PETRON CORPORATION AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS
December 31, 2010
(With Comparative Figures for 2009 and 2008)

PETRON

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of **Petron Corporation** is responsible for all information and representations contained in the consolidated financial statements for the years ended December 31, 2010, 2009 and 2008. The consolidated financial statements have been prepared in conformity with the Philippine Financial Reporting Standards and reflect amounts that are based on the best estimates and informed judgment of management with an appropriate consideration to materiality.

In this regard, management maintains a system of accounting and reporting which provides for the necessary internal controls to ensure that transactions are properly authorized and recorded, assets are safeguarded against unauthorized use or disposition and liabilities are recognized. Management likewise discloses to the company's audit committee and to its external auditor: (i) all significant deficiencies in the design or operation of internal controls that could adversely affect its ability to record, process, and report financial data; (ii) material weaknesses in the internal controls, and (iii) any fraud that involves management or other employees who exercise significant roles in internal controls.

The Board of Directors reviews the consolidated financial statements before such statements are approved and submitted to the stockholders of the Company.

Manabat Sanagustin & Co., CPAs, the independent auditors appointed by the stockholders, have examined the consolidated financial statements of the Company in accordance with Philippine Standards on Auditing and have expressed their opinion on the fairness of presentation upon completion of such examination, in their report to the Board of Directors and stockholders.

RAMON S. ANG
Chairman and Chief Executive Officer

ERIC O. RECTO
President

EMMANUEL E. ERAÑA
Chief Finance Officer

SUBSCRIBED AND SWORN TO before me, a Notary Public for and in the MANDALUYONG CITY, Metro Manila, this MAR 1 5 2011, affiants being personally known to me and signed this instrument in my presence and avowed under penalty of law to the whole truth of contents thereof.

Doc. No. 400;
Page No. 81;
Book No. II;
Series of 2011

VICENTE R. MARQUEZ
Notary Public for Mandaluyong City
Notary Commission No. 0337-10
Until December 31, 2011
PTR no. 1852842 1.28.11 Mandaluyong City
LRN- 0183 05-25-00 Pasig City

PRC-BOA Registration No. 0003
SEC Accreditation No. 0004-FR-2
BSP Accredited

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Petron Corporation and Subsidiaries

We have audited the accompanying consolidated financial statements of Petron Corporation and Subsidiaries, which comprise the consolidated statement of financial position as at December 31, 2010, and the consolidated statement of income, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the 2010 consolidated financial statements present fairly, in all material respects, the consolidated financial position of Petron Corporation and Subsidiaries as at December 31, 2010, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Philippine Financial Reporting Standards.

Other Matter

The consolidated financial statements of Petron Corporation and Subsidiaries as at and for the years ended December 31, 2009 and 2008, prior to the restatements as discussed in Note 39 to the consolidated financial statements, were audited by other auditors whose report thereon dated March 29, 2010, expressed an unqualified opinion on those statements. As part of our audit of the 2010 consolidated financial statements, we also audited the adjustments that were applied to the 2009 and 2008 consolidated financial statements to reflect the change in accounting policy as described in Note 39. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review, or apply any procedures to the 2009 and 2008 consolidated financial statements of Petron Corporation and Subsidiaries other than with respect to the adjustments and, accordingly, we do not express an opinion or any other form of assurance on the 2009 and 2008 consolidated financial statements taken as a whole.

MANABAT SANAGUSTIN CO. & CPAs

JORGE MA. S. SANAGUSTIN
Partner
CPA License No. 0030399
SEC Accreditation No. 0026-AR-2
Tax Identification No. 124-282-616
BIR Accreditation No. 08-001987-7-2010
Issued June 30, 2010; Valid until June 29, 2013
PTR No. 2639631MB
Issued January 3, 2011 at Makati City

March 14, 2011
Makati City, Metro Manila

Manabat Sanagustin & Co., CPAs
The KPMG Center, 9/F
6787 Ayala Avenue
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E-Mail manila@kpmg.com.ph

PRC-BOA Registration No. 0003
SEC Accreditation No. 0004-FR-2
BSP Accredited

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Petron Corporation and Subsidiaries
SMC Head Office Complex
40 San Miguel Avenue
Mandaluyong City

We have audited the accompanying consolidated financial statements of Petron Corporation and Subsidiaries, which comprise the consolidated statement of financial position as at December 31, 2010, and the consolidated statement of income, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the 2010 consolidated financial statements present fairly, in all material respects, the consolidated financial position of Petron Corporation and Subsidiaries as at December 31, 2010, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with Philippine Financial Reporting Standards.

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MANABAT SANAGUSTIN CO. & CPAs

JORGE MA. S. SANAGUSTIN
Partner
CPA License No. 0030399
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Issued June 30, 2010; Valid until June 29, 2013
PTR No. 2639631MB
Issued January 3, 2011 at Makati City

March 14, 2011
Makati City, Metro Manila

PETRON CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

DECEMBER 31, 2010

(With Comparative Figures for 2009)
(Amounts in Million Pesos)

	Note	2010	2009 December 31 (As Restated - Note 39)	2009 January 1 (As Restated - Note 39)
ASSETS				
Current Assets				
Cash and cash equivalents	*6*	**P43,984**	P12,985	P12,827
Financial assets at fair value through profit or loss	*7*	**227**	208	216
Available-for-sale financial assets	*8*	**178**	170	331
Trade and other receivables - net	*9*	**24,266**	29,696	16,875
Inventories	*10*	**28,145**	28,169	30,792
Other current assets	*14*	**4,286**	4,428	11,922
		101,086	75,656	72,963
Assets held for sale	*5*	**823**	-	-
Total Current Assets		**101,909**	75,656	72,963
Noncurrent Assets				
Available-for-sale financial assets	*8*	**983**	1,185	351
Property, plant and equipment - net	*12*	**34,957**	34,784	36,428
Investments in associates	*11*	**804**	-	-
Investment properties - net	*13*	**119**	232	246
Deferred tax assets	*26*	**28**	7	895
Other noncurrent assets - net	*14*	**23,016**	878	892
Total Noncurrent Assets		**59,907**	37,086	38,812
		P161,816	P112,742	P111,775
LIABILITIES AND EQUITY				
Current Liabilities				
Short-term loans	*15*	**P32,457**	P42,744	P53,979
Liabilities for crude oil and petroleum product importation		**11,194**	7,529	8,907
Trade and other payables	*16*	**6,744**	4,916	4,562
Derivative liabilities	*34*	**30**	1	-
Income tax payable		**14**	10	22
Current portion of long-term debt - net	*17*	**11,517**	1,296	1,263
Total Current Liabilities		**61,956**	56,496	68,733

Forward

	Note	2010	2009 December 31 (As Restated - Note 39)	2009 January 1 (As Restated - Note 39)
Noncurrent Liabilities				
Long-term debt - net of current portion	*17*	**P42,885**	P17,596	P8,988
Retirement benefits liability	*29*	**249**	50	-
Deferred tax liabilities	*26*	**1,958**	364	8
Asset retirement obligation	*18*	**815**	541	706
Other noncurrent liabilities	*19*	**609**	511	460
Total Noncurrent Liabilities		**46,516**	19,062	10,162
Total Liabilities		**108,472**	75,558	78,895
Equity Attributable to Equity Holders of the Parent Company				
Capital stock	*20*	**9,475**	9,375	9,375
Additional paid-in capital		**9,764**	-	-
Retained earnings	*20*	**33,748**	27,506	23,266
Other reserves	*20*	**83**	59	14
Total Equity Attributable to Equity Holders of the Parent Company		**53,070**	36,940	32,655
Non-controlling interest		**274**	244	225
Total Equity		**53,344**	37,184	32,880
		P161,816	P112,742	P111,775

See Notes to the Consolidated Financial Statements.

PETRON CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 2010
(With Comparative Figures for 2009 and 2008)
(Amounts in Million Pesos, Except Per Share Amounts)

	Note	**2010**	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
SALES	*36*	**P229,094**	P176,531	P267,676
COST OF GOODS SOLD	*21*	**209,280**	161,583	264,306
GROSS PROFIT		**19,814**	14,948	3,370
SELLING AND ADMINISTRATIVE EXPENSES	*22*	**(7,303)**	(5,748)	(5,222)
INTEREST EXPENSE	*25*	**(4,309)**	(4,251)	(4,180)
INTEREST INCOME	*25*	**839**	205	354
SHARE IN NET LOSS OF AN ASSOCIATE	*11*	**(151)**	-	-
OTHER INCOME (EXPENSES)	*25*	**1,409**	597	(115)
		(9,515)	(9,197)	(9,163)
INCOME (LOSS) FROM OPERATIONS		**10,299**	5,751	(5,793)
INCOME TAX EXPENSE (BENEFIT)	*26, 35*	**2,375**	1,492	(1,873)
NET INCOME (LOSS)		**P7,924**	P4,259	(P3,920)
Attributable to:				
Equity holders of the parent company	*31*	**P7,894**	P4,240	(P3,978)
Non-controlling interest		**30**	19	58
		P7,924	P4,259	(P3,920)
BASIC/DILUTED EARNINGS (LOSS) PER SHARE ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT COMPANY	*31*	**P0.77**	P0.45	(P0.42)

See Notes to the Consolidated Financial Statements.

PETRON CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED DECEMBER 31, 2010
(With Comparative Figures for 2009 and 2008)
(Amounts in Million Pesos)

	Note	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
NET INCOME (LOSS)		**P7,924**	P4,259	(P3,920)
OTHER COMPREHENSIVE INCOME (LOSS)				
Unrealized fair value gains (losses) on available-for-sale financial assets (net of tax effects of P10, P14 and (P2) in 2010, 2009 and 2008, respectively)	*8, 20*	**22**	34	(3)
Exchange difference in translating foreign operations	*20*	**2**	11	6
OTHER COMPREHENSIVE INCOME FOR THE YEAR - NET OF TAX		**24**	45	3
TOTAL COMPREHENSIVE INCOME (LOSS) FOR THE YEAR		**P7,948**	P4,304	(P3,917)
Attributable to:				
Equity holders of the parent company		**P7,918**	P4,285	(P3,975)
Non-controlling interest		**30**	19	58
		P7,948	P4,304	(P3,917)

See Notes to the Consolidated Financial Statements.

PETRON CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2010
(With Comparative Figures for 2009 and 2008)
(Amounts in Million Pesos)

		Equity Attributable to Equity Holders of the Parent Company							
				Retained Earnings					
	Note	Capital Stock	Additional paid-in capital	Appro-priated	Unappro-priated	Other Reserves	Total	Non-controlling Interest	Total Equity
As of January 1, 2010	*20*	**P9,375**	**P -**	**P15,492**	**P12,014**	**P59**	**P36,940**	**P244**	**P37,184**
Unrealized fair value gain on available-for-sale financial assets		**-**	**-**	**-**	**-**	**22**	**-**	**-**	**22**
Exchange difference in translating foreign operations		**-**	**-**	**-**	**-**	**2**	**-**	**-**	**2**
Other comprehensive income		**-**	**-**	**-**	**-**	**24**	**24**	**-**	**24**
Net income for the year		**-**	**-**	**-**	**7,894**	**-**	**7,894**	**30**	**7,924**
Total comprehensive income for the year		**-**	**-**	**-**	**7,894**	**24**	**7,918**	**30**	**7,948**
Appropriation for capital projects	*20*	**-**	**-**	**62**	**(62)**	**-**	**-**	**-**	**-**
Cash dividends	*20*	**-**	**-**	**-**	**(1,652)**	**-**	**(1,652)**	**-**	**(1,652)**
Issuance of shares	*20*	**100**	**9,764**	**-**	**-**	**-**	**9,864**	**-**	**9,864**
As of December 31, 2010		**P9,475**	**P9,764**	**P15,554**	**P18,194**	**P83**	**P53,070**	**P274**	**P53,344**
As of January 1, 2009		P9,375	P -	P23,920	(P654)	P14	P32,655	P225	P32,880
Unrealized fair value gain on available-for-sale financial assets		-	-	-	-	34	-	-	34
Exchange difference in translating foreign operations		-	-	-	-	11	-	-	11
Total comprehensive income		-	-	-	-	45	45	-	45
Net income for the year		-	-	-	4,240	-	4,240	19	4,259
Total comprehensive income for the year		-	-	-	4,240	45	4,285	19	4,304
Reversal of appropriation for the capital projects	*20*	-	-	(8,428)	8,428	-	-	-	-
As of December 31, 2009 (As Restated)		P9,375	P -	P15,492	P12,014	P59	P36,940	P244	P37,184
As of January 1, 2008 (As previously stated)		P9,375	P -	P21,172	P7,520	(P412)	P37,655	P133	P37,788
Prior period adjustments		-	-	-	(510)	423	(87)	-	(87)
As restated		9,375	-	21,172	7,010	11	37,568	133	37,701
Unrealized fair value loss on available-for-sale financial assets		-	-	-	-	(3)	(3)	-	(3)
Exchange difference in translating foreign operations		-	-	-	-	6	6	-	6
Total comprehensive income		-	-	-	-	3	3	-	3
Net loss for the year		-	-	-	(3,978)	-	(3,978)	58	(3,920)
Total comprehensive loss for the year		-	-	-	(3,978)	3	(3,975)	58	(3,917)
Appropriation for capital projects		-	-	2,748	(2,748)	-	-	-	-
Cash dividends		-	-	-	(938)	-	(938)	-	(938)
Issuance of shares		-	-	-	-	-	-	34	34
As of December 31, 2008 (As Restated)	*39*	P9,375	P -	P23,920	(P654)	P14	P32,655	P225	P32,880

See Notes to the Consolidated Financial Statements.

PETRON CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR ENDED DECEMBER 31, 2010

(With Comparative Figures for 2009 and 2008)

(Amounts in Million Pesos)

	Note	**2010**	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
CASH FLOWS FROM OPERATING ACTIVITIES				
Income (loss) before income tax		**P10,299**	P5,751	(P5,793)
Adjustments for:				
Share in net loss of an associate	*11*	**151**	-	-
Retirement expense	*29*	**197**	317	118
Interest expense	*25*	**4,309**	4,251	4,180
Depreciation and amortization	*24*	**3,540**	3,588	3,243
Interest income	*25*	**(839)**	(205)	(354)
Unrealized foreign exchange losses (gains) - net		**(1,053)**	66	(40)
Other loss (gain)		**(76)**	(26)	(15)
Operating income before working capital changes		**16,528**	13,742	1,339
Changes in noncash assets, certain current liabilities and others	*32*	**4,123**	(4,902)	(651)
Interest paid		**(3,897)**	(4,311)	(3,830)
Income taxes paid		**(108)**	(91)	(616)
Interest received		**807**	214	353
Net cash flows provided by (used in) operating activities		**17,453**	4,652	(3,405)
CASH FLOWS FROM INVESTING ACTIVITIES				
Net additions to (including disposals):				
Property, plant and equipment	*12*	**(4,417)**	(1,928)	(5,534)
Investment properties	*13*	**-**	-	(52)
Decrease (increase) in:				
Other receivables		**6,087**	1,135	(4,522)
Other noncurrent assets		**939**	(241)	(396)
Reductions from (additions to):				
Financial assets at fair value through profit or loss		**40**	14	-
Long term investments and advances		**(24,084)**	-	-
Available-for-sale financial assets		**194**	(673)	(49)
Net cash flows used in investing activities		**(21,241)**	(1,693)	(10,553)

Forward

	Note	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds from availment of loans		**P204,941**	P166,214	P142,650
Payments of:				
Loans		**(178,913)**	(168,836)	(125,045)
Cash dividends	*20*	**(1,628)**	-	(924)
Issuance of preferred stock		**9,864**	-	-
Increase (decrease) in other noncurrent liabilities		**334**	(114)	326
Net cash flows provided by (used in) financing activities		**34,598**	(2,736)	17,007
EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS		**189**	(65)	46
NET INCREASE IN CASH AND CASH EQUIVALENTS		**30,999**	158	3,095
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR		**12,985**	12,827	9,732
CASH AND CASH EQUIVALENTS AT END OF YEAR		**P43,984**	P12,985	P12,827

See Notes to the Consolidated Financial Statements.

PETRON CORPORATION AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2010

(With Comparative Figures for 2009 and 2008)
(Amounts in Million Pesos, Except Par Value, Number of Shares and Per Share Amounts, Exchange Rates and Commodity Volumes)

1. Reporting Entity

Petron Corporation (the "Parent Company" or "Petron") was incorporated under the laws of the Republic of the Philippines and is registered with the Philippine Securities and Exchange Commission (SEC) on December 15, 1966. The consolidated financial statements as at and for the year ended December 31, 2010 comprise of the financial statements of Petron Corporation and Subsidiaries (collectively referred to as the "Group") and the Group's interest in associates and jointly controlled entity. Petron is the largest oil refining and marketing company in the Philippines supplying nearly 40% of the country's fuel requirements. Petron's vision is to be the leading provider of total customer solutions in the energy sector and its derivative businesses.

Petron's shares of stock are listed for trading at the Philippine Stock Exchange (PSE). SEA Refinery Holdings B.V. (SEA BV), a company incorporated in The Netherlands and owned by funds managed by the Ashmore Group, was Petron's parent company as of December 31, 2008 and 2009.

On December 24, 2008, San Miguel Corporation (SMC) and SEA BV entered into an Option Agreement granting SMC the option to buy the entire ownership interest of SEA BV in its local subsidiary, SRC. The option may be exercised by SMC within a period of two years from December 24, 2008.

On February 27, 2009, the BOD approved the amendment of Petron's Articles of Incorporation to include the generation and sale of electric power in its primary purpose. The objective is principally to lower the refinery power cost thru self-generation and, in the event there is excess power, to sell the same to third parties.

In connection with the inclusion of the generation and sale of electric power in its primary purpose, Petron received from the Department of Energy the agency's endorsement dated January 15, 2010 of the corresponding amendment of the Parent Company's Articles of Incorporation. Petron submitted all the requirements to SEC in February 2010.

On April 29, 2010, the BOD endorsed the amendment of Petron's Articles of Incorporation and By-Laws increasing the number of directors from ten (10) to fifteen (15) and quorum from six (6) to eight (8). The same was approved by the stockholders during their annual meeting on July 12, 2010. The amendment was approved by the SEC on August 24, 2010.

On April 30, 2010, SMC notified SEA BV that it will exercise its option to purchase 16,000,000 shares of Sea Refinery Corporation (SRC) from SEA BV, which is approximately 40% of the outstanding capital stock of SRC. SRC owns 4,696,885,564 common shares of Petron, representing approximately 50.1% of its issued and outstanding common shares. SMC conducted a tender offer for the common shares of Petron as a result of its intention to exercise the option to acquire 100% of SRC from SEA BV under the Option Agreement. A total of 184,702,538 Petron common shares tendered were crossed at the PSE on June 8, 2010, which is equivalent to approximately 1.97% of the issued and outstanding common stock of Petron. On June 15, 2010, SMC executed the Deed of Sale for the purchase of the 16,000,000 shares of SRC from SEA BV.

On August 31, 2010, SMC purchased additional 1,517,637,398 common shares of Petron from SEA BV through a special block sale crossed at the PSE. Said shares comprise approximately 16% of the outstanding capital stock of Petron.

On October 18, 2010, SMC also acquired from the public a total of 530,624 common shares of Petron, representing approximately 0.006% of the outstanding capital stock of Petron.

On December 15, 2010, SMC exercised its option to acquire the remaining 60% of SRC from SEA BV pursuant to the option agreement. With the exercise of the option, SMC beneficially owns approximately 68% of the outstanding and issued shares of stock of Petron. As such, on that date, SMC obtained control of SRC and Petron.

The registered office address of Petron and its Philippine-based subsidiaries (except Petron Freeport Corporation which has its principal office in the Subic Special Economic Zone) is at the SMC Head Office Complex, 40 San Miguel Avenue, Mandaluyong City.

The accompanying consolidated financial statements for the year ended December 31, 2010 (including comparatives for the years ended December 31, 2009 and 2008) were approved and authorized for issue by the BOD on March 14, 2011.

2. Basis of Preparation

Basis of Measurement

The consolidated financial statements of the Group have been prepared on a historical cost basis of accounting, except for financial assets at fair value through profit or loss (FVPL), available-for-sale (AFS) financial assets, and derivative financial instruments, which are measured at fair value.

Functional and Presentation Currency

The consolidated financial statements are presented in Philippine peso, which is the Parent Company's functional currency. All values are rounded off to the nearest million (P000,000), except when otherwise indicated.

Statement of Compliance

The consolidated financial statements have been prepared in compliance with Philippine Financial Reporting Standards (PFRS). PFRS includes statements named PFRS and Philippine Accounting Standards (PAS) and Philippine Interpretations from International Financial Reporting Interpretations Committee (IFRIC), issued by the Financial Reporting Standards Council (FRSC).

Basis of Consolidation

The consolidated financial statements include the accounts of the Parent Company and its subsidiaries. These subsidiaries are:

Name of Subsidiary	Percentage of Ownership		Country of Incorporation
	2010	2009	
Overseas Ventures Insurance Corporation (Ovincor)	100.00	100.00	Bermuda
Petrogen Insurance Corporation (Petrogen)	100.00	100.00	Philippines
Petron Freeport Corporation (PFC)	100.00	100.00	Philippines
Petron Singapore Trading Pte., Ltd. (PSTPL)	100.00	-	Singapore
Petron Marketing Corporation (PMC)	100.00	100.00	Philippines
New Ventures Realty Corporation (NVRC) and Subsidiary	40.00	40.00	Philippines

On May 13, 2010, the Parent Company incorporated PSTPL in Singapore. PSTPL has an initial capitalization of Singapore Dollar 1 million and will handle crude, ethanol, catalysts and additives procurement, crude vessel chartering and commodity risk management. PSTPL started commercial operations on July 19, 2010.

A subsidiary is an entity controlled by the Group. Control exists when the Group has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefit from its activities. In assessing control, potential voting rights that are presently exercisable or convertible are taken into account. The financial statements of the subsidiaries are included in the consolidated financial statements from the date when the Group obtains control, and continue to be consolidated until the date when such control ceases.

The consolidated financial statements are prepared for the same reporting period as the Parent Company, using uniform accounting policies for like transactions and other events in similar circumstances. Intergroup balances and transactions, including intergroup unrealized profits and losses, are eliminated in preparing the consolidated financial statements.

Non-controlling interests represent the portion of profit or loss and net assets not held by the Group and are presented in the consolidated statement of financial position, separately from equity attributable to equity holders of the Parent Company.

Non-controlling interests represent the interests not held by the Group in NVRC.

3. Summary of Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements, and have been applied consistently by the Group, except for the changes in accounting policies as explained below.

Certain comparative amounts have been reclassified to conform to the current year's presentation (Note 39).

Adoption of New or Revised Standards, Amendments to Standards and Interpretations
The FRSC approved the adoption of a number of new or revised standards, amendments to standards, and interpretations [based on IFRIC Interpretations] as part of PFRSs.

Adopted Effective 2010
The Group has adopted the following PFRSs starting January 1, 2010:

- Amendments to PAS 39, *Financial Instruments: Recognition and Measurement - Eligible Hedged Items,* provide for the following: a) new application guidance to clarify the existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedge relationship; and b) additional application guidance on qualifying items, assessing hedge effectiveness, and designation of financial items as hedged items. The amendments are effective for annual periods beginning on or after July 1, 2009. The adoption of these amendments to standards did not have a material effect on the consolidated financial statements.

- *Improvements to PFRSs 2008* - Amendments to PFRS 5, *Noncurrent Assets Held for Sale and Discontinued Operations*, specify that if an entity is committed to a plan to sell a subsidiary, then it would classify all of that subsidiary's assets and liabilities as held for sale when the held for sale criteria in paragraphs 6 to 8 of PFRS 5 are met. This applies regardless of the entity retaining an interest (other than control) in the subsidiary. Disclosures for discontinued operations are required by the parent when a subsidiary meets the definition of a discontinued operation. The amendments are effective for annual periods beginning on or after July 1, 2009. The new criteria discussed in the amendments to PFRS 5 was taken into consideration when the Group determined its assets held for sale and discontinued operations (Note 5).

- Amendments to PFRS 2, *Share-based Payment*: *Group Cash-settled Share-based Payment Transactions*, clarify the scope of PFRS 2, that an entity that receives goods or services in a share-based payment arrangement must account for those goods or services no matter which entity in the group settles the transaction, and regardless of whether the transaction is equity-settled or cash-settled; and the interaction of PFRS 2 and other standards, that in PFRS 2, a "group" has the same meaning as in PAS 27, *Consolidated and Separate Financial Statements*, that is, it includes only a parent and its subsidiaries. The amendments are effective for annual periods beginning on or after January 1, 2010. The adoption of these amendments to standards did not have a material effect on the consolidated financial statements.

- *Improvements to PFRSs 2009,* contain 15 amendments to 12 standards. The improvements are generally effective for annual periods beginning on or after January 1, 2010. The following are the said improvements or amendments to PFRSs, none of which has a significant effect on the consolidated financial statements of the Group:

  - PAS 1, *Presentation of Financial Statements*. The amendments clarify that the classification of the liability component of a convertible instrument as current or non-current is not affected by terms that could, at the option of the holder of the instrument, result in settlement of the liability by the issue of equity instruments.
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  - PAS 7, *Statement of Cash Flows*. The amendments clarify that only expenditures that result in the recognition of an asset can be classified as a cash flow from investing activities.

- PAS 17, *Leases*. The IASB deleted guidance stating that a lease of land with an indefinite economic life normally is classified as an operating lease, unless at the end of the lease term title is expected to pass to the lessee. The amendments clarify that when a lease includes both the land and building elements, an entity should determine the classification of each element based on paragraphs 7 - 13 of PAS 17, taking account of the fact that land normally has an indefinite economic life.

- PAS 36, *Impairment of Assets*. The amendments clarify that the largest unit to which goodwill should be allocated is the operating segment level as defined in PFRS 8 before applying the aggregation criteria of PFRS 8.

- PAS 38, *Intangible Assets*. The amendments clarify that: (i) an intangible asset that is separable only together with a related contract, identifiable asset or liability is recognized separately from goodwill together with the related item; and (ii) complementary intangible assets with similar useful lives may be recognized as a single asset. The amendments also describe valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination for which no active market exists.

- PAS 39, *Financial Instruments: Recognition & Measurement*. The amendments provide: (i) additional guidance on determining whether loan prepayment penalties result in an embedded derivative that needs to be separated; (ii) clarify that the scope exemption in PAS 39 paragraph 2(g) is restricted to forward contracts, i.e. not options, between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination at a future acquisition date within a reasonable period normally necessary to obtain any required approvals and to complete the transaction; and (iii) clarify that the gains or losses on a cash flow hedge should be reclassified from other comprehensive income to profit or loss during the period that the hedged forecast cash flows impact profit or loss.

- PFRS 2, *Share-Based Payment* and PFRS 3, *Business Combinations* (Revised 2008). The amendments clarify that business combinations as defined in PFRS 3 (2008) are outside the scope of PFRS 2, notwithstanding that they may be outside the scope of PFRS 3 (2008). Therefore business combinations among entities under common control and the contribution of a business upon the formation of a joint venture will not be accounted for under PFRS 2.

- PFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations*. The amendments clarify that the required disclosures for non-current assets (or disposal groups) classified as held for sale or discontinued operations are specified in PFRS 5.

- PFRS 8, *Operating Segments*. The amendments clarify that segment information with respect to total assets is required only if such information is regularly reported to the chief operating decision maker.

- Philippine Interpretation IFRIC 9, *Reassessment of Embedded Derivatives*. The IASB amended the scope of IFRIC 9 so that embedded derivatives in contracts acquired in business combinations as defined in PFRS 3 (2008), joint venture formations and common control transactions remain outside the scope of IFRIC 9.

- Philippine Interpretation IFRIC 16, *Hedges of a Net Investment in a Foreign Operation*. The amendments remove the restriction that prevented a hedging instrument from being held by a foreign operation that itself is being hedged.

▪ Philippine Interpretation of IFRIC 17, *Distributions of Non-cash Assets to Owners*, provides guidance on the accounting for non-reciprocal distributions of non-cash assets to owners acting in their capacity as owners. It also applies to distributions in which the owners may elect to receive either the non-cash asset or a cash alternative. The liability for the dividend payable is measured at the fair value of the assets to be distributed. The interpretation is effective for annual periods beginning on or after July 1, 2009. The adoption of this Philippine Interpretations of IFRIC did not have a material effect on the consolidated financial statements.

Additional disclosures required by the revised standards and improvements were included in the consolidated financial statements, where applicable.

New or Revised Standards, Amendments to Standards and Interpretations Not Yet Adopted

A number of new or revised standards, amendments to standards and interpretations are effective for annual periods beginning after January 1, 2010, and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group, except for PFRS 9 *Financial Instruments*, which becomes mandatory for the Group's 2013 consolidated financial statements and could change the classification and measurement of financial assets. The Group does not plan to adopt this standard early and the extent of the impact has not been determined.

The Group will adopt the following new or revised standards, amendments to standards and interpretations in the respective effective dates:

To be Adopted on January 1, 2011

▪ *Prepayments of a Minimum Funding Requirement (Amendments to Philippine Interpretation IFRIC 14: PAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction)*. These amendments remove unintended consequences arising from the treatment of prepayments where there is a minimum funding requirement and result in prepayments of contributions in certain circumstances being recognized as an asset rather than an expense. The amendments are effective for annual periods beginning on or after January 1, 2011.

▪ Revised PAS 24, *Related Party Disclosures* (2009), amends the definition of a related party and modifies certain related party disclosure requirements for government-related entities. The revised standard is effective for annual periods beginning on or after January 1, 2011.

▪ *Improvements to PFRSs 2010* contain 11 amendments to 6 standards and 1 interpretation. The amendments are generally effective for annual periods beginning on or after January 1, 2011. The following are the said improvements or amendments to PFRSs which the Group did not early adopt. None of these is expected to have a significant effect on the consolidated financial statements of the Group.

- PAS 1, *Presentation of Financial Statements*. The amendments clarify that disaggregation of changes in each component of equity arising from transactions recognized in other comprehensive income also is required to be presented either in the statement of changes in equity or in the notes. The amendments are effective for annual periods beginning on or after January 1, 2011. Early application is permitted.

- PAS 27, *Consolidated and Separate Financial Statements*. The amendments clarify that the consequential amendments to PAS 21, *The Effects of Changes in Foreign Exchange Rates*, PAS 28, *Investments in Associates*, and PAS 31, *Interest in Joint Ventures* resulting from PAS 27 (2008) should be applied prospectively, with the exception of amendments resulting from renumbering. The amendments are effective for annual periods beginning on or after July 1, 2010. Early application is permitted.

- PAS 34, *Interim Financial Reporting*. The amendments add examples to the list of events or transactions that require disclosure under PAS 34 and remove references to materiality in PAS 34 that describes other minimum disclosures. The amendments are effective for annual periods beginning on or after January 1, 2011. Early application is permitted and is required to be disclosed.

- PFRS 1, *First-time Adoption of PFRSs*. The amendments: (i) clarify that PAS 8 is not applicable to changes in accounting policies occurring during the period covered by an entity's first PFRS financial statements; (ii) introduce guidance for entities that publish interim financial information under PAS 34, *Interim Financial Reporting* and change either their accounting policies or use of the PFRS 1 exemptions during the period covered by their first PFRS financial statements; (iii) extend the scope of paragraph D8 of PFRS 1 so that an entity is permitted to use an event-driven fair value measurement as deemed cost for some or all of its assets when such revaluation occurred during the reporting periods covered by its first PFRS financial statements; and (iv) introduce an additional optional deemed cost exemption for entities to use the carrying amounts under previous GAAP as deemed cost at the date of transition to PFRSs for items of property, plant and equipment or intangible assets used in certain rate-regulated activities. The amendments are effective for annual periods beginning on or after January 1, 2011. Early application is permitted and is required to be disclosed.

- PFRS 3, *Business Combinations*. The amendments: (i) clarify that contingent consideration arising in a business combination previously accounted for in accordance with PFRS 3 (2004) that remains outstanding at the adoption date of PFRS 3 (2008) continues to be accounted for in accordance with PFRS 3 (2004); (ii) limit the accounting policy choice to measure non-controlling interests upon initial recognition at fair value or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets to instruments that give rise to a present ownership interest and that currently entitle the holder to a share of net assets in the event of liquidation; and (iii) expand the current guidance on the attribution of the market-based measure of an acquirer's share-based payment awards issued in exchange for acquiree awards between consideration transferred and post-combination compensation cost when an acquirer is obliged to replace the acquiree's existing awards to encompass voluntarily replaced unexpired acquiree awards. These amendments are effective for annual periods beginning on or after July 1, 2010. Early application is permitted and is required to be disclosed.

- PFRS 7, *Financial Instruments: Disclosures*. The amendments add an explicit statement that qualitative disclosure should be made in the context of the quantitative disclosures to better enable users to evaluate an entity's exposure to risks arising from financial instruments. In addition, the IASB amended and removed existing disclosure requirements. The amendments are effective for annual periods beginning on or after January 1, 2011. Early application is permitted and is required to be disclosed.

- Philippine Interpretation IFRIC 13, *Customer Loyalty Programmes*. The amendments clarify that the fair value of award credits takes into account the amount of discounts or incentives that otherwise would be offered to customers that have not earned the award credits. These amendments are effective for annual periods beginning on or after January 1, 2011. Early application is permitted and is required to be disclosed.

▪ Philippine Interpretation IFRIC 19, *Extinguishing Financial Liabilities with Equity Instruments*, addresses issues in respect of the accounting by the debtor in a debt for equity swap transaction. It clarifies that equity instruments issued to a creditor to extinguish all or part of a financial liability in a debt for equity swap are consideration paid in accordance with PAS 39 paragraph 41. The interpretation is applicable for annual periods beginning on or after July 1, 2010.

To be Adopted on January 1, 2012

▪ *Disclosures - Transfers of Financial Assets (Amendments to PFRS 7)*, require additional disclosures about transfers of financial assets. The amendments require disclosure of information that enables users of financial statements to understand the relationship between transferred financial assets that are not derecognized in their entirety and the associated liabilities; and to evaluate the nature of, and risks associated with, the entity's continuing involvement in derecognized financial assets. Entities are required to apply the amendments for annual periods beginning on or after July 1, 2011. Earlier application is permitted. Entities are not required to provide the disclosures for any period that begins prior to July 1, 2011.

▪ Philippine Interpretation IFRIC 15, *Agreements for the Construction of Real Estate*, applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. It provides guidance on the recognition of revenue among real estate developers for sales of units, such as apartments or houses, "off plan"; i.e., before construction is completed. It also provides guidance on how to determine whether an agreement for the construction of real estate is within the scope of PAS 11, *Construction Contracts*, or PAS 18, *Revenue*, and the timing of revenue recognition. The interpretation is effective for annual periods beginning on or after January 1, 2012.

To be Adopted on January 1, 2013

▪ PFRS 9, *Financial Instruments* (2009) was issued as the first phase of the PAS 39 replacement project. The chapters of the standard released in 2009 only related to the classification and measurement of financial assets. PFRS 9 (2009) retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on the entity's business model and contractual cash flow characteristics of the financial asset. In October 2010, a new version of PFRS 9 *Financial Instruments* (2010) was issued which now includes all the requirements of PFRS 9 (2009) without amendment. The new version of PFRS 9 also incorporates requirements with respect to the classification and measurement of financial liabilities and the derecognition of financial assets and financial liabilities. The guidance in PAS 39 on impairment of financial assets and hedge accounting continues to apply. The new standard is effective for annual periods beginning on or after January 1, 2013. Earlier application is permitted. PFRS 9 (2010) supersedes PFRS 9 (2009). However, for annual periods beginning before January 1, 2013, an entity may elect to apply PFRS 9 (2009) rather than PFRS 9 (2010).

The Group will assess the impact of the new or revised standards, amendments to standards and interpretations on the consolidated financial statements upon adoption.

Financial Assets and Financial Liabilities

Date of Recognition. The Group recognizes a financial asset or a financial liability in the consolidated statement of financial position when it becomes a party to the contractual provisions of the instrument. In the case of a regular way purchase or sale of financial assets, recognition is done using settlement date accounting.

Initial Recognition of Financial Instruments. Financial instruments are recognized initially at 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 and loss (FVPL), includes transaction costs.

The Group classifies its financial assets in the following categories: held-to-maturity (HTM) investments, available for sale (AFS) financial assets, financial assets at FVPL and loans and receivables. The Group classifies its financial liabilities as either FVPL financial liabilities or other financial liabilities. 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 every reporting date.

Determination of Fair Value. The fair value for financial instruments traded in active markets at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and ask prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there is no significant change in economic circumstances since the time of the transaction.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include the discounted cash flow method, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

Day 1 Profit. Where the transaction price in a non-active market is different from the fair value of the 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 profit or loss unless it qualifies for recognition as some other type of asset. In cases where use is made of data which are 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.

Financial Assets

Financial Assets at FVPL. A financial asset is classified at FVPL if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at FVPL if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group's documented risk management or investment strategy. Derivative instruments (including embedded derivatives), except those covered by hedge accounting relationships, are classified under this category.

Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term.

Financial assets may be designated by management at initial recognition as at FVPL when any of the following criteria is met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on a different basis;

- the assets are part of a group of financial assets which are managed and their performances are evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or

- the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recognized.

The Group uses commodity price swaps to protect its margin on petroleum products from potential price volatility of international crude and product prices. It also enters into short-term forward currency contracts to hedge its currency exposure on crude oil importations. In addition, the Company has identified and bifurcated embedded foreign currency derivatives from certain non-financial contracts.

Derivative instruments are initially recognized at fair value on the date in which a derivative transaction is entered into or bifurcated, and are subsequently re-measured at fair value. Derivatives are presented in the separate statement of financial position as assets when the fair value is positive and as liabilities when the fair value is negative. Gains and losses from changes in fair value of these derivatives are recognized under the caption marked-to-market gains (losses) included as part of "Other Income (Expenses)" in the separate statement of comprehensive income.

The fair values of freestanding and bifurcated forward currency transactions are calculated by reference to current exchange rates for contracts with similar maturity profiles. The fair values of commodity swaps are determined based on quotes obtained from counterparty banks.

The Group's financial assets at FVPL and derivative assets are included in this category.

The carrying values of financial assets under this category amounted to P227 and P208 as of December 31, 2010 and 2009, respectively (Note 7).

Loans and Receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments and maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not designated as AFS financial assets or financial assets at FVPL.

Subsequent to initial measurement, loans and receivables are carried at amortized cost using the effective interest rate method, less any impairment in value. Any interest earned on loans and receivables shall be recognized as part of "Interest income" in profit or loss on an accrual basis. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are integral part of the effective interest rate. The periodic amortization is also included as part of "Interest income" in the consolidated statement of income. Gains or losses are recognized in profit or loss when loans and receivables are derecognized or impaired, as well as through the amortization process.

Cash includes cash on hand and in banks which are stated at face value. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

The Group's cash and cash equivalents, trade and other receivables, due from affiliates and long-term receivables are included in this category (Notes 6, 9 and 14).

The combined carrying values of financial assets under this category amounted to P90,819 and P42,870 as of December 31, 2010 and 2009, respectively (Note 34).

HTM Investments. HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Group's management has the positive intention and ability to hold to maturity. Where the Group sells other than an insignificant amount of HTM investments, the entire category would be tainted and classified as AFS financial assets. After initial measurement, these investments are measured at amortized cost using the effective interest rate method, less impairment in value. Any interest earned on the HTM investments shall be recognized as part of "Interest income" in the consolidated statement of income on an accrual basis. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are integral part of the effective interest rate. The periodic amortization is also included as part of "Interest income" in the consolidated statement of income. Gains or losses are recognized in profit or loss when the HTM investments are derecognized or impaired, as well as through the amortization process.

As of December 31, 2010 and 2009, the Group has no investments accounted for under this category.

AFS Financial Assets. AFS financial assets are non-derivative financial assets that are either designated in this category or not classified under any of the other financial asset categories. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses and foreign currency differences on AFS debt instruments, are recognized in other comprehensive income and presented in the "Other reserves" in equity. The effective yield component of AFS debt securities, as well as the impact of restatement on foreign currency-denominated AFS investment securities, is reported as part of "Interest income" in the consolidated statement of income. The unrealized gains and losses arising from the changes in fair value of AFS financial assets, net of tax, are excluded from profit or loss and are recognized as other comprehensive income reported in the consolidated statement of comprehensive income and in the consolidated statement of changes in equity under "Other Reserves" account. Any interest earned on AFS debt securities shall be recognized as part of "Interest income" in the consolidated statement of income on an accrual basis. Dividends earned on holding AFS equity securities are recognized as "Dividend income" when the right of collection has been established. When individual AFS financial assets are either derecognized or impaired, the related accumulated unrealized gains or losses previously reported in equity are transferred to and recognized in profit or loss.

Where the Group holds more than one investment in the same security, these are deemed to be disposed on a first-in, first-out basis. Interest and dividends earned on holding AFS financial assets are recognized in "Other Income" account in the consolidated statement of income when the right to receive payment has been established. The losses arising from impairment of such investments are recognized as impairment losses in profit or loss.

AFS financial assets also include unquoted equity instruments with fair values which cannot be reliably determined. These instruments are carried at cost less impairment in value, if any. The Group's investments in debt are classified under this category.

The carrying values of financial assets under this category amounted to P1,161 and P1,355 as of December 31, 2010 and 2009, respectively (Note 8).

Financial Liabilities

Financial Liabilities at FVPL. Financial liabilities are classified under this category through the fair value option. Derivative instruments (including embedded derivatives) with negative fair values are also classified under this category.

The Group carries financial liabilities at FVPL using their fair values and reports fair value changes in the consolidated statement of income.

The carrying values of financial liabilities under this category amounted to P30 and P1 as of December 31, 2010 and 2009, respectively (Note 34).

Other Financial Liabilities. This category pertains to financial liabilities that are not designated or classified as at FVPL. After initial measurement, other financial liabilities are carried at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into account any premium or discount and any directly attributable transaction costs that are considered an integral part of the effective interest rate of the liability.

Included in this category are the Group's liabilities arising from its short term loans, liabilities for crude oil and petroleum product importation, trade and other payables, long-term debt, cash bond, cylinder deposits and other noncurrent liabilities (Notes 15, 16, 17 and 19).

The combined carrying values of financial liabilities under this category amounted to P104,843 and P73,743 as of December 31, 2010 and 2009, respectively (Note 34).

Debt Issue Costs

Debt issue costs are considered as an adjustment to the effective yield of the related debt and are deferred and amortized using the effective interest rate method. When a loan is paid, the related unamortized debt issue costs at the date of repayment are charged against current operations.

Embedded Derivatives

The Group assesses whether embedded derivatives are required to be separated from host contracts when the Group becomes a party to the contract.

An embedded derivative is separated from the host contract and accounted for as a derivative if all of the following conditions are met: a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract; b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and c) the hybrid or combined instrument is not recognized at FVPL. 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.

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 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 a third party under a "pass-through" arrangement.
- 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 the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset 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 is discharged, cancelled or expired. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognized in profit or loss.

Impairment of Financial Assets
The Group assesses at reporting date whether a financial asset or group of financial assets is impaired.

A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

Assets Carried at Amortized Cost. For assets carried at amortized cost such as loans and receivables, the Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If no objective evidence of impairment has been identified for a particular financial asset that was individually assessed, the Group includes the asset as part of a group of financial assets pooled according to their credit risk characteristics and collectively assesses the group for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in the collective impairment assessment.

Evidence of impairment for specific impairment purposes may include indications that the borrower or a group of borrowers is experiencing financial difficulty, default or delinquency in principal or interest payments, or may enter into bankruptcy or other form of financial reorganization intended to alleviate the financial condition of the borrower. For collective impairment purposes, evidence of impairment may include observable data on existing economic conditions or industry-wide developments indicating that there is a measurable decrease in the estimated future cash flows of the related assets.

If there is objective evidence of impairment, 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) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). Time value is generally not considered when the effect of discounting the cash flows is not material. If a loan or receivable has a variable rate, the discount rate for measuring any impairment loss is the current effective interest rate, adjusted for the original credit risk premium. For collective impairment purposes, impairment loss is computed based on their respective default and historical loss experience.

The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The impairment loss for the period shall be recognized in profit or loss. 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 profit or loss, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

AFS Financial Assets. If an AFS financial asset is impaired, an amount comprising the difference between the cost (net of any principal payment and amortization) and its current fair value, less any impairment loss on that financial asset previously recognized in profit or loss, is transferred from equity to profit or loss. Reversals in respect of equity instruments classified as AFS financial assets are not recognized in profit or loss. Reversals of impairment losses on debt instruments are recognized in profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in profit or loss.

In the case of an unquoted equity instrument or of a derivative asset linked to and must be settled by delivery of an unquoted equity instrument, for which its fair value cannot be reliably measured, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows from the asset discounted using its historical effective rate of return on the asset.

Classification of Financial Instruments Between Debt and Equity

From the perspective of the issuer, a financial instrument is classified as debt instrument if it provides for a contractual obligation to:

- deliver cash or another financial asset to another entity
- exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Group
- satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares

If the Group does not have an unconditional right to avoid delivering cash or another financial asset to settle its contractual obligation, the obligation meets the definition of a financial liability.

Offsetting Financial Instruments

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

Inventories

Inventories are carried at the lower of cost and net realizable value. For petroleum products, crude oil, and tires, batteries and accessories (TBA), the net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs to complete and/or market and distribute. For materials and supplies, net realizable value is the current replacement cost.

For financial reporting purposes, Petron uses the first-in, first-out method in costing petroleum products (except lubes and greases, waxes and solvents), crude oil, and other products. Cost is determined using the moving-average method in costing lubes and greases, waxes and solvents, TBA, materials and supplies inventories. For income tax reporting purposes, cost of all inventories is determined using the moving-average method.

For financial reporting purposes, duties and taxes related to the acquisition of inventories are capitalized as part of inventory cost. For income tax reporting purposes, such duties and taxes are treated as deductible expenses in the year these charges are incurred.

Transactions under Common Control

Transactions under common control entered into in contemplation of each other, and business combination under common control designed to achieve an overall commercial effect are treated as a single transaction.

Transfers of assets between commonly controlled entities are accounted for using the book value accounting.

Non-controlling Interests

For acquisitions of non-controlling interests on or after January 1, 2010, the acquisitions are accounted for as transactions with owners in their capacity as owners and therefore no goodwill is recognized as a result of such transactions. Any difference between the purchase price and the net assets of acquired entity is recognized in equity. The adjustments to non-controlling interests are based on a proportionate amount of the net assets of the subsidiary.

Investment in Associates

The Group's investment in associates are accounted for under the equity method of accounting. An associate is an entity in which the Group has significant influence and which is neither a subsidiary nor a joint venture. Significant influence is presumed to exist when the Group holds between 20 and 50 percent of the voting power of another entity.

Under the equity method, the investment in an associate is initially recognized at cost and the carrying amount is increased or decreased to recognize the Group's share of the profit or loss of the associate after the date of acquisition. The Group's share of the profit or loss of the associate is recognized in the Group's profit or loss. Distributions received from an associate reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the Group's proportionate interest in the associate arising from changes in the associate's other comprehensive income. Such changes include those arising from the revaluation of property, plant and equipment and from foreign exchange translation differences. The Group's share of those changes is recognized in other comprehensive income.

Goodwill relating to an associate is included in the carrying amount of the investment and is not amortized.

After application of the equity method, the Group determines whether it is necessary to recognize any additional impairment loss with respect to the Group's net investment in the associate. The consolidated statements of income include the Group's share of the total recognized earnings and losses of the associate on an equity accounted basis, from the date that significant influence commences until the date that significant influence ceases. Adjustments to the carrying amount may also be necessary for changes in the Group's proportionate interest in the associate arising from changes in the associate's other comprehensive income. The Group's share of those changes is recognized in other comprehensive income. Profits and losses resulting from transactions between the Group and the associate are eliminated to the extent of the interest in the associate.

An investment in an associate is accounted for using the equity method from the date when it becomes an associate. Upon acquisition of the investment, any difference between the cost of the investment and the investor's share in the net fair value of the associate's identifiable assets, liabilities and contingent liabilities is accounted for in accordance with PFRS 3, *Business Combinations*. Consequently:

a. goodwill that forms part of the carrying amount of an investment in an associate is not recognized separately, and therefore is not tested for impairment separately. Instead, the entire amount of the investment in an associate is tested for impairment as a single asset when there is objective evidence that the investment in an associate may be impaired.

b. any excess of the Group's share in the net fair value of the associate's identifiable assets, liabilities and contingent liabilities over the cost of the investment is excluded from the carrying amount of the investment and is instead included as income in the determination of the Group's share in the associate's profit or loss in the period in which the investment is acquired.

The Group discontinues applying the equity method when its investment in an associate is reduced to zero. Additional losses are provided only to the extent that the Group has incurred obligations or made payments on behalf of the associate to satisfy obligations of the associate that the Group has guaranteed or otherwise committed. If the associate subsequently reports profits, the Group resumes applying the equity method only after its share of the profits equals the share of net losses not recognized during the period the equity method was suspended.

The financial statements of the associates are prepared for the same reporting period as the Parent Company. The accounting policies of the associates conform to those used by the Group for like transactions and events in similar circumstances.

Interest in a Joint Venture

The Group's 33.33% joint venture interest in Pandacan Depot Services, Inc. (PDSI), included under "Other Noncurrent Assets" account in the consolidated statement of financial position, incorporated on September 29, 2004 under the laws of the Republic of the Philippines, is accounted for under the equity method of accounting. The interest in joint venture is carried in the consolidated statement of financial position at cost plus post-acquisition changes in the Group's share in net income (loss) of the joint venture, less any impairment in value. The consolidated statement of income reflects the Group's share in the results of operations the joint venture presented as part of "Other Income (Expenses) - Miscellaneous" account (Note 25). The Group has no capital commitments or contingent liabilities in relation to its interest in this joint venture.

Results of operations as well as financial position balances of PDSI were less than 1% of the consolidated values and as such are assessed as not material; hence, not separately disclosed.

Property, Plant and Equipment

Property, plant and equipment, except land, are stated at cost less accumulated depreciation and amortization and any accumulated impairment in value. Such cost includes the cost of replacing part of the property, plant and equipment at the time that cost is incurred, if the recognition criteria are met, and excludes the costs of day-to-day servicing. Land is stated at cost less any impairment in value.

The initial cost of property, plant and equipment comprises its construction cost or purchase price, including import duties, taxes and any directly attributable costs in bringing the asset to its working condition and location for its intended use. Cost also includes any related asset retirement obligation and interest incurred during the construction period on funds borrowed to finance the construction of the projects. Expenditures incurred after the asset has been put into operation, such as repairs, maintenance and overhaul costs, are normally recognized as expense in the period the costs are incurred. Major repairs are capitalized as part of property, plant and equipment only when it is probable that future economic benefits associated with the items will flow to the Group and the cost of the items can be measured reliably.

Construction in progress represents structures under construction and is stated at cost. This includes the costs of construction and other direct costs. Borrowing costs that are directly attributable to the construction of plant and equipment are capitalized during the construction period. Construction in progress is not depreciated until such time that the relevant assets are ready for use.

For financial reporting purposes, duties and taxes related to the acquisition of property, plant and equipment are capitalized. For income tax reporting purposes, such duties and taxes are treated as deductible expenses in the year these charges are incurred.

Depreciation and amortization are computed using the straight-line method over the following estimated useful lives of the assets:

For financial reporting purposes, depreciation and amortization are computed using the straight-line method over the estimated useful lives of the following assets:

	Number of Years
Building and related facilities	2 - 25
Refinery and plant equipment	5 - 16
Service stations and other equipment	1 1/2 - 10
Computers, office and motor equipment	2 - 10
Leasehold improvements	10 or the term of the lease, whichever is shorter

The remaining useful lives, residual values, depreciation and amortization method are reviewed and adjusted, if appropriate, periodically to ensure that such periods and method of depreciation and amortization are consistent with the expected pattern of economic benefits from the items of property, plant and equipment.

For income tax reporting purposes, depreciation and amortization are computed using the double-declining balance method.

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Fully depreciated assets are retained in the accounts until they are no longer in use and no further depreciation and amortization are credited or charged to current operations.

An item of property, plant and equipment is derecognized when either it has been disposed of or when it is permanently withdrawn from use and no future economic benefits are expected from its use or disposal. Any gain or loss arising on the retirement and disposal of an item of property, plant and equipment (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss in the period of retirement or disposal.

Investment Properties

Investment properties consist of properties held to earn rentals and/or for capital appreciation. Investment properties, except land, are stated at cost less accumulated depreciation and any impairment in value. Cost includes acquisition costs and directly attributable costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met and excludes the costs of day-to-day servicing of an investment property. Land is carried at cost less any impairment in value.

For financial reporting purposes, depreciation of office units is computed on straight-line basis over the estimated useful lives of the assets of 20 years. For income tax reporting purposes, depreciation is computed using the double-declining balance method. The residual values, useful lives and method of depreciation and amortization of the assets are reviewed and adjusted, if appropriate, at each financial year-end.

Investment property is derecognized either when it has been disposed of or when it is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains and losses on the retirement and disposal of investment property are recognized in profit or loss in the period of retirement or disposal.

Transfers are made to investment property when, and only when, there is a change in use, evidenced by ending of owner-occupation or commencement of an operating lease to another party. Transfers are made from investment property when, and only when, there is a change in use, evidenced by commencement of the owner-occupation or commencement of development with a view to sale.

For a transfer from investment property to owner-occupied property or inventories, the cost of property for subsequent accounting is its carrying value at the date of change in use. If the property occupied by the Group as an owner-occupied property becomes an investment property, the Group accounts for such property in accordance with the policy stated under property, plant and equipment up to the date of change in use.

Cylinder Deposits

The LPG cylinders remain the property of the Group and are loaned to dealers upon payment by the latter of an equivalent 100% of the acquisition cost of the cylinders.

The Group maintains the balance of cylinder deposits at an amount equivalent to three days worth of inventory of its biggest dealers, but in no case lower than P200 at any given time, to take care of possible returns by dealers.

At the end of each reporting period, cylinder deposits, shown under "Other Noncurrent Liabilities" account in the consolidated statement of financial position, are reduced for estimated non-returns. The reduction is credited directly to profit or loss.

Intangible Assets

Intangible assets acquired separately are measured on initial recognition at cost. Subsequently, intangible assets are measured at cost less accumulated amortization and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite.

Intangible assets with finite lives are amortized over the useful life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method used for an intangible asset with a finite useful life are reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortization period or method, as appropriate, and are treated as changes in accounting estimates. The amortization expense on intangible assets with finite lives is recognized in profit or loss consistent with the function of the intangible asset.

Amortization is computed using the straight-line method over 5 to 10 years upon commencement of commercial operations.

Gains or losses arising from disposal of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognized in profit or loss when the asset is derecognized.

As of December 31, 2010 and 2009, the Group has existing and pending trademark registration for its products for a term of 10 to 20 years. It also has copyrights for its 7-kg LPG container, Gasulito with stylized letter "P" and two flames, for Powerburn 2T, and for Petron New Logo (22 styles). Copyrights endure during the lifetime of the creator and for another 50 years after creator's death.

The amount of intangible assets is included under the caption of Others in the "Other Noncurrent Assets" in the consolidated statement of financial position.

Expenses incurred for research and development of internal projects and internally developed patents and copyrights are expensed as incurred and classified under the caption of Others under "Selling and Administrative Expenses" account in the consolidated statement of income (Note 22).

Impairment of Non-financial Assets

The carrying values of property, plant and equipment, investment properties and intangible assets with useful finite lives are reviewed for impairment when events or changes in circumstances indicate that the carrying values may not be recoverable. If any such indication exists, and if the carrying value exceeds the estimated recoverable amount, the assets or cash-generating units are written down to their recoverable amounts. The recoverable amount of the asset is the greater of fair value less costs to sell or value in use. The fair value less costs to sell is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less costs of disposal. 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. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. 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.

An assessment is made at each reporting 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 depreciation and amortization, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in profit or loss. After such a reversal, the depreciation and amortization 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.

Provisions

Provisions are recognized when the Group has: a) a present obligation (legal or constructive) as a result of past event; b) it is probable (i.e., more likely than not) 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 the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax 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 the passage of time is recognized as interest expense. Where the Group expects a provision to be reimbursed, the reimbursement is recognized as a separate asset but only when the receipt of the reimbursement is virtually certain. Provisions are reviewed at each reporting date and adjusted to reflect the current best estimate.

The Group recognizes provisions arising from legal and/or constructive obligations associated with cost of dismantling and removing an item of property, plant and equipment and restoring the site where it is located, the obligation for which the Group incurs either when the asset is acquired or as a consequence of having used the asset during a particular year for purposes other than to produce inventories during the year. Asset retirement obligation (ARO) is presented under Note 18.

Capital Stock

Common Shares

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

Preferred Shares

Preferred shares are classified as equity if it is non-redeemable, or redeemable only at the Parent Company's option, and any dividends are discretionary. Dividends thereon are recognized as distributions within equity upon approval by the Parent Company's BOD.

Preferred shares are classified as a liability if it is redeemable on a specific date or at the option of the shareholders, or if dividend payments are not discretionary. Dividends thereon are recognized as interest expense in profit or loss as accrued.

Revenue

Revenue is recognized to the extent that is probable that the economic benefits will flow to the Group and revenue can be reliably measured. The following specific criteria must also be met before revenue is recognized:

Sale of Goods. Revenue is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, title has transferred, selling price is fixed or determinable and collectibility of the selling price is reasonably assured.

Interest Income. Revenue is recognized as the interest accrues, taking into account the effective yield on the asset.

Rental Income. Revenue from investment properties is recognized on a straight-line basis over the term of the lease. Rent income is included as part of other income.

Dividend Income. Revenue is recognized when the Group's right as a shareholder to receive the payment is established.

Revenue is measured by reference to the fair value of the consideration received or receivable by the Group for goods supplied and services provided, excluding sales tax [or value-added tax (VAT)] except where:

- the sales tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the sales tax is recognized as part of the cost of acquisition of the asset or as part of the expense item as applicable; and,

- receivables and payables that are stated with the amount of sales tax included.

The net amount of sales tax recoverable from, or payable to, the taxation authority is included as part of "Trade and Other Receivables" or "Trade and Other Payables" account in the consolidated statement of financial position.

Cost and Expense Recognition

Costs and expenses are recognized upon receipt of goods, utilization of services or at the date they are incurred.

Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Group as Lessee. Finance leases which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased property, are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are reflected in profit or loss.

Leased asset is depreciated over its estimated useful life. However, if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term, the asset is depreciated over the shorter of the estimated useful life of the asset and the lease term.

Leases which do not transfer to the Group 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 profit or loss on a straight-line basis over the lease term. Associated costs such as maintenance and insurance are expensed as incurred.

Group as Lessor. Leases where the Group does not transfer substantially all the risks and benefits of ownership of the assets are classified as operating leases. Rent income from operating leases is recognized as income on a straight-line basis over the lease term. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized as an expense over the lease term on the same basis as rent income. Contingent rents are recognized as income in the period in which they are earned.

Borrowing Costs

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 recoverable amount, an impairment loss is recognized.

Employee Benefits

The Group has a tax qualified and fully funded defined benefit pension plan covering all permanent, regular, full-time employees administered by trustee banks. Retirement costs are actuarially determined using the projected unit credit method. This method reflects service rendered by employees up to the date of valuation and incorporates assumptions concerning employees' projected salaries. Retirement cost includes current service cost, interest cost, expected return on plan assets, amortization of unrecognized past service costs and effect of any curtailments or settlements. 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 plan, past service cost is recognized immediately as an expense. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting year exceed the greater of 10% of the present value of the defined benefit obligation or 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 defined benefit liability is the aggregate of the present value of the defined benefit obligation, reduced by past service costs 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 resulting asset is measured at the lower of such aggregate or the aggregate of cumulative unrecognized net actuarial losses and past service costs and the present value of any economic benefits available in the form of reductions in the future contributions to the plan.

If the asset is measured at the aggregate of cumulative unrecognized net actuarial losses and past service costs and the present value of any economic benefits available in the form of reductions in the future contributions to the plan, net actuarial losses of the current period and past service costs of the current period are recognized immediately to the extent that they exceed any reduction in the present value of those economic benefits. If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service costs of the current period are recognized immediately. Similarly, net actuarial gains of the current period after the deduction of past service costs of the current period exceeding any increase in the present value of the economic benefits stated above are recognized immediately if the asset is measured at the aggregate of cumulative unrecognized net actuarial losses and past service costs and the present value of any economic benefits available in the form of reductions in the future contributions to the plan. If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service costs of the current period are recognized immediately.

The Group has a corporate performance incentive program that aims to provide financial incentives for the employees, contingent on the achievement of the Group's annual business goals and objectives. The Group recognizes achievement of its business goals through key performance indicators (KPIs) which are used to evaluate performance of the organization. The Group recognizes the related expense when the KPIs are met, that is when the Group is contractually obliged to pay the benefits.

The Group also provides other benefits to its employees as follows:

Savings Plan. The Group established a Savings Plan wherein eligible employees may apply for membership and have the option to contribute 5% to 15% of their monthly base pay. The Group, in turn, contributes an amount equivalent to 50% of the employee-member's contribution. However, the Group's 50% share applies only to a maximum of 10% of the employee-member's contribution. The Savings Plan aims to supplement benefits upon employees' retirement and to encourage employee-members to save a portion of their earnings. The Group accounts for this benefit as a defined contribution pension plan and recognizes a liability and an expense for this plan as the expenses for its contribution fall due. The Group has no legal or constructive obligations to pay further contributions after payments of the equivalent employer-share. The accumulated savings of the employees plus the Group's share, including earnings, will be paid in the event of the employee's (a) retirement, (b) resignation after completing at least five years of continuous services, (c) death, or (d) involuntary separation not for cause.

Land/Home Ownership Plan. The Group established the Land/Home Ownership Plan, an integral part of the Savings Plan, to extend a one-time financial assistance to Savings Plan members in securing housing loans for residential purposes.

Foreign Currency

Foreign currency translations

Transactions in foreign currencies are translated to the respective functional currencies of Group entities at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the year, adjusted for effective interest and payments during the year, and the amortized cost in foreign currency translated at the exchange rate at the end of the year.

Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are retranslated to the functional currency at the exchange rate at the date that the fair value was determined. Non-monetary items in a foreign currency that are measured in terms of historical cost are translated using the exchange rate at the date of the transaction. Foreign currency differences arising on retranslation are recognized in profit or loss, except for differences arising on the retranslation of available-for-sale equity investments, a financial liability designated as a hedge of the net investment in a foreign operation that is effective, or qualifying cash flow hedges, which are recognized in other comprehensive income.

Foreign Operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, if any, are translated to Philippine peso at exchange rates at the reporting date. The income and expenses of foreign operations, excluding foreign operations in hyperinflationary economies, are translated to Philippine peso at exchange rates at the dates of the transactions.

Foreign currency differences are recognized in other comprehensive income, and presented in the foreign currency translation reserve ("Revaluation reserve") in equity. However, if the operation is a non-wholly-owned subsidiary, then the relevant proportionate share of the translation difference is allocated to the non-controlling interest. When a foreign operation is disposed of such that control, significant influence or joint control is lost, the cumulative amount in the translation reserve related to that foreign operation is reclassified to profit or loss as part of the gain or loss on disposal. When the Group disposes of only part of its interest in a subsidiary that includes a foreign operation while retaining control, the relevant proportion of the cumulative amount is reattributed to non-controlling interest. When the Group disposes of only part of its investment in an associate or joint venture that includes a foreign operation while retaining significant influence or joint control, the relevant proportion of the cumulative amount is reclassified to profit or loss.

When the settlement of a monetary item receivable from or payable to a foreign operation is neither planned nor likely in the foreseeable future, foreign exchange gains and losses arising from such a monetary item are considered to form part of a net investment in a foreign operation and are recognized in other comprehensive income, and presented in the "Other reserve" in equity.

Taxes

Current Tax. Current tax assets and liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at reporting date.

Deferred Tax. Deferred tax is provided using the liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes. Deferred tax liabilities are recognized for all taxable temporary differences, except:

- where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- with respect to taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognized for all deductible temporary differences, carryforward benefits of unused tax credits - Minimum Corporate Income Tax (MCIT) and unused tax losses - Net Operating Loss Carry Over (NOLCO), to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward benefits of MCIT and NOLCO can be utilized, except:

- where the deferred tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- with respect to deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred tax assets are recognized only to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilized.

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

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year 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 reporting date.

Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists 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.

Value Added Tax (VAT). Revenues, expenses and assets are recognized net of the amount of VAT, except:

- where the tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the tax is recognized as part of the cost of acquisition of the asset or as part of the expense item as applicable; and

- receivables and payables that are stated with the amount of tax included.

The net amount of tax recoverable from, or payable to, the taxation authority is included as part of receivables or payables in the consolidated statement of financial position.

Assets Held for Sale

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale or distribution rather than through continuing use, are classified as held for sale or distribution. Immediately before classification as held for sale or distribution, the assets, or components of a disposal group, are remeasured in accordance with the Group's accounting policies. Thereafter, the assets or disposal groups are generally measured at the lower of their carrying amount and fair value less costs to sell. Any impairment loss on a disposal group first is allocated to goodwill, and then to remaining assets and liabilities on pro rata basis, except that no loss is allocated to inventories, financial assets, deferred tax assets, employee benefit assets, investment property, which continue to be measured in accordance with the Group's accounting policies. Impairment losses on initial classification as held for sale or distribution and subsequent gains and losses on remeasurement are recognized in profit or loss. Gains are not recognized in excess of any cumulative impairment loss.

Intangible assets, investment property, and property, plant and equipment once classified as held for sale or distribution are not amortized or depreciated. In addition, equity accounting of equity-accounted investees ceases once classified as held for sale or distribution.

Related Parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities. Transactions between related parties are on an arm's length basis in a manner similar to transactions with non-related parties.

Basic and Diluted Earnings Per Common Share (EPS)

Basic EPS is computed by dividing the net income or loss for the period attributable to ordinary equity holders of the Parent Company, net of dividends on preferred shares, by the weighted average number of issued and outstanding common shares during the period, with retroactive adjustment for any stock dividends declared.

The Group has no dilutive potential common shares outstanding that would require disclosure of diluted earnings per share in the consolidated statement of income.

Operating Segments

The Group's operating segments are organized and managed separately according to the nature of the products and services provided, with each segment representing a strategic business unit that offers different products and serves different markets. Financial information on operating segments is presented in Note 36 to the consolidated financial statements.

The measurement policies the Group uses for segment reporting under PFRS 8 are the same as those used in its consolidated financial statements. There have been no changes from prior periods in the measurement methods used to determine reported segment profit or loss. All inter-segment transfers are carried out at arm's length prices.

Segment revenues, expenses and performance include sales and purchase between business segments and between geographical segments. Such sales and purchases are eliminated in consolidation.

The Group's CEO (the chief operating decision maker) reviews management reports on a regular basis.

Contingencies

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

Events After the Reporting Date

Post year-end events that provide additional information about the Group's consolidated financial position at reporting 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 the consolidated financial statements when material.

4. Significant Accounting Judgments, Estimates and Assumptions

The preparation of the Group's consolidated financial statements in accordance with PFRS requires management to make judgments, estimates and assumptions that affect amounts reported in the consolidated financial statements at the reporting date. However, uncertainty about these estimates and assumptions could result in outcome that could require a material adjustment to the carrying amount of the affected asset or liability in the future.

Judgments and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Judgments

In the process of applying the Group's accounting policies, management has made the following judgments, apart from those involving estimations, which have the most significant effect on the amounts recognized in the consolidated financial statements:

Operating Lease Commitments - Group as Lessor/Lessee. The Group has entered into various lease agreements either as a lessor or a lessee. The Group had determined that it retains all the significant risks and rewards of ownership of the properties leased out on operating leases while the significant risks and rewards for properties leased from third parties are retained by the lessors.

Determining Fair Values of Financial Instruments. Where the fair values of financial assets and liabilities recorded in the consolidated statement of financial position cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The Group uses judgments to select from variety of valuation models and make assumptions regarding considerations of liquidity and model inputs such as correlation and volatility for longer dated financial instruments. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair value.

Distinction between Property, Plant and Equipment and Investment Property. The Group determines whether a property qualifies as investment property. In making its judgment, the Group considers whether the property generates cash flows largely independent of the other assets held by an entity. Owner-occupied properties generate cash flows that are attributable not only to the property but also to other assets used in the production or supply process.

Some properties comprise a portion that is held to earn rental or for capital appreciation and another portion that is held for use in the production and supply of goods and services or for administrative purposes. If these portions can be sold separately (or leased out separately under finance lease), the Group accounts for the portions separately. If the portion cannot be sold separately, the property is accounted for as investment property only if an insignificant portion is held for use in the production or supply of goods or services for administrative purposes. Judgment is applied in determining whether ancillary services are so significant that a property does not qualify as investment property. The Group considers each property separately in making its judgment.

Taxes. Significant judgment is required in determining current and deferred tax expense. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Group recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current income tax and deferred tax expenses in the year in which such determination is made.

Beginning July 2008, in the determination of the Group's current taxable income, the Group has an option to either apply the optional standard deduction (OSD) or continue to claim itemized standard deduction. The Group, at each taxable year from the effectivity of the law, may decide which option to apply; once an option to use OSD is made, it shall be irrevocable for that particular taxable year. For 2010, 2009 and 2008 the Group opted to continue claiming itemized standard deductions except for Petrogen, as it opted to apply OSD in 2010.

Contingencies. The Group currently has several tax assessments and legal claims. The Group's estimate of the probable costs for the resolution of these assessments and claims has been developed in consultation with in-house as well as outside legal counsel handling the prosecution and defense of these matters and is based on an analysis of potential results. The Group currently does not believe that these tax assessments, legal and administrative claims will have a material adverse effect on its consolidated financial position and consolidated financial performance. It is possible, however, that future consolidated financial performance could be materially affected by changes in the estimates or in the effectiveness of strategies relating to these proceedings. No accruals were made in relation to these proceedings (Note 38).

<u>Estimates</u>
The key assumptions concerning the future and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing material adjustments to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Allowance for Impairment Losses on Trade and Other Receivables. Allowance for impairment is maintained at a level considered adequate to provide for potentially uncollectible receivables. The level of allowance is based on past collection experience and other factors that may affect collectibility. An evaluation of receivables, designed to identify potential changes to allowance, is performed regularly throughout the year. Specifically, in coordination with the National Sales Division, the Finance Division ascertains customers who are unable to meet their financial obligations. In these cases, the Group's management use sound judgment based on the best available facts and circumstances included but not limited to, the length of relationship with the customers, the customers' current credit status based on known market forces, average age of accounts, collection experience and historical loss experience. The amount of impairment loss differs for each year based on available objective evidence for which the Group may consider that it will not be able to collect some of its accounts. Impaired accounts receivable are written off when identified to be worthless after exhausting all collection efforts. An increase in allowance for impairment of trade and other receivable would increase the Group's recorded selling and administrative expenses and decrease current assets.

Impairment losses on trade and other receivables amounted to P481, P58 and P71 in 2010, 2009 and 2008, respectively (Note 9). Receivables written off amounted P3 and P7 in 2010 and 2008, respectively. There were no receivables written off in 2009.

The carrying value of receivables, amounted to P24,266 and P29,696 as of December 31, 2010 and 2009, respectively (Note 9).

Net Selling Prices of Inventories. In determining the net selling price of inventories, management takes into account the most reliable evidence available at the times the estimates are made. Future realization of the carrying amount of inventories of P28,145 and P28,169 as at the end of 2010 and 2009, respectively (Note 10) is affected by price changes in different market segments for crude and petroleum products. Both aspects are considered key sources of estimation uncertainty and may cause significant adjustments to the Group's inventories within the next financial year. At the end of 2010, the carrying amount of inventories is mostly based on cost.

There is no inventory write-down provided in 2010. Inventory write-down amounted to P1,141 in 2009 and P2,432 in 2008.

Allowance for Inventory Obsolescence. The allowance for inventory obsolescence consists of collective and specific valuation allowance. A collective valuation allowance is established as a certain percentage based on the age and movement of stocks. In case there is write-off or disposal of slow-moving items during the year, a reduction in the allowance for inventory obsolescence is made. Review of allowance is done every quarter, while a revised set-up or booking is posted at the end of the year based on evaluations or recommendations of the proponents. The amount and timing of recorded expenses for any year would therefore differ based on the judgments or estimates made.

Provision for inventory obsolescence in 2010, 2009, and 2008 amounted to P69, P7 and P9, respectively (Note 10).

Financial Assets and Financial Liabilities. The Group carries certain financial assets and financial liabilities at fair value, which requires extensive use of accounting estimates and judgments. Significant components of fair value measurement were determined using verifiable objective evidence (i.e., foreign exchange rates, interest rates, volatility rates). The amount of changes in fair value would differ if the Group utilized different valuation methodologies and assumptions. Any change in the fair value of these financial assets and financial liabilities would affect profit or loss and equity.

Fair value of financial assets and financial liabilities are discussed in Note 34.

Estimated Useful Lives of Property, Plant and Equipment, Intangible Assets and Investment Properties. The Group estimates the useful lives of property, plant and equipment, intangible assets and investment properties based on the period over which the assets are expected to be available for use. The estimated useful lives are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the assets.

In addition, estimation of the useful lives is based on collective assessment of industry practice, internal technical evaluation and experience with similar assets. It is possible, however, that future financial performance could be materially affected by changes in estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of property, plant and equipment, intangible assets and investment properties would increase recorded cost of sales and selling and administrative expenses and decrease noncurrent assets.

There is no change in estimated useful lives of property, plant and equipment, intangible assets and investment properties based on management reviews at the reporting date.

Accumulated depreciation and amortization of property, plant and equipment and investment properties amounted to P31,035 and P28,691 as of December 31, 2010 and 2009, respectively. Property, plant and equipment, net of accumulated depreciation and amortization amounted to P34,957 and P34,784 as of December 31, 2010 and 2009, respectively (Note 12). Investment properties, net of accumulated depreciation amounted to P119 and P232 as of December 31, 2010 and 2009, respectively (Note 13).

Fair Value of Investment Properties. The fair value of investment property presented for disclosure purposes is based on market values, being the estimated amount for which the property can be exchanged between a willing buyer and seller in an arm's length transaction, or based on a most recent sale transaction of a similar property within the same vicinity where the investment property is located.

In the absence of current prices in an active market, the valuations are prepared by considering the aggregate estimated future cash flows expected to be received from leasing out the property. A yield that reflects the specific risks inherent in the net cash flows is then applied to the net annual cash flows to arrive at the property valuation.

Estimated fair values of investment property (office units) amounted to P30 and P214 as of December 31, 2010 and 2009, respectively (Note 13).

Realizability of Deferred Tax Assets. The Group reviews its deferred tax assets at each reporting date and reduces the carrying amount to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. The Group's assessment on the recognition of deferred tax assets on deductible temporary difference and carryforward benefits of MCIT and NOLCO is based on the projected taxable income in the following periods.

Deferred tax assets amounted to P28 and P7 as of December 31, 2010 and 2009, respectively (Note 26).

Impairment of Non-financial Assets. PFRS requires that an impairment review be performed on property, plant and equipment, intangible assets and investment properties when events or changes in circumstances indicate that the carrying value may not be recoverable. Determining the recoverable amount of assets requires the estimation of cash flows expected to be generated from the continued use and ultimate disposition of such assets. While it is believed that the assumptions used in the estimation of fair values reflected in the consolidated financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable amounts and any resulting impairment loss could have a material adverse impact on financial performance.

There were no impairment loss recognized in 2010, 2009 and 2008, respectively.
The aggregate carrying amount of property, plant and equipment and investment properties amounted to P35,076 and P35,016 as of December 31, 2010 and 2009, respectively (Notes 12 and 13).

Present Value of Defined Benefit Obligation. The present value of the retirement obligations depends on a number of factors that are determined on an actuarial basis using a number of assumptions. These assumptions are described in Note 29 to the consolidated financial statements and include discount rate, expected return on plan assets and salary increase rate. Actual results that differ from the assumptions are accumulated and amortized over future periods and therefore, generally affect the recognized expense and recorded obligation in such future periods.

The assumption of the expected return on plan assets is determined on a uniform basis, taking into consideration the long-term historical returns, asset allocation and future estimates of long-term investment returns.

The Group determines the appropriate discount rate at the end of each year. It is the interest rate that should be used to determine the present value of estimated future cash outflows expected to be required to settle the pension obligations. In determining the appropriate discount rate, the Group considers the interest rates on government bonds that are denominated in the currency in which the benefits will be paid. The terms to maturity of these bonds should approximate the terms of the related pension liability.

Other key assumptions for pension obligations are based in part on current market conditions.

While it is believed that the Group's assumptions are reasonable and appropriate, significant differences in actual experience or significant changes in assumptions may materially affect the Group's retirement obligations.

The Group has a net cumulative unrecognized actuarial gain amounting to P21,853 and P500 as of December 31, 2010 and 2009, respectively (Note 29).

Asset Retirement Obligation. The Group has an asset retirement obligation arising from leased service stations and depots. Determining asset retirement obligation requires estimation of the costs of dismantling, installations and restoring leased properties to their original condition. The Group determined the amount of asset retirement obligation, by obtaining estimates of dismantling costs from the proponent responsible for the operation of the asset, discounted at the Group's current credit-adjusted risk-free rate ranging from 4.81% to 11.17% depending on the life of the capitalized costs. While it is believed that the assumptions used in the estimation of such costs are reasonable, significant changes in these assumptions may materially affect the recorded expense or obligation in future periods.

The Group also has an asset retirement obligation arising from its refinery. However, such obligation is not expected to be settled for the foreseeable future and therefore a reasonable estimate of fair value cannot be determined. Thus, the asset retirement obligation amounting to P815 and P541 as of December 31, 2010 and 2009, respectively (Note 18), covers only the Group's leased services stations and depots.

5. Assets Held for Sale

Petron has properties consisting of office units located at Petron Mega Plaza which has a floor area of 21,216 square meters covering the 28th - 44th floors and 209 parking lots recorded as part of property, plant and equipment and investment properties amounting to P6 and P817, respectively, in the statement of financial position. On December 1, 2010, Petron's BOD approved the sale of these properties to provide cash flows for various projects. The total carrying amount of the property, plant and equipment and investment properties as of December 31, 2010 of P823 is presented as "Assets held for sale" in the consolidated statement of financial position.

Total estimated fair value of the properties amounted to P1,242. Management expects to sell the properties within the next 12 months.

6. Cash and Cash Equivalents

This account consists of:

	Note	**2010**	2009
Cash on hand		**P3,626**	P3,101
Cash in banks		**2,822**	1,560
Short-term placements		**37,536**	8,324
	34	**P43,984**	P12,985

Cash in banks earns interest at the respective bank deposit rates. Short-term placements include demand deposits which can be withdrawn at anytime depending on the immediate cash requirements of the Group, and earn interest (Note 25) at the respective short-term placement rates ranging from 1.6% to 6.25% in 2010 and 2.5% to 6.2% in 2009.

7. Financial Assets at Fair Value Through Profit or Loss

This account consists of:

	Note	**2010**	2009
Marketable equity securities	*34*	**P97**	P92
Proprietary membership shares	*34*	**96**	77
Derivative assets	*33, 34*	**34**	39
		P227	P208

The fair values presented have been determined directly by reference to published prices quoted in an active market.

Changes in fair value recognized in 2010, 2009 and 2008 amounted to P64, P22 and (P67), respectively (Note 25).

8. Available-for-Sale Financial Assets

This account consists of investments in government securities of Petrogen and ROP9 bonds of Ovincor.

Petrogen's government securities are deposited with the Insurance Commission (IC) in accordance with the provisions of the IC, for the benefit and security of its policyholders and creditors. These investments bear fixed annual interest rates of 6.25% to 8.875% in 2010, 6.3% to 8.9% in 2009 and 6.8% to 14.6% in 2008 (Note 25).

Ovincor's ROP9 bonds are maintained at the Bank of Bermuda and are carried at fair value with fixed interest rate of 8.3% to 8.9% from May 2009 (purchase date) to March 2015 (maturity date).

The breakdown of investments by contractual maturity dates as of December 31 follows:

	Note	**2010**	2009
Due in one year or less		**P178**	P170
Due after one year through five years		**983**	1,185
	34	**P1,161**	P1,355

The reconciliation of the carrying amounts of available-for-sale financial assets as of December 31 follows:

	2010	2009
Balance at beginning of year	**P1,355**	P682
Additions	**-**	965
Disposals	**(168)**	(326)
Amortization of premium	**(19)**	(12)
Fair value gains	**32**	48
Foreign currency losses	**(39)**	(2)
Balance at end of year	**P1,161**	P1,355

9. Trade and Other Receivables

This account consists of:

	Note	2010	2009
Trade		**P13,121**	P13,119
Related parties - trade	*27*	**1,779**	-
Allowance for impairment loss on trade receivables		**(1,051)**	(781)
		13,849	12,338
Government		**6,688**	13,352
Others		**3,983**	4,060
Allowance for impairment loss on non-trade receivables		**(254)**	(54)
		10,417	17,358
	34	**P24,266**	P29,696

Trade receivables are noninterest-bearing and are generally on a 45 day term. Government receivables pertain to tax claims, such as VAT and specific tax claims (Note 14). Of these receivables, P6,142 is over 30 days but less than one year. The filing and the collection of claims is a continuous process and is closely monitored.

Receivables- Others significantly consist of receivables relating to creditable withholding tax, tax certificates on product replenishment and duties.

A reconciliation of the allowance for impairment at the beginning and end of 2010 and 2009 is shown below:

	Note	2010	2009
Balance beginning of year		**P835**	P782
Additions	*22*	**481**	58
Write off		**(3)**	-
Interest income on accretion		**(8)**	(5)
Balance at end of year		**P1,305**	P835

There were no reversal of allowance for impairment losses in 2010 and 2009.

As of December 31, 2010 and 2009, the age of past due but not impaired trade accounts receivable (TAR) is as follows (Note 33):

	Past Due But Not Impaired				
	Within 30 days	**31 to 60 days**	**61 to 90 days**	**Over 90 days**	**Total**
December 31, 2010					
Reseller	**P15**	**P31**	**P6**	**P1**	**P53**
Lubes	**2**	**3**	**2**	**4**	**11**
Gasul	**39**	**52**	**37**	**44**	**172**
Industrial	**95**	**265**	**164**	**250**	**774**
Others	**-**	**5**	**61**	**68**	**134**
	P151	**P356**	**P270**	**P367**	**P1,144**
December 31, 2009					
Reseller	P20	P6	P6	P22	P54
Lubes	1	13	9	16	39
Gasul	11	40	51	62	164
Industrial	46	593	247	502	1,388
Others	-	5	47	92	144
	P78	P657	P360	P694	P1,789

No allowance for impairment is necessary as regard these past due but unimpaired trade receivables based on past collection experience. There are no significant changes in credit quality. As such, these amounts are still considered recoverable.

10. Inventories

Inventories at net realizable value consists of:

	2010	2009
Crude oil and others	**P13,532**	P13,457
Petroleum	**13,749**	13,903
TBA products, materials and supplies:		
TBA	**27**	18
Materials and supplies	**837**	791
	P28,145	P28,169

The cost of these inventories amounted to P28,532 and P28,571 for 2010 and 2009, respectively.

If the Group used the moving-average method (instead of the first-in, first-out method, which is the Group's policy), the cost of petroleum, crude oil and other products would have increased (decreased) by (P715), (P1,378) and P2,243 as of December 31, 2010, 2009 and 2008, respectively.

Research and development costs (Note 22) on these products constituted the expenses incurred for internal projects in 2010 and 2009.

Inventories (including distribution or transshipment costs) charged to cost of goods sold amounted to P203,767, P156,001 and P259,405 in 2010, 2009 and 2008, respectively (Note 21).

The movements in allowance for decline in value of inventories at the beginning and end of 2010 and 2009 follow:

	2010	2009
Balance at beginning of the year	**P402**	P2,742
Additions due to:		
Write-down	**-**	1,141
Obsolescence	**69**	7
Reversal of allowance for:		
Write-down	**(84)**	(3,488)
Balance at end of year	**P387**	P402

Reversal of allowance for inventory write-down in 2010 and 2009, which was due to price changes, and was charged as part of "Others - net" under "Cost of Goods Sold" account (Note 21).

11. Investments in Associates

This account consists of:

	2010
Acquisition cost:	
Balance at beginning of year	**P -**
Additions	**958**
Balance at end of year	**958**
Share in net loss:	
Balance at beginning of year	**-**
Share in net loss during the year	**(151)**
Share in comprehensive loss	**(3)**
Balance at end of year	**(154)**
	P804

Petrochemical Asia (HK) Limited (PAHL)
On March 13, 2010, the Parent Company acquired 182,000,000 ordinary shares or 40% of the outstanding shares of PAHL from Vantage Stride (Mauritius) Limited ("Vantage Stride").

PAHL is a company incorporated in Hong Kong. It has an authorized capital of Hong Kong Dollar (HK$) 585 million, consisting of 585,000,000 shares at HK$1 per share. Of this, 455,000,000 shares are outstanding. Silverdale (Suisse), S.A. holds the remaining 60% of the outstanding shares of PAHL.

PAHL was incorporated in March 2008 and indirectly owns, among other assets, a 160,000 metric ton-polypropylene production plant in Mariveles, Bataan.

In June 2010, another investor acquired 102,142,858 new "Class B" ordinary shares which reduced Petron's ownership to 33%.

PAHL's business operations is expected to commence on the first quarter of 2011.

Limay Energen Corp. (LEC)
On August 3, 2010, the Parent Company together with Two San Isidro SIAI Assets, Inc. (Two San Isidro), formed LEC with an authorized capital stock of P3,400. Out of its authorized capitalization, P850 has been subscribed, of which P212.5 has been paid up. The Parent Company subscribed to P339.99 worth of shares of LEC representing 40% of the total subscribed capital, while Two San Isidro subscribed to P509.99 worth of shares of LEC, representing the remaining 60% of the total subscribed capital.

LEC was formed to build, operate and maintain a cogeneration power plant that will engage in a generation of power and steam for the primary purpose of supplying the steam and power requirements of Petron Bataan Refinery.

Following are the unaudited condensed and combined financial information of PAHL and LEC:

	2010
Total assets	**P3,880**
Total liabilities	**2,181**
Net loss	**576**

12. Property, Plant and Equipment

This account consists of:

	Buildings and Related Facilities	Refinery and Plant Equipment	Service Stations and Other Equipment	Computers, Office and Motor Equipment	Land and Leasehold Improvements	Construction In-progress	Total
Cost:							
December 31, 2008	P14,082	P31,308	P3,999	P2,214	P4,017	P6,095	P61,715
Additions	713	5,543	159	99	35	949	7,498
Disposals/reclassifications	(93)	-	(88)	(287)	192	(5,593)	(5,869)
December 31, 2009	14,702	36,851	4,070	2,026	4,244	1,451	63,344
Additions	40	4	151	138	92	4,053	4,478
Disposals/reclassifications	(857)	437	1,132	(19)	190	(2,708)	(1,825)
Assets held for sale	(14)	-	-	-	-	-	(14)
December 31, 2010	**13,871**	**37,292**	**5,353**	**2,145**	**4,526**	**2,796**	**65,983**
Accumulated depreciation and amortization:							
December 31, 2008	7,093	12,122	3,101	1,759	1,212	-	25,287
Additions	736	2,317	284	183	52	-	3,572
Disposals/reclassifications	(14)	-	(1)	(284)	-	-	(299)
December 31, 2009	7,815	14,439	3,384	1,658	1,264	-	28,560
Additions	712	2,113	387	163	108	-	3,483
Disposals/reclassifications	(898)	-	(15)	(93)	(3)	-	(1,009)
Assets held for sale	(8)	-	-	-	-	-	(8)
December 31, 2010	**7,621**	**16,552**	**3,756**	**1,728**	**1,369**	**-**	**31,026**
Net book value:							
December 31, 2009	P6,887	P22,412	P686	P368	P2,980	P1,451	P34,784
December 31, 2010	**P6,250**	**P20,740**	**P1,597**	**P417**	**P3,157**	**P2,796**	**P34,957**

Interest capitalized in 2010, 2009 and 2008 amounted to nil, P40 and P316, respectively. Capitalization rates used for general borrowings (both short and long-term loans) were nil in 2010, 5.94% in 2009 and 7.20% in 2008, while capitalization rates used for specific borrowings were nil in 2010 and 2009 and 4.60% to 8.88% in 2008 (Note 17).

No impairment loss was required to be recognized in 2010 and 2009.

Capital Commitments

As of December 31, 2010, the Group has outstanding commitments to acquire property, plant and equipment amounting to P1,142.

13. Investment Properties

The movements and balances as of December 31 follows:

	Land	Office Units	Total
Cost:			
December 31, 2008 and 2009	P100	P263	P363
Additions/Reclassification	-	759	759
Asset held for sale	-	(994)	(994)
December 31, 2010	**100**	**28**	**128**
Accumulated depreciation:			
December 31, 2008	-	117	117
Additions	-	14	14
December 31, 2009	-	131	131
Additions	-	55	55
Asset held for sale	-	(177)	(177)
December 31, 2010	**-**	**9**	**9**
Net book value:			
December 31, 2009	P100	P132	P232
December 31, 2010	**P100**	**P19**	**P119**

The Group's investment properties consist of office units located at Petron Mega Plaza (reclassified as "Assets held for sale" in Note 5) and parcels of land in various locations. Estimated fair values for the office units, based on recent sale of units within the building and/or sale of units in comparative Grade A buildings, amounted to P30 and P214 in 2010 and 2009, respectively.

The Group's parcels of land are located in Metro Manila and some major provinces. As of December 31, 2010 and 2009, the aggregate fair market value of the properties of P120 million, determined by independent appraisers, is higher than their carrying values, considering recent market transactions and specific conditions related to the parcels of land as determined by NVRC.

Rental income earned from office units amounted P16 and P13 and P16 in 2010, 2009 and 2008, respectively, which are recognized as part of "Other Income (Expenses)" account (Note 25).

14. Other Assets

This account consists of:

	Note	**2010**	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Current:				
Input VAT	*9*	**P3,399**	P3,779	P10,739
Prepaid expenses		**781**	510	824
Special-purpose fund		**41**	36	201
Others		**65**	103	158
		P4,286	P4,428	P11,922
Noncurrent:				
Due from affiliates	*27, 33, 34*	**P22,447**	P -	P -
Catalyst	*12*	**169**	243	241
Prepaid rent		**161**	339	100
Long-term receivables	*33, 34*	**122**	189	202
Retirement assets		**-**	-	264
Others – net		**117**	107	85
		P23,016	P878	P892

The "Noncurrent Assets - Others" classification includes franchise fees amounting to P10 and P9 in 2010 and 2009, respectively, net of amortization of franchise fees amounting to P2 in 2010 and 2009. Amortization of franchise fee is included as part of "Selling and Administrative - Depreciation and amortization" account in the consolidated statement of income (Note 22).

Included in Due from affiliates is an advance made by the Parent Company on July 15, 2010, amounting to P20,797 to Petron Corporation Employee Retirement Plan (PCERP) for some investment opportunities. Such advance is interest bearing at market rates.

15. Short-term Loans

This account pertains to unsecured peso loans obtained from local banks with maturities ranging from 30 to 180 days with interest ranging from 3.05% to 4.87%. Also, it pertains to unsecured dollar loan obtained from foreign bank with 29-day term and an interest rate of 1.8% (Note 25). These loans are intended to fund the importation of crude oil and petroleum products (Note 10), capital expenditures (Note 12) and working capital requirements.

Short-term loans of the Group are not subject to covenants and warranties.

16. Trade and Other Payables

This account consists of:

	Note	**2010**	2009
Trade		**P3,772**	P2,200
Accrued interest		**742**	529
Accrued rent		**688**	650
Specific taxes and other taxes payable		**563**	849
Insurance liabilities		**237**	240
Dividends payable		**196**	199
Related parties - trade	*27*	**90**	-
Accrued payroll		**41**	18
Others		**415**	231
		P6,744	P4,916

Accounts payable are liabilities to haulers, contractors and suppliers that are noninterest-bearing and are normally settled on a 30-day term.

17. Long-term Debt

This account consists of:

	Note	**2010**	2009
Unsecured Peso denominated (net of debt issue cost):			
Fixed rate peso loans of 6.73% (a)		**P767**	P1,381
Fixed rate corporate notes of 8.88%, 8.14% and 9.33% (b, c)		**16,162**	16,180
Floating rate peso loan based on PDST-F and SDA rates (d, e)		**2,466**	1,331
Fixed interest rate bonds of 7% in 2010 to 2017 (f)		**19,779**	-
Unsecured Foreign currency denominated (net of debt issue cost):			
Floating rate dollar loan based on LIBOR rate + 2.15% (g)		**15,228**	-
	34	**54,402**	18,892
Less current portion		**11,517**	1,296
		P42,885	P17,596

a. On January 31, 2007, Petron entered into a Club loan agreement with Metropolitan Bank and Trust Company (MBTC) and Citibank amounting to P1,000 each. The loan bears interest of 6.73% (gross of 5% tax) per annum payable in 13 quarterly installments starting January 2009 up to 2012. In December 2007, Citibank assigned P900 of its interest in the Club loan agreement to the following financial institutions:

Bank Name	**Amount**
MayBank Phils.	P500
Mega International Commercial Bank of China	300
Robinsons Bank	100
	P900

In May 2008, Citibank assigned its remaining P100 interest to Insular Life Assurance Co. Ltd.

b. On July 31, 2006, Petron issued a P6,300 Fixed Rate Corporate Note to finance the construction of its Petro Fluidized Catalytic Cracker Unit (PFCCU) and Propylene Recovery Unit and for other general purposes. The note bears annual interest of 8.88% per annum. The note is due on August 2, 2011.

c. On June 5, 2009, Petron issued P5,200 and P4,800 or a total of P10,000 Fixed Rate Corporate Notes. The P5,200 five-year Note bears a fixed rate of 8.14% per annum with a one-time payment of principal on June 2014. On the other hand, the P4,800 seven-year notes bears a fixed rate of 9.33% per annum with 6 principal payments of P48 per year commencing June 2010 and a one-time payment of P4,512 on June 2016.

d. On November 29, 2006, Petron entered into a loan agreement with Land Bank of the Philippines amounting to P2,000 which bears interest calculated based on the prevailing 3-month MART (now PDST-F) rate plus a fixed spread. The loan was used to finance Petron's capital expenditures. The loan has a term of 5 years, inclusive of 2 years grace period whereby the principal is payable in 12 equal quarterly amortization starting March 2009. The last amortization payment is due on November 2011.

e. On December 14, 2010, Petron entered into a three year term facility agreement with Development Bank of the Philippines amounting to P1.8 Billion. The loan is subject to a quarterly repricing and the principal amount is amortized in twelve quarterly installments of P150 million starting March 2011 up to 2014. The loan was obtained to finance Petron's general corporate requirements.

f. On November 10, 2010, Petron issued a P20,000 Peso-Denominated Notes, payable in U.S. Dollars. The notes bear interest of 7% per annum, payable semi-annually in arrears on May 10 and November 10 of each year, with the first interest payment to be made on May 10, 2011. The notes will mature on November 10, 2017. The principal and interest will be translated into and paid in U.S. dollars based upon the average representative market rate at the applicable rate calculation date at the time of each payment.

g. On June 7, 2010, Petron entered into a term facility agreement with Norddeutsche Landesbank Girozentrale, Singapore Branch amounting to US$355 million. The loan is subject to interest rate of LIBOR plus 2.5% and the principal is due in 9 semi-annual installments of US$39.4 million starting June 1, 2011. The loan was used for general corporate purposes and refinancing of peso-denominated debts.

The above mentioned loan agreements contain, among others, covenants relating to merger and consolidation, maintenance of certain financial ratios, working capital requirements, restrictions on guarantees, payments of dividends.

Total interest incurred on the above-mentioned long-term loans amounted to P2,164, P1,310 and P763 in the years ended 2010, 2009 and 2008, respectively. Capitalized interest in 2010, 2009 and 2008 amounted to nil, P40 and P316, respectively (Note 12).

As of December 31, 2010 and 2009, Petron complied with the covenants of its debt agreements.

Movements in debt issue costs follow:

	Note	**2010**	2009
Beginning balance		**P126**	P50
Additions		**634**	104
Accretion for the year	*25*	**(112)**	(28)
Ending balance		**P648**	P126

Repayment Schedule
As of December 31, 2010, the annual maturities of long-term debt are as follows:

Year	**Gross Amount**	**Debt Issue Costs**	**Net**
2011	P11,687	P170	P11,517
2012	4,260	144	4,116
2013	4,107	119	3,988
2014	8,706	85	8,621
2015	1,778	52	1,726
2016	4,512	42	4,470
2017	20,000	36	19,964
	P55,050	P648	P54,402

18. Asset Retirement Obligation

Movements in the ARO are as follows:

	Note	**2010**	2009
Beginning balance		**P541**	P706
Additions		**13**	15
Effect of change in discount rate		**248**	(226)
Accretion for the year	*25*	**46**	60
Settlement	*25*	**(18)**	(14)
Reversal		**(15)**	-
Ending balance		**P815**	P541

19. Other Noncurrent Liabilities

	Note	**2010**	2009
Cash bonds	*34*	**P275**	P245
Cylinder deposits	*34*	**274**	200
Others	*34*	**60**	66
		P609	P511

20. Equity

a. On February 27, 2009, the BOD approved an increase of Petron's authorized capital stock from the current P10,000 to P25,000 (25,000,000,000 shares) through the issuance of preferred shares aimed at raising funds for capital expenditures related to expansion programs as well as to possibly reduce some of Petron's debts. Both items, including a waiver to subscribe to the preferred shares to be issued as a result of the increase in authorized capital stock, were approved by the stockholders on May 12, 2009 at the annual stockholders meeting.

   On October 21, 2009, the BOD approved the amendment of Petron's Articles of Incorporation to reclassify a total of 624,895,503 unissued common shares to preferred shares with a par value of P1.00 per share, which also includes a waiver of the stockholders' pre-emptive rights on the issuance of preferred shares. Features of said preferred shares were approved by the Executive Committee on November 25, 2009.

   In November 2009, the requirements for the registration statement of Petron's preferred shares, the Preliminary Prospectus, were submitted to SEC. The application for listing of preferred shares was also subsequently filed with PSE. By written assent, majority of the stockholders voted for the amendment of the reclassification of unissued common shares to preferred shares.

   On January 21, 2010, the SEC approved Petron's amendment to its Articles of Incorporation to include preferred shares in the composition of its authorized capital stock. On January 22, 2010, the SEC favorably considered the Final Prospectus and the Issue Management and Underwriting Agreement. The SEC subsequently issued an Order permitting the sale of securities on February 12, 2010. Similarly, the PSE also approved the issuance of 100,000,000 preferred shares, which were offered to the public from February 15 to February 26, 2010.

b. Capital Stock

   Common Stock
   As of December 31, 2010, 2009 and 2008, Petron has 9,375,104,497 (P1 par value) issued and outstanding common shares.

   Preferred Stock
   The preferred shares are peso-denominated, cumulative, non-participating, non-voting and are redeemable at the option of the Parent Company. The preferred shares have an issue price of P100 per share (P1 par value) and a dividend rate of 9.5281% per annum computed in reference to the issue price and is payable every March 5, June 5, September 5 and December 5 of each year, when declared by the BOD.

   All shares rank equally with regard to the Parent Company's residual assets, except that holders of preferred shares participate only to the extent of the issue price of the shares plus any accumulated and unpaid cash dividends.

   As of December 31, 2010, Petron has 100,000,000 issued and outstanding preferred shares

c. Retained Earnings

i. Declaration of Cash Dividends

On April 29, 2010, the BOD approved a cash dividend of P2.382 per share which was paid to preferred stockholders on June 7, 2010. Another cash dividend of P2.382 per share was paid on September 16, 2010 to preferred stockholders as of August 10, 2010 record date. Finally, stockholders holding preferred shares as of November 16, 2010 were also paid a cash dividend of P2.382 per share on December 6, 2010.

For common shares, the BOD similarly approved a cash dividend of P0.10 per share to stockholders as of July 30, 2010, which was paid on August 16, 2010.

ii. Appropriation for Capital Projects

Additional appropriation for future capital projects and loan obligations amounted to P2,748 in 2008. On February 27, 2009, Petron's BOD approved a resolution to reverse P8,428 of the appropriated retained earnings. There were no additional appropriations for capital projects made in 2010 and 2009.

d. The Group's unappropriated retained earnings include its accumulated equity in net earnings of subsidiaries, joint venture and associates amounting to P2,208, P2,035 and P1,910 in 2010, 2009 and 2008, respectively. Such amounts are not available for declaration as dividends until declared by the respective investees.

e. The BOD of certain subsidiaries approved additional appropriation amounting to P62 in 2010 to finance future capital expenditure projects.

f. Other reserves pertain to unrealized fair value gains (losses) on AFS financial assets and exchange difference in translating foreign operations.

21. Cost of Goods Sold

This account consists of:

	Note	**2010**	2009	2008
Inventories	*10*	**P203,767**	P156,001	P259,405
Depreciation and amortization	*24*	**2,282**	2,505	2,172
Personnel expenses	*23*	**555**	519	519
Others - net	*10, 30*	**2,676**	2,558	2,210
		P209,280	P161,583	P264,306

Distribution or transshipment costs included as part of inventories amounted to P4,161, P3,747 and P3,801 in 2010, 2009 and 2008, respectively.

22. Selling and Administrative Expenses

This account consists of:

	Note	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Personnel expenses	*23*	**P1,972**	P1,625	P1,375
Purchased services and utilities		**1,311**	1,332	1,202
Depreciation and amortization	*24*	**1,258**	1,083	1,071
Maintenance and repairs		**551**	522	482
Rent	*27, 28*	**544**	479	411
Impairment loss on trade and other receivables	*9*	**481**	58	71
Materials and office supplies		**397**	211	181
Advertising		**222**	222	235
Taxes and licenses		**205**	136	136
Others	*10*	**362**	80	58
		P7,303	P5,748	P5,222

Selling and administrative expenses-Others include research and development costs amounting to P14, P10 and P9 in 2010, 2009 and 2008, respectively.

23. Personnel Expenses

This account consists of:

	Note	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Salaries, wages and other employee costs	*27*	**P2,274**	P1,772	P1,726
Retirement costs - defined benefit plan	*29*	**197**	317	118
Retirement costs - defined contribution plan		**56**	55	50
		P2,527	P2,144	P1,894

The above amounts are distributed as follows:

	Note	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Costs of goods sold	*21*	**P555**	P519	P519
Selling and administrative expenses	*22*	**1,972**	1,625	1,375
		P2,527	P2,144	P1,894

24. Depreciation and Amortization

This account consists of:

	Note	**2010**	2009	2008
Cost of goods sold				
Property, plant and equipment	*12, 21*	**P2,282**	P2,505	P2,172
Selling and administrative expenses				
Property, plant and equipment	*12*	**1,201**	1,067	1,056
Investment properties	*13*	**55**	14	14
Intangible assets		**2**	2	1
	22	**1,258**	1,083	1,071
		P3,540	P3,588	P3,243

25. Interest Expense, Interest Income and Other Income (Expenses)

This account consists of:

	Note	**2010**	2009	2008
Interest expense:				
Long-term debt	*17*	**P2,052**	P1,282	P713
Short-term loans	*15*	**1,368**	2,214	2,614
Bank charges		**673**	649	621
Accretion on debt issue costs	*17*	**112**	28	50
Accretion on ARO	*18*	**46**	60	40
Product borrowings		**12**	13	21
Others		**46**	5	121
		P4,309	P4,251	P4,180
Interest income:				
Advances to PCERP and cash bond	*14*	**P471**	P -	P -
Short-term placements	*6*	**237**	92	225
AFS financial assets		**50**	51	42
Trade receivables		**46**	38	54
Product loaning		**14**	7	8
Cash in banks	*6*	**5**	5	9
Others		**16**	12	16
		P839	P205	P354
Other income (expenses):				
Foreign currency gains (losses) - net	*33*	**P1,465**	P146	(P1,708)
Mark-to-market gain (losses)	*34*	**(98)**	(409)	179
Rent	*13, 28*	**215**	346	357
Insurance claims		**97**	172	33
Changes in fair value of financial assets at FVPL	*7*	**64**	22	(67)
Gain on settlement of ARO	*18*	**18**	14	8
Hedging gains - net		**13**	461	1,159
Miscellaneous		**(365)**	(155)	(76)
		P1,409	P597	(P115)

The Parent Company recognized its share in the net income of PDSI amounting P0.35, P0.51 and P0.41 in 2010, 2009 and 2008, respectively, and recorded it as part of "Other Income (Expenses) - Miscellaneous" account.

26. Income Taxes

Deferred tax assets and liabilities are from the following:

	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Various allowance, accruals and others	**P555**	P77	P981
Rental	**177**	170	164
ARO	**154**	144	673
Retirement benefits liability	**75**	15	-
NOLCO	**-**	1,662	1,113
MCIT	**-**	298	123
Excess of double-declining over straight-line method of depreciation and amortization	**(1,574)**	(1,431)	(1,250)
Capitalized interest, duties and taxes on property, plant and equipment deducted in advance and others	**(625)**	(532)	(572)
Inventory differential	**(207)**	(413)	116
Capitalization taxes and duties on inventories deducted in advance	**(175)**	(360)	(347)
Unrealized foreign exchange (gains) losses – net	**(301)**	20	(32)
Unrealized fair value gains on AFS financial assets	**(9)**	(7)	(2)
Retirement assets	**-**	-	(80)
	(P1,930)	(P357)	P887

The above amounts are reported in the consolidated statement of financial position as follows:

	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Deferred tax assets	**P28**	P7	P895
Deferred tax liabilities	**(1,958)**	(364)	(8)
	(P1,930)	(P357)	P887

Net deferred taxes of individual companies are not allowed to be offset against net deferred tax liabilities of other companies, or vice versa, for purposes of consolidation.

As of December 31, 2010, the NOLCO and MCIT of the Group that can be claimed as deduction from future taxable income and deduction from corporate income tax due were all applied.

The components of income tax expense (benefit) are shown below:

	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Current	**P820**	P254	P240
Deferred	**1,555**	1,238	(2,113)
	P2,375	P1,492	(P1,873)

A reconciliation of tax on the pretax income computed at the applicable statutory rates to tax expense reported in the consolidated statement of income is as follows:

	Note	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Statutory income tax rate		**30.00%**	30.00%	35.00%
Additions to (reductions in) resulting from:				
Change in tax rate		**-**	-	(6.90)
Income subject to ITH	*35*	**(6.40)**	(2.82)	2.95
Interest income subjected to lower final tax and others		**(0.26)**	(0.87)	1.66
Nontaxable income		**(0.33)**	(0.64)	0.90
Nondeductible expense		**0.05**	0.24	(0.29)
Nondeductible interest expense		**0.23**	0.16	(0.59)
Changes in fair value of financial assets at FVPL	*25*	**(0.18)**	(0.13)	(0.40)
Excess of optional standard deduction over deductible expenses		**(0.05)**	-	-
Effective income tax rate		**23.06%**	25.94%	32.33%

Optional Standard Deduction

Effective July 2008, Republic Act (RA) No. 9504 was approved giving corporate taxpayers an option to claim itemized deduction or optional standard deduction (OSD) equivalent to 40% of gross sales. Once the option to use OSD is made, it shall be irrevocable for the taxable year for which the option was made. Petrogen opted to apply OSD in 2010.

Change in Applicable Tax Rate

Effective January 1, 2009, in accordance with Republic Act 9337, RCIT rate was reduced from 35% to 30% and nonallowable deductions for interest expense from 42% to 33% of interest income subjected to final tax.

27. Related Party Disclosures

Lease Agreement

On September 30, 2009, NVRC entered into a 25-year lease with the PNOC without rent-free period, covering a property which it shall use for refinery, commencing January 1, 2010 and ending on December 31, 2039. The annual rental shall be P93 payable on the 15th day of January each year without the necessity of demand. This non-cancelable lease is subject to renewal options and annual escalation clauses of 3% per annum up to 2011. The leased premises shall be reappraised starting 2012 and every fifth year thereafter in which the new rental rate shall be determined equivalent to 5% of the reappraised value, and still subject to annual escalation clause of 3% for the four years following the appraisal. Prior to this agreement, Petron has an outstanding lease agreement on the same property from PNOC. Also, as of December 31, 2010, Petron leases other parcels of land from PNOC for its bulk plants and service stations.

<u>Transactions with current owners/related parties</u>

a. Sales relate to the Parent Company's supply agreements with various SMC subsidiaries. Under these agreements, the Parent Company supplies the bunker, diesel fuel and lube requirements of selected SMC plants and subsidiaries.

b. Purchases relate to purchase of goods and services such as construction, information technology and shipping.

c. Petron entered into a lease agreement with San Miguel Properties, Inc. for its office space covering 6,759 square meters with a monthly rate of P4.8. The lease, which commenced on June 1, 2010, is for a period of one year and is subject to yearly extensions.

d. The Parent Company also pays SMC for its share in common expenses such as utilities and management fees.

e. The Parent Company advanced certain monies to PCERP for some investment opportunities (Note 14).

The balances and transactions with related parties as of and for the year ended December 31, 2010 follows:

Related Parties	**Relationship with Related parties**	**Revenue from Related Parties**	**Purchases from Related parties**	**Amounts owed by Related parties**	**Amounts owed to Related parties**
San Miguel Corporation	Ultimate Parent	**P1**	**P29**	**P2**	**P33**
Pan Asia Energy Holdings Inc.	Under common control	**8,045**	**-**	**1,428**	**-**
Distileria Bago Inc	Under common control	**720**	**-**	**-**	**-**
San Miguel Brewery Inc.	Under common control	**573**	**0.60**	**100**	**-**
San Miguel Packaging Specialist Inc.	Under common control	**350**	**-**	**-**	**-**
SMC Shipping & Lighterage Corporation	Under common control	**304**	**407**	**46**	**13**
Ginebra San Miguel Inc.	Under common control	**169**	**0.30**	**58**	**-**
San Miguel Foods Inc	Under common control	**150**	**3**	**36**	**-**
San Miguel Energy Corporation	Under common control	**83**	**-**	**-**	**-**
San Miguel Yamamura Asia Corporation	Under common control	**40**	**-**	**40**	**-**
Challenger Aero Air Corporation	Under common control	**22**	**2**	**9**	**-**
Mindanao Corrugated Fibreboard Inc.	Under common control	**17**	**-**	**4**	**-**
San Miguel Purefoods Company Inc.	Under common control	**14**	**4**	**-**	**7**
Archen Technologies Inc.	Under common control	**12**	**227**	**2**	**26**
San Miguel Properties Inc.	Under common control	**-**	**63**	**-**	**5**
San Miguel Rengo Packaging Corporation	Under common control	**-**	-	**49**	**-**
Others	Under common control	**12**	**39**	**5**	**6**
		P10,512	**P775**	**P1,779**	**P90**

Key Management Compensation
Total compensation and benefits of key management personnel included as part of "Personnel Expenses" account in the consolidated statement of income consists of the following (Note 23):

	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Salaries and other short-term employee benefits	**P328**	P262	P222
Retirement benefits - defined contribution plan	**11**	9	8
Retirement benefits - defined benefit plan	**399**	234	70
	P738	P505	P300

28. Operating Lease Commitments

Group as Lessee
The Group entered into commercial leases on certain parcels of land for its refinery and service stations (Notes 22 and 27). These leases have an average life of one to sixteen years with renewal options included in the contracts. There are no restrictions placed upon the Group by entering into these leases. The lease agreements include upward escalation adjustments of the annual rental rates.

Future minimum rental payables under the non-cancellable operating lease agreements as of December 31 follows:

	2010	2009	2008
Within one year	**P738**	P596	P506
After one year but not more than five years	**2,661**	2,207	2,189
After five years	**8,741**	5,744	2,126
	P12,140	P8,547	P4,821

Group as Lessor
The Group has entered into lease agreements on its investment property portfolio, consisting of surplus office spaces (Notes 13 and 25). The non-cancellable leases have remaining terms of between three to fourteen years. All leases include a clause to enable upward escalation adjustment of the annual rental rates.

Future minimum rental receivables under the non-cancellable operating lease agreements as of December 31 follows:

	2010	2009	2008
Within one year	**P327**	P231	P247
After one year but not more than five years	**523**	240	277
After five years	**52**	79	93
	P902	P550	P617

29. Retirement Plan

The succeeding tables summarizes the components of net retirement costs under a defined benefit retirement plan recognized in the profit or loss and the funding status and amounts of pension plan recognized in the consolidated statement of financial position. Contributions and costs are determined in accordance with the actuarial studies made for the plans. Annual cost is determined using the projected unit credit method. The Group's latest actuarial valuation date is December 31, 2010. Valuations are obtained on a periodic basis.

The components of retirement benefits cost recognized in profit or loss in 2010, 2009 and 2008 are as follows:

	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Current service cost	**P165**	P161	P191
Interest cost on benefit obligation	**276**	331	319
Expected return on plan assets	**(312)**	(201)	(392)
Curtailment loss	**75**	26	-
Amortization of actuarial gain	**(7)**	-	-
Net retirement costs	**P197**	P317	P118

The retirement benefits cost are recognized as part of personnel expenses in the consolidated statement of income.

The reconciliation of the assets and liabilities recognized in the consolidated statement of financial position is as follows:

	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Present value of defined benefit obligation	**P3,559**	P3,446	P3,534
Fair value of plan assets	**25,163**	3,896	3,832
	(21,604)	(450)	(298)
Unrecognized actuarial gain	**21,853**	500	34
Net retirement liabilities (asset) recognized	**P249**	P50	(P264)

Changes in the present value of the defined benefit obligation are as follows:

	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Balance at beginning of year	**P3,446**	P3,534	P3,852
Interest cost	**276**	331	319
Current service cost	**165**	161	191
Benefits paid	**(1,109)**	(611)	(168)
Actuarial loss (gains) on obligation	**705**	3	(660)
Effect of curtailment	**76**	28	-
Balance at end of year	**P3,559**	P3,446	P3,534

Changes in the fair value of plan assets are as follows:

	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Balance at beginning of year	**P3,896**	P3,832	P4,361
Expected return on plan assets	**312**	201	392
Benefits paid	**(1,109)**	(611)	(168)
Actuarial gains (losses)	**22,064**	474	(753)
Balance at end of year	**P25,163**	P3,896	P3,832
Actual return (loss) on plan assets	**P22,376**	P675	(P361)

The Group expects to pay P1,105 to its defined benefit plans in 2011.

Plan assets consist of the following:

	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Government securities	**48%**	44%	56%
Stocks	**36%**	32%	23%
Real estate	**12%**	15%	13%
Cash	**1%**	1%	1%
Others	**3%**	8%	7%
	100%	100%	100%

The principal actuarial assumptions used to determine retirement benefits are as follows:

	2010	2009	2008
Discount rate	**7.90%**	8.00%	9.80%
Expected rate of return on plan assets	**8.70%**	8.00%	5.50%
Future salary increases	**8.00%**	6.00%	8.00%

The historical information for the current and previous restated four annual periods are as follows:

	2010	2009	2008	2007	2006
Present value of the defined benefit obligation	**P3,559**	P3,446	P3,534	P3,852	P3,783
Fair value of plan assets	**25,163**	3,896	3,832	4,361	4,217
Excess in the plan	**(21,604)**	(450)	(298)	(509)	(434)
Experience adjustments on plan liabilities	**143**	70	(240)	368	151

30. Significant Agreements

Supply Agreement
The Parent Company and Arabian American Oil Company ("Saudi Aramco") have a term contract to purchase and supply, respectively, 90% of the Parent Company's monthly crude oil requirements at Saudi Aramco's standard far east selling prices. The contract is for a period of one year from October 28, 2008 to October 27, 2009 with automatic one-year extensions thereafter unless terminated at the option of either party, within 60 days written notice. Outstanding liabilities of the Parent Company for such purchases are shown as part of "Liabilities for Crude Oil and Petroleum Product Importation" account in the consolidated statement of financial position. The contract was extended until October 27, 2011.

Processing License Agreement. The Parent Company has an agreement with Pennzoil-Quaker State International Corporation (Pennzoil) for the exclusive right to manufacture, sell and distribute in the Philippines certain Pennzoil products until December 31, 2009. The agreement also includes the license to use certain Pennzoil trademarks in exchange for the payment of royalty fee based on net sales value. The agreement was extended to March 31, 2010 to allow the Group to consume the remaining Pennzoil raw materials in its possession.

Royalty expense amounting to P0.06, P0.08 and P0.3 in 2010, 2009 and 2008, respectively, are included as part of "Cost of Goods Sold - Others" account in the consolidated statement of income (Note 21).

Fuel Supply Contract with National Power Corporation (NPC). The Parent Company entered into various fuel supply contracts with NPC. Under the agreements, Petron supplies the bunker fuel and diesel fuel oil requirements to selected NPC plants and NPC-supplied Independent Power Producers (IPP) plants.

As of December 31, 2010, the following are the fuel supply contracts granted to the Parent Company:

Bid Date	Date of Award	Contract Duration	DFO* (in KL*)	IFO* (in KL)	DFO	IFO
Feb 24, 2010	Mar 10, 2010	Mar to Dec 2010	3,058	18,051	P93	P495
Feb 24, 2010	Mar 10, 2010	Mar to Dec 2010	25,558	22,916	786	634
Feb 24, 2010	Mar 10, 2010	Mar to Dec 2010	11,554	-	347	-
Feb 24, 2010	Mar 10, 2010	Mar to Dec 2010	-	50,109	-	1,386
Aug 31, 2010	Sept 15, 2010	Sept to Dec 2010	10,056	-	327	-

** IFO = Industrial Fuel Oil*
DFO = Diesel Fuel Oil
KL = Kilo Liters

In the bidding for the Supply & Delivery of Oil-Based Fuel to NPC, IPPs and Small Power Utilities Group (SPUG) Plants/Barges for the period from January to December 2010, Petron won to supply a total of 50,226 kilo-liters (KL) of diesel fuel and 91,076 KL of bunker fuel worth P1,555 and P2,515 respectively.

Toll Service Agreement with Innospec Limited ("Innospec"). PFC entered into an agreement with Innospec, a leading global fuel additives supplier, in December 2006. Under the agreement PFC shall be the exclusive toll blender of Innospec's fuel additives sold in the Asia-Pacific region consisting of the following and territories: South Korea, China, Taiwan, Singapore, Cambodia, Japan and Malaysia.

PFC will provide the tolling services which include storage, blending, filing and logistics management. In consideration of these services, Innospec will pay PFC a service fee based on the total volume of products blended at PFC Fuel Additives Blending facility.

Tolling services started in 2008 on which PFC recognized revenue amounting to P40, P52 and P7 in 2010, 2009 and 2008, respectively.

31. Basic and Diluted Earnings (Loss) Per Share

Basic and diluted earnings (loss) per share amounts are computed as follows:

	2010	2009 (As Restated - Note 39)	2008 (As Restated - Note 39)
Net income from operations attributable to equity holders of the Parent Company	**P7,894**	P4,240	(P3,978)
Dividends on preferred shares for the period (a)	**715**	-	-
Net income (loss) attributable to equity holders of the Parent Company (b)	**P7,179**	P4,240	(P3,978)
Weighted average number of common shares outstanding (c)	**9,375**	9,375	9,375
Basic/Diluted earnings (loss) per share (b/c)	**P0.77**	P0.45	(P0.42)

32. Supplemental Disclosures on Cash Flow Information

Changes in operating assets and liabilities:

	2010	2009	2008
Decrease (increase) in assets:			
Trade and other receivables	**(P1,803)**	(P5,746)	P5,394
Inventories	**39**	4,964	(2,962)
Other current assets	**78**	(1,094)	(1,342)
Increase (decrease) in liabilities:			
Liabilities for crude oil and petroleum product importation	**3,661**	(1,353)	(3,926)
Trade and other payables	**1,647**	496	(259)
	3,622	(2,733)	(3,095)
Additional (reversal) allowance for impairment of receivables, inventory decline and/or obsolescence and others	**501**	(2,169)	2,444
	P4,123	(P4,902)	(P651)

33. Financial Risk Management Objectives and Policies

The Group's principal financial instruments include cash and cash equivalents, debt and equity securities, bank loans and derivative instruments. The main purpose of bank loans is to finance working capital relating to importation of crude and petroleum products, as well as to partly fund capital expenditures. The Group has other financial assets and liabilities such as trade and other receivables and trade and other payables, which are generated directly from its operations.

It is the Group's policy not to enter into derivative transactions for speculative purposes. The Group uses hedging instruments to protect its margin on its products from potential price volatility of crude oil and products. It also enters into short-term forward currency contracts to hedge its currency exposure on crude oil importations.

The main risks arising from the Group's financial instruments are foreign exchange risk, interest rate risk, credit risk, liquidity risk and commodity price risk. The BOD regularly reviews and approves the policies for managing these financial risks. Details of each of these risks are discussed below, together with the related risk management structure.

Risk Management Structure
The Group follows an enterprise-wide risk management framework for identifying, assessing and addressing the risk factors that affect or may affect its businesses.

The Group's risk management process is a bottom-up approach, with each risk owner mandated to conduct regular assessment of its risk profile and formulate action plans for managing identified risks. As the Group's operation is an integrated value chain, risks emanate from every process, while some could cut across groups. The results of these activities flow up to the Management Committee and, eventually, the BOD through the Group's annual business planning process.

Oversight and technical assistance is likewise provided by corporate units and committees with special duties. These groups and their functions are:

a. The Investment and Risk Management Committee, which is composed of the Chairman of the Board, President, and Vice Presidents of Petron, reviews the adequacy of risk management policies.

b. A cross-functional Commodity Risk Management Committee, which oversees crude oil and petroleum product hedging transactions. The Secretariat of this committee is the Commodity Risk Manager, who is responsible for risk management of crude and product imports, as well as product margins.

c. The Financial Risk Management Unit of the Treasurer's Department, which is in charge of foreign exchange hedging transactions.

d. The Transaction Management Unit of Controllers Department, which provides backroom support for all hedging transactions.

e. The Corporate Technical & Engineering Services Department, which oversees strict adherence to safety and environmental mandates across all facilities.

f. The Internal Audit Department, which has been tasked with the implementation of a risk-based auditing.

The BOD also created separate board-level entities with explicit authority and responsibility in managing and monitoring risks, as follows:

a. The Audit Committee, which ensures the integrity of internal control activities throughout the Group. It develops, oversees, checks and pre-approves financial management functions and systems in the areas of credit, market, liquidity, operational, legal and other risks of the Group, and crisis management. The Internal Audit Department and the External Auditor directly report to the Audit Committee regarding the direction, scope and coordination of audit and any related activities.

b. The Compliance Officer, who is a senior officer of Petron reports to the BOD through the Audit Committee. He monitors compliance with the provisions and requirements of the Corporate Governance Manual, determines any possible violations and recommends corresponding penalties, subject to review and approval of the BOD. The Compliance Officer identifies and monitors compliance risk. Lastly, the Compliance Officer represents the Group before the SEC regarding matters involving compliance with the Code of Corporate Governance.

Foreign Currency Risk

The Group's functional currency is the Philippine peso, which is the denomination of the bulk of the Group's revenues. The Group's exposures to foreign exchange risk arise mainly from United States (US) dollar-denominated sales as well as purchases principally of crude oil and petroleum products. As a result of this, the Group maintains a level of US dollar-denominated assets and liabilities during the period. Foreign exchange risk occurs due to differences in the levels of US dollar-denominated assets and liabilities.

The Group pursues a policy of hedging foreign exchange risk by purchasing currency forwards or by substituting US dollar-denominated liabilities with peso-based debt. The natural hedge provided by US dollar-denominated assets is also factored in hedging decisions. As a matter of policy, currency hedging is limited to the extent of 100% of the underlying exposure.

The Group is allowed to engage in active risk management strategies for a portion of its foreign exchange risk exposure. Loss limits are in place, monitored daily and regularly reviewed by management.

Information on the Group's US dollar-denominated financial assets and liabilities and their Philippine peso equivalents are as follows:

	2010		2009	
	US Dollar	**Peso Equivalent**	US Dollar	Peso Equivalent
Assets				
Cash and cash equivalents	**648**	**28,395**	163	7,519
Trade and other receivables	**173**	**7,606**	86	3,977
Non-current receivables	**1**	**29**	2	70
	822	**36,030**	251	11,566
Liabilities				
Drafts and loans payable	**59**	**2,573**	-	-
Liabilities for crude oil and petroleum product importation	**288**	**12,606**	128	5,929
Long-term debt (including current maturities)	**355**	**15,563**	-	-
	702	**30,742**	128	5,929
Net foreign currency-denominated monetary assets	**120**	**5,288**	123	5,637

The Group reported net foreign exchange gains (losses) amounting to P1,465, P146 and (P1,708) in 2010, 2009 and 2008, respectively, with the translation of its foreign currency-denominated assets and liabilities. These mainly resulted from the movements of the Philippine peso against the US dollar as shown in the following table:

	PhP to US$
December 31, 2008	47.52
December 31, 2009	46.20
December 31, 2010	43.84

The management of foreign currency risk is also supplemented by monitoring the sensitivity of financial instruments to various foreign currency exchange rate scenarios. Foreign exchange movements affect reported equity through the retained earnings arising from increases or decreases in unrealized and realized foreign exchange gains or losses.

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar exchange rate, with all other variables held constant, of profit before tax and equity as of December 31, 2010 and 2009:

	P1 decrease in the US dollar exchange rate		**P1 increase in the US dollar exchange rate**	
2010	**Effect on Income before Income Tax**	**Effect on Equity**	**Effect on Income before Income Tax**	**Effect on Equity**
Cash and cash equivalents	**P28,395**	**P19,877**	**(P28,395)**	**(P19,877)**
Trade and other receivables	**7,606**	**5,324**	**(7,606)**	**(5,324)**
Noncurrent receivables	**29**	**20**	**(29)**	**(20)**
	36,030	**25,221**	**(36,030)**	**(25,221)**
Drafts and loans payable	**(2,573)**	**(1,801)**	**2,573**	**1,801**
Liabilities for crude oil and petroleum product importation	**(12,606)**	**(8,824)**	**12,606**	**8,824**
Long-term debt (including current maturities)	**(15,563)**	**(10,894)**	**15,563**	**10,894**
	(30,742)	**(21,519)**	**30,742**	**21,519**
	P5,288	**P3,702**	**(P5,288)**	**(P3,702)**

	P1 decrease in the US dollar exchange rate		P1 increase in the US dollar exchange rate	
2009	Effect on Income before Income Tax	Effect on Equity	Effect on Income before Income Tax	Effect on Equity
Cash and cash equivalents	P7,519	P5,263	(P7,519)	(P5,263)
Trade and other receivables	3,977	2,784	(3,977)	(2,784)
Noncurrent receivables	70	49	(70)	(49)
	11,566	8,096	(11,566)	(8,096)
Liabilities for crude oil and petroleum product importation	(5,929)	(4,150)	5,929	4,150
	P5,637	P3,946	(P5,637)	(P3,946)

Exposures to foreign exchange rates vary during the year depending on the volume of overseas transactions. Nonetheless, the analysis above is considered to be representative of the Group's currency risk.

Interest Rate Risk
Interest rate risk is the risk that future cash flows from a financial instrument (cash flow interest rate risk) or its fair value (fair value interest rate risk) will fluctuate because of changes in market interest rates. The Group's exposure to changes in interest rates relates mainly to long-term borrowings and investment securities. Investments or borrowings issued at fixed rates expose the Group to fair value interest rate risk. On the other hand, investments or borrowings issued at variable rates expose the Group to cash flow interest rate risk.

The Group manages its interest costs by using a combination of fixed and variable rate debt instruments. Management is responsible for monitoring the prevailing market-based interest rates and ensures that the marked-up rates levied on its borrowings are most favorable and benchmarked against the interest rates charged by other creditor banks.

On the other hand, the Group's investment policy is to maintain an adequate yield to match or reduce the net interest cost from its borrowings prior to deployment of funds to their intended use in operations and working capital management. However, the Group invests only in high-quality money market instruments while maintaining the necessary diversification to avoid concentration risk.

In managing interest rate risk, the Group aims to reduce the impact of short-term volatility on earnings. Over the longer term, however, permanent changes in interest rates would have an impact on profit or loss.

The management of interest rate risk is also supplemented by monitoring the sensitivity of financial instruments to various standard and non-standard interest rate scenarios. Interest rate movements affect reported equity through the retained earnings arising from increases or decreases in interest income or interest expense as well as fair value changes reported in profit or loss, if any.

The sensitivity to a reasonably possible 1% increase in the interest rates, with all other variables held constant, would have decreased the Group's profit before tax (through the impact on floating rate borrowings) by P180 and P13 in 2010 and 2009, respectively. A 1% decrease in the interest rate would have had the equal but opposite effect. There is no impact on the Group's other income.

Interest Rate Risk Table

As at December 31, 2010 and 2009, the terms and maturity profile of the interest-bearing financial instruments, together with its gross amounts, are shown in the following tables:

2010	**<1 year**	**1-<2 years**	**2-<3 years**	**3-<4 years**	**4-<5 years**	**>5 years**	**Total**
Fixed rate							
Philippine peso denominated	**P6,963**	**P202**	**P48**	**P5,248**	**P48**	**P24,511**	**P37,020**
Interest rate	**6.4% - 9.3%**	**6.4% - 9.3%**	**6.4% - 9.3%**	**6.4% - 9.3%**	**6.4% - 9.3%**	**6.4% - 9.3%**	
Floating rate							
Philippine peso denominated	**1,267**	**600**	**600**	**-**	**-**	**-**	**2,467**
Interest rate	**net 1M SDA + margin, 3-mo. Mart1/ PDSTF + margin**	**net 1M SDA + margin**	**net 1M SDA + margin**				
US$ denominated (expressed in Php)	**3,459**	**3,459**	**3,458**	**3,458**	**1,729**	**-**	**15,563**
Interest rate*	**3, 6 mos. Libor + margin**	**3, 6 mos. Libor + margin**	**3, 6 mos. Libor + margin**	**3, 6 mos. Libor + margin**	**3, 6 mos. Libor + margin**		
	P11,689	**P4,261**	**P4,106**	**P8,706**	**P1,777**	**P24,511**	**P55,050**

**The group reprices every 3 months but has been given an option to reprice every 6 months.*

2009	<1 year	1-<2 years	2-<3 years	3-<4 years	4-<5 years	>5 years	Total
Fixed rate							
Philippine peso denominated	P664	P6,963	P202	P48	P5,248	P4,560	P17,685
Interest rate	6.4% - 9.3%	6.4% - 9.3%	6.4% - 9.3%	6.4% - 9.3%	6.4% - 9.3%	6.4% - 9.3%	
Floating rate							
Philippine peso denominated	666	667	-	-	-	-	1,333
Interest rate	3-mo. Mart1/ PDSTF + margin	3-mo. Mart1/ PDSTF + margin					
	P1,330	P7,630	P202	P48	P5,248	P4,560	P19,018

Credit Risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations. In effectively managing credit risk, the Group regulates and extends credit only to qualified and credit-worthy customers and counterparties, consistent with established Group credit policies, guidelines and credit verification procedures. Requests for credit facilities from trade customers undergo stages of review by Marketing and Finance Divisions. Approvals, which are based on amounts of credit lines requested, are vested among line managers and top management that include the President and the Chairman.

Generally, the maximum credit risk exposure of financial assets is the total carrying amount of the financial assets as shown on the face of the consolidated statement of financial position or in the notes to the consolidated financial statements, as summarized below:

	Note	**2010**	2009
Cash in bank and cash equivalents	*6*	**P40,358**	P9,884
Derivative assets	*7*	**34**	39
Trade and other receivables	*9*	**24,266**	29,696
Due from affiliates	*14*	**22,447**	-
Long-term receivables	*14*	**122**	189
		P87,227	P39,808

The credit risk for cash and cash equivalents and derivative financial instruments is considered negligible, since the counterparties are reputable entities with gain high quality external credit ratings. The credit quality of these financial assets is considered to be high grade.

In monitoring trade receivables and credit lines, the Group maintains up-to-date records where daily sales and collection transactions of all customers are recorded in real-time and month-end statements of accounts are forwarded to customers as collection medium. Finance Division's Credit Department regularly reports to management trade receivables balances (monthly) and credit utilization efficiency (semi-annually).

Collaterals. To the extent practicable, the Group also requires collateral as security for a credit facility to mitigate credit risk in trade receivables (Note 9). Among the collaterals held are letters of credit, bank guarantees, real estate mortgages, and cash bonds valued at P2,736 and P2,624 as of December 31, 2010 and 2009, respectively. These securities may only be called on or applied upon default of customers.

Credit Risk Concentration. The Group's exposure to credit risk arises from default of counterparty. Generally, the maximum credit risk exposure of trade and other receivables is its carrying amount without considering collaterals or credit enhancements, if any. The Group has no significant concentration of credit risk since the Group deals with a large number of homogenous trade customers. The Group does not execute any credit guarantee in favor of any counterparty.

The credit risk exposure of the Group based on TAR as of December 31, 2010 and 2009 are shown below (Note 9):

	Neither Past Due Nor Impaired	**Past Due but Not Impaired**	**Impaired**	**Total**
December 31, 2010				
Reseller	**P10**	**P53**	**P40**	**P103**
Lubes	**281**	**11**	**25**	**317**
Gasul	**661**	**172**	**122**	**955**
Industrial	**7,792**	**774**	**717**	**9,283**
Others	**3,974**	**134**	**134**	**4,242**
	P12,718	**P1,144**	**P1,038**	**P14,900**

	Neither Past Due Nor Impaired	Past Due but Not Impaired	Impaired	Total
December 31, 2009				
Reseller	P44	P54	P28	P126
Lubes	238	39	17	294
Gasul	656	164	48	868
Industrial	6,823	1,388	629	8,840
Others	2,789	144	58	2,991
	P10,550	P1,789	P780	P13,119

Credit Quality. In monitoring and controlling credit extended to counterparty, the Group adopts a comprehensive credit rating system based on financial and non-financial assessments of its customers. Financial factors being considered comprised of the financial standing of the customer while the non-financial aspects include but are not limited to the assessment of the customer's nature of business, management profile, industry background, payment habit and both present and potential business dealings with the Group.

Class A "*High Grade*" are accounts with strong financial capacity and business performance and with the lowest default risk.

Class B "*Moderate Grade*" refer to accounts of satisfactory financial capability and credit standing but with some elements of risks where certain measure of control is necessary in order to mitigate risk of default.

Class C "*Low Grade*" are accounts with high probability of delinquency and default.

Below is the credit quality profile of the Group's TAR as of December 31, 2010 and 2009:

	Trade Accounts Receivables per Class			
	Class A	**Class B**	**Class C**	**Total**
December 31, 2010				
Reseller	**(P29)**	**P107**	**P26**	**P104**
Lubes	**113**	**159**	**44**	**316**
Gasul	**419**	**244**	**292**	**955**
Industrial	**2,527**	**5,711**	**1,045**	**9,283**
Others	**3,640**	**538**	**64**	**4,242**
	P6,670	**P6,759**	**P1,471**	**P14,900**
December 31, 2009				
Reseller	(P206)	P313	P21	P128
Lubes	67	190	38	295
Gasul	323	319	226	868
Industrial	2,497	4,917	1,426	8,840
Others	2,506	464	18	2,988
	P5,187	P6,203	P1,729	P13,119

Liquidity Risk

Liquidity risk pertains to the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

The Group's objectives to manage its liquidity risk are as follows: a) to ensure that adequate funding is available at all times; b) to meet commitments as they arise without incurring unnecessary costs; c) to be able to access funding when needed at the least possible cost; and d) to maintain an adequate time spread of refinancing maturities.

The Group constantly monitors and manages its liquidity position, liquidity gaps or surplus on a daily basis. A committed stand-by credit facility from several local banks is also available to ensure availability of funds when necessary. The Group also uses derivative instruments such as forwards and swaps to manage liquidity.

The table below summarizes the maturity profile of the Group's financial assets and financial liabilities based on contractual undiscounted payments used for liquidity management as of December 31, 2010 and 2009.

2010	**Within 3 months**	**After 3 months but not more than 6 months**	**After 6 months but not more than 12 months**	**After 1 year but not more than 5 years**	**Total**
Current financial liabilities:					
Short-term loans	**P32,457**	**P -**	**P -**	**P -**	**P32,457**
Liabilities for crude oil and petroleum product	**11,194**	**-**	**-**	**-**	**11,194**
Trade and other payables (excluding specific taxes and other taxes payable)	**5,507**	**324**	**350**	**-**	**6,181**
Current portion of long-term debt	**426**	**2,203**	**8,888**	**-**	**11,517**
Total current financial liabilities	**49,584**	**2,527**	**9,238**	**-**	**61,349**
Noncurrent financial liabilities:					
Long-term debt	**-**	**-**	**-**	**42,885**	**42,885**
Cash bonds	**-**	**-**	**-**	**275**	**275**
Cylinder deposits	**-**	**-**	**-**	**274**	**274**
Other noncurrent liabilities	**-**	**-**	**-**	**60**	**60**
Total noncurrent financial liabilities	**-**	**-**	**-**	**43,494**	**43,494**
	P49,584	**P2,527**	**P9,238**	**P43,494**	**P104,843**

2009	Within 3 months	After 3 months but not more than 6 months	After 6 months but not more than 12 months	After 1 year but not more than 5 years	Total
Current financial liabilities:					
Short-term loans	P42,744	P -	P -	P -	P42,744
Liabilities for crude oil and petroleum product	7,529	-	-	-	7,529
Trade and other payables (excluding specific taxes and other taxes payable)	4,033	11	10	13	4,067
Current portion of long-term debt	700	596		-	1,296
Total current financial liabilities	55,006	607	10	13	55,636
Noncurrent financial liabilities:					
Cash bonds	-	-	-	245	245
Long-term debt	-	-	-	17,596	17,596
Cylinder deposits	-	-	-	200	200
Other noncurrent liabilities	-	-	-	66	66
Total noncurrent financial liabilities	-	-	-	18,107	18,107
	P55,006	P607	P10	P18,120	P73,743

Commodity Price Risk
Commodity price risk is the risk that future cash flows from a financial instrument will fluctuate because of changes in market prices. The Group enters into various commodity derivatives to manage its price risks on strategic commodities. Commodity hedging allows stability in prices, thus offsetting the risk of volatile market fluctuations. Through hedging, prices of commodities are fixed at levels acceptable to the Group, thus protecting raw material cost and preserving margins. For hedging transactions, if prices go down, hedge positions may show marked-to-market losses; however, any loss in the marked-to-market position is offset by the resulting lower physical raw material cost.

To minimize the Group's risk of potential losses due to volatility of international crude and product prices, the Group implemented commodity hedging for petroleum products. The hedging authority approved by the BOD is intended to: (a) protect margins of MOPS (Mean of Platts of Singapore)-based sales and (b) protect product inventories from downward price risk. Hedging policy (including the use of commodity price swaps, buying of put options, and use of collars and 3-way options; with collars and 3-way options starting in March 2008) developed by the Commodity Risk Management Committee is in place. Decisions are guided by the conditions set and approved by the Group's management.

Other Market Price Risk
The Group's market price risk arises from its investments carried at fair value (FVPL and AFS financial assets). The Group manages its risk arising from changes in market price by monitoring the changes in the market price of the investments.

Capital Management
The Group's capital management policies and programs aim to provide an optimal capital structure that would ensure the Group's ability to continue as a going concern while at the same time provide adequate returns to the shareholders. As such, it considers the best trade-off between risks associated with debt financing and relatively higher cost of equity funds. Likewise, compliance with the debt to equity ratio covenant of bank loans has to be ensured.

An enterprise resource planning system is used to monitor and forecast the Group's overall financial position. The Group regularly updates its near-term and long-term financial projections to consider the latest available market data in order to preserve the desired capital structure. The Group may adjust the amount of dividends paid to shareholders, issue new shares as well as increase or decrease assets and/or liabilities, depending on the prevailing internal and external business conditions.

The Group monitors capital via carrying amount of equity as stated in the consolidated statement of financial position. The Group's capital for the covered reporting period is summarized in the table below:

	2010	2009
Total assets	**P161,816**	P112,742
Total liabilities	**108,472**	75,558
Total equity	**53,344**	37,184
Debt to equity ratio	**2.0:1**	2.0:1

There were no changes in the Group's approach to capital management during the year.

The Group is not subject to externally imposed capital requirements.

34. Financial Assets and Financial Liabilities

The table below presents a comparison by category of carrying amounts and fair values of the Group's financial instruments as of December 31:

		2010		2009	
	Note	**Carrying Value**	**Fair Value**	Carrying Value	Fair Value
Financial assets (FA):					
Cash and cash equivalents	*6*	**P43,984**	**P43,984**	P12,985	P12,985
Trade and other receivables	*9*	**24,266**	**24,266**	29,696	29,696
Due from affiliates	*14*	**22,447**	**22,447**	-	-
Long-term receivables	*14*	**122**	**122**	189	189
Loans and receivables		**90,819**	**90,819**	42,870	42,870
AFS financial assets	*8*	**1,161**	**1,161**	1,355	1,355
Financial assets at FVPL	*7*	**193**	**193**	169	169
Derivatives assets	*7*	**34**	**34**	39	39
FA at FVPL		**227**	**227**	208	208
Total financial assets		**P92,207**	**P92,207**	P44,433	P44,433

		2010		2009	
	Note	**Carrying Value**	**Fair Value**	Carrying Value	Fair Value
Financial liabilities (FL):					
Short-term loans	*15*	**P32,457**	**P32,457**	P42,744	P42,744
Liabilities for crude oil and petroleum product importation		**11,194**	**11,194**	7,529	7,529
Trade and other payables (excluding specific taxes and other taxes payable)		**6,181**	**6,181**	4,067	4, 067
Long-term debt including current portion	*17*	**54,402**	**54,402**	18,892	14,970
Cash bonds	*19*	**275**	**275**	245	245
Cylinder deposits	*19*	**274**	**274**	200	200
Other noncurrent liabilities	*19*	**60**	**60**	66	66
FL at amortized cost		**104,843**	**104,843**	73,743	69,821
Derivative liabilities		**30**	**30**	1	1
Total financial liabilities		**P104,873**	**P104,873**	P73,744	P69,822

The following methods and assumptions are used to estimate the fair value of each class of financial instruments and when it is practicable to estimate such value:

Cash and Cash Equivalents, Trade and Other Receivables and Noncurrent Receivables. The carrying amount of cash and cash equivalents and receivables approximates fair value primarily due to the relatively short-term maturities of these financial instruments. In the case of long-term receivables, the fair value is based on the present value of expected future cash flows using the applicable discount rates based on current market rates of identical or similar quoted instruments.

Derivatives. The fair values of freestanding and bifurcated forward currency transactions are calculated by reference to current forward exchange rates for contracts with similar maturity profiles. Mark-to-market valuation in 2010 and 2009 of commodity hedges were based on the forecasted crude and product prices by Mitsui & Co. Commodity Risk Management Ltd. (MCRM), an independent trading group.

Financial Assets at FVPL and AFS Financial Assets. The fair values of publicly traded instruments and similar investments are based on quoted market prices in an active market. For debt instruments with no quoted market prices, a reasonable estimate of their fair values is calculated based on the expected cash flows from the instruments discounted using the applicable discount rates of comparable instruments quoted in active markets. Unquoted equity securities are carried at cost less impairment.

Long-term Debt - Floating Rate. Variable rate loans are repriced every three months, the carrying value approximates its fair value because of recent and regular re-pricing based on current market rates.

Cash Bonds. Fair value is estimated as the present value of all future cash flows discounted using the market rates for similar types of instruments. Discount rates used in 2010 and 2009 are 5.99% and 5.11%, respectively.

<u>Derivative Financial Instruments</u>
The Group enters into various commodity derivative contracts to manage its exposure on commodity price risk. The portfolio is a mixture of instruments including forwards, swaps and options covering the Group's requirements on crude oil and finished products. These include freestanding and embedded derivatives found in host contracts, which are not designated as accounting hedges. Changes in fair value of these instruments are recognized directly in profit or loss.

The Group's derivative financial instruments according to the type of financial risk being managed are discussed below.

Freestanding Derivatives
Freestanding derivatives consist of commodity derivatives and currency derivatives entered into by the Group.

Commodity Swaps
The Group has outstanding swap agreements covering its oil requirements, with various maturities in 2011. Under the agreements, payment is made either by the Group or its counterparty for the difference between the hedged fixed price and the relevant monthly average index price.

Total outstanding equivalent notional quantity covered by the commodity swaps were 1.5 barrels and 0.5 barrel for 2010 and 2009, respectively. The estimated net receipts for these transactions amounted to P32 and P5.5, respectively.

Commodity Options
As of December 31, 2010, the Group has outstanding 3-way options designated as hedge of forecasted purchases of crude oil with a notional quantity of 2.78 million barrels.

The call and put options can be exercised at various calculation dates in 2011 with specified quantities on each calculation date. The estimated amount charged to profit or loss on these call and put options as of December 31, 2010 amounted to P234.

Outstanding hedge in 2009 with notional quantities of 2.4 MMB have an actual net receipts of P621.8.

Embedded Derivatives
Embedded foreign currency derivative exist in certain U.S. dollar-denominated sales and purchases contracts for various fuel products of Petron. Under the sales contracts, Petron agrees to fix the peso equivalent of the invoice amount based on the average Philippine Dealing System (PDS) rate on the month of delivery. In the purchase contracts, the peso equivalent is determined using the average PDS rate on the month preceding the month of delivery.

Fair Value Changes on Derivatives
The net movements in fair value changes of all derivative transactions in 2010 and 2009 are as follows:

	Note	**Mark-to-market Gain (Loss)**
Fair value at January 1, 2010		**P37**
Net changes in fair value during the year	*25*	**(98)**
Fair value of settled instruments		**65**
Balance at December 31, 2010		**P4**
Fair value at January 1, 2009		P55
Net changes in fair value during the year	*25*	(409)
Fair value of settled instruments		391
Balance at December 31, 2009		P37

Fair Value Hierarchy
In accordance with PFRS 7, financial assets and liabilities measured at fair value in the statement of financial position are categorized in accordance with the fair value hierarchy. This hierarchy groups financial assets and liabilities into three levels based on the significance of inputs used in measuring the fair value of the financial assets and liabilities.

The table below analyzes financial instruments carried at fair value, by valuation method as of December 31, 2010 and 2009. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3: inputs for the asset or liability that are not based on observable market data.

2010	**Level 1**	**Level 2**	**Total**
FVPL	**P193**	**P -**	**P193**
Derivative assets	**-**	**34**	**34**
AFS financial assets	**-**	**1,161**	**1,161**

2009	Level 1	Level 2	Total
FVPL	P169	P -	P169
Derivative assets	-	39	39
AFS financial assets	-	1,355	1,355

As of December 31, 2010 and 2009, the Group has no financial instruments valued based on Level 3. During the year, there were no transfers between Level 1 and Level 2 fair value measurements, and no transfers into and out of Level 3 fair value measurements.

35. Registration with the Board of Investments (BOI)

Isomerization and Gas Oil Hydrotreater Units

On January 7, 2004, the BOI approved Petron's application under RA 8479, otherwise known as the Downstream Oil Industry Deregulation Act (RA 8479), for new investments at its Bataan Refinery for an Isomerization Unit and a Gas Oil Hydrotreater ("Project"). The BOI is extending the following major incentives:

a. ITH for five years without extension or bonus year from January 2005 for the Project and March 2005 for LVN Isomerization or actual start of commercial operations, whichever is earlier.

b. Duty of three percent and VAT on imported capital equipment and accompanying spare parts.

c. Tax credit on domestic capital equipment on locally fabricated capital equipment which is equivalent to the difference between the tariff rate and the three percent duty imposed on the imported counterpart.

d. Exemption from taxes and duties on imported spare parts for consigned equipment with bonded manufacturing warehouse.

e. Exemption from real property tax on production equipment or machinery.

f. Exemption from contractor's tax.

Mixed Xylene, Benzene, Toluene (BTX) and Propylene Recovery Units

On October 20, 2005, Petron registered with the BOI under the Omnibus Investments Code of 1987 (Executive Order 226) as: (1) a non-pioneer, new export producer status of Mixed Xylene; (2) a pioneer, new export product status of Benzene and Toluene; and (3) a pioneer, new domestic producer status of Propylene. Under the terms of its registration, Petron is subject to certain requirements principally that of exporting at least 70% of the production of the mentioned petrochemical products every year except for the produced propylene.

As a registered enterprise, Petron is entitled to the following benefits on its production of petroleum products used as petrochemical feedstock:

a. ITH: (1) for four years from May 2008 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration for Mixed Xylene subject to base figure of 120,460 metric tons per year representing Petron's highest attained production volume for the last three (3) years; (2) for six years from May 2008 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration for Benzene and Toluene; and (3) for six years from December 2007 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration for Propylene.

b. Tax credit equivalent to the national internal revenue taxes and duties paid on raw materials and supplies and semi-manufactured products used in producing its export product and forming parts thereof for ten years from start of commercial operations.

c. Simplification of custom procedures.

d. Access to Customs Bonded Manufacturing Warehouse (CBMW) subject to Custom rules and regulations provided firm exports at least 70% of production output.

e. Exemption from wharfage dues, any export tax, duty, imposts and fees for a ten year period from date of registration.

f. Importation of consigned equipment for a period of ten years from the date of registration subject to the posting of re-export bond.

g. Exemption from taxes and duties on imported spare parts and consumable supplies for export producers with CBMW exporting at least 70% production.

h. Petron may qualify to import capital equipment, spare parts, and accessories at zero duty from date of registration up to June 5, 2006 pursuant to Executive Order (EO) No. 313 and its Implementing Rules and Regulations.

Fluidized Bed Catalytic Cracker (PetroFCC) Unit
On December 20, 2005, the BOI approved Petron's application under RA 8479 for new investment at its Bataan Refinery for the PetroFCC (Note 12). Subject to Petron's compliance with the terms and conditions of registration, the BOI is extending the following major incentives:

a. ITH for five years without extensions or bonus year from December 2007 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration subject to a rate of exemption computed based on the % share of product that are subject to retooling.

b. Minimum duty of three percent and VAT on imported capital equipment and accompanying spare parts.

c. Tax credit on domestic capital equipment shall be granted on locally fabricated capital equipment. This shall be equivalent to the difference between the tariff rate and the three percent (3%) duty imposed on the imported counterpart.

d. Importation of consigned equipment for a period of five years from date of registration subject to posting of the appropriate re-export bond; provided that such consigned equipment shall be for the exclusive use of the registered activity.

e. Exemption from taxes and duties on imported spare parts for consigned equipment with bonded manufacturing warehouse.

f. Exemption from real property tax on production equipment or machinery.

g. Exemption from contractor's tax.

Grease Manufacturing Plant

In December 2005, the BOI approved Petron's application under RA 8479 as an Existing Industry Participant with New Investment in Modernization of the firm's Grease Manufacturing Plant in Pandacan, Manila. The BOI is extending the following major incentives:

a. ITH for a period of five years without extension or bonus year from March 2006 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration subject to base figure of 845 metric tons of grease product representing Petron's highest attained sales volume prior to rehabilitation.

b. Minimum duty of three percent and VAT on imported capital equipment and accompanying spare parts.

c. Tax credit on domestic capital equipment on locally fabricated capital equipment which is equivalent to the difference between the tariff rate and the three percent duty imposed on the imported counterpart.

d. Importation of consigned equipment for a period of five years from date of registration subject to posting of the appropriate re-export bond; provided that such consigned equipment shall be for the exclusive use of the registered activity.

e. Exemption from taxes and duties on imported spare parts for consigned equipment with bonded manufacturing warehouse.

f. Exemption from real property tax on production equipment or machinery.

g. Exemption from contractor's tax.

70 MW Coal-Fired Power Plant (Limay, Bataan)

On November 3, 2010, Petron registered with the BOI as new operator of a 70 MW Coal-Fired Power Plant on a pioneer status with non-pioneer incentives under the Omnibus Investments Code of 1987 (Executive Order No. 226). Subject to Petron's compliance with the terms and conditions of registration, the BOI is extending the following major incentives:

a. ITH for four years from July 2012 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration limited to the revenue generated from the electricity sold to the grid.

b. Importation of consigned equipment for a period of ten years from the date of registration subject to the posting of re-export bond.

c. Zero percent (0%) duty from date of registration up to June 16, 2011 for imported capital equipment, spare parts and accessories.

Yearly certificates of entitlement have been timely obtained by Petron to support its ITH credits.

36. Segment Information

Management identifies segments based on business and geographic locations. These operating segments are monitored and strategic decisions are made on the basis of adjusted segment operating results. The CEO (the chief operating decision maker) reviews management reports on a regular basis.

The Group's major sources of revenues are as follows:

a. Sales of petroleum and other related products which include gasoline, diesel and kerosene offered to motorists and public transport operators through its service station network around the country.

b. Insurance premiums from the business and operation of all kinds of insurance and reinsurance, on sea as well as on land, of properties, goods and merchandise, of transportation or conveyance, against fire, earthquake, marine perils, accidents and all others forms and lines of insurance authorized by law, except life insurance.

c. Lease of acquired real estate properties for petroleum, refining, storage and distribution facilities, gasoline service stations and other related structures.

d. Sales on wholesale or retail and operation of service stations, retail outlets, restaurants, convenience stores and the like.

e. Export sales of various petroleum and non-fuel products to other Asian countries such as South Korea, China, Taiwan, Singapore, Cambodia, Japan, India and Malaysia.

Segment Assets and Liabilities

Segment assets include all operating assets used by a segment and consist principally of operating cash, receivables, inventories and property, plant and equipment, net of allowances and impairment. Segment liabilities include all operating liabilities and consist principally of accounts payable, wages, taxes currently payable and accrued liabilities. Segment assets and liabilities do not include deferred taxes.

Inter-segment Transactions

Segment revenues, expenses and performance include sales and purchases between operating segments. Transfer prices between operating segments are set on an arm's length basis in a manner similar to transactions with third parties. Such transfers are eliminated in consolidation.

Major Customer

The Group does not have a single external customer from which sales revenue generated amounted to 10% or more of the total revenue of the Group.

The following tables present revenue and income information and certain asset and liability information regarding the business segments for the years ended December 31, 2010, 2009 and 2008.

	Petroleum	Insurance	Leasing	Marketing	Elimination	Total
Year Ended December 31, 2010						
Revenue:						
External sales	**P225,072**	**P -**	**P -**	**P4,022**	**P -**	**P229,094**
Inter-segment sales	**11,059**	**139**	**327**	**-**	**(11,525)**	**-**
Segment results	**11,975**	**112**	**252**	**124**	**48**	**12,511**
Net income	**8,367**	**169**	**50**	**161**	**(823)**	**7,924**
Assets and liabilities:						
Segment assets	**163,823**	**2,086**	**2,935**	**1,097**	**(8,153)**	**161,788**
Segment liabilities	**108,665**	**559**	**2,027**	**303**	**(5,040)**	**106,514**
Other segment information:						
Property, plant and equipment	**31,753**	**-**	**1**	**379**	**2,824**	**34,957**
Depreciation and amortization	**3,419**	**-**	**-**	**65**	**(1)**	**3,483**
Year Ended December 31, 2009						
Revenue:						
External sales	173,157	-	-	3,374	-	176,531
Inter-segment sales	2,182	131	194	-	(2,507)	-
Segment results	8,520	101	137	112	330	9,200
Net income	3,982	161	32	104	(20)	4,259
Assets and liabilities:						
Segment assets	110,272	1,966	2,840	1,262	(3,605)	112,735
Segment liabilities	74,862	277	1,981	537	(2,463)	75,194
Other segment information:						
Property, plant and equipment	31,351	-	-	661	2,772	34,784
Depreciation and amortization	3,493	-	-	79	-	3,572
Year Ended December 31, 2008						
Revenue:						
External sales	263,393	-	-	4,283	-	267,676
Inter-segment sales	3,219	151	191	-	(3,561)	-
Segment results	(2,562)	124	150	119	317	(1,852)
Net income (loss)	(4,347)	155	115	92	65	(3,920)
Assets and liabilities:						
Segment assets	107,883	2,036	2,619	1,507	(3,165)	110,880
Segment liabilities	78,042	535	1,792	881	(2,363)	78,887
Other segment information:						
Property, plant and equipment	33,149	1	-	704	2,574	36,428
Depreciation and amortization	3,156	-	-	72	-	3,228

Intersegment sales transactions amounted to P11,525, P2,507 and P3,561 for the year ended December 31, 2010, 2009 and 2008, respectively, which amounts are less than 6% of the total revenues for the years presented.

The following table presents additional information on the petroleum business segment of the Group for the years ended December 31, 2010, 2009 and 2008:

	Reseller	Lube	Gasul	Industrial	Others	Total
Year Ended December 31, 2010						
Revenue	**P92,583**	**P2,104**	**P15,054**	**P90,311**	**P36,079**	**P236,131**
Property, plant and equipment	**4,524**	**345**	**181**	**43**	**26,660**	**31,753**
Capital expenditures	**169**	**1**	**8**	**2**	**2,615**	**2,795**
Year Ended December 31, 2009						
Revenue	74,954	2,079	12,298	68,438	17,570	175,339
Property, plant and equipment	4,296	427	268	64	26,296	31,351
Capital expenditures	575	573	263	55	(16)	1,450
Year Ended December 31, 2008						
Revenue	102,980	2,087	14,993	96,844	49,707	266,611
Property, plant and equipment	4,138	489	255	46	28,221	33,149
Capital expenditures	288	3	58	5	5,722	6,076

Geographical Segments

Segment assets by geographical location as well as capital expenditure on property, plant and equipment and on intangible assets by geographical location are not separately disclosed since the total segments assets of the segment located outside the country. Ovincor and PSTPL, is less than 1% of the consolidated assets of all segments as of the years ended 2010, 2009 and 2008.

The following table presents revenue information regarding the geographical segments of the Group for the years ended December 31, 2010, 2009 and 2008.

	Petroleum	Insurance	Leasing	Marketing	Elimination/ Others	Total
Year Ended December 31, 2010						
Revenue						
Local	**P206,070**	**P76**	**P327**	**P4,022**	**(P3,296)**	**P207,199**
Export/international	**30,061**	**62**	**-**	**-**	**(8,228)**	**21,895**
Year Ended December 31, 2009						
Revenue						
Local	162,565	70	194	3,374	(2,507)	163,696
Export/international	12,774	61	-	-	-	12,835
Year Ended December 31, 2008						
Revenue						
Local	229,769	94	191	4,283	(3,561)	230,776
Export/international	36,843	57	-	-	-	36,900

37. Events After the End of the Reporting Period

On January 3, 2011, the Parent Company entered into a Share Sale and Purchase Agreement with Harbour Centre Port Terminal Inc. for the purchase of 35% of its outstanding and issued capital stock.

On February 2, 2011, the BOD approved cash dividend to preferred stockholders on record as of February 21, 2011 with payment date of March 7, 2011.

38. Other Matters

a. Petron has unused letters of credit totaling approximately P9,236, P33 and P70 as of end of 2010, 2009 and 2008, respectively.

b. Tax Credit Certificates Related Cases

In 1998, the Philippine Bureau of Internal Revenue ("BIR") issued a deficiency excise tax assessment against the Parent Company. The assessment relates to the Parent Company's use of P659 worth of Tax Credit Certificates ("TCCs") to pay certain excise tax obligations from 1993 to 1997. The TCCs were transferred to the Parent Company by suppliers as payment for fuel purchases. The Parent Company is contesting the BIR's assessment before the Philippine Court of Tax Appeals ("CTA"). In July 1999, the CTA ruled that, as a fuel supplier of Board of Investments-registered companies, the Parent Company is a qualified transferee of the TCCs. Following an unfavorable ruling from the CTA En Banc, Petron filed an appeal to the Supreme Court. A Resolution was issued by the Supreme Court (1st Division) on September 13, 2010 denying with finality Commission of Internal Revenue's motion for reconsideration of the Decision dated July 28, 2010.

In November 1999, the BIR issued a P284 assessment against the Parent Company for deficiency excise taxes for the years 1995 to 1997. The assessment results from the cancellation by the Philippine Department of Finance ("DOF") of tax debit memos, the related TCCs and their assignment to the Parent Company. The Parent Company contested the assessment before the CTA. In August 2006, the CTA denied the Parent Company's petition, ordering it to pay the BIR P580 representing the P284 unpaid deficiency excise from 1995 to 1997, and 20% interest per annum computed from December 4, 1999. In July 2010, the Philippine Supreme Court ("SC') nullified the assessment against the Parent Company and declared the Parent Company as a valid transferee of the TCCs. The BIR filed a motion for reconsideration, which remains pending.

In May 2002, the BIR issued a P254 assessment against the Parent Company for deficiency excise taxes for the years 1995 to 1998. The assessment results from the cancellation by the DOF of tax debit memos, the related TCCs and their assignment to the Parent Company. The Parent Company contested the assessment before the CTA. In May 2007, the CTA second division denied the Parent Company's petition, ordering the Parent Company to pay the BIR P601 representing the Parent Company's P254 unpaid deficiency excise taxes for the taxable years 1995 to 1998, and 25% late payment surcharge and 20% delinquency interest per annum computed from June 27, 2002. The Parent Company appealed the decision to the CTA *en banc*, which ruled in favor of the Parent Company, reversing the unfavorable decision of the CTA second division. The BIR is contesting the CTA *en banc* decision before the SC where the case is still pending.

There are duplications in the TCCs subject of the three assessments described above. Excluding these duplications, the aggregate deficiency excise taxes, excluding interest and penalties, resulting from the cancellation of the subject TCCs amount to P911.

c. Pandacan Terminal Operations

In November 2001, the City of Manila enacted City Ordinance No. 8027 ("Ordinance 8027") reclassifying the areas occupied by the oil terminals of the Parent Company, Shell and Chevron from industrial to commercial. This reclassification made the operation of the oil terminals in Pandacan, Manila illegal. However, in June 2002, the Parent Company, together with Shell and Chevron, entered into a Memorandum of Understanding ("MOU") with the City of Manila and DOE, agreeing to scale down operations, recognizing that this was a sensible and practical solution to reduce the economic impact of Ordinance 8027. In December 2002, in reaction to the MOU, Social Justice Society ("SJS") filed a petition with the SC against the Mayor of Manila asking that the latter be ordered to enforce Ordinance 8027. In April 2003, the Parent Company filed a petition with the Regional Trial Court ("RTC") to annul Ordinance 8027 and enjoin its implementation. On the basis of a *status quo* order issued by the RTC, Mayor of Manila ceased implementation of Ordinance 8027.

The City of Manila subsequently issued the Comprehensive Land Use Plan and Zoning Ordinance ("Ordinance 8119"), which applied to the entire City of Manila. Ordinance 8119 allowed the Parent Company (and other non-conforming establishments) a seven-year grace period to vacate. As a result of the passage of Ordinance 8119, which was thought to effectively repeal Ordinance 8027, in April 2007, the RTC dismissed the petition filed by the Parent Company questioning Ordinance 8027.

However, on March 7, 2007, in the case filed by SJS, the SC rendered a decision (the "March 7 Decision") directing the Mayor of Manila to immediately enforce Ordinance 8027. On March 12, 2007, the Parent Company, together with Shell and Chevron, filed motions with the SC seeking intervention and reconsideration of the March 7 Decision, on the ground that the SC failed to consider supervening events, notably (i) the passage of Ordinance 8119 which supersedes Ordinance 8027, as well as (ii) the RTC orders preventing the implementation of Ordinance 8027. The Parent Company, Shell, and Chevron also noted the possible ill-effects on the entire country arising from the sudden closure of the oil terminals in Pandacan.

On February 13, 2008, the SC resolved to allow the Parent Company, Shell and Chevron to intervene, but denied their motion for reconsideration. In its February 13 resolution (the "February 13 Resolution"), the Supreme Court also declared Ordinance 8027 valid, dissolved all existing injunctions against the implementation of the Ordinance 8027, and directed the Parent Company, Shell and Chevron to submit their relocation plans to the RTC. The Parent Company, Shell and Chevron have sought reconsideration of the February 13 Resolution. In compliance with the February 13 Resolution, the Parent Company, Shell and Chevron have submitted their relocation plans to the RTC.

In May 2009, Manila City Mayor Alfredo Lim approved Ordinance No. 8187 ("Ordinance 8187"), which repealed Ordinance 8027 and Ordinance 8119, and permitted the continued operations of the oil terminals in Pandacan.

In June 2009, petitions were filed with the SC, seeking the nullification of Ordinance 8187 and enjoining its implementation. These petitions are still pending.

d. Oil Spill Incident in Guimaras

On August 11, 2006, M/T Solar I, a third party vessel contracted by the Parent Company to transport approximately two million liters of industrial fuel oil, capsized 13 nautical miles southwest of Guimaras, an island province in the Western Visayas region of the Philippines. In separate investigations by the Philippine Department of Justice ("DOJ") and the Special Board of Marine Inquiry ("SBMI"), both agencies found the owners of M/T Solar I liable. The DOJ found the Parent Company not criminally liable, but the SBMI found the Parent Company to have overloaded the vessel. The Parent Company has appealed the findings of the SBMI to the Philippine Department of Transportation and Communication and is awaiting its resolution. The Parent Company believes that SBMI can impose administrative penalties on vessel owners and crew, but has no authority to penalize other parties, such as the Parent Company, who are charterers.

e. Bataan Real Property Tax Cases

The Parent Company has three pending real property tax cases with the Province of Bataan, arising from three real property tax assessments. The first is for an assessment made by the Municipal Assessor of Limay, Bataan in 2006 for the amount of P86.4 covering the Parent Company's isomerization and gas oil hydrotreater facilities which enjoy, among others, a five -year real property tax exemption under the Oil Deregulation Law per the Board of Investments Certificates of Registration. The second is for an assessment made also in 2006 by the Municipal Assessor of Limay for P17 relating to the leased foreshore area on which the pier of the Parent Company's Refinery is located. In 2007, the Bataan Provincial Treasurer issued a Final Notice of Delinquent Real Property Tax requiring the Parent Company to settle the amount of P2,168 allegedly in delinquent real property taxes as of September 30, 2007, based on a third assessment made by the Provincial Assessor covering a period of 13 years from 1994 to 2007. The third assessment cited the Parent Company's non-declaration or under-declaration of machineries and equipment in the Refinery for real property tax purposes and its failure to pay the corresponding taxes for the said period.

The Parent Company timely contested the assessments by filing appeals with the Local Board of Assessment Appeals ("LBAA"), and posted the necessary surety bonds to stop collection of the assessed amount.

However, with regard to the third assessment, notwithstanding the appeal to the LBAA and the posting of the surety bond, the Provincial Treasurer, acting on the basis of the Final Notice of Delinquent Real Property Tax relating to the third assessment, proceeded with the publication of the public auction of the assets of the Parent Company, which was set for October 17, 2007. Due to the Provincial Treasurer's refusal to cancel the auction sale, the Parent Company filed a complaint for injunction on October 8, 2007 before the RTC to stop the auction sale. A writ of injunction stopping the public auction until the final resolution of the case was issued by the RTC on November 5, 2007.

A motion to dismiss filed by the Provincial Treasurer on the ground of forum-shopping was denied by the RTC. However, a similar motion based on the same ground of forum shopping was filed by the Provincial Treasurer before the LBAA and the motion was granted by the LBAA in December 2007. On appeal by the Parent Company, the Central Board of Assessment Appeals ("CBAA"), in August 2008, remanded the case to the LBAA for factual determination, effectively granting the Parent Company's appeal and reversing the LBAA's dismissal of the case.

The RTC issued a Decision dated June 25, 2010 upholding Petron's position and declared null and void the demand on Petron for the payment of realty taxes in the amount of P1,731 made by the Provincial Assessor of Bataan and the levy of the properties of Petron. The Court issued a Writ of Prohibition permanently prohibiting, preventing and restraining the Provincial Treasurer of Bataan from conducting a public auction of the properties of Petron or selling the same by auction, negotiated sale, or any act of disposition pending the finality of the disposition by the LBAA or CBAA, as the case maybe, on the pending appeal made by Petron from the revised assessment of the Provincial Assessor of Bataan.

f. Other Proceedings

The Parent Company is also party to certain other proceedings arising out of the ordinary course of its business, including legal proceedings with respect to tax, regulatory and other matters. While the results of litigation cannot be predicted with certainty, the Parent Company believes that the final outcome of these other proceedings will not have a material adverse effect on its business, financial condition or results of operations.

39. Prior Period Adjustments

In 2010, the Group changed its accounting policy on accounting for its retirement benefit plan to align the Group's policy to that of SMC. Previously, the Group recognized all actuarial gains and losses ("AGL"), arising from changes in the assumptions used by the actuary in calculating the retirement liability at reporting dates, in other comprehensive income as an allowed alternative of PAS 19 *Employee Benefits*. The change in accounting policy resulted in the application of the "corridor approach" in PAS 19 whereby the Group shall now recognize AGL in profit or loss over the remaining working lives of the employees participating in the plan when the net cumulative unrecognized AGL at the end of the previous reporting year exceed the greater of 10% of the present value of the defined benefit obligation or the fair value of the plan assets.

The change in accounting policy was accounted for retrospectively and had an insignificant effect on the Group's earnings per share.

Comparatives have been restated and outlined below to present the impact of the change in accounting policy to previously reported financial position and financial performance of the Group as of and for the year ended December 31, 2009 and January 1, 2009.

Reconciliation of retained earnings and net income follows:

	Retained Earnings		
	January 1, 2009	December 31, 2009	Net income for 2009
As previously reported	P23,776	P28,014	P4,257
Effect of adoption of the "corridor" approach	(510)	(508)	2
As restated	P23,266	P27,506	P4,259

Reconciliation of asset, liability, equity and expense accounts as of January 1, 2009 and December 31, 2009 follows:

Account Description	As Previously Reported	Effect of Recognition	As Restated	As Previously Reported	Effect of Recognition	As Restated
	January 1, 2009			December 31, 2009		
Statement of Financial Position						
Assets						
Deferred tax assets - net	P885	P10	P895	P -	P -	P -
Other noncurrent assets - net	925	(33)	892	1,329	(451)	878
Liability						
Deferred tax liabilities - net	P8	P -	P8	P514	(P150)	P364
Retirement benefits liability	-	-	-	-	50	50
Equity						
Retained earnings	P23,776	(P510)	P23,266	P28,014	(P508)	P27,506
Other reserves	(473)	487	14	(98)	157	59
Statement of Income						
Selling and administrative expenses	P5,222	P -	P5,222	P5,751	(P3)	P5,748
Income tax expense (benefit)	1,873	-	1,873	1,491	1	1,492
Statement of Comprehensive Income						
Actuarial gain/(loss) on defined pension benefit plan	(P64)	P64	P -	P330	(P330)	P -

The "Other Noncurrent Assets - net" adjustments pertain to Retirement assets (Note 14).

COVER SHEET

S.E.C. Registration Number

PETRON CORPORATION AND SUBSIDIARIES

(Company's Full Name)

SMC Head Office Complex
40 San Miguel Avenue
Mandaluyong City

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

Contact Person

Company Telephone Number

12	31	AAFS		
Month	*Day*	FORM TYPE	*Month*	*Day*
			Annual Meeting	

Secondary License Type, If Applicable

Dept. Requiring this Doc.

Amended Articles Number/Section

Total Amount of Borrowings

Total No. of Stockholders

Domestic

Foreign

To be accomplished by SEC Personnel concerned

File Number

LCU

Document I.D.

Cashier

S T A M P S

Remarks = pls. use black ink for scanning purposes.