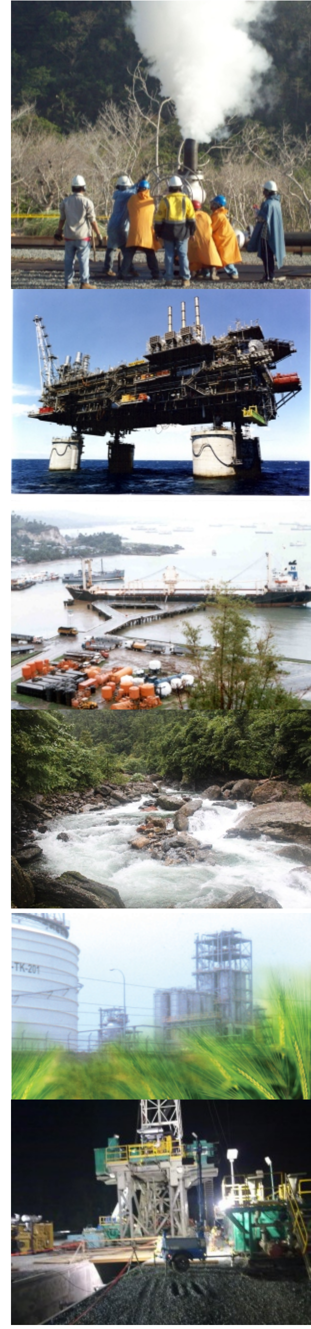
PHILIPPINE NATIONAL OIL COMPANY

PNOC

The Energy Company



2012

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

2012

Annual Report

TABLE OF CONTENTS

2012 Highlights ………………………………………………………………... **1**
Oil and Gas ……………………………………………………………………... **2**
Petroleum Exploration
Natural Gas Development and Production
Coal ………………………………………………………………………………. **2**
Alternative Fuels ……………………………………………………………… **2**
Biofuels
Renewables ……………………………………………………………..…… **8**
Hydropower
Geothermal
Shipping and Transport ………………………………………………… **3**
Real Estate Management ……………………………………………….. **4**
Other Projects ………………………………………………………………….. **5**
Compressed Natural Gas (CNG) Stations
Persistent Organic Pollutants (POPs) Project
2011 PNOC Audited Financial Statements ……………………………... **6**
Board of Directors ……………………………………………………….. **38**

2012 Highlights

- PNOC remitted ₱3.5 billion in dividends to the Bureau of Treasury during the first quarter of 2012.

- PNOC continued to sponsor a scholarship program for students enrolled in courses on engineering and natural sciences in UP Diliman.

Oil and Gas

PNOC Exploration Corporation (PNOC-EC) is the upstream oil and gas subsidiary of the Philippine National Oil Company (PNOC). It is actively engaged in the country's search for indigenous sources of energy. Since its establishment, it has undertaken various onshore and offshore oil and gas exploration activities in many parts of the country.

Petroleum Exploration

As in the past years, PNOC-EC continued to implement an aggressive petroleum exploration program around the country. Presently, PNOC-EC holds interests in six (6) exploration Service Contracts namely Offshore Mindoro, Calamian, West Calamian, West Balabac, East Sabina and Cagayan Basin. Activities covered mostly seismic data acquisition, processing and interpretation, geological and geophysical studies, all in preparation for well drilling activities.

Natural Gas Development and Production

Total natural gas produced from the MalampayaDeepwater Gas-to-Power Project for the year reached 134.49 billion cubic feet, providing for the fuel requirements of its three power plant customers in Batangas. Condensate production reached 4.59 million barrels and was shipped to buyers in Singapore, Thailand and China during the period.

Coal

PNOC-EC continued on with the coal business, serving the requirements of the cement manufacturing and the power production industries with its own production from the ZamboangaSibugay Coal Project (COC 41) and other local mine sources such as Semirara coal and imported coal from Indonesia while serving the requirements of the emerging small-scale user market.

Total coal production from ILB Mines 1, 2 and small scale mines for the year reached 70.11 thousand metric tons (MT) or 44% of target volume of 160 thousand metric tons. Total coal traded for the period is 253.86 thousand metric tons. The continued decline in coal sales is mainly caused by majority of the large industries (power and cement) in the domestic front that use local coal and directly transact with Semirara Mining Corporation and other mining companies.

Alternative Fuels

Considering that the PNOC- Alternative Fuels Corporation (PAFC) was created with the primary mandate to explore, develop and accelerate the utilization and commercialization of alternative fuels, the Company envisions being a strategic participant in biofuels production and in the alternative fuels industry.

Biofuels

The PNOC-AFC has identified possible projects on ethanol production using sweet sorghum and other viable feedstock. In line with this, PNOC-AFC drafted a MOA with the Philippine Agricultural Development and Commercial Corporation (PADCC) on the commercialization of ethanol production using sweet sorghum as feedstock. Moreover, PNOC-AFC prepared the draft feasibility study on the establishment of bio-ethanol using sweet sorghum as feedstock.

Renewables

The PNOC Renewables Corporation (PNOC-RC) is PNOC's newest subsidiary. It is tasked to promote the development and implementation of new and renewable energy sources in the country.

Hydropower

As of 2012, eight of the eleven hydropower service contracts have been stalled because of the non-endorsement of PNOC-RC by the DOE as the rightful RE developer owning the said Service Contracts. The said endorsement is needed by the DENR EMB and the NWRB, as well as the NCIP, to proceed with the next regulatory requirements of these projects and for PNOC RC to proceed with the next steps in the pre-development stage of the project. As a directional policy, these service contracts will be developed under a PPP (public-private partnership) model.

Geothermal

PNOC-RC maintains a 10% share in the Maibarara Geothermal, Inc. (MGI) consortium, which is in the process of building its steam field and power plant.

A low-key groundbreaking ceremony for the 20MW Maibarara Geothermal power plant construction took place last 27 April 2012, attended by local government and DOE officials, and MGI executives. MGI is expected to be operational by 2013.

Shipping and Transport

The PNOC Shipping and Transport Corporation (PSTC) is the shipping and transport arm of PNOC engaged in the business of transporting petroleum products in all parts of the country. It also engages in shipping, tankering, lighterage, barging, towing, and shipment of goods, chattels, and other products, marine and maritime commerce.

PSTC continuously served Petron via Time Charter contract for two (2) double hulled vessels namely M/T PNOC Lapu-Lapu and M/T PNOC Emilio Jacinto in 2012. From January to December, average utilization achieved was 88% for both double hulled vessels, completing 72 trips, and lifting 127,377 metric tons of petroleum and chemical products. SIRE checklist and guidelines were adopted in compliance with the requirements of Petron as well as Class requirements. With the objective to improve the vessels' condition and reduce off-hire periods in the future, maintenance and repairs were usually being done with the vessels especially M/T Lapu-Lapu in the 1st semester.

The first phase of the Manpower Reduction Program (MRP) was implemented in the 4th quarter of 2011 for the purpose of realizing savings resulting in the reduction in employee costs by as much as P 1.1 million per month.MRP Phase 2 (M/T Luna crew and officers) was carried out by the company in the first semester of 2012 due to PNOC Board's directive to sell M/T Luna instead of converting her to double hull.

Real Estate Management

The PNOC Development and Management Corporation (PDMC) is engaged in industrial estate development and management. It has been managing 118 hectares of landholdings in Rosario, Cavite since 2001. To date, 12 hectares more or less, remain in its books as capital and investment assets.

Since the extension of PDMC's corporate life in March 2008, PDMC's activities were mainly on the sale of assets principally 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 in September 2006.

From Costa Verde Inventories, PDMC sold 21 lots vs. its target of 38 lots or 55% compliance with a Total Contract Price of P20.2 million for 2012. El Pueblo Condormitel units sold for the year stood at 12 units with a Total Contract Price of P20.6 million. PDMC had a collection of P21 million including the arrears of the previous year.

PDMC sales and collection for Socialized Housing were turned over to the Rosario, Cavite Local Government Unit in June 2010. A yearly remittance of P30 million is committed by the LGU. For the year, collections only reached P10 million as the LGU is undergoing ongoing compliance with COA Region IV.PDMC has collected P7.6 million of rentals from the long term lease of its 4.9 hectare property inside the Cavite Economic Zone (CEZ) in Rosario, Cavite.PDMC accomplished 117% of its projected revenue from the lease of its capital assets, due to updated payment of rental for the whole year of 2012.

Other Projects

Compressed Natural Gas (CNG) Stations

PNOC-EC is set to undertake the CNG for vehicle project, which is in line with the Department of Energy's (DOE) existing Natural Gas Vehicle Program for Public Transport (NGVPPT).

The project aims to construct CNG distribution infrastructure such as one (1) mother station and two (2) daughter stations to increase the use of CNG in public utility vehicles. This project aims to provide fuel to 1,000 buses in the long-run. Bidding for the CNG equipment started in June 2012. However, activities relating to the planned CNG daughter station in Batangas City were deferred due to unresolved franchising issues with LTFRB/DOTC.

Persistent Organic Pollutants (POPs) Project

As of end-2012, the POPs facility in the Bataan Industrial Park which include building and other related infrastructures was 100% completed. A total of 13.40 metric tons of polychlorinated biphenyls (PCB) oil was successfully treated last March 2012. However, the commercial testing of the destruction of low level PCB wastes was temporarily stopped due to some technical adjustments in some of the equipment. On the other hand, sampling and analysis of inventory of PCBs from the National Grid Corporation of the Philippines (NGCP) and Meralco have been accomplished.

2012
PNOC Audited Financial Statement

PHILIPPINE NATIONAL OIL COMPANY
EXECUTIVE SUMMARY

A. Introduction

The Philippine National Oil Company (PNOC) was created through Presidential Decree No. 334 on November 9, 1973 to provide and maintain an adequate and stable supply of oil. Focusing its efforts and resources in learning the ropes of the petroleum industry, PNOC rose to occupy market leadership in an industry thought to be the domain of multinationals. Its charter was amended to include energy exploration and development.

PNOC initiated the exploration of the country's indigenous oil and non-oil energy resources. Its purpose was to build an energy sector that will bring energy independence to the country. Eventually, PNOC expanded its operations to include total energy development, including indigenous energy sources like oil and gas, coal, and geothermal.

PNOC's vision is to be a world-class Philippine energy enterprise and its mission is to develop 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.

PNOC has five subsidiaries working together to realize PNOC's vision: PNOC Exploration Corporation, PNOC Shipping and Transport Corporation, PNOC Development Management Corporation, PNOC Alternative Fuels Corporation and PNOC Renewables Corporation.

B. Financial Highlights (In Million Pesos)

The operating budget of PNOC for CY 2012 was P416 million. Ninety-five percent of the budget, equivalent to P397 million, was utilized during the year.

The financial position and results of operations of PNOC are summarized as follows:

Financial Position

	2012	2011	Increase (Decrease)
Assets	40,707	43,316	(2,609)
Liabilities	5,428	5,461	(33)
Equity	35,279	37,855	(2,576)

Results of Operation

	2012	2011	Increase (Decrease)
Revenues	2,036	5,593	(3,557)
Operating Expenses	(265)	(295)	30
Income From Operations	1,771	5,298	(3,527)
Foreign Exchange Loss	(1)	(4)	3
Other Charges	(68)	(59)	(9)
Net Profit Before Tax	1,702	5,235	(3,533)
Income Tax	(48)	(34)	(14)
Comprehensive Income For the Period	1,654	5,201	(3,547)

PNOC remitted a total of P3.5 billion in dividends to the Bureau of Treasury in January 2012 (P1.5 billion) and February 2012 (P2.0 billion).

C. Scope of Audit

A financial and compliance audit was conducted on the accounts and operations of PNOC for the year ended December 31, 2012 to determine the fairness of presentation of the financial statements and the propriety of the financial transactions, in accordance with the International Standards on Auditing, applicable laws, rules and regulations.

D. Independent Auditor's Opinion

The Auditor rendered an unqualified opinion on the fairness of the presentation of the financial statements of the PNOC as at December 31, 2012 as stated in the Independent Auditor's Report in Part I.

E. Summary of Audit Observations and Recommendations

Considering that the Annual Audit Reports for CYs 2010 and 2011 were released only in June 2013, we reiterate audit observations and recommendations contained therein, summarized as follows:

1. The engagement of services of private lawyers lacked compliance with the provisions of COA Circular No. 86-255 dated April 2, 1986, as amended by COA Circular No. 95-011 dated December 4, 1995.

   We recommended that the amount of P63,000 be refunded by the responsible officials because numerous decisions of the COA Commission Proper disallowed payments to private lawyers without COA concurrence, e.g. COA Decision No. 2012-015 dated February 16, 2012. The corresponding Notice of Disallowance will be issued.

2. Special allowances of P5.504 million granted to the Solicitor General, Assistant Solicitor General, Senior State Solicitors and Associate Solicitor engaged by PNOC were not duly approved by the Solicitor General and the Secretary of Budget and Management as required by Section 10 of Republic Act No. 9417 dated July 24, 2006.

We recommended that Management obtain written approval for the rates they are paying the lawyers from the OSG in accordance with RA 9417.

F. Status of Implementation of Prior Year's Recommendations

Of the three audit recommendations issued in CY 2011, one was partially implemented and two were not implemented. Details are presented in Part II of this Report.

TABLE OF CONTENTS

		Page
Part I	**AUDITED FINANCIAL STATEMENTS**	
	Independent Auditor's Report	1
	Statement of Financial Position	3
	Statement of Comprehensive Income	4
	Statement of Changes in Equity	5
	Statement of Cash Flows	6
	Notes to Financial Statements	7
Part II	**A. COMMENTS AND OBSERVATIONS**	20
	B. STATUS OF IMPLEMENTATION OF PRIOR YEARS' AUDIT RECOMMENDATIONS	24

PART I

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

Report on the Financial Statements

We have audited the accompanying financial statements of **Philippine National Oil Company** (a Corporation wholly-owned by the Government of the Republic of the Philippines), which comprise the statement of financial position as of December 31, 2012, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International 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 International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An 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 those 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.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of the **Philippine National Oil Company** as of December 31, 2012, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

COMMISSION ON AUDIT

By:

HILCONEDA P. ABRIL
State Auditor V
Supervising Auditor

June 28, 2013

PHILIPPINE NATIONAL OIL COMPANY
(A Corporation Wholly-Owned by the Government of the Republic of the Philippines)
STATEMENT OF FINANCIAL POSITION
December 31, 2012
(In Philippine Peso)

	Notes	**2012**	2011
ASSETS			
Cash and cash equivalents	4	**2,910,851,780**	4,448,276,388
Held-to-maturity investments	5	**3,121,433,119**	4,332,554,164
Receivables	6	**37,688,234**	67,074,047
Investments in subsidiaries and affiliates	7	**5,273,274,356**	5,273,274,356
Investment property	8	**11,600,291,996**	11,610,519,383
Property and equipment	9	**225,642,998**	197,565,275
Deferred tax assets	19	**344,235,388**	389,125,773
Other assets	10	**17,193,320,778**	16,997,732,202
TOTAL ASSETS		**40,706,738,649**	43,316,121,588
LIABILITIES AND EQUITY			
LIABILITIES			
Accounts payable and accrued expenses	11	**341,954,688**	281,423,353
Dividends payable	13	**77,881,632**	96,785,236
Deferred tax liabilities	19	**2,790,604,920**	2,790,669,844
Long-term debt		**-**	77,533,500
Other credits	12	**2,217,625,579**	2,214,874,248
TOTAL LIABILITIES		**5,428,066,819**	5,461,286,181
EQUITY		**35,278,671,830**	37,854,835,407
TOTAL LIABILITIES AND EQUITY		**40,706,738,649**	43,316,121,588

See accompanying Notes to Financial Statements.

PHILIPPINE NATIONAL OIL COMPANY
(A Corporation Wholly-Owned by the Government of the Republic of the Philippines)
STATEMENT OF COMPREHENSIVE INCOME
For the Year Ended December 31, 2012
(In Philippine Peso)

	Notes	**2012**	2011
REVENUES			
Dividend income	14	**1,500,153,820**	5,001,856,255
Interest income		**344,138,338**	387,646,622
Rent income		**192,113,949**	203,450,849
GROSS REVENUES		**2,036,406,107**	5,592,953,726
OPERATING EXPENSES	15	**(265,629,386)**	(295,187,302)
INCOME FROM OPERATIONS		**1,770,776,721**	5,297,766,424
FOREIGN EXCHANGE LOSS	16	**(681,763)**	(4,243,199)
OTHER INCOME (CHARGES)	17	**(67,731,316)**	(59,141,628)
NET PROFIT BEFORE TAX		**1,702,363,642**	5,234,381,597
INCOME TAX	18		
Current		**(3,435,807)**	(3,801,217)
Deferred		**(44,825,461)**	(29,815,424)
COMPREHENSIVE INCOME FOR THE PERIOD		**1,654,102,374**	5,200,764,956

See accompanying Notes to Financial Statements.

PHILIPPINE NATIONAL OIL COMPANY
(A Corporation Wholly-Owned by the Government of the Republic of the Philippines)
STATEMENT OF CHANGES IN EQUITY
For the year ended December 31, 2012
(In Philippine Peso)

	CAPITAL STOCK (Note 13)	RETAINED EARNINGS (Note 13)	TOTAL EQUITY
Balance, January 1, 2011	3,114,595,519	32,088,648,674	35,203,244,193
Comprehensive income for 2011		5,200,764,956	5,200,764,956
Cash dividends for 2011 net earnings		(2,596,951,213)	(2,596,951,213)
Adjustment on cash dividends for 2009 and 2011		47,777,471	47,777,471
Balance, December 31, 2011	**3,114,595,519**	**34,740,239,888**	**37,854,835,407**
Balance, January 1, 2012	3,114,595,519	34,740,239,888	37,854,835,407
Comprehensive income for 2012		1,654,102,374	1,654,102,374
Cash dividends based on Retained earnings as of December 31, 2010		(3,500,000,000)	(3,500,000,000)
Adjustment on Dividends Payable		96,785,236	96,785,236
Cash dividends for 2012 net earnings		(77,881,632)	(77,881,632)
Cash dividends directly remitted by PNOC EC to the National Government		(749,169,555)	(749,169,555)
Balance, December 31, 2012	**3,114,595,519**	**32,164,076,311**	**35,278,671,830**

See accompanying Notes to Financial Statements.

PHILIPPINE NATIONAL OIL COMPANY
(A Corporation Wholly-Owned by the Government of the Republic of the Philippines)
STATEMENT OF CASH FLOWS
For the year ended December 31, 2012
(In Philippine Peso)

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash receipts from customers, subsidiaries and employees	**593,752,929**	726,171,947
Cash paid to suppliers, subsidiaries and employees	**(297,934,212)**	(552,531,451)
Net cash from operating activities	**295,818,717**	173,640,496
CASH FLOWS FROM INVESTING ACTIVITIES		
Maturities (placements) of short-term investments	**6,064,046**	674,424,993
Investment in treasury bonds - net	**1,190,000,000**	(168,572,832)
Cash dividends from subsidiaries / associates	**750,984,265**	2,499,713,555
Loan drawdowns to subsidiaries	**(152,000,000)**	-
Net proceeds from disposal of assets	**40,000**	435,200
Proceeds from redemption of preferred shares	**-**	504,322
Capital expenditures	**(50,798,136)**	(55,034,321)
Net cash from investing activities	**1,744,290,175**	2,951,470,917
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of long-term loans	**(77,533,500)**	(44,304,857)
Payment of cash dividend to National Government	**(3,500,000,000)**	(480,333,387)
Net cash used in financing activities	**(3,577,533,500)**	(524,638,244)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(1,537,424,608)**	2,600,473,169
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**4,448,276,388**	1,847,803,219
CASH AND CASH EQUIVALENTS AT END OF YEAR	**2,910,851,780**	4,448,276,388

See accompanying Notes to Financial Statements.

1. BACKGROUND

The Philippine National Oil Company (PNOC) was created through Presidential Decree No. 334 on November 9, 1973, to provide and maintain an adequate supply of oil. Its charter was amended to include energy exploration and development. Thirty-nine years after its creation, the 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 Company to get more involved in new and renewable energy activities and projects.

The registered office address is PNOC Building 6, Energy Center, Rizal Drive, Bonifacio Global City, Fort Bonifacio, Taguig City.

2. BASIS OF FINANCIAL STATEMENTS PREPARATION

The significant accounting policies that have been used in the preparation of these financial statements are summarized below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Statement of Compliance with International Financial Reporting Standards

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the Philippines as set forth in the International Financial Reporting Standards (IFRS). IFRS include statements named IFRS and International Accounting Standards (IAS) and interpretations issued by the International Financial Reporting Interpretation Committee (IFRIC).

2.2 Basis of Preparation

The financial statements of the Company have been prepared using the measurement bases specified by IFRS for each type of asset, liability, income and expense. These financial statements have been prepared on the historical cost basis.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Cash and Cash Equivalents

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 dates of acquisition.

b. Held-to-Maturity Investments

Held-to-Maturity investments are quoted non derivative financial assets with fixed or determinable payments and fixed maturities for which management has the positive intention and ability to hold to maturity.

c. Investments in Subsidiaries and Affiliates

Investments in wholly-owned and controlled subsidiaries and affiliates are accounted for under the cost method of accounting. They are carried in the Company balance sheet at cost less any impairment in value. The Company recognizes income from the investments only to the extent that it received distributions from accumulated profits of the subsidiaries and associates. Distributions received in excess of such profits are regarded as a recovery of investment and are recognized as a reduction of the cost of the investment.

An impairment is provided for any substantial and presumably permanent decline in the carrying values of the investments.

d. Investment Property

Investment property, consisting of land held to earn rentals and for capital appreciation, is stated at cost.

e. Property and Equipment

Property and equipment are carried at cost less accumulated depreciation and any impairment in value.

The initial cost of property and equipment comprises its purchase price and costs directly attributable to bringing the asset to its working condition and location for its intended use.

Expenditures incurred after the property and equipment have been put into operation, such as repairs and maintenance, are normally charged to income in the period the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as additional cost of property and equipment. When assets are retired or otherwise disposed of, the cost and the related accumulated depreciation are removed from the accounts and any resulting gain or loss is credited or charged to current operations.

Depreciation is computed on a straight-line method based on the estimated useful lives of the assets as follows:

Building and Improvements	25 years
Machinery and equipment	5 years
Communication equipment	5 years
Transportation equipment	5 years
Furniture, fixtures and equipment	5 years
Information technology equipment	3 years

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

f. Bank Borrowings

Interest-bearing bank loans are recorded at face value. Outstanding balances of bank borrowings denominated in foreign currencies are restated using the prevailing rate of exchange at balance sheet date.

Borrowing costs are generally recognized in profit or loss in the period they are incurred.

g. Foreign Currency Transactions

Transactions in foreign currencies are recorded at the rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are restated using the Philippine Dealing and Exchange System (PDEX) rate as of balance sheet date. Exchange gains or losses arising from foreign currency-denominated transactions are credited or charged to current operations.

h. Impairment of Accounts

The Company recognizes impairment based on aging of accounts at 60% for accounts over 2, 3 and 4 years and 100% for those over 5 years.

i. Revenue Recognition

Revenue is recognized when increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be reliably measured.

Interest income is accrued on a time proportion basis, by reference to the principal outstanding and at the effective interest rate.

j. Operating Leases

Leases where the Company retains substantially all the risks and benefits of ownership of the asset are classified as operating lease. Operating lease payments received by the Company are recognized as rental income.

k. Income Taxes

The provision for income tax represents the sum of the tax currently payable and deferred.

Deferred tax is provided on all temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements using the balance sheet liability method. It is determined using tax rates (and laws) that have been enacted or substantially enacted at the balance sheet date and are expected to apply when the related deferred tax asset is realized or the deferred tax liability is settled.

Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

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 profit will be available to allow all or part of the deferred tax asset to be utilized. Unrecognized deferred tax assets are reassessed at each balance sheet date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

l. Events After Reporting Date

Post-year-end events that provide additional information about the Company's position at the reporting date (adjusting events) are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed in the notes to the financial statements when material.

4. CASH AND CASH EQUIVALENTS

This account consists of:

	2012	2011
Cash in banks	**4,043,210**	11,628,395
Money market placements	**2,906,808,570**	4,436,647,993
	2,910,851,780	4,448,276,388

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

5. HELD-TO-MATURITY INVESTMENTS

This account consists of investments in Treasury Notes of **P3,121,433,119** in **2012** and P4,332,554,164 in 2011 that will mature from 2 to 5 years. These investments bear fixed interest rates ranging from 4.5% to 6.25% annually.

6. ACCOUNTS RECEIVABLE

This account consists of:

	2012	2011
Loan receivable	**37,252,936**	37,252,936
Trade receivable	**-**	9,820,955
Non-trade receivable	**435,298**	20,000,156
	37,688,234	67,074,047

7. INVESTMENTS IN SUBSIDIARIES AND AFFILIATES

This account consists of the following:

	Percentage of Ownership	**2012**	2011
Investment in operating subsidiaries/affiliates:			
PNOC Alternative Fuels Corp.	100	**2,400,000,000**	2,400,000,000
PNOC Exploration Corp.	99.79	**2,019,188,332**	2,019,188,332
PNOC Renewables Corporation	100	**374,972,000**	374,972,000
PNOC Shipping & Transport Corp.	100	**190,000,000**	190,000,000
PNOC Development & Management Corp.	98.08	**65,614,724**	65,614,724
Gulf Oil Philippines, Inc.	34	**54,978,000**	54,978,000
		5,104,753,056	5,104,753,056
Investment in non-operating subsidiaries:			
PNOC Coal Corporation	100	**427,067,950**	427,067,950
PNOC Oil Carriers, Inc.	100	**101,615,343**	101,615,343
PNOC Tankers Corp.	100	**50,000,000**	50,000,000
		578,683,293	578,683,293
Allowance for impairment		**(551,615,343)**	(551,615,343)
		27,067,950	27,067,950
Other investments		**141,453,350**	141,453,350
		5,273,274,356	5,273,274,356

The Company's investment of P2.4 billion in the PNOC Alternative Fuels Corporation (PAFC) consists of 8,000,000 shares at P300 per share. On January 13, 2011, the Company's Board of Directors issued Resolution No. 1981 s.2011 directing PAFC to wind down its jatropha operations totalling approximately P600 million after it was determined that the project would require intensive capital and resources. An evaluation of its other business segments (Industrial Park and Persistent Organic Pollutants [POPs] project) will be conducted to assess their viability. Cognizant of the requirements of International Accounting Standard (IAS) 36 – Impairment of Assets, the Company will be making the necessary adjustments on its PAFC investment account after complete financial data and operational information have been obtained.

PAFC has an equity of P2,604,374,988 as at December 31, 2012.

The PNOC Board approved the shortening of the corporate life of the PNOC Shipping and Transport Corporation effective March 15, 2013. This is to protect the interest of PNOC, as the sole stockholder, from the continued deterioration of the latter, which has a negative equity of P904,445,199 as at December 31, 2012.

In 2003, the Securities and Exchange Commission issued a certificate for the revocation of the following PNOC subsidiaries, namely; PNOC Oil Carriers, Inc. and PNOC Tankers Corporation, but the accounts of PNOC Tankers Corporation and PNOC Oil Carriers, Inc., are retained pending receipt of the clearances from the Bureau of Internal Revenue.

8. INVESTMENT PROPERTY

This account consists of land being leased to third parties. Each of the leases contains a lease period of either 25 or 30 years. Upon expiration of the contract, the lease may be renewed for another years upon the mutual agreement of the parties under such terms and conditions as may be agreed upon by them.

It also includes the land and building in the Energy Center and eight (8) properties conveyed by the National Development Company to PNOC as redemption of the preferred shares through a two-tranche *dacion en pago.*

Bulks of properties were initially assessed by a third party appraiser in 2007 and 2008 and adjustments in values were deemed cost. In 2012, certain parcels of land amounting to P 2.711 billion were appraised by Royal Asia Appraisal and CalFil Appraisal at P3.643 billion.

Rental income earned from the investment properties amounted to **P186,772,023** in **2012** and P198,962,454 in 2011.

9. PROPERTY AND EQUIPMENT

The roll forward analysis of this account follows:

	Land, Building and Improvements	Machinery & Equipment	Communication Equipment	Transportation Equipment	Furniture Fixtures and Equipment	Incomplete Construction	Total
COST							
January 1, 2012	332,392,454	163,894	3,312,352	3,889,836	14,454,721	4,459,168	358,672,425
Additions	37,130,245	100,000	146,430	7,108,500	5,691,945	-	50,177,120
Reclass/Adjustments						(4,459,168)	(4,459,168)
Disposals	(428,571)						(428,571)
December 31, 2012	369,094,128	263,894	3,458,782	10,998,336	20,146,666	-	403,961,806
ACCUMULATED DEPRECIATION							
January 1, 2012	(151,234,409)	(123,880)	(1,616,972)	(2,541,700)	(5,590,189)	-	(161,107,150)
Depreciation	(11,812,827)	(436,872)	(676,319)	(862,219)	(3,844,751)		(17,632,988)
Disposals	421,330					-	421,330
December 31, 2012	(162,625,906)	(560,752)	(2,293,291)	(3,403,919)	(9,434,940)	-	(178,318,808)
NET CARRYING AMOUNT							
December 31, 2012	**206,046,892**	**124,472**	**1,165,491**	**7,594,417**	**10,711,726**	**-**	**225,642,998**
December 31, 2011	181,158,045	40,014	1,695,380	1,348,136	8,864,532	4,459,168	197,565,275

10. OTHER ASSETS

This account consists of:

	2012	2011
Banked gas	**14,544,000,000**	14,400,000,000
Due from subsidiaries and affiliates	**1,216,692,924**	1,031,113,118
Purchase price adjustment fund	**809,757,306**	809,757,306
Special deposits	**220,245,855**	206,246,549
Deferred charges	**204,661,676**	340,878,110
Input VAT	**173,078,803**	188,154,845
Non-trade receivable	**11,251,606**	5,658,601
Prepaid expenses	**7,628,425**	9,449,969
Investment in available for sale securities	**3,804,100**	3,804,100
Deposits for utilities and others	**1,639,639**	2,109,512
Long-overdue receivables, net	**188,185**	188,182
Petty cash fund	**122,119**	122,119
Others	**250,140**	249,791
	17,193,320,778	16,997,732,202

PNOC bought the *banked gas* from the Department of Energy amounting to P14.4 billion which is equivalent to 108.6 Petajoules. The banked gas is an accumulation of the volume of natural gas that 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.

Due from subsidiaries and affiliates consists of the following:

	2012	2011
Due from subsidiaries and affiliates		
PNOC Shipping and Transport Corporation	**1,236,095,641**	1,052,226,793
PNOC Oil Carriers, Inc.	**134,085,597**	134,085,597
PNOC Exploration Corporation	**2,780,554**	1,824,745
PNOC Coal Corporation	**1,659,523**	1,616,187
PNOC Development & Management Corp.	**277,332**	438,412
PNOC Alternative Fuels Corporation	**115,858**	9,148
	1,375,014,505	1,190,200,882
Allowance for impairment	**(133,962,735)**	(133,962,735)
	1,241,051,770	1,056,238,147
Due to affiliated companies		
PNOC Tankers Corporation	**(22,790,361)**	(22,790,362)
PNOC Renewables Corporation	**(1,568,485)**	(2,334,667)
	(24,358,846)	(25,125,029)
	1,216,692,924	1,031,113,118

The amount due from PNOC Shipping and Transport Corporation (PSTC) was attributed mainly to PSTC's availment of credit facility from PNOC for a total of P899,402,600, exclusively for the Company's acquisition of two (2) unit double-hull tankers.

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

Deferred charges pertain mainly to the prepaid interest on Retail Treasury coupon bonds and deferred withholding taxes on rental.

11. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

This account consists of:

	2012	2011
Accrued expenses	**107,242,500**	44,915,205
Accounts payable	**30,602,693**	26,569,284
Other accounts payable	**204,109,495**	209,938,864
	341,954,688	281,423,353

Accrued expenses account is comprised mainly of liability to the Bureau of Internal Revenue amounting to P64,746,444 for the interest and surcharges of PNOC deficiency VAT for 2003 under CTA Case No. 7930 and other expenses/services incurred but not invoiced as of the end of the year.

Accounts payable mainly includes the Company's remaining payable to Shell Solar Philippines Corporation for the purchased units of solar homes systems, which were installed in unelectrified rural households in Region 1-7, the Cordillera Administrative Region and the whole of the Mindanao Regions. It also includes payable to Energy Development Corporation representing security deposit for lease of office building.

Other accounts payable consists mainly of funds for the Decentralized Energy Systems (DES) Project, conceptualized with the aim of promoting the use of renewable energy technologies and assisting the Philippine government in providing sustainable and indigenous energy resources for the country. The fund was transferred by EDC to PNOC, in accordance with the provision in the Deed of Assignment dated May 28, 1993. The Deed of Assignment states that in the event of PNOC EDC's partial or full privatization, the project shall be transferred to another institution such as Foundation under PNOC. On July 29, 2010, PNOC and EDC jointly executed a Turnover Certificate where the authorized representatives of each party certified the delivery and receipt of all the assets and instruments evidencing the same as well as the contracts and documents in connection with the DES Project.

Other accounts payable includes salaries payable, taxes withheld and other liabilities to the Philippine Government.

12. OTHER CREDITS

This account includes non-current items of other deferred income and other deferred credits amounting to **P2,217,625,579** and P2,214,874,248 for **2012** and 2011, respectively.

13. EQUITY

a. Capital Stock

The 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 P50 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 additional shares of 6,029,191 were subscribed by the Philippine Government at P500 per share.

b. Retained Earnings

Pursuant to Republic Act 7656, PNOC declared a total cash dividend of P827,051,187 for its 2012 net earnings, which include the amount of P749,169,555 that were remitted directly to the Bureau of Treasury by PNOC-EC .

On January 31, 2012 and February 6, 2012, PNOC remitted a total of P3.5 billion cash dividend to the National Government out of the Company's retained earnings as of December 31, 2010 as required by the Department of Finance in its letter dated January 31, 2012.

14. DIVIDEND INCOME

This account consists of dividends from the following:

	2012	2011
PNOC Exploration Corporation	**1,498,339,110**	4,996,678,220
Gulf Oil Philippines, Inc	**1,786,779**	1,374,445
PNOC Shipping and Transport Corporation	**-**	3,653,734
Others	**27,931**	149,856
	1,500,153,820	5,001,856,255

15. OPERATING EXPENSES

This account consists of:

	2012	2011
Employee Costs	**76,814,960**	72,455,753
Purchased Services and Utilities	**62,906,457**	60,869,310
Business Expenses	**33,299,366**	39,332,248
Depreciation	**30,135,824**	31,891,846
Awards and Indemnities	**28,315,213**	49,260,057
Rentals/ Insurance/ Taxes	**20,070,636**	25,958,155
Materials and Supplies	**8,033,686**	8,260,597
Maintenance and Repairs	**4,447,446**	5,909,660
Miscellaneous Charges	**1,605,798**	1,249,676
	265,629,386	295,187,302

16. FOREIGN EXCHANGE GAIN (LOSS)

This account pertains to realized foreign exchange losses (P680,309) on money market placements in dollar denominations and unrealized foreign exchange gain/loss (P1,454) on realignment of dollar placement balances into Philippine pesos based on PDS rate at year-end of US$1.00=P41.050 vs. peso dollar rate at various value date of investment.

17. OTHER INCOME (CHARGES)

This account consists of the following:

	2012	2011
Gain on disposal of assets	**32,759**	380,000
Other income (charges)	**(67,764,075)**	(59,521,628)
	(67,731,316)	(59,141,628)

18. INCOME TAXES

Components of income tax expense are as follows:

	2012	2011
Current income tax	**3,435,807**	(3,801,217)
Deferred income tax	**44,825,461**	(29,815,424)
	48,261,268	(33,616,641)

The computation of taxable income follows:

Net income per books	**1,702,363,642**	5,234,381,597
Permanent differences		
Interest income	**(316,683,556)**	(327,071,593)
Dividend income	**(1,500,153,820)**	(5,001,856,255)
Non-deductible expenses	**9,869,224**	9,764,556
Temporary differences		
Accrued rental income	**(3,611,882)**	(40,415,683)
Unearned rent income	**3,835,103**	7,677,883
Forex loss – net	**-**	(6,862,530)
Deficiency income tax	**64,746,444**	58,208,165
	(39,634,845)	(66,173,860)

Current income tax was computed based on the Minimum Corporate Income Tax (MCIT) rate of two percent (2%). Under R.A. No. 8424 entitled “An Act amending the National Internal Revenue Code, as Amended and For Other Purposes,” the MCIT shall be imposed whenever a domestic corporation has zero taxable income or whenever the amount of MCIT is greater than the normal income tax due from such corporation.

Effective January 1, 2009, in accordance with Republic Act 9337, RCIT rate was reduced from 35% to 30% and non-allowable deductions for interest expense from 43% to 33% of interest income subjected to final tax.

19. DEFERRED TAX

The components of deferred tax assets are as follows:

	2012	2011
Deferred tax assets:		
Tax effect of temporary differences	**256,700,449**	256,698,407
Carryforward of unused tax losses	**76,806,644**	118,233,677
Minimum Corporate Income Tax (MCIT)	**10,728,295**	14,193,689
	344,235,388	389,125,773

	2012	2011
Deferred tax liabilities:		
Revaluation increment on investment property	**(2,790,604,920)**	(2,790,604,920)
Rental	**-**	64,924
	(2,790,604,920)	(2,790,669,844)

Deferred tax asset is recognized for the tax benefit from deductible temporary differences between the financial reporting bases of assets and liabilities and their related tax bases in compliance with PAS No. 12. The tax effect of temporary differences consist mainly of the unrealized foreign exchange losses on foreign loans, allowance for doubtful accounts and allowance for decline in value of investment.

Deferred tax asset is also recognized for the carryforward of unused tax losses and minimum corporate income tax (MCIT) in accordance with PAS 12. As of December 2012, the Company has accumulated P10,728,295 as MCIT available for deductions against the regular income tax due and Net Operating Loss Carry Over (NOLCO) of P256,022,147 for offsetting against future taxable income for three consecutive years immediately following the year of such loss. Breakdown of the P408.2 million NOLCO is as follows:

Year Incurred	Amount	Applied	Expired	Unapplied
2009	177,724,955	-	177,724,955	-
2010	150,213,442			150,213,442
2011	66,173,860			66,173,860
2012	39,634,845			39,634,845
	433,747,102	-	177,724,955	256,022,147

Deferred tax liability was recognized for the tax liabilities arising from the Company's revaluation increment of its investment properties (see note 8) as of December 31, 2012.

20. RATIONALIZATION PROGRAM

As a continuing commitment of the Company towards a more focused and streamlined organization, the PNOC Change Management Team (CMT) conducted a joint meeting between Management, CMT 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.

The CMT incorporated the revisions on the rationalized structure/table of organization as directed by the PNOC Board of Directors. On February 26, 2010, the PNOC Board approved the Rationalization Plan.

Consequently, the CMT adopted the revised PNOC rationalized structure in March 4, 2010 and submitted the final Rationalization Plan to the Department of Budget and Management (DBM) on June 15, 2010. The DBM requested for a briefing last December 3, 2012 on the Rationalization Plan submitted by PNOC and an official communication on their evaluation will be forwarded to PNOC management for consideration and adoption into the Rationalization Plan.

21. RECLASSIFICATION OF ACCOUNTS

Certain accounts in the 2011 financial statements were reclassified to conform with the 2012 presentation.

22. INFORMATION REQUIRED UNDER RR 15-2010 OF THE BUREAU OF INTERNAL REVENUE

The Bureau of Internal Revenue (BIR) issued on November 25, 2010 Revenue Regulation (RR) 15-2010, Amending Certain Provisions of Revenue Regulations No. 21-2002, as amended, Implementing Section 6 (H) of the Tax Code of 1997, authorizing the commissioner on internal revenue to prescribe additional procedural and/or documentary requirements in connection with the preparation and submission of financial statements accompanying income tax returns. Under the said regulation, companies are required to provide, in addition to the disclosures mandated under IFRSs, and such other standards and/or conventions as may be adopted, in the notes to the financial statements, information on taxes, duties and license fees paid or accrued during the taxable year.

In compliance with the requirements set forth by RR 15-2010, herewith are the information on taxes, duties and license fees paid or accrued during the taxable year.

A. Value Added Tax (VAT)

The Company is a VAT-registered entity with a VAT output tax declaration of P25,476,832 and VAT input taxes of P55,043,279 for 2012.

B. Documentary Stamp Tax (DST) 1,140,534

C. Withholding Taxes

Withholding taxes paid/accrued for the year amounted to:	
Tax on compensation and benefits	**9,333,646**
Creditable withholding taxes	**2,577,560**
VAT and other percentage taxes	**3,901,535**
	15,812,741

D. All other Taxes (National and Local)

Other taxes paid during the year recognized under "Taxes and licenses" account under operating expenses	
Real estate taxes	**11,950,085**
Transfer tax and registration fees	**1,356,398**
Business taxes	**10,500**
Other taxes, fees and licenses	**2,353,697**
	15,670,680

E. Deficiency Tax Assessments and Tax Cases

As of December 31, 2012, PNOC has a pending Application for Abatement of interest and surcharges imposed on deficiency value-added tax (VAT) on the Company's interest income on advances to subsidiaries for the years 2003 and 2009.

It also has one pending tax case with the Bureau of Internal Revenue under OSJ Case No. 2004-13, DOJ Manila which pertains to PNOC's tax liability for the alleged deficiency income tax and deficiency value-added tax liabilities for the year 2000 amounting to P42,416,715.07 and P20,745,129.63. PNOC protested the assessment but was denied by the BIR on June 14, 2004. On July 19, 2004, PNOC filed a Petition for Review in the Department of Justice. However, the DOJ dismissed the petition on April 16, 2010.

PART II

A. COMMENTS AND OBSERVATIONS

B. STATUS OF IMPLEMENTATION OF PRIOR YEARS' AUDIT RECOMMENDATIONS

Part II

A. COMMENTS AND OBSERVATIONS

The efforts of PNOC Management should be commended on the following:

1. PNOC remitted dividends totalling P3.5 billion to the National Treasury in 2012 to help finance government programs and services.

2. Cash advances were granted in conformity with laws, rules and regulations, and were properly supported with valid documents, duly signed by authorized officials and liquidated within the prescribed period. The outstanding cash advance as of December 31, 2012 is only P4,199.99.

3. Proposed adjustments/reclassification affecting certain accounts, such as cash equivalents, investment property, deferred tax assets, other assets, dividends payable, and other charges were immediately acted upon by Management and already reflected in the year-end financial statements.

Considering that the Annual Audit Reports for 2010 and 2011 were released only on June 26, 2013, we reiterated the following audit observations and recommendations contained therein:

1. **The engagement of services of private lawyers lacked compliance with the provisions of COA Circular No. 86-255 dated April 2, 1986, as amended by COA Circular No. 95-011 dated December 4, 1995.**

1.1 COA Circular No. 86-255, as amended by COA Circular No. 95-011, provides that payment out of public funds of retainer fees to private law practitioners who are so hired or employed without the prior written conformity and acquiescence of the Solicitor General or the Government Corporate Counsel, as the case may be, as well as the written concurrence of the Commission on Audit shall be disallowed in audit and the same shall be a personal liability of the officials concerned.

1.2 Our examination of the Professional/technical fees account (410) disclosed an accrual entry per JV#31-12-46 (Dec 2010, 2nd Prelim) providing for the prospective payment of P63,000.00 to the Sonalan Sonalan Perania & Senupe Law Offices (“Sonalan”) in Iloilo City. Further verification revealed that the Sonalan firm has been engaged way back in June 2006 to represent PNOC in a land registration case filed by a Candelaria Dayot entitled *“In the Matter of the Petition to Correct the Technical Description of Lot 6153 of the Cadastral Survey of Iloilo”*. Although PNOC was not impleaded in said case, its interest was affected by the petition which sought to amend the technical description of Lot 6153 to show that its actual area is 117,891 square meters and not 93,955 square meters, or a deficiency in land area of approximately 23,952 square meters. The increase in land area will result in an encroachment into the land owned by PNOC.

1.3 Available documents showed that PNOC obtained the approval of the Office of the Solicitor General (OSG) to hire private counsel on June 21, 2006. However, no records exist to show that the written concurrence of the Commission on Audit (COA) was secured prior to the hiring of said counsel. As a follow-through to the transaction, it was validated that actual payment of P63,000.00 was made to the Sonalan law firm last February 8, 2011 even though no contract was executed between the firm and PNOC, a fact confirmed by the Manager, Legal Department, in her memo of February 02, 2011 to the Manager, Accounting Department.

1.4 ***We recommended that the pertinent provisions of COA Circular 86-255, as amended by COA Circular No. 95-011 be duly complied with.***

1.5 Management gave their assurance that subsequent engagements of private lawyers will be in accordance with the requirements of COA Circular No. 86-255, as amended by COA Circular No. 95-011. As for the case of the hiring of Atty. Nicolas Sonalan, Management hired the former on the strength of the statement made by the then COA Auditor Tobias P. Lozada in his memorandum of November 8, 1995 that *"there is no need for the prior concurrence of COA in your decision to engage the services of Atty. Nicolas Sonalan as counsel in the case of Dayot vs. PNOC …. or in any other contract management may wish to enter into."*

1.6 We believe that then Auditor Lozada was espousing COA Circular No. 95-006 dated May 18, 1995 which effected the total lifting of pre-audit on all transactions of national government agencies, local government units and government-owned and/or controlled corporations. As stated in Section 5.01.12 thereof, one of the pre-audit activities lifted was the *"review and evaluation of government contracts for auditing, accounting and related services*".

1.7 However, the Commission was prompt in clarifying that the hiring of a private lawyer or law firm was an exception to the lifting of pre-audit when it issued COA Circular No. 95-011 dated December 4, 1995 thereby amending all other COA issuances inconsistent therewith. Further, the Office of the President of the Philippines, in its Memorandum Circular No. 9 dated August 27, 1998, reiterated that the written concurrence of COA shall first be secured before the hiring or employment of a private lawyer or law firm. Further, no post-facto approval was sought by the Company from the COA.

1.8 ***We also recommended that the amount of P63,000 be refunded by the responsible officials because numerous decisions of the COA Commission Proper disallowed payments to private lawyers without COA concurrence, e.g. COA Decision No. 2012-015 dated February 16, 2012. The corresponding Notice of Disallowance will be issued.***

2. **Special allowances of P5.504 million granted to the Solicitor General, Assistant Solicitor General, Senior State Solicitors and Associate Solicitor engaged by PNOC were not duly approved by the Solicitor General and the Secretary of Budget and Management as required by Section 10 of Republic Act No. 9417 dated July 24, 2006.**

2.1 Section 8 of Republic Act No. 9417 dated July 24, 2006 provides *"Other benefits. – Consistent with the provisions of Executive Order No. 292 otherwise known as the Revised Administrative Code of 1987, the legal staff of the Office of the Solicitor General are allowed to receive honoraria and allowances from client departments, agencies, and instrumentalities of the Government."*

2.2 Further, Section 10 of the same Act provides *"Grant of Special Allowances. – The Solicitor General, Assistant Solicitor General, Senior State Solicitor, State Solicitors I and II and Associate Solicitors I to III shall be granted special allowances in amounts to be determined by the Secretary of Budget and Management and the Solicitor General."*

2.3 Examination of the account Professional/technical fees (410) for CY 2010 disclosed P1,842,000 in special allowances were granted to the officers of the Office of the Solicitor General (OSG) assigned to handle various PNOC cases. The OSG counsels, numbering from 12 to 17 lawyers, were paid rates ranging from P15,000 to P57,000 per quarter. For CY 2011 and 2012, total payments amounted to P1,916,802 and P1,745,000, respectively.

2.4 Upon the Audit Team's request, however, neither a Memorandum of Agreement nor an approval by the OSG and DBM for the rates of special allowances could be presented for examination. Instead, a copy of a memorandum dated July 19, 2007 from Bernadette B. Jugan, Manager, Legal Department to Glenda G. Martinez, SVP-Management Services, was presented wherein it was stated that lawyers/solicitors maintain that there is no written document to show how each lawyer is compensated by OSG's client companies. An estimate or approximation of the rates was given (through SMS or text) on how allowances from client agencies were shared among OSG lawyers, viz:

Assistant Solicitor	=	P 5,000 per month
Solicitor	=	P10,000 per month
Assistant Solicitor General	=	P16,000 per month
Solicitor General	=	P19,000 per month

2.5 ***We recommended that Management obtain written approval for the rates they are paying the lawyers from the OSG in accordance with RA 9417.***

2.6 Management made the assurance that they will make representations to the OSG to clarify this issue and obtain the necessary approvals to cure whatever defects are obtaining in the payment of said allowances.

2.7 To date, Management has stopped the payment to OSG lawyers effective December 31, 2012, but has not submitted any document showing approval for the said special allowances.

2.8 ***Accordingly, we will issue the necessary Notice of Disallowance.***

B. STATUS OF IMPLEMENTATION OF PRIOR YEARS' RECOMMENDATIONS

The following audit observations and their corresponding recommendations were issued in 2010 and reiterated in 2011 and 2012. Their status and/or actions taken by Management on the observations are as follows:

AUDIT OBSERVATIONS	RECOMMENDATIONS	STATUS/ACTION TAKEN
1. The engagement of services of private lawyers lacked compliance with the provisions of COA Circular No. 86-255 dated April 2, 1986, as amended by COA Circular No. 95-011 dated December 4, 1995.	We recommended that the pertinent provisions of COA Circular 86-255, as amended by COA Circular No. 95-011 be duly complied with.	Not Implemented. (Reiterated in Comments and Observations No. 1 of Part II.A of the Report)
2. Special allowances of P1.842 million in CY 2010 and P1.917 million in CY 2011 were granted to the Solicitor General, Assistant Solicitor General, Senior State Solicitors and Associate Solicitor engaged by PNOC were not duly approved by the Solicitor General and Secretary of Budget and Management as required by Section 10 of Republic Act No. 9417 dated July 24, 2006.	We recommended that Management obtain written approval for the rates they are paying the lawyers from the OSG in accordance with RA 9417.	Not Implemented. (Reiterated in Comments and Observations No. 2 of Part II.A of the Report)
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)	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,	Partially implemented. The memorandum of PNOC Legal Department dated June 11, 2013 informed, among others, that they received the Decision of Regional Trial Court, Branch 7 of Batangas City dated April 18, 2013 denying PNOC's Application for Original Registration of Title

AUDIT OBSERVATIONS	RECOMMENDATIONS	STATUS/ACTION TAKEN
	an investigation should be conducted to determine the nature of PCC's claim on the dry creek and the location thereof.	over the five lots in Bauan, Batangas. PNOC filed a Motion for Reconsideration on June 6, 2013 appealing to the court to reconsider the said Decision and render a new one granting the Application since based on the required service notice to the public as set forth in PD 1529, PNOC has fully complied with same based on the evidence presented.

BOARD OF DIRECTORS

CHAIRMAN

JOSE RENE ALMENDRAS *(Until October 29, 2012)*
CARLOS JERICHO PETILLA

PRESIDENT AND CEO

ANTONIO M. CAILAO

DIRECTOR

FEDERICO C. PASCUAL *(Served until March 15, 2012)*
DANTE B. CANLAS
BOB D. GOTHONG
VICTOR S. ZIGA *(Served until September 17, 2012)*
MA. GLADYS C. STA. RITA
POTENCIANO V. LARRAZABAL JR.
PEDRO A. AQUINO JR. *(Assumed office September 27, 2012)*
JOHN J. ARENAS *(Assumed office September 27, 2012)*

BUSINESS ADDRESSES

Philippine National Oil Company (PNOC)
Building 6, Energy Center, Rizal Drive, Bonifacio Global City
Taguig City 1634 PHILIPPINES
Telephone No.: +63 2 789-7662
Web Site: www.pnoc.com.ph

PNOC Exploration Corporation
Building 1, Energy Center, Rizal Drive, Bonifacio Global City
Taguig City 1634 PHILIPPINES
Telephone No.: +63 2 479 9400
Website: www.pnoc-ec.com.ph

PNOC Alternative Fuels Corporation
Building 5, Energy Center, Rizal Drive, Bonifacio Global City
Taguig City 1634 PHILIPPINES
Telephone Nos.: +63 2 817 9694
Website: www.pnoc-afc.com.ph

PNOC Renewables Corporation
Building 5, Energy Center, Rizal Drive, Bonifacio Global City
Taguig City 1634 PHILIPPINES
Telephone No.: +63 2 840 3079 to 82
Website: www.pnoc-rc.com.ph

PNOC Development and Management Corporation
Building 5, Energy Center, Rizal Drive, Bonifacio Global City
Taguig City 1634 PHILIPPINES
Telephone Nos.: +63 2 840 2652
Website: www.pnoc-dmc.com.ph