs of various oil and energy-related companies. Although initially set up to cater to logistical support needs of the energy industry, ESB's services now extends to other commercial clients with the granting by the Philippine Ports Authority (PPA) of a permit to operate as private commercial port under Certificate of Registration No. 291 on October 8, 1996. The permit is co-terminus with the 25-year foreshore lease agreement of ESB with the Department of Environment and Natural Resources (DENR) effective May 3, 1996 and which expires on May 3, 2021. ESB is also a Customs Bonded Warehouse which helps companies to expedite the unloading and loading of cargoes at ESB ports.

The Company entered into a 25-year long term lease with Zamboanga Development and Management Corporation (ZDMC) for a one-hectare land area and 61,100 square meters foreshore area for the latter to put up a grains bulk handling, storage and jetty facilities (the first in Southern Luzon area) to achieve a sustainable logistics development program for the country as part of the ten-point agenda of the National Government. ESB also has long term lease contracts with a variety of companies including importers, logistics companies and a telecoms company. The Company has also negotiated for a one-hectare land area with a Singapore-based logistics company for the storage of casings/tubulars for the consumption of oil and gas exploration service contractors. ESB, as the only energy base in the Philippines, aims to contribute to the exploration industry by providing prompt and efficient service to the increasing needs of oil, gas and other energy related companies, as well as commercial clients.

b. PNOC ALTERNATIVE FUELS CORPORATION (PAFC)

Alternative Fuels

Jatropha Plantations

In line with the Company's mandate on the development, production, utilization and commercialization of alternative fuels, the establishment and development of jatropha plantations have been undertaken throughout the country. As of 2009, the Company has established 6,653 hectares of plantations.

On a regional scale, the Company has already completed a total of 2,788 hectares of plantations in Luzon, specifically in five provinces namely: Zambales, Nueva Ecija, Rizal, Quezon and Palawan. Likewise, the Company established a total of 3,015 hectares of plantations in the Visayas region. These plantations are located in Iloilo, Negros Occidental, Cebu and Biliran.

In the Mindanao region, 850 hectares of plantations have been completed in three (3) sites namely, Iligan, Saranggani and Surigao del Norte. In addition, land preparation is ongoing for two (2) additional sites in Cagayan de Oro and Malungon, Saranggani.

Research and Development (R&D)

While jatropha has already been tested, proven and accepted abroad for its viability as a biodiesel feedstock, it is imperative that the Philippines have its own in-country R&D initiatives to address technical issues both in agronomy and biodiesel production. This will ensure that biodiesel production from jatropha is sustainable and compliant with international standards and consequently bring economic and environmental benefits to the country.

The Integrated R&D Program on jatropha aims to consolidate all research initiatives from feedstock production, technology development up do biofuels production, among others, to support the development of the overall biofuel industry in the country towards energy independence and cleaner environment while providing rural employment and income.

In 2008, the Company continued its R&D collaborations with various research institutions and the academe on tissue culture, integrated germplasm and oil extraction to assess and identify the best germplasm management, varietal improvement, seed technology and development of in-vitro propagation protocol for *Jatropha curcas*, and to develop advanced method of jatropha oil extraction.

The Company in collaboration with the University of the Philippines Los Banos-Institute of Plant Breeding (UPLB-IPB) made an effort to identify the best variety of *Jatropha curcas* that contains maximum oil yield. In 2008, 798 accessions of *Jatropha curcas* were gathered and profiled from 36 provinces, 170 municipalities, and 279 villages. Out of these accessions, 13 were identified and isolated for further evaluation for the parental pool. This is the largest varietal base of jatropha in the region.

Likewise, the Company, in collaboration with the Department of Science and Technology (DOST) closely worked together on the formulation of parameters in the processing of *Jatropha curcas* to biodiesel that conforms to set standards and the establishment of a dedicated demonstration facility for jatropha processing.

Last year, the DOST started setting the integrated jatropha oil extraction and biodiesel plant. A small-scale jatropha processing facility has already been installed at the DOST compound which includes an expelling machine, a decorticator and a filter press. Likewise, the installation of a biofuel testing facility is near completion. The facility is designed to analyze major biofuel parameters (both for biodiesel and bioethanol of various feedstocks). The integrated plant will be used as basis to enhance efficiency in jatropha biodiesel production while meeting local and international standards. Under the agreement, the Company and DOST will continuously conduct engine performance and emission tests of oil produced from the aforesaid facilities to ensure vehicle compatibility and cleaner air.

IEC Activities

The Company has been one of the main movers to increase public awareness on the benefits of *Jatropha curcas.* The Company took the lead in information dissemination on jatropha being a feedstock for biodiesel through its various IEC initiatives. In 2009, the Company participated in foreign exhibits and took advantage of the print media and the internet to expand its IEC activities. Likewise, the Company established networking and partnerships to boost investors' interest on the jatropha industry.

As part of the promotional and networking activities, the Company undertook the following:

Print - The Company updated, designed and produced copies of the Company's folders and brochures. The Company, likewise, updated its content on Jatropha. In addition, the Company prepared press and photo releases which were published in various national broadsheets in the country.

Broadcast – Ocular visits and location with the PNOC mother company and all its subsidiaries, participated as one of the exhibitors in the Oil Gas Asia (OGA) 2009. Exhibit held at the Kuala Lumpur Convention Center (KLCC) from June 10-12, 2009.

Likewise, in November 2009, the Company also participated in the 9th ASEAN Council on Petroleum (ASCOPE) Conference and Exhibitions held at the IMPACT Exhibition and Convention Center in Bangkok, Thailand last November 18-20, 2009.

Web – The Company continues to update its website to inform and guide site visitors. The information posted on the website include company profile, press releases and IEC materials, among others.

The PNOC-AFC Industrial Park

Services

The Company continuously provided raw and fire water, power supply within the Park and other commercial areas, and jetty services to its existing locators. The volume of raw and fire water usage of the locators was recorded at 1,378,927 cubic meters while the existing jetty was able to accommodate 169,168 metric tons of shipments. These services provided the bulk of revenue for the Park.

Legal Matters

Several meetings and hearings were conducted to address the various legal concerns of the Company specifically on land issues in the Industrial Park which include the Hanamel Property, the Leonardo Serios and Violata Laciste-claimed areas and the 55-hectare contested property. The Hanamel Case was dismissed by the Regional Trial Court Branch 4 of Balanga Bataan in favor of the Company on January 17, 2009. The plaintiff appealed said case before the Court of Appeals.

Corporate Social Responsibility (CSR) Program

As part of the CSR Program of the Company's Industrial Park, health, safety, security and environment programs were implemented last year. In addition, the Company's Industrial Park continuously conducted environmental regular water and ambient air quality monitoring as part of its environmental quality monitoring activity.

Likewise, strict implementation of the solid and hazardous waste management in the Park was undertaken. In addition, the preparatory activities in putting up funds to cover the implementation of various environmental projects in the Park were started last year. This activity is a joint effort with the existing locators.

With its goal to be the "Model Industrial Park with a Programmatic Environmental Compliance Certificate" for the Park, the Company's Guidebook was completed. Currently, the Guidebook is now with Environmental Management Bureau for review and approval. The Guidebook provides pertinent information to assist the interested parties in doing business in the Park. It outlines the standards, rules and regulations for operation that must be strictly adhered by each locator, service and utility provider, and contractor in the Park. It also provides guidelines for the Park personnel on how to manage, operate and implement the policies of the Park.

Certification to International Organization for Standardization (ISO)

As early as 2008, the Company has exerted great effort to secure certification from the International Organization for Standardization (ISO) for Quality Management System (ISO 9001:2008), Environmental Management System (ISO 14001:2004) and Occupational Health and Safety Management System (OHSAS 18001:2007) for the Industrial Park. The certification from the ISO will provide the Company's Industrial Park the needed boost to transform it into a world-class industrial state. On October 21, 2009, three (3) certificates were issued to the Park, while the ceremonial/formal awarding was held last December 14, 2009.

It is noteworthy that the Company's Industrial Park was the first government-owned and controlled corporation in the country to be awarded with ISO 9001:2008 and the first to have obtained three certifications at the same time.

Persistent Organic Pollutants (POPS) Project

The POPS Project is a part of a global program that will introduce and apply a non-combustion technology to destroy polychlorinated biphenyls (PCBs) wastes, and it is the first of its kind in the country. The Company partnered with the Department of Natural Resources under the funding of United Nations Industrial Development Organization (UNIDO) for the implementation of the Project. The Company will host and operate the PCB destruction facility to be located at Company's Industrial Park.

The POPs project is expected to generate revenue for the Industrial Park mainly from the following: a) income from the storage fee of PCB-contaminated materials; b) cleaning of PCBs from contaminated materials (current rate of US$6-10 per kilogram); and c) potential income from scrapped metals during the process.

The specific plan for the installation and technical specifications of equipment foundations and other engineering requirements have been finalized, while necessary construction permits and other vital documents from the municipal/local government have already been secured.

As part of its information awareness campaign, the POPS project was already presented to the surrounding communities. In partnership with the Bataan LGU, partner non-governmental organization, Environmental Management Bureau and UNIDO, the Company's Industrial Park has conducted IEC activities at the local and national levels.

The construction of the POPS Destruction Facility has been successfully bidded out last December 10, 2009. The construction of the facility is expected to commence by February 2010. Meanwhile, pooling of technical staff that will be hired for the project is now being finalized, while the contracts with Manila Electric Company (MERALCO), National Power Corporation (NPC), National Grid Corporation of the Philippines (NGCP) and Power Sector Assets and Liabilities Management (PSALM) for the transformers that will be treated in the said facility are being drafted.

c. PNOC SHIPPING AND TRANSPORT CORPORATION (PSTC)

In 2009, the Company operated four (4) owned tankers, all contracted by Petron Corporation, namely: (1) M/T General Antonio Luna under Consecutive Voyage Charter Party (CVCP) expiring on December 2010; (2) M/T Dr. Jose P. Rizal under Time Charter (TC) until 2013; (3) M/T PNOC Lapu-lapu under TC for 10 years; and (4) PNOC Emilio Jacinto also under TC for 10 years ending 2017. The three tankers under TC have existing registrations with the Board of Investments under E.O. 226, also known as Omnibus Investment Code of 1987 and are enjoying certain privileges in the form of Income Tax Holiday (ITH).

M/T Lauren Kate, which is owned by Ocean Tankers Corporation, was chartered on September 2009. She was on back-to-back CVCP arrangement with Petron Corporation carrying bio-fuels and other special chemicals for bay and river, as well as inter-island operations.

Reinforcing its goal of providing efficient marine transport services, the Company also embarked on a program to develop and implement a quality management system that is compliant with ISO 9001:2000 standards. The ISO seal of approval focuses the organization on refinement of core business processes which management believes is essential to delivering quality service to its customer.

Following stringent performance guidelines and quality management procedures, the Company's ISO Team ensured that all core processes are geared towards organizational efficiency, effectiveness and productivity. Through a combination of intensive orientation, documentation and infrastructure improvements, PSTC promises to develop and effectively implement an efficient quality management system.

The current preparation for ISO Certification is a reflection of the Company's thrust of consistently delivering high standards of performance in its business processes.

d. PNOC DEVELOPMENT AND MANAGEMENT CORPORATION (PDMC)

Costa Verde Subdivision

In July 2003, the Company entered into a Joint Development Agreement with Sta. Lucia Realty and Development, Inc. for the development of its 32 hectare property in Rosario, Cavite into a mixed residential and commercial subdivision called Costa Verde Subdivision.

During the calendar year 2008, PDMC proceeded with the sale and disposition of its inventories and the collection of accounts from its socialized housing project under E.O. 59 and its Costa Verde Mixed Residential – Commercial Estate Project in a joint development agreement with Sta. Lucia Realty and Development Inc.

From the Socialized Housing Project, a total of 3,631 lots were generated as inventory of which 3,455 lots were already disposed. For 2009, PDMC sold 204 lots while 176 lots are still to be disposed of for the coming year. As of December 31, 2009, the project has about 2,312 beneficiary accounts with arrearages of more than 1 year up to 7 years with the bulk on a 1 year up to 4 years. Because of the difficulty in collecting the amortization, the company engaged the services of ESP Collection Agency in the administration of collection proper for the Socialized Housing accounts. On the other hand, of the total 539 lots inventory for Costa Verde Project, 32% or 170 lots represents the balance of saleable properties, consisting of 53 commercial and 117 residential lots.

El Pueblo Manila Condormitel and Other Projects

PDMC also entered into a Contract to Sell with Phoenix Sun International Corporation (PSIC) for the acquisition of condormitel units equivalent to 2,020 square meters at P24,750 per square meter or a total purchase of P50 million at the Energy Town Likas Housing (Now, El Pueblo Housing Project).

The Company also has a pending development agreement with LGTM Corporation for the development of its 5.7 hectare property in Rosario, Cavite into a residential subdivision. PDMC also received a proposal from First mega Holdings Corporation for the long term lease of PDMC's 7,118 square meter commercial property along Gen. Trias Drive, Rosario, Cavite to be developed by the First Mega Holdings Corporation as a station Mall.

e. PNOC RENEWABLES CORPORATION (PRC)

The Company has established partnerships with foreign entities for the exploration of possible opportunities in solar and wind power projects. Agreements have been forged with the following companies, to wit:

- EXA Electronics and Construction Incorporated (EXA E&C)

  On September 26, 2008, the Company had entered into a Memorandum of Understanding (MOU) with EXA E&C to undertake joint activities to explore the feasibility of certain renewable energy activities in the country.

- ASEA Group, Inc.

  On September 2, 2008, the Company entered into a Mutual Non-disclosure Agreement with ASERA Group, Inc. for future discussions regarding one or more potential business transactions between them or their affiliated companies.

- Philippine Hybrid Energy Systems Inc. (PHESI)

  On December 16, 2008, the Company entered into an agreement with PHESI that in the future, both parties will enter into discussions with respect to contractual arrangements pertaining to power projects, including the possibility of forming a partnership to jointly develop, own and operate said projects.

Hydroelectric power projects that are in the initial stages of discussion are the 7 MW Langogan Hydropower Project (HPP); 23.5 MW Timbaban HPP; 60 MW Benguet HPP (ILJIN Electric Philippines); 25 MW Laiban HPP in Rizal and 35 MW Libacao HPP in Panay (California Energy).

The Company also successfully negotiated the transfer of Shell Solar Power Corporation (SSPC) inventories of Solar Home Systems (SHS) to PNOC. It also secured contracts with the Department of Energy for the solar energization of 45 barangays in Sulu Provinces.

On the development of biomass as an energy source, the Company has initiated talks on possible tie-ups with Waste to Biomass projects with the INORA Group; Pangrea Green Italy; AREVA Bioenergies; and PADISCOR.

PNOC Natural Gas Vehicle Development Project

The PNOC Natural Gas Vehicle (NGV) Development Project consists of information, education and communication (IEC) activities on NGV's; supply of natural gas to the demonstration vehicles through the operation of mobile refueling facility; and conversion of a PNOC service to a bi-fuel gas vehicle. The whole project aims to contribute to the government's thrust to achieve a diverse, reliable and affordable energy supply that also meets environmental challenges by promoting the exploration, development and utilization of natural gas for vehicles, and initiating the development of infrastructure for the supply of natural gas for vehicles in Metro Manila.

PNOC has been an active member of the ASEAN Council on Petroleum (ASCOPE), which has initiated various projects on energy in the ASEAN region. As a result of the constant collaboration of the PNOC with other ASEAN member countries through the ASCOPE, it has established a healthy working relationship with PETRONAS representing Malaysia. PNOC's zealous efforts to bring the Enviro 2000 natural gas vehicle taxis in the Philippines paved the way to the signing of a Memorandum of Understanding (MOU) on May 7, 2002 between PNOC and PETRONAS NGV of Malaysia.

The MOU covers the field demonstration of Enviro 2000, original equipment manufacturer NGV's from PETRONAS NGV, Malaysia. Six units of Enviro 2000 have been used in the PNOC's IEC activities on the use of natural gas transport. Since 2002, PNOC has been conducting orientation activities that highlight the benefits of using natural gas in motor vehicles, the features of Enviro 2000 as examples of Original Equipment Machine Natural Gas Vehicles (OEM NGV's), and updates on NGV development in the Philippines.

To date, the PNOC has contributed an equivalent of about 250 hours of IEC activities on NGVs and NGV industry development in the country resulting in a widespread public awareness on NGV technology and its benefits in the economy and the environment.

A total of 16,000 copies of brochure about NGVs and other materials on NGV Development in the Philippines were produced and distributed during the IEC activities, through media exposure, different environmental and energy exhibits, participation in DOE's economy runs and DENR's various Clean Air Campaign activities, car show exhibits, in the "Pulong Bayan ni Pangulong Gloria" hosted by the City of Manila Municipality and in various schools in Metro Manila and provinces.

With the above-mentioned accomplishments, PNOC through its then President, Thelmo Y. Cunanan, was awarded as the NGV World Champion for Asia Pacific in October 2004 in Buenos Aires by the International Association of Natural Gas Vehicle (IANGV) for its contribution to the development of NGV industry.

On-going activities:

- One unit of Enviro 2000 was already converted from right-hand-drive to left-hand drive. The plan of converting the remaining units into a left-hand-drive is still pending and awaiting budget approval. The Deed of Donation was already signed by PETRONAS and PNOC on December 1, 2008 and June 4, 2009, respectively.

- The application for accreditation to Natural Gas Vehicle Program for public transport is still in process.

- Test drive of the unit was undertaken on April 7, 2008 from PNOC to Mamplasan Daughter Station in Biñan, Laguna and vice versa. The vehicle was tested for refueling at the station.

3. BASIS OF FINANCIAL STATEMENT PREPARATION

The accompanying consolidated financial statements have been prepared in accordance with the accounting principles generally accepted in the Philippines as set forth in Philippine Financial Reporting Standards (PFRSs) and the applicable practices of the oil and gas industry not covered by the existing PFRS/PAS. PFRS include statements named PFRS and Philippine Accounting Standards (PAS) and interpretations issued by the Financial Reporting Standards Council (FRSC).

The financial statements have been prepared using the measurement bases specified by PFRS for each type of asset, liability, income and expense. These financial statements have been prepared on the historical cost basis except for trade and other receivables, inventories, investment property, property, plant and equipment and assets held for sale.

The measurement bases are more fully described in the accounting policies that follow:

- Trade and other receivables – at fair value net of allowance for doubtful accounts (refer to Note 7);

- Inventories – land inventories and parts and supplies are stated at lower of cost or net realizable value and coal inventories at moving average (refer to Note 8);

- Investment property – measured initially at its cost, and subsequently at fair market value (refer to Note 13);

- Property, plant and equipment – initially measured at cost net of accumulated depreciation, depletion and amortization (refer to Note 14)

- Assets held for sale – stated at lower of carrying amount and fair value less cost to sell (refer to Note 10).

The financial statements are presented in Philippine peso because this is the currency of the primary economic environment in which PNOC and its subsidiaries operate. All values are rounded to the nearest peso, except when otherwise indicated.

The accounting policies adopted are consistent with those of the previous financial year, except for adoption of the following new and amended PFRS and Philippine Interpretations, which became effective beginning January 1, 2009.

PAS 1, *Presentation of Financial Statements*

The amendment clarifies that financial instruments classified as held for trading in accordance with PAS 39 are not necessarily required to be presented as current assets or current liabilities. Instead, normal classification principles under PAS 1 should be applied. In addition, the revised standard separates owner and non-owner changes in equity. The statement of changes in equity includes only details of transactions with owners, with non-owner changes in equity presented in a reconciliation of each component of equity presented in a reconciliation of each component of equity. The standard also introduces the statement of comprehensive income: it presents all items of recognized income and expenses, either in one single statement, or in two linked statements. The Company has elected to present a single statement of comprehensive income.

PAS 16, *Property, Plant and Equipment* and consequential amendment to PAS 7, *Statement of Cash Flows*

The amendment clarifies that an entity in the course of ordinary activities, sells property, plant and equipment that was held for rental transfers the property, plant and equipment to inventories at carrying amount when they ceased to be rented and are held for sale. A consequential amendment to PAS 7 states that cash flows arising from purchase, rental and sale of those assets are classified as cash flows from operating activities. Also, the term “net selling price” has been replaced with “fair value less cost to sell” in the definition of recoverable amount so as to achieve consistency with the terminology used in PFRS 5.

PAS 23, *Borrowing Costs (Revised)*

The revised PAS 23 requires capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to be ready for its intended use or sale.

PAS 28, *Investment in Associates*

Where an investment in associate is accounted for in accordance with PAS 39, only certain rather than all disclosure requirements in PAS 28 need to be made in addition to disclosures required by PAS 32 and PFRS 7.

PAS 36, *Impairment of Assets*

Where fir value less cost to sell is calculated on the basis of discounted cash flows, disclosure equivalent to those for value-in-use calculation should be made.

PAS 38, *Intangible Assets*

The amendment clarifies when to recognize a prepayment asset, including advertising or promotional expenditures. In the case of supply of goods, the entity recognizes such expenditure as an expense when it has a right to access the goods. For services, an expense is recognized on receiving the service. Also, prepayment may only be recognized in the vent that payment has been made in advance of obtaining right of access to goods or receipt of services. The amendment clarifies also the description of valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination that are not traded in active markets.

PAS 39, *Financial Instruments: Recognition and Measurement*

The definition of financial asset or financial liability at fair value through profit or loss as it relates to items that ate held for trading was changed. A financial asset or liability that is part of a portfolio of financial instruments managed together with evidence of an actual recent pattern of short-term profit taking is included in such a portfolio on initial recognition. The company initially determined that adoption of this amendment will not have a material effect on its 2009 financial statements.

PAS 40, *Investment Property*

PAS 40 is amended to include property under construction or development for future use as investment property in its definition or investment property. This results in such property being within the scope of PAS 40; previously, it was within the scope of PAS 16. Also, if an entity's policy is to measure investment property at fair value, but during construction or development of an investment property the entity is unable to reliably measure its fair value, then the entity would be permitted to measure the investment property at cost until construction or development is complete. At such time, the entity would be able to measure the investment property at fair value.

PFRS 8, *Operating Segments*

PFRS 8 replaced PAS 14, *Segment Reporting,* upon its effective date. The Company concluded that the operating segments determined in accordance with PFRS 8 are the same as the business segments previously identified under PAS 14.

Adoption of the following changes in PFRS did not have an impact on the consolidated financial statements.

Philippine Interpretation IFRIC 13, *Customer Loyalty Programmes*

This Interpretation requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore, part of the fair value of the consideration received is allocated to the award credits and realized in income over the period that the award credits are redeemed or expire.

Philippine Interpretation IFRIC 16, *Hedges of a Net Investment in a Foreign Operation*

This Interpretation provides guidance on identifying foreign currency risks that qualify for hedge accounting in the hedge of net investment; where within the group the hedging instrument can be held in the hedge of a net investment; and how an entity should determine the amount of foreign currency gains or losses, relating to both the net investment and the hedging instrument, to be recycled on disposal of the net investment.

Philippine Interpretation IFRIC 18, *Transfers of Assets from Customers*

This Interpretation is to be applied prospectively to transfers of assets from customers received on or after July 1, 2009. The Interpretation provides guidance on how to account for items of property, plant and equipment received from customers, or cash that is received and used to acquire or construct assets that are used to connect the customer to a network, or to provide ongoing access to a supply of goods or services or both. When the transferred item meets the definition of an asset, the asset is measured at fair value on initial recognition as part of an exchange transaction. The service delivered is identified and the consideration received (the fair value of the asset) allocated to each identifiable service. Revenue is recognized as each service is delivered by the entity.

Amendment to PAS 32, *Financial Instruments: Presentation* and PAS 1 *Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation.*

The standards have been amended to allow a limited scope exception for puttable financial instruments to be classified as equity if they fulfill a number of specified criteria.

PFRS 1 and PAS 27 Amendments – *Cost of Investment in a Subsidiary, Jointly Controlled Entity or Associate*

The amendments to PFRS 1, *First-time Adoption of Philippine Financial Reporting standards,* allowed an entity to determine the "cost" of investments in subsidiaries, jointly controlled entities or associates in its opening PFRS financial statements in accordance with PAS 27, Consolidated and Separate Financial Statements, or using a deemed cost method. The amendment to PAS 27 required all dividends from a subsidiary, jointly controlled entity or associate to be recognized in the income statement in the separate financial statement. The revision to PAS 27 was applied prospectively. The new requirement affects only the parent's separate financial statements and does not have an impact on the consolidated financial statements.

PFRS 2, *Share-based Payment – Vesting Conditions and Cancellations*

The amendment to PFRS 2, *Share-based Payments,* clarifies the definition of vesting conditions and prescribes the treatment for an award that is cancelled. It defines a vesting condition as a condition that includes an explicit or implicit requirement to provide services. It further requires non-vesting conditions to be treated in a similar fashion to market conditions. Failure to satisfy a non-vesting condition within the control of either the entity or the counter-party is accounted for as cancellation.

PFRS 3, *Business Combinations (Revised)*

The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the income statement. There is a choice on an acquisition-by-acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs should be expensed.

Philippine Interpretation IFRIC 9 and PAS 39 Amendments – *Embedded Derivatives*

The amendment to Philippine Interpretation IFRIC 9, Re-assessment of Embedded Derivatives, requires an entity to assess whether an embedded derivative must be separated from a host contract when the entity reclassifies a hybrid financial asset out of the fair value through profit or loss category. This assessment is to be made based on circumstances that existed on the later of the date the entity first became a party to the contract and the date of any contract amendments that significantly change the cash flows of the contract. PAS 39, Financial Instruments: Recognition and Measurement, now states that if an embedded derivative cannot be reliably measured, the entire hybrid instrument must remain classified as at fair value thru profit or loss.

Improvements to PFRSs 2008 and 2009

The omnibus amendments to PFRSs issued in 2008 and 2009 were issued primarily with a view of removing inconsistencies and clarifying wordings. There are separate transitional provisions for each standard. The adoption of the said amendments in 2008 did not have any significant impact on the Company's financial statements.

PAS 18, *Revenue.* The amendment adds guidance (which accompanies the standard) to determine whether an entity is acting as a principal or as an agent. The features to consider are whether the entity has primary responsibility for providing the goods or service, has inventory risk, has discretion in establishing prices, and bears the credit risk.

Effective in 2010

Revised PFRS 3, *Business Combinations* and PAS 27, *Consolidated and Separate Financial Statements*

The revised PFRS 3 introduces a number of changes in the accounting for business combinations that will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs, and future reported results.

The revised PAS 27 requires, among others, that:

- Change in ownership interests of a subsidiary (that do not result in loss of control) will be accounted for as an equity transaction and will have no impact on goodwill nor will it give rise to a gain or loss;

- Losses incurred by the subsidiary will be allocated between controlling and non-controlling equity investment in the subsidiary; and

- On loss of control of a subsidiary, any retained interest will be re-measured to fair value and this will impact the gain or loss recognized on disposal.

The changes introduced by the revised PFRS 3 and PAS 27 must be applied prospectively and will affect future acquisitions and transactions with non-controlling interests.

Amendment to PAS 39, *Financial Instruments: Recognition and Measurement – eligible Hedged Items*

The Amendment addresses only the designation of a one-sided risk in a hedged item, and the designation of inflation as a hedged risk or portion in particular situations. The amendment clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as a hedge item.

Philippine Interpretation IFRIC 17, *Distributions of Non-cash Assets to Owners*

The Interpretation covers accounting for all non-reciprocal distribution of non-cash assets to owners. It provides guidance on when to recognize a liability, how to measure it and the associated assets, and when to derecognize the asset and liability and the consequences of doing so.

Philippine Interpretation IFRIC 18, *Transfers of Assets from Customers*

The Interpretation applies to the accounting for transfers of items of property, plant and equipment by an entity that receive such transfers from its customer, wherein the entity must then use such transferred asset either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services, or to both.

Effective in 2012

Philippine Interpretation IFRIC 15, *Agreement for Construction of Real Estate*

The Interpretation covers accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. This Interpretation requires that revenue on construction of real estate be recognized only upon completion, except when such contract qualifies as construction contract to be accounted for under PAS 11, *Construction Contacts,* or involves rendering of services in which case revenue is recognized based on stage of completion. Contracts involving provision of services with the construction materials and where the risks and reward of ownership are transferred to the buyer on a continuous basis will also be accounted for based on stage of completion.

The Company is in the process of assessing the impact of the above new and amended accounting standards and Interpretations effective subsequent to 2008 on the Company's financial statements in the period of initial application. Additional disclosures required by these amendments will be included in the financial statements when these amendments are adopted.

Basis of Consolidation

The consolidated financial statements comprise the financial statements of the Parent Company and its subsidiaries where it owns more than 50% of the voting stock as of December 31 of each year. The financial statements of the subsidiaries are prepared for the same reporting year as the Parent Company, using consistent accounting policies.

All significant intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated in full in the consolidation.

Subsidiaries are fully consolidated from the date on which control is transferred to the Company or Parent Company. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Consolidation of subsidiaries ceases when control is transferred out of the Company or Parent Company.

The results of subsidiaries acquired or disposed during the year are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate.

The subsidiaries included in the consolidation are the following: PNOC Exploration Corporation (PNOC EC), PNOC Shipping and Transport Corporation (PSTC), PNOC Development and Management Corporation (PDMC), PNOC Alternative Fuels Corporation (PAFC), PNOC Renewables Corporation (formerly PNOC Dockyard and Engineering Corporation (PDEC)), PNOC Coal Corporation (PCC), PNOC Oil Carriers, Inc. (POCI) and PNOC Tankers Corporation.

Minority Interests

Minority interests represent the portion of profit or loss and the net assets not held by the Company and are presented separately in the consolidated statements of income, changes in equity and in the equity section of the consolidated balance sheets, separately from Equity Attributable to Equity Holders of the Parent.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.

a) Revenue Recognition

Revenue is measured at the fair value of the consideration received or receivable. Revenue is recognized when there is persuasive evidence that an arrangements exists, delivery has occurred, title has transferred, selling price is fixed or determinable and collectability of the selling price is reasonably assured.

Revenue from sale of gas, condensate and oil of the Malampaya Project is recognized upon delivery in accordance with the provisions of Gas Sales and Purchase Agreement (GSPA) with customers and the Joint Operating Agreement (JOA) entered into by and among the SC 38 partners. Delivery of natural gas is recognized when the gas arrives at the designated delivery points at the power plants and meets the required quality specifications set out in the relevant GSPA.

Billings for undelivered gas are credited to deferred income and recognized as revenue upon delivery. Under the “take-or-pay” provision of the GSPA, buyers shall pay the full contracted volume or quantity even if there is no delivery of the produced gas during the period. Annual reconciliation of volume actually taken and contracted volume is made to determine the deficiency or shortfall. The SC 38 consortium is bound to deliver the deficiency volumes in the future.

Sale of real estate is recognized using installment method and upon receipt of sufficient down payment. Under the installment method, gross profit on sale is initially deferred and recognized when the principal payments on the related installment contracts receivable are collected. Realized income is computed based on the collections multiplied by the average gross profit rate of the project.

Interest revenue is accrued on a time proportion basis, by references to the principal outstanding and at the effective interest rate. Rental income arising on investment properties is accounted for on a straight-line basis over the lease term. Demurrage revenues are recognized on cash basis in view of the uncertainties involved in the collection of demurrage charges, i.e. demurrage billing have always been subject of dispute between the Company and its customers.

b) <u>10% Interest in Service Contract 38</u>

The Company records its 10% participating interest in the Malampaya Gas Project under the criteria "jointly controlled assets". Under this criteria, the Company recognizes in its separate financial statements its share of the jointly controlled assets, classified according to the nature of the assets rather than as investment; any liabilities that it has incurred; its share of any liabilities incurred jointly with other ventures in relation to the joint venture; any income from sale of use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and any expenses that it has incurred in respect of its interest in the joint venture.

Estimated abandonment and site restoration cost is provided using the accrued liability method and computed based on units of production and estimated proved reserves.

c) <u>Cash and Cash Equivalents</u>

Cash includes cash on hand and in banks. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash, with original maturities of three months or less from date of acquisition and that are subject to an insignificant risk of change in value.

d) <u>Short-term Investments</u>

Short-term investments are money market placements in the form of treasury bills and special savings deposits with more than three months maturity but less than one-year term.

e) <u>Trade and Other Receivables</u>

Trade and other receivables are stated at face value, net of allowances for doubtful accounts. The allowance is established by charges to income.

The Parent Company and its subsidiaries perform a regular review of the age and status of the accounts relative to historical collections, changes in customer payment terms, assessment of current economic environment and other factors that may affect ability to collect payments.

f) <u>Allowance for Doubtful Accounts</u>

The allowance for doubtful accounts is established when there is a basis to doubt the collectability of accounts, specifically identified to be potentially uncollectable, and other accounts based on aging schedule of outstanding receivables and assessment of current economic environment.

The receivables of PNOC EC's SC 38 Malampaya Project are not provided with allowance for doubtful accounts. This is in view of the Project being in operation as specialized industry where both the SC 38 Project Consortium and its customers strictly adhere to their reciprocal obligations. Moreover, the Project's Gas Sales and Purchase Agreement (GSPA), as well as the related contracts, provides reasonable assurance to the SC 38 Project Consortium for the appropriate collection of its accounts receivable.

g) Inventories

Inventories are stated at the lower of cost and net realizable value. Cost includes invoice amount, service fees and other delivery charges, net of trade and cash discounts. Cost is determined as follows: moving average for materials and supplies as well as coal inventories, specific identification of cost method for saleable land, prevailing market price for condensate inventory, and first-in, first-out (FIFO) method for uninstalled solar home systems (SHS) units.

Net realizable value represents the estimated selling price in the ordinary course of business less all estimated costs of completion and the estimated costs necessary to make the sale.

h) Allowance for Inventory Obsolescence

The Company provides for an allowance for inventory obsolescence to reflect the estimated net realizable value.

Net realizable value is based on estimated selling prices less any further costs expected to be incurred for disposal.

i) Investments

Investments in shares of stocks, in which the Parent Company and its subsidiaries are not the controlling stockholders, are carried at cost. An allowance is set up for any substantial and apparent permanent decline in the carrying values of these investments.

Investments classified as available-for-sale are measured at subsequent reporting dates at fair value. Gains and losses arising from changes in fair value are recognized directly in equity, until the security is disposed or is determined to be impaired, at which time the cumulative gain or loss previously recognized in equity is included in the net profit or loss for the period.

j) Investment Property

Investment property, which is property held to earn rentals and/or capital appreciation, is stated at fair market value, less any subsequent accumulated depreciation and impairment in value.

Depreciation is computed on the straight-line method based on the 30 years estimated useful lives of the assets.

The useful life and method of depreciation are reviewed periodically to ensure that the period and method of depreciation are consistent with the expected pattern of economic benefits from items of investment property.

k) <u>Property, Plant and Equipment</u>

Property and equipment are initially measured at cost, less any subsequent accumulated depreciation, depletion and impairment in value.

The initial cost of property and equipment consists of its purchase price and costs directly attributable to bringing the asset to its working condition and location for its intended use. Subsequent expenditures relating to an item of property, plant and equipment that have already been recognized are added to the carrying amount of the asset when it is probable that future economic benefits, in excess of the originally assessed standard of performance of the existing asset, will flow to the Company. All other expenses relating to an item of property, plant and equipment that is described as repairs and maintenance are charged to profit or loss in the period these are incurred.

The cost of Service Contract (SC) 38 project-related wells, platforms and other facilities includes acquisition costs and capitalized exploration and development costs. The carrying values are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets or cash-generating units are written down to their estimated recoverable amount.

Major spare parts and stand-by equipment qualify as property and equipment when the Company expects to use them for more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property and equipment, they are accounted for as property and equipment.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets ranging from 5 to 30 years.

Depreciation, depletion and amortization of wells, platforms and other facilities are computed using the unit-of-production method based on the estimated proved reserves. Depreciation of other SC 38 Project-related other facilities and equipment are computed using the straight-line method based on the estimated useful life of 21 years.

The useful life and method of depreciation are reviewed periodically to ensure that the period and method of depreciation are consistent with the expected pattern of economic benefits from items of property and equipment.

Stand-by equipment is depreciated from the date it is made available for use over the shorter of the life of the stand-by equipment or the life of the asset for which the stand-by equipment is part of while major spare parts should be depreciated over the period starting when it is brought into service, continuing over the lesser of its useful life and the remaining expected useful life of the asset to which it relates.

Construction in progress is stated at cost and is not depreciated until such time that the assets are completed and/or put into operational use.

Gain or loss arising from the disposal or retirement of an asset is determined by computing the difference between the sales proceeds and the carrying amount of the asset and is recognized as income or expense for the period.

l) <u>Exploration and Development Costs</u>

PNOC EC adopts the successful efforts method of accounting for its oil and gas operations. All exploration costs, except the cost of exploratory wells, are charged to expense as incurred. Costs of exploratory wells (including stratigraphic test wells) are initially capitalized and deferred pending the outcome of the drilling operation. If proved reserves are discovered, the associated costs are capitalized and amortized, as the related proved developed reserves are produced. However, if the exploratory well or stratigraphic test well proves to be dry, the accumulated drilling costs are charged to expense.

Development costs, which include the costs of drilling development wells, are capitalized regardless of whether or not proved reserves are found while production costs are expensed as incurred.

Capitalized cost is amortized using the “unit-of-production method” whereby property acquisition costs (net of accumulated DD&A) are amortized over the estimated proved reserves.

For coal exploration and other projects, the Parent Company uses the full-cost method of accounting. Under this method, all costs directly incurred in the acquisition, exploration and development of a project area, including directly-related overhead costs, are capitalized. All exploration costs, likewise, are tentatively deferred pending determination on whether the area contains coal reserves of commercial quantity. When coal reserve of commercial quantity is proved, cost is amortized over proved reserves using the unit-of-production method.

PAFC’s research cost are charged to expense, while development costs are capitalized only after technical and commercial feasibility of the asset for sale or use have been established. This means that the Corporation intends to complete the intangible asset and either uses it or sells it and be able to demonstrate how the asset will generate future economic benefits.

If the Corporation cannot distinguish the research phase of an internal project to create an intangible asset from the development phase, the entity treats the expenditure for that project as if it were incurred in the research phase only.

m) Impairment of Assets

The carrying values of long-lived assets are reviewed for impairment when events or changes in circumstances indicate that the carrying values may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amounts, the assets or cash-generating units are written down to their recoverable amounts. Recoverable amount is the greater of net selling price and value in use. The net selling price is the amount obtainable from the sale of an asset at arm's-length transaction. In assessing value in use, the estimated future cash flows are discounted to their present value using pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the asset. For an asset that does not generate independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in statements of income. If at balance sheet date there is an indication that an impairment loss may be decreased, reversal of an impairment loss is recognized as income in the income statement. The increased carrying amount due to reversal should not be more than what the depreciated historical cost would have been if the impairment had not been recognized.

n) Investment in Joint Ventures

A joint venture is a contractual arrangement whereby the group and other parties undertake an economic activity that is subject to joint control.

Where a group of companies undertakes its activities under the joint venture arrangements directly, the group's share of jointly-controlled assets and any liabilities incurred jointly with other ventures are recognized in the financial statements of the ventures and classified according to their nature.

Liabilities and expenses incurred directly in respect of interests in jointly-controlled assets are accounted for on an accrual basis. Income from the sale or use of the group's share of the output of jointly-controlled assets, and its share of joint venture expenses, are recognized when it is probable that the economic benefits associated with the transactions will flow to/from the group and their amount can be measured reliably.

PNOC EC reports its 10% interest in SC 38 using joint venture proportionate consolidation. The Company's share of the assets, liabilities, income and expenses are combined with the equivalent items in the Company's financial statements on a line-by-line basis.

Investments in joint venture include accumulated intangible costs directly attributable to exploration and development activities, such as the expenses incurred to acquire the legal right to explore, and the costs of exploratory drilling and testing. In accordance with the successful-efforts method of accounting, non-drilling costs and other pre-operating expenses such as corporate overhead, except those expenses which are directly related to exploratory drilling activities, are expensed as incurred.

o) Assets Held for Sale

Assets classified as held for sale if their carrying amounts will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale that should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Assets classified as held for sale are measured at the lower of the carrying amount and the fair value less costs to sell.

p) Trade and Other Payables

Trade payables are liabilities mainly to suppliers/contractors and to government agencies accrued as of year-end and are stated at nominal values.

q) Leases

Operating Leases

The Company as a Lessor

Leases where the Company retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset recognized over the lease terms on the same bases as rental income. Operating lease payments are recognized as income in the consolidated statement of income on a straight-line basis over the lease term.

The Company as a Lessee

Leases where the lessor retains substantially all the risks and benefits of ownership of the assets are classified as operating leases. Operating lease payments are recognized as expense in the consolidated statement of income on a straight-line basis over the lease term. Associated costs, such as maintenance and insurance, are expensed as incurred.

Finance Lease

The Company as a Lessor

Leases wherein the Company substantially transfers to the lessee all risks and benefits incidental to ownership of the leased item are classified as finance leases and are presented as receivable at an amount equal to the Company's net investment in the lease. Finance income is recognized based on the pattern reflecting a constant periodic rate of return on the Company's net investment outstanding in respect of the finance lease.

The Company as a Lessee

Assets held under finance leases are recognized as assets of the Company at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income, unless they are directly attributable to qualifying assets, in which case they are capitalized in accordance with the Company's general policy on borrowing costs.

r) <u>Borrowing Costs</u>

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets are added to the cost of the assets, until such time that the assets are substantially ready for their intended use or sale which necessarily takes a substantial period of time. Income earned on the temporary investment of specific borrowings, pending their expenditure on qualifying assets, is deducted from the borrowing costs eligible for capitalization.

All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

s) <u>Foreign Currency Transactions</u>

The Company converts into local currency its foreign currency-denominated transactions using, whenever appropriately applicable, the average and actual foreign exchange rate prevailing during the month and date of transaction, respectively. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated using the closing exchange rate at balance sheet date. Non-monetary assets and liabilities are translated at historical exchange rates. Foreign exchange gains and losses arising on foreign currency fluctuations are recognized in profit or loss for the period.

t) <u>Retirement Benefit Plan</u>

A defined benefit plan is a retirement plan that defines an amount of retirement benefit that an employee of PNOC Subsidiaries will receive on retirement, usually dependent on one or more factors such as age, years of service and salary. The determination of the Company's obligation and cost of retirement and other retirement benefits is dependent on the selection of certain assumption used by actuaries in calculating such amounts. In accordance with IAS, actual results that differ from the assumptions area accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods. The retirement plan is tax exempt, funded, non-contributory and administered by a trustee.

u) <u>Income Taxes</u>

Tax expense recognized in the consolidated statement of income comprises the sum of current tax and deferred tax not recognized in other comprehensive income or directly in equity. Changes in deferred tax assets or liabilities are recognized as a component of tax income or expense in consolidated statement of income.

The tax currently payable is based on the taxable profit for the year. Taxable profit differs from net profit as reported in the statement of comprehensive income because of items of income or expenses that are taxable or deductible in other years and items that are neither taxable or deductible. The Company's liability for current tax is calculated using the tax rates and tax laws applicable to the periods to which it relates.

Deferred income tax is accounted for using the balance sheet liability method on all temporary differences at the end of the reporting period between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to: (a) temporary differences between the financial reporting bases of assets and liabilities and their related tax bases; (b) net operating loss carryover, or NOLCO; and (c) the carry-forward benefit of the excess of the minimum corporate income tax, or MCIT, over the regular corporate income tax. Deferred tax assets and liabilities are measured using the tax rates applicable in the years in which those temporary differences are expected to be recovered or settled and NOLCO are expected to be applied provided such tax rates have been enacted or substantially enacted at the end of the reporting period.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority on either the taxable entity or different taxable entities where there is an intention to settle the balances on a net basis.

Current and deferred taxes are recognized as an expense or income in profit or loss, except to the extent that it relates to items recognized in other comprehensive income or directly in equity. In this case, the tax is also recognized in other comprehensive income or directly in equity, respectively.

v) <u>Contingencies</u>

Contingent liabilities are not recognized in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefit is remote. Contingent assets are not recognized in the financial statements but disclosed when an inflow of economic benefits is probable.

w) <u>Subsequent Events</u>

Post-year-end events that provide further evidence of existing conditions affecting Company's financial position at the balance sheet date (adjusting events) are reflected in the financial statements. Post-year-end events that are indicative of conditions that arose subsequent to balance sheet date are disclosed in the notes to the financial statements when material.

x) <u>Use of Estimates</u>

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make judgments, estimates and assumption that affect the amounts reported in the financial statements and accompanying notes. The estimates and assumptions used in the accompanying financial statements are based upon management's evaluation of relevant facts and circumstances as of the date of the financial statements. Actual results could differ from such estimates.

y) <u>Earnings per share</u>

Earnings per share is computed based on the net income for the year divided by the weighted average number of outstanding shares during the year. There are no dilutive potential common shares outstanding that would require disclosure of diluted earnings per share in the income statement.

5. CASH AND CASH EQUIVALENTS

This account consists of:

	2009	2008
Cash in bank	**65,057,980**	781,973,913
Petty cash	**2,097,297**	7,874,315
Cash equivalents	**5,404,104,578**	8,592,961,271
	5,471,259,855	9,382,809,499

Cash in banks earn interest at the respective bank deposit rates. Cash Equivalents consist of money market placements that are made for varying periods of up to three months depending on the immediate cash requirements of the Company and earned interest at the respective money market placement rates.

6. SHORT-TERM INVESTMENTS

This consists mainly of money market placements in the form of Government Securities and Savings Deposits with more than three months maturity but less than one year.

7. TRADE AND OTHER RECEIVABLES

This account consists of:

	2009	2008
Trade receivables	**1,650,086,443**	1,432,631,518
Others	**1,455,532,444**	1,885,840,068
	3,105,618,887	3,318,471,586
Allowance for doubtful accounts	**(272,943,886)**	(250,574,584)
	2,832,675,001	3,067,897,002

Trade receivables pertain mainly to PNOC EC's receivables on Coal project which consist of coal sales and integrated services (P737.61 million). It also includes PNOC EC's 10% in the SC 38 Consortium's receivables on gas and condensate sales (P422.57 million), receivables from Energy Supply Base (P37.25 million) which refers to rentals, pier services, supply of fuel as well as other fees for the usage of EC's facilities and equipments by customers from the energy and commercial sectors, PSTC's receivables from hauling or transporting of refined petroleum products to local oil companies (P30.17 million) and PDMC's mortgage contract receivables (P71.64 million).

Other receivables consist mainly of current portion of long-term loan receivables from EDC (P1,004.70 million), claims from the various government agencies, employees, contractors/suppliers, banks for interests on placements and investments, and insurance firms.

8. INVENTORIES

This account consists of the following inventories:

	2009	2008
Land	**760,633,500**	761,058,693
Coal	**426,924,607**	196,392,045
Parts and supplies	**92,757,667**	85,774,741
Solar panels	**20,156,791**	23,541,880
Condensate	**32,185,202**	14,484,210
	1,332,657,767	1,081,251,569
Allowance for obsolescence	**(4,801,347)**	(4,801,347)
	1,327,856,420	1,076,450,222

Land inventory consists of the balance of PDMC's saleable properties in Rosario, Cavite, comprising of about 24,029 square meters for socialized housing and 41,776 square meters for Costa Verde Subdivision. It also includes PPDC's saleable land in Bataan.

Coal inventory represents PNOC EC's undelivered stock to various Coal Terminals with a total volume of 95,143.485 metric tons.

Parts and supplies inventories consist mainly of PNOC EC's 10% share in the inventory of SC 38 Consortium (P61.55 million) while the condensate inventory pertains to Company's 10% in the undelivered stock of SC 38 Malampaya Project stored in its offshore Concrete Gravity Structure in offshore Palawan with a volume of 10,418.74 bbls.

9. PREPAID EXPENSES AND OTHER CURRENT ASSETS

This account consists of the following:

	2009	2008
Prepaid expenses	**246,715,720**	368,585,134
Special deposits	**44,790,732**	765,898,001
Other prepaid and deferred charges	**784,211,560**	366,869,648
	1,075,718,012	1,501,352,783

Prepaid expenses pertains mainly to PNOC EC's prepaid income tax representing the Company's share in the tax component of the unearned revenue on the undelivered gas of the "take or pay" deficiency per Gas Sales and Purchase Agreement (GSPA) with customers of the Camago Malampaya Project.

Special deposits account consists mainly of cash of dissolved subsidiaries reserved against future claims.

Other prepaid and deferred charges include taxes withheld by customers, current portion of dry-docking costs and other prepaid expenses.

10. ASSETS HELD FOR SALE

This account includes the following:

	2009	2008
Property, Plant & Equipment	**490,467,400**	487,796,434
Surplus property available for sale	**16,717,857**	17,215,088
	507,185,257	505,011,522

The property, plant and equipment consist mainly of the Parent Company's real estate properties that are made available for sale and for disposal as of year-end. These properties are not suitable for the Parent Company's long-term energy projects and other viable energy-allied industrial and commercial undertakings and are located within residential and agricultural areas with minimal potential to attract prospective lessees / joint venture partners.

11. LONG-TERM RECEIVABLES

This account consists of receivables from the following:

	2009	2008
Energy Development Corporation	**3,227,990,900**	4,491,801,269
Socialized housing	**106,501,161**	115,866,442
First Gas Power Corporation	**10,086,298**	62,015,524
Costa Verde Subdivision	**33,189,887**	26,926,347
Natural Resources Development Corp.	**37,252,936**	37,252,936
FGP Corporation	**7,325,257**	17,684,480
National Power Corporation	**15,622,041**	16,035,937
	3,437,968,480	4,767,582,935

The receivables from Energy Development Corporation represent the Parent Company's pass through loans granted out of the proceeds of its long-term loans from International Bank for Reconstruction and Development and Overseas Economic Cooperation Fund.

PDMC's mortgage receivables from contractors generated by the socialized housing and mixed residential and commercial housing projects in Rosario, Cavite, shall be collected within long periods ranging from two (2) to twenty-five (25) years.

The receivables from First Gas Power Corporation, FGP Corporation and National Power Corporation represent PNOC EC's 10% share in receivables including interests for the "take or pay" deficiency or the undelivered gas of the Malampaya Project.

The receivable from Natural Resources Development Corp. (NRDC) represents the P30 million principal loan and accrued interests of P5,436,804.82 from March 12, 2004 to April 23, 2007 transferred by then PNOC Energy Development Corporation (EDC) as per Deed of Assignment of Interests and Rights executed by an between PNOC EDC and PNOC on April 23, 2007. PNOC recorded additional accrued interests of P1,816,131.63 from April 24, 2007 up to February 29, 2008.

12. INVESTMENT IN AVAILABLE-FOR-SALE SECURITIES

This account pertains to the investments in treasury bonds that will mature after one year up to five years. These investments bear fixed interest rates ranging from 3.9% to 11.0% for peso denominated and 5.85% to 6.45% for dollar denominated.

13. INVESTMENTS

This account consists of investments in the following:

	2009	2008
National Development Corporation-7% Preferred shares	**369,151,000**	369,151,000
Investment in Joint Ventures	**130,851,942**	131,458,843
Goodyear Philippines	**96,453,350**	96,453,350
Gulf Oil Philippines, Inc.	**54,978,000**	54,978,000
Others	**128,998,146**	130,268,582
	780,432,438	782,309,775

The investment in National Development Company (NDC) refers to the 7% preferred shares issued to PNOC in payment of its account under an agreement dated May 31, 1984. The shares are redeemable in equal amounts commencing January 1, 2001, and every year thereafter for a period of five years. On January 24, 2006, NDC informed PNOC that they are looking into options to address the redemption of a possible land swap in exchange for the preferred shares and will submit a proposal for PNOC's consideration. On April 19, 2006 and November 28, 2006, PNOC requested for an updated list of NDC's and/or its subsidiaries' real estate properties which may be considered for possible land swap. On August 1, 2007, NDC sent a list of 10 properties located in various areas in Luzon, which are mostly idle lots and on August 28, 2007, NDC offered, instead of land swap, the 65 has. portion of its property in Isabel, Leyte, where the Leyte Industrial Development Estate (LIDE) is located. Based on the ocular inspection of LIDE site made by PNOC on September 19-21, 2007, PNOC did not accept the LIDE site as it will entail substantial amount to develop the area into an industrial site. On January 25, 2008, NDC sent a new list of their landholdings, buildings and shares for the proposed land swap. PNOC conducted evaluation on which properties may be considered for the redemption of the preferred shares.

Investment in joint ventures consists of oil, gas and coal exploration projects in partnership with other oil companies, namely: Coal Mine Development (Lalat & ILB Areas), 10% share in investment of SC 38 Consortium and Ragay Gulf. In compliance with successful efforts method of accounting for oil and gas projects, P96.07 million drilling expenses were capitalized.

Other investments include PNOC's investment in Talisay Bioenergy, Inc. (TBI). The Company signed a Memorandum of Agreement (MOA) with TBI and Bronzeoak Philippines (BP) for the development, construction and operation of a 30 mega-watt Bagasse-Fired Cogeneration Power Plant in Talisay, Negros Occidental on April 23, 2004. The project will supply energy to the First Farmers Holdings Corporation (FFHC) sugar mill and refinery under an Energy Supply Agreement and to the Central Negros Electric Cooperative (CENECO) under a Power Supply Agreement. The Development Agreement provides that the Company shall have an equity share of 30% of the total shares or 15,000 shares at US$400 per share for a total of US$6.0 million. However, in its letter of June 12, 2007, TBI withdrew the offer to pursue the project because the Energy Supply Agreement was not finalized and the Power Supply Agreement was cancelled leaving the financial closing unrealized. A due diligence report disclosed that PNOC's investment may no longer be recovered since communication with TBI could no longer be established by the Company. Therefore, the Company recognized a 100% impairment loss on its investment amounting to P57,685,382.

14. PROPERTY, PLANT & EQUIPMENT

The details of this account are as follows:

	Land, Leases & Improvements	Buildings and Improvements	Wells, Platforms and other Facilities	Plant Facilities	Pier Facilities	Tankers	Machinery and Equipment	Transportation Equipment	Furniture, Fixtures & Equipment	Construction in Progress	Others	Total
COST												
January 1, 2009	1,262,134,872	303,784,912	11,553,276,584	310,643,315	200,580,156	1,323,471,936	144,681,332	68,295,820	198,725,053	11,909,273	40,893,744	15,418,396,997
Additions	254,074,598	12,515,830	164,609,648	6,155,921		1,613,542	10,556,360	16,921,354	20,271,236	(1,122,515)	5,154	485,601,128
Adjustments	(1,092,189)			(1,055,558)	(132,213)		(6,946,157)	(1,996,202)	(19,158,524)	1,775,860	(597,169)	(29,202,152)
Disposals				(354,504)	(180,166)		(1,484,181)	(2,108,454)	(5,593,325)			(9,720,630)
December 31, 2009	**1,515,117,281**	**316,300,742**	**11,717,886,232**	**315,389,174**	**200,267,777**	**1,325,085,478**	**146,807,354**	**81,112,518**	**194,244,440**	**12,562,618**	**40,301,729**	**15,865,075,343**
ACCUMULATED DEPRECIATION												
January 1, 2009	(3,138,308)	(134,331,375)	(3,025,375,110)	(222,641,974)	(160,020,256)	(181,491,369)	(114,250,857)	(44,658,929)	(107,027,421)		(9,049,536)	(4,001,985,135)
Provision	(86,153)	(17,080,241)	(556,575,627)	(14,936,996)	(13,016,408)	(67,411,314)	(3,010,110)	(7,387,668)	(26,453,765)		(2,519,401)	(708,477,683)
Adjustments	1,084,780	2,426,554		1,055,558	132,312			2,002,111	17,173,065		593,369	24,467,749
Disposals				362,456	9,618,915			2,108,452	280,758			12,370,581
December 31, 2009	**(2,139,681)**	**(148,985,062)**	**(3,581,950,737)**	**(236,160,956)**	**(163,285,437)**	**(248,902,683)**	**(117,260,967)**	**(47,936,034)**	**(116,027,363)**	**-**	**(10,975,568)**	**(4,673,624,488)**
NET CARRYING AMOUNT												
December 31, 2009	**1,512,977,600**	**167,315,680**	**8,135,935,495**	**79,228,218**	**36,982,340**	**1,076,182,795**	**29,546,387**	**33,176,484**	**78,217,077**	**12,562,618**	**29,326,161**	**11,191,450,855**

	Land, Leases & Improvements	Buildings and Improvements	Wells, Platforms and other Facilities	Plant Facilities	Pier Facilities	Tankers	Machinery and Equipment	Transportation Equipment	Furniture, Fixtures & Equipment	Construction in Progress	Others	Total
COST												
January 1, 2008	993,820,883	300,327,444	11,492,137,462	300,378,650	200,580,156	543,413,839	128,805,166	52,913,484	148,263,679	76,280,220	39,722,717	14,276,643,700
Additions		1,084,984	61,139,122	11,980,612		780,058,097	25,456,834	17,355,700	56,488,290	(40,622,469)		912,941,170
Adjustments	268,313,989	2,372,484		(1,586,252)				(11,364)	910,449	(23,748,478)	1,339,286	247,590,114
Disposals				(129,695)			(9,580,668)	(1,962,000)	(6,937,365)		(168,259)	(18,777,987)
December 31, 2008	**1,262,134,872**	**303,784,912**	**11,553,276,584**	**310,643,315**	**200,580,156**	**1,323,471,936**	**144,681,332**	**68,295,820**	**198,725,053**	**11,909,273**	**40,893,744**	**15,418,396,997**
ACCUMULATED DEPRECIATION												
January 1, 2008	(2,953,347)	(123,421,829)	(2,471,328,275)	(207,976,176)	(146,522,973)	(122,921,227)	(110,689,981)	(38,629,621)	(89,444,988)		(7,020,239)	(3,320,908,656)
Provision	(184,961)	(11,208,191)	(554,046,835)	(14,795,491)	(13,497,283)	(58,570,142)	(3,560,876)	(7,604,570)	(23,790,569)		(2,215,216)	(689,474,134)
Reclassifications		298,645						11,264	331,808		18,760	660,477
Disposals				129,693				1,563,998	5,876,328		167,159	7,737,178
December 31, 2008	**(3,138,308)**	**(134,331,375)**	**(3,025,375,110)**	**(222,641,974)**	**(160,020,256)**	**(181,491,369)**	**(114,250,857)**	**(44,658,929)**	**(107,027,421)**	**-**	**(9,049,536)**	**(4,001,985,135)**
NET CARRYING AMOUNT												
December 31, 2008	**1,258,996,564**	**169,453,537**	**8,527,901,474**	**88,001,341**	**40,559,900**	**1,141,980,567**	**30,430,475**	**23,636,891**	**91,697,632**	**11,909,273**	**31,844,208**	**11,416,411,862**

15. INVESTMENT PROPERTY

This account includes the Parent Company's land leased out mainly to Petron Corporation where its refinery and other facilities are located. A long-term lease agreement was executed between the Parent Company and Petron for continued use of these properties for a period of 25 years from September 1, 1993 to August 31, 2018, subject to renewal. It also includes the land and building of Energy Development Corporation which was purchased under the Deed of Absolute Sale dated May 29, 2009.

Included also is PAFC's land totaling approximately 910,935 square meters and is presently leased to Orica Explosives Philippines, Inc. for a period of five (5) years from March 1, 2004 to February 28, 2009, excluding a one-year clear-up period from March 1, 2009 to February 28, 2010.

This account include also PDMC's parcel of land leased out mainly to Philippine Export Processing Zone Authority (PEZA) situated in Site 2A Rosario, Cavite with a total land area of 49,951 square meters and covered by TCT No. 288199. It has a historical cost of P99,902 and was appraised by Valencia Appraisal Corporation on May 2005 for P27,972,560. However, in June 2007 the subject lot was appraised by eValue Philippines Inc in the amount of P174,829,000. Updating of the appraisal value is scheduled for CY 2010.

16. EXPLORATORY AND DEVELOPMENT COSTS

The deferred exploration and development costs pertain to the following:

	2009	2008
Cauayan Coal Project	**97,819,520**	97,819,519
Natural Gas Study	**60,722,257**	60,722,258
BATMAN Natural Gas Study Project	**64,998,077**	59,904,066
ILB Deferred Development Cost	**18,648,253**	-
Isabela Coal Mine Mouth Power Plant	**50,769,173**	41,469,503
Indonesia Coal Project	**52,958,407**	26,068,297
Jatropha Methyl Ester	**44,749,193**	43,709,715
Surigao COC Application Project	**22,851,200**	19,776,322
Lumbog Coal Project	**40,888,792**	9,961,482
Isabela Coal Exploration Project	**15,924,724**	11,799,605
Malampaya Oil Rim Exploration	**10,114,403**	10,114,403
Malongan & Alegria Coal Project	**13,365,721**	2,635,798
Coal Exploration Project- COC 41 Other Areas	**7,710,081**	4,439,269
Siay Coal Project	**3,733,717**	1,737,033
Natural Gas Vehicle Program	**1,320,035**	1,320,035
Central Cebu Coal Project	**312,750**	-
Camago Malampaya Oil Leg	**122,807**	122,807
DOST-PCIERD	**87,654**	87,654
	507,096,764	391,687,766

17. DEFERRED CHARGES AND OTHER ASSETS

This account includes the following:

	2009	2008
Banked gas	**14,400,000,000**	-
Purchase price adjustment	**809,757,306**	809,757,306
Jatropha plantations	**147,703,344**	178,989,042
Long-term receivables	**123,603,456**	90,775,779
Special deposits and funds	**13,186,375**	12,655,494
Cash - restricted	**26,101,552**	21,101,552
Deposit for sinking fund	**-**	78,614,651
Collateral for bonds issued	**-**	46,967,647
Others	**180,129,256**	165,927,451
	15,700,481,289	1,404,788,922
Allowance for doubtful accounts	**(84,413,120)**	(84,413,121)
	15,616,068,169	1,320,375,801

The banked gas was bought by PNOC from the Department of Energy amounting to P14.4 billion, equivalent to 108.6 Petajoules. The gas has been paid for but not yet taken by the Ilijan power plant of the National Power Corporation (NPC). The NPC and PSALM entered into a Gas Sale and Purchase Agreement (GSPA) with SC 38 Consortium, whereby NPC is committed to take a minimum volume of gas every year or take-or-pay commitment. Any unconsumed gas, but has been paid for, goes to the banked gas. Under certain conditions in the GSPA, NPC can recover this banked gas in succeeding years within the term of the GSPA.

The Purchase Price Adjustment (PPA) fund is a trust fund under the Stock Purchase Agreement executed by and between the Parent Company, Saudi Arabian Oil Company and ARAMCO Overseas Company (AOC). This amount is to be held in trust approximately until 2014 to be used when and if necessary, to satisfy indemnity payment obligations of the Parent Company to Saudi Aramco and AOC arising out of representations and warranties of the Parent Company under the Stock Purchase Agreement.

Jatropha plantations pertain to the market value of the nurseries managed by the PNOC-AFC currently existing in different sites all over the country. It started with two nurseries in 2007, namely, Fort Magsaysay and Cagayan de Oro. These nurseries are evaluated/assessed every balance sheet date by independent parties in accordance with existing standards and procedures. Re-measurement of these assets is done every year to determine the gain or loss arising from changes in valuation. Between May and June 2009, agreements with cooperatives and local government units were entered. Some of the Company's developed plantations were done with the participation of some local government units and their endorsed farmer-cooperative. The Company recognized loss arising from revaluation of jatropha plantation amounting to 31,285,698 and P10,095,578 for 2009 and 2008, respectively.

Long-term receivables comprised mainly of long overdue trade accounts from various government agencies and private institution that have been outstanding for more than two years.

Cash–restricted pertains to the balance of PNOC EC's trust fund placed in savings deposit with the Land Bank of the Philippines which is intended to cover indemnity benefits of directors and officers who are involved in any action or suit filed against the Company.

Other deferred charges includes PSTC's major repair costs of M/T PNOC Emilio Jacinto amounting to P34.936 million on the Company's claim of various expenses , including lost income, from the Seller, the Manufacturer of the main engine or from the Shipbuilder, through an appropriate action filed before a competent tribunal. However, PSTC has yet to file an arbitration case in Singapore, the outcome of which will determine its proper classification to Claims Receivable account. It also includes the amount of P35.723 million representing claims for damages of other two tankers, M/T Dr. Jose P. Rizal and M/T PNOC Lapu-lapu pending the determination of the final amount of compensation for the amount of dam.

18. TRADE AND OTHER PAYABLES

This account consists of the following:

	2009	2008
Accounts Payable and accrued expenses	**625,893,296**	534,309,911
Accrued interest	**181,696,853**	224,565,881
Other current liabilities	**224,420,745**	190,987,410
	1,032,010,894	949,863,202

19. OTHER CREDITS

This account consists mainly of PNOC EC's unearned revenue for the net entitlements from the undelivered gas of the "take-or-pay" transactions of the SC 38 Malampaya Project where customers are obliged to pay the contracted volume or quantity even if there is no delivery or consumption of the produced gas during the period.

Outstanding balances of these foreign obligations were restated into Philippine pesos based on the prevailing foreign exchange rates at December 31, 2009 (USD1=JPY91.63: USD1=PHP46.425).

A substantial portion of these obligations are guaranteed by the Philippine Government in consideration for surety given to creditor banks, the Philippine Government, through DOF Order No. 35-89 dated September 1, 1989 and DOF Memorandum Circular dated March 1, 1991, directed government-owned and controlled corporations to pay to the Bureau of Treasury a guarantee fee of 1% per annum on the outstanding balances of guaranteed borrowings.

20. LONG-TERM LOANS

Long-term loans are summarized as follows:

Creditor/Project Name		Maturities	Interest Rate	2009	2008
International Bank for Reconstruction and Development					
3164 PH Energy Sector Project					
- US$150.0 million	PNOC and PNOC EDC	1995 to 2010	1/2 of 1% over cost of qualified borrowings	**403,072,339**	1,199,064,514
3702 PH Geothermal Exploration Project					
- US$64.0 million	PNOC EDC	1999 to 2013	1/2 of 1% over cost of qualified borrowings	**1,017,070,838**	1,264,677,574
3747 PH Geothermal Exploration Project					
- US$114.0 million	PNOC EDC	1999 to 2014	1/2 of 1% over cost of qualified borrowings	**1,194,827,310**	1,454,037,708
- JPY 12.4 billion		1999 to 2014		**932,427,746**	1,181,013,344
Overseas Economic Cooperation Fund (OECF)					
15th Yen Palinpinon II Geothermal Power Project					
- JPY 4.0 billion	PNOC EDC	1999 to 2019	5.7 %	**747,014,545**	853,968,574
Landbank of the Philippines					
- PHP 1.5 billion	PSTC	2005 to 2013		**166,143,214**	210,448,071
TOTAL				**4,460,555,992**	6,163,209,785
Less: Current portion				**1,103,229,930**	1,426,798,246
				3,357,326,062	4,736,411,539

21. OTHER LONG-TERM LIABILITIES

This account consists of the following:

	2009	2008
Liability for future abandonment costs	**70,848,211**	64,020,654
Others	**90,044,789**	77,422,306
	160,893,000	141,442,960

The liability for future abandonment costs pertains to the accumulated amount out of the estimated US$3.00 million PNOC EC's share in the future abandonment costs of SC 38 Malampaya Project. Using the accrued liability method in accounting for this transaction, the liability for future abandonment costs expensed amounted to P6.83 million in 2009 and P6.35 million in 2008.

Other long-term liabilities comprised mainly of PNOC EC's retirement liability (P72.7 million) covering all regular employees which provides a retirement benefit. This account include also PNOC EC's liability (P12.32 million) for the security deposit for the second sub-phase acquisition of 3D seismic data for SC 58 West Calamian Project and PAFC's liability (P4.97 million) for the retention money deducted from billings of contractors for projects that remained outstanding for four to eight years.

22. CAPITAL STOCK

The Parent Company's authorized capital stock is divided into ten million no par value shares of which two million shares were initially subscribed and paid for by the Philippine Government at 50 per share. The remaining shares may be subscribed and paid for by the Republic of the Philippines or by government financial institutions at no less than P50 a share. From 1975 to 1988, an additional 6,029,191 shares were subscribed by the Republic of the Philippines at P500 per share.

23. DONATED CAPITAL

The Kremco 750 Drilling Rig and the Drilling Rig Simulator were donated to PNOC EC by Petro Canada under the Program Management Agreement between PNOC EC, Petro Canada and Office of Energy Affairs (OEA) in 1992. The equipments were received by PNOC EC in 1993 and were turned over to PNOC Energy Development Corporation (PNOC EDC) and were utilized for PNOC EDC's geothermal drilling operations and training of personnel, respectively.

The assets were returned to PNOC EC in 1998 as a result of the separation of PNOC EC from PNOC EDC Management. The Drilling Rig was eventually used by the Company for the drilling operations in Mindanao in 1999. It is being leased by Energy Development Corporation (EDC) for their drilling project in Lihir Island, Papua New Guinea under a Lease Agreement ending March 31, 2009.

In 2005, the Drilling Rig Simulator, together with its housing facilities, was transferred back to PNOC EDC through a Deed of Donation between the two companies. The adjustment in the total amount of P6,412,484 was effected in 2007.

24. REVALUATION SURPLUS

This account consists mainly of the appraisal of PRC's real estate properties located at Bauan Batangas with a total area of 166,416 square meters with total appraised value of P277,529,750. The appraisal was conducted by Cal Fil Appraisal on September 2, 2008 and January 21, 2005.

It includes also the appraisal value of 118,176 square meters of PDMC's land area located in Rosario, Noveleta and Gen. Trias, Cavite amounting to P217,107,580 of which P174,829,000 was carried as Investment Property in the Company's books of accounts. The appraisal was conducted by eValue Phils. Inc in June 2007.

25. RETAINED EARNINGS

As of December 31, 2009, a total of P6.5 billion was appropriated for investment projects and capital requirements of PNOC EC (P6.2 billion), PDMC (P168 million) and PSTC (P150 million).

The Board of Directors of PNOC EC approved on December 17, 2009 the appropriation of P6.2 billion retained earnings as of December 31, 2009 to meet the company's cash requirements for capital expenditures and exploration projects in the next three (3) years.

The appropriation of P168 million for PDMC was approved under Board Resolution No. 02, S'2008 dated March 28, 2008 for purposes of funding the following projects: Business Processing Outsourcing (BPO) Center in site B, Housing Project (Row-Houses) in site 1D, Model Houses for Costa Verde Project and Medium Rise Building (MRB) in Site 2F.

For PSTC, the initial appropriation of P88 million was approved under Board Resolution No. 11, series of 2006 dated April 25, 2006. The P50 million is intended for the anticipated conversion of the vessels M/T Gen. Antonio Luna and M/T Dr. Jose P. Rizal into double hull (requirement from International Maritime Organization) and the other P38 million as equity participation on future vessel acquisitions. In 2007, the Board of Directors approved Resolution No. 8, series of 2008 dated April 15, 2008, increasing the appropriation of Retained Earnings from P88 million to P150 million. The additional appropriation of P62 million is intended solely for equity participation on future double hull tankers and acquisition of Landing Craft Tankers (LCT).

Pursuant to Republic Act No 7656, PNOC declared a total cash dividend of P464,819,562 to the National Government out of the Company's 2009 net earnings while a total of P1,502,531,459 cash dividend was declared and remitted directly to the Bureau of Treasury by PNOC EC (P1.5 billion) and PSTC (P2.5 million).

PNOC remitted to the Bureau of Treasury (BTr) the amount of P324,852,416 and P1,092,183,067 on April 30, 2009 and September 30, 2009, respectively, as cash dividend for its 2008 net earnings. In addition, a total of P217,625,819 was remitted directly to the BTr by the following subsidiaries: PNOC EC (P99,789,496), PDMC (P99,558,900) and PSTC (18,277,422).

As of December 31, 2009, PDMC has an outstanding dividend payable of P3,310,759 for the unclaimed dividends issued to various individual stockholders.

26. NET SALES

This account consists of the following:

	2009	2008
Oil and gas production	**4,650,999,377**	5,795,745,133
Coal operations	**1,944,606,217**	2,531,198,062
Shipping	**441,569,068**	347,913,420
Energy supply base	**89,367,951**	320,441,577
Socialized housing	**70,344,128**	44,315,452
Lease income	**23,490,817**	19,630,097
Water	**23,999,859**	17,927,537
Thruput	**19,651,516**	12,714,489
Solar Home Systems	**13,896,268**	-
Right of way	**7,729,102**	3,536,922
Others	**2,003**	601,103
	7,285,656,306	9,094,023,792

Revenues from Oil and Gas Production pertains to PNOC EC's 10% participating interest in Service Contract 38 (SC38) called the Malampaya Project which is involved in the exploration and development of the contract area in offshore Northwest Palawan, Philippines. The Project supplies fuel to three power plants in Batangas, the Ilijan, Sta. Rita and San Lorenzo plants, and one gas plant in Tabangao. The Malampaya Project also produced condensate, which is shipped to buyers in Singapore, Thailand and China. For 2009, the Malampaya Project produced total natural gas of 133.33 billion cubic feet (BCF) and 132.01 BCF gas offtake in 2008. Total condensate production, on the other hand registered at 5.47 million barrels in 2009 and 5.57 million barrels in 2008.

Coal operations came from PNOC EC's own mining operations from one of its coal operating contract (COC), known as the Zamboanga Sibugay Project or COC-41, within the Malangas Coal Reservation, and its engagement in coal trading activities. It operates three coal terminals where coal shipments, sourced from third parties, are stored before delivery to customers. For the year 2009, total coal sales were 612.93 thousand metric tons (MT) while in 2008, sales volume was at 869.98 thousand MT.

27. COST OF SALES

This account consists of the following:

	2009	2008
Coal purchases and landed costs	**1,648,687,672**	1,966,334,863
Oil and gas production costs	**1,165,129,616**	666,413,158
Depreciation and amortization charges	**649,676,364**	640,799,655
Employee costs	**99,444,464**	81,151,458
Purchased services and utilities	**76,056,143**	51,368,870
Fuel, oil, and TBA	**64,418,048**	293,933,106
Coal marketing and selling	**52,682,443**	142,093,890
Rental, insurance and taxes	**36,416,771**	31,748,436
Maintenance and repairs	**31,971,668**	45,162,616
Materials and supplies	**10,807,626**	10,846,127
Solar Home Systems	**10,625,332**	-
Business and other expenses	**6,630,338**	4,896,281
Shipping and delivery	**4,360,956**	7,874,431
Taxes and licenses	**3,061,378**	5,853,634
Land and development costs	**434,831**	1,011,638
Miscellaneous expenses	**35,660**	68,155
	3,860,439,310	3,949,556,318

28. GENERAL AND ADMINISTRATIVE EXPENSES

This account consists of the following:

	2009	2008
Employee costs	**352,073,294**	299,693,215
Purchased services and utilities	**288,874,484**	261,001,343
Business expenses	**106,939,831**	116,614,212
Rental/insurance/taxes	**100,724,185**	76,058,611
Depreciation/amortization	**62,837,327**	42,627,765
Materials and supplies	**38,094,734**	32,583,740
Maintenance and repairs	**24,004,157**	16,521,416
Provision for doubtful accounts	**-**	1,270,562
Others	**62,125,609**	4,089,719
	1,035,673,621	850,460,583

29. OTHER INCOME (CHARGES)

This account consists of the following:

	2009	2008
Interest income - net of final tax	**1,181,852,111**	1,209,466,510
Gain on revaluation of investment property	**264,171,440**	-
Lease income	**180,676,967**	179,697,790
Gain on disposal of assets	**57,838,988**	34,539,948
Guarantee fee on coal contracts	**25,831,509**	12,662,652
Dividend income	**872,852**	375,801,030
Foreign exchange gain/(loss)	**(154,220,660)**	83,532,727
Interest expense	**(104,591,780)**	(144,065,924)
Jatropha expenses	**(66,390,390)**	-
Loss on revaluation of jatropha plantations	**(31,285,698)**	-
Gain on sale of 40% Petron share	**-**	20,912,223,854
Impairment loss	**-**	(57,685,382)
Other income (charges)	**36,455,265**	51,414,898
	1,391,210,604	22,657,588,103

30. INCOME TAX

Components of income tax expense are as follows:

	2009	2008
Current tax	**954,916,937**	1,713,671,440
Deferred tax	**34,954,302**	414,020,682
	989,871,239	2,127,692,122

The current tax pertains mainly to PNOC EC (P945.5 million) while the deferred tax is comprised of P106 million for PAFC, reduced mainly by PNOC EC's deferred tax benefit of P50.72 million.

31. DEFERRED TAX

The analysis of deferred income tax for financial reporting purposes follows:

	2009	2008
Deferred tax assets:		
Tax effect on temporary differences	**427,129,744**	354,946,978
Carry forward of unused tax credits	**248,239,032**	210,265,891
Minimum corporate income tax (MCIT)	**53,415,962**	46,220,243
Total deferred tax assets	**728,784,738**	611,433,112
Deferred tax liability:		
Revaluation surplus	**3,309,550,352**	3,104,171,988
Prepaid Insurance	**1,318,428**	1,415,348
Rental	**201,802**	485,945
Total deferred tax liability	**3,311,070,582**	3,106,073,281

32. EARNINGS PER SHARE

Basic earnings per share amounts are computed as follows:

	2009	2008
Net income (after tax) attributable to equity holders	**2,775,090,235**	24,816,688,884
Number of shares	**8,029,191**	8,029,191
Basic earnings per share	**345.63**	3,090.81

33. RATIONALIZATION/PRIVATIZATION

PNOC

As a continuing commitment of PNOC towards a more focused and streamlined organization, the PNOC Change Management Team (CMT) conducted a joint meeting between Management and consultants to discuss the final draft of the Rationalization Program (RP) for the Company. After thorough discussion, the group agreed to finalize the Rationalization Program for PNOC and was presented to the PNOC Board of Directors in their meeting of December 11, 2009.

Several suggestions and additional inputs were given by the Board of Directors for eventual incorporation into the final version of the PNOC Rationalization Plan.

The CMT discussed the inputs of the Board of Directors and agreed that the proposed RP should be approved by the Board in the early part of 2010 after which, the company will submit the RP to the Department of Budget and Management in the first half of 2010.

PNOC EC

In February 2007, the Boards of Directors of PNOC EC and the Parent Company approved a plan to privatize PNOC EC through an Additional Public Offering of its authorized capital stock. In this connection, the PNOC EC Privatization Committee (PRIVACOM) was also formed and authorized by the Boards of Directors of the Parent Company and PNOC EC to coordinate the process of selecting the Financial Advisor/Lead Arranger/Underwriters/Global Coordinator to advise, guide and assist in the design, planning, preparation and implementation of the program for the privatization of PNOC EC.

The mandate for the financial advisory/underwriting/global coordinating services was awarded by the PRIVACOM in September 2007 to Citigroup Global Markets Lt. and ATR KimEng Capital Partners, Incorporated.

However, due to the effects of the global financial crisis and the current volatility in the global market, the planned privatization was postponed pending the uncertainties in the market.

34. SIGNIFICANT AGREEMENTS

Service Contracts

Under Presidential Decree No. 334, as amended, the Parent Company is empowered to undertake exploration, discovery, development and extraction of all forms of energy resources, including geothermal, coal and oil.

Accordingly, the Parent Company thru its subsidiaries, entered into service contracts with the Department of Energy for the exploration, development and utilization of the country's natural resources, subject to sharing of net proceeds with the government for the right granted. The government's share comprises of income taxes and royalty fees. The royalty fees are shared by the government through DOE and the local government units.

35. COMMITMENTS

Prior to Petron's privatization in 1994, majority of its landholdings amounting to P153 million was transferred to the Parent Company as property dividend in 1993. Portion of these properties specifically bulk plants and service stations was leased back to Petron and a leasehold agreement between Petron and the Parent Company was executed for a period of 25 years from September 1, 1993 to August 31, 2018 subject to renewal.

Annual leasehold rental has reached P140.20 million in 2009 and P140.14 million in 2008.

36. CONTINGENCIES

COMPROMISE AGREEMENT

PNOC

Paul Mata vs. Petron and PNOC

In 1983, Petron engaged the services of Mr. Paul Mata for collection of monies owed to Petron and Filoil by the Manila Yellow Taxicab Co. and the Monserrats: Felipe, Enrique Jr. and Rosario vda. de Monserrat. It was a "no collection, no fee" contract, with expenses to be shouldered by Mr. Mata, who would get 40% of whatever amount was collected.

Mr. Mata was able to identify leviable properties of the Monserrats consisting of several parcels of land in V. Mapa St. in Sta. Mesa, Manila. However, these properties were heavily encumbered.

Mr. Mata then moved to have the various encumbrances cancelled. He continued the civil suit (#89462) initiated by Filoil Marketing (Petron's predecessor in interest) against Felipe Monserrat and filed a civil case against Enrique Monserrat (#7285). He obtained favorable decisions on these cases, and so proceeded to have the properties sold in execution of the decision. A public auction was held at which Petron emerged as the highest bidder at P4M. Through Mr. Mata's efforts, the properties were eventually registered in Petron's name.

For all his efforts, Mata was paid the sum of P200,000 or 5% of P4M. Efren Dimalanta, Petron's collection manager, wrote Mr. Mata, offering to pay the balance by way of a proportionate share in the V. Mapa properties. When Mata sought registration of his (35%) rights, Petron reneged, saying, among others, that Dimalanta was not authorized to assign any part of the property. A series of negotiations failed to resolve the issue, and so in 1993 Mata brought suit against Petron for enforcement of the collection services contract. In the same year, Petron transferred the properties to PNOC as property dividends prior to its privatization.

The properties involved are seven (7) parcels of land having a total area of 7,296 square meters. While the certificates of title are in the name of Petron, possession of said certificates as well as other pertinent documents, are with Mr. Mata and/or his attorney-in-fact, Mr. Peter Kairuz.

On December 14, 2001, a Compromise Agreement was signed by Mr. Paul Mata, Petron Corporation and PNOC, wherein Petron and PNOC assigned to P. Mata, 35% of all its rights, interest and participation in the subject properties. The Compromise Agreement was approved by the Court in January 2002.

On December 4, 2006, the Supreme Court decided with finality, that the subject properties consisting of 7,296 square meters located in V. Mapa, Sta. Mesa, manila belongs to Petron Corporation.

In order to enforce the Compromise Agreement, a Deed of Assignment in real property was executed by PNOC and Paul Mata on January 17, 2008. Under the said Deed of Assignment, PNOC as assignor, assigned, transferred and conveyed to Mr. Paul Mata its 35% undivided share, rights and interest in the said properties. Thus, PNOC and Mr. Paul Mata are now co-owners of the subject V. Mapa properties.

CONTINGENT LIABILITIES

PNOC-AFC

Claim of Asiakonstruct (Asia Construction and Development Corporation)

This arose from a contract between PPDC and ACDC in 1995 for the construction of the Petrochemical Park's electrical distribution system. The original target date of completion was May 12, 1996; however, several changes and extension were made. When work on the project stopped in 2003, only about 97% had been completed. It appears that several adverse conditions intervened, including climate limitations and financial difficulties experienced by ACDC. In December 2003, the PPDC manpower reduction program took effect. In November 2004, PPDC received demand from ACDC for the payment of P14.49 million as balance on the contract plus damages and interests for a total of P35.14 million. Several similar demands followed.

A paucity of records hampered, and continues to hamper efforts of the new management of PPDC to close or settle the account. All of the personnel involved in the project have already left PPDC. A series of meeting were held between representatives of PPDC and ACDC. It was agreed that P14.08 million be considered as the balance due ACDC on the contract. Still to be resolved are issued on (a) payment of interest: whether interest should be paid at all; rate of interest, and date when interests should start, if at all; (b) PPDC's counterclaim of P5.56 million for lost and damaged materials.

Status: Negotiations came to a halt when PNOC informed Asiakonstruct that per COA's advise, no interest may be charged against the government especially in the absence of stipulation on interest payments.

CASES

PNOC

1. **Republic of the Philippines (represented by DPWH) vs. Spouses Manuel T. Lim, PNOC et. al**
   Civil Case No. CEB-25019
   RTC Branch 13, Cebu City

   For: Expropriation

   DPWH expropriated certain parcels of land near Archbishop Reyes Ave. in Cebu City. One of the properties affected by the expropriation is the portion of the lot owned by PNOC. The court issued an Order directing plaintiff DPWH t to pay the fair market value of the expropriated lots with legal interest from the time of taking of the property to the defendants. On August 2, 2005, PNOC filed a Motion for Execution of the Judgment rendered by the court on December 13, 2001.

Status: DPWH deposited with the Office of the Clerk of Court in the Regional Trial Court of Cebu, the partial payment for the just compensation for PNOC in the amount of P1,608,983.25. PNOC filed a motion to withdraw the partial payment. The Court granted the withdrawal and initial payment will be withdrawn only upon issuance of Certificate of Finality by the Clerk of Court.

2. **Application for Original Registration of Titles of Five (5) Parcels of Lots located in Bauan, Batangas**
   Cadastral Case (LRC Case No. N-1772)
   RTC Branch VII, Batangas

   For: Original registration and titling

   This is a petition filed by PNOC to have the five (5) parcels of lots owned by PNOC Coal Corporation to be registered and a Certificate of Title be issued in the name of PNOC.

   Status: Trial State (ex-parte). PNOC will present evidence and testimony of witness/es.

3. **PNOC vs. Spouses Ruben A. Banawa and Carmina M. Banawa**
   Civil Case No. 09-10617 (Ejectment)
   MTC Branch 44, Pasay City

   PNOC filed an ejectment case on November 24, 2009 against Spouses Banawa for failure to voluntarily vacate PNOC lot located in Pasay City, after the Contract of Lease with PNOC which ended on December 31, 2008.

   Status: The summons and the copy of the complainant was substitudely served upon the defendants on December 18, 2009.

4. **PNOC vs. Spouses Roque S. Villaruel and Soledad Villaruel**
   Civil Case No. 09-10618 (Ejectment)
   MTC Branch 45, Pasay City

   PNOC filed an ejectment case on November 24, 2009 against Spouses Villaruel for failure to voluntarily vacate PNOC lot located in Pasay City, after the Contract of Lease with PNOC which ended on December 31, 2008.

   Status: The summons and the copy of the complainant were duly served to the defendants on December 1, 2009.

5. **PNOC vs. Spouses Rolando D. Ladera and Ma. Elena C. Ladera**
   Civil Case No. 09-10619 (Ejectment)
   MTC Branch 45, Pasay City

   PNOC filed an ejectment case on November 24, 2009 against Spouses Ladera for failure to voluntarily vacate PNOC lot located in Pasay City, after the Contract of Lease with PNOC which ended on December 31, 2008.

Status: The summons and the copy of the complainant were duly served to the defendants on December 1, 2009.

6. **PNOC vs. Spouses Patricio I. Villanueva and Luisa Villanueva**
   Civil Case No. 09-10621 (Ejectment)
   MTC Branch 47, Pasay City

   PNOC filed an ejectment case on November 24, 2009 against Spouses Villanueva for failure to voluntarily vacate PNOC lot located in Pasay City, after the Contract of Lease with PNOC which ended on December 31, 2008.

   Status: The defendants refused to receive the Summons. On December 7, 2009, the summons was duly served thru the Barangay Official.

7. **PNOC vs. Christine M. Ladera**
   Civil Case No. 09-10616 (Ejectment)
   MTC Branch 47, Pasay City

   PNOC filed an ejectment case on November 24, 2009 against Christine M. Ladera for failure to voluntarily vacate PNOC lot located in Pasay City, after the Contract of Lease with PNOC which ended on December 31, 2008.

   Status: On December 7, 2009, the defendant was duly served with the copy of the summons.

8. **PNOC vs. Spouses Ambrosio P. Gabriel and Felisa E. Gabriel**
   Civil Case No. 09-10620 (Ejectment)
   MTC Branch 48, Pasay City

   PNOC filed an ejectment case on November 24, 2009 against Spouses Gabriel for failure to voluntarily vacate PNOC lot located in Pasay City, after the Contract of Lease with PNOC which ended on December 31, 2008.

   Status: No return of summons yet received by PNOC.

9. **PNOC vs. Spouses Roberto and Celestina Ocampo**
   Civil Case No. 09-10615 (Ejectment)
   MTC Branch 48, Pasay City

   PNOC filed an ejectment case on November 24, 2009 against Spouses Ocampo for failure to voluntarily vacate PNOC lot located in Pasay City, after the Contract of Lease with PNOC which ended on December 31, 2008.

   Status: No return of summons yet received by PNOC.

10. **Bayan Muna Party List Representative et. al.,**
    Vs PGMA, DENR, DOE, PNOC, PNOC-EC et. al.,
    G. R. No. 181702, 181703 & 182734
    Supreme Court

    For: Petition for Certiorari and Prohibition with Application for Temporary Restraining Order

    This is a petition filed last June 2008 by members of the party list representatives and other congressmen to have the Joint Venture Marine Seismic Undertaking (JSMU) among CNOOC, PNOC and Petro Vietnam, to be declared unconstitutional and to enjoin the parties from further implementation of the agreement.

Status: The parties already filed their respective memoranda. For resolution.

11. Voltaire Rovira vs. PNOC
CA-GR CV No. 80608
Court of Appeals, Cagayan de Oro

For: Specific Performance and Damages

This is a case filed by former PNOC Director Voltaire Rovira against PNOC for specific performance and damages stating two causes of action. First, PNOC should be held liable for payment of his travel and hotel expenses to Manila to attend purportedly a PNOC Board meeting and second, he claims that he should not be held liable to pay for the unpaid balance of P434,254.17 under the Vehicle Acquisition Plan of the PNOC Board of Directors. On February 12, 2003, the Court dismissed the complaint for failure of the complainant to appear on the scheduled pre-trial. A Motion for reconsideration was filed but the same was denied in is Order dated August 4, 2003. Mr. Rovira appealed the case to the Court of Appeals.

Status: The Court of Appeals granted Mr. Rovira's appeal on May 28, 2009. The Court remanded the case for further proceeding in the RTC Banch 5, Iligan City.

12. Keppel Philippines Shipyard, Inc. vs. PNOC/PDEC
CA-GR CV No. 86830
Court of Appeals, Manila

For: Specific Performance

This case originated from the Contract of Lease executed on August 6, 1976, between Keppel and LUSTEVECO wherein the latter leased certain parcels of land located in Bauan, Batangas to Keppel. The contract among others, provided for the Lessee's firm and absolute option to purchase the leased property for a total price of P4,090,000.00 at the end of the 25 years lease period subject to the condition that Keppel would be qualified to own land.

PDEC subsequently succeeded to and assumed all of LUSTEVECO's rights and obligations under the Agreement. PNOC then succeeded and assumed all the rights and obligations of PDEC upon its cessation of operation in 1996. In 2003, Keppel filed the instant case against PNOC and PDEC in order to enforce the agreement alleging that it was already qualified to own property. RTC decided the case in favor of Keppel hence, PNOC appealed in the Court of Appeals.

Status: Pending in the Court of Appeals. Both parties had already submitted their respective briefs. The Compromise Agreement signed by Keppel and PNOC was referred to NEDA for evaluation and study.

Expropriation Cases

These are the twelve (12) expropriation cases prosecuted in the name of PNOC but handled previously by then PNOC-EDC. These cases were turned-over by EDC to PNOC on November 2009. The said cases were now handled by the OSG as counsel for PNOC.

1. **PNOC vs. Spouses Dominador and Minerva Samson and Tongonan Holdings & Development Corporation (defendant-intervenor)**
   Civil Case No. 3392-0
   RTC Branch 35, Ormoc City

   This is an expropriation case filed on June 10, 1996 by PNOC EDC in the name of PNOC, covering 2,780 sq. meters, portion of a three lots owned by Spouses Samson. PNOC EDC intended to use the said area for the construction and operation of the 125 MW Upper Mahiao Power Plant Project. On February 25, 1997, Tongonan Holdings Development Corporations (THDC) filed a Motion to Intervene on the ground that it is the true owner of the subject property having purchased the same from Spouses Samson on June 11, 1994.

   On November 27, 2000, RTC rendered a decision directing PNOC to pay THDC the total amount of P33,937,700 plus six percent (6%) interest per annum from the date of filing until fully paid. PNOC EDC appealed the said decision thru Petition for Review in Court of Appeals, then in the Supreme Court. On June 25, 2008, the Supreme Court denied PNOC's petition and on September 17, 2008, the Supreme Court denied with finality PNOC's Motion for Reconsideration and on November 20, 2008, the decision become final and executor order is recorded in the Book of Entries of Judgments.

   Status: The Supreme Court has already issued a final and executor order for PNOC to pay the just compensation on the expropriated lots. However, the execution is still pending in RTC Branch 35, Ormoc City.

   On February 10, 2009, RTC issued an Alias Writ of Execution ordering the branch sheriff to cause the execution of the judgment. Likewise, Notice of Garnishment was also issue by the Sheriff on October 19, 2009, ordering the President of the Landbank of the Philippines in Malate and the Manager of the Landbank of the Philippines in Makati, Buendia Branch to garnish the accounts, deposits, money of PNOC in their possession for the payment of the money judgment in favor of THDC, amounting to P62,055,005.00 as of October 19, 2009. PNOC sought the lifting of the Notice of Garnishment issued by the Sheriff and the quashal of the Writ of Execution.

2. **PNOC vs. Oscar Maglasang and Leonilo Maglasang**
   Civil Case No. 3267-O, RTC Branch 35, Ormoc City
   Civil Case No. 3273-O, RTC Branch 35, Ormoc City
   Supreme Court G.R. No. 155407

   The case originally involved two separate cases for expropriation filed against Oscar Maglasang and Leonilo Maglasang involving two parcels of land utilized by EDC in the 125MW Upper Mahiao Power Plant Project. The RTC consolidated the two cases, rejected the recommendation of the commissioner and proceeded to make its own determination of just compensation in a joint judgment settling the amount of P700.00/sq. meters. On appeal of both parties, the Court of Appeals reduced the amount of just compensation to P300.00/sq. meters rejecting the "inflation factor" used by RTC, and using as basis the NPC deed of sale. The Court of Appeals denied the Motion of Recognition filed by PNOC. The Supreme Court denied PNOC's Petition for Review and affirmed the Court of Appeals decision. The amount of just compensation are P18,999,900.00 for Lot No. 11900; and P29,461,800.00 for Lot No. 11907, both with interest of 6% per annum from the time of filing of expropriation cases in October 1994 and November 1994, respectively.

Status: There is already a final and executory order from the Supreme Court for PNOC to pay the just compensation on the expropriated lots. However, the execution is still pending in RTC Branch 35, Ormoc City.

3. **PNOC vs. Pablita Maputi, et al.**
Court of Appeals, Cebu City
CA G.R. CV-NO 02912
RTC Branch 42, Dumaguete City (Civil Case No. 9787)

This is an expropriation case covering an area of 30,376 sq. meters used for EDC's re-injection wells. The case has gone through three (3) sets of commissioners whose recommendation were struck down by the court for being baseless and/or excessive, unconscionable, and unreasonable considering the actual area and value of the lots involved. The RTC proceeded to determine the amount of just compensation at P48.00/sq. meters for the area of 30,376 sq. meters or for the total of P1,461,328.60, with the interest at the rate of 6% per annum from November 8, 1991 until fully paid and with damages for improvements amounting to P12,685.40. The RTC also denied defendant's claim for royalties, which as computed by the defendants would have amount to at least P140 million.

Status: The case is now pending appeal at the Court of Appeals, Cebu City.

4. **PNOC and PNOC-EDC vs. Jessie Manahon Toting, et al.,**
Court of Appeals, Cebu City
CA G.R. CV-NO 02958
RTC Branch 40, Dumaguete City (Civil Case No. 10148)

This is an expropriation case covering two (2) parcels of land, which, however, were not only established to be inalienable and in disposable lands of the public domain but also admitted by the Defendant as such. The RTC rendered decision dismissing the expropriation case as the subject lands were part of the inalienable and in disposable lands of the public domain. RTC awarded the total amount of P64,192.00 (P47,014.00 for the Tax Declaration No. 20-281 and P17,178.40 for Tax Declaration No. 20-686) based on the written inventory executed in the presence and with the conformity of the original defendant on December 11, 1991.

Status: The case is now pending appeal.

5. **PNOC vs. Mamerto Espina and Flor Penaranda**
Regional Trial Court Branch 35, Ormoc City
Civil Case No. 3670-0)

This is an expropriation case filed against the spouses Espina for a portion of their lot covered by TCT No. TH-246, situated in Sitio Cambantog, Brgy. Lake Danao, Ormoc City, with a total amount of 197,296 sq. meters. The lot will be used to form part of the network of the EDC's Leyte Geothermal production and reinjection wells and related facilities. The Espinas are demanding that their entire lot be acquired by PNOC at the rate of Five Hundred Pesos (P500.00) per sq. meter. The just compensation issue has been resolved by the Commissioner; however both parties opposed the findings of the Commissioner. The court set the case further hearing on the determination of the just compensation issue.

Status: The court granted the Motion for Ocular inspection filed by the defendant to determine the exact portion occupied by EDC.

6. PNOC vs. Heirs of Flaviano Maglasang
Civil Case No. 3268-0
RTC Branch 35, Ormoc City

This is an expropriation case filed on October 25, 1995 against the Heirs of Flaviano Maglasang for the entire property covered by Tax declaration No. 21016-00256 with an area of 333,044 square meters located at Rizal, Kananga Leyte, to be use by EDC for their Leyte Geothermal Production Field.

Status: Trial is on-going before the Board of Commissioners for the determination of the just compensation. Plaintiff claims that their fair market value of the property is at P45,038.96. Plaintiff submitted its Position Paper on the valuation of just Compensation. Defendant is yet to present evidence on just compensation.

7. PNOC vs. Flasalie Maglasang
Civil Case No. 3276
RTC Branch 35, Ormoc City

This is an expropriation case filed on December 1, 1994 for the entire lot covered by TCT No. P-22898 with an area of 91,913 sq. meters located at Brgy. Lim-ao, Kananga Leyte to be used for the Leyte Geothermal Production Field.

Status: Trial is on-going before the Board of Commissioners for the valuation of just compensation. Defendant’s turn to present evidence.

8. PNOC vs. Margie Leila Maglasang
Civil Case No. 3298-0
RTC Branch 12, Ormoc City

This is an expropriation case filed on May 11, 1995 against Margie Leila Maglasang for a 6,725.90 sq. meter portion of lot covered by TCT No. T-4712 located at Brgy. Lim-ao Kananga, Leyte particularly used as pipeline route and corridor, access road and sump ponds of LGPF. Plaintiff's valuation is at P1.48 per square meter.

Status: Trial on-going before the Board Commissioners for the valuation of just compensation. Plaintiff has presented its evidence and submitted its Formal Offer of Evidence. Defendant is still presenting its evidence and has a pending Motion for Ocular inspection.

9. PNOC vs. Willie Vestil
Civil Case No. 3393-0
RTC Branch 35, Ormoc City

This is an expropriation case filed on May 11, 1995 against Willie Vestil for the Lot covered by TCT No. T-20186 with an area of 49,996 square meters located in Kananga Leyte to be used for the Leyte Geothermal Production Field. Plaintiff claims that the fair market value of the property is P68,144.54. Plaintiff presented its evidence on the valuation of just compensation. The court issued an Order dated January 12, 2006 for the Commissioner to submit the status of the query as to the fair market value of the property.

Status: Commissioner is yet to submit valuation.

10. PNOC vs. Carmencita P. Gual et. al.,
Civil Case No. 12649
RTC Branch 36, Dumaguete City
CA G.R. NO. 02152, Court of Appeals, Cebu City

This is an expropriation case covering 5,722 square meter property in Puhagan, Valencia Negros Oriental to be used by EDC as Thermal Pond. In its complaint, EDC alleges that the just compensation is P71,530.00 representing the fair market value of the property. After trial, the court approved the Commissioner's Final Report dated June 23, 2006 which set the just compensation at P421,960.00 based on a certification issued by Ms. Nena D. Locsin of the Department of Agriculture on the income that would have been derived from the property from abaca use. Both party appealed the decision of the RTC to the Court of Appeals.

Status: Waiting for the Court Order to file Appeal Brief.

11. PNOC vs. Angel C. Yulo
Civil Case No. 1140
RTC Branch 62, Bago City

This is an expropriation case filed on October 25, 2001 against Angel Yulo for the 101,010 square meters portion of the property covered by TCT No. T-11769, to be used specifically for the construction and installation of geothermal power facilities and related system. Plaintiff's valuation of the property is at P6.00 per square meter equivalent to the zonal value of the property at the time of filing of the complaint. Defendant in his answer alleged that the value of the property is at least twenty million per hectare. A Writ of Possession was issued in favor of EDC on July 22, 2002. The case was referred to mediation and Judicial Dispute Resolution but no settlement was made.

Status: Pre-Trial

12. PNOC vs. Spouses Celso G. Garilva and Anita H. Garilva
Civil Case No. 1141
Rtc branch 62, Bago City

This is an expropriation case filed on October 10, 2001 against Spouses Garilva for a 48,627 square meters portion of Lot No. 2594-A covered by OCT No. P7 to be used by EDC for the construction and installation of geothermal power facilities and related systems. Plaintiff's valuation of the property is pegged at P6.00 per square meter which is equivalent to the zonal value of the property at the time of filing of the complaint. A Writ of Possession was issued in favor of PNOC on November 22, 2001.

Status: For Pre-Trial

Terminated/Settled Cases of PNOC (for the year 2009)

1. Heirs of Maria Soliven represented by Barbara Abrahano vs PNOC

Civil Case No. 2007-0129-D
RTC Branch 42, Dagupan City

For: Declaration of Right of Way with Application for the Issuance of Restraining Order

On April 11, 2007, a complaint with application for the issuance of restraining order was filed against PNOC, to restrain PNOC from fencing the subject property and to declare that portion of the PNOC property located in Sta. Barbara, Pangasinan has been used as easement in favor of Abrahano. The court granted a Temporary Restraining Order (TRO), preventing PNOC from fencing the property. PNOC filed a Motion for Reconsideration and quashal of the TRO issued. The court in its resolution quashed the TRO.

Status: During the Pre- Trial conference, plaintiff's counsel manifested in court to drop the case for unwillingness of the plaintiff Abrahano to continue the case. PNOC likewise moved to dismiss the case. Case was terminated thru court order dated January 16, 2009.

2. Tirso B. Savellano vs. BIR, PNOC and PNB

G.R. No. 180004
Supreme Court

For: Petition for Review on Certiorari

Tirso Savellano (petitioner) seeks interest payment on the informer's reward granted to him by the Supreme Court in the previous cases PNOC vs. CA, CIR and Tirso Savellano, G.R. No. 109976 and PNB vs CA, CIR and Tirso Savellano, G.R. No. 112800, which decision became final and executory on September 9, 2005.

Petitioner Savellano on May 2, 2006, received his informer's reward in the amount of P44,243,767.61. On Jul 11, 2006, petitioner filed a motion at the Court of Tax Appeals (CTA) for further payment of interest which represents interest on the informer's reward received. On January 7, 2007, CTA denied the Motion for lack of merit. A Motion for Reconsideration was likewise filed but it was denied by CTA on October 3, 2007.

Status: The Supreme Court denied the Petition for failure of the Petitioner to sufficiently show any irreversible error in the Court of Appeal's decision. The Supreme Court likewise, denied the Motion for Reconsideration filed by Savellano in its order dated March 9, 2009. On April 21, 2009, decision of the Supreme Court denying the Petition became final and executor.

3. **Jamal Ashley Yahya Abbas vs. Nieves L. Osorio, Pedro A. Aquino, Jr., Roland F. Rodriguez and PNOC**
   CA-G.R. SP No. 58128
   Court of Appeals

   For: Petition for review at CA (Illegal Termination Case)

   Jamal Ashley Yahya Abbas filed an illegal termination case at Civil Service Commision (CSC) assailing his termination of employment in PNOC. CSC dismissed the complaint and thereafter petitioner Abbas filed a Motion for Reconsideration, which was then denied by CSC. He filed a petition for Review with the Court of Appeals.

   Status: The Court of Appeals denied the petition. On January 16, 2009, CA informed the parties that since no petition or motion for reconsideration was filed, its decision dated February 22, 2008 became final on October 16, 2008

4. **PNOC vs. Maria Nabong**
   Civil Case No. 16931
   Municipal Trial Court in the City
   Branch III, Cabanatuan City

   For: Accion Publiciana

   This is an ejectment case filed by PNOC against Mrs. Nabong who occupied the PNOC property located in San Roque, Cabanatuan City. The sheriff caused the service of the summons together with the complaint however the defendant could not be located at the given address.

   Status: On September 17, 2009, the court in its order granted PNOC's Motion to withdraw the case. Note that the case became moot after the subject property has been demolished by the City Government of Cabanatuan.

5. **Petition for Cancellation of Adverse Claim Annotated on PNOC Transfer Certificate of Title Nos. T-78619 & T-78620**
   MC Case No. 2008-179
   RTC Branch 60, Lucena City

   For: Special Action for Cancellation of Adverse Claim

   This is a petition filed by PNOC on November 11, 2008, in order to cancel the adverse claim of a certain Rosemarie Perigrin in PNOC lots located in Brgy. Ibabang Iyam, Lucena City. The said claim is annotated on PNOC Transfer Certificate of Titles Nos. T-78619 & T-78620.

   Status: On November 16, 2009, the Court granted PNOC's petition for cancellation of adverse claim annotated in PNOC's Transfer Certificate of Titles Nos. T-78619 & T-78620.

PNOC Exploration Corporation (PNOC EC)

As Petitioner

1. **PNOC-EC vs. Rafael G. Mangubat**
   Case No. 02-47516
   Quezon City RTC Branch 218

   For: Collection of sum of money (P665,294.70) plus interest. The case was filed because of non-payment by Mr. Mangubat of his remaining loan obligation to PNOC EC, which he was able to secure pursuant to a Vehicle Acquisition Plan (VAP) duly approved by the President of the Philippines.

   Status: A writ of execution for the sum of P665,294.70, plus attorney's fees of P66,529.47, has been issued against Mr. Mangubat and in favor of PNOC EC. The court sheriff is looking for properties and bank accounts of Mr. Mangubat to attach and/or garnish.

2. **PNOC-EC vs. Jose M. Asistio**
   Case No. 69263
   Pasig City RTC Branch 67

   For: Collection of sum of money (P719,333.30) plus interest. The case was filed because of non-payment by Mr. Asistio of his remaining loan obligation to PNOC EC, which he was able to secure pursuant to a Vehicle Acquisition Plan (VAP) duly approved by the President of the Philippines.

   Status: By the Order of the trial court dated September 3, 2009, the case against Mr. Asistio was dismissed for failure to prosecute. The OGCC has been asked to recommend to PNOC EC whether to file a motion for reconsideration of the dismissal or re-file the case.

3. **PNOC-EC vs. Bernardo F. Ople**
   Case No. 02-48508
   Quezon City RTC Branch 98

   For: For collection of sum of money (P805,555.54) plus interest. The case was filed because of non-payment by Mr. Ople of his remaining loan obligation to PNOC EC, which he was able to secure pursuant to a Vehicle Acquisition Plan (VAP) duly approved by the President of the Philippines.

   Status: The next hearing for continuation of the presentation of Mr. Ople's evidence will be held on May 4, 2010. Mr. Ople will be the next witness at the hearing.

4. **PNOC-EC vs. Pedro T. Santos**
   Case No. 69262
   Pasig City RTC Branch 67

   For: Collection of sum of money (P697,666.60) plus interest. The case was filed because of non-payment by Mr. Santos of his remaining loan obligation to PNOC EC, which he was able to secure pursuant to a Vehicle Acquisition Plan (VAP) duly approved by the President of the Philippines.

   Status: Mr. Santos filed a Petition for Review in the Supreme Court from the Court of Appeals decision denying his petition for certiorari, which in turn, questioned the RTC's Order declaring him in default. The Supreme Court denied Mr. Santos' petition in a decision promulgated on September 23, 2008. To date, Mr. Santos has not filed any motion for reconsideration from the Supreme Court's decision. The high court is thus expected to issue a finality of judgment and order the remanding of the case to the Regional Trial Court.

5. **PNOC-EC vs. Felimon Joson**
   Case No. 1901-1907
   1st Municipal Circuit Trial Court (MCTC) of Mabini & Tingloy, Batangas

   For: Criminal cases for bouncing checks in the total of P1.52 million. Mr. Joson issued the checks in payment of United Planters Product's (customer of ESB) outstanding obligation to PNOC EC.

   Status: Mr. Joson was acquitted by the trial court of the charges against him in a decision dated February 28, 2007. While a civil action against him was initially contemplated, inability to determine his whereabouts has made the filing of such action impracticable.

6. **SC 38 Consortium vs First Gas Power Corporation and FGP Corporation**
   Case No. 15070/JEM
   Hongkong International Arbitration Court

   The SC 38 Consortium is party to Gas Sale and Purchase Agreements (GSPA) with First Gas Power Corporation (FGPC) and FGP Corporation (FGP). In July 2007, the SC 38 Consortium commenced arbitration against FGPC and FGP to resolve disputes arising under the GSPAs regarding Force Majeure (FM) claims made by FGP and FGPC and unused scheduled maintenance days. FGPC and FGP are claiming that by reason of various outages said to have occurred in the transmission lines which transmit electrical power from the FGPC's and FGP Corp.'s power plants to Meralco, the electrical output from the said plants was restricted and such outages fall under the definition of FM under the GSPAs. The second issue pertains to periods of Scheduled Maintenance allowed under the GSPAs, and how unused Schedules Maintenance Days are accounted for at the end of each Contract Year. The amount being claimed by the SC38 Consortium in this arbitration is US$5.4 million for FGPC and US$3.9 million for FGP (PNOC ECs share in the claim is 10%, commensurate to its 10% participating interest in SC38). SC 38 Consortium has also sought clarity on the language of the FM provision considering that the issue on Force Majeure is a recurrent issued s FGPC and FGP continue to make similar claims.

Status: A Final Partial Award has been rendered by the Arbitral Tribunal in August 2009. The Arbitral Tribunal has reserved the right to resolve all outstanding issued pertaining to quantum (i.e. computation of relief) and other matters. Negotiations between SC 38 and FG are on-going to close out the unresolved items, including the treatment and computation of future claims under the tems of the Award. Should negotiations fail, the Parties may request the Tribunal to settle all remaining issues.

As Defendant

1. **Province of Palawan vs. SC#38 Joint Venture Partners**
CCN 4108
Palawan Regional Trial Court

As a member of the SC 38 Consortium, PNOC EC is involved as a party defendant in a case filed by the Province of Palawan in a Regional Trial Court in Puerto Princesa City against the SC 38 consortium for the collection of alleged delinquent real property taxes for the years 2002 to 2005 totaling P265,259,194.28, 10% of which shall be paid by PNOC EC if the Consortium will lose the case. For its defense, the Consortium relies mainly on the provision of SC 38 granting exemption to the SC 38 Consortium from local and national taxes, except income tax.

Status: The case is at the trial proper stage, with the Province of Palawan set to present a witness from the provincial treasurer's office.

2. **Burgundy Global Exploration Corp. vs. PNOC- EC & Mitra Energy Ltd.**
Case No. 06-450
Makati City Regional Trial Court (RTC) Branch 59

For: Prohibition and mandamus. This case was filed by Burgundy Global to stop PNOC EC from awarding the CMOL project to Mitra Energy Ltd and to require PNOC EC to award the same project to Burgundy Global allegedly as the most qualified Filipino corporation pursuant to the "Filipino First" policy of the Constitution.

Status: After the signing by the parties of a Participation Agreement for the development of the CMOL Project, the same parties executed a Compromise Agreement in which they mutually agreed to amicably settle their respective claims in the above civil case. The Compromise Agreement was filed in the Court of Appeals, which later promulgated a Judgment approving the Compromise Agreement last August 27, 2009.

3. **Taiwan Overseas Mining Co., Phils., Inc. vs. PNOC and PNOC- EC**
   Case No. 06-450
   Makati City Regional Trial Court (RTC) Branch 59

   For: Declaratory Relief. TOMC prays that the Court rule on the respective rights and obligations of the parties under the Joint Venture Agreement signed between TOMC and PNOC Coal Corp., the predecessor-in-interest of PNOC EC.

   Status: A Compromise Agreement was executed by the parties in relation with PNOC ECs buy out of TOMCs interest in their Joint Venture. This Compromise Agreement was approved by the trial court in its decision dated July 22, 2009. In the same Compromise Agreement, the annual guarantee fee to be paid by TOMC as settlement was fixed at P29 million. This amount was deducted from the buy-out consideration paid by PNOC EC to TOMC.

4. **Wilson International Trading Private Limited (Singapore) vs. PNOC Exploration Corporation (Philippines)**
   Case No. 16890/CYK
   International Chamber of Commerce (ICC) administered arbitration in Singapore

   Wilson International Trading Private Limited ("Wilson") has filed a Request for Arbitration with the Secretariat of the International Chamber of Commerce International Court of Arbitration claiming alleged losses and demurrage amounting to US$2,111,357.78 allegedly in connection with Coal Sales Contract No. S9068N. PNOC EC has engaged external counsel and is preparing to file its answer.

   Status: PNOC EC is preparing to file its Answer to Wilson's Request for Arbitration. The Parties are currently negotiating the choice of the Arbitrator who will hear the case.

PNOC DEVELOPMENT AND MANAGEMENT CORPORATION (PDMC)

1. In November 1997, the Company, through the Office of the Solicitor General (OSG), filed complaints for the ejection of more than 1,000 squatter families on the Company's properties in Rosario and Noveleta, Cavite. A decision in favor of the Company was granted in Rosario, Cavite, under Civil Case No. 546. Under Civil Case No. 760 filed in Noveleta, Cavite, the Company through the assistance of the OSG, obtained a favorable decision. Motions for Writs of Execution were filed by the Company to enforce the decision. However, the executions of these writs were held in abeyance pending completion of the privatization of the Company. On December 10, 2001, President Gloria Macapagal Arroyo issued Executive Order No. 59 authorizing the Company to segregate and dispose of 25 hectares of its properties in Noveleta and Rosario, Cavite, to its bonafide occupants. Ejection and demolition cases will be filed based on contracts pursuant to E.O. No. 59.

2. A complaint for alleged illegal dismissal filed by the former Administrator/Corporate Secretary against the Company, its former FDMC President and former Treasurer, is still pending with the National Labor Relations Commission. A decision was rendered by the Labor Arbiter ordering PDMC to pay the former Administrator/Corporate Secretary the amount of P9,795,396 plus other benefits and privileges or their monetary equivalent which PDMC normally pays to its regular employees as part of her backwages. The case was appealed to the Commission and a cash bond in the amount of P9,795,396 was deposited with the NLRC as required under the rules. On the other hand, the Company obtained a favorable decision from the Court of Appeals with respect to the issue on the jurisdiction of the NLRC on the case. The decision of the Court of Appeals was appealed by the former Administrator / Corporate Secretary to the Supreme Court. The company's liability could not be determined with certainty based on the foregoing, pending the receipt of the decision of the Supreme Court on the issue of jurisdiction and of the NLRC on the appeal of the decision of the Labor Arbiter.

3. A civil case was filed by Spouses Serafin and Carmen Abutin against the Company and the PEZA for the re-conveyance of property ceded by then Filoil Refinery Corporation in favor of Spouses Abutin in exchange for the use of the latter's property for purposes of erecting wooden electric posts allegedly for operations of the refinery. The Company's liability could not be determined with certainty when the Court allowed the parties to explore possibility of settlement despite termination of the pre-trial proceedings.

4. A money claim was filed with the National Labor Relations Commission (NLRC) by a former Manager separated under a manpower Reduction Program (MRP) for the following amounts: (1) P100,325, representing the interest on the remaining 40 monthly amortizations on complainant's car loan which, according to the complainant, should not have been deducted from her MRP separation benefits; (2) P11,497, representing the complainant's car allowance for one-half month; and (3) P595,795, should be added to her MRP separation benefits. The Company obtained a favorable decision from the Labor Arbiter. The decision was appealed by the former Manager to the Commission. The Company's liability could not be determined with certainty pending receipt of the decision by the Commission.

6. A complaint was filed against the Company and its corporate officers docketed as Civil Case No. 08-1026 entitled "Narciso T. Expeño vs. PDMC, Joseph John M. Literal, et, al." before the Regional Trial Court of Makati, Branch 61 praying for the declaration of the bidding conducted by the Company on Site 2A on January 17, 2007 and the Notice of Award to Majestic Technical Skills Development & Landscape Corporation as null and void. The Company's liability could not be determined with certainty except as to the bid price of P336,081,136.00 since the property was purchased on an "as is, where is" basis with the winning bidder shouldering the costs of removal of informal dwellers within the property, the payment of disturbance compensation to farmers and other expenses incidental in taking lawful possession of the property.

PNOC ALTERNATIVE FUELS CORPORATION (PAFC)

1. Hanamel Rolgins vs. PNOC Petrochemical Development Corporation (PPDC)

The case is for removal of cloud and annulment of title with damages where PPDC lost per decision of the Supreme court dated June 9, 1999. However, it was remanded to Regional Trial Court as ordered by the Supreme Court for the determination of Hanamel's counterclaim amounting to P1.7 billion. The Company's Legal Department with the assistance of the Office of the Corporate Counsel, met with the Legal Counsel and controlling stockholders of Hanamel to explore possible settlement of the case. It is also seeking to have the initial testimony of Atty. Victorio Dimagiba expunged from the records preparatory to filing a demurrer to evidence. Demurrer to evidence was granted by the court thus Hanamel's compulsory counter claim was dismissed Notice of Appeal filed by Hanamel.

2. Republic of the Philippines vs. Serios

The Republic is represented by the Office of the Solicitor General and had presented witnesses who were heads of the Investigating team of the Land Management Bureau (LMB), representative of the LMB Records Section and the vault keeper of the Office of the Register of Deeds of Bataan. Thereafter, the Branch 4 of the Regional Trial Court of Bataan granted the demurrer to evidence filed by the heirs of Serios. Hence, a notice of appeal was filed and the Company intends to continue helping the Republic pursue its case before the Court of Appeals.

3. Invictus Fiesta, Renato Linao, Alfonso Cunanan and Joel Andres vs. PNOC Alternative Fuels Corporation

Labor Arbiter Arthur L. Almansec of the National Capital Regional Arbitration Branch of the National Labor Relations Commission dismissed, for lack of merit, the charges of illegal suspension and dismissal filed by complainants Fiesta, et. al. against the Company. On appeal filed by same complainants, the Third Division of the National Labor Relations Commission issued a resolution dated September 22, 2008 dismissing the same for failure to comply with Sec. 4, Rule VI of the New Rules of Procedure of the Commission. The Company filed comment to the petition for review.

4. People of the Philippines vs. John Dalmacio, et. al.

The case was filed last June 2008. It is a case for violation of Sec. 1 of Municipal Ordinance No. 14-2001 known as the Municipal Fishery Code of Mariveles pending with the Municipal Trial court of Mariveles, Bataan following the arraignment which was held on July 17, 2008. The motorized fishing vessel used is currently with the Company's custody pending determination of its disposition by the Court.

5. **People of the Philippines vs. Leo Mendiola**

The case is about the electrical cable stealing incident which transpired in the Petrochemical Park. The Company has completed presenting its evidence and witnesses. Accused Mendiola is now presenting his evidence and witnesses.

6. **People of the Philippines vs. Rogelio Alberba**

This case is for ejectment of Rogelio Alberba over the subject property of the Company with an area of 5,268 square meters.

Then PPDC's claims are: (a) P100,000 for accrued rentals; (b) P100,000 for reimbursement for litigation expenses, and (c) P50,000 attorney's fees. Alberba, on the other hand, claims improvements erected on the property, i.e. trees, plants, etc., in the amount of P380,000.00

7. **PNOC-AFC Industrial Park vs. Informal Dwellers**

As part of Management's aim to utilize the Company Industrial Park and in keeping with the purpose for which it was established under Presidential Decree No. 949 (P.D. 949), it initiated the pursuance of the filing of appropriate cases against informal dwellers within the vicinity. This has been supported by the incumbent Municipal Mayor Nelson David of Limay, Bataan, by the municipality's non-issuance of business permits to the aforesaid informal dwellers with business establishments within the area.

37. EVENTS AFTER BALANCE SHEET DATE

PSTC

Declaration of Dividends

The PSTC's Board under Resolution No. 15 Series of 2010 dated May 25, 2010 approved the declaration and remittance of cash dividends to the Philippine National Oil Company and the National Government through the Bureau of Treasury, in the amount of P2 million.

PAFC

Alternative Fuels

For the first five months of 2010, an additional 200 hectares of jatopha plantations was established. The additional plantations are located in Quezon (50 hectares), Malungon, Saranggani (100 hectares) and Siargao, Surigao del Sur (50 hectares). Maintenance activities such as weeding and fertilization are being undertaken in existing plantations established last year. As of May 2010, 2,700 hectares is established in Luzon, 3,015 hectares in Visayas and 1,000 hectares in Mindanao or a total of 6,715 hectares all over the country.

However, with the El Niño phenomenon experienced during the first half of this year, slow growth of the jatropha plantations became evident. In addition, the absence of rains in the plantation areas have resulted in longer duration for the conduct of maintenance activities particularly fertilization. It has been estimated that an additional seedling mortality ranging from 10 – 15% will be contributed by the dry spell brought about by El, Niño. Further, fire incidents were reported in Iba (Zambales), Rodriguez (Rizal), Mainit (Surigao del Norte) and Malungon (Saranggani) resulting in damages to 250 hectares of jatropha plantations. Replanting of the burned area was conducted in Rodriguez, Rizal but the partner-grower was only able to cover a small portion owing to the absence of rains. The major cause of the fires was uncontrolled burning from nearby/adjacent grassland areas to the plantations. Burning is normally done by upland farmers to induce vegetation for the growth of young grasses for pasture and to clear the land of vegetation for cultivation.

Meanwhile, the jatropha plantation in Fort Magsaysay which was originally developed as a commercial plantation will be converted into an area for research and development wherein varietal/provenance testing, intercropping, fertilizing, pruning, technology testing and plant growth regulation trials will be undertaken. Based on the Resolution No. 023, S2010, the Company's Board approved the conversion of the said plantation from commercial venture into a research and development activities and the corresponding reduction of the planted area from 238 hectares to 100 hectares.

For R&D initiatives in collaboration with other government agencies and research institutions, studies are continuously undertaken on the improvement of planting techniques, among others. Specifically with DOST, the jatropha processing facility and biofuels testing laboratory have been inaugurated and fully tested during the first quarter of this year. The said facility will be utilized for the training of manpower for the commercial operation of the Company's processing facilities. It will likewise be used for the testing of new processes for extraction and refining as well as the evaluation of other biofuels feedstocks.

Memoranda of Agreement were signed with Haura Biofuels Pte. Ltd. For the demonstration of organic nutrition technology on improving fruit yield and increasing il content, as well as possible business partnership for the establishment of 50,000 hectares of jatropha plantations. Further, agreements were forged with Hacienda Plantations, Inc. for the establishment of a jatropha plantation and Ruben & Del Machine Shop and Engineering Works for putting up a jatropha oil expeller to serve as a pilot facility for future commercial operation of jatropha crude oil. Likewise, the Company in collaboration with the Department of Energy (DOE) targets to put up processing equipment for biodiesel production from used cooking/vegetable oil. As a pilot project, the collaboration will be focused on experimenting the appropriate technology and processes of converting used cooking oil collected from households and commercial establishments into a biodiesel fuel that is compliant with the existing Philippine National Standard. To date, the said equipment is being purchased.

Persistent Organic Pollutants (POPS) Project

As of June 2010, the construction of the polychlorinated biphenyl (PCB) destruction facility is in full swing. Hiring of technical staff for the project is on-going. The project is targeted to be commercially operational by the 3rd quarter of this year.

Meanwhile, the contracts with Manila Electric Company (Meralco), National Grid Corporation of the Philippines (NGCP), and Power Sector Assets and Liabilities Management (PSALM) for the transformers and other materials that will be treated in the said facility are in the finalization stage.

Industrial Park

Provision of services in terms of park administration and site development such as raw and fire water, power supply within the Company's Industrial Park and other commercial areas, and jetty services is continuously being undertaken in the Industrial Park as efforts geared towards enticing new locators are being conducted.

In addition, the repair and rehabilitation of the jetty pier is envisioned to be undertaken this year after the completion of the assessment study aimed at evaluating the structural integrity of the jetty and recommending appropriate repairs to handle current and additional operational loads. To date, bidding is ongoing to prospective contractors for this activity.

Further, implementation of Social Development Program, Corporate Social Responsibility (CSR) Program, and Health and Environmental Management Program is a continuing activity in the Park.

COMMENTS AND OBSERVATIONS

PHILIPPINE NATIONAL OIL COMPANY

1. Real estate properties recognized in the books are not covered by Transfer Certificates of Title in the name of the Company

Inspection of Transfer Certificates of Title (TCTs) pertaining to properties recognized in the books of accounts of the Company disclosed that several real estate properties are not registered in the name of PNOC. These properties include the following:

a. Eighteen (18) parcels of land with a total area of 74,095 square meters located in Badoc, Ilocos Norte which were conveyed to PNOC by Petron Corporation as property dividend when the latter was privatized. Out of the 18 properties indicated in the Deed of Conveyance, only 14 were specifically identified and for which emancipation patents have been issued to seven (7) lots. The remaining parcels of land have been subjected to the Comprehensive Agrarian Reform Program.

b. Properties in Gaunan, Lepaga, M'lang, Cotabato with total land area of 196,377 square meters. These are allegedly being occupied and cultivated by Muslim rebels. Due to the peace and order problem in the area, research and investigation were temporarily deferred.

c. Ten (10) parcels of land with a total area of 19,926 square meters. These were previously owned by the Malangas Coal Corporation, a wholly-owned subsidiary of PNOC but were transferred to the latter upon the dissolution of the former in 1996. Only four (4) of the 10 properties have complete documentation but PNOC is unable to present any Deed of Assignment to facilitate the transfer of the title to its name. The remaining six (6) lots are not supported with any documentation that could establish PNOC's legal right over it.

d. An untitled property at the Petron Refinery in Limay, Bataan, consisting of 30, 653 square meters is subject to a petition filed by PNOC for the issuance of Original Certificate of Title under LR Case No. 011-ML, LRA Record No. N-69668. The Community Environment and Natural Resources Office of the Department of Environment and Natural Resources (DENR) in Pilar, Bataan, reported that this lot is not covered by any land patent and/or title. Originally, it was subject to a Petition for Adjudication filed by Ms. Dolores Cuevas, et.al. on March 7, 1958, but the court dismissed the case on September 30, 1958. The petitioners filed a Motion for Reconsideration but the same was dismissed for lack of merit.

e. An untitled lot located at Barrio Sapa, Rosario, Cavite, with an area of 6,837 square meters which was verified to be part of the public domain. This was conveyed under a Deed of Absolute Sale executed between Filoil Refinery Corporation (now PNOC Development & Management Corporation [PDMC]) and Petron Corporation in 1991.

f. Lot 186-B-A-2 located in Magsaysay, Parang, Maguindanao, with an area of 15,000 square meters, was conveyed by Petron Corporation to PNOC in 1993. However, both Petron and PDMC are claiming ownership of the property. PDMC asserts that the title is still in the name of Filoil upon verification with the Registry of Deeds. Further, PDMC alleges that there are several lots which were acquired by Petron from Filoil and were given as property dividends to PNOC, but their transfer to Petron was questionable.

We recommended that Management obtain an updated status of the impediments that continue to obstruct the issuance of TCTs under the name of the Company for the real properties abovementioned.

According to Management, the present status and/or actions taken on the issues raised regarding the properties are as follows:

1) Two surveyors have been contracted for the properties. First was a local surveyor from Badoc, Ilocos Norte to conduct a field survey; and a second for the relocation survey to determine, among others, the exact location and boundaries of the properties. Both surveyors failed to undertake their task due to threats of physical injury from the people claiming ownership of the properties.

2) The whole area was offered as a site for the socialized housing project of the government in accordance with the implementation of Republic Act 7279.

3) The ten properties are presently assigned to the PNOC Exploration Corporation (PNOC EC), a subsidiary company.

4) The Company is awaiting the issuance of the decree of registration by the Land Registration Authority (LRA). According to the Records Officer of the Ordinary and Cadastal Decree Division of the LRA, they have yet to receive the reply to their letters sent last October 13, 2010 to the CENRO, LMB and Branch Clerk of Court (RTC Branch 4, Balanga City). To facilitate the issuance of the decree of registration, the Company has secured the approved lot plan for Lot 237 from LMS Region 3 and submitted the same to the LRA.

5) The Company is awaiting the transmittal of survey plans by the private contractor. Latest information from a representative of the contractor disclosed that the research regarding the issue of public domain is still ongoing at the LMS CALABARZON Office in Calamba City. The representative, however, has been furnished a copy of the Deed of Absolute Sale containing the property description. EMD has completed its research at the PENRO of Cavite and has verified the same to be a part of public domain. No certification can be issued until the submission of the approved survey plan.

6) The documents pertaining to the transfer of property between Petron Corporation and Filoil Refinery Corporation are still unavailable from PDMC. According to PDMC, releases of information/data on the property were deferred due to a pending case involving, among others, the subject property.

2. Transfer Certificates of Titles of seventy-eight (78) properties are still in the name of previous owners

Sixty-five (65) TCTs over real estate properties recorded in the books are still in the name of its previous owners. Fifty-six (56) of these properties were registered in the name of various PNOC subsidiaries/affiliates, viz:

Company	No. of TCTs
Filoil Refinery Corporation	26
Esso Philippines, Inc.	18
Petrophil Corporation	5
BATS Services, Inc.	4
PNOC Dockyard & Eng'g. Corp.	3

These properties were acquired from Petron Corporation as part of the property dividends declared in 1993. The remaining properties were previously owned by the Export Processing Zone Authority (1) and private individuals (8), but transfer of the titles in the name of PNOC have not been effected.

Moreover, out of the 26 properties registered in the name of Filoil Refinery Corporation (now PDMC), 11 are co-owned by PDMC and PNOC. The companies are waiting for the approval of the survey plan so that the titles may be transferred to PNOC.

We recommended that management continue to exert efforts to have the abovementioned properties titled in the name of the Company.

According to Management, the status of the issues raised regarding the above properties are as follows:

a) FILOIL REFINERY CORPORATON (FRC)
   - Eight of the eleven properties titled to Filoil Refinery Corporation and co-owned with PNOC were consolidated into TCT No. T-1089867 while the other three (3) co-owned lots were consolidated into TCT No. T-1298406. PNOC and PDMC agreed to execute the appropriate deed of transfer to document the actual configuration of the properties as partitioned per approved survey plan.
   - With regard to one property titled to EPZA covered by TCT No. 147729, PDMC is presently coordinating with the legal officer of EPZA. As agreed in a recent meeting with PDMC, photocopies of the documents pertaining to the property were already transmitted to the Company.
   - Twelve TCTs pertaining to properties fully conveyed to PNOC, which were denied registration by the former Register of Deeds, were presented to the LRA for inscription of the technical description. The Land Registration Examiner at the LRA Department of Registration advised PNOC to determine which were transferred from reconstituted TCTs, otherwise, inscription of technical description will require court proceedings.

- The documents pertaining to the transfer of the property located in Parang, Maguindanao between Petron and FRC are still unavailable from PDMC. According to PDMC, release of information on the property was deferred due to a pending case involving, among others, the subject property.
- The property located in Pasong Tamo, Tandang Sora, Quezon City was offered as a site for the socialized housing project of the government in connection with RA 7279.

b) ESSO PHILIPPINES, INC.

- These 18 lots located in Badoc, Ilocos Norte, as mentioned in the preceding page, have not been surveyed because of threat of physical harm to the contracted surveyors.

c) PETROPHIL CORPORATION

- One property located in Sta. Rosa, Laguna covered by TCT No. 254954 – still awaiting transmittal by the contracted surveyor of the approved survey plan. Approval of the technical description by the CALABARZON LMS Office in Calamba, Laguna is still pending.
- Two properties located in Gaunan, Lepaga, M'lang, North Cotabato – the whole area was offered as a site for socialized housing project of the government in connection with RA 7279.
- One property located in Talugtog (Cuyapo), Nueva Ecija – awaiting result of final survey of private lands covered by CARP. PNOC will validate in the masterlist of CARP-covered properties in the PENRO.
- One property located in San Jose City, Nueva Ecija – coordinated with the DARAB and surviving relatives of the original owner and was informed that a new attorney-in-fact has not yet been designated by the relatives.

d) BATANGAS SERVICES, INC.

- The Deed of Sale with Right to Repurchase is not available at the National Archives of the Philippines. PNOC has coordinated with the children of the original owner who were not able to present any copy of the Deed of Sale with Right to Repurchase.

e) PNOC DOCKYARD & ENGINEERING CORPORATION

- The PNOC Dockyard & Engineering Corporation was reactivated as PNOC Renewables Corporation (PRC). All assets held by PNOC as trustee-receiver were returned to PRC.

3. **Six (6) parcels of lots carried in the books at P4.618 million are still registered in the name of the PNOC Coal Corporation (PCC)**

   Transfer Certificates of Title and tax declarations of lots situated in Batangas with an aggregate carrying amount of P4.618 million and total land area of 10,204 square meters are still registered in the name of PCC and ownership thereof has not been transferred to PNOC. Details of these lots are as follows:

TCT No./Tax Dec. No.	Lot No.	Location	Area (sq. m.)	Amount (P)	Remarks
032-00265	8911	Powerhouse	2,862	1,287,900.00	Title to be reconstituted
032-00263	8922	lot	635	285,750.00	For final registration
032-00264	8924	Coal Terminal	423	190,350.00	For final registration
032-00262	8951	Coal Terminal	1,948	876,600.00	For final registration
032-00261	8917	Coal Terminal	2,050	922,500.00	For final registration
		Coal Terminal	2,286	1,028,700.00	Untitled
		Dry Creek		47,002.98	Registration fees/documentary and other fees
				4,618,802.98	

   Five parcels of lots with a carrying amount of P4.619 million have tax declarations as the only proof of ownership. Records show that the title for Lot No. 8911 is for reconstitution while the titles for four (4) other lots are for regional registration as of July 14, 1999. Moreover, included in the Schedule of Land account is a dry creek with a book value of P1.028 million which is untitled. By law, creeks belong to the state are therefore outside the commerce of men.

   Inquiry disclosed that PNOC was not able to monitor/follow-up the status of the reconstitution/registration of the titles of the abovementioned 5 parcels of lots. Hence, no document was executed to transfer ownership thereof in the name of PNOC.

   We recommended that representations be made to concerned government agencies in order to have updated information of the status of the reconstitution/registration of the untitled lots. Further, an investigation should be conducted to determine the nature of PCC's claim on the dry creek and the location thereof.

4. **Redemption price of 7% cumulative and redeemable preferred shares of the National Development Company (NDC) which expired in 2005 amounting to P369.151 million; and corresponding dividends receivable totaling P620.17 million was not recognized in the books as of December 31, 2008**

   During last year's audit, the issue of management's non-collection of the total redemption price of the Company's investment in NDC's 7% preferred shares due last 2005, and the non-receipt of dividends in arrears from 1984 to 2008 which totaled P989.324 million was raised.

Verification of the status of the Company's claim against NDC disclosed that the same has remained unsettled as of December 31, 2009.

In view thereof, we reiterateD our previous year's recommendation that the Company pursue and continue the negotiation with NDC to collect the redemption price of the investment and accumulated dividends.

PNOC EXPLORATION CORPORATION

5. Continued maintenance of a Directors' and Officers' Liability Trust Fund amounting to P26.892 million without legal basis

Our audit of Account 104001 – Restricted Cash disclosed that the account represents the balance of PNOC EC Directors' and Officers' Liability Trust Fund set up by virtue of Board Resolution No. 11 dated February 13, 2007. The Fund will be used to defray costs that may arise in case any of the Company's directors and officers gets involved in legal disputes as a result of their official acts.

The Fund is covered by a Trust Agreement (ITF No. 03-690) with the Land Bank of the Philippines for a total amount of P50 million. An initial deposit of P10 million was made when the account was opened on April 11, 2007. Thereafter, deposits of P10 million and P5 million were made on April 11, 2008 and December 14, 2009, respectively. The fourth quarterly report on the LBP Trust Fund showed an accumulated total asset of P26,892,007.38 and an accumulated income of P714,665.50 for the period ended December 31, 2009.

Section 4 of PD 1445, sub-paragraph (b) states that "Government funds or property shall be spent or used solely for public purposes." It is our position that the Fund's purpose does not conform to this provision because utilizing government resources to provide protection to directors and officers is not a public purpose.

This issue has been the subject of an audit observation memorandum last year (PNOC EC-AOM-2008-04) dated March 10, 2009 and during the CY 2008 exit conference between the COA audit team and PNOC EC officers, it was our understanding that Management conveyed its concurrence to our recommendation that the maintenance of the Fund be discontinued and that the same be reclassified to the cash in bank account. However, verification showed that the recommendation was not implemented as of December 31, 2009. Further, during the exit conference for the CY 2009 audit, Management clarified that they did not commit to implement the recommendation.

According to Management, as part of the Company's mandate, it bids out, negotiates and executes huge contracts, as well as enters into joint ventures for exploration, development, production, and trading of oil, gas and coal. The Board and the various committees under it, approve such transactions, while the officers execute and implement the same. As such, they are vulnerable to lawsuit threats, harassment and pressure from losing bidders, politicians and influence peddlers.

With liability insurance covering them, they will be able to discharge their functions objectively, free from fears of costly harassment suits. Providing insurance will attract competent, dedicated, sincere and well-meaning people from the private sector to join the Company. Further, the insurance is not a benefit for the directors and senior officers since availment from the Fund is contingent only upon the filing of a suit in connection with the discharge of their official functions. Moreover, certain criteria/guidelines must be complied with in order to be avail of the liability trust fund.

We reiterated our previous recommendation that the maintenance of the Directors' and Officers' Liability Trust Fund be discontinued and that the restricted funds be reverted back to the original cash in bank account since the purpose of the liability trust fund does not conform with Section 4, sub-par. (b) of P.D. 1445.

6. Outstanding receivable from a former member of the board amounting to P643,379 has remained uncollected since March 2007

Our audit of Account 104301 – Other current receivables disclosed that as of December 31, 2009, the receivable from a former member of the Company's Board of Directors in the total amount of P643,379 remained uncollected. This pertains to the advances made by the Company for the hospital bills of former Director during his confinement at St. Luke's Hospital from March 21-24, 2007 amounting to P979,731 net of reimbursements made by Insular Life of P328,853 and the application of his allowance of P7,499 to his outstanding account. This amount was advanced by the Company because Insular Life was unable to process all his insurance claims because of insufficient documentation.

This issue was the subject of an audit observation last year (PNOC EC–AOM-2008-06 dated March 31, 2009) and we recommended that the Company exert all means to collect from the former member of the board.

According to Management, the Company's Vice President and General Manager for FCSICT Division and Compliance Officer personally went to the Office of the former director to follow-up the collection of his personal account amounting to P643,379. He was fully informed of the nature of the charges against his personal account but initial efforts to collect proved to be futile. Management gave its assurance that they will have their Legal Department make the necessary written representations to demand payment from said director.

We reiterated our recommendation that Management continue to pursue the collection of this outstanding account.

Management, through a letter dated September 15, 2010 made representations to demand the settlement of the account. Both parties agreed that the amount be settled through twelve monthly installments. The director issued twelve post-dated checks corresponding to twelve monthly installments beginning September 30, 2010 up to August 31, 2011 for the total amount of P643,379.

7. Grant of medical expense benefits to members of the board of directors amounting to P1.613 million without the required board resolution of PNOC, its majority stockholder, and exemption from Administrative Order No. 103 from the Office of the President

In a memorandum dated April 12, 2006, Mr. Eduardo V. Manalac, former PNOC President and CEO, approved the extension of medical and hospitalization benefits through a self-insurance scheme to the Members of the Board of Directors of PNOC EC as follows: Board members who are 60 years old and below (including their qualified dependents) will be entitled for enrollment to the Group Hospitalization Insurance Plan (GHIP). For directors who are more than 60 years old, the Company shall set up a self-insurance fund amounting to P100,000 per member annually. The Directors are also entitled to the use of medical and dental facilities (including medicines and other medical supplies) and an annual Executive Health Examination equivalent to the approved package for executives of the Company.

In November 2007, the PNOC EC Board of Directors approved, through Board Resolution No. 54, Series of 2007, the increase of the self-insurance fund to a maximum of P1 million for each director per year. Thereafter, an unnumbered and undated Resolution, Series of 2009, was approved by several members of the Board to further modify the entitlement as follows –

> *"… should one or more directors incur actual medical expenses greater than the individual coverage of P1 million for one (1) year, the other members of the board each agree to share an equal portion of their unused yearly coverage to cover the excess."*

Our audit disclosed that Account 504007 - Other Personnel Benefits – Medical Benefits carried a balance of P3,236,934.05 as of December 31, 2009. Nearly 50% of the balance or P1,613,008.65 was incurred for the reimbursements of medical expenses of four (4) members of the Board of Directors of PNOC-EC namely, Directors Crismel F. Verano for P1,328,837.75; Eduardo F. Hernandez for P250,089.90; Jacinto V. Paras for P32,581.00; and Jaime K. Recio for P1,500.00.

We have validated that these medical benefits were not included in the CY 2009 Report of Salaries, Allowances and Fringe Benefit/s received by members of the board of director and senior officials submitted to COA. Instead, the expenses were included in the account "Employee Cost" even if members of the board are not organic employees of the Corporation.

Section 30 of the Corporation Code of the Philippines provides that –

> *"In the absence of any provision in the by-laws fixing their compensation, the Directors shall not receive any compensation, as such directors, except for reasonable per diems: Provided, however, That such <u>compensation other than per diems may be granted to directors by the vote of the stockholders representing at least a majority of the outstanding capital stock</u> at a regular or special stockholders' meeting."* (Underscoring supplied)

Moreover, Section 3 (b) of Administrative Order No. 103 dated August 31, 2004 – Directing the Continued Adoption of Austerity Measures in Government states that –

> *"All national government agencies (NGAs), including state universities and colleges (SUCs), government owned and controlled corporations (GOCCs), government financial institutions, (GFIs) and other government corporate entities (OGCEs), whether exempt from Salary Standardization Law or not, are hereby directed to:*
>
> *(a) xxx*
>
> *(b) For other non full-time officials and employees, including members of the governing boards, committees, and commissions: (i) suspend the grant of new or additional benefits, such as but not limited to per diems, honoraria, housing and miscellaneous allowances, or car plans: and (ii) in the case of those receiving per diems, honoraria and other fringe benefits in excess of Twenty Thousand Pesos (P20,000) per month, reduce the combined total of said per diems, honoraria and benefits to a maximum of Twenty Thousand Pesos (P20,000) per month."*

The medical/hospitalization expenses incurred by the four members of the PNOC EC Board of Directors are recorded under Account 504007 – Other Personnel Benefits – Medical Benefits (classified under employee costs), which under Company policy, is one of the fringe benefits given only to organic/salaried employees. Therefore, medical benefits extended to board members should not be classified under said account.

Fees, allowances and other benefits received by the board members are recorded under account 531901 – Other Professional and Technical Services classified under Purchased Services and Utilities. The Company's chart of accounts describes the charges to Account 531901 as cost of other professional and technical services contracted by the Company not classified under specific professional and technical services accounts. The fees and allowances of directors are recurring expenses that should be provided with a separate/own sub-account for proper identification.

More importantly, the requirements under Section 30 of the Corporation Code, and Section 3 (b) of Administrative Order No. 103 were not complied with. The initial medical and hospitalization benefit amounting to P100,000.00 through a self-insurance scheme is not included in the benefits granted by PNOC under Board Resolution No. 1635-A dated September 8, 2006. This was authorized merely through a memorandum of former President Manalac. The resolution increasing the self-insurance fund to P1 million and its subsequent modification allowing the other members to share an equal portion of their unused yearly coverage to cover the excess of one or more directors was passed by the PNOC EC Board Members themselves. This is unauthorized since only the vote of a majority of stockholders can grant or modify the benefits of subsidiaries. Furthermore, no exemption from Administrative Order No. 103 could be presented.

According to Management, they are amenable to charge medical and hospitalization expenses in the excess of P100,000.00 as receivables from the board members.

In the absence of a board resolution from PNOC authorizing the grant of said benefits, and an exemption from AO 103 from the Office of the President, we recommend that charging of the whole amount as receivables from the members of the board of directors.

Management, through a memorandum to Director Hernandez dated May 25, 2010, informed the former Director of his excessive reimbursements of medical benefits and suggested offsetting these against his receivables from the Company. In June 2010 the former director agreed that management withhold the amount of P150,089.90 from his receivables from the Company to fully settle his excess reimbursements.

8. Expenses amounting to P107,401 were incurred for the purchase of medicines that do not bear any official representation for the Company

Examination of expenditures made against Account 593101 revealed that a purchase amounting to P55,264.80 was made for ten (10) capsules of Sutent 25 mg. (a medicine for the treatment of advanced kidney cancer) and was charged to Cost Center 111501 – Board of Directors Liaison. This was covered by Purchase Order No. 4500001241 dated September 2, 2009. Thereafter, a purchase for another ten (10) capsules amounting to P52,136.61 which was covered by Purchase Order No. 4500001278 was charged against Cost Center 111101 - Office of the President. The end-user of the Sutent 25 mg. capsules or the reason on how said purchase reflects an official representation for the Company was not indicated in any of the supporting documents for both disbursements.

According to Management, they have referred this matter to Chairman Jacinto Paras for comment since both purchases were coursed through and acted favorably by his office. As of this writing, we have not received any comment or response from the Office of the PNOC EC Chairman.

We recommend the immediate refund of the P107,401.41 spent for the purchase of the Sutent 25 mg. capsules in the absence of convincing or substantive proof that the subject purchases were related to the Company's official representation.

9. The compensation package of the Corporate Secretary may not be in harmony with the mandated duties and responsibilities of said position

The Board of Directors, through an unnumbered Resolution, Series of 2008, approved the compensation package of the incumbent Corporate Secretary (CorSec) consisting of the following:

a. Basic compensation - P30,000.00 per month
b. CORSEC allowance - P14,000.00 per month for 1 Board meeting per month with an increment of P2,000.00 per additional Board meeting, Executive Committee and other meetings where the Board will request; the total of which shall not exceed P20,000.00 per month.

c. Credit card privilege – P35,000.00 per month
d. 13th month pay, cash gift, other bonuses, gratuity pay, financial assistance and the like whenever granted by the company. The basis for computing bonuses, cash gifts, gratuity pay and financial assistance and the like shall be P50,000.00.
e. Uniform allowance – P12,000 per year plus P7,000.00 (for suit) every three years
f. Gasoline allowance – 250 liters per month
g. Group life, travel and accident insurance
h. Group hospitalization insurance plan (P1,000,000.00 maximum per year)
i. Free use of Company's medical clinic, including dental
j. Free mobile phone at Plan 2500 per month
k. Annual Executive Health Examination
l. Reimbursements of reasonable actual expenses for transportation and meals incurred while attending to out-of-office/official business

The CorSec is neither a member of the Board of Directors nor a regular employee of the Company. He was appointed by the BOD on May 13, 2008 during a regular meeting and immediately thereafter was elected Corporate Secretary during the organizational meeting on June 10, 2008. However, our examination showed that he is entitled to the compensation of both the members of the Board of Directors and that of regular-salaried employees of the Company.

Analysis of Account 585901 – Other Business Expenses, and Account 531901 – Other Professional and Technical Services disclosed that for the period January 1 to December 31, 2009, the CorSec received a total compensation of P1,447,401.49, exclusive of insurance premiums (items g., h. and k.) and reimbursements for reasonable actual expenses while attending out-of-office official business (item l). A review of prior years' documents revealed that the Manager of the Legal Department had been previously designated as CorSec as a concurrent assignment without any additional remuneration. Thus, we employ the test of necessity, i.e., that the allowances are essential to the fulfillment of the CorSec's duties and responsibilities and that their absence will result in his inability to perform or will negatively affect the discharge of said functions.

Article VI, par. 6, page 13, of the Amended By-Laws of the Company dated August 18, 1995, the express powers and duties of the Corporate Secretary are as follows:

> *"a. Keep full minutes of all meetings of the Board of Directors and of the stockholders;*
> *b. Keep the stock and transfer book, maintain a current register of stockholders with their corresponding addresses, keep the corporate seal which he shall stamp on all documents requiring such seal of the Corporation;*
> *c. Fill and countersign all certificates of stock issued, making the corresponding annotation on the margin or stub or such certificates upon issuance;*
> *d. Give or cause to be given, all notices required by law or by the by-laws of the Corporation as well as notice of all meetings of the Board or Directors and of the stockholders;*

e. Perform such other duties as may be prescribed by the Board of Directors or by the President.

The Board of Directors may designate stock and transfer agents for the performance and execution of the powers and duties stated in sub-paragraphs (b) and (c) above, and other functions relative to stock transfers, said performance, execution and functions being exercised under the general supervision of the Secretary."

In accordance with the last paragraph, the Company has availed of the services of the Philippine National Bank as its stock and transfer agent. Moreover, we noted that the CorSec is assisted by two (2) assistant corporate secretaries in the performance of the above duties.

We refer to Section 25, page 252, of The Corporation Code of the Philippines Annotated, 9th Edition, 2006, where it is stated that *"It is within the power of the board to fix the salaries of corporate officers whom it appoints (SEC Opinion, Oct. 14, 1968), for the power to employ must necessarily include the power to grant compensation. It may likewise grant bonuses to them <u>subject to the test of reasonableness</u>."* (Underscoring ours)

In his letter-reply dated May 15, 2010, the CorSec asserted that the audit observation was premised on incomplete facts and an enumeration of what qualities an effective Corporate Secretary "should have" was made. Further, a comparison of his basic salary was made with the basic salary of a Vice President to illustrate the gross disparity of the CorSec's compensation with that of other officers. It was also stated that the workload of the CorSec substantially multiplied due to the increase in number of board meetings in relation to the privatization of the Company. Lastly, the CorSec explicitly asserts that he was being singled out since the compensation package of other officers was not raised as an audit issue.

We made no issue on the effectiveness of the Corporate Secretary in performing his duties, and we have no intention of comparing his remuneration with other salaried officers of the Company. We enumerated his compensation for the purpose of seeking justification if all the allowances are necessary for him to be able to fulfill his duties and responsibilities. It is unfortunate that his reply failed to address this issue.

We recommend that the subject compensation package be revisited by the members of the board to determine if the same is prudent and reasonable vis-à-vis the mandated duties and responsibilities of said position.

10. The grant of credit card allowances to members of the board of directors have been converted to direct cash payments. Total credit card and cash allowances paid in 2008 and 2009 amounted to P3,163,182 and P3,735,000, respectively.

During the audit of CY 2008 transactions, we noted that members of the Board of Directors (BOD) were granted Visa Card privileges through Landbank of the Philippines (LBP) in the amounts of P40,000 and P35,000 per month for the Chairman and each Member of the Board, respectively. This privilege was initiated in September 2006 by PNOC during the term of former President Eduardo Manalac. It could be remembered that during the exit conference, the audit team recommended and management agreed that the grant of the said benefits be discontinued due to lack of legal basis, and that the total amount paid shall be recorded as receivables from the members of the BOD. A separate management letter on this finding was issued by the COA Supervising Auditor.

Verification showed that management discontinued the grant of visa card privileges to the members of the BOD effective April 2009. However, it was observed that new allowances for the same amounts as that of the credit card privilege were granted in cash to the members of the board. The additional allowances from April to December 2009, which amounted to P2.39 million, were charged to the Other Professional and Technical Services account. The credit card privilege and/or cash allowance could not be specifically classified as to whether it is for representation, extraordinary or miscellaneous expenses.

Section 12 of Presidential Decree No. 927, which amended Executive Order No. 334, the Charter of the Philippine National Oil Company, provides as follows:

> *"Section 12. Appointment, control and discipline of personnel. - Any provision of law to the contrary notwithstanding, the "Board" upon recommendation of the President of the Company, shall appoint the officers and employees of the Company <u>and its subsidiaries; fix their compensation, allowances and benefits</u>, their working hours and other conditions of employment as it may deem proper; x x x x"* (underscoring ours)

Furthermore, we quote the pertinent provisions of Memorandum Order No. 20 dated June 25, 2001 of the Office of the President, viz:

> *" x x x x do hereby order and direct all heads of GOCCs, GFIs and subsidiaries exempt from or not following the SSL to:*
>
> > *Section 1. Immediately suspend the grant of any salary increases and new or increased benefits such as but not limited to allowances; incentives; reimbursement of expenses; intelligence, confidential or discretionary expenses; and such other benefits not in accordance with those granted under SSL. This suspension shall cover senior officer level positions, including Members of the Board of Directors or Trustees.*
> >
> > *x x x x x x x x x x x x x x x x x x x x x x*
> >
> > *Section 3. Any increase in salary or compensation of GOCCs/GFIs that are not in accordance with the SSL shall be subject to the approval of the President."*

We recommended that a copy of the board resolution from PNOC granting the additional allowances to the PNOC EC members of the Board of Directors in accordance with the provisions of Section 12 of the PNOC Charter be presented for verification.

We also requested a copy of the approval for the increase in allowances/benefits from the Office of the President of the Philippines as stated in Section 3 of Memorandum Order No. 20 dated June 25, 2001.

Management furnished us a copy of a Certificate from the PNOC Corporate Secretary dated March 6, 2007 stating that the PNOC Board has resolved, that consistent with the previous practice, the Chairman and Directors of the Board of Directors of PNOC subsidiary corporations be, as they hereby are, granted additional reasonable benefits and allowances. However, the additional benefits and allowances were not identified in the resolution. In a memorandum dated September 12, 2006, former PNOC President Eduardo V. Manalac enumerated that the additional reasonable benefits and allowances passed and approved for PNOC subsidiaries provided that the subsidiary had posted a net income during the preceding year are as follows:

One-month anniversary bonus	P30,000.00
One-month Yuletide bonus	P30,000.00
Credit Card Limit	
- Chairman	P40,000.00
- Directors	P35,000.00

As to the approval for the increase in allowances/benefits from the Office of the President of the Philippines as stated in Section 3 of Memorandum Order No. 20, the Company replied that the issue should be referred to PNOC since it was the latter that granted said benefits and allowances.

We believe that the composition of the reasonable benefits and allowances should have been stated in the PNOC board resolution that was approved by the board. The PNOC President, by himself, does not have authority to decide for the board. Thus, the force and effect of the memorandum of September 12, 2006 remains suspect.

11. Payments of various allowances to the members of the board totaling P10.727 million have no sufficient legal basis.

Examination of Account 531901 – Other Professional and Technical Services disclosed that P10,727,000.00 or 46.55% of the P23,043,672.29 account balance as of December 31, 2009 were payments made for directors' fees, additional allowance, incentive pay, anniversary bonus, economic and financial assistance, 13th month pay, Christmas bonus, year-end financial assistance and cash gift to the members of the board. The said amount also includes credit card allowances granted to the Board of Directors.

Section 1 of Memorandum No. 20 dated June 25, 2001 suspended the grant of any salary increases and new or increased benefits to senior officer level positions including members of the Board of Directors or Trustees of GOCCs, GFIs and subsidiaries that are exempted from the Salary Standardization Law (SSL). Section

2 of the memorandum required the submission of a pay rationalization plan for senior officer positions and members of the Board of Directors/Trustees reducing their actual pay package to not more than two times the standard rates of equivalent/comparable positions in the national government. Said rationalization plan shall be subject to the approval of the President as provided in Section 3 of the same memorandum.

Further, Section 3 (c) of Administrative Order No. 103 dated August 31, 2004 - Directing the continued adoption of austerity measures in the Government issued by Malacañang also provides that –

> "For other non full-time officials and employees, including members of their governing boards, committees and commissions: (i) suspend the grant of new or additional benefits, such as but not limited to per diems, honoraria, housing and miscellaneous allowances, or car plans; and (ii) in the case of those receiving per diems, honoraria and other fringe benefits in excess of Twenty Thousand Pesos (P20,000.00) per month, reduce the combined total of said per diems, honoraria, and benefits to a maximum of Twenty Thousand Pesos (P20,000.00) per month. "

In compliance with AO 103 the PNOC Board approved Resolution No. 1522, S' 2004 dated October 5, 2004 prescribing the minimum and maximum allowance (honorarium/ travel/representation/fuel/per diem) for all the Directors of PNOC and subsidiaries at P14,000.00 per month for one (1) board meeting per month with an incremental allowance of P2,000 per additional board meeting within the month, but not to exceed P20,000.00 per month per Director. The Board further resolved that the Directors shall continue to receive their respective current monthly Director's fee and that the allowance and fees provided in the resolution shall be subject to future adjustments as may be justified. However, as provided in Section 3 of Memorandum No. 20, any increase in the salary or compensation of GOCCs/GFIs that are not in accordance with SSL shall require the approval of the President.

Moreover, Paragraph 2 of DBM Circular No. 2002-2 dated January 2, 2002 clarified that only salaried personnel are entitled to receive benefits such as Personal Economic Relief Allowance (PERA), additional compensation, year- end bonus and retirement benefits unless expressly provided by law. The members of the Board of Directors are not salaried officials to the Company, hence, are not entitled to receive such allowances and benefits.

In view of the foregoing, we believe that except for the payment of the P20,000.00 maximum per diem per month to each member of the Board of Directors, payments for director's fee, additional allowance, incentive pay, anniversary bonus, economic and financial assistance, 13th month pay, Christmas bonus, year-end financial assistance and cash gift are wanting of legal basis.

We recommend that the grant of all other allowances other than the P20,000 per diem be stopped by the Company.

According to Management, it was the PNOC Mother Board that authorized the grant of the allowances to the Company's members of the board of directors. Thus, the issue will be referred to PNOC for comment.

PNOC DEVELOPMENT AND MANAGEMENT CORPORATION

12. Total compensation granted to members of the Board of Directors exceeded the ten percent (10%) limit of prior year's net income by 124% or P4.205 million

Title III, Section 30, of the Corporation Code of the Philippines provides that:

> *"Sec. 30. Compensation of directors. - In the absence of any provision in the by-laws fixing their compensation, the directors shall not receive any compensation, as such directors, except for reasonable per diems: Provided, however, that any such compensation other than per diems may be granted to directors by the vote of the stockholders representing at least a majority of the outstanding capital stock at a regular or special stockholders' meeting. In no case shall the total yearly compensation of directors, as such directors, exceed ten (10%) of the net income before income tax of the corporation during the preceding year." (Underscoring supplied)*

Our examination of the pertinent disbursing vouchers and supporting documents on directors' fees and other allowances and expenses revealed that a total of P7,605,536.28 was disbursed for CY 2009, a summary of which are as follows:

(a)	Directors' Fees	P 2,082,353.08
(b)	Directors' Transportation	180,000.00
(c)	Per Diems	3,456,470.58
(d)	Other Directors' Fees	1,886,712.62
	Total	**P 7,605,536.28**

The Company generated a CY 2008 Income before income tax of P33,997,937 therefore setting a limit of P3,399,794 in total CY 2009 compensation that could be granted to the members of its board of directors. However, as could be gleaned from the above preceding paragraph, an excess of P4,205,742 or about 124% above the lawful limit was incurred for 2009.

According to Management, Article IV, paragraph 4 of PDMC's by-laws provides for the compensation of directors, to wit:

> "*4. Compensation.* Directors, as such, shall receive such compensation for their services as may be from time to time fixed by the stockholder of Class "B" Common Shares."

The basis for the grant of the compensation for directors is the Memorandum of former PNOC President Antonio A. Lopa dated November 22, 2000 in relation to

PNOC Board Resolution No. 1328 s.2000, stating that Director's Fees for members of the PNOC Board were adjusted from P20,000 to P30,000 beginning fiscal year 2000. Resolution No. 1328, s.2000 of PNOC was issued and approved by PNOC as stockholder of Class "B" common shares of PDMC. Said resolution was applied and mirrored by the Company as to the limits of the compensation (Director's Fees) received by the PDMC Board in compliance with Section 30 of the Corporation Code and Article IV, paragraph 4 of the Company's by-laws.

Management also claims that Other Director's Fees amounting to P1,886,712.62 is duly authorized since it is included in the 2009 Corporate Operating Budget as part of the P44.8 million allotment for Maintenance Expenses. Finally, management asserts that per diems are not to be included in the 10% limitation specified under Section 30 of the Corporation Code.

PNOC Board Resolution No. 1328 s. 2000, which increased monthly Director's Fees from P20,000 to P30,000, and Representation Allowance from P10,000 to P15,000, was approved for PNOC members of the board only. There was no indication that the same increase in rates was granted to PDMC or to other PNOC subsidiaries.

We take exception to Management's position that per diems are not to be included in the 10% limitation specified under Section 30 of the Corporation Code there being no clear or distinct argument presented that would disqualify it to be compensation. The fact that per diems at fixed rates are given to members of the board for attending board meetings without the necessity of presenting receipts qualifies the same as remuneration.

We recommended that Management strictly comply with the pertinent provisions of Section 30 of the Corporation Code of the Philippines.

13. Additional allowances in the form of credit card signing privileges amounting to P2.435 million were granted to the members of the board of directors without appropriate authority

Verification of the composition of Other Business Expenses disclosed that P2,435,000 in credit card signing privileges for the members of the board of directors were charged to this account. This forms part of the additional allowances granted to the board members in the amount of P50,000 monthly to the Chairman; and P40,000 monthly to the directors.

As a brief background, the credit card privilege was approved by the PNOC Board during the tenure of former President Eduardo Manalac sometime in September 2006. A Certificate from the PNOC Corporate Secretary dated March 6, 2007 stated that the PNOC Board resolved, that consistent with the previous practice, the Chairman and Directors of the Board of Directors of PNOC subsidiary corporations are hereby granted additional reasonable benefits and allowances provided that the subsidiary had posted a net income during the preceding year. However, the additional benefits and allowances were not identified in the resolution. In a memorandum dated September 12, 2006, former PNOC President Eduardo V. Manalac enumerated that the additional reasonable benefits and allowances passed and approved for PNOC subsidiaries as follows:

One-month anniversary bonus	P30,000.00
One-month Yuletide bonus	P30,000.00
Credit Card Limit	
• Chairman	P40,000.00
• Directors	P35,000.00

We believe that the composition of the reasonable benefits and allowances should have been stated in the resolution that was approved by the PNOC board. The PNOC President, by himself, does not have authority to decide for the board. Adjustments to the amounts of allowances to its present levels have been made through board resolutions of the subsidiaries themselves.

It has been raised as an audit concern for, among others, its apparent lack of legal basis particularly in view of the provisions of Memorandum Order No. 20 dated June 25, 2001 of the Office of the President, viz:

> *" x x x x do hereby order and direct all heads of GOCCs, GFIs and subsidiaries exempt from or not following the SSL to:*
>
> > *Section 1. Immediately suspend the grant of any salary increases and new or increased benefits such as but not limited to allowances; incentives; reimbursement of expenses; intelligence, confidential or discretionary expenses; and such other benefits not in accordance with those granted under SSL. This suspension shall cover senior officer level positions, including Members of the Board of Directors or Trustees.*
> >
> > *x x x x x x x x x x x x x x x x x x x x x*
> >
> > *Section 3. Any increase in salary or compensation of GOCCs/GFIs that are not in accordance with the SSL shall be subject to the approval of the President."*

According to management, the matter should be referred to PNOC since it was the latter that granted said benefits and allowances. They will be forwarding the issue to PNOC for its comment and final disposition.

14. Expenses totaling P2723,853 charged against discretionary funds were not in accordance with the guidelines prescribed under COA Circular No. 2006-001

COA Circular 2006-001 dated January 3, 2006 governing the guidelines on the audit of Extraordinary and Miscellaneous Expenses (EME) and other similar expenses provides that *"The claim for reimbursement of such expenses shall be supported by receipts and/or other documents evidencing disbursements."*

Section II of the same Circular provides an enumeration of the nature or purpose of the expenditures that could be charged against Extraordinary and Miscellaneous Expenses, viz:

a. meetings, seminars and conferences;
b. official entertainment;
c. public relations;
d. educational, athletic and cultural activities;
e. contribution to civic and charitable institutions;
f. membership in government associations;
g. membership in national professional organizations duly accredited by the Professional Regulation Commission;
h. membership in the Integrated Bar of the Philippines;
i. subscription to professional technical journals and informative magazines, library books and materials; and
j. other similar expenses not supported by regular budget allocation.

Examination of supporting documents relative to payments made out of discretionary funds disclosed that there were several expenses charged against the fund that were not in accordance with the provisions of COA Circular No. 2006-001, as follows:

1.	payment for medical/dental fees	P 39,156.10
2.	payment for repairs & maintenance of motor vehicles	97,948.15
3.	purchase of computer accessories	23,589.00
4.	payment of official travel costs	112,159.75
	Total	P 272,853.00

Further, we also noted that the computer accessories were not issued to their respective end-users through a memorandum receipt.

We recommended and Management agreed that the provisions of COA Circular No. 2006-001 dated January 3, 2006 be strictly adhered to in the administration of discretionary funds. Further, the computer accessories that were purchased must be issued to their end-users through a memorandum receipt.

PNOC SHIPPPING AND TRANSPORT CORPORATION

15. The arbitration case to recover major repair costs amounting to P34.936 million for the repair of the M/T PNOC Emilio Jacinto has yet to be filed after two years from the vessel's breakdown

We refer to the other prepaid and deferred charges amounting to P98.769 million that are carried under the Other Assets classification of the balance sheet as of December 31, 2009. Of this amount, P34.936 million pertains to the major repair costs of M/T PNOC Emilio Jacinto which were reclassified from various expense accounts (i.e., repairs, depreciation, borrowing costs, insurance, etc.) to deferred charges account on the basis of the opinion of their legal counsel. Management maintains that the Corporation can claim said expenses, including lost income, from the seller, the manufacturer of the main engine, or from the shipbuilder, through legal action filed before a competent tribunal. The outcome of the arbitration case will determine if said deferred charges could be classified to a claims receivable account.

This issue was the basis for the inclusion of an Emphasis of Matter paragraph on the unqualified opinion on the audit certificate issued for the year ended December 31, 2008. During the exit conference for the 2008 audit, management gave its assurance that appropriate steps have been set in motion to prepare the filing of the case in Singapore.

In this connection, we requested PSTC management for advice or provide us copies of pertinent documents for evaluation and reference.

According to management, they are still awaiting the final settlement of their Government Service Insurance System (GSIS) claim under the Hull and Machinery Insurance cover of MT Jacinto in the amount of P12.2 million based on the submitted adjustment report of Richards Hogg Lindley (Phils.) dated July 19, 2010. Appropriate legal procedures are presently being undertaken by the PSTC legal counsel in preparation for filing an arbitration case in Singapore within the year.

16. Discrepancies and abnormal balances were noted in the Inventory account for materials, supplies, fuel and store inventories at the Limay, Bataan warehouse.

Our audit of the Fuel and Stores Inventories – Materials and Supplies account (Code 225-1005) pertaining to materials and supplies stored at the warehouse in Limay, Bataan disclosed the following:

a) As of December 31, 2009, the account had an outstanding balance of P13,733,795.97 consisting of slow-moving items which are presented separately in the financial statements, i.e., Other Assets-Materials and Supplies amounting to P6,197,797.35; and Current Assets-Fuel and Stores Inventories amounting to P7,535,998.62. Examination of samples disclosed certain balances with peculiarities as follows:

a.1) Some items carried in the Storehouse 225 ledger had negative balances, viz:

Code	Particulars	Date	Unit Price	Quantity	Amount
15 193 221 06	Compound Grinding E	10/30/2009	463.6370	-1.00	(463.64)
24 653 202 45	Paint Aluminum	12/30/2009	463.6600	-3.00	(1,390.98)
24 653 339 45	Paint Enamel	12/30/2009	352.6800	-10.00	(3,526.80)
32 288 473 39	Tape Teflon	12/30/2009	8.7800	-67.00	(588.26)
63 427 008 20	Abrasive Sheet	12/30/2009	1.0000	-27.00	(27.00)
86 629 357 20	Folder, Pressboard, Legal Size	12/30/2009	8.7610	-30.00	(262.83)
86 629 363 20	Folder, Pressboard, Letter Size	12/30/2009	9.7140	-17.00	(165.14)
	Total				(6,424.65)

It appears that the negative balances resulted from the issuance of items that have already been delivered but could not yet be recorded as inventory because they remained unpaid. Apparently, the system only recognizes paid up items.

a.2) It was also observed that no stock cards were maintained to monitor the movement of inventory items, thus determination of balances as of a particular date were not possible. Audit tests by the team revealed that some items that were validated to have zero balances during actual count still carried positive balances per record. Details of samples lifted from Storehouse 225 ledgers to this effect are as follows:

Code	Particulars	Date	Unit Price	Quantity		Amount	
				Per Count	Per Records	Per Count	Per Record
15 537 013 27	Airlube 320	11/30/2005	66.5930	0	2,310	0.00	153,829.69
24 653 895 45	Paint Red Deck 1120 ME Finch	8/30/2006	458.1820	0	4	0.00	0.00
32 288 430 39	Tape Electrical	2/28/2006	41.9290	0	17	0.00	712.82
32 288 473 39	Tape Teflon, 1/2"	12/30/2009	8.7800	0	67	0.00	588.26
37 381 228 42	Gasket; Compressed Asbestos	12/30/2009	3,016.8660	0	12	0.00	36,202.39
37 382 107 42	Gasket; Rubber N-Prene S-999	12/30/2005	28.0020	0	297	0.00	8,316.68
37 382 201 42	Gasket; Rubber 1/16"x60"x60"	11/30/2009	85.5040	0	92	0.00	7,958.42
63 219 039 39	Band It SST201	2/28/2006	3,530.9950	0	7	0.00	24,716.98
82 757 474 20	Helmet Safety	12/31/2004	442.3200	0	16	0.00	7,077.12
86 629 309 20	Eraser; Seed P-51	12/30/2005	1.3650	0	12	0.00	16.38
92 382 080 20	Valve Gate, 1-1/2" x 125"	9/30/2006	1,647.0400	0	1	0.00	1,647.04
92 382 221 20	Valve Gate, Bronze, 1-1/4	8/30/2005	178.1860	0	5	0.00	890.93
	Total					0.00	241,956.71

a.3) Also noted were discrepancies in the computation of inventory balances per item. Sampling of entries resulted in a variance of P139,228.72 as presented below:

Code	Particulars	Qty	Unit Price	Amount		Difference
				Per Audit	Per Ledger	
15 578 291 19	Oil,; Dispersant BPI	3	42,737.2790	128,211.84	218,211.84	(90,000.00)
86 350 762 50	Report; Material Received	20	212.6800	4,253.60	0.00	4,253.60
86 830 699 32	Paper; Onion Skin, Letter Size	9	76.6110	689.50	766.11	(76.61)
87 067 003 20	Main Bearing Included Thrust Bearing	8	1,956.5300	15,652.24	1,562.24	14,090.00
87 067 017 20	Valve Spring	82	22.0700	1,809.74	1,898.02	(88.28)
87 067 019 20	Exhaust Valve Seats	86	1,438.1350	123,679.61	4,609.61	119,070.00
87 067 024 20	Intake Valve Seats	92	1,438.1400	132,308.88	13,238.42	119,070.46
87 070 021 20	Exhaust Valve Stem	9	334.4500	3,010.05	30,100.50	(27,090.45)
	Total			409,615.46	270,386.74	139,228.72

a.4) Further analysis of the account disclosed that items carried in the books for at least P2,290,090.97 were slow or non-moving. Annex A illustrates that some items have not moved since 2004. No allowance for obsolescence was provided for 2009, although previous Notes to Financial Statements have stated that allowances have been regularly provided for.

We recommended that management conduct a thorough evaluation of the account and make the appropriate steps to reconcile actual with recorded balances. An assessment of slow and non-moving items is suggested to provide a basis for the provision of appropriate allowance for obsolescence.

We also recommended the maintenance of inventory cards or a practicable method of monitoring the receipts and issuances of inventory items. Management may also consider exploring the possibility of reformulating the present system wherein unpaid purchases of items are not recorded as inventory.

Management committed to correct whatever deficiencies were noted during the audit. A thorough inventory and reconciliation of balances will be undertaken immediately, and the appropriate allowance for inventory obsolescence will be provided after the identification and segregation of obsolete and non-moving inventory items. Management has engaged the services of Terraweb Solutions, an IT contractor, to upgrade the existing computer systems.

17. Continued non-reimbursement of valid port expenses by Petron Corporation contrary to the provisions of Time Charter Contracts

Our audit of the Other Current Receivables Account (188), which includes reimbursable port expenses incurred by PSTC's vessels when servicing Petron Corporation, disclosed that not all port expenses are reimbursed by the latter. Out of the total recorded reimbursable port expenses of ₱13,689,530.17, 46.7% or ₱6,395,477.02 was initially processed by Petron. Of the this amount, only ₱5,979,770.23 was reimbursed, leaving an underpayment of ₱415,706.79. This issue has been the subject of audit observations during the past several years and according to past discussions with management, it has been a practice of Petron Corporation to exercise its discretion in slashing valid reimbursable expenses. Thereafter, a meeting between the two parties will be made to arrive at a compromise agreement over disputed charges that have already accumulated over the years.

We refer to Section 8 of the Time Charter Contract which governs the issue of reimbursement of port expenses. It clearly states that *"the Charterer shall provide and pay for all fuel, towage and pilotage and shall pay agency fees, port charges, commissions, expenses of loading and unloading cargoes, canal dues and all charges, x x x ."* Further, *all port expenses including but not limited to usage fees, pilotage fees, launch services, customs formalities/overtime charges, tug assist services, mooring gang, banca hire (excluding use by crew), hose connection/disconnection (shore side), quarantine expenses when required and agent's expenses when required shall be for the account of the Charterer."*

We recommended that the following measures be taken, viz:

a) Evaluate the expenses that have been consistently been excluded by Petron from reimbursement and determine if the nature of said expenditures belong to a uniform or identical nature; and

b) Explore the possibility of formulating a policy that will positively address this recurring issue.

Management commented that Petron imposes their own tariff rates for all reimbursable expenses which are arbitrarily set for all their haulers including PSTC. With the transfer of Billing and Collection functions under Finance Department, management shall endeavor to reconcile and pursue collection of these outstanding unpaid balances from Petron Corporation.

18. Accounts Receivables amounting to P8.669 million continue to be uncollected for a period of more than five (5) years

Our audit of the Long Term Notes & Accounts Receivables Account (270) for the year ended December 31, 2009 disclosed that long outstanding accounts amounting to P8,668,614.85 have remained uncollected for at least five (5) years. The amount is shared between two customers details of which are as follows:

Customer	Amount	No. of Years Outstanding
Delsan Shipping	2,981,119.60	5
Safeway Maritime Baulkers, Inc.	5,687,495.25	6
Total	8,668,614.85	

Our verification disclosed that receivables from Delsan Shipping relates to charter hire of MT Petron III which was outstanding since 2004, while the balance of receivables from Safeway Maritime Baulkers, Inc. (SBMI) was the result of an unsettled issue between PSTC and SBMI in 2003 for the cost of bunker fuel left on board the chartered two tankers namely, M/T Agoncillo and M/T Bonifacio, to service Petron Corporation.

An allowance for doubtful accounts of P2,628,058.85 was provided based on the new policy adopted per Board Resolution #23, Series 2009. Since said receivables remained unsettled for more than five (5) years, we requested for information on what actions, if any, has management taken for the past years to collect these amounts.

According to Management, these accounts will be referred to the Office of the Government Corporate Counsel (OGCC) for appropriate legal action.

PNOC ALTERNATIVE FUELS CORPORATION

19. De-recognition of land inventory development cost amounting P222.517 million without the necessary valuation from an independent appraiser

During our audit of the Corporation's 2009 accounts, we noted the de-recognition of land inventory amounting to P 222,517,414.08 through the following adjusting entry:

Entry Made

Reserve for development cost	P 222,517,414.08	
Land inventory		P 222,517,414.08
To adjust reserve accounts from land inventory to reserve Development cost.		

An interview with the Accounting Manager disclosed that the entry was made to offset the reserve account against land inventory. Apparently, the composition of the Reserve for Development Cost account could no longer be determined and Management decided to write off the whole amount which resulted in a significant write-down of the Land Inventory account.

It could be remembered that this issue was the subject of an audit observation during the audit of CY 2008 transactions of the Corporation, and later became one of the bases for the rendition of a qualified opinion.

Briefly, the P222.517 million reserve represents the actual and estimated construction cost to complete the development project in Bataan which was capitalized as part of the cost of Land Inventory, including civil works, road network, drainage and sewerage systems, perimeter fence, electrical lighting and other related development costs. Our observation focused on the absence of an assessment or evaluation of the reserve for a considerable period thereby leading us to conclude that the carrying amounts do not reflect the current best estimate of the account. We then recommended that in accordance with Philippine Accounting Standard (PAS) 2, an appraisal or review of the account be conducted to determine its best current valuation so as to have a basis for the appropriate adjusting entries to be made.

However, it seems that the complete write-off of the reserve account was made without the necessary appraisal/valuation. Thus, the adjusting entry has no concrete basis.

We recommended that the adjusting entry made be reversed and that an adjustment to the reserve account be made only on the basis of an appraisal or evaluation of the actual and estimated construction costs made to complete the development project in Bataan.

According to Management, they will reverse the entry that was made by debiting Land Inventory and crediting Reserve for Development Cost amounting to P222.52 million, and that appropriate adjusting entries will only be made after the required appraisal or evaluation in accordance with PAS 2 has been complied with.

We further recommend that an approval of the request for the relief of accountability for the said property and the dropping of the amount from the land inventory account should be secured from the Commission on Audit pursuant to the pertinent provisions of the Revised Rules of Procedures.

20. Receivables from grower-partners amounting to P10.795 million representing unliquidated cash advances were recognized in the books of accounts without due notification to the parties involved

During our audit of the Corporation's Other Receivables account, we noted that the Company recognized additional receivables from the following Jatropha Project partners, to wit:

Cebu	P 2,100.00
Nueva Vizcaya State University	457,110.42
Ozamiz	13,985.00
Pampanga College of Agriculture	1,705,758.86
Tarlac College of Agriculture	1,896,661.49
UP Los Banos	6,719,680.37
Total	**P 10,795,296.14**

These receivables pertain to unliquidated balances of cash advances granted to the above-named Jatropha Project partners that were validated to be outstanding during the audit of CY 2008 transactions.

However, inquiry from Accounting Department personnel disclosed that said partners were not duly informed that the unliquidated cash advances have been charged against their respective accounts. This unilateral action by the Corporation might give rise to uncollectible receivables since the other parties are not aware about it and therefore do not recognize the existence of their liabilities.

We recommended that the Jatropha Project partners be notified in writing about the outstanding cash advance balances and demand that the liquidation thereof or refund of the unspent amounts be immediately undertaken. Further, considering the time that has lapsed since the advances have remained outstanding, it is suggested that this issue be taken up with the Legal Department to explore appropriate legal action that may have to be taken in anticipation of the partners' unwillingness to liquidate said cash advances.

According to Management, the said amounts were originally charged to the Jatropha Plantation account since these refer to workers' payroll in the Cebu and Ozamiz nurseries, and others were releases to State Universities and Colleges for the establishment of nurseries. In 2008, these were reclassified to Other Receivables because of disallowed disbursements on overpayment of wages to workers in Cebu and Ozamiz; and unliquidated cash advances of the mentioned universities and colleges. As stated in the Memorandum of Agreement, no liquidation report shall be required for every release of fund under jatropha projects, and that the utilization shall be exclusively managed by the project partner. Instead, an accomplishment report shall be submitted before pertinent tranche of funds is released. Submission of liquidation reports is only an additional requirement of our Accounting Department.

21. Results of evaluations made by consultants disclosed the status of various nurseries and plantations that necessitate remedial action as recommended by the consultants hired by the Company

Our review of the evaluation/assessment reports on the jatropha seedling nurseries and plantations submitted by Consultants Arturo Castillo and June Alvarez and the valuation report of Ms. Lilia Laure disclosed findings of similar nature among the different project sites which are summarized as follows:

NURSERIES

a) <u>Abandoned and are no longer maintained</u>

- Mariano Marcos State University, Ilocos Norte
- Mariveles, Bataan
- Cagayan de Oro City
- U.P. Los Banos (contract has expired)

b) <u>With seedlings ready for extraction and outplanting but have not been hauled by PAFC</u>

- Mariano Marcos State University, Ilocos Norte
- Pampanga Agricultural College
- Tarlac College of Agriculture
- Nueva Vizcaya State University
- General Santos City

c) <u>With seedlings that are overgrown and bearing flowers and fruits</u>

- Cagayan de Oro City

PLANTATIONS

d) <u>Suffered partial destruction by fire</u>

- Rodriguez, Rizal (55.69 hectares burned)
- Fort Magsaysay, Nueva Ecija (176 hectares burned)
- Iba, Zambales (135 hectares burned)
- Palawan (2 hectares burned)
- General Santos City (2 hectares burned)
- Surigao del Norte (2 hectares burned)

e) <u>Site/location problems such as difficult accessibility, lack of water and poor site preparation</u>

- Rodriguez, Rizal – situated in mountainous areas with moderate to sharp inclination; lacks proper site preparation
- Cadiz City – plantations are situated in rolling terrains and no permanent roads are available for better accessibility
- Ilog, Negros Occidental – plantation areas are located in hilly and unproductive lands dominated by cogon and grass

f) Not producing the desired quantity of seeds

- Rodriguez, Rizal
- Fort Magsaysay
- Iba, Zambales
- Cadiz City
- Palawan
- Kabankalan

g) Plants already bearing fruits but no collection of seeds was done

- Iligan

h) Lack of plantation maintenance or administration

- Biliran
- Malungon, Saranggani
- General Santos City
- Iba, Zambales

In view of the abovementioned findings, we recommended that Management implement the recommendations of the consultants that need to be prioritized, to wit:

1. Selection of plantation area must be scrutinized further by a Selection and Awards Committee. Development of selection criteria must be established and strictly implemented.
2. Prospective Partner-Growers must be evaluated objectively as to its project management capacity and level of commitment.
3. PAFC must implement strict compliance by Grower-Partners on the submission of technical and financial reports, and should conduct regular on-site ocular inspections to verify the veracity of the reports. (reporting periods preferably near the year-end dates)
4. Conduct thorough periodic performance evaluation of Grower-Partners.
5. Formulate liability clause against Partner-Growers in case plantations suffer losses due to their negligence.
6. PAFC must develop a contingency plan to address drought, grass and forest fire, or any acts of man resulting to devastation of plantations.

22. The Early Retirement Plan for pioneer employees was implemented without the necessary concurrence of the PNOC Board of Directors, appropriate funding and approval of the Office of the President of the Philippines

This is a reiteration of audit finding number 2 contained in the Annual Audit Report for the year ended December 31, 2008.

The Board of Directors, through Resolution No. 08-001, series of 2008, approved the following: (1) early retirement pay to pioneer employees of the Company or those whose appointments were implemented within one year from the date of the Company's commencement of operations as PNOC Alternative Fuels Corporation, or amendment of its Articles of Incorporation on July 17, 2006; and (2) retirement pay to its President and Chief Executive Officer.

We observed the following deficiencies, viz:

(a) Funds for the Early Retirement Plan were not included in the 2008 Corporate Operating Budget. Consequently, disbursements for the benefits paid to separated employees were sourced from the Company's operating fund.

(b) No approval from the President of the Republic of the Philippines was obtained as required under pertinent sections of Memorandum Order No. 20 dated June 25, 2001.

(c) The Retirement Plan was not elevated to the PNOC Board of Directors for concurrence as no board resolution from the PNOC, its majority stockholder, could be presented. This is expressly required under Section 12 of PD 927 which amended Executive Order No. 334, the Charter of the Philippine National Oil Company. Further, considering that the plan was triggered off by changes in the Company's policy direction as resolved by the PNOC Board during its 2008 strategic planning conference, the same should bear the approval of the same Board for purposes of determining its alignment with such policy directions.

We recommended that this issue be taken up by the Company with the PNOC Board in order to come up with a definitive position on the matter since succeeding PAFC officers and employees and other PNOC subsidiaries might avail of this type of benefit in the future.

According to Management, during the Stockholders' Meeting last June 9, 2009, the stockholders did not ratify PAFC Board Resolution No. 08-001, s.2008 which established the Early Retirement Plan for pioneer employees. Subsequently, during the regular meeting of the PAFC Board on Feb. 11, 2010, Resolution No. 10, s.2010 was passed enjoining future members of the PAFC Board to refrain from adapting similar retirement plans and other schemes that would result in unnecessary expenses. The said Resolution was submitted to the PNOC Board for appropriate action.

In view of the deficiencies noted, payment of benefits under the Early Retirement Plan of the Company is bereft of legal basis and shall be accorded audit action correspondingly.

BOARD OF DIRECTORS

ANGELO T. REYES - *Chairman*
ANTONIO M. CAILAO – *President and Chief Executive Officer*
EMIL P. JURADO
DANTE B. CANLAS
BOB D. GOTHONG
RAMON B. MITRA
JULIO J. JALANDONI
NICANOR L. SERING
RAYMOND DEMOCRITO C. MENDOZA *(served until 18 April 2009)*
GREGORIO T. IPONG *(assumed his post on 23 October 2009)*

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