PNOC ALTERNATIVE FUELS CORPORATION
EXECUTIVE SUMMARY

A. Introduction

The PNOC Alternative Fuels Corporation (PNOC-AFC) was formerly known as PNOC Petrochemical Development Corporation (PPDC). PPDC was incorporated on May 13, 1993, and registered with the Securities and Exchange Commission (SEC) under SEC Registration No. AS093-03633, to develop the first integrated petrochemical industry in the Philippines.

On June 7, 2006, majority vote of the PPDC Board of Directors resolved to amend the Articles of Incorporation of the Company, specifically by modifying its primary purpose, secondary purposes, as well as its corporate name. This was ratified thereafter by two-thirds (2/3) vote of the stockholders owning or representing its outstanding capital stock in a stockholders' meeting held last June 9, 2006.

On July 13, 2006, the Amended Articles of Incorporation of the PPDC was approved by the SEC reflecting its new name as ***PNOC Alternative Fuels Corporation.*** Its mandate is: to explore, develop, and accelerate the utilization and commercialization of existing and emerging alternative sources of energy and technologies, and carry on the business of alternative fuels and other related activities thereto; to enhance the energy security and promote sustainable energy development; to develop projects for implementation of alternative fuel sources which shall include but not limited to bio-fuels, bio-diesel, bio-mass, bio-gas, and such other energy systems that support environmental sustainability and energy consumption efficiency; to purchase, acquire, own, hold, lease, develop, sell, construct, maintain, and operate production plants, refineries, factories, equipment, pipelines, transportation facilities, patent rights, technical and engineering know-how, appliances, industrial sites, storage, warehouses, offsite, and industrial utilities which are used or incidental to production, manufacturing, processing, converting, fabricating, storage, trading, marketing, distributing, beneficiating, disposing, buying, selling, bartering, transporting, importing, exporting, or making of alternative fuels; to advance energy research development of alternative energy sources through technical, financial and institutional arrangements, as well as venture into financing and operating of energy projects, utilizing alternative fuels through innovating schemes, such as but not limited to joint ventures and other sharing arrangements.

Then President of the Philippines, Gloria Macapagal-Arroyo, in a Joint National Economic and Development Authority (NEDA) Board and National Anti-Poverty Commission (NAPC) Cabinet Group Meeting held at the Malacañang Palace on August 8, 2006, issued her directives for the Company to have primary responsibility over the Bio-Fuel Project and be the one to coordinate with the concerned agencies.

The Company has retained as its secondary purpose, its mandate to manage, operate, and develop some 530 hectares of land in Bataan as a petrochemical industrial estate, known as Petrochemical Park pursuant to its Articles of Incorporation. The Company was also mandated to cause the establishment of petrochemical and related industries thereat either by itself or in joint venture with private investors.

The Company initially developed about 85 hectares of the Petrochem Park for the midstream plants. Facilities, such as raw and firewater distribution systems, road network and drainage system, a power distribution system, and a 1.3 - kilometer feedstock pier, are in place.

The principal and registered office address of the Company is at PNOC-Alternative Fuels Corporation, 2nd Floor Lapanday Center, Pasong Tamo, Makati City.

B. Financial Highlights (In Million Pesos)

1. Comparative Financial Position

	2011	2010	Increase (Decrease)
Assets	3,018.432	3,158.127	(139.695)
Liabilities	422.286	431.546	(9.260)
Equity	2,596.146	2,726.581	(130.435)

2. Comparative Results of Operation

	2011	2010	Increase (Decrease)
Revenues	78.164	76.805	1.359
Cost of Sales	(81.874)	(69.016)	(12.858)
Gross Margin	(3.710)	7.789	(11.499)
General, Administrative & Other Operating Expenses	(90.663)	(132.000)	41.337
Loss From Operations	(94.373)	(124.211)	29.838
Other Income/(Charges)	(80.549)	(46.945)	(33.604)
Loss Before Tax	(174.922)	(171.156)	(3.766)
Income Tax Expense	46.639	(41.071)	87.710
Net Loss	(128.283)	(212.227)	83.944

C. Scope of Audit

A financial and compliance audit was conducted on the accounts and operations of PAFC for the year ended December 31, 2011, to determine the fairness of presentation of the financial statements and the propriety of the financial transactions, in accordance with the International Standards on Auditing, applicable laws, rules and regulations.

D. Independent Auditor's Opinion

Deficiencies in accounting records and supporting documents have rendered uncertain the Company's Revaluation Surplus amounting to P1.008 billion, Land Inventory account amounting to P256.38 million and Land – Property, Plant and Equipment account amounting to P5.67 million or representing 42.08% of the total assets as at December 31, 2011. As a result, the Auditor was not able to determine whether any adjustments were necessary regarding several transactions recorded in the land account. Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, the Auditor have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, the Auditor did not render an audit opinion on the fairness of presentation of the financial statements of PAFC as at December 31, 2011, as stated in the Independent Auditor's Report in Part I.

E. Significant Audit Observations and Recommendations

A summary of the significant audit observations are presented below with details presented in Part II.A of this Report.

1. The balances of the Land-PPE account as of December 31, 2011 was overstated by P4.955 million and the Land Inventory account was understated by P1.228 million due to unrecorded sale of land, under-recording of value of land that was reclassified to Land Inventory Account and under-recording of the land donated for relocation site. Further, some transactions recorded in these accounts lacked the necessary details to validate their correctness.

    a. The Schedule of Land – PPE included a lump-sum amount of P720,000 but lacked details as to the covering certificates of title and the unit cost per sq.m of land.

    b. The Land Inventory Schedule showed a number of lots that was sold in the total amount of P33,865,747.50 but lacked details as regards the area sold and the certificate of titles covering the sold lots.

    c. The land affected by the increase in value as a result of the revaluation/appraisals conducted sometime in December 2001 and December 2009 amounting to P754,321,871.00 and P254,074,591.61, respectively, was not properly identified.

    We recommended that Management analyze the accounts Land-PPE and Land Inventory and prepare the necessary adjusting entry/entries to reflect the correct balances. We further recommended that Management reconstruct their records and locate the documents supporting the transactions subject of this observation.

2. Direct write-off of Land Inventory and its Reserve for Development Cost in the amount of P222.517 million was made by the Company without a determination of the composition, existence and valuation of the items being written off.

    We reiterated our previous recommendations that Management:

    a. **Reverse the adjusting entry writing off the reserve account and writing down the land inventory account. Write-off should only be done on the basis of an appraisal or evaluation of the actual and estimated construction costs to complete the development project in Bataan;**

b. **Seek the Commission on Audit's approval for the relief of accountability for said property and the dropping of the amount from the Land Inventory account pursuant to the pertinent provisions of the 2009 Revised Rules of Procedure of COA;**

c. **Present its Land Inventory account at the lower of cost or net realizable value and provide any gain or loss on its revaluation as provided in PAS 2; and**

d. **Make an appraisal of the Reserve for Development Cost account through an independent appraiser and recognize any impairment thereof as required by PAS 36.**

3. The Company wrote off the amount of P240.06 million from the biological asset/Jathropha plantation account without assessing the amount that can be recovered from its investment.

   We recommended that the Company reverse the entry which wrote off the portion of P240.06 million from the Jatropha plantation account.

4. Funds totaling P64.50 million that was released to Royal Green Energy Development, Inc. and Petrogreen Oil Commodity Holdings, for their partnership with the Company in the Jatropha project development, remained outstanding despite the termination of all Jatropha undertakings in January 2011.

   We recommended that Management:

   a. **Institute appropriate legal remedies to enforce PAFC's right against the failure of Petrogreen and Royal Green to submit the documents required under their respective MOAs;**

   b. **Seek the disqualification of the aforementioned partner growers from applying for another project in any other Government Organizations;**

   c. **Require the partner-growers to submit a Fund Utilization Report; and**

   d. **Reclassify the biological asset/Jatropha plantation account to the investment account according to the provisions of the MOA.**

5. Deferred tax asset totaling P113.90 million as of December 31, 2011 was recognized even without available taxable profit; thus, is not in accordance with Philippine Accounting Standard (PAS) 12.

   We recommended that Management derecognize the total amount of P113.90 million in deferred tax asset arising from the deductible temporary differences until such time that it is probable that the Company will have a taxable profit. In addition, we recommended a reclassification of the deferred tax asset arising from unused tax credits to "Due from BIR" since these items will be used as payment for its income tax dues.

F. Status of Implementation of Prior Year's Recommendations

Of the nine (9) audit recommendations issued in CY 2010, three (3) were fully implemented, two (2) were partially implemented, three (3) were not implemented, and one (1) was no longer an issue. Details are presented in Part II.B of this Report.