


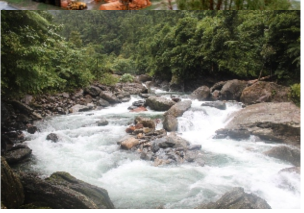

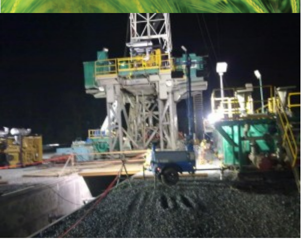

PHILIPPINE NATIONAL OIL COMPANY

2011
Annual Report

VISION

To be a world-class
Philippine energy enterprise

MISSION

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

CORE VALUES

Professional Integrity
Professional Excellence
Company Loyalty
Teamwork

PHILIPPINE NATIONAL OIL COMPANY

2011

Annual Report

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President's Report

PNOC was created to provide and maintain an adequate and stable supply of oil and petroleum products for domestic requirements. In its 38 years of existence, PNOC continues to fulfill its commitment of ensuring a stable supply of energy. Through these years, it has made remarkable achievements in the energy sector.

When PNOC's subsidiary, Petron Corporation was privatized in 1994, the Company's financial resources increased, paving the way for opportunities to develop various energy projects.

PNOC played an important role in developing the natural gas industry. The San Antonio Power Plant, the first natural gas-fired power plant was commissioned in 1994 to supply electricity to some 10,000 households in San Antonio, Isabela. In 2002, it participated in the largest energy infrastructure undertaking in Philippine history, the Malampaya Deepwater Gas to Power Project, together with petroleum majors, Shell Exploration as Project Operator and Texaco as Partner.

The commissioning of a 3-MW geothermal pilot power plant in Tongonan, Leyte In 1997 marked the start of commercial use of geothermal energy as power. Through its commitment and dedication, hard work and good corporate governance, the company reached a stature like no other government corporation did. PNOC became the world's second largest geothermal producer.

PNOC also ventured into the coal mining business. As early as the 80's, the Malangas Coal Mines in Zamboanga del Sur produced thousands of metric tons of coal. To this day, PNOC still engages in mining coal reserves in Zamboanga del Sur.

PNOC broadened its horizon and concentrated not only in conventional energy but also ventured into renewable energy. The Netherlands-assisted Solar Home Systems(SHS) Distribution Project was completed providing electricity to families in far-flung areas with the installation of 15,100 units of SHS in Regions 1-7, Cordillera Administrative Region, and Mindanao.

PNOC's move to modify its petrochemical subsidiary's primary mandate and corporate name in 2006 was in response to the government's thrust in searching for alternative sources of energy by promoting the development and commercial production of biofuels.

Presently, PNOC, together with its subsidiaries, continue to face the challenge in exploring for new energy sources, whether conventional or renewable, to support the country's pursuit for energy supply security.

In 2011, PNOC's programs and projects were aligned to the Energy Reform Agenda (ERA) set by the Department of Energy. The Agenda was created to set a policy framework for the country in terms of energy development under the Aquino administration. The ERA focuses on providing “Energy Access for More”. PNOC’s major activities for the year were mainly anchored on one of the major pillars of the Agenda which is ensuring energy security of supply for the country.

Oil and Gas

PNOC Exploration Corporation (PNOC EC), the upstream oil and gas subsidiary of the Philippine National Oil Company (PNOC), is actively engaged in the country's search for indigenous sources of energy.

Petroleum Exploration

PNOC-EC's dedication in the search for indigenous sources of energy for the country has brought the company to all the more intensify its exploration activities for this year. It operates various onshore and offshore oil and gas exploration activities in many parts of the country and continuously provides technical and professional services to a host of domestic and foreign exploration firms.

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

One of the exploration projects, West Balabac, where the company holds a 25% participating interest, has shown promising results from the acquired 3D seismic data. The data showed a trend of prospective carbonate build-ups and structural anomalies from Malaysia to Northwest Palawan. Additional 2D seismic survey was conducted during the year to further evaluate the block. Initial work on fast track data were very encouraging and a potential follow-up 3D seismic program on prospective structures is being considered for 2012.

Natural Gas Development and Production

PNOC-EC has a 10% participating interest in the first and so far, the single biggest natural gas undertaking and infrastructure investment in Philippine history, the Malampaya Gas-to-Power Project. The inauguration of the project signaled the birth of the natural gas industry in the Philippines.

The Malampaya Deepwater Gas-to-Power Project continued to produce gas and condensate and supplies the fuel requirements of its three power plant customers in Batangas. Moreover, it provides for the gas fuel requirements of Pilipinas Shell Petroleum Corporation's refinery in Tabangao, Batangas and compressed natural gas for the pilot phase of the CNG public transport project of the government through the Department of Energy.

Total natural gas produced from the for the period reached 136.37 billion cubic feet. Condensate production stood at 5.23 million barrels and was shipped to buyers in Singapore, Thailand and China during the year.

Availability of a natural gas infrastructure is vital to the development of the natural gas industry. In 2003, President Arroyo mandated PNOC to spearhead the development of downstream natural gas infrastructure projects. PNOC's Natural Gas Development Projects involved the setting up of natural gas infrastructure projects comprising of the Batangas-to-Manila(BATMAN 1) Gas Pipeline Project, the Bataan LNG Terminal, the Bataan-to-Manila (BATMAN 2) Gas Pipeline Project, and the 500-MW power plant in Limay. This network of natural gas pipelines would bring gas from the Malampaya, closer to its consumers.

The Batangas-to-Manila Gas Pipeline Project is the initial task in the national plan to develop the gas industry in the Philippines, thereby displacing oil consumption for both power and non-power sectors.

In February, the Department of Energy, together with the World Bank and Japan International Cooperation Agency (JICA), started updating the Master Plan Study (developed in 2002) for the Development of the Natural Gas Industry in the Philippines. The Master Plan will cover revalidation of: (i) existing feasibility studies (FS) on the Batangas-to-Manila pipeline project; (ii) viability of identified natural gas infrastructure projects; and (iii) prioritization of natural gas infrastructure projects. Target completion of the study is by the end of 2011.

A public consultation was held in December where the initial draft of the JICA masterplan study for the BATMAN projects was presented. The masterplan study was being finalized by WB and JICA for submission to DOE by end of January 2012.

New Ventures

PNOC EC continued to evaluate prospective new ventures and exploration opportunities, both here and overseas. PNOC EC participated in the formal launching of the 4th Philippine Energy Contracting Round (PECR) on 30 June 2011. The Company continued the evaluation of the areas being offered by the DOE and continued its discussion with potential joint venture partners for possible bids in 2012.

Other Projects

CNG Stations

PNOC EC is set to undertake the Compressed Natural Gas (CNG) for vehicles project, which is in line with the Department of Energy's (DOE) existing Natural Gas for Vehicle Program for Public Transport (NGVPPT). The program's objective is to promote the use of indigenous natural gas in the transport sector and improve the air quality in Metro Manila and nearby provinces.

The project aims to construct CNG distribution infrastructures such as one (1) mother station and two (2) daughter stations to increase the use of CNG in public utility vehicles. This project targets to provide fuel to 1,000 buses in the long-run.

For the year 2011, project proponents have already submitted the final copy of the Terms of Reference (TOR) for the procurement of the CNG equipment package, prime mover and hauling equipment. The NGVPPT Steering Committee reviewed the Memorandum of Agreements (MOAs) among SC38 Consortium, PNOC EC and DOE.

Oil Trading

Aside from its coal business, PNOC EC is now delivering petroleum products to Bangladesh which is being sourced from a private trading agent. For 2011, PNOC EC delivered 427.99 thousand metric tons of petroleum products to Bangladesh Petroleum Corporation (BPC). The BPC's demand was brought about by the country's reliance on diesel power plants for electricity.

Coal

One of the most important of the primary fossil fuels is coal. PNOC EC continues its coal mining efforts in Zamboanga Sibugay to supply the coal requirements of industrial and power plant customers.

Its coal business mainly caters to serving the requirements of the cement manufacturing and the power production industries and also caters to requirements of the emerging small-scale user market. Sources of coal come from its own production from the Zamboanga Sibugay Coal Project (COC 41) and from other local mine sources such as Semirara coal and imported coal from Indonesia.

For the year, total coal production from the Integrated Little Baguio (ILB) Coal Mines in Zamboanga Sibugay stood at 148.56 thousand metric tons (MT). Production was lower than target because of delays in the repairs, rehabilitation and development activities in the Main and Ventilation shafts caused by power curtailment in the area and delays in the procurement of necessary equipment/materials.

On the marketing activities, total coal traded for the period totaled 540.20 thousand metric tons. High sales volume was brought about by high demand for local coal. No sale was made to the export market for the year.

PNOC EC widened its scope of operations and embarked on coal exploration and development. The Lumbog area, south of the ILB mine, was evaluated to have mineable coal reserves. In March, the Board of Directors approved the implementation of development activities in the area. Procurement of mining equipment for mine development started in the second quarter and implementation of all pre-development activities was ongoing.

In the pipeline is the establishment of two mine-mouth power plants in Isabela and Malangas.

The Isabela Coal Mine and Power Plant Project, which is envisioned as the first mine-mouth power plant in the country, is being developed in cooperation with the DOE for the Province of Isabela under COC 122. The project consists of a coal mine production area and a power generating facility. Lignite coal with total reserves of 28 million MT found in various areas will be mined to supply coal fuel to the power plant, that will be situated in Cauayan City.

The project aims to promote the use of indigenous coal for power generation and augment the energy supply requirement of Isabela and nearby provinces.

PNOC EC awarded the Land Acquisition and Resettlement Plan (LARP) Consultancy contract to Lichel Technologies, Incorporated for the implementation of the study. The consultant completed census and inventory in the barangays of Cabugao, Cauayan City and Villaluz, Benito Soliven during the second quarter. After completion of the study, conduct of the Grid Impact Study and Front-end Engineering Design of the power plant will follow.

Aside from COC 122 Isabela Coal Mine-mouth Power Plant project, PNOC EC is keen to enter the power sector with plans to construct 100-MW mine-mouth coal-fired power plants in the province of Zamboanga Sibugay, Malangas. The power plant aims to supply the power requirement of PNOC EC's coal mining operations under COC 41, also in Zamboanga Sibugay and to improve the electricity generation in the Mindanao grid.

For 2011, PNOC EC engaged a consultant for the Feasibility Study of the Coal-fired Power Plant Project in Malangas, Zamboanga, Sibugay. The study was completed in the third quarter and in October, the DOE approved the conduct of the Grid Impact Study (GIS) with the National Grid Corporation of the Philippines

Alternative Fuels

Since its creation in 2006, PNOC Alternative Fuels Corporation's (PAFC), continues its efforts to pursue its mandate to explore, develop, and accelerate the utilization and commercialization of alternative fuels in the country.

Presently, PAFC's operations on the use of alterntive fuels, are both developmental and commercial in nature. In support of the govt's call to introduce more environment-friendly alternative fuels, the company is engaged in biofuels production and utilization. This will not only result to increased local and global demand for biofuels, but will also contribute to the Philippine Government's thrust towards reduced dependence on imported and polluting oil, and towards energy security and a cleaner environment.

As a secondary mandate, the PAFC shall also pursue the development, operation and management of a petrochemical industrial estate. The complex, located in Limay and Mariveles, Bataan, is approximately 530 hectares, of which 80 hectares have been fully developed.

Petrochemicals

The company continuously provides basic services such as raw and fire water, power supply, and jetty services to the locators within the Industrial Park and commercial areas. These services provided the bulk of revenues for the Park. The Locator Agreement with Philippine Polypropylene Inc. was signed on March 14, 2011. To ensure the structural integrity of the jetty and to handle the current and additional operational loads more efficiently, the repair and rehabilitation of the jetty pier was started in February 2011 and was 35% complete as of end December.

As part of the program to improve other services in park administration, several site development/improvement endeavors were undertaken in 2011. The rehabilitation of park lighting (roadway, jetty and common areas) was completed while the rehabilitation of the power supply distribution system and repairs of jetty were nearing completion. Rehabilitation of roadway and jetty post is ongoing while on rehabilitation of distribution lines, erection of distribution poles and replacement of corroded poles were started.

The Environmental Management Program (EMP) is responsible for ensuring environmental regulations and compliance at the Park. Environment-related activities were undertaken and complied with including environmental quality monitoring of air, water (effluent marine), raw water and ambient noise and efficient management of solid and hazardous wastes in the Park.

Correlated to the environmental management program is the Clean and Green Program of the Park involving shoreline cleaning, international coastal clean-up, provincial eco-tourism and, clean and green province-wide campaign. During the period, the Park organized the Coastal Clean-Up Project and participated in the Tree Planting Project of the Department of Environment and Natural Resources (DENR).

In line with the occupational safety and security, the Park implements the Emergency Preparedness and Response Plan that requires that newly hired personnel and new sets of security guards undergo intensive training before deployment to his/her work station.

Persistent Organic Pollutants (POPs) Project

The POPs Project is a part of a global program that will introduce and apply a non-combustion technology to destroy polychlorinated biphenyls (PCBs) wastes. This is the first of its kind not only in the country but in Southeast Asia as well. The PNOC-AFC has partnered with the DENR under the auspices funding of the United Nations Industrial Development Organization (UNIDO) for the implementation of the Project. The PNOC-AFC will host and operate the PCB destruction facility to be located at the Industrial Park.

The construction of the said facility is in full swing with the primary building already completed while the construction of Building 2 to accommodate large transformers is ongoing. Likewise, the PCB destruction equipment was installed and training of technical staff for the project is ongoing. Permits were secured from the EMB-DENR.

A contract was signed with Ajinomoto for the treatment of 24,000 kilos of PCB wastes. Goodyear's PCB inventory was also hauled and transported to the POPs facility ready for treatment. Processing of PCB wastes was started and 2,800 kgs. of PCB oil from Goodyear Philippines, Inc. were successfully treated on December 8, 2011.

Agreements are being finalized with Manila Electric Company, National Power Corporation, National Grid Corporation of the Philippines, Power Sector Assets and Liabilities Management and other private companies such as San Miguel Corporation (SMC). These companies are waiting for the pronouncement from the Environmental Management Bureau (EMB) on the commissioning of the facilities before signing contracts with PAFC for the treatment of their PCB wastes.
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Renewables

Development in the renewable energy industry continues to improve since the Renewables Energy Act was established in 2008. PNOC takes part in this growing development in the country when it created its newest subsidiary, PNOC Renewables Corporation(PNOC RC) in February 2008.

PNOC RC was created to help promote the research and development of the various RE technologies. The company aims to implement various renewable energy projects and programs to foster sustainable growth and at the same time mitigate climate change. PNOC RC carries on with the development, utilization and commercialization of its hydropower, geothermal and solar projects for 2011.

Hydropower

Activities for the eleven (11) hydropower service contracts awarded to PNOC RC progressed significantly during the year. In addition, technical competence of operations personnel greatly improved in terms of handling the pre-development of run-of-river hydropower projects, thus reducing need for hiring consultants to do pre-feasibility studies.

Feasibility studies for Siaton, Okoy, Abuan, Sicopong, Jalaur, and Pacuan-Guinobaan were completed in the 4th quarter of 2011. Siaton, Okoy and Pacuan-Guinobaan are being considered for Public-Private Partnership while Jalaur will be put on hold as the project site is identified by the National Irrigation Authority (NIA) as a multi-purpose project, wherein the resource will be used as irrigation and water source. Power generation comes in as a lower priority in a multi-purpose reservoir project.

Geothermal

Various consortia were formed to develop geothermal sites at Mainit-Sadanga, Buguias-Tinoc and Maibarara. These projects, though with long gestations, will be able to contribute in lowering electricity prices.

Mt. Isarog Geothermal Project (20 MW)

PRC was awarded a Renewable Energy Contract in February 2010 by the DOE, to explore and develop the geothermal resource in the perimeters of Mt. Isarog located in Camarines Sur. A Certificate of Non Coverage was issued by the DENR – EMB in November 2010 for the Mt. Isarog Geothermal Project. IECs were conducted to several stakeholders, the most recent being with Partido Development Administration (PDA), the development arm of the fourth district of Camarines Sur, last January 2011. The fourth district is where majority of the service contract area is located.

Maibarara Geothermal (20 MW)

The 20-MW project is operated by Maibarara Geothermal, Inc., a joint venture corporation owned by PetroEnergy Resources Corporation's wholly-owned subsidiary, PetroGreen Energy Corporation, and jointly with Trans-Asia Oil and Energy Development Corporation and PNOC Renewables Corporation, with the latter maintaining a 10% share.

From January to April, the work-over for the three (3) wells of the Maibarara Geothermal Project was completed and a flow test conducted to check the commerciality of these wells. The Maibarara well flowed successfully at 1:20 pm on March 5, 2011. The project is expected to perform commercial operations by end of 2013 when well rehabilitation, grid impact studies, power purchase agreements and power plant design and construction have been achieved.

Buguias-Tinoc (20 MW) and Mainit-Sadanga (20 MW)

A consortium, PRC – Magma Energy Resources Inc. was formed to develop geothermal sites at Mainit-Sadanga, and Buguias-Tinoc Geothermal Prospect Areas. The areas under the service contract are inhabited by communities covered under the Indigenous

Peoples Rights Act (IPRA) so the consortium is currently in the process of securing Free, Prior and Informed Consent (FPIC) permits from the National Commission on Indigenous Peoples (NCIP). FPIC kicked-off in the second week of January. The consortium reviewed and evaluated existing reports and data covering the areas and conducted remote sensing. The other items in its work plan would be realized only after the FPIC has been granted.

Solar

In May, PNOC RC was among the parties that signed the MOA on the Boni Tunnel Energy Efficient Lighting Project. This project, initiated by DOE late in 2010, aims to replace existing lights of the Boni Tunnel with energy efficient LED lamps and to utilize solar energy for part of its electricity requirement. PNOC RC's contribution of 128 units of 50-W solar PV modules were already in place. Civil works by the Department of Public Works and Highways (DPWH) are ongoing. Other participants include the DPWH, MMDA, ADB, the Mandaluyong City Government, and Philips Electronics and Lighting Incorporated. Philips and PNOC RC are ready to provide the luminaires and solar panels, respectively.

<u>Shipping and Transport</u>

The shipping arm of PNOC was then formed to support Petron's domestic transport needs. PNOC Shipping and Transport Corporation or PSTC started with a fleet of tankers, barges and tugboats in 1978. It also engages in shipping, tankering, lighterage, barging, towing, and shipment of goods, chattels, and other products, marine and maritime commerce.

Up until 2008, PSTC disposed of several of its fleet to sustain operational efficiency. Presently, it operates four vessels transporting crude and petroleum cargo for Petron to various parts of the country.

These four company-owned vessels are composed of two (2) double-hulled M/Ts Emilio Jacinto and Lapu-Lapu and two single-hulled M/Ts Antonio Luna and J. P. Rizal. These vessels served Petron's requirements with their live Time Charter contracts. For 2011, average utilization for the two (2) double-hulled vessels was 61% while that of the single-hulled vessels was 58%.

Ship Inspection Report (SIRE) checklist and guidelines were adopted. The progress of quality and safety management systems was continuously being monitored to secure ISO 9001:2008 accreditations within the year. Renewal of safety management certificate was obtained for M/T J.P. Rizal.

PSTC's vessels completed a total of 108 voyages transporting 407,154 metric tons of petroleum cargo to various parts of the country for 2011.

Real Estate Management

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

Since the extension of PDMC's corporate life in March 2008, PDMC's activities were mainly on the sale of assets principally based on its Privatization Plan, as approved by the PDMC and PNOC Boards as well as by the Privatization Council of the Department of Finance in September 2006.

Sales and collection for the Socialized Housing units were turned over to Rosario, Cavite Local Government Unit in 2010. The transfer of the project to the LGU ensures PDMC the collection of P30 million per year for five years.

For the period ending December 2011, PDMC sold 35 lots of its Costa Verde Inventories.

PDMC recently outsourced the marketing of the remaining inventory units in its El Pueblo Project in Sta. Mesa, Manila. PDMC is to finalize with El Pueblo Marketing on the Marketing Agreement for the El Pueblo Condominiums owned by PDMC. A total of 8 units were sold through unit reservation.

2011 PNOC Audited Financial Statement

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, 2011, 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, 2011 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, 2012

PHILIPPINE NATIONAL OIL COMPANY
(A Corporation wholly-owned by the Government of the Republic of the Philippines)
STATEMENT OF FINANCIAL POSITION
December 31, 2011
(In Philippine Peso)

	Notes	2011	2010
ASSETS			
Current Assets			
Cash and cash equivalents	4	**4,441,747,053**	1,847,803,219
Short-term Investments	5	**10,628,398**	678,288,657
Accounts receivable	6	**140,069,095**	151,353,353
Due from subsidiary companies	7	**978,704,647**	878,268,074
Prepaid expenses and other current assets	8	**746,838,985**	720,013,490
Total current assets		**6,317,988,178**	4,275,726,793
Non-current Assets			
Long-term receivables - net	9	**70,481,579**	114,786,436
Investment in available for sale securities	10	**4,268,292,694**	4,099,719,862
Investments	11	**5,273,274,356**	5,459,543,766
Property and equipment - net	12	**197,565,275**	161,631,125
Investment property	13	**11,610,519,383**	10,967,028,172
Deferred tax assets	26	**389,125,773**	420,096,073
Other non-current assets - net	14	**15,213,999,379**	15,213,991,726
Total Non-current Assets		**37,023,258,439**	36,436,797,160
Non-current Assets Held for Sale	15	**-**	490,467,400
TOTAL ASSETS		**43,341,246,617**	41,202,991,353
LIABILITIES AND EQUITY			
LIABILITIES			
Current Liabilities			
Accounts payable and accrued expenses	17	**281,423,353**	336,492,134
Dividends payable	19	**96,785,236**	528,110,858
Due to subsidiary companies	7	**25,125,029**	27,090,162
Current portion of long-term debt	16	**44,304,857**	44,304,857
Total Current Liabilities		**447,638,475**	935,998,011
Non-current Liabilities			
Long-term debt - net of current portion	16	**33,228,643**	77,533,500
Deferred tax liabilities	26	**2,790,669,844**	2,791,824,720
Other credits	18	**2,214,874,248**	2,194,390,929
Total Non-current Liabilities		**5,038,772,735**	5,063,749,149
EQUITY	19	**37,854,835,407**	35,203,244,193
TOTAL LIABILITIES AND EQUITY		**43,341,246,617**	41,202,991,353

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, 2011
(In Philippine Peso)

	Notes	**2011**	2010
REVENUES			
Interest income		**387,646,622**	324,276,131
Dividend income	20	**5,001,856,255**	1,000,992,296
Rent income		**203,450,849**	199,399,152
GROSS REVENUES		**5,592,953,726**	1,524,667,579
OPERATING EXPENSES	21	**(295,187,302)**	(293,953,570)
INCOME FROM OPERATIONS		**5,297,766,424**	1,230,714,009
FOREIGN EXCHANGE LOSS, NET	22	**(4,243,199)**	(32,754,771)
FINANCE COSTS	23	**-**	(1,399,198)
OTHER CHARGES, NET	24	**(59,141,628)**	(21,995,773)
NET PROFIT BEFORE TAX		**5,234,381,597**	1,174,564,267
INCOME TAX	25		
Current		**(3,801,217)**	(3,491,271)
Deferred		**(29,815,424)**	(58,123,222)
PROFIT		**5,200,764,956**	1,112,949,774
OTHER COMPREHENSIVE INCOME		**-**	-
COMPREHENSIVE INCOME FOR THE PERIOD		**5,200,764,956**	1,112,949,774

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, 2011
(In Philippine Peso)

	Capital Stock (Note 19.a)	Retained Earnings Appropriated (Note 19.b)	Retained Earnings Unappropriated (Note 19.b)	Total
Balance, January 1, 2010	3,114,595,519		31,538,936,566	34,653,532,085
Appropriations for various PNOC projects		25,652,854,000	(25,652,854,000)	-
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			(3,388,154)	(3,388,154)
Balance, December 31, 2010	**3,114,595,519**	**25,652,854,000**	**6,435,794,674**	**35,203,244,193**
Balance, January 1, 2011	3,114,595,519	25,652,854,000	6,435,794,674	35,203,244,193
Net income for 2011			5,200,764,956	5,200,764,956
Cash dividends for 2011 net earnings			(2,596,951,213)	(2,596,951,213)
Adjustment on cash dividend for 2009 and 2011			47,777,471	47,777,471
Balance, December 31, 2011	**3,114,595,519**	**25,652,854,000**	**9,087,385,888**	**37,854,835,407**

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, 2011
(In Philippine Peso)

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash receipts from customers, subsidiaries and employees	**726,171,947**	4,847,362,668
Cash paid to suppliers, subsidiaries and employees	**(552,409,332)**	(727,062,085)
Net cash from operating activities	**173,762,615**	4,120,300,583
CASH FLOWS FROM INVESTING ACTIVITIES		
Maturities (placements) of short-term investments	**667,773,539**	(20,803,803)
Investment in treasury bonds - net	**(168,572,832)**	(1,857,555,452)
Cash dividends from subsidiaries / associates	**2,499,713,555**	501,045,926
Net proceeds from disposal of assets	**435,200**	507,949
Proceeds from redemption of preferred shares	**504,322**	-
Capital expenditures	**(55,034,321)**	(12,987,413)
Net cash used in investing activities	**2,944,819,463**	(1,389,792,793)
CASH FLOWS FROM FINANCING ACTIVITIES		
Repayment of long-term loans	**(44,304,857)**	(4,338,717,636)
Payment of cash dividend to National Government	**(480,333,387)**	-
Net cash used in financing activities	**(524,638,244)**	(4,338,717,636)
NET DECREASE IN CASH AND CASH EQUIVALENTS	**2,593,943,834**	(1,608,209,846)
CASH & CASH EQUIVALENTS AT BEGINNING OF YEAR	**1,847,803,219**	3,456,013,065
CASH & CASH EQUIVALENTS AT END OF YEAR	**4,441,747,053**	1,847,803,219

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-eight 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, Merritt Road, Fort Bonifacio, 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, 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)*

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. The amendment has had no effect on the financial position or performance of the Company because the Company does not have these types of instruments.

2.4 New standards, amendments and interpretations issued but not effective beginning January 1, 2011 and not early adopted

The amended standard comes into effect for accounting periods beginning on or after January 1, 2013. Earlier application is permitted.

PFRS 9, *Financial Instruments*

The Financial Reporting Standards Council (FRSC) has approved in December 2011, the adoption of Amendments to IFRS 9 and IFRS 7, *Mandatory Effective Date of IFRS 9 and Transition Disclosures*, issued by the International Accounting Standards Board (IASB), as Amendments to PFRS 9, *Financial Instruments* and PFRS 7, *Financial Instruments: Disclosures*.

Mandatory Effective Date of PFRS 9 and Transition Disclosures (Amendments to PFRS 9 and PFRS 7) amended the effective date of PFRS 9 so that PFRS 9 is required to be applied for annual periods beginning on or after January 1, 2015. Earlier application is permitted.

The amendments also modified the relief from restating prior periods. Further, PFRS 7 was amended to require additional disclosures on transition from PAS 39, *Financial Instruments: Recognition and Measurement* to PFRS 9.

PFRS 9 addresses the classification, measurement, and recognition of financial assets and financial liabilities. PFRS 9 replaces parts of PAS 39 that relate to the classification and measurement of financial instruments. PFRS 9 requires financial assets to be classified into two measurement categories: those measured as at fair value and those measured at amortized cost. The determination is made at initial recognition. The classification depends on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. For financial liabilities, the standard retains most of the PAS 39 requirements. The main change is that, in cases where the fair value option is taken for financial liabilities, the part of a fair value change due to an entity's own credit risk is recorded in other comprehensive income rather than the income statement, unless this creates an accounting mismatch.

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. The amendments affect disclosures only and have no impact on the Company's financial position or performance.

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.

Effective in 2013

PAS 1, *Financial Statement Presentation – Presentation of Items of Other Comprehensive Income*

The amendments to PAS 1 change the grouping of items presented in Other Comprehensive Income (OCI). Items that could be reclassified (or "recycled") to profit or loss at a future point in time (for example, upon derecognition or settlement) would be presented separately from items that will never be reclassified. The amendment affects presentation only and has therefore no impact on the Company's financial position or performance. The amendment becomes effective for annual periods beginning on or after July 1, 2012.

PAS 19, *Employee Benefits (Amendment)*

Amendments to PAS 19 range from fundamental changes such as removing the corridor mechanism and the concept of expected returns on plan assets to simple clarifications and rewording. The Company is currently assessing the impact of the amendments to PAS 19. The amendment becomes effective for annual periods beginning on or after January 1, 2013.

PAS 27, *Separate Financial Statements (as revised in 2011)*

As a consequence of the new PFRS 10, *Consolidated Financial Statements* and PFRS 12, *Disclosure of Interests in Other Entities,* what remains of PAS 27 is limited to accounting for subsidiaries, jointly controlled entities, and associates in separate financial statements. The amendment becomes effective for annual periods beginning on or after January 1, 2013.

PAS 28, *Investment in Associates and Joint Ventures (as revised in 2011)*

As a consequence of the new PFRS 11, *Joint Arrangements* and PFRS 12, PAS 28 has been renamed PAS 28, *Investment in Associates and Joint Ventures*, and describes the application of the equity method to investments in joint ventures in addition to associates. The amendment becomes effective for annual periods beginning on or after January 1, 2013.

PFRS 7, *Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities*

These amendments require an entity to disclose information about rights of set-off and related arrangements (such as collateral agreements). The new disclosures are required for all recognized financial instruments that are set off in accordance with PAS 32. These disclosures also apply to recognized financial instruments that are subject to an enforceable master netting arrangement or 'similar agreement', irrespective of whether they are set-off in accordance with PAS 32. The amendments require entities to disclose, in a tabular format unless another format is more appropriate, the following minimum quantitative information. This is presented separately for financial assets and financial liabilities recognized at the end of the financial reporting period:

a. The gross amounts of those recognized financial assets and recognized financial liabilities;
b. The amounts that are set off in accordance with the criteria in PAS 32 when determining the net amounts presented in the statement of financial position;
c. The net amounts presented in the statement of financial position;
d. The amounts subject to an enforceable master netting arrangement or similar agreement that are not otherwise included in (b) above, including:

    - Amounts related to recognized financial instruments that do not meet some or all of the offsetting criteria in PAS 32; and
    - Amounts related to financial collateral (including cash collateral); and

e. The net amount after deducting the amounts in (d) from the amounts in (c) above.

The amendments to PFRS 7 are to be retrospectively applied for annual periods beginning on or after January 1, 2013. The amendment affects disclosures only and has no impact on the Company's financial position or performance.

PFRS 10, *Consolidated Financial Statements*

PFRS 10 replaces the portion of PAS 27 that addresses the accounting for consolidated financial statements. It also includes the issues raised in Standards Interpretations Committee (SIC) 12, *Consolidation – Special Purpose Entities*. PFRS 10 establishes a single control model that applies to all entities including special purpose entities. The changes introduced by PFRS 10 will require management to exercise significant judgment to determine which entities are controlled, and therefore, are required to be consolidated by a parent, compared with the requirements that were in PAS 27. This standard becomes effective for annual periods beginning on or after January 1, 2013.

PFRS 12, *Disclosure of Interests with Other Entities*

PFRS 12 includes all of the disclosures that were previously in PAS 27 related to consolidated financial statements, as well as all of the disclosures that were previously included in PAS 31 and PAS 28. These disclosures relate to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. A number of new disclosures are also required. This standard becomes effective for annual periods beginning on or after January 1, 2013.

PFRS 13, *Fair Value Measurement*

PFRS 13 establishes a single source of guidance under PFRS for all fair value measurements. PFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under PFRS when fair value is required or permitted. This standard becomes effective for annual periods beginning on or after January 1, 2013.

Effective in 2014

PAS 32, *Financial Instruments: Presentation – Offsetting Financial Assets and Financial Liabilities*

These amendments to PAS 32 clarify the meaning of "currently has a legally enforceable right to set-off" and also clarify the application of the PAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. The amendment is not expected to have any impact on the net assets of the Company. The amendments to PAS 32 are to be retrospectively applied for annual periods beginning on or after January 1, 2014.

Effective in 2015

PFRS 9, *Financial Instruments: Classification and measurement*

PFRS 9 as issued reflects the first phase of 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, 2015. In subsequent phases, hedge accounting and impairment of financial assets will be addressed with the completion of this project expected on the first half of 2012. The adoption of the first phase of PFRS 9 will have an effect on the classification and measurement of the Company's financial assets, but potentially will have no impact on classification and measurement of financial liabilities. The Company will quantify the effect in conjunction with the other phases, when issued, to present a comprehensive picture.

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. <u>Investment Property</u>

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

g. <u>Non-Current Assets Held for Sale</u>

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. <u>Bank Borrowings</u>

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. <u>Foreign Currency Transactions</u>

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. <u>Provision for Doubtful Accounts</u>

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. <u>Financial Instruments</u>

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.

Impairment of Financial Asset

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.

<u>Derecognition of Financial Assets and Liabilities</u>

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.

l. 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.

o. 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:

	2011	2010
Cash in bank	**11,628,395**	4,400,281
Petty cash fund	**122,119**	122,119
Money market placements	**4,429,996,539**	1,843,280,819
	4,441,747,053	1,847,803,219

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:

	2011	2010
Government Securities	**--**	546,987,090
Time Deposits	**10,628,398**	131,301,567
	10,628,398	678,288,657

6. ACCOUNTS RECEIVABLE

This account consists of:

	2011	2010
Trade Receivables	**9,820,955**	9,820,955
Non-trade Receivables	**85,943,283**	97,227,541
Current Portion of Long-term Receivables	**44,304,857**	44,304,857
	140,069,095	151,353,353

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 PNOC Shipping and Transport Corporation out of the proceeds of the Company's long-term loans (Note 9).

7. RELATED PARTY TRANSACTIONS

This account consists of the following:

	2011	2010
Due from affiliated companies		
PNOC Shipping and Transport Corporation	**974,693,293**	870,363,436
PNOC Oil Carriers, Inc.	**134,085,597**	134,085,597
PNOC Exploration Corporation	**1,824,745**	6,013,718
PNOC Coal Corporation	**1,616,187**	1,466,910
PNOC Development & Management Corp.	**438,412**	280,876
PNOC Alternative Fuels Corporation	**9,148**	20,272
Sub-total	**1,112,667,382**	1,012,230,809
Allowance for Doubtful Accounts	**(133,962,735)**	(133,962,735)
	978,704,647	878,268,074

Due to affiliated companies		
PNOC Tankers Corporation	**22,790,362**	22,790,362
PNOC Renewables Corporation	**2,334,667**	4,299,800
	25,125,029	27,090,162

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:

	2011	2010
Special deposits	**208,356,061**	181,131,197
Prepaid expenses	**9,449,969**	10,158,034
Other deferred charges	**529,032,955**	528,724,259
	746,838,985	720,013,490

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 P188,154,845 and P185,656,985, respectively.

9. LONG-TERM RECEIVABLES, NET

This account consists of receivables from the following companies:

	2011	2010
PNOC Shipping & Transport Corporation	**33,228,643**	77,533,500
Natural Resources Development Corporation	**37,252,936**	37,252,936
PNOC Oil Carriers, Inc.	**24,486,172**	24,486,172
	94,967,751	139,272,608
Allowance for doubtful accounts	**(24,486,172)**	(24,486,172)
	70,481,579	114,786,436

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 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 **P4,268,292,694** in **2011** and P4,099,719,862 in 2010, that will mature after one year up to five years. These investments bear fixed interest rates ranging from 5.125% to 5.805% for peso denominated and 3.093% to 4.125% for dollar denominated placements.

11. INVESTMENTS, AT COST

This account consists of the following:

	Percentage of Ownership	**2011**	2010
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
Other investments		**141,453,350**	141,453,350
		141,453,350	327,722,760
		5,273,274,356	5,459,543,766

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

In 2003, the Securities and Exchange Commission 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, 2011	281,442,524	119,251	4,651,638	3,889,836	23,796,517	2,588,677	316,488,443
Additions	50,949,930	44,643			1,943,224	4,459,168	57,396,965
Reclassifications /							
Adjustments			(1,339,286)		(11,285,020)	(2,588,677)	(15,212,983)
Disposals							
December 31, 2011	332,392,454	163,894	3,312,352	3,889,836	14,454,721	4,459,168	358,672,425
ACCUMULATED DEPRECIATION							
January 1, 2011	(139,271,400)	(119,050)	(2,073,553)	(1,770,153)	(11,623,162)		(154,857,318)
Provision	(11,963,009)	(4,830)	(882,605)	(771,547)	(5,205,948)		(18,827,939)
Reclassifications /							
Adjustments			1,339,186		11,238,921		12,578,107
Disposals							
December 31, 2011	(151,234,409)	(123,880)	(1,616,972)	(2,541,700)	(5,590,189)		(161,107,150)
NET CARRYING AMOUNT							
December 31, 2011	**181,158,045**	**40,014**	**1,695,380**	**1,348,136**	**8,864,532**	**4,459,168**	**197,565,275**
December 31, 2010	142,171,124	201	2,578,085	2,119,683	12,173,355	2,588,677	161,631,125

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 and eight (8) properties conveyed by the National Development Company to PNOC for an equivalent amount of P368,646,678.41 as redemption of the preferred shares through a two-tranche *dacion en pago.*

The properties were initially assessed by a third party appraiser in 2007 and 2008 and adjustments in values were deemed cost. The Company will be scheduling the next appraisal in late 2012 or early 2013 and for five-year periodic intervals thereafter.

Rental income earned from the investment properties amounted to **P238,317,994** and P194,997,647 in **2011** and 2010, respectively.

14. OTHER NON–CURRENT ASSETS, NET

This account consists of:

	2011	2010
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	**249,791**	242,138
	15,298,412,500	15,298,404,847
Allowance for doubtful accounts	**(84,413,121)**	(84,413,121)
	15,213,999,379	15,213,991,726

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.

With the directive from the PNOC Board to put on hold the sale of real properties, this account was reclassified to the Investment Property account in December 2011 closing.

16. LONG-TERM DEBT

This account consists of the outstanding balance of an 8-year pass through loan by PNOC to PNOC Shipping and Transport Corporation with the Land Bank of the Philippines, maturing on 2013 with a prevailing treasury bill rate at conversion date plus fixed spread of 2.5%.

	2011	2010
Long-term loan	**77,533,500**	121,838,357
Less: Current Portion	**44,304,857**	44,304,857

	33,228,643	77,533,500

17. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

This account consists of:

	2011	2010
Accrued Expenses	**44,915,205**	94,306,603
Accounts Payable	**26,569,284**	66,839,560
Other Accounts Payable	**209,938,864**	175,345,971
	281,423,353	336,492,134

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 **P2,214,874,248** and P2,194,390,929 for **2011** and 2010, 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

P50 a share. From 1975 to 1988 additional shares of 6,029,191 were subscribed by the Philippine Government at P500 per share.

b. Retained Earnings

The PNOC Board of Directors approved the appropriation of P25,652,854,000 from retained earnings for the various projects of the Company and its subsidiaries.

Pursuant to Republic Act 7656, PNOC declared a total cash dividend of **P2,596,951,213** for its **2011** net earnings which included the amount of **P2,500,165,977** that were remitted directly to the Bureau of the Treasury by its subsidiaries, PNOC EC and PSTC.

20. DIVIDEND INCOME

This account consists of dividends from the following:

	2011	2010
PNOC Exploration Corp.	**4,996,678,220**	998,892,740
PNOC Shipping and Transport Corp.	**3,653,734**	1,000,000
Gulf Oil Phiippines, Inc.(GOPI)	**1,374,445**	1,099,556
Others	**149,856**	--
	5,001,856,255	1,000,992,296

21. OPERATING EXPENSES

This account consists of:

	2011	2010
Employee Costs	**72,455,753**	68,974,512
Purchased Services and Utilities	**60,869,310**	54,141,613
Awards and Indemnities	**49,260,057**	63,161,153
Business Expenses	**39,332,248**	27,764,857
Depreciation	**31,891,846**	32,342,567
Rentals/Insurance/Taxes	**25,958,155**	35,305,464
Materials and Supplies	**8,260,597**	5,921,894
Maintenance and Repairs	**5,909,660**	5,115,332
Miscellaneous Charges	**1,249,676**	1,226,178
	295,187,302	293,953,570

22. FOREIGN EXCHANGE GAIN(LOSS)

This account pertained to realized foreign exchange losses (P4,356,479) on money market placements in dollar denominations and unrealized foreign exchange gain (P113,280) on realignment of dollar placement balances into Philippine pesos based on PDS rate at year-end of US$1.00=P43.919 vs. peso-dollar rate at various value date of investment.

23. FINANCE COSTS

This account refers to interest expense on long-term loans. There were no finance costs for **2011** while P1,399,198 was incurred for 2010.

24. OTHER INCOME (CHARGES)

This account consists of the following:

	2011	2010
Gain on disposal of assets	**380,000**	473,669
Other income (charges)	**(59,521,628)**	(22,469,442)
	(59,141,628)	(21,995,773)

Other charges include mainly the amount of P58,208,165 representing payment for deficiency taxes for VAT on interest income for the years 2003 and 2009. In 2010, the account includes mainly the amount of P16,988,339 representing payment for the purchase of Mr. Paul Mata's 35% share over eight (8) parcels of land at Sta. Mesa, Manila.

25. INCOME TAXES

Components of income tax expense are as follows:

	2011	2010
Current income tax	**3,801,217**	3,491,271
Deferred income tax	**29,815,424**	58,123,222
	33,616,641	61,614,493

	2011	2010
Net income per books	**5,234,381,597**	1,174,564,267
Permanent differences		
Interest income	**(327,071,593)**	(253,482,252)
Dividend income	**(5,001,856,255)**	(1,000,992,296)
Non-deductible expenses	**9,764,556**	4,117,027
Temporary differences		
Accrued rental income	**(40,415,683)**	(3,393,326)
Unearned rent income	**7,677,883**	332,944
Forex loss - net	**(6,862,530)**	(26,613,726)
Reversal of advance collection of rental	**--**	(44,746,080)
Deficiency income tax paid	**58,208,165**	--
Taxable Income	**(66,173,860)**	(150,213,442)

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:

	2011	2010
Deferred tax assets:		
Tax effect of temporary differences	**256,698,407**	269,733,382
Carryforward of unused tax losses	**118,233,677**	136,048,697
Minimum Corporate Income Tax (MCIT)	**14,193,689**	14,313,994
	389,125,773	420,096,073

	2011	2010
Deferred tax liabilities:		
Revaluation increment on investment property	**(2,790,604,920)**	(2,790,604,920)
Rental	**(64,924)**	(1,219,800)
	(2,790,669,844)	(2,791,824,720)

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 2011**, the Company has accumulated **P14,193,689** as MCIT available for deductions against the regular income tax due and Net Operating Loss Carry Over (NOLCO) of **P394,112,257** for offsetting against future taxable income for three consecutive years immediately following the year of such loss. Breakdown of the P394.112 million NOLCO is as follows:

Year Incurred	Amount	Applied	Expired	Unapplied
2008	125,557,260	--	125,557,260	--
2009	177,724,956	--	--	177,724,955
2010	150,213,442	--	--	150,213,442
2011	66,173,860	--	--	66,173,860
	519,669,517	--	125,557,260	394,112,257

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.

With the enactment of the Governance Committee for GOCCs (GCG), the pending rationalization plans submitted to the DBM have been turned over to the GCG for review. There are no developments on the matter as of this date.

29. CONTINGENCIES

1. **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.

2. **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.

3. **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.

4. **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.

5. **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.

6. **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.

7. **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

8. **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.

9. **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.

10. 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.

These are the eleven (11) 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.

a) 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.

b) 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.

c) ***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.

d) ***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.

e) ***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.

f) ***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.

g) ***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.

h) ***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 have yet to submit valuation.

i) ***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.

j) ***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.

k) ***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, herewith are the information on taxes, duties and license fees paid or accrued during the taxable year.

A. Value Added Tax (VAT)

The Company is a VAT-registered entity with a VAT output tax declaration of P38,778,388 and VAT input taxes of P49,564,875 for 2011.

B. Documentary Stamp Tax (DST) **135**

C. Withholding Taxes

Withholding taxes paid/accrued for the year amounted to:	
Tax on compensation and benefits	**8,102,460**
Creditable withholding taxes	**12,220,468**
VAT and other percentage taxes	**3,069,425**
	23,392,353

D. All other Taxes (National and Local)

Other taxes paid during the year recognized under "Taxes and licenses" account under operating expenses	
Real estate taxes	**11,270,030**
Transfer tax and registration fees	**2,181,550**
Business taxes	**10,500**
Other taxes, fees and licenses	**187,347**
	13,649,427

E. Deficiency Tax Assessments and Tax Cases

As of December 31, 2011, PNOC has a pending Application for Abatement of interest and surcharges imposed on deficiency value-added tax (VAT) on the Company's interest income on advances to subsidiaries for the years 2003 and 2009.

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

Part II

A. COMMENTS AND OBSERVATIONS

Reiterations of Last Year's Audit Findings

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

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

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

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

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

1.5 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 transactions of national government agencies, local government units and government-owned and/or controlled corporations. As stated in Section 5.01.12 thereof, one of the pre-audit activities lifted was the *"review and evaluation of government contracts for auditing, accounting and related services*".

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

1.8 We 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.

1.9 We will issue the necessary Notice of Disallowance.

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 *"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 the officers of the Office of the Solicitor General (OSG) assigned to handle various PNOC cases. The OSG counsels, numbering from 12 to 17 lawyers, were paid rates ranging from P15,000 to P57,000 per quarter. For CY 2011, total payments amounted to P1,916,802.

2.3 Upon the Audit Team's request, 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, was presented wherein it was stated that lawyers/solicitors maintain that there is no written document to show how each lawyer is compensated by OSG's client companies. An estimate or approximation of the rates was given (through SMS or text) on how allowances from client agencies were shared among OSG lawyers, viz:

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

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

3.1 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 are still registered in the name of PCC and ownership thereof has not been transferred to PNOC. Details of these lots are as follows:

TCT No./Tax Dec. No.	Lot No.	Location	Area (sq. m.)	Amount (P)	Remarks
032-00265	8911	Powerhouse lot	2,862	1,287,900.00	Title to be reconstituted
032-00263	8922	Coal Terminal	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
		Dry Creek	2,286	1,028,700.00	Untitled
				47,002.98	Registration fees/documentary and other fees
				4,618,802.98	

3.2 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 is for reconstitution while the titles for four (4) other lots are for regional registration as of July 14, 1999. Moreover, included in the Schedule of Land account is a dry creek with a book value of P1.028 million which is untitled. By law, creeks belong to the state are therefore outside the commerce of men.

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

3.4 ***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.***

B. STATUS OF IMPLEMENTATION OF PRIOR YEARS' RECOMMENDATION

The following audit observations and their corresponding recommendations were issued during last year's audit. Their status and/or actions taken by Management on the observations are as follows:

FINDINGS/OBSERVATION	RECOMMENDATIONS	STATUS/ACTION TAKEN
1. The engagement of services of private lawyers lacked compliance with the provisions of COA Circular No. 86-255 dated April 2, 1986, as amended by COA Circular No. 95-011 dated December 4, 1995.	We recommended that the pertinent provisions of COA Circular 86-255, as amended by COA Circular No. 95-011 be duly complied with.	Management gave their assurance that subsequent engagements of private lawyers will be in accordance with the requirements of COA Circular No. 86-255 as amended by COA Circular No. 95-011. As for the case of the hiring of Atty. Nicolas Sonalan, Management hired the former on the strength of the statement made by Atty. Tobias Lozada, then PNOC resident auditor. They request consideration on the application of the COA rule thereon in view of said statement. Reiterated in Comments and Observations no. 1 of Part II.A.
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 approved by the Solicitor General and Secretary of Budget and Management as required by Section 10 of Republic Act No. 9417 dated July 24, 2006.	We recommended that Management obtain written approval for the rates they are paying the lawyers from the OSG in accordance with RA 9417.	Management has sent written representations to the OSG to clarify the issues raised in the audit finding. To date, the same has not been replied to but they will follow it up with OSG. Reiterated in Comments and Observations no. 2 of Part II.A.

FINDINGS/OBSERVATION	RECOMMENDATIONS	STATUS/ACTION TAKEN
3. The carrying amount of investment property transferred by Malangas Coal Corporation (MCC) and stated at P455,057.60 in the balance sheet as of December 31, 2010 was not presented in accordance with International Accounting Standard (IAS 40).	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.	Implemented.
4. Real estate properties recognized in the books are not covered by Transfer Certificates of Title in the name of the Company.	We recommended that Management take the necessary steps to have the titles of said properties transferred to the Company.	Implemented. Coordination with concerned government agencies are continuously being made until desired results are obtained.
5. Six (6) parcels of lots carried in the books at P4.618 million are still registered in the name of the PNOC Coal Corporation (PCC)	We recommended that representations be made to concerned government agencies in order to have updated information of the status of the reconstitution/ registration of the untitled lots. Further, an investigation should be conducted to determine the nature of PCC's claim on the dry creek and the location thereof.	Partially implemented. Efforts have been initiated to comply with the requirements of concerned government agencies until the properties are transferred to the name of the Company. Reiterated in Comments and Observations no. 3 of Part II.A.

2011 BOARD OF DIRECTORS

Chairman	:	**Jose Rene D. Almendras**
President/CEO	:	**Antonio M. Cailao**
Directors	:	**Emil P. Jurado** *(served until 22 February 2011)*
		Dante B. Canlas
		Bob D. Gothong
		Nicanor L. Sering *(served until 17 April 2011)*
		Federico C. Pascual
		Felipe M. Medalla *(served from 13 January 2011 to 1 July 2011)*
		Victor S. Ziga *(assumed office on 17 March 2011)*
		Ma. Gladys C. Sta. Rita *(assumed office on 17 March 2011)*
		Potenciano V. Larrazabal, Jr. *(assumed office on 18 April 2011)*

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