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, 2010, 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 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. The 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, 2010 and its financial performance and its cash flows for the year then ended in accordance with Philippine Financial Reporting Standards.

Other Matters

We draw attention to Notes 29 and 30 to the financial statements which describe uncertainties related to the outcome of civil and tax cases pending before various courts. Our opinion is not qualified in respect of this matter.

Report on the Supplementary Information Required Under Revenue Regulations 15-2010

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary information required by the Bureau of Internal Revenue on taxes, duties and license fees disclosed in Note 30 to the financial statements is presented for purposes of additional analysis and is not a required part of financial statements prepared in accordance with Philippine Financial Reporting Standards. Such supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

COMMISSION ON AUDIT

By:

EDNA D. SANTOS
State Auditor V

June 18, 2013

PHILIPPINE NATIONAL OIL COMPANY
(A Corporation wholly-owned by the Government of the Republic of the Philippines)
STATEMENT OF FINANCIAL POSITION
December 31, 2010
(In Philippine Peso)

	Notes	**2010**	2009
ASSETS			
Current Assets			
Cash and cash equivalents	4	**1,847,803,219**	3,456,013,065
Short-term Investments	5	**678,288,657**	657,484,854
Accounts receivable	6	**151,353,353**	1,169,058,345
Due from subsidiary companies	7	**878,268,074**	963,289,704
Prepaid expenses and other current assets	8	**720,013,490**	472,435,823
Total current assets		**4,275,726,793**	6,718,281,791
Non-current Assets			
Long-term receivables - net	9	**114,786,436**	3,387,082,193
Investment in available for sale securities	10	**4,099,719,862**	2,242,164,410
Investments	11	**5,459,543,766**	5,642,425,356
Property and equipment - net	12	**161,631,125**	167,989,282
Investment property	13	**10,967,028,172**	10,816,789,014
Deferred tax assets	26	**420,096,073**	477,201,298
Other non-current assets - net	14	**15,213,991,726**	15,213,974,367
Total Non-current Assets		**36,436,797,160**	37,947,625,920
Non-current Assets Held for Sale	15	**490,467,400**	490,467,400
TOTAL ASSETS		**41,202,991,353**	45,156,375,111
LIABILITIES AND EQUITY			
LIABILITIES			
Current Liabilities			
Accounts payable and accrued expenses	17	**336,492,134**	382,083,169
Dividends payable	19	**528,110,858**	464,819,562
Due to subsidiary companies	7	**27,090,162**	41,349,629
Current portion of long-term debt	16	**44,304,857**	1,103,229,930
Total Current Liabilities		**935,998,011**	1,991,482,290
Non-current Liabilities			
Long-term debt - net of current portion	16	**77,533,500**	3,357,326,062
Deferred tax liabilities	26	**2,791,824,720**	2,790,806,722
Other credits	18	**2,194,390,929**	2,363,227,953
Total Non-current Liabilities		**5,063,749,149**	8,511,360,737
EQUITY	19	**35,203,244,193**	34,653,532,084
TOTAL LIABILITIES AND EQUITY		**41,202,991,353**	45,156,375,111

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, 2010
(In Philippine Peso)

	Notes	**2010**	2009
REVENUES			
Interest income		**324,276,131**	1,034,734,206
Dividend income	20	**1,000,992,296**	1,505,926,067
Rent income		**199,399,152**	173,170,278
GROSS REVENUES		**1,524,667,579**	2,713,830,551
OPERATING EXPENSES	21	**(293,953,570)**	(266,859,779)
INCOME FROM OPERATIONS		**1,230,714,009**	2,446,970,772
FOREIGN EXCHANGE LOSS, NET	22	**(32,754,771)**	(54,913,883)
FINANCE COSTS	23	**(1,399,198)**	(8,023,601)
OTHER INCOME (CHARGES) , NET	24	**(21,995,773)**	47,669,039
NET PROFIT BEFORE TAX		**1,174,564,267**	2,431,702,327
INCOME TAX	25		
Current		**(3,491,271)**	(6,901,201)
Deferred		**(58,123,222)**	16,677,222
PROFIT		**1,112,949,774**	2,441,478,348
OTHER COMPREHENSIVE INCOME		**-**	-
COMPREHENSIVE INCOME FOR THE PERIOD		**1,112,949,774**	2,441,478,348

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, 2010
(In Philippine Peso)

	Capital Stock (Note 19.a)	**Retained Earnings** (As restated) (Note 19.b)	**Total**
Balance, January 1, 2009	3,114,595,519	31,854,194,556	34,968,790,075
Net income for 2009		2,441,478,348	2,441,478,348
Cash dividends for 2009 net earnings		(1,967,351,020)	(1,967,351,020)
Additional cash dividends for 2008 net earnings		(766,797,622)	(766,797,622)
Reversal for revaluation increment for disposed landholdings		(22,587,697)	(22,587,697)
Balance, December 31, 2009	**3,114,595,519**	**31,538,936,565**	**34,653,532,084**
Balance, January 1, 2010	3,114,595,519	31,538,936,565	34,653,532,084
Net income for 2010		1,112,949,774	1,112,949,774
Cash dividends for 2010 net earnings		(559,849,512)	(559,849,512)
Additional cash dividends for 2009 net earnings		(3,388,153)	(3,388,153)
Balance, December 31, 2010	**3,114,595,519**	**32,088,648,674**	**35,203,244,193**

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, 2010
(In Philippine Peso)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash receipts from customers, subsidiaries and employees	**4,847,362,668**	2,964,394,242
Cash paid to suppliers, subsidiaries and employees	**(727,062,085)**	(1,771,471,980)
Net cash from operating activities	**4,120,300,583**	1,192,922,262
CASH FLOWS FROM INVESTING ACTIVITIES		
Maturities (placements) in short-term investments	**(20,803,803)**	14,293,117,255
Investment in treasury bonds - net	**(1,857,555,452)**	414,006,641
Cash dividends from subsidiaries / associates	**501,045,926**	3,394,609
Net proceeds from disposal of assets	**507,949**	65,034
Purchase of banked gas from DOE	**-**	(14,400,000,000)
Capital Expenditures	**(12,987,413)**	(1,558,816,506)
Net cash used in investing activities	**(1,389,792,793)**	(1,248,232,967)
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of long-term loans	**(4,338,717,636)**	(1,567,273,454)
Payment of cash dividend to National Government	**-**	(1,417,035,483)
Payment of cash collateral	**-**	42,147,409
Net cash used in financing activities	**(4,338,717,636)**	(2,942,161,528)
NET DECREASE IN CASH AND CASH EQUIVALENTS	**(1,608,209,846)**	(2,997,472,233)
CASH & CASH EQUIVALENTS AT BEGINNING OF YEAR	**3,456,013,065**	6,453,485,298
CASH & CASH EQUIVALENTS AT END OF YEAR	**1,847,803,219**	3,456,013,065

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-seven 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, Taguig City.

2. BASIS OF FINANCIAL STATEMENT 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 Philippine 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 Philippine Financial Reporting Standards (PFRS). 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 separately from its subsidiaries to facilitate consolidation.

2.2 Basis of Preparation

The financial statements of the Company 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 assets held for sale which are stated at lower of carrying amount and fair value less cost to sell (refer to Note 3g).

The financial statements are presented in Philippine Peso, which is the Company's presentation currency. All values are rounded to the nearest peso.

2.3 Changes in Accounting Policies

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, 2010.

- *PFRS 3*, *Business Combinations (revised)* and *PAS 27*, *Consolidated and Separate Financial Statements (Amended)*

  The revised standards are effective for annual periods beginning on or after July 1, 2009. PFRS 3 (Revised) introduces significant changes in the accounting for business combinations occurring after this date. Changes affect the valuation of non-controlling interest, the accounting for transaction costs, the initial recognition and subsequent measurement of a contingent consideration and business combinations achieved in stages. These changes will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs and future reported results.

  PAS 27 (Amended) requires that a change in the ownership interest of a subsidiary (without loss of control) is accounted for as a transaction with owners in their capacity as owners. Therefore, such transactions will no longer give rise to goodwill, nor will it rise to a gain or loss. Furthermore, the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. PFRS 3 (Revised) will be applied prospectively while PAS 27 (Amended) will be applied retrospectively with a few exceptions.

Adoption of the following changes in standards and Philippine Interpretation based on International Financial Reporting Interpretations Committee (IFRIC) interpretations did not have any significant impact on the Company's financial statements.

- PFRS 2, *Share-based Payment (Amendment) – Group Cash-settled Share-based Payment Transactions*

- PAS 39, *Financial Instruments: Recognition and Measurement (Amendment) – Eligible Hedged Items*

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

2.4 Improvements to PFRS

In May 2008 and April 2009, the International Accounting Standards Board (IASB) issued omnibus amendments to the following standards, primarily with a view of removing inconsistencies and clarify wording. The adoption of the following amendments resulted in changes to accounting policies but did not have significant impact on the financial position and performance of the Company.

- PFRS 8, *Operating Segments*

  PFRS 8 clarifies that segment assets and liabilities need only be reported when those assets and liabilities are included in measures that are used by the chief operating decision maker (CODM).

- PAS 7, *Statement of Cash Flows*

  PAS 7 states that only expenditure that results in recognizing an asset can be classified as a cash flow from investing activities.

Other amendments resulting from the Improvements to PFRS to the following standards did not have any impact on the accounting policies, financial position or performance of the Company.

Issued in May 2008

- PFRS 5*, Noncurrent Assets held for Sale and Discontinued Operations*

Issued in April 2009

- PFRS 2, *Share-based Payment*
- PFRS 5*, Noncurrent Assets held for Sale and Discontinued Operations*
- PAS 1, *Presentation of Financial Statements*
- PAS 17, *Leases*
- PAS 36, *Impairment of Assets*
- PAS 36, *Intangible Assets*
- PAS 39, *Financial Instruments: Recognition and Measurement*
- Philippine Interpretation IFRIC 9, *Reassessment of Embedded Derivatives*
- Philippine Interpretation IFRIC 16, *Hedges of a Net Investment in a Foreign Operation*

Effective in 2011

PAS 24, *Related Party Disclosures (Amended)*

The Amended standard is effective for annual periods beginning on or after January 1, 2011. It clarified the definition of a related party to simplify the identification of such relationships and to eliminate inconsistencies in its application. The revised standard introduces a partial exemption of disclosure requirements of government-related entities. The Company does not expect any impact on its financial position or performance. Early adoption is permitted for either the partial exemption for government-related entities or for the entire standard.

PAS 32, *Financial Instruments: Presentation (Amendment) – Classification of Right Issues*

The Amendment to PAS 32 is effective for annual periods beginning on or after February 1, 2010 and amended the definition of financial liability in order to classify rights issues (and certain options or warrants) as equity instruments in cases where such rights are given pro rata to all of the existing owners of the same class of an entity's non-derivative equity instruments, or to acquire a fixed number of the entity's own equity instruments for a fixed amount in any currency.

Philippine Interpretation IFRIC 14 (Amendment), *Prepayments of a Minimum Funding Requirement*

The amendment to Philippine Interpretation IFRIC 14 is effective for annual periods beginning on or after January 1, 2011, with retrospective application. The amendment provides guidance on assessing the recoverable amount of a net pension asset. The amendment permits an entity to treat the prepayment of a minimum funding requirement as an asset.

Philippine Interpretation IFRIC 19, *Extinguishing Financial Liabilities with Equity Instruments*

Philippine Interpretation IFRIC 19 is effective for annual periods beginning on or after July 1, 2010. The Interpretation clarifies that equity instruments issued to a creditor to extinguish a financial liability qualify as consideration paid. The equity instruments issued are measured at their fair value. In case that this cannot be reliably measured, the instruments are measured at the fair value of the liability extinguished. Any gain or loss is recognized immediately in consolidated statement of comprehensive income.

Effective in 2012

PFRS 7, *Financial Instruments: Disclosures (Amendments) – Disclosures – Transfers of Financial Assets*

The amendments to PFRS 7 are effective for annual periods beginning on or after July 1, 2011. The amendments will allow users of financial statements to improve their understanding of transfer transactions of financial assets, including understanding the possible effects of any risks that may remain with the entity that transferred the assets. The amendments also require additional disclosures if a disproportionate amount of transfer transactions are undertaken around the end of a reporting period.

PAS 12, *Income Taxes (Amended) – Deferred tax: Recovery of Underlying Assets*

The amendment to PAS 12 is effective for annual periods beginning on or after January 1, 2012, provides a practical solution to the problem of assessing whether recovery of an asset will be through use or sale. It introduces a presumption that recovery of the carrying amount of an asset will, normally, be through sale.

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

The Interpretation, effective for annual periods beginning on or after January 1, 2012, 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 Contracts,* 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.

Effective in 2013

PFRS 9, *Financial Instruments: Classification and Measurement*

PFRS 9, as issued in 2010, reflects the first phase of the work in the replacement of PAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in PAS 39. The standard is effective for annual periods beginning on or after January 1, 2013. In subsequent phases, hedge accounting and derecognition will be addressed. The completion of this project is expected in middle of 2011.

Improvements to PFRS (issued in May 2010)

Improvements to PFRS is an omnibus of amendments to PFRS. The amendments have not been adopted as they become effective for annual periods on or after either July 1, 2010 or January 1, 2011. The Company expects o impact on the financial statements from the adoption of the following amendments:

- PFRS 3, *Business Combinations*
- PFRS 7*, Financial Instruments: Disclosures*
- PAS 1, *Presentation of Financial Statements*
- PAS 27, *Consolidated and Separate Financial Statements*
- Philippine Interpretation IFRIC 13, *Customer Loyalty Programs*

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. Short-term Investments

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

c. Inventories

Inventories are stated at lower of cost and net realizable value. Cost is calculated using the first–in, first–out (FIFO) method.

d. Investments

Investments in wholly-owned and controlled subsidiaries and associates 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 allowance is provided for any substantial and presumably permanent decline in the carrying values of the investments.

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, plant and equipment.

f. Investment Property

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

g. Non-current Assets Held for Sale

Non-current assets are classified as held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly 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 date of classification.

Non-current assets held for sale are measured at the lower of their carrying amounts or fair value less cost to sell.

h. 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.

i. 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.

j. Provision for Doubtful Accounts

The Company provides allowance for bad debts based on aging of accounts at 60% for accounts over 2, 3 and 4 years and 100% for those over 5 years.

k. Financial Instruments

Financial instruments are recognized initially at fair value. Except for financial instruments valued at fair value through profit or loss (FVPL), the initial measurement includes transaction costs. The Company classifies its financial assets into the following categories: financial assets at FVPL, held-to-maturity (HTM) investments, available for sale (AFS) investments, and loans and receivables. For financial liabilities, the Company classifies them into financial liabilities at FVPL and other financial liabilities. The classification depends on the purpose for which the investments were acquired and whether they are quoted in an active market. Management determines the classification of its investments at initial recognition and, where allowed and appropriate, reevaluates such designation at every reporting date.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest, dividends, gains and losses relating to a financial instrument or a component that is a financial liability, are reported as expense or income. Distributions to holders of financial instruments classified as equity are charged directly to equity, net of any related income tax benefit.

Offsetting Financial Instruments

Financial assets and financial liabilities are offset with the net amount reported in the statement of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented at gross in the statement of financial position.

Fair Value of Financial Instruments

The fair value of financial instruments traded in active markets at reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without deduction for transaction costs. When current bid and ask prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction.

For all other financial instruments not traded in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include net present value techniques, comparison to similar instruments for which observable market prices exist, and other relevant valuation models.

HTM Investments

Quoted non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as HTM investments when the Company has the positive intention and ability to hold to maturity. If the Company were to sell more than an insignificant amount of HTM investments, the entire category would be tainted and would have to be reclassified as AFS investments. Furthermore, the Company would be prohibited to classify any financial assets as HTM investments for the following two years.

After initial measurement, HTM investments are measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are integral parts of the effective interest rate. Gains and losses are recognized in the statement of income when the HTM investments are derecognized or impaired, as well as through the amortization process.

Short-term investments are classified under this category.

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, loans and receivables are carried at amortized cost using the effective interest method less any allowance for impairment. Gains and losses are recognized in the consolidated statement of income when the loans and receivables are derecognized or impaired, as well as through the amortization process.

Loans and receivables are classified as current assets if maturity is within 12 months from the reporting date. Otherwise, these are classified as non-current assets.

Classified under loans and receivables are cash and cash equivalents, trade and other receivables, and due from related party accounts.

AFS Investments

AFS investments are those non-derivative financial assets that are designated as such or are not classified as financial assets designated at FVPL, HTM investments or loans and receivables.

They are purchased and held indefinitely, and may be sold in response to liquidity requirements or changes in market conditions.

AFS investments are initially measured at fair value plus directly attributable transaction costs. After initial measurement, AFS investments are subsequently measured at fair value with unrealized gains and losses being recognized as a separate component of equity until the investments are disposed of or are determined to be impaired. The Company uses the specific identification method in determining the cost of securities sold. Unquoted equity securities are carried at cost, net of impairment. Interest earned or paid on the investments is reported as interest income or expense using the effective interest rate. Dividends earned on investments are recognized in the statement of income when the right of payment has been established.

AFS investments are classified as current if these are expected to be realized within 12 months from the reporting date. Otherwise, these are classified as non-current assets.

AFS investments include quoted and unquoted investments in government securities and membership equity shares.

Other Financial Liabilities

Other financial liabilities, which include loans payable, trade and other payables, due to related parties and long-term debt are initially recognized at fair value of the consideration received less directly attributable transaction costs. After initial recognition, other financial liabilities are subsequently measured at amortized cost using the effective interest method.

Amortized cost is calculated by taking into account any related issue costs, discount or premium. Gains and losses are recognized in the statement of income when the liabilities are derecognized, as well as through the amortization process.

<u>Impairment of Financial Asset</u>

The Company assesses at each reporting date whether a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is deemed to be impaired, if and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (an incurred loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or a group of financial assets that can be reliably estimated. Objective evidence of impairment may include indications that the borrower or a group of borrowers is experiencing significant financial difficulty, default or delinquency in interest or principal payments, the probability that they will enter bankruptcy or other financial reorganization and where observable data indicate that there is measurable decrease in the estimated future cash flows, such as changes in arrears or economic conditions that correlate with defaults.

Assets Carried at Amortized Cost

For assets carried at amortized cost, the Company first assesses whether an objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If the Company determines that no objective evidence of impairment exists for individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses for impairment. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment for impairment.

If there is an objective evidence that an impairment loss has been incurred, the amount of loss is measured as the difference between the asset's carrying value and the present value of the estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial assets' original effective interest rate which is the effective interest rate computed at initial recognition. The carrying value of the asset is reduced through the use of an allowance account and the amount of loss is charged to the statement of income. If in case the receivable has proven to have no realistic prospect of future recovery, any allowance provided for such receivable is written off against the carrying value of the impaired receivable. If, in a subsequent year, the amount of the estimated impairment loss decreases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is reduced by adjusting the allowance account. Any subsequent reversal of an impairment loss is recognized in the statement of income, to the extent that the carrying value of the asset does not exceed its amortized cost at reversal date.

AFS Investments

For AFS Investments, the Company assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired.

In the case of equity investments classified as AFS, impairment indicators would include a significant or prolonged decline in the fair value of the investments below its cost. Where there is evidence of impairment, the cumulative loss, measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognized in the consolidated statement of income, is removed from equity and recognized in the statement of income. Impairment losses on equity investments are not reversed through the statement of income. Increases in fair value after impairment are recognized directly in the statement of changes in comprehensive income.

In the case of debt instruments classified as AFS, impairment is assessed based on the same criteria as financial assets carried at amortized cost. Future interest income is based on the reduced carrying amount and is accrued based on the rate of interest used to discount future cash flows for the purpose of measuring impairment loss. Such accrual is recorded as part of "Interest income" in the statement of income. If, in a subsequent year, the fair value of a debt instrument increases and that increase can be objectively related to an event occurring after the impairment loss was recognized in the statement of income, the impairment loss is reversed through the statement of income.

AFS Investments Carried at Cost

If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such unquoted equity instrument, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. The carrying amount of the asset is reduced through the use of an allowance account.

Derecognition of Financial Assets and Liabilities

Financial Asset

A financial asset (or where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognized when:

a. the right to receive cash flows from the asset has expired
b. the Company retains the right to receive cash flows from the asset, but has assumed as obligation to them in full without material delay to a third party under a "pass through" arrangement; or
c. the Company has transferred its right to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset but has transferred the control of the asset.

When the Company has transferred its rights to receive cash flows from an asset or has entered into a "pass-through" arrangement, and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Company's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of original carrying amount of the asset and the maximum amount of consideration that the Company could be required to repay.

Financial Liabilities

A financial liability is derecognized when the obligation under the liability is discharged, cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognized in the statement of income.

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.

Rental income arising on investment properties is accounted for on a straight-line basis over the lease terms.

m. 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.

n. 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.

n. Events After Reporting Date

Post-year-end events that provide additional information about the Company's position at the balance sheet 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:

	2010	2009
Cash in bank	**4,400,281**	4,250,292
Petty cash fund	**122,119**	122,119
Money market placements	**1,843,280,819**	3,451,640,654

	1,847,803,219	3,456,013,065

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. SHORT-TERM INVESTMENTS

This account consists mainly of money market placements with more than three months maturity but less than one year, summarized as follows:

	2010	2009
Government Securities	**546,987,090**	182,339,690
Time Deposits	**131,301,567**	475,145,164
	678,288,657	657,484,854

6. ACCOUNTS RECEIVABLE

This account consists of:

	2010	2009
Trade Receivables	**9,820,855**	**9,820,955**
Non-trade Receivables	**97,227,641**	**110,227,773**
Current Portion of Long-term Receivables	**44,304,857**	**1,049,009,617**
	151,353,353	**1,169,058,345**

Trade receivables consist of receivable from Department of Energy for the sale and distribution of solar homes systems units in different rural areas in the Philippines.

The non-trade receivables consist mainly of accrued interests receivable on treasury bills and special savings deposits invested with private banks and government financial institutions. The current portion of long-term receivables refers to loans granted to certain subsidiaries out of the proceeds of the Company's long-term loans (Note 9). Each subsidiary agreed to reimburse the Company in proportion to its share of the loan.

7. RELATED PARTY TRANSACTIONS

This account consists of the following:

	2010	2009
Due from affiliated companies		
PNOC Shipping and Transport Corporation	**870,363,436**	958,181,196
PNOC Oil Carriers, Inc.	**134,085,597**	134,085,597
PNOC Exploration Corporation	**6,013,718**	3,232,430
PNOC Coal Corporation	**1,466,910**	1,249,181
PNOC Development & Management Corp.	**280,876**	330,385
PNOC Alternative Fuels Corporation	**20,272**	173,650
Sub-total	**1,012,230,809**	1,097,252,439
Allowance for Doubtful Accounts	**(133,962,735)**	(133,962,735)
	878,268,074	963,289,704

Due to affiliated companies		
PNOC Tankers Corporation	**22,790,362**	22,790,362
PNOC Renewables Corporation	**4,299,800**	18,559,267
	27,090,162	41,349,629

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. The loan is payable in thirty-two (32) equal quarterly amortization of principal over a period of eight (8) years with one (1) year grace period from the date of the actual availment.

8. PREPAID EXPENSES AND OTHER CURRENT ASSETS

This account consists of:

	2010	2009
Special deposits	**181,131,197**	43,759,085
Prepaid expenses	**10,158,034**	2,991,238
Other deferred charges	**528,724,259**	425,685,500
	720,013,490	472,435,823

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

Other deferred charges mainly consist of VAT Input and prepaid interest on Retail Treasury coupon bonds amounting to P185,656,985 and P301,011,929, respectively.

9. LONG-TERM RECEIVABLES, NET

This account consists of receivables from the following companies:

	2010	2009
PNOC Shipping & Transport Corporation	**77,533,500**	121,838,357
Natural Resources Development Corporation	**37,252,936**	37,252,936
PNOC Oil Carriers, Inc.	**24,486,172**	24,486,172
Energy Development Corporation	**-**	3,227,990,900
	139,272,608	3,411,568,365
Allowance for doubtful accounts	**(24,486,172)**	(24,486,172)
	114,786,436	3,387,082,193

The receivables from PNOC Shipping & Transport Corporation represent loans granted out of the proceeds of the PNOC's long-term loans (Note 16) and agreed to reimburse the Company, any and all installments of principal and interest at due dates plus expenses related to the loans, which the company may incur until the loans are fully settled. The long-term receivable from the Energy Development Corporation (EDC) was prepaid in May 2010 pursuant to Article V Section 5.01 (b) of the Share Purchase Agreement covering EDC's full privatization in December 2007. Both the EDC and PNOC Board of Directors approved the prepayment of the loans on February 16 and February 26, 2010, respectively.

The receivable from Natural Resources Development Corporation (NRDC) represents the P30,000,000 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 as per Deed of Assignment of Interests and Rights executed by and 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.

10. INVESTMENTS IN AVAILABLE FOR SALE SECURITIES

This account consists of investments in treasury bonds amounting to **P4,099,719,862** in **2010** andP2,242,164,410 in 2009, 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 5.847% to 6.45% for dollar denominated.

11. INVESTMENTS, AT COST

This account consists of the following:

	Percentage of Ownership	2010	2009
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 decline in value of Investment		**(551,615,343)**	(551,615,343)
		27,067,950	27,067,950
Preferred shares		**186,269,410**	369,151,000
Other investments		**141,453,350**	141,453,350
		327,722,760	510,604,350
		5,459,543,766	5,642,425,356

In 2003, the Securities and Exchange Commission has issued a certificate for the revocation of the four (4) PNOC subsidiaries, namely; PNOC Oil Carriers, Inc., PNOC Tankers Corporation, Petron Tankers Corporation and Petrophil Tankers Corporation. PNOC's investments with Petron Tankers Corporation and Petrophil Tankers Corporation were written-off in the books after the Bureau of Internal Revenue issued a Certificate of No Outstanding Liability dated June 29, 2005 and July 2, 2005, respectively. The accounts of PNOC Tankers Corporation and PNOC Oil Carriers, Inc., were retained pending receipt of the same clearances from the BIR.

Preferred shares refer to the 7% shares issued by the National Development Company (NDC) 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. PNOC requested for an updated list of NDC's and/or its subsidiaries' real estate properties which may be considered for possible land swap. PNOC conducted series of evaluation on which properties submitted by NDC may be considered for the redemption of the preferred shares.

On December 21, 2010, a Memorandum of Agreement and Dacion En Pago Agreement between PNOC and NDC was signed for the settlement of the principal amount of P369.151 million, as follows:

1. Turn-over to PNOC of NDC's eight (8) real estate properties (7 of which are leased to Chevron Service Station up to Y2024), in two (2) tranches. The first tranche, consisting of five (5) properties was turned over in December 2010 with a total value of P182,881,589.93, while the second tranche, consisting of three (3) properties, with a total value of P185,765,088.48 shall be turned over to PNOC at the end of 2011 with a cash component of P504,321.59.

2. Payment of the transfer tax and registration fees shall be for PNOC's account and all other costs shall be borne by NDC.

3. PNOC will receive the lease income from the seven (7) properties beginning May 2011.

12. PROPERTY, PLANT AND EQUIPMENT, NET

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, 2010	277,248,237	405,615	5,339,728	20,507,670	31,359,029	3,096,267	337,956,546
Additions	1,098,020			1,350,893	7,594,537	2,588,676	12,632,126
Reclassifications /							
Adjustments	3,096,267	(286,364)	(688,090)	(17,968,727)	(14,914,223)	(3,096,266)	(33,857,403)
Disposals					(242,826)		(242,826)
December 31, 2010	281,442,524	119,251	4,651,638	3,889,836	23,796,517	2,588,677	316,488,443
ACCUMULATED DEPRECIATION							
January 1, 2010	(127,386,907)	(405,315)	(1,651,941)	(19,122,925)	(21,400,176)		(169,967,264)
Provision	(11,884,493)		(1,105,802)	(614,154)	(5,335,056)		(18,939,505)
Reclassifications /							
Adjustments		286,265	684,190	17,966,926	14,888,724		33,826,105
Disposals					223,346		223,346
December 31, 2010	(139,271,400)	(119,050)	(2,073,553)	(1,770,153)	(11,623,162)		(154,857,318)
NET CARRYING AMOUNT							
December 31, 2010	**142,171,124**	**201**	**2,578,085**	**2,119,683**	**12,173,355**	**2,588,677**	**161,631,125**
December 31, 2009	147,117,214	5,151,456	375,435	5,029,817	4,221,601	6,093,759	167,989,282

13. INVESTMENT PROPERTY

This account consists of land leased out mainly to Petron Corporation where its refinery and other facilities are located. A long-term lease agreement was executed by and between the 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.

Rental income earned from the investment properties amounted to **₱194,997,647** and ₱166,306,945 in **2010** and 2009, respectively.

14. OTHER NON–CURRENT ASSETS, NET

This account consists of:

	2010	2009
Banked gas	**14,400,000,000**	14,400,000,000
Purchase price adjustment fund	**809,757,306**	809,757,306
Long-overdue receivables	**84,601,303**	84,601,303
Investment in available-for-sale	**3,804,100**	3,804,100
Others	**242,138**	224,779
	15,298,404,847	15,298,387,488
Allowance for doubtful accounts	**(84,413,121)**	(84,413,121)
	15,213,991,726	15,213,974,367

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. Under certain conditions in the GSPA, NPC can recover this banked gas in succeeding years within the term of the GSPA.

Long-overdue receivables represent receivables from various government agencies and private institutions that have been outstanding for more than two years.

15. NON-CURRENT ASSETS HELD FOR SALE

This account consists of real estate properties for sale and for disposal that are not suitable for the Company’s long-term energy projects and other viable energy-allied industrial and commercial undertakings. These are located within residential and agricultural areas with minimal potential to attract prospective lessees / joint venture partners.

16. LONG-TERM DEBT

This account consists of outstanding balances of the foreign obligations restated into Philippine pesos based on the prevailing foreign exchange rates at year-end (**USD1=JPY 82.48; USD1=₱43.811** in **December 2010** and USD1=JPY 91.63; USD1=₱46.425 in December 2009).

A substantial portion of these obligations are guaranteed by the Philippine Government. In consideration for the surety given to creditor banks, the Philippine Government, through Department of Finance (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. Details follow:

CREDITOR/PROJECT		**MATURITIES**		**2010**	**2009**
International Bank for Reconstruction and Development					
3164 PH Energy Sector Project	PNOC and EDC	1995 to 2010	1/2 of 1% over cost of qualified borrowings	-	403,072,339
3702 PH Geothermal Exploration Project	PNOC EDC	1999 to 2013	1/2 of 1% over cost of qualified borrowings	-	1,017,070,838
3747 PH Eximbank Geothermal Exploration Project	PNOC EDC	1999 to 2014	1/2 of 1% over cost of qualified borrowings	-	2,127,255,056
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
Landbank of the Philippines	PSTC	2013	Prevailing Tbill rate at conversion date plus fixed spread of 2.5%	121,838,357	166,143,214
TOTAL				**121,838,357**	**4,460,555,992**
Less: Current Portion				44,304,857	1,103,229,930
				77,533,500	**3,357,326,062**

17. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

This account consists of:

	2010	2009
Accrued Expenses	**94,306,603**	165,664,801
Accounts Payable	**66,839,560**	117,233,936
Other Accounts Payable	**175,345,971**	99,184,432
	336,492,134	382,083,169

Accrued expenses account is comprised mainly of accrued interest on long-term loans 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 Energy Development Corporation for the purchased building improvements and Shell Solar Philippines Corporation for the purchased units of solar homes systems, which were installed in unelectrified rural households in Region1-7, the Cordillera Administrative Region and the whole of the Mindanao Regions.

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.

18. OTHER CREDITS

This account includes non-current items of other deferred income and other deferred credits amounting to **₱2,194,390,929** and ₱2,363,227,953 for **2010** and 2009, respectively.

19. 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 ₱50 a share. From 1975 to 1988 additional shares of 6,029,191 were subscribed by the Philippine Government at ₱500 per share.

b. Retained Earnings

Pursuant to Republic Act 7656, PNOC declared a total cash dividend of **P559,849,512** for its **2010** net earnings which include the amount of P449,946,370 that were remitted directly to the Bureau of Treasury by its subsidiaries, namely PNOC-EC (P499,446,370) and PSTC (P500,000).

20. DIVIDEND INCOME

This account consists of dividends from the following:

	2010	2009
PNOC Exploration Corp.	**998,892,740**	1,500,000,000
PNOC Shipping and Transport Corp.	**1,000,000**	5,062,916
Gulf Oil Phiippines, Inc.(GOPI)	**1,099,556**	863,151
	1,000,992,296	1,505,926,067

21. OPERATING EXPENSES

This account consists of:

	2010	2009
Employee Costs	**68,974,512**	62,096,853
Purchased Services and Utilities	**54,141,613**	75,270,673
Rentals/ Insurance/ Taxes	**35,305,464**	54,494,587
Business Expenses	**27,764,857**	36,885,172
Awards and Indemnities	**63,161,153**	-
Depreciation	**32,342,567**	28,754,063
Materials and Supplies	**5,921,894**	5,348,079
Maintenance and Repairs	**5,115,332**	2,748,066
Miscellaneous Charges	**1,226,178**	1,262,286
	293,953,570	266,859,779

22. FOREIGN EXCHANGE GAIN(LOSS)

This account pertained to realized foreign exchange losses on money market placements in dollar denominations amounting to P27,068,050 and realignment of dollar placement balances into Philippine pesos based on PDS rate at year-end of US$1.00=P43.811 vs. peso dollar rate at various value date of investment.

23. FINANCE COSTS

This account consists of the following:

	2010	2009
Interest expense on long-term loans	**1,399,198**	8,018,620
Guarantee fee	**-**	4,981
	1,399,198	8,023,601

24. OTHER INCOME (CHARGES)

This account consists of the following:

	2010	2009
Gain on disposal of assets	**473,669**	51,162,674
Other income (charges)	**(22,469,442)**	(3,493,635)
	(21,995,773)	47,669,039

Other income (charges) includes mainly the amount of P16,988,339 representing payment for the purchase of Mr. Paul C. Mata's 35% share over 8 parcels of land at Sta. Mesa Manila.

25. INCOME TAXES

Components of income tax expense are as follows:

	2010	2009
Current income tax	**3,491,271**	6,901,201
Deferred income tax	**58,123,222**	(16,677,222)
	61,614,493	(9,776,021)

	2010	2009
Net income per books	**1,174,564,267**	2,431,702,328
Permanent differences		
Interest income	**(253,482,252)**	(943,060,216)
Dividend income	**(1,000,992,296)**	(1,505,926,067)
Gain on disposal of assets		(4,267,910)
Non-deductible expenses	**4,117,027**	11,552,827
Temporary differences		
Accrued rental income	**(3,393,326)**	(1,037)
Unearned rent income	**332,944**	84,612,406
Forex loss - net	**(26,613,726)**	(67,096,296)
Reversal of advance collection of rental	**(44,746,080)**	
Net loss carry over	**-**	(185,240,989)
Taxable Income	**(150,213,442)**	(177,724,954)

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 42% to 33% of interest income subjected to final tax.

26. DEFERRED TAX

The components of deferred tax assets are as follows:

	2010	2009
Deferred tax assets:		
Tax effect of temporary differences	**269,733,382**	291,779,053
Carryforward of unused tax losses	**136,048,697**	162,153,188
Minimum Corporate Income Tax (MCIT)	**14,313,994**	23,269,057
	420,096,073	477,201,298

	2010	2009
Deferred tax liabilities:		
Revaluation increment on investment property	**(2,790,604,920)**	(2,790,604,920)
Rental	**(1,219,800)**	(201,802)
	(2,791,824,720)	(2,790,806,722)

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 2010**, the Company has accumulated **₱14,313,994** as MCIT available for deductions against the regular income tax due and Net Operating Loss Carry Over (NOLCO) of **P453,495,657** for offsetting against future taxable income for three consecutive years immediately following the year of such loss. Breakdown of the P453.50 million NOLCO is as follows:

Year Incurred	Amount	Applied	Expired	Unapplied
2006	185,240,989	185,240,989		-
2007	237,228,411		237,228,411	-
2008	125,557,260		-	125,557,260
2009	177,724,956		-	177,724,956
2010	150,213,442		-	150,213,442
	875,965,057	185,240,989	237,228,411	453,495,657

Deferred tax liability was recognized for the tax liabilities arising from the Company's revaluation increment of its investment properties (see note 13) and accrued rental income as of December 31, 2010.

27. 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.

The 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. The 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 for transport.

Since 2002, the 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 original objectives of the program have been achieved and accomplished such as the information, education, communication activities relative to the NGVs.

The management considered several alternative uses for the five (5) NGVs such as: (1) operation of the vehicles, (2) re-exportation of the vehicles, (3) maintaining the vehicles in "status quo", and (4) disposal.

From among the alternative uses, the fourth option was considered since the advantages of terminating the project far outweigh the minimal benefits that PNOC will gain from continuing the project due to the cost implications and the documentary requirements that need to be addressed to fully utilize the NGVs. In any case, the NGVs have served their purpose of public awareness.

As of 2010, all five (5) vehicles were already donated to various technical schools which would enhance the technical skills of students and the other one was left in the PNOC compound for posterity and historical values. The recipients of the NGVs were: Don Bosco Technical Institute, Technical Education and Skills Development Authority (TESDA), Technological Institute of the Philippines-Manila, Technological Institute of the Philippines-Taguig and University of Makati

28. 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.

29. CONTINGENCIES

a. Compromise Agreement: 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 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 and PNOC, wherein Petron and PNOC assigned to P. Mata, 35% of all its rights, interests 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.

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 Paul Mata are now co-owners of the subject V. Mapa properties.

b. 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 City

For: Original registration and titling

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

Status: PNOC will present evidence and testimony of witness/es.

c. 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 ended on December 31, 2008.

Status: Submitted for resolution.

d. 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: For resolution.

e. Voltaire Rovira vs. PNOC
CA-GR CV No. 80608
Court of Appeals, Cagayan de Oro
Civil Case No. 5947, RTC Branch V. Iligan City

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 its Order dated August 4, 2003. Mr. Rovira appealed the case to the Court of Appeals. On May 28, 2009, the Court of Appeals granted Mr. Rovira's appeal and remanded the case for further proceeding in RTC, Iligan City.

Status: Trial stage and plaintiff turn to present it evidence.

f. 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. Keppel and PNOC/PDEC entered into a Compromise Agreement to settle the case amicably. However, the Compromise Agreement signed by Keppel and PNOC is still subject for approval by the Office of the Solicitor General. In the meantime, respective memoranda were filed by the parties in the CA.

g. PNOC vs Antonio Bulatao
Civil Case No. 9292
MTC Branch 11, Tarlac City

For: Ejectment

PNOC filed an ejectment case on September 7, 2010 against the defendant Antonio Bulatao for failure to voluntarily vacate PNOC lot located in Brgy. Slapungan, Tarlac City.

Status: The case is set for mediation proceedings.

h. Petron Corporation vs. Hon. Danilo P. Galvez, Presiding Judge Regional Trial Court, 6th Judicial Region, Branch 24, Iloilo City; Sun Gas, Inc. and PNOC
CA-G.R. CEB SP. No. 04139
MTC Branch 1, Tarlac City

For: Injunction and damages (with prayer for Temporary Restraining Order and Writ of Preliminary Injunction)

PNOC filed a complaint-in-intervention in RTC Branch 24, Iloilo City in the case of Petron Corporation vs. Sun Gas Incorporated, because defendant Sun Gas Inc. installed a swing barrier consisting of steel and bamboo pole totally blocking the road right-of-way going to PNOC lot and Petron depot.

Status: On appeal in the Court of Appeals, Cebu City

i. Pilipinas Shell Petroleum Corp. vs. Candelaria Dayot (defendant)
PNOC; Petron Corporation; Iloilo Jar Corporation (Intervenor Appellants)
CA-G.R. Ceb CV No. 02250
RTC Branch 33, Civil Case No. 21424

For: Injunction and damages (with prayer for restraining order and preliminary injunction)

PNOC is the registered owner of Lot 2 Pcs-5341 Amd. 2 in Iloilo City under TCT No. 11027 located in Lapus District, Iloilo City. PNOC intervened in Iloilo RTC Branch 33, Civil Case No. 21424 entitled "Pilipinas Shell Petroleum Corporation vs. Candelaria Dayot, et al." because the former registered owner of the subject road lot gave notice to Pilipinas Shell, PNOC and Petron the closing of the existing road right of way which affect the means of ingress and egress from the main road to the PNOC's lot being leased to Petron in Iloilo City.

Status: On appeal in the Court of Appeals, Cebu City.

j. **Candelaria Dayot** (Petitioner) **vs. The Register of Deeds of Iloilo City** (Respondent-Apellee)
Shell Chemical Company Phil, Inc., Petron Corporation and PNOC (Oppositors-Intervenor-Appellees)
CA-G.R. CEB CV No. 00949

For: Petition for issuance of Certificate of Title over Lot 2 (Pcs-5341 Amd. 2)

Dayot filed the petition in order to acquire certificate of title over parcels of land. PNOC claimed ownership over one of the subject lots. Thereafter, PNOC intervened in the petition for issuance of certificate of title filed by Dayot and presented copy of title. RTC dismissed the petition and the petitioner appealed the case in the Court of Appeals.

Status: Pending appeal.

k. Candelaria Dayot, et al. vs. Traders Royal Bank, Shell Chemical Company (Phil.), Petron Corporation and PNOC
CA-G.R. CEB CV No. 01221

For: Recovery of Ownership and Possession

Candelaria Dayot filed the case against PNOC and other private corporations for the recovery of parcels of land located in Lapuz. Iloilo City. One of the subject lots is covered by TCT no. T-110237 in the name of PNOC consisting of 17,000 square meters. For failure to prove ownership over the subject lot, RTC dismissed the case. Dayot appealed the case in the Court of Appeals in Cebu City.

Status: Pending appeal.

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 are 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 three lots owned by Spouses Samson. PNOC EDC intended to use the said area for the construction and operation of the 125MW 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 became final and executory and is recorded in the Book of Entries of Judgments.

   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 issued by the Sheriff on October 19, 2009, directing the President of the Landbank of the Philippines in Malate and the Manager of the Landbank of the Philippines in Makati, Buendia Branch to release the amounts due therein in payment for the money judgment in favor of THDC, amounting to P62,055,005.00 as of October 19, 2009.

   PNOC opposed the Notice of Garnishment in the RTC. PNOC then filed a Petition for Certiorari with Application for Temporary Restraining Order and/or Preliminary Injunction with the Court of Appeals, Cebu City.

   However, the petition was not acted upon by the CA and no TRO was issued. Thereafter, RTC Ormoc City denied PNOC's opposition and ordered garnishment of PNOC account with an order for the bank official to release payment under pain of contempt.

   Status: The garnished account of PNOC in Land Bank amounting to P62,760,102.40 was released by the bank in payment of the just compensation and to satisfy the judgment obligation.

2. ***PNOC vs. Oscar Maglasang and Leonilo Maglasang***
Civil Case No. 3267-0, RTC Branch 35, Ormoc City
Civil Case No. 3273-0, 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. The court determined the just compensation in a joint judgment settling the amount of P700.00/sq. meters.

On appeal by both parties, the Court of Appeals reduced the amount of just compensation to P300.00/sq. meters or the total amount of 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. The Supreme Court affirmed the Court of Appeals' Decision.

Status: The case is pending execution in RTC Branch 35, Ormoc City. For failure to pay the money judgment after a writ of execution had been issued amounting to P97,872,188.98, as of April 19, 2011, a Notice of Garnishment was issued on PNOC accounts in Land Bank of the Philippines. PNOC filed a Motion to lift the notice of garnishment issued by the Sheriff which was denied by the court, hence, a Motion for Reconsideration has been filed. RTC issued an Order for the Delivery Money directing Land Bank to deliver and pay to the court the judgment obligation. Defendants also filed a Motion to Release Funds of PNOC in Land Bank. For resolution.

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

This is an expropriation case covering an area of 30,376 sq. m. 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, based on the evidence already presented by the parties, proceeded to determine the amount of just compensation at P48.00/sq. m. for the area of 30,376 sq. m. or for the total of P1, 461,328.60, with the interest at the rate of 6% per annum from November 08, 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
From: 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 indisposable 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 indisposable lands of the public domain. RTC awarded the total amount of Php64,192.00 (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 Espinas for a portion of their lot covered by TCT No. TH-246, situated in Sitio Cambantog, Brgy. Lake Danao, Ormoc City, with a total area of 197,296 sq. meters. The lot will be used to form part of the road network of EDC's Leyte Geothermal Production Field (LGPF) leading to its 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 square meter. The just compensation issue has been resolved by the Commissioner. The court set the case further hearing on the determination of the just compensation issue.

Status: Respondent's turn to present evidences on the amount of just compensation.

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 33,044 square meters located at Rizal, Kananga Leyte, to be used 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 the 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 01, 1994 for the entire Lot covered by OCT No. P-22898 with an area of 91,913 square meters located at Brgy. Lim-ao, Kananga Leyte to be used for the Leyte Geothermal Production Field. Plaintiff's valuation is at P1.48 per square meter.

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 of 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 TXT 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: Commissioners are yet to submit valuation.

10. ***PNOC vs. Carmencita P. Gual et. al.,***
Civil Case No. 12649
RTC Branch 36, Dumaguete 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.

Status: For dismissal after EDC settled the case by paying the amount of P421,960.00 as just compensation.

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 systems. 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 P20 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 conference was conducted. Respondent manifested in court that they will file a third party complaint against EDC.

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

30. INFORMATION REQUIRED UNDER RR 15-20 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 PFRSs, 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 hereunder 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 P23,551,949 and VAT input taxes of P44,875,958 claimed for 2010.

B. Documentary Stamp Tax (DST)

No DST paid for 2010.

C. Withholding Taxes

Withholding taxes paid/accrued for the year amounted to:	
Tax on compensation and benefits	**6,664,699**
Creditable withholding taxes	**12,345,864**
VAT and other percentage taxes	**3,587,189**
	22,597,752

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	**14,812,224**
Transfer tax and registration fees	**8,027,070**
Business taxes	**10,500**
Other taxes, fees and licenses	**217,037**
	23,066,831

E. Deficiency Tax Assessments and Tax Cases

As of December 31, 2010, the Company has pending cases with the Bureau of Internal Revenue (BIR) as follows:

1. CTA Case No. 7930
Court of Tax Appeals En banc

A petition for review filed by PNOC at the Department of Justice (DOJ) in order to review the assessment of the BIR on the alleged deficiency value added tax of PNOC for the year 2003 in the amount of P114,052,623.87.

However, on December 5, 2008, the DOJ dismissed the petition contending that the Department has no jurisdiction over the petition. The Company then filed a Petition for Review with the CTA (13th Division). However, the petition was dismissed. A motion for reconsideration was filed but the same was also dismissed. A petition for review is presently pending in the CTA en banc.

2. OSJ Case No. 2004-013
Department ofJustice, Manila

This refers to PNOC's tax liability for the alleged deficiency income tax and deficiency value added tax liabilities for the CY 2000 amounting to P42,416,715.07 and P20,745,129.63, respectively. The Company protested the assessment but was denied by the BIR on June 14, 2004. On July 19, 2004, PNOC filed a petition for review with the Department of Justice (DOJ). However, the DOJ dismissed the petition on April 16, 2010.

Part II

COMMENTS AND OBSERVATIONS

A. Current Year's Operations

1. **Written concurrence of the Commission on Audit was not secured for engaging the services of private lawyers in violation of COA Circular No. 86-255, as amended by COA Circular No. 95-011.**

1.1 COA Circular No. 86-255 dated April 2, 1986, as amended by COA Circular No. 95-011 dated December 4, 1995, 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 According to Management, in November 1995, the Company sought the concurrence of COA to the engagement of Atty. Nicolas Sonalan as external counsel for the Dayot cases in Iloilo. Then COA Auditor Tobias P. Lozada replied that with the new policy of COA to audit transactions only after they have been paid, *"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, in his memorandum of November 8, 1995, was espousing COA Circular No. 95-006 dated May 18, 1995 which effected the total lifting of pre-audit on all transaction 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 therefore reiterate our recommendation on the strict compliance with COA Circular No. 95-011 and Memorandum Circular No. 9 of the Office of the President.***

2. **Special allowances of P1.842 million granted to the Solicitor General, Assistant Solicitor General, Senior State Solicitors and Associate Solicitor engaged by PNOC were not duly covered by Memorandum of Agreements stating their authority and their corresponding individual rates.**

2.1 Section 8 of Republic Act No. 9417 dated July 24, 2006 provides that *"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 Examination of the account Professional/technical fees (410) for CY 2010 disclosed P1,842,000 in special allowances were granted to officers of the Office of the Solicitor General (OSG) assigned to handle the various PNOC cases. The OSG counsels, numbering from 12 to 17 lawyers, were paid rates ranging from P15,000 to P57,000 per quarter.

2.3 However, neither a Memorandum of Agreement nor any written authority from the OSG for the receipt of said allowances and the individual rates thereof 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, both of the PNOC, was presented wherein it was stated that lawyers/solicitors maintain that there was no written document to show how each lawyer was 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

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

2.5 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.

3. **The investment property transferred by Malangas Coal Corporation (MCC) was carried at its initial cost of P455,057.60 in the balance sheet as of December 31, 2010 and not at its fair market value of P6,435,554, as required by IAS 40. Moreover, the transfer of property was not covered by a Deed of Sale/Transfer/ Assignment.**

3.1 International Accounting Standard (IAS 40) on Investment Property, paragraph 30, provides that an entity shall choose as its accounting policy either the fair value model or the cost model and shall apply that policy to all its investment property. Further, paragraph 33 states that after initial recognition, an entity that chooses the fair value model shall measure all of its investment property at fair value.

3.2 The Company adopted IAS 40 on its investment property effective 2007 when it recognized an appraisal increase of P8.262 billion, and subsequently in 2008 for P1.062 billion which was duly disclosed in its Notes to Financial Statements.

3.3 However, our examination of the investment property account disclosed that 18 parcels of land transferred to the Company by the defunct Malangas Coal Corporation continued to be carried at their initial cost of P455,058 and not at their fair value of P6,435,554. It was also observed that the transfer was not appropriately covered by supporting documents (deed of sale/transfer/assignment).

3.4 ***We recommended that the Company have the 18 parcels of land assessed by an independent appraiser and appropriate accounting entries be made to carry the investment property in the books at their fair value as required by IAS 40***.

3.5 According to Management, they will compose a team that will look into the documentation of transfer of 18 properties from the Malangas Coal Corporation. The recommended assessment/appraisal by an independent appraiser shall be promptly scheduled upon obtaining the necessary documents for the transfer.

B. Reiteration of Last Year's Audit Findings

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

   1.1 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 were not registered in the name of PNOC. These properties include the following:

   a. Eighteen 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. 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.

   c. 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.

   d. 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.

   1.2 ***We reiterated our previous audit recommendation that Management take the necessary steps to have the titles of said properties transferred to the Company.***

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

2.1 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 were still registered in the name of PCC and ownership thereof has not been transferred to the 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	

2.2 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 was for reconstitution while the titles for four other lots were for regional registration as of July 14, 1999. Moreover, included in the Schedule of Land account was a dry creek with a book value of P1.028 million which was untitled. By law, creeks belong to the state and are therefore outside the commerce of men.

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

2.4 ***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.***

STATUS OF IMPLEMENTATION OF PRIOR YEARS' RECOMMENDATION

FINDINGS/OBSERVATION	RECOMMENDATIONS	STATUS/ACTION TAKEN
1. Real estate properties recognized in the books are not covered by Transfer Certificates of Title (TCT) in the name of the Company.	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 mentioned.	Not implemented. Reiterated in Comments and Observations B.1.
2. Transfer Certificates of Title of seventy-eight (78) properties are still in the name of previous owners.	We recommended that Management continue to exert efforts to have the abovementioned properties titled in the name of the Company.	Partially implemented. Management has initiated serious efforts to comply with the requirements of concerned agencies to have the TCTs transferred to PNOC.
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.	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.	Not implemented. Reiterated in Comments and Observations B.2.
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.	We reiterated our recommendation that the Company pursue and continue the negotiation with NDC to collect the redemption price of the investment and accumulated dividends.	Implemented. Negotiations are underway and NDC has committed to make initial settlement through *dacion en pago* preferably in second semester of 2011.