

# COVER SHEET

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S.E.C. Registration  
Number

T H E P H I L O D R I L L C O R P O R A T I O N

(Company's Full Name)

8 t h F l o o r , Q u a d A l p h a C e n t r u m

B u i l d i n g , 1 2 5 P i o n e e r S t r e e t

M a n d a l u y o n g C i t y

(Business Address : No. Street City / Town / Province)

Reynaldo E. Nazarea

Contact Person

631-8151

Company Telephone Number

0 9

Month

3 0

Day

SEC Form 17Q (September 2009)

FORM TYPE

Month

Day

Annual Meeting

Secondary License  
Type, If Applicable

Dept. Requiring this Doc.

Amended Articles Number/Section

9346

Total No. of Stockholders

Total Amount of Borrowings

P0.00

Domestic

Foreign

To be accomplished by SEC Personnel concerned

File Number

\_\_\_\_\_

LCU

Document I.D.

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Cashier

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**SECURITIES AND EXCHANGE COMMISSION  
SEC FORM 17-Q**

**ANNUAL REPORT PURSUANT TO SECTION 17 OF THE SECURITIES  
REGULATION CODE AND SECTION 141 OF THE CORPORATION CODE OF THE  
PHILIPPINES.**

1. For the quarterly period ended September 30, 2009
2. SEC Identification Number: 38683
3. BIR Tax Identification No.: 041-000-315-612
4. Exact name of registrant as specified in its charter :  
THE PHILODRILL CORPORATION
5. Philippines Province, Country or other jurisdiction of incorporation  
or organization
6. \_\_\_\_\_ (SEC Use Only)  
Industry Classification Code
7. 8th Floor, Quad Alpha Centrum, 125 Pioneer Street, Mandaluyong City 1550  
Address of principal office Postal Code
8. (632) 631-8151/52  
Registrant's telephone number, including area code
9. Not Applicable
10. Securities registered pursuant to Sections 8 and 12 of the SRC, or Sec. 4 and of  
the RSA

Number of Common Stock Outstanding
191,868,805,358

Amount of Debt Outstanding

Total Liabilities P18,887,458.00

11. Are any or all of these securities listed on the Philippine Stock Exchange.

Yes [ x ]      No [ ]

12. Check whether the issuer

- (a) has filed all reports required to be filed by Section 11 of the SRC and SRC Rule 17 thereunder or Section 11 of the RSA and RSA Rule 11(a)-1 thereunder, and Sections 26 and 141 of the Corporation Code of the Philippines during the preceding 12 months (or for such shorter period that the registrant was required to file such reports);

Yes [ x ]      No [ ]

- (b) has been subject to such filing requirements for the past 90 days.

Yes [ x ]      No [ ]

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## **PART 1 – FINANCIAL INFORMATION**

### ***Item 1. Financial Statements***

1. The unaudited Consolidated Financial Statements of the Company for the 3rd quarter ended 30 September 2009 are included in this report. The schedules listed in the accompanying Index to Supplementary Schedules are filed as part of the SEC Form 17Q.
2. Interim Statements of Operations for the current interim period (01 January to 30 September 2009), with comparative Statement of Operations for the comparable period (01 January to 30 September 2008) are attached to this report.
3. A statement showing changes in equity cumulatively for the current financial year to date (01 January to 30 September 2009), with a comparative statement for the comparable year-to-date period of the immediately preceding financial year (01 January to 30 September 2008) are attached to this report.
4. The basic and diluted earnings/loss per share are presented on the face of the attached Statement of Operations (01 January to 30 September 2009), as well as the basis of computation thereof.
5. The Company's interim financial report for the 3rd quarter 2009 is in compliance with Generally Accepted Accounting Principles ("GAAP"). Included in this report is a summary of the Company's significant accounting policies.
6. The Company follows the same accounting policies and methods of computation in its interim financial statements (01 January to September 30, 2009) as compared with the most recent annual financial statements (2008), and no policies or methods have been changed. There were NO reclassifications of financial assets made into and from each category as of the current reporting period.
7. There were NO seasonal or cyclical aspects that had a material effect on the financial condition or results of interim operations of the Company.
8. There were NO unusual items during the interim period (01 January to 30 September 2009), the nature, amount, size or incidents of which have affected the assets, liabilities, equity, net income or cash flows of the Company.

9. There were NO changes in the estimates of amounts reported in prior financial year (2008), which had a material effect in the current interim period (01 January to 30 September 2009).
10. There were NO issuances, repurchases and repayments of debt and equity securities during the current interim period (January 1 to September 30, 2009).
11. There were NO dividends paid on any Company share during the interim period (January 1 to September 30, 2009).
12. The Company does not generate revenues from any particular segment and its business is not delineated into any segment, whether by business or geography. The Company is not required to disclose segment information in its financial statements.
13. Up to the time of filing of this quarterly report, there were NO material events subsequent to the end of the interim period (January 1 to September 30, 2009) that have not been reflected in the financial statements for said interim period.
14. There were NO changes in the composition of the Company during the interim period (January 1 to September 30, 2009) and there were NO business combinations, acquisition or disposal of subsidiaries and long-term investments, restructurings and discontinuance of operations during said interim period.
15. The Company has NO contingent liabilities or contingent assets as of its last annual balance sheet date (December 31, 2008) and as of end of current interim period (September 30, 2009), EXCEPT those disclosed in Note 9 to the Company's 2008 Audited Financial Statements.
16. There are NO material contingencies and any other events or transactions that are material to an understanding of the current interim period (January 1 to September 30, 2009).

***Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.***

Financial Performance

Total revenues for the three quarters ended September 30, 2009 increased by P107.0 million or 101% to P212.6 million from P105.6 million for the same period last year. The combined production increased to 708,014 barrels for the three quarters ended September 30, 2009, from 80,166 barrels produced for the same period last year. The increase was mainly due to the Galoc production and revenues booked following the

termination of the Extended Production Test (EPT) in June 2009. As of September 30, 2009, share in Galoc revenues amounted to P84.83 million for the equivalent post-EPT production of 579,002 barrels. The average price per barrel for the period ended September 30, 2009 was \$65.94 as compared to \$87.99 for the same period last year. Equity in net earnings of associates slightly decreased by P0.08 million. Miscellaneous income decreased by P2.6 million mainly due to the absence in 2009 of the farmin bonus relative to the West Linapacan project. Interest income decreased by P1.1 million or 41% due to the absence in 2009 of interest income booked on subscriptions receivable for the interim period ended September 30, 2008. Foreign exchange gains/losses reflected a net gain of P1.5 million for the three quarters of 2009 as compared to P0.4 million for the same period last year.

Total costs and expenses increased by P29.5 million from P114.0 million for the three quarters of 2008 to P143.5 million for the three quarters of 2009. Interest and financing charges decreased by P6.0 million or 47% due to the full settlement of all loans made in April 2009. Operating costs increased by 28% due to the booking of the share in operating costs of Galoc oilfield. The company's net income amounted to P57.0 million for the three quarters of 2009 as compared with the P5.2 million net loss for the same period last year.

The Company's top five (5) key performance indicators are as follows:

	Sept. 30, 2009	Dec. 31, 2008
Current Ratio	<i>11.85 : 1</i>	<i>0.72 : 1</i>
Current Assets	210,383,196	109,038,805
Current Liabilities	17,748,342	151,482,198
Debt to Equity Ratio	<i>0.01 : 1</i>	<i>0.12 : 1</i>
Total Liabilities	18,887,458	159,839,150
Stockholders Equity	1,643,448,395	1,339,099,455
Equity to Debt Ratio	<i>87.01 : 1</i>	<i>8.38 : 1</i>
Stockholders Equity	1,643,448,395	1,339,099,455
Total Liabilities	18,887,458	159,839,150
Book Value per Share	<i>0.0085655</i>	<i>0.00872</i>
Stockholders Equity	1,643,448,395	1,339,099,455
Shares outstanding	191,868,805,358	153,495,044,287
Income (Loss) per Share	<i>0.0003221*</i>	<i>(0.0000339)*</i>
Net Income (Loss)	56,998,483	(5,205,475)
Weighted ave. no. of shares	176,945,676,053	153,495,044,287

\*for the period January 1 to September 30

The current ratio of 0.72:1 as of December 31, 2008 increased to 11.85 : 1 as of September 30, 2009. The Company's current assets exceeded its current liabilities by P192.6 million as of September 30, 2009. The "Available-for-sale (AFS) Investments" account in the balance sheet consists of shares of stock which are listed with the Philippine Stock Exchange and which could be sold to meet the Company's obligations as might be called for by future circumstances. These shares of stock had an aggregate market value of P102.5 million as of September 30, 2009 and P51.0 million as of December 31, 2008. If these shares would be considered part of Current Assets, the recomputed current ratio would be 17.63: 1 as of September 30, 2009 and 1.06:1 as of December 31, 2008.

Total assets increased from P1.499 billion as of December 31, 2008 to P1.66 billion as of September 30, 2009. Cash increased by P63.4 million due to the reimbursement of expenses relative to SC14 Nido, Matinloc and Galoc blocks and collection of share in Galoc revenues. Receivables increased by P18.8 million or 24% due to some trade receivables accrued as of September 30, 2009. Crude oil inventory increased by P34.1 million due to the higher level of crude oil on storage as inventory as of September 30, 2009. AFS investments increased by P51.5 million or 101% due to the adjustment in the valuation reserve pertaining to the listed stock investments of the company.

Total current liabilities reflected a decrease of P133.7 million from P151.5 million as of December 31, 2008 to P17.7 million as of September 30, 2009 mainly due to the full settlement of loans made during the interim period.

Stockholders' equity increased by P304.3 million from P1.339 billion as of December 31, 2008 to P1.643 billion as of September 30, 2009 mainly due to the subscription to the company's stock rights offering. The valuation reserve pertaining to the company's listed stock investments was adjusted from P163.0 million as of December 31, 2008 to P111.5 million as of September 30, 2009. The company's retained earnings amounted to P22.6 million as of September 30, 2009 as compared to the deficit balance of P34.4 million as of December 31, 2008.

The Company has a majority-owned subsidiary, Phoenix Gas & Oil Exploration Corporation (PGO). The Company acquired 100% of PGO's capital stock in May 2007. Since PGO has NOT yet started commercial operations, disclosure on performance indicators are as follows:

	Sept. 30, 2009	Dec. 31, 2008
Current Ratio	0	0
Current Assets	0	0
Current Liabilities	0	0
Debt to Equity Ratio	0.006 : 1	0.003 : 1
Total Liabilities	57,863	29,092
Stockholders' Equity	9,141,264	9,170,034
Equity to Debt Ratio	158 : 1	315 : 1
Stockholders' Equity	9,141,264	9,170,034
Total Liabilities	57,863	29,092
Book Value per Share	0.0007	0.0007
Stockholders' Equity	9,141,264	9,199,127
Average shares outstanding	12,505,000,000	12,505,000,000
Income (loss) per Share	0.000002	0.000002
Net Income (Loss)	(28,770)	(27,060)
Average shares outstanding	12,505,000,000	12,505,000,000

### Discussion and Analysis of Material Events and Uncertainties

In general, Management is not aware of any material event or uncertainty that has affected the current interim period and/or would have a material impact on future operations of the Company. The Company will continue to be affected by the Philippine business environment as may be influenced by any local/regional financial and political crises.

1. There are NO known trends, demands, commitments, events or uncertainties that have or are reasonably likely to have material impact on the Company's liquidity. Should the Company's cash position be not sufficient to meet current requirements, the Company may consider: a) collecting the balance of subscriptions receivable; b) selling a portion of its existing investments and assets and c) generating cash from loans and advances.

There are NO events that will trigger direct or contingent financial obligation that is material to the company, including any default or acceleration of an obligation.

2. There are NO material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the company with unconsolidated entities or other persons created during the reporting period.
3. The Company has NO material commitments for capital expenditures, except for the Company's share in the exploration and development expenditures in the SCs and GSECs. The Company expects to be able to fund such expenditures from the collection of the balance of subscriptions receivable, and from loans, or to avoid incurring these expenditures altogether by way of farm-outs.
4. There are NO known trends, events or uncertainties that have had or are reasonably expected to have a material impact on the revenues or income of the Company from continuing operations.
5. There are NO significant elements of income or loss that did not arise from the Company's continuing operations.
6. There have been NO material changes from period to period in one or more line items of the Company's financial statements, except those discussed below:

Cash increased by P63.4 million due to the reimbursement of expenses relative to SC14 Nido, Matinloc and Galoc blocks and collection of share in Galoc revenues.

Receivables increased by P18.8 million or 24% due to trade receivables accrued as of end of the interim period.

Crude oil inventory increased by P34.0 million due to higher level of crude oil on storage as of September 30, 2009.

Other current assets decreased by P0.6 million due to amortization of prepaid expenses booked during the interim period.

AFS investments increased by P51.5 million or 101% due to the adjustment in the valuation reserve pertaining to the listed stock investments of the Company.

Other noncurrent assets decreased by P0.3 million or 36% due to amortization of other deferred charges.

Trade and other payables, loans payable and advances from related companies decreased by P8.9 million, P121.7 million, and P3.0 million, respectively, due to the settlement of loans and accounts during the interim period.

Non-current liabilities decreased by P7.2 million or 86% due to payment of the pension liability.

Subscribed capital stock and subscriptions receivable increased by P375.8 million and P187.9 million, respectively, from the December 31, 2008 balances. The increase was due to the company's stock rights offering.

Unrealized losses on decline in market value of AFS investments decreased by P51.5 million or 31.6% due to the adjustment in the valuation reserve pertaining to the listed stock investments of the Company.

The company's retained earnings amounted to P22.6 million as of September 30, 2009 as compared with the deficit balance of P34.4 million as of December 31, 2008. The increase of P57 million was due to the net income booked for the three quarters of 2009.

Petroleum revenues increased by P94.5 million or 100% mainly due to the booking of the company's share in Galoc revenues following the termination of the EPT. As of September 30, 2009, post-EPT production from Galoc totaled to 579,002 barrels. The average price per barrel for the period ended September 30, 2009 was \$65.94 as compared to \$87.99 for the same period last year.

Miscellaneous income decreased by P2.6 million mainly due to the absence in 2009 of the farmin bonus relative to the West Linapacan project.

Interest income decreased by P1.1 million or 41% due to the absence in 2009 of the interest income on subscriptions receivable booked for the interim period ended September 30, 2008.

Foreign exchange gains (losses) reflected a net gain of P1.5 million for the three quarters of 2009 as compared to P0.4 million for the same period last year.

Interests and financing charges decreased by P6.0 million. The decrease was due to the full settlement of loans made during the interim period ended September 30, 2009 as compared to the same period last year.

Share in costs and operating increased by 28% due to the booking of the company's share in the Galoc operating expenses during the interim period.

General and administrative expenses increased by P12.8 million or 63% due to the some expenses booked relative to the stock rights offering, pension plan and other provisions for year-end expenses.

Net income amounted to P57.0 million for the three quarters of 2009, as compared to the net loss of P5.2 million for the same period last year.

7. There are NO seasonal aspects that had material effect on the financial condition or results of operations.

### ***Item 3. Management's Assessment and Evaluation of Financial Risk Exposures***

#### **A. Financial Instruments**

Since there were NO financial assets reclassified into and from each category, disclosures on the following are:

- a. The financial assets reclassified into and from each category; - Not Applicable
- b. For each reporting period until derecognition, the carrying amounts and fair values of all financial assets reclassified in the current reporting period and previous reporting periods;- Not Applicable
- c. For financial assets reclassified in rare circumstances, the facts that would establish such kind of circumstances; -Not Applicable
- d. In the reporting period to which financial assets are reclassified, the fair value of the gains or losses of those assets as recognized either in profit or loss, or in equity (other comprehensive income) in that reporting period and previous reporting periods;- Not Applicable
- e. For the remainder of the instruments' lives, the gains or losses that would have been recognized in profit or loss, or equity had they not been reclassified, together with the gains, losses, income and expenses now recognized;-Not Applicable
- f. As at date of reclassification, the effective interest rates and estimated amounts of cash flows the company expects to recover. – Not Applicable

## Fair Values of Financial Instruments

The following table shows the carrying amounts and fair values of the Group's financial assets and financial liabilities:

	Consolidated Unaudited September 2009	Consolidated Unaudited September 2009	Consolidated Audited December 2008	Consolidated Audited December 2008
	Fair Values	Carrying Values	Fair Values	Carrying Values
<b>FINANCIAL ASSETS</b>				
Cash on hand	1,223	1,223	40,054	40,054
Cash in banks	11,190,786	11,190,786	940,774	940,774
Short term placements	53,197,800	53,197,800		
Accounts with contract operators	59,748,500	59,748,500	35,015,455	35,015,455
Receivable from Nido Petroleum	0	0	27,232,131	27,232,131
Advances to related companies	9,874,489	9,874,489	19,850,492	19,850,492
Accrued interest receivables	23,008,981	23,008,981	18,556,464	18,556,464
Dividends	2,250,000	2,250,000	2,250,000	2,250,000
Advances to officers and employees	1,192,694	1,192,694	1,081,779	1,081,779
Accounts with partners	2,516,375	2,516,375	761,259	761,259
Others	90,305	90,305	118,133	118,133
	<b>163,071,152</b>	<b>163,071,152</b>	<b>105,806,487</b>	<b>105,806,487</b>
<b>AFS financial assets</b>				
Quoted equity instruments	91,602,557	91,602,557	40,094,902	40,094,902
Unquoted equity instruments	10,877,340	10,877,340	10,877,340	10,877,340
	<b>102,479,897</b>	<b>102,479,897</b>	<b>50,972,242</b>	<b>50,972,242</b>
	<b>265,551,050</b>	<b>265,551,050</b>	<b>156,818,783</b>	<b>156,818,783</b>
<b>FINANCIAL LIABILITIES</b>				
Loans payable	0	0	121,724,515	121,724,515
Accounts payable and accrued liabilities				
Accrued interest	0	0	7,861,430	7,861,430
Accounts with partners	8,714,042	8,714,042	5,151,086	5,151,086
Advances from related companies	0	0	3,054,250	3,054,250
Accrued liabilities	3,412,825	3,412,825	2,145,226	2,145,226
Others	1,319,949	1,319,949	3,352,220	3,352,220
Dividends payable	5,035,941	5,035,941	5,035,941	5,035,941
Subscriptions payable	2,069,233	2,069,233	2,069,233	2,069,233
	<b>20,551,990</b>	<b>20,551,990</b>	<b>150,393,901</b>	<b>150,393,901</b>

The carrying amounts of financial assets and liabilities approximate their fair values because of their short-term nature. Quoted AFS investments are carried at fair value based on the quoted values of the securities.

## B. Financial Risk Management Objectives and Policies

### Financial Risk Management Objectives and Policies

The Group's principal financial instruments comprise mainly of cash, short term placements, receivables, advances to/from related companies, AFS financial assets, loans payable, accounts payables and accrued liabilities, dividends payable and subscriptions payable. The main purpose of these financial instruments is to provide financing for the Group's operations and capital intensive projects.

The Board of Directors (BOD) is mainly responsible for the overall risk management approach and for the approval of risk strategies and principles of the Group.

The main risks arising from the Group's financial instruments are credit and concentration risks, liquidity risk, and market risks. The market risks exposure of the Group can be further classified to foreign currency risk, equity price risk and commodity price risk. The BOD reviews and approves the policies for managing some of these risks and they are summarized as follows:

*Credit and concentration risks*

Credit risk is such risk where the Group could incur a loss if its counterparties fail to discharge their contractual obligations, although the Group trades only with recognized, creditworthy third parties. As of September 30, 2009, all of the outstanding trade receivables are from the SC14 A, B, B-1 & C-1 consortiums. At present, the SC14 A, B & B-1 consortium has a supply agreement with Pilipinas Shell Petroleum Corporation (PSPC), assuring PSPC with sale of the SC14 A, B & B-1 consortium's petroleum products. For SC14 C-1 consortium, the operator, Galoc Production Company has a crude agency agreement with Vitol Asia Pte. Ltd. for the marketing of the Galoc production.

With respect to credit risk arising from other financial assets of the Group, which comprise of cash and AFS financial assets, the Group's exposure to credit risk could arise from default of the counterparty, having a maximum exposure equal to the carrying amount of these instruments gross of any collaterals and credit enhancements. The table below summarizes the Group's exposure to credit risk for the components of the unaudited consolidated balance sheet as of September 30, 2009:

Loans and receivables	
Cash in banks	11,190,786
Short term placements	53,197,800
Accounts with contract operators	59,748,500
Receivable from Nido Petroleum	0
Advances to related companies	9,874,489
Accrued interest	23,008,981
Dividends	2,250,000
Advances to officers and employees	1,192,694
Accounts with partners	2,516,375
Others	90,304
AFS investments	
Quoted	91,602,557
Unquoted	10,877,340
Gross maximum credit risk exposure	<b>265,549,827</b>

The table below shows the credit quality of the Group's financial assets by class as of September 30, 2009 based on the Group's credit evaluation process:

	Neither past due nor impaired High Grade	Neither past due nor impaired Standard Grade	Past due but not impaired	Impaired Financial Assets	Total
Loans and receivables					
Cash in banks	11,190,786				11,190,786
Short term placements	53,197,800				53,197,800
Accounts with contract operators	59,748,500				59,748,500
Advances to related companies			9,874,488	5,614,118	15,488,606
Accrued interest			19,330,702	3,678,279	23,008,981
Dividends	2,250,000				2,250,000
Advances to officers and employees	1,192,694				1,192,694
Accounts with partners	2,516,375				2,516,375
Others	90,305			3,427,560	3,517,864
AFS investments:					
Quoted equity instruments		91,602,557			91,602,557
Unquoted equity instruments		10,877,340			10,877,340
Total	130,186,460	102,479,897	29,205,190	12,719,957	274,591,503

High grade credit quality financial assets pertain to financial assets with insignificant risk of default based on historical experience and/or counterparty credit standing. Standard grade credit quality financial assets are those assets with history of default but cannot be deemed uncollectible because it arises from related companies for which there is common control.

#### Liquidity risk

Liquidity risk is such risk where the Group becomes unable to meet its payment obligations when they fall due under normal and stress circumstances. The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank loans and operating cash flows. The Group addresses liquidity concerns primarily through cash flows from operations and short-term borrowings.

#### Foreign currency risk

Foreign currency risk is such risk that the value of the Group's financial instruments diminish due to unfavorable changes in foreign exchange rates. The Parent Company's transactional currency exposures arise from sales in currencies other than its functional currency. All of the parent Company's share in petroleum operations revenue are denominated in US dollar. Likewise, the Parent Company is exposed to foreign exchange risk arising from its US dollar-denominated trade receivables.

### Equity price risk

Equity price risk is such risk where the fair values of the investments in quoted equity securities could decrease as a result of changes in the levels of equity indices and the value of individual stocks. The Group is exposed to equity securities price risk because of investments held by the Parent Company, which are classified in the consolidated balance sheets as AFS financial assets.

### Commodity price risk

The Parent Company's revenues are based on international commodity quotations (i.e., primarily on the average Dubai oil prices) over which the Parent Company has no significant influence or control. This exposes the Parent Company's results of operations to commodity price volatilities that may significantly impact its cash inflows.

### Interest Rate Risk

Interest rate risk is such risk where the possibility of changes in interest rates would unfavorably affect future cash flows from the financial statements. The Group's exposure to the risk of changes in interest rates relates primarily to the bank loans which are reviewed and reset by the creditor banks regularly. As of June 30, 2009, the Company had fully paid its outstanding bank loans.

## **PETROLEUM PROJECTS**

### **1.0 Service Contract 6A (Octon)**

Farminee Vitol GPG SA has undertaken re-processing of about 75 sq km of 3D seismic data in Octon area in conjunction with the re-processing of Galoc 3D seismic data as part of Galoc Phase 2 evaluation activities. Geophysical contractor CGGVeritas completed the pre-stack time migration phase last July, while the pre-stack depth migration will be completed towards end-November 2009. Evaluation of the re-processed data will follow and the results expected to contribute in the better understanding of the Octon reservoir.

The Octon re-processing program substitutes for the Octon Block Consortium's work program for the first year of the extension period (March 2009 – February 2010) that was submitted earlier to the Department of Energy (DOE) as justification for the requested contract extension. The re-scheduled work program of field evaluation leading to development will be the consortium's program for 2010, possibly extending to 2011.

## 2.0 Service Contract 6 (Cadlao)

Philodrill is continuing negotiations with Blade Petroleum and Venturoil who have earlier expressed interest to purchase Philodrill's 1.65% revenue interest (ORRI) in the Cadlao Field.

## 3.0 Service Contract 6B (Bonita)

The exclusivity of Venturoil on the Bonita Block, as well as the non-producing sub-blocks in Service Contract 14, expired on September 30, 2009.

## 4.0 Service Contract No. 14 (Production Blocks)

### 3<sup>rd</sup> Quarter 2009 Crude Oil Production Summary (in barrels)

	<b>Nido</b>	<b>Matinloc</b>	<b>North Matinloc</b>	<b>Total</b>
July	0	5,114	5,670	10,784
August	11,910	4,743	3,789	20,442
September	0	5,614	4,064	9,678
<b>Total</b>	<b>11,910</b>	<b>15,471</b>	<b>13,523</b>	<b>40,904</b>

The consortium completed 3 shipments during the third quarter, involving 11,910 barrels of crude oil from Nido, 9,688 barrels from Matinloc and 9,171 barrels from North Matinloc. As of end-September, about 10,436 barrels of combined Matinloc and North Matinloc crude are onboard the storage tanker.

Underwater inspections of the Nido and Matinloc platforms were conducted last August and September as part of the yearly maintenance work to ensure continuous protection for the sub-sea and surface structures of the production platforms. The inspected facilities were found to be in good condition.

## 5.0 Service Contract No. 14 (Retention Block, Tara, Libro and North Matinloc)

Venturoil's extension of option to farm-in expired in September 2009.

## **6.0 Service Contract No. 14 C-1 (Galoc)**

The Galoc Field produced 547,223 barrels for the period from July 1 to September 30, 2009. Cumulative production stood at 2,830,893 barrels as of September 30, 2009.

During the third quarter of 2009, Galoc Production Company (GPC) completed 2 offtakes involving about 371,180 barrels. These cargoes were sold to Petron Corporation and SK Energy of South Korea. As of September 30, about 203,600 barrels are on board the FPSO Rubicon Intrepid.

The Galoc Field was shut down from June 24 until August 13 due to multiple operational glitches and equipment failures aggravated by several weather conditions during the period. The disconnection of the FPSO due to Typhoon Fera on June 24<sup>th</sup> resulted in the twisting of the umbilical section and tether lines which in turn damaged sections of the riser that required replacement. GPC had to bring in a larger workboat to facilitate speedy repair and reconnection works. Production operations resumed on August 13 at a stabilized rate 12,600 barrels of oil per day.

As part of the assessment of the Galoc Field for possible Phase 2 development, GPC embarked on re-processing of 3D seismic data covering the Galoc and the adjacent Octon area. Results are expected to contribute to a better understanding of the Galoc reservoir and to identify locations for drilling new development wells. Evaluation of the re-processed data is ongoing.

## **7.0 Service Contract 14 C-2 (West Linapacan)**

The G & G activities for the West Linapacan Block continue as programmed, although delayed by a few months. In July, Pitkin presented the results of the completed seismic inversion performed by Schlumberger. Likewise, ISIS completed the Sequence Stratigraphy Study the results of which Pitkin was still reviewing as of end-September. Also during the same period, Pitkin was still reviewing their contractor's initial report on the field development conceptual engineering study.

In view of unexpected delays in the completion of G & G studies, Pitkin sought for an extension on its Phase 1 work commitment which expired in August 2009 as per the farm-in agreement. The Consortium granted the extension with the issuance of an executed amendment to the farm-in agreement such that the completion of the Phase 1 Work Program shall be on or before June 30, 2010.

## **8.0 Service Contract No. 41 (Sulu Sea)**

Geophysical contractor DownUnder Geosolutions completed the 3D seismic data re-processing and have delivered the full inversion volume and processing report to Tap Oil in July. They are currently integrating the new re-processed data and the results from the new well drilled last year into their models of the Sandakan Basin. Tap Oil believes that this will help in the characterization of further drilling prospects within the block, as several different play types in the area remain untested.

## **9.0 Service Contract No. 53 (Onshore Mindoro)**

In response to Pitkin's request for the extension of Sub-Phase 1 of SC 53, the DOE merged the first 2 sub-phases to form a new Sub-Phase 1 (July 2005 to March 2011) with the work commitment of minimum 200 line-km 2D seismic acquisition and drilling of one well. The new Sub-Phase 2 will be for the period March 2011 to July 2012 with a commitment to drill 2 wells.

Pitkin awarded the 2D seismic data acquisition to BGP, a Chinese seismic contractor. Based on BGP's submitted preliminary project timetable, they will conduct a pre-survey of the site and set-up a base camp by mid-September and start the navigation survey in October. Actual data recording should commence in November or December. As of 30 September 2009, BGP had already mobilized its seismic crew to the survey areas.

## **10.0 SWAN BLOCK**

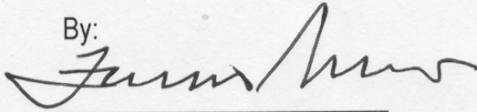
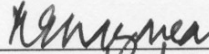
Philodrill continue to wait for PNOC-EC's response to the proposed participation in SC 57 and SC 58.

## PART II – OTHER INFORMATION

There were NO items for disclosure that were not made under SEC Form 17C during the current interim period (01 January to 30 September 2009).

### SIGNATURES

Pursuant to the requirements of Securities Regulation Code, the registrant has caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

By: 	
Date: _____	Date: <u>11/9/09</u>
FRANCISCO A. NAVARRO Executive Vice President	REYNALDO E. NAZAREA Treasurer & VP-Administration

**THE PHILODRILL CORPORATION**  
**INDEX TO FINANCIAL STATEMENTS AND SUPPLEMENTARY SCHEDULES**  
**SEC FORM 17Q**

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\*These schedules, which are required by Part IV(e) of RSA 48, have been omitted because they are either not required, not applicable or the information required to be presented is included in the Company's financial statements or the notes to financial statements.

**THE PHILODRILL CORPORATION**
**Balance Sheets**

	Consolidated	
	(Unaudited)	(Audited)
	September 30	December 31
	2009	2008
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash & short-term placements	64,389,814	980,828
Receivables	98,217,778	79,401,103
Crude oil inventory	35,659,760	1,596,162
Advances to related companies - net	9,874,489	25,464,610
Other current assets	2,241,355	1,596,102
<b>Total Current Assets</b>	<b>210,383,196</b>	<b>109,038,805</b>
<b>Noncurrent Assets</b>		
Property and equipment - net	299,774,835	297,098,016
Investments - Associates	226,645,338	219,853,948
Available-for-sale investments	102,479,896	50,972,242
Deferred oil exploration and development costs	822,623,934	821,218,862
Other noncurrent assets	428,654	756,732
<b>Total Noncurrent Assets</b>	<b>1,451,952,657</b>	<b>1,389,899,800</b>
<b>TOTAL ASSETS</b>	<b>1,662,335,853</b>	<b>1,498,938,605</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities</b>		
Trade and other payables	10,643,168	19,598,259
Loans payable	0	121,724,515
Advances from related companies	0	3,054,250
Dividends payable	5,035,941	5,035,941
Subscriptions payable	2,069,233	2,069,233
<b>Total Current Liabilities</b>	<b>17,748,342</b>	<b>151,482,198</b>
<b>Noncurrent Liabilities</b>		
Pension liability	0	7,217,836
Deferred income tax liability	1,139,116	1,139,116
<b>Total Noncurrent Liabilities</b>	<b>1,139,116</b>	<b>8,356,952</b>
<b>Stockholders' Equity</b>		
<b>Capital stock - P0.01 par value</b>		
Authorized - 200 billion shares in 2009		
- 155 billion shares in 2008		
Issued	1,542,897,100	1,534,949,112
Subscribed	375,790,954	1,331
Subscriptions receivable	(187,895,497)	(687)
Paid in capital from sale of treasury	1,624,012	1,624,012
Unrealized losses on decline in market value of investments	(111,525,251)	(163,032,906)
Retained Earnings (Deficit)	22,557,077	(34,441,407)
<b>Total Stockholders' Equity</b>	<b>1,643,448,395</b>	<b>1,339,099,455</b>
<b>TOTAL LIABILITES AND STOCKHOLDERS' EQUITY</b>	<b>1,662,335,853</b>	<b>1,498,938,605</b>

**THE PHILODRILL CORPORATION**

**Statements of Income**

	<b>Consolidated</b>			
	<b>January 1</b>	<b>January 1</b>	<b>July 1</b>	<b>July 1</b>
	<b>to Sept 30</b>	<b>to Sept 30</b>	<b>to Sept 30</b>	<b>to Sept 30</b>
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
<b>REVENUES</b>				
Share in petroleum operations	188,353,061	93,879,722	118,874,652	23,531,367
Equity in net earnings of associates - net	8,791,390	8,875,350	4,869,790	3,848,790
Miscellaneous	247,669	2,871,511	(5,635,988)	2,869,161
	<b>197,392,120</b>	<b>105,626,583</b>	<b>118,108,454</b>	<b>30,249,318</b>
<b>INTEREST INCOME</b>	<b>1,598,772</b>	<b>2,699,922</b>	<b>84,140</b>	<b>246,600</b>
<b>FOREIGN EXCHANGE GAINS (LOSSES)</b>	<b>1,460,302</b>	<b>436,885</b>	<b>988,494</b>	<b>551,169</b>
<b>COSTS AND EXPENSES</b>				
Interest and financing charges	(6,677,741)	(12,634,918)	(108,680)	(30,473,756)
Share in costs and operating	(103,671,787)	(81,074,566)	(46,156,398)	(3,633,051)
General and administrative	(33,103,183)	(20,259,381)	(15,292,958)	(6,287,272)
Loss on sale of investment	0	0	0	0
	<b>(143,452,711)</b>	<b>(113,968,865)</b>	<b>(61,558,036)</b>	<b>(40,394,079)</b>
<b>NET INCOME (LOSS)</b>	<b>56,998,483</b>	<b>(5,205,475)</b>	<b>57,623,052</b>	<b>(9,346,992)</b>
<b>Earnings (loss) per share was computed as follows:</b>				
Net income (loss)	56,998,483	(5,205,475)	57,623,052	(9,346,992)
Weighted average no. of shs	176,945,676,053	153,495,044,287	176,945,676,053	153,495,044,287
<b>Income (Loss) per share</b>	<b>0.000322</b>	<b>(0.00003)</b>	<b>0.00033</b>	<b>(0.00006)</b>

**THE PHILODRILL CORPORATION****Statements of Cash Flows****(Unaudited)****Consolidated**

	<b>January 1 to Sept 30 2009</b>	<b>January 1 to Sept 30 2008</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Income (Loss) before income tax	56,998,483	(5,205,475)
Adjustments for:		
Depletion, depreciation and amortization	4,779,795	2,295,702
Equity in net losses (earnings) of associates - net	(8,791,390)	(8,875,350)
Operating loss before working capital changes	52,986,888	(11,785,123)
Decrease (increase) in:		
Receivables	(24,843,960)	(1,641,873)
Crude oil inventory	(34,063,598)	9,530,782
Other current assets	(645,253)	(28,798)
Increase in accounts payable and accrued expenses	(20,982,293)	(18,473,057)
Net cash from (used in) operating activities	(27,548,215)	(22,398,069)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Cash dividends received	2,000,000	2,000,000
Reductions in (additions to):		
Property and equipment	(7,292,405)	(605,041)
Deferred oil exploration and development costs	(1,405,072)	23,270,630
Advances to affiliated companies - net	23,034,598	(32,818,960)
Investments	0	0
Other noncurrent assets	501,793	(251,742)
Subscriptions payable	0	0
Net cash from (used in) investing activities	16,838,914	(8,405,113)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Payments of:		
Loans payable	(121,724,515)	31,000,000
Cash dividend payable	0	22,088
Proceeds from subscriptions receivable	195,842,801	817,382
Net cash from (used in) financing activities	74,118,286	31,839,470
<b>NET INCREASE (DECREASE) IN CASH</b>	<b>63,408,985</b>	<b>1,036,288</b>
<b>CASH, BEGINNING</b>	<b>980,828</b>	<b>3,825,792</b>
<b>CASH, ENDING</b>	<b>64,389,813</b>	<b>4,862,080</b>

**THE PHILODRILL CORPORATION**

**Statement of Changes in Stockholders' Equity**

	Jan-Sep 2009	Jan-Sep 2008
<b>CAPITAL STOCK - P0.01 par value</b>		
Authorized -	200 billion shs	155 billion shs
<b>Issued</b>		
Balance at the beginning of year	1,534,949,111	1,529,187,292
Issuances for the period	7,947,989	5,761,819
<b>Adjustments</b>		
Balance at end of second quarter	1,542,897,100	1,534,949,111
<b>Subscribed</b>		
Balance at the beginning of year	1,331	5,763,151
Preemptive rights	383,737,611	
Issuances for the period	(7,947,988)	(5,761,819)
<b>Adjustments</b>		
Balance at end of second quarter	375,790,954	1,332
<b>Subscriptions receivable</b>		
Balance at the beginning of year	(686)	(818,070)
Preemptive rights	(383,737,611)	
Collection of subscriptions receivable	195,842,800	817,384
Balance at end of second quarter	(187,895,496)	(686)
<b>Deposit on subscriptions</b>		
Balance at the beginning of year	0	0
Collection of deposit on SR	98,940,319	0
Application of deposit against SR	(98,940,319)	
Balance at end of second quarter	0	0
<b>Paid in capital from sale of treasury</b>		
Balance at the beginning of year	1,624,012	1,624,012
Acquisition	0	0
Balance at end of second quarter	1,624,012	1,624,012
<b>Unrealized Losses on Decline in Market Value of Long-term Investments</b>		
Balance at the beginning of year	(163,032,906)	(87,875,464)
Adjustments	51,507,655	(28,170,913)
Balance at end of second quarter	(111,525,251)	(116,046,377)
<b>Retained Earnings</b>		
Balance at the beginning of year	(34,441,406)	(49,541,472)
Net income (loss) for the period	56,998,483	(5,205,475)
Balance at end of second quarter	22,557,077	(54,746,947)
<b>Total Stockholders' Equity</b>	<b>1,643,448,395</b>	<b>1,365,780,445</b>

**THE PHILODRILL CORPORATION**  
**SCHEDULE B - AMOUNTS RECEIVABLE FROM DIRECTORS, OFFICERS**  
**EMPLOYEES, RELATED PARTIES AND PRINCIPAL STOCKHOLDERS (OTHER THAN AFFILIATES)**  
**FOR THE THIRD QUARTER ENDED SEPT 30,**

2009

Name and Designation of Debtor	Beginning Balance	Additions	Amounts Collected	Amounts Written off	Current	Not Current	Ending Balance
Various officers and employees	1,052,780	351,920	212,006		1,192,694		1,192,694
	1,052,780	351,920	212,006	0	1,192,694	0	1,192,694

THE PHILODRILL CORPORATION  
SCHEDULE C - LONG TERM INVESTMENTS IN SECURITIES  
(NONCURRENT MARKETABLE EQUITY SECURITIES,  
OTHER LONG TERM INVESTMENTS IN STOCK  
INVESTMENTS IN BONDS AND OTHER DEBT SECURITIES)  
FOR THE THIRD QUARTER ENDED SEPT 30, 2009

Name of Issuing Entity and Description of Investment	BEGINNING BALANCE		ADDITIONS			DEDUCTIONS		ENDING BALANCE		Dividends Received/ Accrued from Investments Not Accounted for by the Equity Method
	Number of Shares or Principal Amount of Bonds and Notes	Amount in Pesos	Equity in Earnings (Losses) of Investees for the Period	Others	Distribution of Earnings by Investees	Others	Number of Shares or Principal Amount of Bonds and Notes	Amount in Pesos		
Investments in associates-at equity										
Penta Capital Investment Corp.	1,600,000	177,106,765	3,938,100				1,600,000	181,044,865		
Penta Capital Holdings, Inc.	300,000	44,668,783	931,690				300,000	45,600,473		
Phoenix Gas & Oil Explo.		0		0			12,505,000,000	0		
		221,775,548	4,869,790	0	0	0		226,645,338		0
Amount shown under the caption "Available For Sale Investments"										
Atlas Consolidated Mining and Development Corporation	3,123,293	101,061,306					3,123,293	101,061,306		
Anglo Philippine Holdings Corp.	6,000	5,907					6,000	5,907		
Vulcan Industrial & Mining Corp.	3,910,000	5,042,136					3,910,000	5,042,136		
United Paragon Mining Corp.	6,839,068,254	72,983,955					6,839,068,254	72,983,955		
Philippine Gold	325,000	10,877,340					325,000	10,877,340		
South China Petroleum Explo., Inc.	2,540,034	3,392,405					2,540,034	3,392,405		
Fil-Estate Land, Inc.	5,186,800	10,423,888					5,186,800	10,423,888		
CJH Golf Club, Inc.	17	10,200,006					17	10,200,006		
		213,986,943	0	0	0	0		213,986,943		0
less-allowance for decline in market value		132,372,112				(20,865,065)		111,507,047		
		81,614,831	0	0	0	20,865,065		102,479,896		
		303,390,379	4,869,790	0	0	20,865,065		329,125,234		0

**THE PHILODRILL CORPORATION**  
**SCHEDULE D - INDEBTEDNESS OF UNCONSOLIDATED SUBSIDIARIES AND AFFILIATES**  
**FOR THE THIRD QUARTER ENDED SEPT 30, 2009**

Name of Affiliate	Beginning Balance	Ending Balance
Alakor Corporation	9,000,000	0
Fil-Energy Corporation	4,753,762	4,753,762
Ocean Composite Yacht, Inc.	4,500,000	4,500,000
Vulcan Industrial and Mining Corporation	3,356,629	3,356,630
Pacific Rim Export Holdings, Corp.	1,114,118	1,114,118
United Paragon Mining Corporation	732,819	732,819
Others	1,031,279	1,031,278
	24,488,607	15,488,607
Less-allowance for doubtful accounts	5,614,118	5,614,118
	18,874,489	9,874,489

**THE PHILODRILL CORPORATION**  
**SCHEDULE E - PROPERTY AND EQUIPMENT**  
**FOR THE THIRD QUARTER ENDED SEPTEMBER 30, 2009**

Classification	Beginning Balance	Additions at Cost	Retirements	Other Changes- Additions (Deductions)	Ending Balance
Wells, platforms and other facilities	584,607,460	7,130,877			591,738,337
Office condominium units and improvements	8,659,962				8,659,962
Office furniture, fixtures and equipment	11,611,113	60,401			11,671,514
Transportation equipment	10,277,196				10,277,196
	<b>615,155,731</b>	<b>7,191,278</b>	<b>0</b>	<b>0</b>	<b>622,347,009</b>

**THE PHILODRILL CORPORATION**  
**SCHEDULE F - ACCUMULATED DEPLETION, DEPRECIATION AND AMORTIZATION**  
**FOR THE THIRD QUARTER ENDED SEPTEMBER 30, 2009**

Classification	Beginning Balance	Additions Charged to Costs and Expenses	Retirements	Other Changes- Additions (Deductions)	Ending Balance
Wells, platforms and other facilities	294,421,903	2,202,420			296,624,323
Office condominium units and improvements	8,371,551	722			8,372,273
Office furniture, fixtures and equipment	11,155,444	112,009			11,267,453
Transportation equipment	5,794,265	513,860			6,308,125
	<b>319,743,163</b>	<b>2,829,010</b>	<b>0</b>	<b>0</b>	<b>322,572,173</b>

**THE PHILODRILL CORPORATION**  
**SCHEDULE G - INTANGIBLE ASSETS AND OTHER ASSETS**  
**FOR THE THIRD QUARTER ENDED SEPTEMBER 30, 2009**

Classification	Beginning Balance	Additions at Cost	Charged to Costs and Expenses	Charged to Other Accounts	Other Changes Additions (Deductions)	Ending Balance
Deferred oil exploration and development costs	863,419,834	815,774			0	864,235,608
less-Allowance for unrecoverable deferred oil explo costs	(41,611,674)					(41,611,674)
	<u>821,808,160</u>	<u>815,774</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>822,623,934</u>

**THE PHILODRILL CORPORATION  
SCHEDULE M - CAPITAL STOCK  
FOR THE THIRD QUARTER ENDED SEPTEMBER 30, 2009**

Title of Issue	Authorized	Issued and Outstanding	Subscribed	Number of shares Reserved for Options, etc.	Number of shares held by Directors, Officers and Employees	Others
<b>Common shares at P0.01 par value</b>	<b>200,000,000,000</b>	<b>154,289,709,968</b>	<b>37,579,095,390</b>	<b>0</b>	<b>902,104,084</b>	<b>190,966,701,274</b>

**THE PHILODRILL CORPORATION**  
**SCHEDULE N - AGING OF ACCOUNTS RECEIVABLES**  
**FOR THE THIRD QUARTER ENDED SEPTEMBER 30, 2009**

**1) AGING OF ACCOUNTS RECEIVABLE**

Type of Accounts Receivable	Total	1 month	2-3 months	4-6 months	7 months to 1 year	1-2 years	3-5 years	5 years above	past due accts & items in litigation
<b>a) Trade receivables</b>									
1) Account with contract operator less allowance for doubtful accounts	62,264,875 0	20,793,264	21,228,764	6,083,460	14,159,386	0	0	0	0
<b>Net Trade Receivables</b>	<b>62,264,875</b>	<b>20,793,264</b>	<b>21,228,764</b>	<b>6,083,460</b>	<b>14,159,386</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>b) Non-trade receivables</b>									
1) Accrued interest receivable less allowance for doubtful accounts	21,896,819 (3,678,279)	25,719 0	52,296 0	156,888 0	183,464 0	374,328 0	776,790 0	20,327,333 (3,678,279)	0 0
2) Account with officers and employees	1,192,694	264,590	45,950	0	882,154	0	0	0	0
3) Dividend receivable	2,250,000	0	0	0	0	0	0	2,250,000	0
4) Others less allowance for doubtful accounts	17,719,229 (3,427,560)	6,766,754 0	1,753,036 0	5,640,473 0	131,407 0	0 0	0 0	3,427,560 (3,427,560)	0 0
<b>Net Non-Trade Receivables</b>	<b>35,952,903</b>	<b>7,057,063</b>	<b>1,851,281</b>	<b>5,797,361</b>	<b>1,197,025</b>	<b>374,328</b>	<b>776,790</b>	<b>18,899,054</b>	<b>0</b>
<b>Net Receivables</b>	<b>98,217,778</b>	<b>27,850,327</b>	<b>23,080,046</b>	<b>11,880,822</b>	<b>15,356,411</b>	<b>374,328</b>	<b>776,790</b>	<b>18,899,054</b>	<b>0</b>

**2) ACCOUNTS RECEIVABLE DESCRIPTION**

Type of Accounts Receivable	Nature/Description	Collection Period
<b>a) Trade receivables</b>		
1) Account with contract operator	share in crude oil revenue net of share in production costs	30 days
<b>b) Non-trade receivables</b>		
1) Accrued interest receivable	interest receivable on advances	
2) Account with officers and employees	other advances to officers and employees	
3) Dividend receivable	share in dividend declared by affiliate	

## Summary of Significant Accounting Policies and Financial Reporting Practices

### Basis of Preparation

The consolidated financial statements have been prepared using the historical cost basis, except for crude oil inventory which is valued at market and quoted available-for-sale (AFS) financial assets which are measured at fair value. The consolidated financial statements are presented in Philippine Peso (Peso), which is the Parent Company's functional currency. All amounts are rounded off to the nearest Peso except when otherwise indicated.

### Statement of Compliance

The consolidated financial statements of the Group have been prepared in accordance with Philippine Financial Reporting Standards (PFRS).

### **Changes in Accounting Policies**

The accounting policies adopted are consistent with those of the previous financial years except as follows:

The Group has adopted the following new Philippine Interpretations based on International Financial Reporting Interpretations Committee (IFRIC) Interpretations and amendments to previously issued Philippine Accounting Standards (PAS) during the year. Adoption of these interpretations did not have a material effect on the consolidated financial statements except for the additional disclosures, where required.

- Philippine Interpretation IFRIC 11, *Group and Treasury Share Transaction*, requires arrangements whereby an employee is granted rights to an entity's equity instruments to be accounted for as an equity-settled scheme by the entity even if (a) the entity chooses or is required to buy those equity instruments (e.g., treasury shares) from another party, or (b) the shareholder(s) of the entity provide the equity instruments needed. It also provides guidance on how subsidiaries, in their separate financial statements, account for such schemes when the subsidiary's employees receive rights to the equity instruments of the parent. As the Group currently has no such transactions, the Interpretation did not have any effect on its consolidated financial statements.
- Philippine Interpretation IFRIC 12, *Service Concession Arrangements*, covers contractual arrangements arising from entities providing public services. The Group is not a party to any concession arrangement, thus, this Interpretation did not have any impact on the consolidated financial statements.
- Philippine Interpretation IFRIC 14, *The Limit on a Defined Benefit Asset Minimum Funding Requirements and their Interaction*, provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognized as an asset under PAS 19, *Employee Benefits*. The Interpretation did not have any impact on the consolidated financial statements.
- Amendments to PAS 39, *Financial Instruments: Recognition and Measurement*, and PFRS 7, *Financial Instruments: Disclosures - Reclassification of Financial Assets*, allows reclassification of certain financial instruments held-for-trading to either held-to-maturity (HTM), loans and receivables or AFS financial assets categories as well as certain instruments from investments to loans and receivables. The Group has no financial instruments held-for-trading, thus, the amendments did not have any impact on the consolidated financial statements.

### Basis of Consolidation

The consolidated financial statements comprise the balance sheets of the Parent Company and PGO, its wholly owned subsidiary, as of December 31, 2008 and 2007, and the related statements of income of the Parent Company for each of the three years in the period ended December 31, 2008, and of PGO for each of the two years in the period ended December 31, 2008. The financial statements of the subsidiary are prepared for the same reporting year as the Parent Company using consistent accounting policies.

### *Subsidiary*

A subsidiary is an entity over which the Parent Company has the power to govern the financial and operating policies of the entity, or generally has an interest of more than one half of the voting rights of the entities. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Parent Company controls another entity. A subsidiary is fully consolidated from the date control is transferred to the Parent Company directly or through the holding companies. Control is achieved where the Parent Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. They are deconsolidated from the date on which control ceases.

All intra-group balances, transactions, income and losses resulting from intra-group transactions that are recognized in assets are eliminated in full. However, intra-group losses that indicate impairment are recognized in the consolidated financial statements.

### Investments in Associates

Associates are entities which the Group has significant influence but not control, generally accompanying a shareholding of between 20% to 50% of the voting rights. Investments in associates are accounted for under the equity method of accounting and are initially recognized at cost.

The Group's share of its associates' post-acquisition profits or losses is recognized in the consolidated statement of income and its share of post-acquisition movements in reserves is recognized in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognize further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealized gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealized losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies have been changed where necessary to ensure consistency with the policies adopted by the Group.

### Interest in Jointly Controlled Assets

Interest in jointly controlled assets is accounted for by recognizing in the consolidated financial statements the Group's share in the jointly controlled assets and included principally in the "Property and equipment" and "Deferred oil exploration costs" accounts in the consolidated balance sheet and any liabilities incurred jointly with the other venturers as well as the related revenues and expenses of the joint venture. The Group also recognizes the expenses which it has incurred in respect of its interest in the joint venture and the related liabilities.

### Business Combination and Goodwill

Business combinations are accounted for using the purchase method. This involves recognizing identifiable assets and liabilities of the acquired business initially at fair value. If the acquirer's interest in the net fair value of the identifiable assets and liabilities exceeds the cost of the business combination, the acquirer shall (a) reassess the identification and measurement of the acquiree's identifiable assets and liabilities and the measurement of the cost of the combination; and (b) recognize immediately in profit or loss any excess remaining after that reassessment.

When a business combination involves more than one exchange transaction, each exchange transaction shall be treated separately using the cost of the transaction and fair value information at the date of each exchange transaction to determine the amount of any goodwill associated with that transaction. This results in a step-by-step comparison of the cost of the individual investments with the Group's interest in the fair value of the acquiree's identifiable assets, liabilities and contingent liabilities at each exchange transaction. The fair values of the acquiree's identifiable assets, liabilities and contingent liabilities may be different at the date of each exchange transaction. Any adjustments to those fair values relating to previously held interests of the Group is a revaluation to be accounted for as such and presented separately as part of equity.

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share in the net identifiable assets of the acquired subsidiary or associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is recognized separately as a noncurrent asset. Goodwill on acquisitions of associates is included in investments in associates and is tested annually for impairment as part of the overall balance.

Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

Impairment is determined for goodwill by assessing the recoverable amount of the cash-generating unit (CGU) or group of CGUs to which the goodwill relates. Where the recoverable amount of the CGU or group of CGUs is less than the carrying amount of the CGU or group of CGUs to which goodwill has been allocated, an impairment loss is recognized. Impairment losses relating to goodwill cannot be reversed in future periods. The Group performs its impairment test of goodwill on an annual basis.

#### *Acquisition of PGO*

On May 2, 2007, the Parent Company acquired 100% of the shares of PGO, an entity which have participating interests in various oil properties in the Philippines and has not yet started commercial operations as of the said date.

The fair values of the identifiable assets of PGO as of the date of acquisition are as follows:

	<b>Fair Values</b>	Carrying Values
Wells, platforms and other facilities (Note 6)	<b>₱21,234,458</b>	₱21,234,458
Deferred oil exploration costs (Note 9)	<b>10,695,328</b>	10,695,328
	<b>31,929,786</b>	31,929,786

As of May 2, 2007, PGO has no liabilities. Since there was no fair value available for the acquired assets, the Parent Company assumed that the carrying value was the asset's fair value and carried the same in its consolidated financial statements. The purchase price for the net asset acquired was P32.6 million which resulted to a goodwill of P0.7 million. The Parent Company immediately impaired this goodwill at the acquisition date. As of December 31, 2008, PGO has not yet started commercial operations.

#### Cash

Cash consists of cash on hand and in banks.

#### Financial Assets and Financial Liabilities

The Group recognizes financial asset or a financial liability in the consolidated balance sheet when it becomes a party to the contractual provisions of the instrument. Purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace are recognized on the settlement date. Financial instruments are recognized initially at fair value, which is the fair value of the consideration given (in case of an asset) or received (in case of a liability). The initial measurement of financial instruments, except for those designated at fair value through profit or loss (FVPL), includes transaction cost.

On initial recognition, the Group classifies its financial assets in the following categories: HTM investments, AFS financial assets, FVPL financial assets and loans and receivables, as appropriate. Financial liabilities are classified as either financial liabilities at FVPL or other financial liabilities, as appropriate. The classification depends on the purpose for which the investments are acquired and whether they are quoted in an active market. Management determines the classification of its financial assets and financial liabilities at initial recognition and, where allowed and appropriate, re-evaluates such designation at each balance sheet 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 benefits.

As of December 31, 2008 and 2007, the Group has no financial assets classified as HTM investments and financial assets and financial liabilities at FVPL.

#### *Determination of fair value*

The fair value of financial instruments that are actively traded in organized financial markets is determined by reference to quoted market prices (bid price for long positions and ask price for short positions), without any deduction from transaction costs at the close of business on the balance sheet date. When current bid and asking prices are not available, the price of the most recent transaction is used since it provides evidence of current fair value as long as there has not been a significant change in economic circumstances since the time of transaction.

For investments and all other financial instruments where there is no active market, fair value is determined using generally acceptable valuation techniques. Such techniques include using arm's length market transactions; reference to the current market value of another instrument, which is substantially the same; discounted cash flow analysis and other valuation models.

#### *Day1 Profit*

Where the transaction price in a non-active market is different from the fair value based on other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Group recognizes the difference between the transaction price and fair value (a Day 1 profit) in the consolidated statement of income unless it qualifies for recognition as some other type of asset. In cases where use is made of data which is not observable, the difference between the transaction price and model value is only recognized in the consolidated statement of income when the inputs become observable or when the instrument is derecognized. For each transaction, the Group determines the appropriate method of recognizing the 'Day 1' profit amount.

#### *Embedded derivatives*

An embedded derivative is separated from the host financial or non-financial contract and accounted for as a derivative if all of the following conditions are met:

- the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristic of the host contract;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- the hybrid or combined instrument is not recognized as at FVPL.

The Group assesses whether embedded derivatives are required to be separated from host contracts when the Group first becomes party to the contract. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

Embedded derivatives that are bifurcated from the host contracts are accounted for either as financial assets or financial liabilities at FVPL. Changes in fair values are included in the consolidated statement of income.

The Group has no embedded derivatives as of December 31, 2008 and 2007.

#### *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 subsequently carried at amortized cost using the effective interest method less any allowance for impairment. Amortized cost is calculated taking into account any discount or premium on acquisition and includes transaction costs and fees that are an integral part of the effective interest rate and transaction costs. 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. These financial assets are included in current assets if maturity is within twelve months from the balance sheet date. Otherwise, these are classified as non-current assets.

As of December 31, 2008 and 2007, the Group's loans and receivables consist of cash in banks and receivables (Note 19).

#### *AFS financial assets*

AFS financial assets are non-derivative financial assets that are designated as AFS or are not classified in any of the three other categories. The Group designates financial instruments as AFS financial assets if they are purchased and held indefinitely and may be sold in response to liquidity requirements or changes in market conditions. After initial recognition, AFS financial assets are measured at fair value with unrealized gains or losses being recognized directly in equity as "Net unrealized loss on decline in value of AFS financial assets".

When the financial asset is disposed of, the cumulative gains or losses previously recorded in equity are recognized in the consolidated statement of income. Interest earned on the investments is reported as 'Interest income' using the effective interest method. Dividends earned on investments are recognized in the consolidated statement of income as 'Dividends income' when the right of payment has been established. The Group considers several factors in making a decision on the eventual disposal of the investment. The major factor of this decision is whether or not the Group will experience inevitable further losses on the investment. These financial assets are classified as noncurrent assets unless the intention is to dispose of such assets within twelve months from the balance sheet date.

As of December 31, 2008 and 2007, the Group classifies its investments in shares of stocks as AFS financial assets (Note 8).

#### *Other financial liabilities*

Other financial liabilities are initially recorded at fair value, less directly attributable transaction costs. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any issue costs, and any discount or premium on settlement. Gains and losses are recognized in the consolidated statement of income when the liabilities are derecognized as well as through the amortization process.

As of December 31, 2008 and 2007, the Group classifies its loans payable, accounts payable and accrued liabilities, dividends payable and subscriptions payable as other financial liabilities (Note 19).

#### Offsetting Financial Instruments

Financial assets and financial liabilities are set off and the net amount is reported in the consolidated balance sheet 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.

#### Impairment of Financial Assets

The Group assesses at each balance sheet date whether a financial asset or a 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 has occurred after the initial recognition of the asset (an incurred loss event) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated. Evidence of impairment may include indications that the contracted parties or a group of contracted parties 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.

#### *Loans and receivables*

If there is objective evidence that an impairment loss on financial assets carried at amortized cost has been incurred, the amount of loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced through the use of an allowance account. The amount of loss is recognized in the consolidated statement of income.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in the group of financial assets with similar credit risk and characteristics and that group of financial assets is collectively assessed for impairment. Those characteristics are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtor's 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 of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in the consolidated statement of income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

In relation to receivable, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Group will not be able to collect all the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through the use of an allowance account. Impaired receivables are derecognized when they are assessed as uncollectible.

#### *AFS financial assets*

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

In case of equity investments classified as AFS financial assets, this would include a significant or prolonged decline in the fair value of the investments below its cost. When 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 consolidated statement of income.

Impairment losses on equity investments are not reversed through the consolidated statement of income. Increases in fair value after impairment are recognized directly in equity.

In the case of debt instruments classified as AFS financial assets, 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 consolidated statement of income. If, in subsequent year, the fair value of a debt instrument increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statement of income, the impairment loss is reversed through the consolidated statement of income.

#### Derecognition of Financial Assets and Financial Liabilities

##### *Financial assets*

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

- the rights to receive cash flows from the asset have expired;
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to third party under a 'pass-through' arrangement; or
- the Group has transferred its rights 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 risks and rewards of the asset, but has transferred control of the asset.

Where the Group 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 Group'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 the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

#### *Financial liabilities*

A financial liability is derecognized when the obligation under the liability was discharged, cancelled or has expired.

Where 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 an 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 consolidated statement of income.

#### Crude Oil Inventory

Crude oil inventory is carried at market value.

#### Property and Equipment

Property and equipment are stated at cost less accumulated depletion, depreciation and amortization and any impairment in value. Such cost includes the cost of replacing part of such property and equipment when that cost is incurred and the recognition criteria are met.

The initial cost of property and equipment, other than wells, platforms and other facilities, comprises its purchase price, including taxes and any directly attributable costs of 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, related accumulated depletion, depreciation and amortization, and any allowance for impairment are removed from the accounts and any gain or loss resulting from their disposals is recognized in consolidated statement of income.

Depletion of wells, platforms and other facilities are provided on a field basis under the unit-of-production method based upon estimates of proved reserves. The depletion base includes the exploration and development cost of producing oilfields.

Depreciation of property and equipment, other than wells, platforms and other facilities, is computed using the straight-line method over the estimated useful lives of the assets as follows:

	Number of Years
Office condominium units and improvements	20
Transportation equipment	5
Office furniture, fixtures and equipment	3

Depreciation and amortization of an item of property and equipment begins when it becomes available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation or amortization ceases at the earlier of the date that the item is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with PFRS 5, *Noncurrent Assets Held for Sale and Discontinued Operations*, and the date the asset is derecognized.

Wells in progress pertains to those development costs relating to Service Contract (SC) where oil in commercial quantities are discovered and are subsequently reclassified to “Wells, platforms and other facilities” shown under “Property and equipment” account in the consolidated balance sheet upon commercial production. Depletion of wells in progress commences upon transfer to property and equipment.

The assets’ useful lives and depletion, depreciation and amortization methods are reviewed periodically to ensure that the periods and methods of depletion, depreciation and amortization are consistent with the expected pattern of economic benefits from items of property and equipment.

#### Deferred Oil Exploration Costs

The Group follows the full cost method of accounting for exploration costs determined on the basis of each SC/Geophysical Survey and Exploration Contract (GSEC) area. Under this method, all exploration costs relating to each SC/GSEC are deferred pending determination of whether the contract area contains oil and gas reserves in commercial quantities. The exploration costs relating to the SC/GSEC area where oil and gas in commercial quantities are discovered are subsequently capitalized as “Wells, platforms and other facilities” shown under the “Property and equipment” account in the consolidated balance sheet upon commercial production. When the SC/GSEC is permanently abandoned or the Group has withdrawn from the consortium, the related deferred oil exploration costs are written-off. SCs and GSECs are considered permanently abandoned if the SCs and GSECs have expired and/or there are no definite plans for further exploration and/or development.

#### Impairment of Noncurrent Non-financial Assets

The Group assesses at each balance sheet date whether there is an indication that noncurrent non-financial assets, which include property and equipment, deferred oil exploration costs, investments in associates and other noncurrent assets may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group makes an estimate of the asset’s recoverable amount. An asset’s recoverable amount is the higher of an asset’s or CGU’s fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or

groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses of continuing operations are recognized in the consolidated statement of income in those expense categories consistent with the function of the impaired asset.

For assets excluding goodwill, an assessment is made at each balance sheet date as to whether there is any indication that previously recognized impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depletion, depreciation and amortization, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the consolidated statement of income unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase. After such a reversal, the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

#### Revenue Recognition

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Group and the amount of revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, excluding discounts, rebates and other sales taxes or duty. The following specific recognition criteria must also be met before revenue is recognized:

##### *Petroleum revenue*

Revenue from petroleum operations is recognized as income at the time of production.

##### *Rental income*

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

##### *Interest income*

Interest income is recognized as the interest accrues taking into account the effective yield on the asset.

##### *Dividend income*

Dividend income is recognized when the right to receive the payment is established.

#### Borrowing Costs

Borrowing costs generally are recognized as expense in the consolidated statement of income when incurred. Borrowing costs are capitalized if they are directly attributable to the acquisition or construction of a qualifying asset. Capitalization of borrowing costs commences when the activities to prepare the asset are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalized until the assets are substantially ready for their intended use. If the carrying amount of the asset exceeds its estimated recoverable amount, an impairment loss is recorded.

#### Retirement Benefits Costs

Retirement benefits costs are actuarially determined using the projected unit credit method. The projected unit credit method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation. Upon introduction of a new plan or improvement of an existing plan, past service costs are recognized on a straight-line basis over the average period until the amended benefits become vested. To the extent that the benefits are already vested immediately, past service cost is immediately expensed. Actuarial gains and losses are recognized as income or expense when the cumulative unrecognized actuarial gains and losses at the end of the previous reporting year exceeded 10% of the higher of the present value of defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plan. The past service cost is recognized as an expense on a straight line basis over the average period until the benefits become vested. If the benefits are already vested immediately following the introduction of, or changes to, the retirement plan, past service cost is recognized immediately.

Retirement benefits liability is the aggregate of the present value of the defined benefit obligation and actuarial gains and losses not recognized reduced by past service cost not yet recognized and the fair value of plan assets out of which the obligations are to be settled directly.

If such aggregate is negative, the asset is measured at the lower of such aggregate or the aggregate cumulative unrecognized net actuarial losses and past service cost and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

#### Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date whether the fulfillment of the arrangement is dependent on the use of a specific asset or the arrangement conveys a right to use the asset.

A reassessment is made after inception of the lease only if one of the following applies:

- (a) there is a change in contractual terms, other than a renewal or extension of the arrangement;
- (b) a renewal option is exercised or extension granted, unless the term of the renewal or extension was initially included in the lease term;
- (c) there is a change in the determination of whether fulfillment is dependent on a specified asset; or
- (d) there is a substantial change to the asset.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios (a), (c) or (d) and at the date of renewal or extension period for scenario (b).

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the consolidated statement of income on a straight line basis over the lease term.

## Income Taxes

### *Current income tax*

Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the tax authority. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted as of the balance sheet date.

### *Deferred income tax*

Deferred income tax is recognized on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognized for all taxable temporary differences. Deferred income tax assets are recognized for all deductible temporary differences, and carryforward benefits of unused tax credits from excess of minimum corporate income tax (MCIT) over the regular corporate income tax (RCIT), and unused tax losses from net operating loss carryover (NOLCO), to the extent that it is probable that sufficient future taxable profit will be available against which the deductible temporary differences, excess MCIT over RCIT and NOLCO can be utilized.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient future taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at each balance sheet date and are recognized to the extent that it has become probable that sufficient future taxable profit will allow the deferred income tax asset to be recovered.

Deferred income tax assets and deferred income tax liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the balance sheet date.

Deferred income tax assets and deferred income tax liabilities are offset, if a legally enforceable right exist to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

## Provisions and Contingencies

Provisions are recognized when: (a) the Group has a present obligation (legal or constructive) as a result of a past event; (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation. If the effect of time value of money is material, provisions are determined by discounting the expected future cash flows at a pretax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to passage of time is recognized as an interest expense.

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

## Basic/Diluted Earnings (Loss) Per Share

Basic earnings (loss) per share is computed by dividing net income (loss) for the year by the weighted average number of common shares issued and outstanding during the year after giving retroactive effect to stock dividends declared and stock rights exercised during the year, if any.

Diluted earnings (loss) per share is computed by dividing net income (loss) for the year (after deducting interest on convertible preferred shares) by the weighted average number of shares issued and outstanding during the year plus the weighted average number of common shares that would be issued on the conversion of all dilutive potential common shares into common shares.

As of December 31, 2008, the Group has potential dilutive common shares from its stock rights offering and no potential dilutive common shares in 2007 and 2006.

#### Foreign Currency Transactions and Translations

Transactions in foreign currencies are recorded using the applicable exchange rate at the date of the transaction. Outstanding monetary assets and liabilities denominated in foreign currencies are retranslated using the applicable closing functional currency exchange rate at the balance sheet date. Foreign exchange gains or losses arising from foreign currency-denominated transactions and translations are recognized in the consolidated statement of income.

#### Segment Reporting

Currently, the Group has only one business segment. The Group is primarily involved in oil exploration and production. Revenue generated consists mainly of revenue from petroleum operations. Other income is derived from rent of office spaces. In terms of geographic segments, the Group currently has no geographical segments.

Management monitors the operating results of its business unit separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on operating profit or loss which in certain respects is measured differently from operating income or loss in the consolidated financial statements. Group financing, excluding interest income and expense and income taxes are managed on a group basis and are not allocated to operating segments.

#### Events After the Balance Sheet Date

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

#### **Future Changes in Accounting Policies**

The following are the new and revised accounting standards and Interpretations that will become effective subsequent to 2008. Except as otherwise indicated, the Group does not expect the adoption of these new and amended PFRS and Philippine interpretations to have any significant impact on its consolidated financial statements.

#### *Effective in 2009*

- PFRS 1, *First-time Adoption of PFRS - Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*, allows an entity, in its separate financial statements, to determine the cost of investments in subsidiaries, jointly controlled entities or associates (in its opening PFRS financial statements) as one of the following amounts: (a) cost determined in accordance with PAS 27; *Consolidated and Separate Financial Statements*, (b) at the fair value of the investment at the

date of transition to PFRS, determined in accordance with PAS 39; (c) or previous carrying amount (as determined under generally accepted accounting principles) of the investment at the date of transition to PFRS.

- PFRS 2, *Share-based Payment - Vesting Condition and Cancellations*, clarifies the definition of a vesting condition and prescribes the treatment for an award that is effectively cancelled. It defines a vesting condition as a condition that includes an explicit or implicit requirement to provide services. It further requires nonvesting conditions to be treated in a similar fashion to market conditions. Failure to satisfy a nonvesting condition that is within the control of either the entity or the counterparty is accounted for as a cancellation. However, failure to satisfy a nonvesting condition that is beyond the control of either party does not give rise to a cancellation.
- PFRS 8, *Operating Segments*, replaces PAS 14, *Segment Reporting*, and adopts a full management approach to identifying, measuring and disclosing the results of an entity's operating segments. The information reported would be that which management uses internally for evaluating the performance of operating segments and allocating resources to those segments. Such information may be different from that reported in the balance sheet and statement of income and the Group will provide explanations and reconciliations of the differences. This standard is only applicable to an entity that has debt or equity instruments that are traded in a public market or that files (or is in the process of filing) its financial statements with a securities commission or similar party.
- Amendments to PAS 1, *Presentation of Financial Statements*, introduce a new statement of comprehensive income that combines all items of income and expenses recognized in the profit or loss together with 'other comprehensive income'. Entities may choose to present all items in one statement, or to present two linked statements, a separate statement of income and a statement of comprehensive income. This amendment also requires additional requirements in the presentation of the balance sheet and owner's equity as well as additional disclosures to be included in the consolidated financial statements.
- Revised PAS 23, *Borrowing Costs*, requires capitalization of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements in the standard, the Group will adopt this as a prospective change. Accordingly, borrowing costs will be capitalized on qualifying assets with a commencement date after January 1, 2009. No changes will be made for borrowing costs incurred to this date that have been expensed.
- Amendments to PAS 27 prescribe changes in respect of the holding companies, separate financial statements including (a) the deletion of 'cost method', making the distinction between pre-acquisition and post-acquisition profits no longer required; and (b) in cases of reorganizations where a new parent is inserted above an existing parent of the group (subject to meeting specific requirements), the cost of the subsidiary is the previous carrying amount of its share of equity items in the subsidiary rather than its fair value. All dividends will be recognized in profit or loss. However, the payment of such dividends requires the entity to consider whether there is an indicator of impairment.
- Amendment to PAS 32, *Financial Instruments: Presentation*, and PAS 1 - *Puttable Financial Instruments and Obligations Arising on Liquidation*, specifies, among others, that puttable financial instruments will be classified as equity if they have all of the following specified features: (a) the instrument entitles the holder to require the entity to repurchase or redeem the instrument (either on an ongoing basis or on liquidation) for a pro-rata share of the entity's net assets, (b) the instrument is in the most subordinate class of instruments, with no priority over other claims to the assets of the entity on liquidation, (c) all instruments in the subordinate class have identical

features (d) the instrument does not include any contractual obligation to pay cash or financial assets other than the holder's right to a pro rata share of the entity's net assets, and (e) the total expected cash flows attributable to the instrument over its life are based substantially on the profit or loss, a change in recognized net assets, or a change in the fair value of the recognized and unrecognized net assets of the entity over the life of the instrument.

- Philippine Interpretation IFRIC 13, *Customer Loyalty Programmes*, requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and realized in income over the period that the award credits are redeemed or expired.
- Philippine Interpretation IFRIC 16, *Hedges of a Net Investment in a Foreign Operation*, provides guidance on identifying foreign currency risks that qualify for hedge accounting in the hedge of a net investment; where within the group the hedging instrument can be held in the hedge of a net investment; and how an entity should determine the amount of foreign currency gains or losses, relating to both the net investment and the hedging instrument, to be recycled on disposal of the net investment.

#### *Improvements to PFRSs*

In May 2008, the International Accounting Standards Board issued its first omnibus of amendments to certain standards, primarily with a view to removing inconsistencies and clarifying wording. These are the separate transitional provisions for each standard:

- PFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, specifies when a subsidiary is held for sale, all of its assets and liabilities will be classified as held for sale under PFRS 5, even when the entity retains a non-controlling interest in the subsidiary after the sale.
- PAS 1 clarifies assets and liabilities classified as held for trading are not automatically classified as current in the balance sheet.
- PAS 16, *Property, Plant and Equipment*, replaces the term 'net selling price' with 'fair value less costs to sell', to be consistent with PFRS 5 and PAS 36, *Impairment of Assets*. It also clarifies that items of property, plant and equipment held for rental that are routinely sold in the ordinary course of business after rental, are transferred to inventory when rental ceases and they are held for sale. Proceeds of such sales are subsequently shown as revenue. Cash payments on initial recognition of such items, the cash receipts from rents and subsequent sales are all shown as cash flows from operating activities.
- PAS 19 revises the definition of 'past service costs' to include reductions in benefits related to past services ('negative past service costs') and to exclude reductions in benefits related to future services that arise from plan amendments. Amendments to plans that result in a reduction in benefits related to future services are accounted for as a curtailment. It also revises the definition of 'return on plan assets' to exclude plan administration costs if they have already been included in the actuarial assumptions used to measure the defined benefit obligation. It also revises the definition of 'short-term' and 'other long-term' employee benefits to focus on the point in time at which the liability is due to be settled. It also deletes the reference to the recognition of contingent liabilities to ensure consistency with PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

- PAS 20 - *Accounting for Government Grants and Disclosures of Government Assistance*, clarifies that loans granted with no or low interest rates will not be exempt from the requirement to impute interest. The difference between the amount received and the discounted amount is accounted for as a government grant.
- PAS 23 revises the definition of borrowing costs to consolidate the types of items that are considered components of 'borrowing costs', i.e., components of the interest expense calculated using the effective interest rate method. This revised standard disallows the alternative treatment of borrowing costs, which permits the recognition of borrowing costs as expense.
- PAS 28, *Investment in Associates*, clarifies that if an associate is accounted for at fair value in accordance with PAS 39, only the requirement of PAS 28 to disclose the nature and extent of any significant restrictions on the ability of the associate to transfer funds to the entity in the form of cash or repayment of loans applies. It also defines an investment in an associate as a single asset for the purpose of conducting the impairment test. Therefore, any impairment test is not separately allocated to the goodwill included in the investment balance.
- PAS 29, *Financial Reporting in Hyperinflationary Economies*, revises the reference to the exception that assets and liabilities should be measured at historical cost, such that it notes property, plant and equipment as being an example, rather than implying that it is a definitive list.
- PAS 31, *Interest in Joint Ventures*, clarifies that if a joint venture is accounted for at fair value, in accordance with PAS 39, only the requirements of PAS 31 to disclose the commitments of the venturer and the joint venture, as well as summary financial information about the assets, liabilities, income and expense will apply.
- PAS 36 provides that, when discounted cash flows are used to estimate 'fair value less cost to sell', additional disclosure is required about the discount rate, consistent with disclosures required when the discounted cash flows are used to estimate value-in-use'.
- PAS 38, *Intangible Assets*, provides that, expenditure on advertising and promotional activities is to be recognized as an expense when the Group either has the right to access the goods or has received the services. Advertising and promotional activities now specifically include mail order catalogues. It also deletes references to there being rarely, if ever, persuasive evidence to support an amortization method for finite life intangible assets that results in a lower amount of accumulated amortization than under the straight-line method, thereby effectively allowing the use of the unit of production method.
- PAS 39 provides changes in circumstances relating to derivatives - specifically derivatives designated or de-designated as hedging instruments after initial recognition - are not reclassifications. It also clarifies when financial assets are reclassified as a result of an insurance company changing its accounting policy in accordance with paragraph 45 of PFRS 4, *Insurance Contracts*, such is a change in circumstance, not a reclassification. It further removes the reference to a 'segment' when determining whether an instrument qualifies as a hedge. It requires use of the revised effective interest rate (rather than the original effective interest rate) when remeasuring a debt instrument on the cessation of fair value hedge accounting.
- PAS 40, *Investment Properties*, revises the scope (and the scope of PAS 16) to include property that is being constructed or developed for future use as an investment property. Where an entity is unable to determine the fair value of an investment property under construction, but expects to be able to determine its fair value on completion, the investment under construction will be measured at cost until such time as fair value can be determined or construction is complete.

- PAS 41, *Agriculture*, removes the reference to the use of a pretax discount rate to determine fair value, thereby allowing use of either a pretax or post-tax discount rate depending on the valuation methodology used and removes the prohibition to take into account cash flows resulting from any additional transformations when estimating fair value. Instead, cash flows that are expected to be generated in the 'most relevant market' are taken into account.

*Effective in 2010*

- Revised PFRS 3, *Business Combinations* and PAS 27, introduce a number of changes in the accounting for business combinations that will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs, and future reported results. The revised PAS 27 requires, among others, that (a) change in ownership interests of a subsidiary (that do not result in loss of control) will be accounted for as an equity transaction and will have no impact on goodwill nor will it give rise to a gain or loss; (b) losses incurred by the subsidiary will be allocated between the controlling and non-controlling interests (previously referred to as 'minority interests'); even if the losses exceed the non-controlling equity investment in the subsidiary; and (c) on loss of control of a subsidiary, any retained interest will be remeasured to fair value and this will impact the gain or loss recognized on disposal. The changes introduced by the revised PFRS 3 and PAS 27 must be applied prospectively and will affect future acquisitions and transactions with noncontrolling interests.
- Amendment to PAS 39 - *Eligible hedged items*, addresses only the designation of a one-sided risk in a hedged item, and the designation of inflation as a hedged risk or portion in particular situations. The amendment clarifies that an entity is permitted to designate a portion of the fair value changes or cash flow variability of a financial instrument as a hedged item.
- Philippine Interpretation IFRIC 17, *Distributions of Non-cash Assets to Owners*, covers accounting for all non-reciprocal distribution of non-cash assets to owners. It provides guidance on when to recognize a liability, how to measure it and the associated assets and when to derecognize the asset and liability and the consequences of doing so.
- Philippine Interpretation IFRIC 18, *Transfers of Assets from Customers*, applies to the accounting for transfers of items of property, plant and equipment by an entity that receive such transfers from its customer, wherein the entity must then use such transferred asset either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services, or to do both.

*Effective in 2012*

- Philippine Interpretation IFRIC 15, *Agreement for Construction of Real Estate*, covers accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. This interpretation requires that revenue on construction of real estate be recognized only upon completion, except when such contract qualifies as construction contract to be accounted for under PAS 11, *Construction Contracts*, or involves rendering of services in which case revenue is recognized based on stage of completion. Contracts involving provision of services with the construction materials and where the risks and reward of ownership are transferred to the buyer on a continuous basis, will also be accounted for based on stage of completion.

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