ASSURANCE AND ADVISORY
BUSINESS SERVICES

PNOC ENERGY DEVELOPMENT CORPORATION

(A Subsidiary of Red Vulcan Holdings Corporation)

Financial Statements
December 31, 2007, 2006 and 2005

and

Independent Auditors' Report

SGV & Co
A MEMBER PRACTICE OF ERNST & YOUNG GLOBAL

Quality In Everything We Do

SYCIP GORRES VELAYO & CO.

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BOA/PRC Reg. No. 0001
SEC Accreditation No. 0012-FR-1

INDEPENDENT AUDITORS' REPORT

The Stockholders and the Board of Directors
PNOC Energy Development Corporation

We have audited the accompanying financial statements of PNOC Energy Development Corporation (a subsidiary of Red Vulcan Holdings Corporation), which comprise the balance sheet as of December 31, 2007, and the statement of income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory notes. The financial statements of the Company as of and for the years ended December 31, 2006 and 2005 were audited by another auditor whose report dated March 27, 2007, expressed an unqualified opinion on those statements. Those financial statements, however, do not include the restatement adjustments as discussed in Note 44.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Philippine Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the 2007 financial statements referred to above present fairly, in all material respects, the financial position of PNOC Energy Development Corporation as of December 31, 2007, and its financial performance and its cash flows for the year then ended in accordance with Philippine Financial Reporting Standards.

We also audited the adjustments described in Note 44 to the financial statements that were applied to restate the 2006 and 2005 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

SYCIP GORRES VELAYO & CO.

Ladislao Z. Avila, Jr.
Partner
CPA Certificate No. 69099
SEC Accreditation No. 0111-AR-1
Tax Identification No. 109-247-891
PTR No. 0017573, January 3, 2008, Makati City

January 22, 2008

PNOC ENERGY DEVELOPMENT CORPORATION
(A Subsidiary of Red Vulcan Holdings Corporation)

BALANCE SHEET
DECEMBER 31, 2007
(With Comparative Figures for 2006)

	2007	2006 (Restated)
ASSETS		
Current Assets		
Cash and cash equivalents (Note 6)	**₱2,797,581,577**	₱9,999,202,227
Trade and other receivables (Note 7)	**4,925,681,584**	4,355,257,059
Concession receivable (Note 34)	**2,199,986,327**	2,070,920,965
Available-for-sale (AFS) investments (Note 10)	**1,177,589,987**	1,341,751,679
Parts and supplies inventories (Note 8)	**1,140,044,062**	1,164,452,145
Due from affiliated companies	–	4,785,103
Derivative assets	–	344,000,987
Other current assets (Note 9)	**535,582,774**	917,776,810
	12,776,466,311	20,198,146,975
Noncurrent assets held for sale (Note 11)	**1,672,516,100**	–
Total Current Assets	**14,448,982,411**	20,198,146,975
Noncurrent Assets		
Concession receivable - net of current portion (Note 34)	**34,695,434,198**	36,895,420,525
Intangible asset (Note 13)	**8,738,836,827**	8,794,316,944
Deferred income tax assets - net (Note 30)	**3,052,792,587**	4,919,954,067
Exploration and evaluation assets (Note 14)	**1,171,922,174**	1,614,922,295
Property and equipment (Note 12)	**1,111,020,356**	2,469,219,679
Investment property (Note 15)	**5,121,709**	278,921,181
Other noncurrent assets (Note 16)	**1,846,624,604**	2,221,561,116
Total Noncurrent Assets	**50,621,752,455**	57,194,315,807
TOTAL ASSETS	**₱65,070,734,866**	₱77,392,462,782
LIABILITIES AND EQUITY		
LIABILITIES		
Current Liabilities		
Trade and other payables (Note 17)	**₱3,637,782,267**	₱6,429,065,264
Income tax payable	**418,986,388**	507,932,215
Current portion of long-term debt (Note 20)	**2,031,565,879**	3,171,351,515
Current portion of obligations to power plant contractors (Note 19)	**246,719,220**	2,766,401,494
Current portion of royalty fee payable (Note 18)	**456,273,707**	524,644,631
Due to Philippine National Oil Company (PNOC)	–	350,844,177
Total Current Liabilities	**6,791,327,461**	13,750,239,296

(Forward)

	2007	2006 (Restated)
Noncurrent Liabilities		
Long-term debt - net of current portion (Note 20)	**₱20,809,947,547**	₱33,308,649,468
Royalty fee payable - net of current portion (Note 18)	**1,277,653,457**	1,419,678,292
Obligations to power plant contractors - net of current portion (Note 19)	**96,287,392**	413,180,565
Retirement and other post-retirement benefit plans (Note 39)	**912,069,757**	869,569,338
Other long-term liabilities (Note 21)	**330,168,646**	256,432,845
Total Noncurrent Liabilities	**23,426,126,799**	36,267,510,508
EQUITY		
Common stock (Note 22)	**15,000,000,000**	15,000,000,000
Preferred stock (Note 22)	**75,000,000**	–
Additional paid-in capital (Note 22)	**6,278,075,648**	6,278,075,648
Accumulated unrealized gain on AFS investments (Note 10)	**368,549,253**	131,462,811
Retained earnings (Note 23)	**13,131,655,705**	5,965,174,519
Total Equity	**34,853,280,606**	27,374,712,978
TOTAL LIABILITIES AND EQUITY	**₱65,070,734,866**	₱77,392,462,782

See accompanying Notes to Financial Statements.

PNOC ENERGY DEVELOPMENT CORPORATION
(A Subsidiary of Red Vulcan Holdings Corporation)

STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 2007
(With Comparative Figures for the Years Ended December 31, 2006 and 2005)

	Years Ended December 31		
	2007	2006 (Restated)	2005 (Restated)
REVENUES			
Revenue from sale of electricity	**₱11,291,898,705**	₱12,329,293,369	₱13,221,450,697
Revenue from sale of steam	**4,521,232,474**	4,173,352,911	4,184,165,193
Interest income on service concession	**2,236,906,585**	2,357,591,482	2,470,503,366
Revenue from drilling services	**624,777,831**	261,449,987	149,524,840
Construction revenue	**108,813,951**	6,599,983,742	2,194,333,202
	18,783,629,546	25,721,671,491	22,219,977,298
OPERATING EXPENSES			
Purchased services and utilities (Note 24)	**(3,037,996,158)**	(5,097,022,773)	(6,729,759,120)
Construction costs	**(101,137,594)**	(6,021,156,889)	(2,042,725,148)
Depreciation and amortization	**(220,109,054)**	(97,686,449)	(82,724,315)
Operations and maintenance (Note 25)	**(3,069,862,420)**	(3,241,956,710)	(3,290,215,921)
General and administrative (Note 26)	**(2,375,691,381)**	(1,047,347,557)	(1,861,315,361)
	(8,804,796,607)	(15,505,170,378)	(14,006,739,865)
FINANCIAL INCOME (EXPENSES)			
Interest income - net of final tax	**648,736,545**	330,161,680	446,165,085
Interest expense (Note 27)	**(1,567,038,735)**	(2,330,786,357)	(2,604,375,818)
	(918,302,190)	(2,000,624,677)	(2,158,210,733)
OTHER INCOME (CHARGES)			
Foreign exchange gains - net (Note 28)	**3,900,346,224**	2,041,014,023	6,442,750,524
Derivatives gain (loss)	**56,011,571**	(145,851,332)	200,262,741
Miscellaneous - net (Note 29)	**(204,412,937)**	(22,068,021)	(97,370,469)
	3,751,944,858	1,873,094,670	6,545,642,796
INCOME BEFORE INCOME TAX	**12,812,475,607**	10,088,971,106	12,600,669,496
PROVISION FOR INCOME TAX (Note 30)	**(4,160,994,421)**	(3,225,629,880)	(3,426,506,227)
NET INCOME	**₱8,651,481,186**	₱6,863,341,226	₱9,174,163,269
Basic/diluted earnings per share (Note 31)	**₱0.577**	₱0.565	₱0.765

See accompanying Notes to Financial Statements.

PNOC ENERGY DEVELOPMENT CORPORATION
(A Subsidiary of Red Vulcan Holdings Corporation)

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED DECEMBER 31, 2007
(With Comparative Figures for the Years Ended December 31, 2006 and 2005)

	Common Stock	Preferred Stock	Additional Paid-in Capital	Accumulated Unrealized Gain on AFS Investments	Retained Earnings Appropriated	Retained Earnings Unappropriated	Total
Balance, January 1, 2005, as previously reported	₱10,000,000,000	₱–	₱–	₱–	₱–	(₱8,262,782,320)	₱1,737,217,680
Impact of early adoption of IFRIC 12 (Note 3)	–	–	–	–	–	908,737,729	908,737,729
Prior period adjustments (Note 44)	–	–	–	–	–	(718,285,385)	(718,285,385)
Balance, January 1, 2005, as restated	10,000,000,000	–	–	–	–	(8,072,329,976)	1,927,670,024
Net income, as restated	–	–	–	–	–	9,174,163,269	9,174,163,269
Gain on AFS investments recognized in equity (Note 10)	–	–	–	110,309,139	–	–	110,309,139
Total recognized income for the year	–	–	–	110,309,139	–	9,174,163,269	9,284,472,408
Balance, December 31, 2005	₱10,000,000,000	₱–	₱–	₱110,309,139	₱–	₱1,101,833,293	₱11,212,142,432
Balance, January 1, 2006, as previously reported	₱10,000,000,000	₱–	₱–	₱110,309,139	₱–	₱1,653,315,043	₱11,763,624,182
Impact of early adoption of IFRIC 12 (Note 3)	–	–	–	–	–	675,548,451	675,548,451
Prior period adjustments (Note 44)	–	–	–	–	–	(1,227,030,201)	(1,227,030,201)
Balance, January 1, 2006, as restated	10,000,000,000	–	–	110,309,139	–	1,101,833,293	11,212,142,432
Net income, as restated	–	–	–	–	–	6,863,341,226	6,863,341,226
Gain on AFS investments recognized in equity (Note 10)	–	–	–	22,235,323	–	–	22,235,323
Gain on AFS investments removed from equity and recognized in profit and loss (Note 10)	–	–	–	(1,081,651)	–	–	(1,081,651)
Total recognized income for the year	10,000,000,000	–	–	21,153,672	–	6,863,341,226	6,884,494,898
Appropriation for exploration projects	–	–	–	–	1,653,315,043	(1,653,315,043)	–
Stock dividends - 20%	2,000,000,000	–	–	–	–	(2,000,000,000)	–
Issuance of common shares (Note 22)	3,000,000,000	–	6,278,075,648	–	–	–	9,278,075,648
Balance, December 31, 2006	₱15,000,000,000	₱–	₱6,278,075,648	₱131,462,811	₱1,653,315,043	₱4,311,859,476	₱27,374,712,978

(Forward)

	Common Stock	Preferred Stock	Additional Paid-in Capital	Accumulated Unrealized Gain on AFS Investments	Retained Earnings Appropriated	Retained Earnings Unappropriated	Total
Balance, January 1, 2007, as previously reported	₱15,000,000,000	₱–	₱6,278,075,648	₱131,462,811	₱1,653,315,043	₱4,782,924,651	₱27,845,778,153
Impact of early adoption of IFRIC 12 (Note 3)	–	–	–	–	–	1,106,906,850	1,106,906,850
Prior period adjustments (Note 44)	–	–	–	–	–	(1,577,972,025)	(1,577,972,025)
Balance, January 1, 2007, as restated	15,000,000,000	–	6,278,075,648	131,462,811	1,653,315,043	4,311,859,476	27,374,712,978
Net income, as restated	–	–	–	–	–	8,651,481,186	8,651,481,186
Gain on AFS investments recognized in equity (Note 10)	–	–	–	245,024,166	–		245,024,166
Gain on AFS investments removed from equity and recognized in profit and loss (Note 10)	–	–	–	(7,937,724)	–	–	(7,937,724)
Total recognized income for the year	–	–	–	237,086,442	–	8,651,481,186	8,888,567,628
Issuance of preferred shares (Note 22)	–	75,000,000	–	–	–	–	75,000,000
Cash dividends - ₱0.099 a share (Note 23)	–	–	–	–	–	(1,485,000,000)	(1,485,000,000)
Balance, December 31, 2007	₱15,000,000,000	₱75,000,000	₱6,278,075,648	₱368,549,253	₱1,653,315,043	₱11,478,340,662	₱34,853,280,606

See accompanying Notes to Financial Statements.

PNOC ENERGY DEVELOPMENT CORPORATION
(A Subsidiary of Red Vulcan Holdings Corporation)

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2007
(With Comparative Figures for the Years Ended December 31, 2006 and 2005)

	Years Ended December 31		
	2007	2006 (Restated)	2005 (Restated)
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax	**₱12,812,475,607**	₱10,088,971,106	₱12,600,669,496
Adjustments for:			
Interest expense	**1,567,038,735**	2,330,786,357	2,604,375,816
Depreciation and amortization (Note 12)	**260,053,996**	128,983,367	114,709,736
Unrealized foreign exchange losses (gains)	**(3,252,473,403)**	(2,446,842,473)	(6,581,568,490)
Interest income on service concession	**(2,236,906,585)**	(2,357,591,482)	(2,470,503,366)
Interest income	**(648,736,545)**	(330,161,680)	(446,165,085)
Gain on derivatives	**(58,497,977)**	(145,851,332)	200,262,671
Receipt of inventories from power plant contractor	**–**	(125,636,878)	–
Gain on disposals of property and equipment	**–**	(1,730,483)	–
Operating income before working capital changes	**8,442,953,828**	7,140,926,502	6,021,780,778
Decrease (increase) in:			
Trade and other receivables	**(570,424,525)**	244,158,095	(143,152,562)
Parts and supplies inventories	**24,408,083**	(82,052,395)	93,437,098
Service concession receivable	**4,307,827,549**	4,307,827,549	4,307,827,549
Derivative assets	**402,498,964**	324,754,827	(372,714,468)
Other current assets	**382,194,036**	(387,302,002)	5,735,578,833
Increase (decrease) in trade and other payables	**(2,747,543,551)**	1,154,041,585	572,375,484
Net cash generated from operations	**10,241,914,384**	12,702,354,161	16,215,132,712
Income taxes paid	**(2,382,778,768)**	(3,277,594,061)	(380,688,835)
Interest paid	**(1,567,038,735)**	(2,330,786,357)	(2,604,375,816)
Net cash flows from operating activities	**6,292,096,881**	7,093,973,743	13,230,068,061
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest received	**648,736,545**	330,161,680	446,165,085
Decrease in exploration and evaluation assets	**461,679,362**	623,844,176	3,288,783,303
Increase (decrease) in other noncurrent assets	**430,780,017**	(503,784,092)	(451,661,034)
Increase (decrease) in available-for-sale investments	**401,248,134**	1,473,118,337	(2,683,469,705)
Proceeds from sale of investment	**45,000,000**	62,500	(62,500)
Proceeds from disposal of property and equipment	**3,210,009**	2,175,000	–
Addition to intangible asset	**(108,813,951)**	(6,599,983,742)	(2,194,333,202)
Additions to property and equipment (Note 12)	**(158,166,483)**	(540,830,419)	(967,958,447)
Decrease in due to PNOC	**(350,844,177)**	(13,323,561)	(96,143,183)
Net cash flows from (used in) investing activities	**1,372,829,456**	(5,228,560,121)	(2,658,679,683)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of preferred shares (Note 22)	**75,000,000**	–	–
Increase (decrease) in other long-term liabilities	**72,496,772**	(3,805,337,473)	(6,017,750,328)
Proceeds from (payments to) affiliated companies	**4,785,103**	(2,191,285)	1,421,864
Proceeds from initial public offering (Note 22)	**–**	9,278,075,648	–
Proceeds from loan availments	**–**	2,725,632,762	2,437,307,488
Payment of cash dividend (Note 23)	**(1,485,000,000)**	–	–
Payments of long-term debt	**(13,533,828,862)**	(4,512,480,992)	(3,388,597,422)
Net cash flows from (used in) financing activities	**(14,866,546,987)**	3,683,698,660	(6,967,618,398)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(7,201,620,650)**	5,549,112,282	3,603,769,980
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**9,999,202,227**	4,450,089,945	846,319,965
CASH AND CASH EQUIVALENTS AT END OF YEAR	**₱2,797,581,577**	₱9,999,202,227	₱4,450,089,945

See accompanying Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

1. Corporate Information

PNOC Energy Development Corporation (the "Company") is a company incorporated and domiciled in the Philippines whose shares are publicly traded. It was registered with the Philippine Securities and Exchange Commission (SEC) on March 5, 1976. The Company is involved in geothermal steam production and power generation business, and drilling and consultancy services.

The Company became a subsidiary of Red Vulcan Holdings Corporation starting November 29, 2007. Red Vulcan Holdings Corporation is a wholly owned subsidiary of First Gen Corporation, a publicly listed entity. The ultimate parent of the Company is First Philippine Holdings Corporation.

The registered office address of the Company is Merritt Road, Ft. Bonifacio, Taguig City, Metro Manila.

The Board of Directors (BOD) approved and authorized for issue the Company's financial statements on January 22, 2008.

2. Basis of Preparation

The financial statements have been prepared on a historical cost basis, except for derivatives and AFS investments that have been measured at fair value. The financial statements are presented in Philippine peso, the Company's functional currency.

Statement of compliance
The financial statements of the Company have been prepared in compliance with Philippine Financial Reporting Standards (PFRS).

Changes in accounting policies
The accounting policies adopted are consistent with those of the previous financial year, except as follows:

The Company has adopted the following new and amended PFRS and Philippine Interpretations during the year. Adoption of these new and amended standards and Interpretations did not have any significant effect on the financial performance or position of the Company. They did however give rise to additional disclosures, including in some cases, revisions to accounting policies.

- PFRS 7, *Financial Instruments: Disclosures*
- Philippine Accounting Standards (PAS) 1 Amendment - *Presentation of Financial Statements*
- Philippine Interpretation IFRIC 8, *Scope of IFRS 2, Share-based Payment*
- Philippine Interpretation IFRIC 9, *Reassessment of Embedded Derivatives*
- Philippine Interpretation IFRIC 10, *Interim Financial Reporting and Impairment*

The Company has also early adopted Philippine Interpretation IFRIC 12, *Service Concession Arrangements.* The effect of adopting Philippine Interpretation IFRIC 12 is discussed in Note 3.

The principal effects of these changes are as follows:

PFRS 7, *Financial Instruments: Disclosures*
This standard introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, as well as sensitivity analysis to market risk. It replaces PAS 30, *Disclosures in the Financial Statements of Banks and Similar Financial Institutions*, and the disclosure requirements in PAS 32, *Financial Instruments: Disclosure and Presentation*. It is applicable to all entities that report under PFRS. Adoption of this standard resulted to the inclusion of additional disclosures such as market risk sensitivity analysis, contractual maturity analysis of financial liabilities and aging analysis on financial assets that are neither past due nor impaired (see Note 42). The Company availed of the transitional relief on disclosure of comparative information PFRS 7.

Amendment to PAS 1, *Presentation of Financial Statements*
This amendment introduces disclosures about the level of the Company's capital and how it manages capital. Adoption of the Amendment resulted to the inclusion of additional disclosures on capital management (see Note 42).

Philippine Interpretation IFRIC 8, *Scope of PFRS 2, Share-based Payment*
This Interpretation requires PFRS 2 to be applied to any arrangements in which the entity cannot identify specifically some or all of the goods received, in particular where equity instruments are issued for consideration which appears to be less than fair value. As the Company does not have any such transaction, the Interpretation had no impact on the financial position or performance of the Company.

Philippine Interpretation IFRIC 9, *Reassessment of Embedded Derivatives*
Philippine Interpretation IFRIC 9 states that the date to assess the existence of an embedded derivative is the date that an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. Adoption of this Interpretation had no significant impact on the financial position or performance of the Company.

Philippine Interpretation IFRIC 10, *Interim Financial Reporting and Impairment*
The Company adopted Philippine Interpretation IFRIC 10 as of January 1, 2007, which requires that an entity must not reverse an impairment loss recognized in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost. As the Company has no goodwill and had no impairment losses previously reversed with respect to its investments in AFS equity instruments, the Interpretation had no impact on the financial position or performance of the Company.

Philippine Interpretation IFRIC 12, *Service Concession Arrangements*
The Company has elected to early adopt Philippine Interpretation IFRIC 12 as of January 1, 2007, as it applies to the infrastructure and other assets constructed or acquired by the Company in connection with its geothermal service contracts, geothermal resources sales agreements, and

power purchase agreements with the Government of the Republic of the Philippines and certain of its agencies. Philippine Interpretation IFRIC 12 becomes effective for annual periods beginning on or after January 1, 2008. This Interpretation applies to service concession operators and explains how to account for the obligations undertaken and rights received in service concession arrangements. Refer to Note 3 for the detailed discussion on the impact of adopting this Interpretation.

3. Effect of Adoption of Philippine Interpretation IFRIC 12

As discussed in Note 2 and as allowed by its transitional provisions, the Company early adopted Philippine Interpretation IFRIC 12, *Service Concession Arrangements*, on its service concession and related arrangements as more fully described in Note 34. Accordingly, the Company has recognized the consideration received or receivable in exchange for its infrastructure construction services or its acquisition of infrastructure to be used in the arrangements as either a financial asset to the extent that the Company has an unconditional contractual right to receive cash or other financial asset for its construction services from or at the direction of the grantor, or an intangible asset for the right to charge users of the public service.

Adoption of this Interpretation resulted in the following:

- Derecognition of the carrying amounts of the concession assets consisting of the production wells, fluid collection and recycling systems, building infrastructures, power plants and other assets amounting to ₱44,672.94 million as of January 1, 2005;
- Recognition of financial assets initially at the fair value of the construction services and subsequently carried at amortized cost using the effective interest rate method, which had a carrying amount of ₱42,753.90 million as of January 1, 2005;
- Recognition of the aggregate effect on retained earnings as of January 1, 2005 of the profits on construction services; elimination of depreciation and amortization expenses on the concession assets; reduction in revenues relating to the collection of the financial assets; interest income on the amortization of the financial assets and the amortization of the intangible asset, which resulted to an increase of ₱908.74 million as of January 1, 2005.

The effect of adopting this Interpretation has increased the reported net income in 2006 by ₱431.36 million and has decreased the reported net income in 2005 by ₱233.19 million; and has increased the reported total assets as of December 31, 2006 and 2005 by ₱1,106.91 million and ₱675.55 million, respectively.

The effect of adopting this Interpretation is an increase in the reported basic/diluted earnings per share in 2006 by ₱0.036 and a decrease by ₱0.019 in 2005.

As allowed by the transition provisions of Philippine Interpretation IFRIC 12, the Company applied this Interpretation retroactive to January 1, 2005.

4. Significant Accounting Judgments and Estimates

The preparation of the Company's financial statements requires management to make judgments, estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities, at the reporting date. However, uncertainty about these assumptions and estimates could result in outcomes that could require material adjustments to the carrying amounts of the assets or liabilities in the future.

Judgments
In the process of applying the Company's accounting policies, management has made the following judgment, apart from those involving estimates, which has the most significant effect on the amounts recognized in the financial statements:

Functional currency
The Company's transactions are denominated or settled in various currencies such as the Philippine peso, US dollar, and Japanese yen. The Company has determined that its functional currency is the Philippine peso, which management has evaluated to be the currency that most faithfully represents the economic substance of the Company's underlying transactions, events and conditions.

Service concession arrangements
In applying Philippine Interpretation IFRIC 12, the Company has made a judgment that its service contracts in Tongonan, Leyte; Palinpinon, Negros Oriental; Bacon-Manito in Albay and Sorsogon; and Mt. Apo in North Cotabato qualify under the financial asset model; while its service contract in Northern Negros qualifies under the intangible asset model. Refer to the accounting policy on service concession arrangements for the discussion of financial asset model and intangible asset model.

Deferred revenue on stored energy
Under the Company's addendum agreements with National Power Corporation (NPC), the Company has commitment to NPC for certain stored energy that NPC can lift for a certain specified period provided that the Company is able to generate such energy over and above the nominated energy for each given year in accordance with the related power purchase agreements. The Company has made a judgment based on historical information that the probability of future liftings by NPC from the stored energy is remote and accordingly has not deferred any portion of the collected revenues. The stored energy commitments are however disclosed in the financial statements under the discussion on contingencies and commitments (see Note 43).

Estimates and assumptions
The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below:

Impairment of receivables
The Company maintains an allowance for doubtful accounts at a level that management considers adequate to provide for potential uncollectibility of its trade and other receivables, and its receivables arising from service concession arrangements. The Company evaluates specific balances where management has information that certain amounts may not be collectible. In these cases, the Company uses judgment, based on available facts and circumstances, and based on a

review of the factors that affect the collectibility of the accounts including, but not limited to, the age and status of the receivables, collection experience, past loss experience and, in the case of the receivables arising from service concession arrangements, the expected net cash inflows from the concession. The review is made by management on a continuing basis to identify accounts to be provided with allowance. These specific reserves are re-evaluated and adjusted as additional information received affects the amount estimated.

The carrying amounts of trade and other receivables and receivables arising from service concession arrangements are ₱4,925.68 million and ₱36,895.42 million, respectively, as of December 31, 2007 (₱4,355.26 million and ₱38,966.34 million in 2006).

In addition to specific allowance against individually significant receivables, the Company also makes a collective impairment allowance against exposures which, although not specifically identified as requiring a specific allowance, have a greater risk of default than when originally granted. This collective allowance is based on historical default experience.

Impairment of non-financial assets
The Company assesses whether there are any indicators of impairment for all non-financial assets at each reporting date. These non-financial assets (intangible assets arising from service concession arrangements, property and equipment, investment property, deferred income tax assets and claim for excess input vat) are tested for impairment when there are indicators that the carrying amounts may not be recoverable. Where the collection of a tax claim is uncertain based on the assessment of the Company's legal counsel, the Company provides an allowance for impairment. When value in use calculations are undertaken, management must estimate the expected future cash flows from the asset or cash generating unit and choose a suitable discount rate in order to calculate the present value of those cash flows. Further details, including a sensitivity analysis of key assumptions, are given in Note 42.

Estimating useful life of intangible asset arising from service concession arrangement and property and equipment
The Company estimates the useful life of intangible asset arising from service concession arrangement and property and equipment based on the period over which the asset is expected to be available for use and on the collective assessment of industry practices, internal evaluation and experience with similar arrangements. The estimated useful life is revisited periodically and updated if expectations differ materially from previous estimates. For purposes of determining the estimated useful life of the intangible asset arising from a service concession arrangement, the Company included the renewal period on the basis of the constitutional and contractual provisions and the Company's historical experience of obtaining approvals of such renewals at no significant cost. The carrying amount of the intangible asset arising from a service concession arrangement and property and equipment are ₱8,738.84 million and ₱1,111.02 million as of December 31, 2007 (₱8,794.32 million and ₱2,469.22 million in 2006).

Exploration and evaluation assets
Exploration and evaluation costs are capitalized in accordance with PFRS 6, *Exploration for and Evaluation of Mineral Resources*. Capitalization of these costs is based, on certain instances, on management's judgment of the degree to which the expenditure can be associated with finding specific geothermal reserve. The Company determines impairment of projects based on the technical assessment of its resident scientists in various disciplines or based on management's

decision not to pursue any further commercial development of its exploration projects. At December 31, 2007, the carrying amount of capitalized exploration and evaluation costs was ₱1,171.92 million (₱1,614.92 million in 2006).

Retirement and other post-employment benefits
The cost of defined benefit retirement plan and other post-retirement medical and life insurance benefits is determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future retirement pay increases. Due to the long term nature of these plans, such estimates are subject to significant uncertainty. The net retirement benefit liability at December 31, 2007 is ₱912.07 million (₱869.57 million in 2006). Further details are given in Note 39.

Provision for dismantlement, removal and restoration costs
In determining the amount of provisions for dismantlement, removal and restoration costs, assumptions and estimates are required in relation to the expected cost to dismantle, remove or restore sites and infrastructure when such obligation exists. The Company has made an assessment that such costs are not significant as of December 31, 2007 and 2006.

Provision for liabilities on regulatory assessments
The Company is currently involved in certain regulatory assessments. The Company's estimate of the probable costs for the resolution of these assessments has been developed in consultation with in-house and outside counsels and is based upon the analysis of the potential results. It is possible, however, that future results of operations could be materially affected by changes in the estimates or in the effectiveness of strategies relating to these proceedings. As of December 31, 2007 provision for liabilities on these regulatory assessments amount to ₱1,364.76 million (₱1,047.31 million in 2006).

Impairment of AFS financial assets
The Company classifies certain assets as AFS and recognizes movements in their fair value in equity. When the fair value declines, management makes assumptions about the decline in value to determine whether it is an impairment that should be recognized in profit or loss. At December 31, 2007 no impairment losses have been recognized for AFS financial assets (2006: NIL). The carrying amount of AFS financial assets was ₱1,194.00 million (₱1,353.90 million in 2006).

Deferred income tax assets
Deferred tax assets are recognized to the extent that it is probable that taxable profit will be available against which the assets can be utilized. Significant management judgment is required to determine the amount of net deferred tax assets that can be recognized, based upon the likely timing and level of future taxable profits together with future tax planning strategies. The carrying value of recognized deferred income tax assets at December 31, 2007 was ₱3,052.792 million (₱4,919.95 million in 2006). There are no unrecognized deferred income tax assets at December 31, 2007 (2006: NIL). Further details are contained in Note 30.

Fair values of embedded derivatives
The fair values of embedded derivatives that are not quoted in active markets are determined using valuation techniques. Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by qualified personnel independent of the area that created them. All models are reviewed before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practicable, models use only observable data, however areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates. Changes in assumptions about these factors could affect reported fair value of financial instruments. Refer to Note 42 for information on the carrying values of these instruments.

5. Summary of Significant Accounting Policies

Foreign currency translation
The financial statements are presented in Philippine peso, which is the Company's functional and presentation currency. Transactions in foreign currencies are initially recorded at the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to profit or loss. Nonmonetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Nonmonetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.

Parts and supplies inventories
Inventories are valued at the lower of cost and net realizable value. Cost includes invoice amount, net of trade and cash discounts. Cost is calculated using the moving-average method. Net realizable value represents the current replacement costs.

Property and equipment
Property and equipment is stated at cost less accumulated depreciation and accumulated impairment losses. Such cost includes the cost of replacing part of the property and equipment when that cost is incurred, if the recognition criteria are met. All other repair and maintenance costs are recognized in profit or loss as incurred.

Depreciation is calculated on a straight-line basis over the estimated useful life of the asset. An item of property and equipment is derecognized upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in profit or loss in the year the asset is derecognized. The assets' residual values, useful lives and methods of depreciation are reviewed, and adjusted if appropriate, at each financial year end.

Construction in progress is stated at cost and is not depreciated until such time that the assets are completed and/or put into operational use.

Noncurrent assets held for sale
Assets are classified as noncurrent assets held for sale if their carrying amounts will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale that should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Noncurrent assets classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell and depreciation on such assets cease.

Investment properties
Investment properties are measured initially at cost, including transaction 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. Subsequent to initial recognition, investment properties are stated at cost less accumulated depreciation and any accumulated impairment losses.

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

No assets held under operating lease have been classified as investment properties.

Service concession arrangements
Public-to-private service concession arrangements where: (a) the grantor controls or regulates what services the Company must provide with the infrastructure, to whom it must provide them, and at what price; and (b) the grantor controls-through ownership, beneficial entitlement or otherwise-any significant residual interest in the infrastructure at the end of the term of the arrangement are accounted for under the provisions of Philippine Interpretation IFRIC 12. Infrastructures used in a public-to-private service concession arrangement for its entire useful life (whole-of-life assets) are within the scope of this Interpretation if the conditions in (a) are met.

This Interpretation applies to both: (a) infrastructure that the Company constructs or acquires from a third party for the purpose of the service arrangement; and (b) existing infrastructure to which the grantor gives the Company access for the purpose of the service arrangement.

Infrastructures within the scope of this Interpretation are not recognized as property and equipment of the Company. Under the terms of contractual arrangements within the scope of this Interpretation, the Company acts as a service provider. The Company constructs or upgrades infrastructure (construction or upgrade services) used to provide a public service and operates and maintains that infrastructure (operation services) for a specified period of time.

The Company recognizes and measures revenue in accordance with PAS 11, *Construction Contracts*, and PAS 18, *Revenues,* for the services it performs. If the Company performs more than one service (i.e. construction or upgrade services and operation services) under a single contract or arrangement, consideration received or receivable shall be allocated by reference to the relative fair values of the services delivered, when the amounts are separately identifiable.

When the Company provides construction or upgrade services, the consideration received or receivable by the Company is recognized at its fair value. The Company accounts for revenue and costs relating to construction or upgrade services in accordance with PAS 11. Revenue from construction contracts is recognized based on the percentage-of-completion method, measured by reference to the percentage of costs incurred to date to estimated total costs for each contract. The Company accounts for revenue and costs relating to operation services in accordance with PAS 18.

The Company recognizes a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services. The Company recognizes an intangible asset to the extent that it receives a right (a license) to charge users of the public service.

When the Company has contractual obligations it must fulfill as a condition of its license (a) to maintain the infrastructure to a specified level of serviceability or (b) to restore the infrastructure to a specified condition before it is handed over to the grantor at the end of the service arrangement, it recognizes and measures these contractual obligations in accordance with PAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, i.e., at the best estimate of the expenditure that would be required to settle the present obligation at the balance sheet date.

In accordance with PAS 23, *Borrowing Costs*, borrowing costs attributable to the arrangement are recognized as an expense in the period in which they are incurred unless the Company has a contractual right to receive an intangible asset (a right to charge users of the public service). In this case, borrowing costs attributable to the arrangement are capitalized during the construction phase of the arrangement in accordance with the allowed alternative treatment under that Standard.

Intangible asset
The Company's intangible asset pertains mainly to its right to charge users of the public service in connection with the service concession and related arrangements. This is recognized initially at the fair value of the construction services. Following initial recognition, the intangible asset is carried at cost less accumulated amortization and any accumulated impairment losses.

The intangible asset is amortized using the straight-line method over the estimated useful economic life which is the service concession period, and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortization period and the amortization method are reviewed at least at each financial yearend. 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 is recognized in profit or loss in the expense category consistent with the function of the intangible asset.

Gains or losses arising from derecognition 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.

Exploration and evaluation assets
All costs incurred in the geological and geophysical activities such as costs of topographical, geological and geophysical studies; rights of access to properties to conduct those studies; salaries and other expenses of geologists, geophysical crews, or others conducting those studies are charged outright to expense.

If the results of initial geological and geophysical activities reveal the presence of geothermal resource that will require further exploration and drilling, subsequent exploration and drilling costs are accumulated and deferred under the Exploration and Evaluation Assets account.

These costs include the following:

a. costs associated with the construction of temporary facilities;

b. costs of drilling exploratory and exploratory-type stratigraphic test wells, pending determination of whether the wells can produce proved reserves; and,

c. costs of local administration, finance, general and security services, surface facilities and other local costs in preparing for and supporting the drilling activities, etc. incurred during the drilling of exploratory wells.

After tests conducted on the drilled exploratory wells reveal that these wells cannot produce proved reserves, the capitalized costs are charged to expense except when management decides to use the unproductive wells, for recycling or waste disposal.

Impairment of non-financial assets
The Company assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Company estimates the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or group of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded subsidiaries or other available fair value indicators.

Impairment losses of continuing operations are recognized in profit or loss in those expense categories consistent with the function of the impaired asset, except for property previously revalued where the revaluation was taken to equity. In this case the impairment is also recognized in equity up to the amount of any previous revaluation.

For assets excluding goodwill, 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 Company makes an estimate of recoverable amount. 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, had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in profit or loss unless the asset is carried at revalued amount, in which case the reversal is treated as a revaluation increase.

Investments and other financial assets

Financial assets within the scope of PAS 39, *Financial Instruments: Recognition and Measurement,* are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, or available-for-sale financial assets, as appropriate. When financial assets are recognized initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs.

The Company determines the classification of its financial assets on initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial yearend.

All regular way purchases and sales of financial assets are recognized on the trade date, which is the date that the Company commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Offsetting financial instruments

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

Fair value

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

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

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

Financial assets at fair value through profit or loss
Financial assets at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition as at fair value through profit or loss.

Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments or a financial guarantee contract. Gains or losses on investments held for trading are recognized in profit or loss.

The Company assesses whether embedded derivatives are required to be separated from host contracts when the Company first becomes party to the contract. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required. 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 measured at fair value with changes in fair value reported in net profit or loss.

Classified under this category are the Company's bifurcated embedded derivatives.

Held-to-maturity investments
Non-derivative financial assets with fixed or determinable payments and fixed maturities are classified as held-to-maturity when the Company has the positive intention and ability to hold to maturity. After initial measurement held-to-maturity investments are measured at amortized cost using the effective interest method. Gains and losses are recognized in profit or loss when the investments are derecognized or impaired, as well as through the amortization process.

The Company has no held-to-maturity investments as of December 31, 2007 (2006: NIL).

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

Loans and receivables are included in current assets if maturity is within 12 months from the balance sheet date. Otherwise, these are classified as noncurrent assets.

Classified under loans and receivables are trade receivables and other receivables, service concession receivable and due from affiliated companies.

Available-for-sale financial investments
Available-for-sale financial assets are those non-derivative financial assets that are designated as such or are not classified as financial assets designated at fair value through profit and loss, held-to-maturity investments or loans and receivables. They are purchased and held indefinitely, and may be sold in response to liquidity requirements or changes in market conditions.

Available-for-sale financial investments are initially measured at fair value plus directly attributable transaction cost. After initial measurement, available-for-sale financial investment are subsequently measured at fair value with unrealized gains and losses being recognized a separate component of equity until the investment is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognized in equity is included in the net profit or loss for the period.

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

AFS financial assets are classified as current if they are expected to be realized within 12 months from the balance sheet date. Otherwise, these are classified as noncurrent assets.

AFS investments include ROP bonds, Golf & Country club, Petron and PLDT shares.

Other financial liabilities
Other financial liabilities which include loans and borrowings, trade and other payables and due to PNOC are initially recognized at fair value of the consideration received less directly attributable transaction costs. After initial recognition, other financial liabilities are subsequently measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any related issue costs, discount or premium. Gains and losses are recognized in the statement of income when the liabilities are derecognized, as well as through the amortization process.

Impairment of financial assets
The Company assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

Assets carried at amortized cost
If there is objective evidence that an impairment loss on assets carried at amortized cost has been incurred, 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 (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through use of an allowance account. The amount of the loss 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, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date. Any subsequent reversal of an impairment loss is recognized in profit or loss.

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

Available-for-sale financial investments
If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in profit or loss, is transferred from equity to profit or loss. Reversals in respect of equity instruments classified as available-for-sale are not recognized in profit or loss. Reversals of impairment losses on debt instruments are reversed through 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.

<u>Derecognition of financial assets and liabilities</u>

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

- the rights to receive cash flows from the asset have expired;
- the Company retains the right to receive cash flows from the asset, but has assumed as obligation to them in full without material delay to a third party under a “pass through” arrangement; or
- the Company 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 the control of the asset.

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

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

Cash and cash equivalents
Cash and cash equivalents in the balance sheet comprise cash at banks and on hand and short term deposits with an original maturity of three months or less and that are subject to insignificant risk of changes in value.

For the purpose of the cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Provisions
Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in profit or loss net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre tax rate that reflects, 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 a finance cost.

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

Company as a lessee
Operating lease payments are recognized as an expense in profit or loss on a straight-line basis over the lease term.

Company as a lessor
Leases where the Company does not transfer substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized over the lease term on the same bases as rental income. Contingent rents are recognized as revenue in the period in which they are earned.

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

Revenue from sale of electricity and steam
(For service contracts qualifying under the intangible asset model and for other revenue streams for the financial asset model of service concession arrangements)

Sale of electricity is consummated whenever the electricity generated by the Company is transmitted to the transmission line of the buyer for a consideration. Sale of steam is recognized when the steam generated by the Company or its by-product passes to the flowmeters installed at the interface point for conversion by the buyer into power. Revenues from sale of electricity and steam are based on sales price, net of the portion of the billings representing collection of concession receivable and related interest charges.

Interest income
Revenue is recognized as interest accrues (using the effective interest rate, that is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset).

Construction revenue
Construction revenue is recognized by reference to the stage of completion of the contract activity at the balance sheet date. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognized as an expense immediately.

Rendering of services
Revenue is recognized as services are rendered.

Retirement and other post-retirement benefits
The Company maintains a funded, non-contributory defined benefit retirement plan. The Company also provides post-retirement medical and life insurance benefits which are unfunded. The cost of providing benefits under the defined benefit plan is determined using the projected unit credit actuarial valuation method. 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 period exceeded 10% of the higher of the defined benefit obligations and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plan.

The past service cost is recognized as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested immediately following the introduction of, or changes to, the retirement plan, past service cost is recognized immediately. The defined benefit asset or liability comprises the present value of the defined benefit obligation less past service cost not yet recognized and less the fair value of plan assets out of which the obligations are to be settled directly. The value of any asset is restricted to the sum of any past service cost not yet recognized and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

Borrowing costs
Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, are added to the cost of the assets, until such time that the assets are substantially ready for their intended use or sale, which necessarily take a substantial period of time. Income earned on the temporary investment of specific borrowings, pending their expenditure on qualifying assets, is deducted from the borrowing costs eligible for capitalization. All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

Taxes

Current income tax

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

Current income tax relating to items recognized directly in equity is recognized in equity and not in profit or loss.

Deferred income tax

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

- where the deferred income 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

- in respect of 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 income tax assets are recognized for all deductible temporary differences, carry-forward of unused tax credits and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carry-forward of unused tax credits and unused tax losses can be utilized except:

- where the deferred income 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

- in respect of deductible temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, deferred income 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 income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at each balance sheet date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to 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 the balance sheet date.

Deferred income tax relating to items recognized directly in equity is recognized in equity and not in profit or loss.

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

Sales tax
Revenues, expenses and assets are recognized net of the amount of sales tax 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 receivables or payables in the balance sheet.

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

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

Diluted earnings per share is computed by dividing net income for the year by the weighted average number of common shares issued and outstanding during the year plus the weighted average number of common shares that would be issued for outstanding common stock equivalent. The Company does not have dilutive common stock equivalents.

Segment reporting
For management purposes, the Company's operating businesses are organized and managed separately according to the nature of the products and services provided. Financial information on business segment is presented in Note 33. The Company has one geographical segment and derives principally all its revenues from domestic operations.

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

Future changes in accounting policies

Standards issued but not yet effective

PAS 1, *Presentation of Financial Statements*
A revised PAS 1, Presentation of financial statements is to be applied for annual periods beginning on or before January 1, 2009. The main revisions to PAS 1 arise from the IASB's consideration of the US standard SFAS 130, *Reporting Comprehensive Income*. The IASB has also taken the opportunity to improve the structure and wordings of PAS 1.

PAS 23, *Borrowing Costs*
A revised PAS 23, *Borrowing Costs,* was issued in March 2007, and becomes effective for financial years beginning on or after January 1, 2009. The standard has been revised to require capitalization of borrowing costs when such costs relate to a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

The Company expects that this revision will have no impact on the Company's financial statements since the Company is already capitalizing borrowing costs relating to qualifying assets.

Philippine Interpretation IFRIC 13, *Customer Loyalty Programmes*
Philippine Interpretation IFRIC 13 was issued in June 2007 and becomes effective for annual periods beginning on or after July 1, 2008. This Interpretation requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled. The Company expects that this interpretation will have no impact on the Company's financial statements as no such schemes currently exist.

Philippine Interpretation IFRIC 14, *PAS 19 - The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction*
Philippine Interpretation IFRIC 14 was issued in July 2007 and becomes effective for annual periods beginning on or after January 1, 2008. This Interpretation provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognized as an asset under PAS 19, *Employee Benefits*. The Company expects that this Interpretation will have no impact on its financial position or performance.

6. **Cash and Cash Equivalents**

	2007	2006
Cash on hand and in banks	**₱16,353,040**	₱60,380,562
Cash equivalents	**2,781,228,537**	9,938,821,665
	₱2,797,581,577	₱9,999,202,227

Cash in banks earn interest at the respective bank deposit rates. Cash equivalents consist of money market placements which are made for varying periods of up to three months depending on the immediate cash requirements of the Company and earned interest of ₱304.48 million in 2007 (₱318.11 million in 2006).

7. Trade and Other Receivables

	2007	2006
Trade	**₱4,674,443,525**	₱4,232,642,072
Others	**628,456,657**	122,614,987
	5,302,900,182	4,355,257,059
Allowance for doubtful accounts	**377,218,598**	–
	₱4,925,681,584	₱4,355,257,059

Trade receivables are non-interest bearing and are generally on 30 days' terms while other receivables comprise mainly of receivables from employees, contractors and suppliers.

The rollforward analysis of allowance for doubtful accounts, which pertains to trade receivables is presented below:

January 1, 2007	₱–
Charges for the year	377,218,598
	₱377,218,598

8. Parts and Supplies Inventories

	2007	2006
Landed		
Drilling tubular products and equipment spares	**₱493,364,974**	₱515,495,138
Pump, production/steam gathering system, steam turbine, valves and valve spares	**175,536,519**	180,648,919
Heavy equipment spares	**190,242,480**	86,901,635
Chemical, chemical products, gases and catalyst	**80,965,812**	94,503,340
Electrical, cable, wire product and compressor spares	**53,232,630**	50,031,092
Measuring instruments, indicators and tools, safety equipment and supplies	**33,787,261**	34,738,670
Automotive, mechanical, bearing, seals, v-belt, gasket, tires and batteries	**29,441,624**	34,711,525
Construction and hardware supplies, stationeries and office supplies, hoses, communication and other spares and supplies	**2,852,740**	141,178,526
	1,059,424,040	1,138,208,845
In transit	**75,542,983**	22,789,590
Materials and supplies for disposals	**5,077,039**	3,453,710
	₱1,140,044,062	₱1,164,452,145

In-transit inventories include items not yet received but ownership or title to the goods already passed to the Company.

9. Other Current Assets

	2007	2006
Tax credit certificate	**₱386,956,078**	₱711,222,564
Prepaid expenses	**125,589,232**	121,117,426
Advances to contractors	**23,037,464**	52,223,863
Restricted cash	**–**	33,212,957
	₱535,582,774	₱917,776,810

The tax credit certificate pertains to the ₱811.22 million certificate issued by the Bureau of Internal Revenue (BIR) in 2006. Of this amount, ₱324.27 million was applied against income taxes due as of December 31, 2007 (₱100.00 million in 2006).

10. Available-for-Sale (AFS) Investments

	2007	2006
Quoted investments		
Government debt securities	**₱1,177,589,987**	₱1,341,751,679
Equities	**16,336,106**	12,072,279
	1,193,926,093	1,353,823,958
Unquoted investments		
Equities	**74,550**	74,550
	₱1,194,000,643	₱1,353,898,508

Quoted and unquoted equity investments are included under Other Noncurrent Assets account.

Gain (loss) on AFS investments is presented under a separate component of equity with details as follows:

	2007	2006
Gain or loss recognized in equity	**₱377,568,628**	₱132,544,462
Gain or loss removed from equity and recognized in profit or loss	**(9,019,375)**	(1,081,651)
Net accumulated unrealized gain or loss on AFS investments	**₱368,549,253**	₱131,462,811

The Company uses the specific identification method in determining the cost of securities sold.

11. Noncurrent Assets Held for Sale

This account consists of the land owned by the Company in Fort Bonifacio previously presented under the following accounts in 2006:

	Area (sq. m.)	Amount
Property and equipment	24,464.87	₱1,399,570,246
Investment property	4,826.13	272,945,854
	29,291.00	₱1,672,516,100

The properties were classified as noncurrent assets held for sale in accordance with the Company's Board Resolution No. 115 series of 2007 dated November 13, 2007, whereby the Company agreed to sell these properties to PNOC. The Company expects the sale to be completed within one year from December 31, 2007.

There are no liabilities directly associated with the noncurrent asset held for sale.

12. **Property and Equipment**

2007	Buildings and improvement	Exploration, machinery and equipment	Transportation equipment	Furniture, fixtures and equipment	Laboratory equipment	Land, leases and improvement	Construction in progress	Major spares	Surplus assets available for sale	**Total**
COST										
Balance - January 1	₱348,605,868	₱1,158,038,095	₱49,324,273	₱162,660,784	₱46,070,652	₱1,727,641,708	₱50,735,205	₱27,236,986	₱4,266,849	**₱3,574,580,420**
Additions	–	–	–	–	–	235,471	149,324,599	8,143,778	462,635	**158,166,483**
Retirements/Write-Off	–	(614,210)	(2,508,632)	(6,789,335)	(409,104)	–	–	–	(2,866,469)	**(13,187,750)**
Reclassifications/Adjustments	–	9,986,240	4,036,110	15,631,082	3,583,192	(1,399,570,246)	(24,426,142)	(9,506,360)	–	**(1,400,266,124)**
Balance - December 31	348,605,868	1,167,410,125	50,851,751	171,502,531	49,244,740	328,306,933	175,633,662	25,874,404	1,863,015	**2,319,293,029**
ACCUMULATED DEPRECIATION										
Balance - January 1	188,626,885	705,696,155	39,087,595	135,287,405	36,662,701	–	–	–	–	**1,105,360,741**
Additions	20,053,401	52,395,147	5,122,900	14,066,308	3,268,554	–	–	–	–	**94,906,310**
Retirements/Write-Off	–	(615,794)	(2,275,730)	(6,677,119)	(409,098)	–	–	–	–	**(9,977,741)**
Reclassifications/Adjustments	–	29,084,813	–	(11,982,476)	881,026	–	–	–	–	**17,983,363**
Balance - December 31	208,680,286	786,560,321	41,934,765	130,694,118	40,403,183	–	–	–	–	**1,208,272,673**
Net book value	₱139,925,582	₱380,849,804	₱8,916,986	₱40,808,413	₱8,841,557	₱328,306,933	₱175,633,662	₱25,874,404	₱1,863,015	**₱1,111,020,356**
2006										
COST										
Balance - January 1	₱345,519,804	₱651,214,114	₱53,739,631	₱152,839,306	₱42,336,741	₱1,712,937,830	₱48,182,295	₱19,531,878	₱1,336,526	₱3,027,638,125
Additions	–	499,329,083	–	–	–	14,703,878	23,599,419	1,691,110	1,506,929	540,830,419
Retirements/Write-Off	(12,824,958)	(1,683,301)	(7,256,802)	(5,574,159)	(1,049,074)	–	(21,685,286)	–	(244,265)	(50,317,845)
Reclassifications/Adjustments	15,911,022	9,178,199	2,841,444	15,395,637	4,782,985	–	638,777	6,013,998	1,667,659	56,429,721
Balance - December 31	348,605,868	1,158,038,095	49,324,273	162,660,784	46,070,652	1,727,641,708	50,735,205	27,236,986	4,266,849	3,574,580,420
ACCUMULATED DEPRECIATION										
Balance - January 1	169,057,216	634,409,217	38,984,360	127,719,356	34,610,059	–	–	–	–	1,004,780,208
Additions	28,288,720	72,825,103	10,118,974	13,203,295	3,693,657	–	–	–	–	128,129,749
Retirements/Write-Off	(8,719,051)	(1,538,165)	(10,015,739)	(5,635,246)	(1,641,015)	–	–	–	–	(27,549,216)
Balance - December 31	188,626,885	705,696,155	39,087,595	135,287,405	36,662,701	–	–	–	–	1,105,360,741
Net book value	₱159,978,983	₱452,341,940	₱10,236,678	₱27,373,379	₱9,407,951	₱1,727,641,708	₱50,735,205	₱27,236,986	₱4,266,849	₱2,469,219,679

Total costs of assets retired/written-off amounted to ₱0.34 million in 2007 and ₱0.84 million in 2006, net of ₱9.98 million and ₱27.55 million accumulated depreciation, respectively.

Total purchase commitments as of December 31, 2007 and 2006 year amounted to ₱27.36 million and ₱64.51 million, respectively.

Management believes that, based on the assessment performed, there are no property and equipment found impaired.

Depreciation is calculated on a straight-line basis over the economic life of the asset as follows:

Buildings and improvements	5-25 years
Exploration, machinery and equipment	2-10 years
Furniture, fixtures & equipment	3-10 years
Laboratory equipment	5-10 years
Transportation equipment	5 years

As discussed in Note 11, land with a carrying value of ₱1,399.57 million was reclassified in 2007 to noncurrent assets held for sale.

13. **Intangible Asset**

	2007	2006
Cost		
January 1	**₱8,794,316,944**	₱2,194,333,202
Additions	**108,813,951**	6,599,983,742
December 31	**8,903,130,895**	8,794,316,944
Accumulated amortization		
January 1	–	–
Provision	**(164,294,068)**	–
December 31	**(164,294,068)**	–
Carrying amount	**₱8,738,836,827**	₱8,794,316,944

Amortization expense charged to operations during 2007 amounted to ₱164.29 million.

Management believes that, based on the assessment performed, the intangible asset is not impaired.

The intangible asset is being amortized over the term of the related Geothermal Service Contract of the Northern Negros Geothermal Project (see Notes 3 and 34).

14. **Exploration and Evaluation Assets**

	2007	2006
January 1	**₱1,614,922,295**	₱2,238,766,471
Additions	**84,962,253**	625,431,104
Transfers to financial assets/intangible asset	**(527,962,374)**	(1,249,275,280)
December 31	**₱1,171,922,174**	₱1,614,922,295

Deferred exploration and evaluation costs pertain to the following project areas:

	2007	2006
Cabalian, Southern Leyte	**₱558,363,775**	₱363,970,378
Northern Negros	**445,872,148**	858,210,728
Mindanao	**76,080,913**	–
Ilocos Norte	**48,427,707**	39,546,367
Bacman-Tanawon	**37,315,026**	37,315,026
Other areas	**5,862,605**	315,879,796
	₱1,171,922,174	₱1,614,922,295

15. **Investment Property**

<u>**2007**</u>

	Land	Building	Total
Cost			
January 1	₱272,945,854	₱8,570,000	₱281,515,854
Reclassified to noncurrent asset held for sale (see Note 11)	(272,945,854)	–	(272,945,854)
December 31	–	8,570,000	8,570,000
Accumulated depreciation			
January 1	–	2,594,673	2,594,673
Additions	–	853,618	853,618
December 31	–	3,448,291	3,448,291
Net book value	**₱–**	**₱5,121,709**	**₱5,121,709**

<u>2006</u>

	Land	Building	Total
Cost			
January 1	₱272,945,854	₱8,570,000	₱281,515,854
Additions	–	–	–
December 31	272,945,854	8,570,000	281,515,854
Accumulated depreciation			
January 1	–	1,741,055	1,741,055
Additions	–	853,618	853,618
December 31	–	2,594,673	2,594,673
Net book value	**₱272,945,854**	**₱5,975,327**	**₱278,921,181**

As discussed in Note 11, the above land was reclassified in 2007 to noncurrent assets held for sale.

Depreciation expense charged to operations amounted to ₱0.85 million in 2007 and 2006.

Management believes that, based on the assessment performed, there are no investment property found impaired.

Fair value of the building as of December 31, 2006 based on the appraisal report of an independent appraiser amounted to ₱22.67 million. Management believes that the fair value as of December 31, 2007 is not significantly different from the fair value as of the prior year.

16. Other Noncurrent Assets

	2007	2006
Long-term receivables	**₱2,981,776,511**	₱3,660,076,242
Prepaid expenses	**764,352,330**	1,053,172,238
Deferred royalty fee	**464,520,286**	896,494,151
Special deposits and funds	**36,785,822**	27,826,772
Cash collateral on PCIR Bonds	**3,066,807**	3,632,164
Others	**503,454,809**	177,926,671
	₱4,753,956,565	₱5,819,128,238
Less: Allowance for doubtful accounts	**2,907,331,961**	3,597,567,122
	₱1,846,624,604	₱2,221,561,116

The composition of long-term receivables is as follows:

	2007	2006
Claims for value added tax (VAT) refund	**₱1,894,719,994**	₱1,894,719,994
NPC accounts and other receivables	**1,087,056,517**	1,765,356,248
	₱2,981,776,511	₱3,660,076,242

The decrease in long-term receivables pertains mainly to the reclassification to trade accounts receivable portion of the receivable from NPC brought about by the agreement between NPC and the Company on October 26, 2007.

In 2007, the allowance for doubtful accounts for trade receivables was established after the Company performed the regular review of the age and status of the accounts relative to historical collections, changes in customer payment terms and other factors that may affect ability to collect payments. Except for accounts covered by special agreements with NPC, it was estimated that accounts outstanding over one year or account subject to contractual interpretation-dispute should have 100% provision (see Note 38).

Likewise, for other receivables, it was also established that accounts outstanding less than one year should have no provision but accounts outstanding over one year should have a 100% provision, which was arrived at after assessing individually significant balances. Provision for individually non-significant balances was made on a portfolio or group basis after performing the regular review of the age and status of the individual accounts and portfolio/group of accounts relative to historical collections, changes in payment terms and other factors that may affect ability to collect payments.

The BIR-related claims pertain to the Company's claims for the refund of input VAT on BOT fees amounting to ₱1,894.72 million which was initially denied by the BIR regional level on July 2, 2002. Subsequently, on September 2, 2002, the Company submitted a letter for reconsideration, RDO 50 endorsed the request for reconsideration to the BIR Head Office legal department and the review of the claims is still on going.

The prepaid expenses pertain mainly to the 25% advance payment to Kanematsu Corporation for the construction of Northern Negros Geothermal Power Plant Project.

The special deposits and funds mainly consisted of the ₱11.73 million sinking fund required by the Department of Finance and ₱4.72 million escrow account in favor of terminated employees.

Cash amounting to US$74,057.79 on PCIR Bonds was pledged and deposited with the Bangko Sentral ng Pilipinas as collateral to secure the Company's outstanding International Bank of Japan (IBJ) Loans which was converted into Republic of the Philippines' (ROP) bonds in a Memorandum of Agreement dated November 16, 1992 (see Note 20). The peso equivalent of the collateral as of December 31, 2007 and 2006 were ₱3.07 million and ₱3.63 million, respectively.

The accounts grouped as Others pertained mainly to the input VAT on the purchase of goods and services which will be claimed for refund from the BIR.

The rollforward analysis of the allowance for doubtful accounts pertaining to long-term receivables is presented below.

	2007	2006
January 1	**₱3,597,567,122**	₱4,034,910,390
Charges for the year	**33,382,345**	300,090,132
Recoveries	**(723,617,506)**	(737,433,400)
December 31	**₱2,907,331,961**	₱3,597,567,122

17. Trade and Other Payables

	2007	2006
Accounts payable - trade	**₱3,392,254,842**	₱5,303,670,215
Accrued interest and guarantee fees	**139,924,021**	1,011,270,018
Withholding and other taxes payable	**56,557,449**	95,908,096
SSS and other contributions	**38,921,376**	5,454,446
Deferred credits	**6,297,836**	6,846,940
Miscellaneous current liabilities	**3,826,743**	5,915,549
	₱3,637,782,267	₱6,429,065,264

Accounts payable - trade, which comprised mainly of the accrued capacity fees for build-operate-transfer (BOT) plants, decreased due to the full payment of obligations to power plant contractor for Malitbog, Mahanagdong and Leyte Optimization power plants. The comparative amounts include recognition of Department of Energy's (DOE) assessment amounting to ₱866.40 million representing royalty fees for the period 1996 to 1998 relative to the Company's service contracts for Southern Negros Geothermal Production Field. In 2007, a credit adjustment on this expense was made as a result of the re-computation of the recoverable costs with the DOE based on the amended provisions set in the geothermal service contracts, which allows recovery of the translation effects of the Company's foreign loans and financing costs.

The decrease in accrued interest and guarantee fees was due mainly to the settlement of guarantee fees on long-term loans.

18. Royalty Fee Payable

	2007	2006
Due to DOE (see Note 35)	**₱1,477,653,457**	₱1,619,678,292
Due to Local Government Units (LGUs) (see Note 35)	**256,273,707**	324,644,631
	1,733,927,164	1,944,322,923
Current portion	**(456,273,707)**	(524,644,631)
Long-term portion	**₱1,277,653,457**	₱1,419,678,292

A reconciliation of the recognized 'Day 1' gain and accretion on the deferred royalty fee due to the DOE is shown below:

	2007	2006
Net day 1 gain (loss), January 1	**₱397,267,332**	₱479,501,891
Additions	**39,769,240**	95,703,507
Accretion	**(211,445,798)**	(177,938,066)
Net day 1 gain (loss), December 31	**₱225,590,774**	₱397,267,332

As discussed in Note 35, by virtue of PD 1442, the Company entered into seven service contracts with the DOE granting the Company the right to explore, develop, and utilize the country's geothermal resource subject to sharing of net proceeds with the government. The Company pays royalty fees to the DOE and LGUs under the arrangement.

The royalty fees are paid to the Department of Energy based on an agreed payment schedule. As the liability is non-interest bearing, a day 1 gain is recognized upon accrual of royalty fee. The day 1 gain pertains to the difference between the maturity value and present value of the royalty fee due. ₱39.77 million, ₱95.70 million, and ₱182.22 million were recognized as day 1 gains for 2007, 2006, and 2005, respectively, and are included under "Miscellaneous - net" in the statements of income. Subsequent to initial recognition, royalty fee payable is accreted to its maturity value based on its effective interest rate.

The effective interest rate on royalty fee payable ranges from 12.38% to 12.72%, 11.75% to 12.26%, and 10.89% to 11.58% for 2007, 2006 and 2005, respectively.

Accretion recognized in 2007, 2006, and 2005 amounted to ₱211.45 million, ₱177.94 million, and ₱140.23 million, respectively. Such accretion is included under "Interest expense" in the statements of income. As of December 31, 2007 and 2006, the unamortized discount amounted to ₱255.59 million and ₱397.27 million, respectively.

19. Obligations to Power Plant Contractors

	Minimum Payments		Present Value of Minimum Payments	
	2007	2006	**2007**	2006
Amounts payable under BOT Contracts:				
Within one year	**₱265,744,529**	₱2,904,781,721	**₱246,719,220**	₱2,766,401,494
In the second to fifth years inclusive	**100,347,856**	434,680,911	**96,287,392**	413,180,565
Future finance charges	**(23,085,773)**	(159,880,573)	**–**	–
Present value of obligations	**343,006,612**	3,179,582,059	**343,006,612**	3,179,582,059
Amount due for settlement within 12 months (shown under current liabilities)	**(246,719,220)**	(2,766,401,494)	**(246,719,220)**	(2,766,401,494)
Amount due for settlement after 12 months	**₱96,287,392**	₱413,180,565	**₱96,287,392**	₱413,180,565

This account pertains to the balance of the obligations to the power plant contractors in connection with the construction of the geothermal power plants in some of the Company's geothermal service contract areas.

20. Long-Term Debt

The Company's foreign-currency denominated long-term debts were translated into Philippine pesos based on the prevailing foreign exchange rates at balance sheet date (USD1=JPY113.688: USD1=PHP41.411 on December 31, 2007 and USD1=JPY118.934: USD1=PHP49.045 on December 31, 2006).

The details of the Company's long-term debts are as follows:

Creditor/Project	Maturities	Interest rate	**2007**	2006
International Bank for Reconstruction and Development				
2969 PH Bacon-Manito Geothermal Power Plant - USD41 million	1994 to 2008	½ of 1% over cost of qualified borrowings	**₱213,917,487**	₱464,006,909
3164 PH Energy Sector Loan - USD118 million	1995 to 2010	½ of 1% over cost of qualified borrowings	**1,327,865,958**	2,017,103,046

(Forward)

Creditor/Project	Maturities	Interest rate	2007	2006
3702 PH Geothermal Exploration Project - USD64 million	1999 to 2013	½ of 1% over cost of qualified borrowings	**₱1,194,375,196**	₱1,516,373,173
3747 PH Geothermal Exploration Project - USD114 million	1999 to 2014	½ of 1% over cost of qualified	**1,353,629,819**	1,701,179,610
- JPY12.4 billion	1999 to 2014	borrowings/3.5%	**971,506,792**	1,270,302,115
Overseas Economic Cooperation Fund				
8th Yen Tongonan I Geothermal Power Plant (share in OECF-NPC loan) - JPY5.8 billion		3.0%	**259,486,510**	411,272,172
- JPY1.5 billion (Restructured)	1990 to 2010	3.2%	**117,990,135**	163,260,896
9th Yen Palinpinon I Geothermal Power Plant - JPY 10.8 billion	1991 to 2011	3.0%	**529,623,002**	770,899,584
15th Yen Palinpinon I Geothermal Power Plant - JPY4.0 billion	1999 to 2019	5.7%	**650,141,912**	800,031,045
18th Yen Palinpinon II Geothermal Power Plant - JPY77.4 million	2003 to 2023	3.0%	**21,310,198**	25,681,845
19th Yen Mt. Labo Geothermal Project - JPY10.8 billion	2004 to 2024	4.9%	**96,686,098**	115,897,514
21st Yen Northern Negros Geothermal Project - JPY14.5 billion, of which JPY5.9 billion was drawn during the year	2007 to 2027	2.7%/2.3%	**3,612,377,416**	4,299,364,022
National Government Principal Collateralized Interest Reduction Bonds (PCIR) - USD328 thousand	1992 to 2017	Year 1 - 4 ¼% 2 - 5 ¼% 3 - 5 ¾% 4-5 - 6 ¼% 6-25 - 6 ½%	**13,579,092**	16,082,359
Miyazawa I - JPY5.2 billion		Tranche A=3.78%	**1,889,975,187**	2,137,344,037
- JPY6.8 billion	June 1, 2009	Tranche B=1.60% + LIBOR	**2,471,931,240**	2,795,603,036

(Forward)

Creditor/Project	Maturities	Interest rate	**2007**	2006
Miyazawa II				
- JPY22.0 billion	June 26, 2010	2.37%	**₱7,738,708,293**	₱9,516,416,274
ING Syndicated US$90 Million 5-Year Loan				
- USD45.7 million		Tranche 1=3.70% + 6 mos. LIBOR	**–**	2,327,388,315
- USD44.3 million	February 21, 2008	Tranche 2=3.39% + 6 mos. LIBOR	**–**	1,414,168,571
Land Bank of the Philippines				
- PHP1.5 Billion	June 29, 2008	Ave. 91-day T-Bill + 2%	**378,409,091**	882,954,546
Standard Chartered 5-Year Loan				
-USD75 million	August 4, 2009	LIBOR + 2.22%	**–**	3,834,671,914
Total			**₱22,841,513,426**	₱36,480,000,983
Current portion			**(2,031,565,879)**	(3,171,351,515)
Long-term portion			**₱20,809,947,547**	₱33,308,649,468

The Principal Collateralized Interest Reduction Bonds (PCIRBs) represents converted outstanding International Bank of Japan (IBJ) loans equivalent to USD327,910 to Republic of the Philippines (ROP) bonds in a Memorandum of Agreement dated November 16, 1992. The ROP bonds carry interest rate of 6.5% per annum payable semi-annually with bullet principal payment in 2017. A cash collateral amounting to US$74,057 was deposited with the Bangko Sentral ng Pilipinas as part of the agreement and will be returned to the Company without interest upon full settlement of the bonds.

Embedded prepayment (call) options were bifurcated from the USD90 million ING syndicated loan and USD75 million Standard Chartered term loan and presented in the balance sheet as Derivative assets. The changes in fair value of the embedded options are presented below.

	2007	2006
January 1	**₱344,000,988**	₱522,904,483
Changes in fair value during the year	**56,011,569**	(178,903,496)
Settlement during the year	**(400,012,557)**	–
December 31	**₱–**	₱344,000,987

The changes in fair value during the year are included under Derivative gain (loss) in the statement of income. All bifurcated embedded prepayment (call) options were exercised during 2007.

The long-term debts are presented net of unamortized transaction costs. A rollforward analysis of unamortized transactions costs is shown below.

	2007	2006
January 1	**₱95,844,697**	₱154,441,805
Amortization	**(57,416,753)**	(48,803,340)
Foreign exchange gain	**(4,297,629)**	(9,793,768)
December 31	**₱34,130,315**	₱95,844,697

Amortization during the year is included under "Interest Expense" in the statement of income.

Transaction costs include arrangement/management fee and documentary stamps for ING Syndicated (USD 90 million), USD 75 million Standard Chartered, Miyazawa I (JPY 12 billion) and Miyazawa II (JPY 22 billion) loans.

21. Other Long-Term Liabilities

This account consists of accrued vacation and sick leave entitlement and post-retirement medical/life insurance benefits of employees.

22. Capital Stock and Additional Paid-In Capital

The Company is subject to the nationality requirement that at least sixty percent (60%) of its capital stock must be owned by Filipino citizens since it is engaged in the exploration and exploitation of the country's energy resources.

Details are as follows:

	2007	2006
Capital stock		
Common stock authorized and issued - 15,000,000,000 shares @ ₱1 par value	**₱15,000,000,000**	₱15,000,000,000
Preferred stock authorized and issued - 7,500,000,000 shares @ ₱0.01 par value	**75,000,000**	–
Additional paid-in capital	**6,278,075,648**	6,278,075,648

On June 30, 2007, the SEC approved the Company's issuance of 7.5 billion preferred shares with 8% cumulative interest and with voting rights, at a par value of ₱0.01 share and with a limitation that only Filipino citizens can purchase. The 4.5 billion shares were subscribed and paid by PNOC while the remaining 3 billion shares were subscribed and paid by the PNOC EDC Retirement Fund.

On July 10, 2007, PNOC made a follow-on offering of another 3 billion common shares resulting to a total of 9 billion common shares, representing 60.00% of the Company's outstanding common shares, being listed and traded with the Philippine Stock Exchange. Thus, the controlling interest of PNOC was reduced to 46.70%.

On November 29, 2007, the Company was fully privatized through the sale by PNOC of the combined 6 billion common shares (or 40.00% of total outstanding common shares) and the 7.5 billion preferred shares from PNOC and PNOC EDC Retirement Fund, to Red Vulcan Holdings Corporation, a subsidiary of First Gen Corporation. As a result, the Company is now considered a public company under Section 17.2 of the Securities Regulation Code, with First Philippine Holdings Corporation as the ultimate Parent Company, also a listed company in the Philippines.

As of year of December 31, 2007, there are 656 common stockholders and one (1) preferred shareholder of the Company.

23. Retained Earnings

On April 17, 2007, the BOD approved a cash dividend of ₱0.099 per share or a total of ₱1.485 billion to stockholders on record as of May 15, 2007 payable on June 5, 2007.

The Company's retained earnings include a revaluation increment deemed as part of cost of certain property and equipment and investment property amounting to ₱2,077.89 million, of which ₱1,438.56 million is related to land classified as Noncurrent asset held for sale (see Note 11). This amount is not available for dividend declaration until realized.

24. Purchased Services and Utilities

	2007	2006 (Restated)	2005 (Restated)
BOT fees	**₱2,105,680,050**	₱4,782,877,101	₱6,438,272,867
Professional and technical services	**387,199,262**	180,015,600	170,838,255
Other purchased utilities	**219,335,104**	2,933,363	3,309,962
Other purchased services	**166,636,601**	97,174,098	81,641,346
Rig mobilization charges	**85,527,042**	4,043,465	5,778,151
Hauling and handling costs	**40,958,297**	17,085,706	18,191,343
Contractual employee costs	**28,278,317**	8,227,076	7,915,974
Others	**4,381,485**	4,666,364	3,811,222
	₱3,037,996,158	₱5,097,022,773	₱6,729,759,120

The 2006 and 2005 balances of some accounts were reclassified to conform to the 2007 presentation.

25. Operations and Maintenance Expenses

	2007	2006 (Restated)	2005 (Restated)
Employee costs	**₱1,258,171,369**	₱1,073,803,172	₱1,041,481,591
Rental, insurance and taxes	**948,320,803**	781,286,614	875,151,527
Maintenance and repairs	**647,829,416**	451,424,582	350,693,484
Materials and supplies	**569,879,759**	416,312,987	463,279,097
Royalty fees	**499,577,821**	470,394,682	528,839,664
Business and other expenses	**12,482,584**	48,734,673	30,770,558
Grantor assessment adjustment	**(866,399,332)**	–	–
	₱3,069,862,420	₱3,241,956,710	₱3,290,215,921

The royalty fee adjustment was the result of the re-computation of the recoverable costs with the DOE based on the amended provisions set in the geothermal service contracts, which allows recovery of the translation effects of the Company's foreign loans and financing costs. The amended provisions and the royalty adjustments were agreed with the DOE in July 2007.

The 2006 and 2005 balances of some accounts were reclassified to conform to the 2007 presentation.

26. General and Administrative Expenses

	2007	2006 (Restated)	2005 (Restated)
Employee costs	**₱968,231,017**	₱768,231,969	₱1,026,341,053
Rental, insurance and taxes	**547,152,473**	240,029,847	188,204,585
Purchased services and utilities	**345,802,058**	254,840,285	225,002,928
Provision for doubtful accounts	**286,828,060**	299,176,115	238,503,085
Materials and supplies	**112,145,705**	70,789,787	65,432,633
Business and other expenses	**87,303,846**	97,237,692	61,351,980
Depreciation	**39,944,942**	30,443,300	31,985,421
Maintenance and repairs	**28,145,359**	24,156,921	24,493,676
Others	**3,268,160**	–	–
Credit adjustment on allowance for doubtful accounts	**(43,130,239)**	(737,558,359)	–
	₱2,375,691,381	₱1,047,347,557	₱1,861,315,361

27. Interest Expense

	2007	2006	2005
Interest on long-term loans	**₱1,567,138,662**	2,325,188,938	₱2,604,498,658
Interest on short-term loans	**–**	5,704,019	–
	1,567,138,662	2,330,892,957	2,604,498,658
Amounts included in the cost of qualifying assets	**(99,927)**	(106,600)	(122,840)
	₱1,567,038,735	2,330,786,357	₱2,604,375,818

This account pertains to interest charges on long-term and short-term loans. The amount included in the cost of qualifying assets represents the capitalized interest charges on loans utilized for the development of Northern Negros Geothermal Project.

28. **Foreign Exchange Gains** - Net

	2007	2006	2005
Foreign exchange gains on long-term loans	**₱4,239,574,615**	₱2,189,474,403	₱6,607,781,514
Foreign exchange losses on other accounts	**(339,228,371)**	(148,460,380)	(165,030,990)
Net	**₱3,900,346,244**	₱2,041,014,023	₱6,442,750,524

This account pertains to foreign exchange gains (losses) on repayment and realignment of foreign loans, short-term placements in US dollar denomination and cash in banks in US dollar and Japanese yen currencies. The foreign exchange gain was attributed largely to the realignment of foreign loans because of the appreciation of the yen and the peso against the US dollar (December 31, 2007: USD1=JPY113.688/ PHP41.411; December 31, 2006: USD1-JPY118.934/PHP49.045; December 31, 2005 USD1-JPY117.855/PHP53.062).

29. **Miscellaneous Income (Charges)** - Net

	2007	2006 (Restated)	2005 (Restated)
Day 1 gain	**₱39,769,239**	₱95,703,507	₱182,218,941
Waste disposal fees	**17,893,896**	18,011,912	–
Profit on sale of securities	**7,937,724**	1,081,651	–
Sale/retirement of fixed assets	**7,416,775**	–	–
Gain on retirement of parts and supplies inventory	**5,683,609**	–	–
Upper Mahiao Plant materials inventory turned over by contractor	**–**	125,636,878	–
Others	**(283,114,180)**	(262,501,969)	(279,589,410)
	(₱204,412,937)	(₱22,068,021)	(₱97,370,469)

30. **Income Taxes**

	2007	2006
Deferred tax assets	**₱6,753,386,479**	₱8,047,196,850
Deferred tax liability	**(3,700,593,892)**	(3,127,242,783)
Net	**₱3,052,792,587**	₱4,919,954,067

The deferred tax assets consist mainly of the undepreciated balance of the foreign exchange losses on payment and realignment of the payable to contractors capitalized under BIR reporting, unrealized foreign exchange losses on foreign loans and allowance for doubtful accounts. The account is net of deferred tax liability on the deductible expenses provided under PD 1442 and the increase in fair value of property and equipment applied as deemed costs recognized during the conversion to PFRS.

The components of the Company's deferred income tax assets and liabilities follow:

Deferred Tax Assets

	Foreign exchange losses (gains) BOT Power Plants	Unrealized foreign exchange losses (gains)	Allowance for doubtful accounts	Financial/ Tangible Assets	Others	Total
At January 1, 2007	₱4,673,833,358	₱1,229,264,289	₱1,064,246,930	₱509,705,776	₱570,146,497	₱8,047,196,850
Charged to income for the period	(327,283,783)	(1,013,929,250)	85,184,203	(70,683,170)	32,901,629	(1,293,810,371)
At December 31, 2007	**₱4,346,549,575**	**₱215,335,039**	**₱1,149,431,133**	**₱439,022,606**	**₱603,048,126**	**₱6,753,386,479**

	Foreign exchange losses (gains) BOT Power Plants	Unrealized foreign exchange losses (gains)	Allowance for doubtful accounts	Financial/ Tangible Assets	Others	Total
At January 1, 2006	₱4,924,077,551	₱2,459,898,738	₱1,217,680,715	₱711,713,444	₱63,779,855	₱9,377,150,303
Charged to income for the period	(250,244,193)	(1,230,634,449)	(153,433,785)	(202,007,668)	506,366,642	(1,329,953,453)
At December 31, 2006	**₱4,673,833,358**	**₱1,229,264,289**	**₱1,064,246,930**	**₱509,705,776**	**₱570,146,497**	**₱8,047,196,850**

Deferred Tax Liability

	Deductible expenses per PD 1442	Others	Total
At January 1, 2007	(₱3,085,955,501)	(₱41,287,282)	(₱3,127,242,783)
Charged to income for the period	(575,913,974)	2,562,865	(573,351,109)
At December 31, 2007	**(₱3,661,869,475)**	**(₱38,724,417)**	**(₱3,700,593,892)**

	Deductible expenses per PD 1442	Others	Total
At January 1, 2006	(₱2,986,489,231)	₱56,947,740	(₱2,929,541,491)
Charged to income for the period	(99,466,270)	(98,235,022)	(197,701,292)
At December 31, 2006	**(₱3,085,955,501)**	**(₱41,287,282)**	**(₱3,127,242,783)**

	Deferred Tax Assets	**Deferred Tax Liability**	**Net Deferred Tax Assets**
At January 1, 2007	₱8,047,196,850	(₱3,127,242,783)	₱4,919,954,067
Charged to income for the period	(1,293,810,371)	(573,351,109)	(1,867,161,480)
At December 31, 2007	₱6,753,386,479	(₱3,700,593,892)	₱3,052,792,587

	Deferred Tax Assets	**Deferred Tax Liability**	**Net Deferred Tax Assets**
At January 1, 2006	₱9,377,150,303	(₱2,929,541,491)	₱6,447,608,812
Charged to income for the period	(1,329,953,453)	(197,701,292)	(1,527,654,745)
At December 31, 2006	₱8,047,196,850	(₱3,127,242,783)	₱4,919,954,067

Components of income tax expense are as follows:

	2007	2006	2005
Current tax	**₱2,293,832,941**	₱1,697,975,135	₱1,677,383,618
Deferred tax	**1,867,161,480**	1,527,654,745	1,749,122,609
	₱4,160,994,421	₱3,225,629,880	₱3,426,506,227

A reconciliation between tax expense and the product of accounting income multiplied by the tax rates of 35.00% in 2007, 2006 and 32.50% in 2005 is as follows:

	2007	2006	2005
Accounting income	**₱12,812,475,607**	₱10,088,971,107	₱12,600,669,496
Tax expense	**4,484,366,462**	3,531,139,887	4,095,217,586
Tax effect of non-deductible interest expense	**53,375,602**	55,866,123	56,284,818
Non-deductible foreign contractor's tax - excess	**4,389,682**	2,200,505	–
Interest income - net of final tax	**(106,342,260)**	(114,072,117)	(121,088,650)
Non-deductible gains on embedded Derivatives	–	(113,444,854)	(604,699,566)
Effect of change in tax rate	**(274,795,065)**	(136,059,664)	792,039
	₱4,160,994,421	₱3,225,629,880	₱3,426,506,227

31. Earnings Per Share (EPS)

The EPS amount was computed as follows:

	2007	2006	2005
Net income attributable to common shareholders	**₱8,651,481,186**	₱6,863,341,226	₱9,174,163,269
Weighted average numbers of shares for EPS	**15,000,000,000**	12,142,584,872	12,000,000,000
Basic/diluted EPS	**₱0.577**	₱0.565	₱0.765

Computation of weighted average number of shares for EPS calculation is as follows:

	Beginning Balance	**Shares Issued**	**Outstanding Shares**	**Number of Days** [(1)]	**Weighted Average Number of Shares**
December 31, 2005	10,000,000,000	2,000,000,000[(1)]	12,000,000,000	365	12,000,000,000
December 31, 2006	10,000,000,000	2,000,000,000[(1)]		365	
		2,608,695,652		18	
		391,304,348	15,000,000,000	13	12,142,584,872
December 31, 2007	15,000,000,000	–	15,000,000,000	365	15,000,000,000

(1) Retroactive effect of stock dividends declared in 2006

32. Personnel Expenses

	2007	2006	2005
Salaries and other benefits	**₱2,018,742,958**	₱1,968,065,036	₱1,905,208,595
Retirement benefit costs (see Note 39)	**329,567,591**	121,063,507	504,917,081
Social security costs	**42,316,907**	35,299,516	35,626,807
	₱2,390,627,456	₱2,124,428,059	₱2,445,752,483

33. Business Segment Information

The Company's operating businesses 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.

The Electricity segment refers to the revenue from sale of electricity out of the power plant operations. Revenue of this segment is covered by long-term power purchase agreements. The Steam segment pertains to the revenue from the sale of steam which is covered by the Geothermal Service Contracts. The Services segment comprises revenues from construction and drilling operations. The Others segment includes corporate and technical and administrative support groups.

The Company operates and generates revenues principally in the Philippines. Thus, geographical business information is not required.

Financial information on the business segments are summarized as follows:

2007

	Electricity	Steam	Services	Others	Total
Revenue	₱13,215,638,368	₱4,834,399,396	₱733,591,782	₱–	₱18,783,629,546
Segment expenses	(6,784,168,707)	(1,351,068,572)	(668,262,070)	(1,297,258)	(8,804,796,607)
Segment results	6,431,469,661	3,483,330,824	65,329,712	(1,297,258)	9,978,832,939
Interest income	–	–	–	648,736,545	648,736,545
Interest expense	–	–	–	(1,567,038,735)	(1,567,038,735)
Unallocated corporate income				3,751,944,858	3,751,944,858
Income taxes	–	–	–	(4,160,994,421)	(4,160,994,421)
Net income	**₱6,431,469,661**	**₱3,483,330,824**	**₱65,329,712**	**(₱1,328,649,011)**	**₱8,651,481,186**
Other information:					
Segment assets	₱54,348,783,001	₱975,955,001	₱634,356,803	₱–	₱55,959,094,805
Unallocated corporate assets	–	–	–	9,111,640,061	9,111,640,061
Total assets	**₱54,348,783,001**	**₱975,955,001**	**₱634,356,803**	**₱9,111,640,061**	**₱65,070,734,866**
Segment liabilities	(₱16,907,127,255)	(₱11,570,477,888)	(₱90,057,472)	₱–	(₱28,564,662,615)
Unallocated corporate liabilities	–	–	–	(1,652,791,645)	(1,652,791,645)
Total liabilities	**(₱16,907,127,255)**	**(₱11,570,477,888)**	**(₱90,057,472)**	**(₱1,652,791,645)**	**(₱30,217,454,260)**
Capital expenditure	₱–	₱–	₱131,276,344	₱26,890,139	₱158,166,483
Depreciation and amortization	164,294,068	–	95,759,928	–	260,053,996
Other non-cash items	(2,042,556,482)	(1,249,671,902)	–	39,754,981	(3,252,473,403)

2006

	Electricity	Steam	Services	Others	Total
Revenue	₱14,309,670,214	₱4,550,567,548	₱6,861,433,729	₱–	₱25,721,671,491
Segment expenses	(6,919,572,964)	(2,276,708,328)	(6,308,448,005)	(441,081)	(15,505,170,378)
Segment results	7,390,097,250	2,273,859,220	552,985,724	(441,081)	10,216,501,113
Interest income	–	–	–	330,161,680	330,161,680
Interest expense	–	–	–	(2,330,786,357)	(2,330,786,357)
Unallocated corporate income	–	–	–	1,873,094,670	1,873,094,670
Income taxes	–	–	–	(3,225,629,880)	(3,225,629,880)
Net income	₱7,390,097,250	₱2,273,859,220	₱552,985,724	(₱3,353,600,968)	₱6,863,341,226
Other information:					
Segment assets	₱60,898,234,211	₱1,309,574,832	₱674,401,033	₱–	₱62,882,210,076
Unallocated corporate assets	–	–	–	14,510,252,706	14,510,252,706
Total assets	₱60,898,234,211	₱1,309,574,832	₱674,401,033	₱14,510,252,706	₱77,392,462,782
Segment liabilities	(₱33,137,844,428)	(₱12,776,508,799)	(₱89,064,522)	₱–	(₱46,003,417,749)
Unallocated corporate liabilities	–	–	–	(4,014,332,055)	(4,014,332,055)
Total liabilities	(₱33,137,844,428)	(₱12,776,508,799)	(₱89,064,522)	(₱4,014,332,055)	(₱50,017,749,804)
Capital expenditure	₱–	₱–	₱504,974,708	₱35,855,711	₱540,830,419
Depreciation and amortization	–	–	128,893,367	–	128,893,367
Other non-cash items	(1,331,094,503)	(728,440,287)	–	(387,307,683)	(2,446,842,473)

2005

	Electricity	Steam	Services	Others	Total
Revenue	₱15,346,083,592	₱4,530,035,664	₱2,343,858,042	₱–	₱22,219,977,298
Segment expenses	(9,405,338,809)	(2,250,373,216)	(2,329,418,126)	(21,609,714)	(14,006,739,865)
Segment results	5,940,744,783	2,279,662,448	14,439,916	(21,609,714)	8,213,237,433
Interest income	–	–	–	446,165,085	446,165,085
Interest expense	–	–	–	(2,604,375,818)	(2,604,375,818)
Unallocated corporate income	–	–	–	6,545,642,796	6,545,642,796
Income taxes	–	–	–	(3,426,506,227)	(3,426,506,227)
Net income	₱5,940,744,783	₱2,279,662,448	₱14,439,916	₱939,316,122	₱9,174,163,269
Other information:					
Segment assets	₱62,726,984,575	₱7,597,498,410	₱880,346,557	₱–	₱71,204,829,542
Unallocated corporate assets	–	–	–	9,781,409,610	9,781,409,610
Total assets	₱62,726,984,575	₱7,597,498,410	₱880,346,557	₱9,781,409,610	₱80,986,239,152

(Forward)

	Electricity	Steam	Services	Others	Total
Segment liabilities	(₱40,642,849,970)	(₱14,067,308,381)	(₱132,020,248)	₱–	(₱54,842,178,599)
Unallocated corporate liabilities	–	–	–	(5,595,381,932)	(5,595,381,932)
Total liabilities	(₱40,642,849,970)	(₱14,067,308,381)	(₱132,020,248)	(₱5,595,381,932)	(₱60,437,560,531)
Capital expenditure	₱–	₱–	₱21,584,504	₱23,099,475	₱44,683,979
Depreciation and amortization	–	–	639,351,921	–	639,351,921
Other non-cash items	(3,441,571,268)	(2,472,429,444)	–	(667,567,778)	(6,581,568,490)

34. **Description of The Service Concession and Related Arrangements**

All geothermal resources in public and/or private lands in the Philippines, whether found in, on or under the surface of dry lands, creeks, rivers, lakes, or other submerged lands within the waters of the Philippines belong to the State, inalienable and imprescriptible, and their exploration, development and exploitation are governed under Presidential Decree No. 1442 (PD 1442, An Act to promote the exploration and development of geothermal resources). Under PD 1442, the Government may enter into service contracts for the exploration, development and exploitation of geothermal resources.

Pursuant to PD 1442, the Company has entered into the following service contracts with the Government of the Republic of the Philippines (Government, represented by the Ministry/Department of Energy) for the exploration, development and production of geothermal fluid for commercial utilization:

a. Tongonan, Leyte, dated May 14, 1981
b. Southern Negros, dated October 16, 1981
c. Bacman, Sorsogon, dated October 16, 1981
d. Mt. Apo, Kidapawan, Cotabato, dated March 24, 1992
e. Mt. Labo, Camarines Norte and Sur, dated March 19, 1994
f. Northern Negros, dated March 24, 1994
g. Mt. Cabalian, Southern Leyte, dated January 13, 1997

The exploration period under the service contracts shall be five (5) years from the effective date, renewable for another two (2) years if the Company has not been in default in its exploration, financial and other work commitments and obligations and has provided a work program for the extension period acceptable to the Government. Where geothermal resource in commercial quantity is discovered during the exploration period, the service contracts shall remain in force for the remainder of the exploration period or any extension thereof and for an additional period of twenty-five (25) years thereafter, provided that, if the Company has not been in default in its obligations under the contracts, the Government may grant an additional extension of fifteen (15) to twenty (20) years.

The Company shall acquire for the geothermal operations materials, equipment, plants and other installations as are required and necessary to carry out the geothermal operations. All materials, equipment, plants and other installations erected or placed on the contract areas of a movable nature by the Company shall remain the property of the Company unless not removed therefrom within one year after the expiration and/or termination of the related service contract in which case, ownership shall be vested in the Government.

The service contracts provide that, among other privileges, the Company shall have the right to enter into agreements for the disposition of the geothermal resources produced from the contract areas, subject to the approval of the Government.

Pursuant to such right, the Company has entered into agreements for the sale of the geothermal resources produced from the service contract areas principally with the NPC, a government owned and controlled corporation. These agreements are for 25 years and may be opened for renegotiation by either party after 5 years from the date of commercial operations.

Pursuant to such right also, the Company has also entered into agreements with NPC for the development, construction and operation of a geothermal power plant by the Company in its geothermal service contract areas and the sale to NPC of the electrical energy generated from such geothermal power plants. These agreements are for 25 years of commercial operations and may be extended upon the request of the Company by notice of not less than 12 months prior to the end of the contract period, the terms and conditions of any such extension to be agreed upon by the parties.

The Company's agreements with NPC for the sale of the geothermal resources produced from the service contract areas and the sale of the electrical energy generated from the geothermal power plants contain certain provisions relating to pricing control in the form of a cap in the Company's internal rate of return for specific contracts; as well as for payment by NPC of minimum guaranteed monthly remuneration and nominated capacity.

For the Northern Negros service contract, the Company does not have agreements with NPC for the sale of the geothermal resources and electrical energy produced from the service contract area. The Company instead enters into contracts with distribution utilities, electric cooperatives and other third party buyers of electricity for the sale of the electrical energy generated from the service contract.

The Company has made a judgment that these service concessions and related arrangements qualify for accounting under Philippine Interpretation IFRIC 12, *Service Concession Arrangements*. Accordingly, the Company has recognized the consideration received or receivable in exchange for its infrastructure construction services or its acquisition of infrastructure to be used in the arrangements as either a financial asset to the extent that the Company has an unconditional contractual right to receive cash or other financial asset for its construction services from or at the direction of the grantor, or an intangible asset for the right to charge users of the public service.

Revenue and profits recognized in 2007, 2006 and 2005, on exchanging construction services for a financial or an intangible asset amounted to ₱108.81 million, ₱6,599.98 million, and ₱2,194.33 million, respectively; and ₱7.68 million, ₱578.83 million and ₱151.61 million, respectively.

The disclosures have been provided in aggregate since management believes that the service concession arrangements are similar in nature.

35. Service Contracts

As discussed in Note 34, by virtue of PD 1442, the Company entered into seven service contracts with the DOE granting the Company the right to explore, develop, and utilize the country's geothermal resource subject to sharing of net proceeds with the government. The net proceeds is what remains after deducting from the gross proceeds the allowable recoverable costs, which include development, production and operating costs.

The allowable recoverable costs shall not exceed 90% of the gross proceeds. The Company pays 60% of the net proceeds as government share and retains the remaining 40%.

The 60% government share is comprised of royalty fees and income taxes. The royalty fees are shared by the Government through DOE (60%) and the LGU (40%).

The Company secured an approval from the DOE to defer remittance of the royalty portion of the Government share at P180 million per year. A portion of said payment was applied to the amortization of the deferred royalty fees as of December 31, 1998, and the balance to 1999 and future obligations. On March 23, 2004, the Company and DOE agreed to increase the royalty payment plan to P200 million per year starting 2004. A portion of the revised payment shall be applied to the amortization of the deferred royalty fees as of December 31, 2003 and the balance to 2004 and future obligations for existing Company operating projects. However, remittances to the local government units of their share in royalty fees are made as they fall due pursuant to the Local Government Code.

Total royalty fees due to DOE and to LGUs are shown in Note 18.

The DOE approved the application of the Company for the 20-year extension of the Tongonan, Palinpinon and Bacon-Manito Geothermal Service Contracts (GSCs). The extension is embodied in the fourth amendment to the GSCs dated October 30, 2003. The amendment extended the Tongonan GSC from May 15, 2011 to May 16, 2031, while the Palinpinon and Bacon-Manito GSCs are extended from October 16, 2011 to October 17, 2031.

36. Geothermal Resources Sales Contract

The geothermal energy currently produced by the Company's geothermal projects is supplied to the power plants owned and operated by NPC pursuant to the following steam sales contracts:

<u>Tongonan I</u>

Under the steam sales contract entered in June 1984 for Tongonan I, NPC agrees to pay the Company a base price per kilowatt-hour of net generation, subject to inflation adjustments and based on a guaranteed take-or-pay rate at 75% plant factor for a period of twenty-five years.

<u>Palinpinon I</u>

The steam sales contract for Palinpinon I provides, among others, that NPC shall pay the Company a base price per kilowatt-hour of gross generation, subject to inflation adjustments and based on a guaranteed take-or-pay rate at 75% plant factor. The contract is for a period of twenty years commencing on December 25, 1988.

Palinpinon II

In June 1996, the Company and NPC signed a steam sales contract for Palinpinon II's four modular plants - Nasuji, Okoy, Sogongon I and Sogongon II. Under the terms and conditions, NPC agrees to pay the Company a base price per kilowatt-hour of gross generation, subject to inflation adjustments and based on a guaranteed take-or-pay rate commencing from the established commercial operation period, using the following plant factors: 50% for the first year, 65% for the second year and 75% for the third and subsequent years. The contract is for a period of twenty-five years for each module commencing on December 13, 1993 for Nasuji; November 28, 1994 for Okoy; January 28, 1995 for Sogongon I and March 23, 1995 for Sogongon II.

Bacon-Manito I

The steam sales contract for the Bacon-Manito (Bacman) geothermal resources entered in November 1988 provides, among others, that NPC shall pay the Company a base price per kilowatt-hour of gross generation, subject to inflation adjustments and based on a guaranteed take-or-pay rate at 75% plant factor. The contract is for a period of twenty-five years commencing in May 1993.

Bacon-Manito II

Bacman II's steam sales contract with NPC was signed in June 1996 for its two 20-MW capacity modular plants - Cawayan and Botong. The terms and conditions under the contract contain, among others, NPC's commitment to pay the Company a base price per kilowatt-hour of gross generation, subject to inflation adjustments and based on a guaranteed take-or-pay rate, commencing from the established commercial operation period, using the following plant factors: 50% for the first year, 65% for the second year and 75% for the third and subsequent years. The contract is for a period of twenty-five years commencing in March 1994 for Cawayan and December 1997 for Botong.

37. Build-Operate-Transfer (BOT) Contracts

Pursuant to Republic Act Number 7718 dated May 5, 1994 (Amended BOT Law), the Company entered into Energy Conversion Agreements (ECA) with various international geothermal power producers for the construction and operation of power plants in Leyte and Mindanao to convert the geothermal steam to be supplied by the Company to electricity. Under these contracts, the BOT Contractor shall deliver electricity to NPC on behalf of the Company.

Leyte

Under the ECA with the BOT Contractors, namely: California Energy for a) 125 MW Power Plant - Upper Mahiao Agreement; b) 231 MW Power Plant - Malitbog Agreement; and c) 180 MW Power Plant - Mahanagdong Agreement and with Ormat Inc. for the Leyte Optimization Project BOT Agreement, the Company shall pay the BOT Contractors monthly energy fees to be computed based on actual energy delivered and capacity fees, which include capital and fixed operating cost recovery fees and service fees, to be computed on a per kilowatt nominated capacity basis.

Except for the capital cost recovery portions, the fees are subject to inflation adjustments. The contracts are for a period of ten years commencing July 1996 for the Upper Mahiao Agreement, July 1997 for the Malitbog and Mahanagdong Agreements and September 1997 for the Optimization Agreement. The ownership of the Upper Mahiao Power Plant was transferred to the Company on June 25, 2006; Malitbog and Mahanagdong Power Plants were transferred on July 25, 2007; and the Optimization Power Plants on September 25, 2007.

Mindanao

Under the terms and conditions of the ECA with Oxbow Power Corporation and Marubeni Corporation, the Company shall pay the BOT Contractor monthly energy efficiency fees and capacity fees, which include capital and fixed operating cost recovery fees and service fees, to be computed on a per kilowatt nominated capacity basis and excess energy fees which are payment for the share of BOT Contractor for the revenues from surplus energy generation on top of the nominated energy. Except for energy efficiency payments and capital cost recovery portion of capacity fees, the fees are subject to inflation adjustments. The contract is for a period of ten years commencing in March 1997 for Mindanao I (47 MW) and June 1999 for Mindanao II (48.25 MW). An Amendment to the Mindanao I ECA was signed on November 17, 2006 extending the contract period to June 2009 with corresponding restructuring of BOT fees.

The fair value of these BOT contracts are included as part of the fair value of the construction services accounted for under Philippine Interpretation IFRIC 12 as discussed in Note 34.

38. Power Purchase Agreements

The electricity produced by the Company is sold to NPC, pursuant to the following Power Purchase Agreements (PPA):

Leyte-Cebu, Leyte-Luzon

The PPA provides, among others, that NPC shall pay the Company a base price per kilowatt-hour of electricity delivered subject to inflation adjustments. The PPA stipulates a contracted annual energy of 1,370 GWH for Leyte-Cebu and 3,000 GWH for Leyte-Luzon throughout the cooperation period. It also stipulates a nominated energy of not lower than 90% of the contracted annual energy.

On November 12, 1999, NPC agreed to accept from PNOC EDC a combined average annual nominated energy of 4,455 GWH for the period July 25, 1999 to July 25, 2000 for both Leyte-Cebu and Leyte-Luzon PPA. The annual nominated energy starting July 25, 2000 and onwards is being contested by NPC, which is one of the issues of the ongoing arbitration with NPC. The contracts are for a period of twenty-five years commencing in July 1996 for Leyte-Cebu and July 1997 for Leyte-Luzon (see Note 16).

47 MW Mindanao I

The PPA provides, among others, that NPC shall pay the Company a base price per kilowatt-hour of electricity delivered subject to inflation adjustments. The PPA stipulates a minimum offtake energy of 330 GWH for the first year and 390 GWH per year for the succeeding years. The contract is for a period of twenty-five years commencing in March 1997.

48.25 MW Mindanao II

The PPA provides, among others, that NPC shall pay the Company a base price per kilowatt-hour of electricity delivered subject to inflation adjustments. The PPA stipulates a minimum offtake energy of 398 GWH per year. The contract is for a period of twenty-five years commencing in June 1999.

39. Retirement and Other Post-Retirement Benefit Plans

The Company maintains a funded, non-contributory, defined benefit retirement plan. The plan covers all permanent employees and is administered by a trustee bank. The Company also provides post-retirement medical and life insurance benefits which are unfunded.

The following tables summarize the components of net benefit expense recognized in the statements of income and the funded status and amounts recognized in the balance sheets:

	2007	2006	2005
Current service cost	**₱137,976,928**	₱97,756,610	₱119,616,100
Interest cost on benefit obligation	**154,587,224**	150,770,729	192,005,800
Expected return on plan assets	**(102,814,445)**	(122,261,769)	(197,662,400)
Net actuarial gain recognized in the year	**–**	(33,404,348)	(43,356,400)
Net benefit expense	**₱189,749,707**	₱92,861,222	₱70,603,100
Actual return on plan assets	**₱45,943,657**	₱152,765,772	₱144,715,700

	2007	2006
Present value of defined benefit obligations	**₱2,692,826,116**	₱2,187,879,669
Fair value of plan assets	**(1,626,128,399)**	(1,468,777,785)
	1,066,697,717	719,101,884
Unrecognized actuarial gains (losses)	**(154,627,960)**	150,467,454
Benefit liability	**₱912,069,757**	₱869,569,338

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

	2007	2006
Defined benefit obligation at beginning of year	**₱2,187,879,669**	₱1,507,707,292
Interest cost	**154,587,224**	150,770,729
Current service cost	**137,976,928**	97,756,610
Benefits paid	**(48,593,043)**	(33,418,770)
Actuarial losses gains on obligation	**260,975,338**	465,063,808
Defined benefit obligation at end of year	**₱2,692,826,116**	₱2,187,879,669

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

	2007	2006
Fair value of plan assets at beginning of year	**₱1,468,777,785**	₱1,222,617,694
Expected return	**102,814,445**	122,261,769
Contributions by employer	**160,000,000**	126,813,090
Benefits paid	**(48,593,043)**	(33,418,770)
Actuarial gains (losses)	**(56,870,788)**	30,504,002
Fair value of plan assets as at end of year	**₱1,626,128,399**	₱1,468,777,785

The Company expects to contribute ₱134.00 million to its defined benefit retirement plan in 2008. The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:

	2007	2006
	%	%
Fixed Income	**88.23**	86.80
Equities	**10.05**	10.67
Real Properties	**0.51**	0.56
Others	**1.21**	1.97
	100.00	100.00

The principal actuarial assumptions used in determining retirement and post-retirement medical and life insurance benefit obligations are as follows:

	2007	2006
Discount rate	**7.00%**	7.00%
Expected rate of return on assets	**7.00%**	10.00%
Future salary increases	**6.00%**	6.00%
Medical trend rate	**3.00%**	–

The assumption on the discount rate is based on the long-term government bond rates approximating the expected working life of the employees as published by the Philippine Dealing Exchange Corporation. The assumption on the expected rate of return on plan assets is based on the asset allocation while the expected rate of salary increases is based on discussion with the management which is around 2.00% - 3.00% more than the projected inflation rate of about 3.00% - 4.00%.

Amounts for the current and previous four periods are as follows:

	2007	2006	2005	2004	2003
Defined benefit obligation	**(₱2,672,620,165)**	(₱2,187,879,669)	(₱1,791,112,900)	(₱1,758,346,900)	(₱2,338,457,300)
Plan assets	**1,626,128,399**	1,468,777,785	1,222,617,700	1,594,938,200	1,398,086,630
Deficit	**(₱1,046,491,766)**	(₱719,101,884)	(₱568,495,200)	(₱163,408,700)	(₱940,370,670)

The experience adjustments on plan liabilities amounted to ₱7.62 million in 2007 and ₱137.09 million in 2006.

A one percentage point change in the assumed rate of increase in medical costs would have the following effects:

	Increase	Decrease
2007		
Effect on the aggregate current service cost and interest cost	15.91%	13.47 %
Effect on the defined benefit obligation	13.22%	11.47%
2006		
Effect on the aggregate current service cost and interest cost	–	–
Effect on the defined benefit obligation	14.09%	12.16%

40. **Supplementary Disclosures of Geothermal Reserves**

In October 2004, the Company has contracted GeothermEX to provide an independent review of the updated geothermal energy reserves estimation made by the Company's Reservoir Engineering Department for four geothermal fields: Bacon-Manito (Luzon), Mindanao (Mindanao), Palinpinon (Southern Negros) and Greater Tongonan (Leyte).

Five available methods of estimating geothermal reserves were considered as regards their applicability to the Company's fields: empirical methods, volumetric reserve estimation, decline curve analysis, lumped-parameter modeling and numerical simulation of the reservoir. It was concluded that, of these methods, only volumetric estimation and numerical simulation are generally useful to the Company in estimating reserves. The Company has conducted numerical simulation to most of its fields. A detailed review of one such simulation study, for Mindanao field, showed it to be reasonable. It is pointed out that while numerical simulation is more sophisticated than volumetric reserve estimation, the latter can be readily conducted in a probabilistic way, while the former cannot.

GeothermEX, in their report released in December 2004, used the same volumetric reserve estimation method used by PNOC EDC for the various geothermal fields patterned after the United States Geological Survey but differ only in the heat recovery factor. GeothermEX concluded that the Company's estimation is conservative due to the low heat recovery factor values of 0.10 to 0.30. On the other hand, GeothermEX estimates of reserves in these field locations are 2.25 times more than those of the Company.

Proved geothermal reserves refer to reserves which can be produced with known certainty and delineated in known production limits as confirmed by drilling and production history.

Probable reserves refer to those that could be proven by normal step-out drilling as well as those that could be extracted by improved recovery techniques like acidizing.

Possible reserves refer to those reserves that are currently unextractable because of resource and technology problems but may be found to be commercial in the future.

The following table shows a comparison of estimated geothermal energy reserves from the Company and GeothermEX:

Estimated Geothermal Energy Reserves

Field	Mean Reserves Company Estimates (MWe)	Mean Reserves GeothermEX Estimates (MWe)	Proved Reserves GeothermEX Estimates (MMBFOE)	Proved Reserves GeothermEX Estimates (GWh of energy)
Greater Tongonan (Leyte)	415	867	145.4	96,940
Palinpinon (Negros Oriental)	170	440	74.4	49,612
Bacon-Manito (Luzon)	185	421	65.3	43,542
Mindanao	203	478	54.1	36,105
Total	973	2,206	339.2	226,199

Source: GeothermEX Report, December 2004

GeothermEX Estimates of Reserves in Million Barrels of Oil Equivalent

Field	Proved Reserves (MMBFOE)	Proved Probable Reserves (MMBFOE)	Proved Probable Possible Reserves(MMBFOE)
Greater Tongonan	145.4	247.2	455.6
Bacon-Manito	65.3	98.2	222.9
Palinpinon	74.4	189.0	211.8
Mindanao	54.1	97.3	171.9
Total	339.2	631.7	1,062.2

Source: GeothermEX Report, December 2004

41. Remuneration of Key Management Personnel

The remuneration of the directors and other members of key management personnel by benefit type follow:

	2007	2006	2005
Short-term employee benefits	**₱39,626,921**	₱40,419,545	₱23,437,384
Post-employment benefits	**76,699,639**	60,434,375	58,194,080
	₱116,326,560	₱100,853,920	₱81,631,464

42. Financial Risk Management Objectives and Policies

The Company's financial instruments consist mainly of cash and cash equivalents, AFS investments, and long-term debt. The main purpose of these financial instruments is to finance the Company's operations and accordingly manage its exposure to financial risks. The Company has various financial assets and liabilities such as trade receivables, trade payables and other liabilities which arise directly from its operations.

The main risks arising from the Company's financial instruments are credit risk, interest rate risk, liquidity risk, and foreign currency risk. The Company's Enterprise Wide Risk Management Program identifies these risks based on the likelihood of occurrence and impact to the business, formulates risk management strategies, assesses risk management capabilities and continuously monitors the risk management efforts. The BOD's Risk Committee reviews and promulgates policies for managing each of these risks as summarized below.

Credit risk

The Company's geothermal and power generation business trades with only one major customer - the NPC, a government-owned-and-controlled corporation. Any failure on the part of NPC to pay its obligations to the Company would significantly affect the Company's business operations. The Company monitors closely its collection with NPC. Receivable balances are monitored on an ongoing basis to ensure that the Company's exposure to bad debts is not significant. The maximum exposure of trade receivable is equal to the carrying amount.

With respect to credit risk arising from other financial assets of the Company, which comprise cash and cash equivalents, non-trade and other receivables, AFS financial assets, deferred royalty fee and cash collateral on PCIR bonds, the Company's exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments. The Company trades only with recognized, creditworthy third parties and/or transacts only with institutions and/or banks which have demonstrated financial soundness and which have passed the financial evaluation and accreditation of the Company.

The table below shows the Company's aging analysis of past due but not impaired receivables as of December 31, 2007:

		Past due but not impaired					
In thousand Pesos	Neither past due nor impaired	Less than 30 days	31 days to 1 year	Over 1 year up to 3 years	Over 3 years	Past due or impaired	Total
Trade receivables	₱4,297,225	₱–	₱–	₱–	₱–	₱1,401,809	₱5,699,034
Interest receivable	34,120		–	–	–	–	34,120
Due from employees	97,020	–	4,845	1,472	41	–	103,378
Due from contractors/suppliers	18,158	–	12,018	–	–	13,070	43,246
Due from others	43,246	–	417,536	–	–	1,944,116	2,404,898
Total	₱4,489,769	₱–	₱434,399	₱1,472	₱41	₱3,358,995	₱8,284,676

Foreign currency risk

The Company's exposure to foreign currency risk resulted from the financial assets and liabilities that are denominated in U.S. dollar and Japanese yen. This primarily arise from future payments of foreign loans, BOT lease obligations and other commercial transactions and the Company's investment in ROP Bonds.

The Company's exposure to foreign currency risk to some degree is mitigated by some provisions in the Company's geothermal service contracts, steam sales agreements and power purchase agreements. The service contracts allow full cost recovery while the sales contracts include billing adjustments covering the movements in Philippine peso and the US dollar rates, US Price and Consumer Indices, and other inflation factors.

To mitigate the effects of foreign currency risk, the Company will prepay, refinance or hedge its foreign currency denominated loans, whenever deemed feasible.

The Company's foreign currency-denominated financial assets and liabilities (translated in Philippine peso) as of December 31, 2007 are as follows:

	2007			2006		
	Original Currency		**Peso**	Original Currency		Peso
	Yen	**US Dollar**	**Equivalent[1]**	Yen	US Dollar	Equivalent[2]
Current Financial Assets						
Cash equivalents	–	**2,757,445**	**114,188,538**	–	5,425,000	266,069,125
Cash on hand and in banks	**6,458,189**	**65,265**	**5,055,106**	4,508,865	497,639	26,266,015
Trade and other receivables	–	**1,151,599**	**49,294,872**	–	1,158,735	61,578,524
Investment in AFS securities	–	–	–	–	–	–
Quoted investments	–	–	–	–	–	–
Government debt securities	–	**28,436,647**	**1,177,589,987**	–	27,357,563	1,341,751,679
Total Current Financial Assets	**6,458,189**	**32,410,956**	**1,346,128,503**	4,508,865	34,438,937	1,695,665,343
Total Financial Assets	**6,458,189**	**32,410,956**	**1,346,128,503**	4,508,865	34,438,937	1,695,665,343

	2007			2006		
	Original Currency		**Peso**	Original Currency		
	Yen	**US Dollar**	**Equivalent[1]**	Yen	US Dollar	Peso Equivalent[2]
Current Financial Liabilities						
Trade and other payables	–	**1,817,746**	**75,274,681**	1,017,262,067	4,427,423	636,631,670
Due to parent companies	–	–	–	45,067,955	1,555,445	90,639,645
Current portion of interest-bearing financial liabilities	**680,746,571**	**972,410,217**	**1,653,156,788**	1,854,675,232	95,185,940	5,433,207,555
Total Current Financial Liabilities	**680,746,571**	**974,227,963**	**1,728,431,469**	2,917,005,254	101,168,808	6,160,478,870
Noncurrent Financial Liabilities						
Interest-bearing financial liabilities - net of current portion	**17,929,855,693**	**3,130,957,335**	**21,060,813,028**	51,197,880,324	233,431,062	32,561,114,727
Total Noncurrent Financial Liabilities	**17,929,855,693**	**3,130,957,335**	**21,060,813,028**	51,197,880,324	233,431,062	32,561,114,727
Total Financial Liabilities	**18,610,602,264**	**4,105,185,298**	**22,789,244,497**	54,114,885,578	334,599,870	38,721,593,597

[1]USD1=JPY113.688 and USD1= ₱41.411
[2]USD1=JPY118.934 and USD1= ₱49.045

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar and Japanese yen exchange rates, with all other variables held constant, of the Company's profit before tax as at December 31, 2007.

	Foreign currency appreciates (depreciates) by	Effect on profit before tax
USD	PHP0.50	(40,283,248)
	(PHP3.00)	241,699,488
JPY	PHP0.010	(505,302,869)
	(PHP0.003)	162,559,770

Interest rate risk

The Company's exposure to the risk of changes in market interest rates relates primarily to the Company's long-term debt obligations with floating interest rates and AFS investments.

The interest rates of some of the Company's long-term borrowings, AFS debt investments and finance leases (to which the Company is a lessee) are fixed at the inception of the loan agreement and/or lease.

The Company regularly evaluates its interest rate risk by taking into account the cost of qualified borrowings being charged by its creditors. Prepayment, refinancing or hedging the risks are undertaken when deemed feasible and advantageous to the Company.

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Company's profit before tax and equity as of December 31, 2007.

	Increase/decrease in basis points	Effect on profit before tax	Effect on Equity
PHP	+25	(461,348)	–
	50	922,696	–
USD	+25	(9,683,970)	(9,759,410)
	50	19,367,940	19,888,289
JPY	+10	(2,476,908)	–
	10	2,476,908	–

Liquidity risk

The Company's objective is to maintain a balance between continuity of funding and sourcing flexibility through the use of available financial instruments. The Company manages its liquidity profile to meet its working and capital expenditure requirements and service debt obligations. As part of the liquidity risk management program, the Company regularly evaluates and considers the maturity of both its financial investments and financial assets (e.g. trade receivables, other financial assets) and resorts to short-term borrowings whenever its available cash or matured placements are not enough to meet its daily working capital requirements. To ensure immediate availability of short-term borrowings, the company maintains credit lines with banks on a continuing basis.

The table below summarizes the maturity analysis of the Company's financial liabilities at December 31, 2007 based on contractual undiscounted payments:

In Thousand Pesos	**On demand**	**Less than 3 months**	**3 to 6 months**	**6 to 12 months**	**1 to 5 years**	**More than 5 years**	**Total**
2007							
Trade and other payables	**₱–**	**₱3,032,940**	**₱604,431**	**₱411**	**₱–**	**₱–**	**₱3,637,782**
Trade payables	–	2,787,413	604,431	411			3,392,255
Accrued interest and guarantee fees	–	139,924	–	–	–	–	139,924
Withholding and other taxes payable	–	56,557	–	–	–	–	56,557
SSS and other contributions	–	38,921	–	–	–	–	38,921
Deferred credits	–	6,298	–	–	–	–	6,298
Miscellaneous current liabilities	–	3,827	–	–	–	–	3,827
Royalty fee payables	**–**	**306,274**	**50,000**	**100,000**	**1,503,244**	**–**	**1,959,518**
Liability to power plant contractors	**–**	**66,436**	**66,436**	**132,872**	**100,348**	**–**	**366,092**
Long-term debt	**–**	**264,201**	**1,425,032**	**1,305,986**	**19,906,853**	**3,113,768**	**26,015,840**
Total	**₱–**	**₱3,669,851**	**₱2,145,899**	**₱1,539,269**	**₱21,510,445**	**₱3,113,768**	**₱31,979,232**

In Thousand Pesos	On demand	Less than 3 months	3 to 6 months	6 to 12 months	1 to 5 years	More than 5 years	Total
2006							
Trade and other payables	₱–	₱5,120,778	₱942,721	₱365,566	₱–	₱–	₱6,429,065
Trade payables	–	3,994,144	942,721	365,566	–	–	5,302,431
Accrued interest & guarantee fees	–	1,011,270	–	–	–	–	1,011,270
Withholding and other taxes payables	–	95,908	–	–	–	–	95,908
SSS and other contributions	–	5,454	–	–	–	–	5,454
Deferred credits	–	6,847	–	–	–	–	6,847
Miscellaneous current liabilities	–	7,155	–	–	–	–	7,155
Royalty fee payables	–	374,645	50,000	100,000	1,816,946	–	2,341,591
Liability to power plant contractors	–	1,111,477	1,109,923	683,382	434,681	–	3,339,463
Long-term debt	–	1,020,393	1,459,594	3,193,621	31,065,801	4,106,251	40,845,660
Total	₱–	₱7,627,293	₱3,562,238	₱4,342,569	₱33,317,428	₱4,106,251	₱52,955,779

Financial assets and financial liabilities

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

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

Set out below is a comparison of carrying amounts and fair values of the Company's financial instruments as of December 31, 2007 and 2006.

	2007		2006	
Financial assets	**Carrying Amount**	**Fair Value**	Carrying Amount	Fair Value
Cash and cash equivalents	**₱2,797,581,577**	**₱2,797,581,577**	₱10,032,415,184	₱10,032,415,184
Trade and other receivables	**4,925,681,584**	**4,925,681,584**	4,355,257,059	4,355,257,059
Due from affiliated companies	–	–	4,785,103	4,785,103
AFS investments (debt investments)	**1,177,589,987**	**1,177,589,987**	1,341,751,679	1,341,751,679
AFS investments (equity investments)	**16,410,656**	**16,410,656**	12,146,829	12,146,829
Derivative assets	–	–	344,000,987	344,000,987
	₱8,917,263,804	**₱8,917,263,804**	₱16,090,356,841	₱16,090,356,841

	2007		2006	
Financial liabilities	**Carrying Amount**	**Fair Value**	Carrying Amount	Fair Value
Trade and other payables	**₱3,637,782,267**	**₱3,637,782,267**	₱6,429,065,264	₱6,429,065,264
Due to PNOC	–	–	350,844,177	350,844,177
Royalty fee payable	**1,733,927,164**	**2,083,225,515**	1,944,322,923	2,129,184,108
Long-term debt	**23,092,378,906**	**21,231,466,800**	36,831,709,967	30,577,653,733
	₱28,464,088,337	**₱26,952,474,582**	₱45,555,942,331	₱39,486,747,282

The methods and assumptions used by the Company in estimating the fair value of financial instruments are:

Cash and other cash equivalents
Carrying amounts approximate fair values.

Trade and other receivables, due from affiliated companies, trade and other payables
These are instruments with relatively short maturity. Carrying amounts approximate fair values.

AFS investments
Fair values of debt securities are based on quoted market prices. For equity investments that are not quoted, the investments are carried at cost less allowance for impairment losses due to the unpredictable nature of future cash flows and the lack of suitable methods of arriving at a reliable fair value.

Derivative instruments
Fair values are estimated based on prices derived using the binomial pricing methodology.

Long-term debt and royalty fee payable
Fair values are estimated using the discounted cash flow methodology using the Company's current incremental borrowing rates for similar borrowings with maturities consistent with those remaining for the liability being valued, if any.

The Company classifies its financial instruments in the following categories.

2007	Cash	Loans and Receivables	AFS	Derivative Assets	Liabilities at Amortized Cost	Total
FINANCIAL ASSETS						
Cash and cash equivalents	**₱2,797,581,577**	**₱–**	**₱–**	**₱–**	**₱–**	**₱2,797,581,577**
Trade and other receivables	–	**4,351,678,817**	–	–	–	**4,351,678,817**
Trade receivable - net	–	4,297,224,927	–	–	–	4,297,224,927
Loans and notes receivable (included in Other receivables)	–	54,453,890	–	–	–	54,453,890
AFS investments (equity investments)	–	–	**16,410,656**	–	–	**16,410,656**
Quoted	–	–	16,336,106	–	–	16,336,106
Unquoted	–	–	74,550	–	–	74,550
AFS investments (debt investments)	–	–	**1,177,589,987**	–	–	**1,177,589,987**
Quoted	–	–	1,177,589,987	–	–	1,177,589,987
FINANCIAL LIABILITIES						
Accounts payable - trade	–	–	–	–	**3,392,254,846**	**3,392,254,846**
Royalty fee payable	–	–	–	–	**1,733,927,166**	**1,733,927,166**
Long-term debt	–	–	–	–	**23,092,378,906**	**23,092,378,906**
Total	**₱2,797,581,577**	**₱4,351,678,817**	**₱1,194,000,643**	**₱–**	**₱28,218,560,918**	**₱36,561,821,955**

2006	Cash	Loans and Receivables	AFS	Derivative Assets	Liabilities at Amortized Cost	Total
FINANCIAL ASSETS						
Cash and cash equivalents	**₱10,032,415,184**	**₱–**	**₱–**	**₱–**	**₱–**	**₱10,032,415,184**
Trade and other receivables	–	**4,259,439,729**	–	–	–	**4,259,439,729**
Trade receivable - net	–	4,232,642,072	–	–	–	4,232,642,072
Loans and notes receivable (included in Other receivables)	–	26,797,657	–	–	–	26,797,657
Available for sale investments (equity investments)	–	–	**12,146,829**	–	–	**12,146,829**
Available for sale investments (debt investments)	–	–	**1,341,751,679**	–	–	**1,341,751,679**
Derivative assets	–	–		**344,000,987**	–	**344,000,987**

(Forward)

2006	Cash	Loans and Receivables	AFS	Derivative Assets	Liabilities at Amortized Cost	Total
FINANCIAL LIABILITIES						
Accounts Payable - trade	₱–	₱–	₱–	₱–	₱5,303,670,215	₱5,303,670,215
Due to PNOC	–	–	–	–	350,844,177	350,844,177
Royalty fee payable	–	–	–	–	1,944,322,923	1,944,322,923
Long-term debt	–	–	–	–	36,831,709,967	36,831,709,967
Total	₱10,032,415,184	₱4,259,439,729	₱1,353,898,508	₱344,000,987	₱44,430,547,282	₱60,420,301,690

Capital Management

The primary objective of the Company's capital management is to ensure that it maintains a healthy capital ratio in order to comply with its financial loan covenants and support its business operations.

The Company manages and makes adjustment to its capital structure as it deems necessary. To maintain or adjust its capital structure, the Company may increase the levels of capital contributions from its creditors and owners/shareholders through debt and new shares issuance, respectively.

The Company monitors capital using the debt to equity ratio, which is long-term liabilities divided by total liabilities plus stockholders' equity. The Company's policy is to keep the debt to equity ratio not more than 70:30. The Company's long-term liabilities include royalty fees payable (net of current portion), obligations to power plant contractors (net of current portion), long-term debt (net of current portion), retirement benefit obligation and other long-term liabilities. Total liabilities are current liabilities (which includes trade and other payables, income tax payable, current portion of long -term debt and obligations to power plant contractors) plus long-term liabilities. Equity includes capital stock attributable to common and preferred shares, unrealized gains reserve and retained earnings.

Table below shows the Company's debt to equity ratio as at December 31, 2007 and 2006.

	2007	2006
Current liabilities	₱6,791,327,461	₱13,750,239,296
Noncurrent liabilities	23,426,126,799	36,267,510,508
Stockholders' equity	34,853,280,606	27,374,712,978
Debt to equity ratio	36.0%	46.9%

43. Commitments and Contingencies

Stored Energy

On various dates, the Company entered into Addendum Agreements to the PPA for the Unified Leyte and GRSC for BacMan 2 projects, where any excess generation above the nominated energy or take-or-pay volume will be credited against payments made by NPC for the periods it was not able to take electricity or steam, where applicable. As of December 31, 2007, the commitment for stored energy follows (in gigawatt-hours):

Unified Leyte	4,326.6
BacMan 2 - Cawayan	306.1

44. Prior Period Adjustments

The financial statements for 2006 and 2005 have been restated to effect the following prior period adjustments:

In million pesos

	Effect on retained earnings as of January 31, increase (decrease)		
	2007	2006	2005
Adjustment in provision for taxes	**(₱615.74)**	(₱451.65)	(₱379.65)
Adjustment in accounting for financial instruments and embedded derivatives	**(963.92)**	(203.83)	(338.63)
Net effect of recognition and reversal of expenses	**1.69**	(571.55)	–
	(₱1,577.97)	(₱1,227.03)	(₱718.28)

These corrections including effects of early adoption of Philippine Interpretation IFRIC 12 brought about an increase in net income in 2006 by ₱80.42 million and a decrease of ₱741.93 million in 2005's net income. Relatively, these adjustments resulted in an increase and a decrease of the basic/diluted earnings per share in 2006 and 2005 by ₱0.007 per share and ₱0.062 per share, respectively.