

POWER SECTOR ASSETS AND LIABILITIES MANAGEMENT CORPORATION
NOTES TO THE FINANCIAL STATEMENTS
(In Philippine Peso)

1. GENERAL INFORMATION

The need for reforms in the entire power industry became evident when the power crisis started in 1989 and continued well into the 1990s. Series of laws were then enacted that instituted reforms in the industry. The latest law, and one that embodies the most extensive reforms, was Republic Act No. 9136, known as the Electric Power Industry Reform Act of 2001 or "EPIRA", enacted on June 26, 2001. The major aspects of the reforms embodied in the EPIRA include: 1) restructuring of the entire power industry to introduce competition in the generation sector; 2) change from government to private ownership; and 3) introduction of a stable regulatory framework for the electricity sector.

Restructuring of the Electric Power Industry

The EPIRA restructured the power industry by organizing it into four (4) sectors: generation, transmission, distribution and supply. The structural reforms resulted in the following:

- a) Two government-owned and controlled corporations (GOCCs), the Power Sector Assets and Liabilities Management Corporation (PSALM) and the National Transmission Corporation (TransCo) were created. PSALM takes over the generation and other disposable assets of the NPC and manages its financial obligations, while TransCo takes over the transmission functions of NPC;
- b) NPC was retained as a GOCC performing the missionary electrification function through the Small Power Utility Group (SPUG);
- c) The distribution and supply sectors were separated to promote retail competition and open access was introduced;
- d) The sale of sub-transmission assets to distribution utilities (DUs) was mandated;
- e) A wholesale trading market for electricity was established;
- f) The end-user rates and retail distribution rates were unbundled according to specific electricity services provided by industry participants;
- g) A universal charge was imposed as part of electricity tariffs;
- h) The Department of Energy (DOE) was given the added role of supervising the restructuring of the electricity industry;
- i) The Energy Regulatory Board (ERB) was abolished and the Energy Regulatory Commission (ERC) was created in its stead;
- j) The National Electrification Administration (NEA) was given the additional mandate of preparing electric cooperatives to operate and compete under a deregulated electricity market;
- k) Electric cooperatives (ECs) were given the option to convert into either a stock cooperative under the Cooperatives Development Act or a stock corporation under the Corporation Code; and

- I) The Joint Congressional Power Commission (JCPC) was created to monitor and ensure the proper implementation of the EPIRA, determine inherent weaknesses in the law and recommend necessary remedial legislation or executive measures.

PSALM was created under the EPIRA to take ownership of all the existing generation assets, independent power producer (IPP) contracts, real estate and all other disposable assets, and to assume all liabilities and obligations of National Power Corporation (NPC). The principal purpose of PSALM is to manage the orderly sale, disposition and privatization of NPC's assets with the objective of liquidating in an optimal manner all of NPC's financial obligations and stranded contract costs. To strengthen the financial viability of electric cooperatives, PSALM was also tasked to assume all outstanding financial obligations of electric cooperatives to National Electric Administration (NEA) and other government agencies incurred for the purpose of financing the Rural Electrification Program.

PSALM shall exist for a period of twenty-five (25) years from the effectivity of the EPIRA, unless otherwise provided by law, and all assets and liabilities of the Corporation outstanding upon the expiration of its term of existence shall revert to and be assumed by the National Government.

Included in PSALM's mandate is the collection, administration and application of NPC's portion of the universal charge (UC). The universal charge refers to the charge, if any, imposed on all electricity end-users for the following purposes:

- a) Recovery of the stranded debts and stranded contract costs of NPC as well as the qualified stranded contract costs of distribution utilities resulting from the restructuring of the industry. The *stranded debts* of NPC refer to any unpaid obligations which have not been liquidated by the proceeds from the sales and privatization of its assets. *Stranded contract costs* of NPC or distribution utility is the excess of the contracted cost of electricity under eligible contracts over the actual selling price of the contracted energy output of such contracts in the market. Such contracts should have been approved by the Energy Regulatory Board as of December 31, 2000;
- b) Missionary electrification, which refers to the provision by NPC-SPUG of power generation and its associated power delivery systems in areas that are not connected to the transmission system;
- c) Equalization of taxes and royalties applied to indigenous or renewable sources of energy vis-à-vis imported energy fuels;
- d) An environmental charge equivalent to one-fourth of one centavo per kilowatt-hour (P0.0025k/Wh), which shall accrue to an environmental fund to be used solely for watershed rehabilitation and management. Said fund shall be managed by NPC; and
- e) A charge to account for all forms of cross-subsidies for a period not exceeding three (3) years.

The UC is a non-bypassable charge which is passed on and collected from all end-users on a monthly basis by the distribution utilities. The collections by the distribution utilities and TransCo in any given month shall be remitted to PSALM on or before the fifteenth (15th) of the succeeding month. Any end-user or self-generating entity not connected to a distribution utility shall remit its corresponding UC directly to TransCo.

NPC - Assets/Debts transferred to PSALM

As of December 31, 2008, the following NPC assets and liabilities were transferred to PSALM.

Assets transferred to PSALM	
Electric plants under capital lease, net	456,777,856,390
Current assets	101,008,390,595
Utility plants, net	77,103,244,049
Investment and other assets	64,081,241,964
Deferred charges	16,350,152,971
Net assets transferred to TransCo	<u>115,693,280,923</u>
Total assets	<u>831,014,166,892</u>
Liabilities assumed by PSALM	
BOT Lease obligation	487,876,887,631
Long-term debts	326,031,895,265
Other current liabilities	69,590,238,676
Deferred credits	21,356,158,403
Total liabilities	<u>904,855,179,975</u>
Capital from asset-debt transfer	<u>(73,841,013,083)</u>

The generation assets transferred by NPC to PSALM include the following:

Lands

Angat HEPP	Botocan HEPP (CBK-IMPISA)
Mak-Ban GPP	Ilijan Gas Pipeline
Mak-Ban GPP Ormat	Naga CTPP 1 (Cebu CTPP)
Tiwi GPP	Power Barge 117 (Nasipit) -
Masinloc CFTPP	Upper Agno HEPP
Batangas CFTPP	Pantabangan-Masiway HEPP
Panay DPP	Barit-Cauayan HEPP
Bohol DPP	Loboc HEPP
Agus HEPP 1,2,4,5,6,7	Talomo HEPP
Pulangui HEPP 4	Agusan HEPP
Sual CFTPP	Manila TPP 1 & 2
Bauang First Private Power Corp	Sucacat TPP 1,2,3,4
San Roque Power Corp	Bataan TPP 1 & 2
Luzon HEPP (Bakun 1)	Bataan GT

ABB Bataan Combined Cycle 1 & 2
Malaya TPP 1 - Land
Kalayaan HEPP (CBK-IMPISA)
Caliraya HEPP (CBK-IMPISA)

Malaya GT
Talavera DPP (Cebu DPP 2)
Aplaya DPP
Gen. Santos DPP

Generation Plants

Operating

Angat HEPP
Amlan HEPP
Mak-Ban GPP 1,2,3,4,5,6, Ormat, 7,8,9,10
Tiwi GPP 1,2,3,4,5,6
Bac-Man GPP 1
Bac-Man GPP 2 (Cauayan)
Bac-Man GPP 2 (Botong)
Tongonan (Leyte) GPP
Palinpinon GPP 1
Palinpinon GPP 2 (Nasuji)
Palinpinon GPP 2 (Okoy)
Palinpinon GPP 2 (Sogongon)
Batangas CFTPP 1
Batangas CFTPP 2

Panay DPP 1
Panay DPP 3
Bohol DPP
Power Barge 101
Power Barge 102
Power Barge 103
Power Barge 104
Agus HEPP 1,2,4,5,6,7
Pulangui HEPP 4
Iligan DPP 1
Talomo HEPP
Agusan HEPP
Upper Agno HEPP
Masinloc CFTPP

Decommissioned

Manila TPP 1 & 2
Sucat TPP 1,2,3,4
Sucat GT LB
Bataan TPP 1 & 2
Bataan GT
Malaya GT
Cebu DPP 2

Aplaya DPP
Gen. Santos DPP
Iligan DPP 2
Navotas GT 1 (Energy) U1, U2, U3
Navotas GT 2 (Tileman)
Naga GT LB 1
Naga GT LB 2

Independent Power Producers (IPPs)

Bataan CC DPP 1 & 2
Malaya TPP 1 & 2
Kalayaan HEPP
Caliraya HEPP
Botocan HEPP

Naga DPP 1
Naga CFTPP 1 & 2
Power Barge 117
Power Barge 118

Liabilities assumed by PSALM include the following:

a. BOT Lease Obligations

Independent Power Producer	Power Plant	Amount
Team Energy Corp.	Pagbilao Power 1	73,974,440,000
	Pagbilao Power 2	73,864,971,808
Team Sual Corporation	Sual Coal Plant I	68,351,625,443
	Sual Coal Plant 2	69,076,173,279
KEPCO Ilijan Corp.	Ilijan Natural Gas	67,139,210,724
Bauang Private Power Corp.	Bauang Diesel PP	59,040,076,630
Luzon Hydro Corp.	Bakun Plant Unit I	17,220,523,078
	Bakun Plant Unit II	16,721,247,938
Steag State Power Inc.	Mindanao Coal Fired 1	11,108,008,722
	Mindanao Coal Fired 2	11,121,120,943
CBK Power Co. Ltd.	Kalayaan 2 Unit 3	9,407,576,712
	Kalayaan 2 Unit 4	9,551,725,614
San Roque Power Corp.	San Roque Hydro Electric PP	1,300,186,740
		487,876,887,631

b. Long-term debts

Bonds/loans transferred by NPC to PSALM in 2008 on a per bank/creditor basis are summarized as follows:

NAME OF BANK/CREDITOR	AMOUNT
Deutsche Bank	71,227,500,000
Bank of New York/JP Morgan Chase Manhattan	54,082,775,000
Citibank	39,504,700,000
Bureau of Treasury	38,613,000,000
Department of Energy	28,297,252,592
Land Bank of the Phils./Development Bank of the Phils.	20,000,000,000
International Bank for Reconstruction and Development	14,089,134,555
Eximbank of Japan	12,896,683,445
US Bank	11,305,952,376
Bank of Tokyo-Mitsubishi UFJ	10,859,680,000
Asian Development Bank	10,499,244,261
Kreditanstalt fur Wiederaufbau	8,169,007,897
Overseas Economic Cooperation Fund	4,244,439,155
Japan Bank for International Cooperation	3,816,088,342
National Government	3,322,310,817
Instituto de Credito Oficial	1,244,024,282
Caliraya-Botocan-Kalayaan Power Corporation	1,210,707,950
Natixis/Credit National	1,144,865,889
Artigiancassa MCA	707,348,640
Nordic Investment/Development Fund	625,780,896
Banco de Oro/Development Bank of Phils.	350,000,000
Eximbank of Korea	305,550,909
Erste Bank Osterreichischen	262,324,906

US Agency for International Development	48,088,129
Total	336,826,460,041
Less bond discount	10,794,564,776
Net	326,031,895,265

Operation and Maintenance Agreement (OMA)

Pursuant to the Implementing Rules and Regulations (IRR) of the EPIRA, PSALM has the power to operate the generation assets, directly or through NPC, prior to privatization of such assets.

The Operation and Maintenance Agreement signed on February 17, 2009 between PSALM and NPC provides for the continued orderly operation and maintenance of the transferred generation and other disposable assets and the provision of necessary corporate services from transfer date until the turn-over of such assets to buyers. NPC shall also provide preservation services to all decommissioned plants and mothballed plants in accordance with the agreed performance standards to prevent the deterioration of serviceable equipment and systems prior to disposal. Furthermore, NPC shall continue to discharge its duties and contractual obligations under existing IPP contracts such as the supply of fuel, payment of capacity, energy and other fees, purchase of power generated, etc. NPC shall turn over the IPP plants under IPP contracts to PSALM after the termination/expiration of the IPP contracts, with PSALM having the option to include these plants in the OMA.

NPC shall prepare the budget it needs annually to perform its obligations under the OMA and submit the O&M Budget to PSALM for review and approval. Upon approval, PSALM shall release the funding in accordance with the O&M Budget subject to existing accounting and auditing rules and regulations. NPC shall regularly submit to PSALM reports on the performance of the generation and other assets and the use of the funds.

Using the privatization proceeds and income from the operation of the generation and other assets, PSALM shall be responsible in servicing outstanding financial obligations of NPC arising from: (1) loans, issuances of bonds, securities and other instruments of indebtedness; and (2) IPP contracts.

Operation and Maintenance Service Contract (OMSC)

Pursuant to its privatization mandate, PSALM schedules the selling of the plants thru open and competitive bidding on dates such that the date of turn-over to the winning bidder/new owner would correspond with the termination of the plants' operation and maintenance agreements with third parties. In some instances, the biddings would not proceed as planned due to various constraints, delaying the turn-over of the plants to the new owners. Pending these plants' privatization and to still continue the operation of the plants, prevent their deterioration, and service the power requirements of the public.

IPP Administrator (IPPA)

PSALM was mandated under the EPIRA to competitively select and appoint qualified independent entities called Independent Power Producer Administrators (IPPAs) to administer and manage the contracted energy output of NPC/PSALM IPP contracts. The IPPAs are qualified private sector independent entities with whom PSALM will enter into “back to back” contracts referred to as “Administration Agreements,” with NPC as a concurring party and the respective IPPs as counterparties. These Administration Agreements mirror applicable provisions of the Energy Conversion Agreements (ECAs)/Power Purchase Agreements (PPAs) that NPC entered into with the IPPs, in effect transferring the rights and obligations of NPC under these contracts to the IPPAs. The IPPAs will be appointed through public biddings to be conducted by PSALM.

A major responsibility that has been transferred to the IPPA under the Sual and Pagbilao Administration Agreements is the management of fuel (coal) procurement. A number of risks associated with the ECAs of these plants were also transferred under the Administration Agreements but PSALM will continue to bear risks that the IPPA cannot manage, such as Government, Force Majeure and extended outage risks. In return, the IPPA will have the unfettered opportunity to manage and trade the contracted capacities of these plants in the Wholesale Electricity Spot Market (WESM) and through bilateral contracts. For thermal plants, revenues for the first few years are guaranteed to the IPPA through the assignment of Transition Supply Contracts (TSCs).

The IPPA process gives successful bidders a way to enter the WESM for a very low capital outlay. The Sual and Pagbilao structure, for example, enables bidders to pay the fixed monthly fees and the pass through energy fees of the IPPs out of cash flows. Thus, no upfront financing is required.

This is a unique way to enter the WESM. The assets are relatively new, high quality plants that were built and are well maintained by some of the best IPP developers in the world. The IPPAs will have most of the benefits of being owners of generating stations, such as controlling the fuel and its dispatch, trading, and contracting of the plant, but without maintenance cost or capital upgrades. Also, many of the risks of owning a plant are explicitly managed through the contract. If there is an extended outage, for example, there is up to a 90% discount on the monthly fees.

Wholesale Electricity Spot Market (WESM)

The commercial operation of the WESM (June 26 2006) is one of the pre-conditions to retail competition and open access. Other conditions as required in the Implementing Rules and Regulations (IRR) of the EPIRA are the: (i) approval of the unbundling of the transmission and distribution charges; (ii) initial implementation of the Cross Subsidy Removal System; (iii) privatization of 70% of the total capacity of NPC plants in Luzon and the Visayas; and (iv) transfer of the management and control of at least 70% of the total energy output of power plants under contract with IPPs.

The WESM is initially a market for energy. Eventually, with the approval of the ERC, there will be a market for ancillary services for regulation, contingency reserve and dispatchable reserves.

Electricity is offered and traded in a 24 hour by 7 days market. There are hourly prices published and used as basis for settlements. Prices in the spot market are volatile ranging from zero prices during off peak hours to as high as twelve pesos during peak hours. Distribution Utilities (DUs), Electric Cooperatives (ECs) and Suppliers/Aggregators can source their electricity requirements from the spot market or through Transition Supply Contracts (TSCs) with NPC. There is a provision in the EPIRA where DUs must source at least 10% of their requirements from the spot market.

In parallel to the spot market, DUs, ECs and Suppliers can enter into Transition Supply Contracts (TSCs) with NPC. These contracts can have predetermined rates such as the NPC Grid Rate or Time of Use (TOU) rates (plus other charges as approved by the ERC) that eliminate the volatility if one will source from the spot market.

On the demand side of the spot market, MERALCO is the biggest customer of the WESM. There are electric cooperatives such as the Camarines Sur Electric Cooperative (CASURECO) and the Ilocos Norte Electric Cooperative (INEC) which have registered as market participants in the WESM.

Since 2006, when the WESM commenced its operations, PSALM has been effectively acting as the interim IPPA by bidding the NPC/PSALM IPPs' energy output into the WESM on a day-to-day basis.

PSALM traded in the WESM a total of 1,646 MW consisting of NPC/PSALM IPP power plants located in the Luzon and Visayas Grid. The total rated capacity of the portfolio of plants in the Luzon Grid is 965 MW while those in the Visayas Grid is 681 MW.

National Transmission Corporation (TransCo)

TransCo started operations as a functional unit in charge of the transmission functions of NPC. TransCo started independent operations in March 2003, although its operations continued to be carried in NPC's books of accounts. On December 31, 2008, TransCo's books were separated from the books of NPC and TransCo ceased as one of NPC's functional units.

The creation of TransCo under the EPIRA as a GOCC that will assume the transmission function of NPC and the responsibility for the planning, construction and centralized operation and maintenance of the high voltage transmission facilities (the Grid), including grid interconnections and ancillary services, was meant to separate the power transmission system from the power generation system. TransCo was also mandated to privatize sub-transmission assets transferred from NPC by selling these assets to qualified distribution utilities.

As provided in the EPIRA, TransCo is wholly-owned by PSALM and its transmission function is also subject to privatization. Based on the government's

Privatization Plan, PSALM privatized the transmission assets by way of an award of a Concession to a qualified bidder in an open and competitive bidding process. The concession contract was awarded to the consortium of Monte Oro Grid Corporation, Inc. as the winning bidder in the fourth round of bidding for the TransCo concession contract held on December 12, 2007. The consortium, composed of Monte Oro Grid Resources Corp., Calaca High Power Corp. and State Grid Corp. of China, won with their bid price of US\$3.95 billion. The consortium established the National Grid Corporation of the Philippines (NGCP) as the "Concessionaire."

On February 28, 2008, the Concession Agreement became effective. Republic Act No. 9511 (The TransCo Franchise Law) was enacted on December 1, 2008 and became effective on December 20, 2008. The operation and management of the transmission business by NGCP commenced on January 15, 2009 upon receipt by PSALM of 25% of the concession fee as upfront payment (Commencement Fee). The balance of the concession fee will be paid by the Concessionaire with interest in semi-annual installments for 20 years.

KEY ACCOMPLISHMENTS

The achievements of PSALM in 2010 are detailed below:

I. Asset Management

Privatization of Generation Assets

As of December 31, 2010, PSALM has successfully bid out twenty-six (26) generating power facilities and four (4) decommissioned plants. Twenty (20) of these operating plants, with a total rated capacity of 3,440.23 MW, account for 91.73% of PSALM-owned capacities in the Luzon and Visayas grids.

Privatization of Operating Generation Plants

PSALM successfully bid out the 218 MW Angat Hydro Electric Power Plant (HEPP) to Korea Water Resources Development Corporation (K-Water) for US\$440.88 million on April 28, 2010 and the 150 MW BacMan Geothermal Power Plant (GPP) to Bac-Man Geothermal Inc. for US\$28.25 million on May 5, 2010. The privatization of the two plants generated US\$469.13 million in expected proceeds, bringing the total bid price of the twenty-six (26) generation plants and four (4) decommissioned plants sold as of December 31, 2010, with a total capacity of 4,320.33 MW, to US\$3.475 billion.

Bac-Man GPP was successfully turned over on September 3, 2010, ahead of its original schedule of 2011, upon receipt of full payment. Angat HEPP is yet to be turned over to K-Water due to the Status Quo Ante Order issued by the Supreme Court on May 24, 2010. The Order requires PSALM, its agents, representatives, and/or persons acting in its stead to maintain the status quo prevailing before the filing of the Petition with the Court on May 19, 2010. PSALM has already issued a Notice of Award to K-Water on May 5, 2010.

In the first quarter of 2010, Power Barges 117 & 118, Limay Combined Cycle and Naga LBGT, which were auctioned in 2009 then placed under OMSCs pending completion of deliverables under their respective Asset Purchase Agreements (APAs), were turned over to the new owners.

With the successful privatization of the above plants, the remaining unsold generation plants are the Agus and Pulangui Hydroelectric Power Plants.

Privatization of Decommissioned Generation Plants

The lone decommissioned plant slated for privatization in 2010 was the Sucat Thermal Power Plant. However, the privatization of the Sucat Plant did not push through as the plant is being targeted for rehabilitation under the DOE Energy Reform Agenda.

The privatization of the Navotas Plant was cancelled as the PSALM Board decided in June 2010 through Board Resolution No. 2010-0616-003 that PSALM will not dispute the claim of ownership of the local government of Navotas resulting from non-payment of real property taxes by NPC.

As of December 31, 2010, only the Bataan Thermal Power Plant remains to be privatized.

Privatization of IPPs

The projected third wave of IPP privatization was supposed to cover the ECAs of the 1200 MW Ilijan Gas-Fired Combined Cycle Power Plant and the Malaya Thermal Power Plant and the PPA of the Unified Leyte A and B Geothermal Power Plants in Leyte that supply power to the Luzon Grid. However, only the contracted energy output of Ilijan Power Plant was successfully bid out on April 16, 2010 to San Miguel Corporation for US\$870 million.

The privatization of the Unified Leyte Power Plants was deferred pending the commercial operations of WESM in the Visayas. On the other hand, the Malaya Power Plant bidding in June 2010 was declared a failure since only one bidder submitted a bid. Subsequently, the DOE instructed PSALM in August 2010 not to include Malaya in the 2010 privatization plan.

As of December 2010, the existing IPP contracts are the following:

Plant Name	Contract Type	End of Agreement
<i>NPC-owned</i>		
Caliraya HEPP	BROT-PPA	February 2026
Botocan HEPP	BROT-PPA	February 2026
Kalayaan HEPP 1 & 2	BROT-PPA	February 2026
Malaya TPP 1 & 2	ROM-ECA	Jan 25, 2011 but with OMSC up to 10-25-11
Cebu DPP 1	ROM-ECA	March 25, 2012
Cebu TPP 1	ROM-ECA	March 25, 2012
Cebu TPP 2	ROM-ECA	March 25, 2012

<i>IPP-owned</i>		
Casecnan HEPP	BOO-PPA	April 2022
Kalayaan HEPP 3 & 4	BROT-PPA	February 2026
Bakun HEPP (NMHC)	BOO-PPA	January 2026
Ampohaw	BOO-PPA	January 2018
Unified Leyte GPP A & B	BOO-PPA	A-July 2022 & B-July 2021
Zamboanga DPP	BOO-ECA	December 2015
General Santos DPP	BOO-ECA	March 2016
Mt. Apo GPP 1 & 2	BOO-PPA	1-March 2022 & 2-June 2024
Mindanao Coal 1 & 2	BOT	March 2034

Privatization of Transmission Assets

The transmission assets were privatized by way of the award of a Concession Contract to the National Grid Corporation of the Philippines. The Concession commenced on January 15, 2009, upon payment of US\$987.5 million or 25% of the Concession Fee of US\$3.95 billion as Commencement Fee. The balance of US\$2.96 billion of the Concession Fee will be paid by the Concessionaire with interest in semi-annual installments falling on the 15th day of January and July of each year for 20 years. In CY 2010, total deferred payments (2nd and 3rd) received from NGCP for the TransCo concession amounted to P14.257 billion.

Privatization of Non-power Assets

Five percent (5%) of excluded assets of Tiwi, Panay and Masinloc plants were disposed, generating proceeds of P87.99 million. A Disposal Policy and Implementing Structure for Real Estates presented by Management on October 18, 2010 was approved by the Board.

Management of Privatization Proceeds

PSALM started receiving privatization proceeds from the sale of NPC generating plants in January 2005. As of December 31, 2010, actual privatization proceeds collected amounted to US\$4.85 billion.

On June 20, 2007, the joint Boards of PSALM and NPC, under Board Resolution No. 07-29, approved the utilization of the privatization proceeds to liquidate principal and interest obligations of NPC as they fall due. This was amended on October 4, 2007 by Board Resolution No. 07-61, which granted authority to PSALM Management to utilize the privatization proceeds to:

- Prepay NPC's principal obligations;
- Settle NPC's principal and interest obligations as they become due only after NPC shows deficit in its cash flow after utilization of its own internally generated cash;
- Manage NPC's liabilities with the objectives of reducing interest cost and liquidity risk in 2009-2011 and hedging foreign exchange risks at terms and conditions advantageous to the government; and
- Pay other financial obligations of NPC.

From August 22, 2007 to December 31, 2010, a total of US\$3.25 billion dollar proceeds and P70.09 billion peso proceeds were utilized to cover mostly the financial obligations of NPC such as the maturing obligations, IPP obligations and the prepayment of the more expensive Yen-denominated obligations of NPC, as well as other privatization-related expenditures. A total of US\$77.21 million and P34.59 billion proceeds were also utilized for peso/dollar swaps/conversions for debt service and other privatization-related expenses.

As of end December 2010, the balance of dollar proceeds is US\$14.63 million, while the balance of the peso proceeds amounts to P04.44.million.

II. Universal Charge (UC) Administration

UC-Stranded Contract Costs (UC-SCC) and Stranded Debts (UC-SD)

PSALM complemented the Liability Management Program (LMP) financing activities by filing petitions with the ERC for the recovery of the CY 2008 UC-SCC and the CY 2009-2029 Projected UC-SD. The UC-SCC petition seeks approval for PSALM/NPC to recover the shortfall incurred in operating the eligible IPPs in the Luzon Grid in the amount of P22.26 billion over a period of five (5) years. On the other hand, in order to stabilize and mitigate increases in the level of NPC's SD, PSALM seeks approval to recover over a 17-year period a levelized UC-SD amounting to P470.86 billion. The calculated levelized SD is the estimated shortfall of NPC in paying its financial obligations.

In 2010, PSALM filed for the CY 2009 SCC amounting to P26.76 billion and 2010 SD amounting to P54.99 billion. On November 15, 2010 the ERC dismissed all these petitions due to allegation that PSALM "failed to submit pertinent documents" as required under the ERC rules. However, PSALM is still entitled to recover such amounts upon the release of the revised rules for the recovery of the SCC and SD portion of the Universal Charge.

To further improve the administration of the Universal Charge funds, the following were undertaken by PSALM in 2010:

1. To facilitate their submission of the billing, collection and remittance reports and keep PSALM records current and updated, the Universal Levy Administration System (ULAS), a web-based information system, was developed by PSALM for use by the collecting entities (CEs). To facilitate the implementation of the ULAS, series of seminar/workshops were conducted in the Mindanao and Visayas CEs in 2009. Ten (10) seminar/workshops for the Luzon CEs were conducted in 2010.
2. Implementation of the ULAS effective October 1, 2010 per PSALM Memorandum to all CEs dated September 24, 2010.
3. To be consistent with Section 34 (e) of the EPIRA, the recognition of UC-Accounts Receivables (UC-AR) from UC billed to UC actually collected by CEs from end-users. The change in accounting policy was approved and confirmed by the PSALM Board under Resolution No. 2010-0505-007 dated May 5, 2010.

4. Transfer from the General Accounting Division (GAD) to the Universal Charge Administration Department (UCAD) of the UC accounting function, which covers recording, posting, adjusting, reconciling UC bank and receivable accounts, and preparing Notes to Financial Statements. However, the pre-audit function pertaining to UC disbursements remains with GAD.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Preparation of Financial Statements

The financial statements are prepared on a historical cost basis and transactions are recorded using the accrual basis of accounting. The assets transferred from NPC were recorded at their carrying amounts (balances as reflected in NPC books) as of the transfer date of December 31, 2008.

The preparation of the financial statements in accordance with Philippine Financial Reporting Standards require the Company to make estimates and assumptions that affect the reported amounts of resources, liabilities, income and expenses and the disclosures of contingent resources and liabilities. Future events may occur which can cause the assumptions used in arriving at the estimates to change. The effects of any change in estimates are reflected in the financial statements as they become reasonably probable.

Estimates and judgments are continually evaluated and are based on historical experiences and other factors including expectations of future events that are believed to be reasonable under the circumstances.

Cash Equivalents

Cash equivalents consist of short-term placements/time deposits which are highly liquid investments with a maturity of three months or less from the date of acquisition and which are subject to insignificant risk of changes in value.

Receivables and Allowance for Bad Debts

Receivables are initially measured at face value and subsequently at amortized cost. Impairment loss is recognised using an allowance account. A 10% impairment allowance is recognised for accounts past due for more than one year, while accounts with disputes are provided a 15% allowance for impairment. Dormant accounts are provided 100% impairment allowance.

Inventories

Inventories are valued at cost using the moving-average method and consist only of office supplies.

Assets Held for Sale

Assets held for sale consist of generation plants in service and decommissioned plants that are scheduled for privatization in 2010. These also include those plants that have been previously bid out but whose sale were not consummated by end of 2009, either because the bidding was declared a failure or because the winning bidder failed to close the sale, but which are still intended to be sold in 2010.

Under Philippine Financial Reporting Standards (PFRS) 5, "Non-current Assets Held for Sale", a non-current asset is classified as held for sale if its carrying amount 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.

Non-current assets classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell, the carrying amount being the amount reflected in the NPC books at the date of transfer.

Build-Operate-Transfer (BOT) Plants

Total capacity fees for the duration of the cooperation period are capitalized and recognized as asset under BOT Electric Plants under Capital Lease account. A liability corresponding to the unpaid portion of the capital recovery fees is set up under BOT Lease Obligation. BOT assets are amortized over 20 years, except for Hopewell Pagbilao which is amortized over 29 years.

Upon turnover of the privatized BOT plant to the appointed IPPA, the asset is derecognized from the books of PSALM in conformity with IAS/PAS 17 (Leases). However, the corresponding BOT lease obligations are not derecognized because they are not transferred to the appointed IPPA.

IPPA Receivable

As structured, the contract (Administration Agreement) between the IPPA and PSALM can be classified as a finance lease because it substantially transfers the risks and rewards incidental to ownership to the IPPA.

Based on IAS/PAS 17, the contract between the IPPA and PSALM may be classified as a finance lease because, in substance, the contract contains the following indicators of a finance lease:

- a) the lease transfers ownership of the asset to the lessee by the end of the lease term;
- b) the lease term is for the major part of the economic life of the asset even if title is not transferred; and

- c) the leased assets are of such a specialized nature that only the lessee can use them without major modifications.

The IPPA structure provides that:

- a) full ownership of the generating plant and the right to use the land transfers to the IPPA at the end of the contract period;
- b) the contract is for a period of fifteen (15) years, which is for the most part of the economic life of the asset given that, on the average, the estimated economic life of the transferred generating plants is thirty (30) to forty (40) years, based on their last revaluation in 1996;
- c) the leased generating plant is of a specialized nature and size that operating this asset and managing its output require highly technical expertise and considerable financial capability that only qualified entities such as the IPPAs can bid for administration of their contracted capacity and eventually own and operate them.

The IPP asset under a finance lease is presented as a lease receivable from the IPPA in the amount equal to the aggregate of the monthly payments to be made by the winning bidder throughout the contract period. The schedule of monthly payments was part of the Financial Bid of the IPPA and is made part of the Administration Agreement as Annex 1 to Schedule I.

Property, Plant and Equipment and Depreciation

NPC-transferred assets

Property, plant, and equipment transferred from NPC include electrification, power and energy structures and referred to as utility plants. The last external revaluation of these plants was of the 1996 asset prices. These structures are recognized in PSALM's books at their carrying amounts as stated in NPC books as of the transfer date of December 31, 2008. While these assets were carried in NPC books, regular annual maintenance, repairs and minor replacements were charged to expense as they were incurred, whereas major maintenance, which was done on periodic three-to five-year intervals, was deferred, amortized and charged to operations over the number of years interval. Rehabilitation expenditures that would result in improvement of the plant's efficiency beyond five years were capitalized and transferred to plant cost upon completion of work orders.

Depreciation was charged from the date of acquisition of the fixed assets or after the completion of work orders and computed on a straight-line basis. Depreciating the asset based on the sound value over its remaining useful life will result in amortizing the remaining cost of the asset reflective of its true physical state. The average remaining useful life was determined by subtracting the age of the asset from the estimated standard economic life. Depletion, which shows the periodic provision for the depletion of extractable natural resources such as steam, natural gas, etc., was also computed on a straight-line basis.

The same NPC depreciation policies were adopted by PSALM on the transferred assets, including the estimated standard economic life as ascertained by the last independent appraiser of NPC, as follows:

<u>Type of Plant</u>	<u>Economic Life</u>
1. Thermal Production	
a. Oil-fired	
b. Coal-fired	35 yrs
2. Hydraulic Production	40 yrs
3. Geothermal Production	30 yrs
4. Other Production	
a. Combined-cyle	
b. Diesel Plants and Barges	
c. Gas Turbine	20 yrs

PSALM-acquired

Property and equipment consisting of computers, office furniture and fixtures, vehicles and communication equipment are stated at cost less accumulated depreciation and any impairment in value. The stated cost comprises its purchase price and directly attributable costs of bringing the asset to working condition for its intended use. Generally, tangible assets that are expected to be used for more than one year are considered as capital assets. Expenditures for repairs and maintenance are charged to expense as incurred.

Depreciation is computed on a straight-line basis over the useful lives of the assets as follows:

Furniture, fixtures and equipment	5 – 10 years
Transportation equipment	7 years
Computers and accessories	5 years

Residual value equivalent to ten percent (10%) of the acquisition cost is deducted before dividing the same by the estimated useful life.

The carrying values of property and equipment are reviewed for impairment when changes in circumstances indicate that the carrying value may not be recoverable or may have diminished. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount and impairment losses are recognized in profit or loss.

On January 9, 2009, PSALM filed with the ERC its petition for the adoption of proposed asset valuation guidelines using an indexation method to revalue NPC's assets to its current cost level in lieu of the conduct of an appraisal by an external appraiser.

The public consultation on the petition was held on February 23, 2009, whereupon ERC directed PSALM to revise the Asset Valuation Guidelines based on comments from interested parties.

Assumed REP Loans

Electric cooperatives (ECs) loans from National Electrification Administration (NEA) and from other government agencies (OGA) and local government units (LGUs), which were incurred for the purpose of financing the Rural Electrification Program and which were assumed by PSALM, were previously recorded under the deferred asset account "Assumed Rural Electrification Program Loans" that was subjected to amortization. The amortization expense for this account was computed based on a straight-line, 10-year amortization of the total assumed NEA loans and a straight-line amortization of the OGA and LGU loans over the remaining balance of the 10-year period, beginning from the year the OGA and LGU loans were assumed. The related liability account was set up in the books of PSALM.

Taxes

Taxes for current and prior periods are, to the extent unpaid, recognized as a liability. If the amount already paid in respect of current and prior periods exceeds the amount due for those periods, the excess payment is recognized as an asset.

Unlike the NPC whose Charter provides that NPC shall be exempt from direct and indirect taxes, the EPIRA (the law that created PSALM) does not contain a provision that exempts PSALM, as an entity, from taxation.

While PSALM as an entity is not per se tax-free, there are certain transactions of PSALM which are exempt from taxation. The tax treatment of PSALM's transactions is set forth in BIR Ruling No. 020-02 dated May 13, 2002, the pertinent provisions of which are summarized as follows:

1. Income of PSALM arises from the exercise of essential government function and, thus, exempt from tax.

Under Section 32(B)(7)(b) of the Tax Code of 1997, income derived from the exercise of any essential government function accruing to the Government of the Philippines is excluded from gross income. The defined activities of PSALM under Section 50 of EPIRA are essentially governmental functions.

2. Gain from the sale by PSALM of the generation facilities to qualified buyers is not subject to income tax.

Such income is considered income from exercise of essential government function and thus, exempt from income tax pursuant to Sec. 32(B)(7)(b) of the Tax Code.

3. Privatization of assets by PSALM is not subject to VAT.

The sale or disposition by PSALM of NPC assets is completely not related with the original business of NPC as a power generation company, which function is now being assumed by PSALM, and neither is it incidental thereto.

Moreover, the disposition or sale of NPC assets are isolated transactions, therefore, not subject to VAT (BIR Ruling No. 113-98 dated July 23, 1998).

4. The collection of universal charge by PSALM will not be considered as taxable income nor will it form part of its gross receipts for VAT purposes.

The universal charge received by PSALM is not subject to income tax since it is not in the nature of income as defined in Sec. 32(A) of the Tax Code and Section 36, Revenue Regulations No. 2, otherwise known as the Income Tax Regulations.

5. "The loans, credits and indebtedness contracted under this subsection and the payment of the principal, interest and other charges thereon, as well as the importation of machinery, equipment, materials and supplies by the Corporation, paid from the proceeds of any loan, credit or indebtedness incurred under this Act, shall also be exempt from all taxes, fees, imposts, other charges and restrictions, including import restrictions, by the Republic of the Philippines, or any of its agencies and political subdivisions." – Sec. 8. *Authority to Incur Indebtedness and Issue Bonds; Their Conditions, Privileges and Exemptions; Sinking funds; Guarantee*, Subsection (b) Foreign Loans, RA No. 6395 (NPC Charter).
6. Income derived by foreign governments, financing institutions owned, controlled or enjoying refinancing from foreign governments, and international or regional financial institutions established by foreign governments, from loans to PSALM shall be tax exempt, (Sec. 32(B)(7) (a), 1997 Tax Code).
7. Interest income arising from foreign commercial loans is exempt from income tax pursuant to any of the tax treaties that the Philippines has with other country.

Under certain tax treaties, interest income arising from commercial loans may be exempt from income tax, subject to compliance of the conditions provided in the treaty.

In 2005, RA 9337 or the R-VAT law was enacted. RA 9337 imposed 12% Value-added tax (VAT) on the sale of electricity, except for the sale of electricity sourced from renewable resources such as, but not limited to, biomass, solar, wind, hydropower, geothermal, ocean energy and other emerging energy resources, which is subject to zero 0% rate VAT. Thus, the sale by PSALM of generated power shall be subject to VAT at 12% or 0% rate as may be applicable.

Bonds Payable

Bonds payable are presented net of unamortized discount and are revalued at year-end to reflect Philippine peso exchange rate prevailing as of the end of reporting date.

Revenue Recognition

Revenue/gain from sale of the generation plants is recognized in full upon receipt of cash payment. The sale price is payable in cash or on installment. Normal terms for installment is 40% cash upfront and the 60% balance payable in 14 equal semi-annual payments at an agreed interest. The 60% deferred payment is recorded as Asset Sale Receivable.

Gain from the privatization of IPPs is recorded as Other Deferred Credits – Unearned Finance Income. The earned portion will subsequently be recorded as Finance Income over the life of the Administration Agreement.

Other revenues are recognized when it is probable that future economic benefits will be received and such future benefits can be measured reliably.

Foreign Currency Transactions

The accounting records of the Corporation are maintained in Philippine pesos. Transactions denominated in foreign currencies are translated into Philippine pesos at exchange rates prevailing on the transaction dates in accordance with PAS 21, "The Effects of Changes in Foreign Exchange Rates," which requires that foreign currency transactions shall be recorded on initial recognition in the functional currency by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of transaction.

The Corporation translates its foreign currency-denominated deposits and loans at year-end rates in accordance with PAS 21, which requires foreign currency monetary items to be translated at end of reporting date using the closing rate. The resulting gains and losses from the exchange differences are recognized in profit or loss.

Year-end foreign currency exchange rates follow:

	2010	2009
Philippine Peso (P) : US Dollar (\$)	43.8850	46.3560
Philippine Peso (P) : Japanese Yen (¥)	0.5374	0.5059
Philippine Peso (P) : Korean Won (KRW)	.0384	.0397
Philippine Peso (P) : Euro (EUR)	58.0335	66.6646

3. CASH AND CASH EQUIVALENTS

This account consists of the following:

	2010	2009
Cash Collecting Officer	-	1,358
Cash-Disbursing Officers	50,000	14,251

Petty Cash Fund	135,537	117,173
Payroll fund	-	735
Cash in Bank – Local Currency, CA	1,588,813,230	2,085,851,122
Cash in Bank-Local Currency, TD	4,787,000,000	32,380,011,673
Cash in Bank-Foreign Currency, SA	318,285,927	339,342,417
Cash in Bank- Foreign Currency, TD	597,264,359	749,178,345
Cash – Bangko Sentral ng Pilipinas	19,490,501,816	26,477,726,781
	26,782,050,869	62,032,243,855

Cash-Banko Sentral ng Pilipinas pertains to the proceeds from PSALM's bond exchange in 2009 deposited with the bank in compliance with the BSP Monetary Board Resolution No. 1720 dated December 1, 2009 and Section 113 of Republic Act (RA) No. 7653, (The New Central Bank Act), dated June 14, 1993.

4. POWER RECEIVABLES

This account is composed of receivables from the following entities:

	2010	2009
Utilities	65,530,490,765	63,682,955,199
Cooperatives	15,431,048,706	14,052,854,056
Industries	7,055,862,492	6,227,138,389
Government	6,481,769,425	8,959,187,282
Others	409,226,303	2,184,368,075
Total	94,908,397,691	95,106,503,001
Recovery/(Refunds)	(14,571,824,444)	(10,222,989,877)
	80,336,573,247	84,883,513,124
Current portion	36,023,772,109	80,168,312,119
Allowance for bad debts	(2,797,701,266)	(8,990,691,083)
	33,226,070,843	71,177,621,036
Non-current portion	44,312,801,138	4,715,201,005
Allowance for bad debts	(8,137,741,733)	(2,227,247,443)
	36,175,059,405	2,487,953,562

Power receivables consists of the trade collectibles for the power generation charges, including ancillary service charges and restructured power receivables, net of refunds to power customers as a result of ERC decisions.

The basic power generation rate is based on a return-on-rate-base ("RORB") method with time-of-use pricing. The RORB method takes a ratio (calculated as a percentage of investment in facilities and working capital necessary for day to day operations, or "rate base") of rate base to determine the return on rate base that will be considered together with the operating costs in determining the generation charge.

PSALM and NPC jointly filed the Application for a revised basic generation charge in Luzon, Visayas and Mindanao grids with the ERC on January 16, 2009, docketed as ERC Case No. 2009-004RC. The revised basic generation charge application sought, among others, the issuance of a provisional authority and for an automatic adjustment in the succeeding quarters of the basic generation charges, to reflect the impact of the sale, transfer and disposal of NPC generation assets.

An Order dated February 16, 2009 was issued by the ERC, provisionally approving the implementation of the following new generation rate adjustments effective March 2009 billing period:

GRID	Provisionally Approved Generation Rate (PhP/kWh)	Provisionally Approved Rate Increase (PhP/kWh)
Luzon	4.3648	0.4682
Visayas	4.0339 *	1.1460 *
Mindanao	2.8177	0.7147

* On March 23, 2009, the ERC issued an Order modifying the February 16, 2009 Order and provisionally authorizing NPC and PSALM to implement, for the Visayas grid, a P0.8376 per kWh rate increase, instead of P1.1460 per kWh, effective February 26 to March 25, 2009 billing. Thus the new basic generation rate for Visayas, as provisionally approved by the ERC, is P3.7255/kWh.

The ERC provisional authority (PA) issued on February 16, 2009 was implemented starting the March 2009 billing period. On February 8, 2010, ERC issued an order directing NPC and PSALM to submit the asset valuation reports not later than June 15, 2010; otherwise, it shall be constrained to revoke the PA previously granted. In compliance with said Order, PSALM submitted on June 15, 2010 the results of the 2010 appraisal conducted by Royal Asia Appraisal Corporation (RAAC).

On August 14, 2008, PSALM submitted to the ERC its Proposed Rules for the Automatic Recovery of NPC/PSALM's Generation Assets' Monthly Fuel, Purchased Power and Foreign Exchange-Related Costs. After several consultative processes, the ERC passed Resolution No. 19 dated August 3, 2009 adopting the Rules for Automatic Recovery of Monthly Fuel and Purchased Power Costs and Foreign Exchange-Related Costs. This effectively replaced the existing GRAM and ICERA guidelines, thus eliminating the need for PSALM and NPC to file for cost recoveries every quarter and await a decision from the ERC before passing the costs to customers. However, on November 12, 2009, PSALM filed a Motion for Clarification of the Rules. Acting on the said Motion, the ERC issued an Order dated December 14, 2009 amending the Rules. The Rules took effect on February 27, 2010. The Automatic Cost Adjustment (ACA) Mechanism based on these Rules was reflected as a separate item in the power bill starting February 27 - March 25, 2010 billing period.

In an Order dated September 6, 2010, the ERC directed PSALM to collect modified ACA rates equivalent to P0.5916/kWh for the Luzon Grid. This Order limits the increase in ACA Rates for August 2010 billing period at ten percent (10%) based on the July 2010 billing period.

Additionally, in its Order dated September 27, 2010, ERC directed PSALM to calculate the ACA rate adjustments equivalent to the percentage of the changes in the computed Fuel and Purchased Power Cost Adjustments (FPPCA) and Foreign Exchange Adjustments (FxA) with base cost of the previous month's ACA rates computation effective September 2010 billing period.

Power receivables – non-current consists substantially of receivables from Meralco of P36.119 billion representing penalty on below contracted demand/energy for the period covering 2001 to 2004 which Meralco deducted from its power bill payments to NPC. This resulted in a dispute between the parties. In February 2002, the parties entered into negotiation to settle the dispute and on July 15, 2003, signed a Settlement Agreement.

Under the SA, Meralco shall pay NPC P27.5 billion representing the difference between the contracted energy for the years 2002 to 2004 and the total energy Meralco bought from January 2002 to April 2003, subject to adjustment from the date of signing of the SA and the energy that Meralco will purchase from NPC for the rest of 2003 and 2004. On the other hand, NPC shall credit Meralco for transmission delays as well as for energy corresponding to NPC's sales to directly-connected customers located in Meralco's existing franchise areas, totaling P7.5 billion. The net payable of Meralco to NPC amounted to P20.05 billion.

In ERC Case No. 2004-109 dated 14 September 2009, the Joint Application for approval of the SA between Meralco and NPC was temporarily archived by the ERC until further notice. This was due to the challenge brought up on the validity of the SA by the Office of the Solicitor General (OSG) based on the following grounds:

- a. That the SA, being a compromise of reciprocal claims between NPC and Meralco, should have been submitted to the OSG for approval;
- b. That the NPC Board had no authority to compromise the NPC's claims mentioned in the SA, which only the COA had the power to compromise in behalf of the NPC; and
- c. That the SA is grossly disadvantageous and prejudicial to the government.

Meralco moved that the ERC issue an Order suspending its consideration of the application for pass-through until after it has commenced and completed proceedings in the regular courts for the adjudication of the issues the OSG has raised on the validity of the SA. This "Manifestation and Motion to Suspend Proceedings" filed by Meralco on 4 June 2008 was granted by ERC in the same ERC Case No. 2004-109.

On November 23, 2009, MERALCO filed the Petition for Declaratory Relief at the Pasig Regional Trial Court (RTC) to declare the SA as valid and binding. On August 16, 2010, the OSG reiterated its Opposition and moved to suspend the

proceedings. After the RTC denied its motion, the OSG filed a Motion to Dismiss or to Stay the Proceedings and subsequently a Motion for Reconsideration, both of which were denied by the RTC.

On November 19, 2010, the OSG filed a Petition for Certiorari, Prohibition, and Mandamus at the Court of Appeals (CA), with an Application for a Temporary Restraining Order (TRO). On December 1, 2010, the CA issued a TRO that expires February 1, 2011.

Refunds represent billing adjustments (in the form of reductions in future power bills) arising from the ERC Orders.

The recognition of the refunds was based on Deferred Accounting Adjustments (DAAs), which were approved by the ERC in accordance with the existing Generation Rate Adjustment Mechanism (GRAM) and Incremental Currency Exchange Rate Adjustment (ICERA) Guidelines dated February 24, 2003.

Currently, no GRAM DAA charges are being imposed in Luzon, Visayas and Mindanao Grids considering that the amounts previously authorized were already fully collected/refunded but still subject to further verification. For the ICERA DAA, the ERC issued a Decision for the 9th-14th ICERA dated 15 November 2010 effective December 2010 billing period as follows:

	LUZON	VISAYAS	MINDANAO
ICERA	(0.3444)	0.0865	(0.2557)

To date, the ERC has yet to issue its Decision on the Luzon grid's 13th – 15th GRAM and the 10th – 15th GRAM for the Visayas and Mindanao Grids. The hearings for the 16th GRAM/15th ICERA and 17th GRAM/16th ICERA have been recently completed.

The filing of 17th GRAM and 16th ICERA application is in accordance with the implementation of ACA, which is a replacement of the GRAM and ICERA. The ERC-approved DAA under the GRAM and ICERA mechanism for Luzon, Visayas and Mindanao Grids shall be applicable and continually charged until the full amount shall have been recovered/refunded.

The approved amount (whether a refund or a recovery) is being monitored on a monthly basis by multiplying the approved rate per kWh by the sales volume for the month. The monthly resulting amounts are tracked until their total equals the approved amount.

5. RECEIVABLE FROM IPPAs

	2010	2009
IPPA receivable, net	415,653,963,965	241,002,108,951
Less non-current portion	404,058,052,388	239,330,453,504
	11,595,911,577	1,671,655,447

IPPA receivable, net represents the aggregate of the monthly payments, inclusive of both dollar and peso components, by the appointed IPPAs for the contracted capacities of the following IPPs, net of deferred finance income/loss:

IPPA	Power Plant	(In Million Peso)
San Miguel Energy Corp.	Sual	130.415
Therma Luzon, Inc.	Pagbilao	97.448
South Premiere Power Corp.	Ilijan	81.827
Strategic Power Development Corp.	San Roque	80.575
Amlan Hydro Power, Inc.	Bakun	25.389

6. DUE FROM GOVERNMENT AGENCIES

	2010	2009
Due from NGAs:		
Bureau of Internal Revenue	44,858,284,287	40,921,454,569
Dept. of Finance/Bureau of the Treasury (San Roque Multi-purpose Project/Advances for BNPP)	30,212,911,806	29,161,371,968
Bureau of Customs	1,555,026,568	1,541,633,683
Dept. of Budget and Management	31,891,751	-
Department of National Defense	22,712,634	22,712,634
Court of First Instance	13,602,054	-
Metropolitan Manila Dev. Authority	4,245,469	2,280,677
Dept. of Public Works & Highways	600,000	600,000
Phil. Nuclear Research Institute	309,735	-
Supreme Court of the Philippines	64,011	-
Department of Energy	20,000	-
Commission on Audit	14,324	-
National Commission on Indigenous People	9,658	-
	76,699,692,297	71,650,053,531
Due from GOCCs:		
NPC – for reconciliation	11,048,498,452	10,644,341,262
MWSS	602,939,653	-
National Transmission Corporation	279,085,364	-
Advances to PGI	58,425,588	58,425,588
PHIVIDEC Industrial Authority	38,037,650	37,980,760
GSIS	34,246,924	484,000
Clark Development Corporation	2,422,084	-
National Electrification Admin.	451,586	103,179
Others	565,474	7,915,229
	12,064,672,775	10,749,250,018
Due from LGUs	4,815,103	-
	88,769,180,175	82,399,303,549

Bureau of Internal Revenue (BIR)

This account pertains mostly to deferred taxes and duties corresponding to estimated fuel specific tax of P2.595 billion, taxes paid under protest in the amount of P10.867 billion, and input taxes of P31.395 billion.

The P3.813 billion taxes paid under protest pertains to the payment by PSALM of VAT on the sale of Pantabangan-Masiway and Magat power plants. The payment was made pursuant to a Memorandum of Agreement (MOA) by and among BIR, NPC, and PSALM.

The MOA provides, among others, that;

- (i) the above amount representing the basic VAT shall be remitted to BIR by NPC/PSALM under protest;
- (ii) the parties will refer the resolution of the tax issue to the appropriate courts or body;
- (iii) any resolution in favor of NPC/PSALM shall be immediately executory, that a favorable ruling from the Department of Justice (DOJ) shall be tantamount to the filing of an application for refund (in cash)/ tax credit certificate (TCC) at the option of NPC/PSALM, and that BIR undertakes to release the tax refund/TCC within 15 working days from issuance of the ruling; and
- (iv) in the event of failure by BIR to fulfill the undertaking referred to in (iii) above, NPC/PSALM shall assign to DOF its right to the refund of the subject remittance, and the DOF shall offset such amount against any liability of NPC/PSALM to the National Government pursuant to the objectives of the EPIRA on the application of the privatization proceeds.

The DOJ, in its 13 March 2008 Decision, declared null and void the imposition of the VAT on the privatization sale of Pantabangan-Masiway and Magat power plants and directed the BIR to refund to NPC/PSALM the amount paid under protest. The BIR filed a Motion for Reconsideration, which motion was denied by DOJ in its Order dated 14 January 2009.

San Roque Multi-Purpose Project

The P25.836 billion advanced by NPC as of December 2010 to the San Roque Multi-Purpose Project (SRMP) arose from a Memorandum of Agreement (MOA) in 1998 by and between the Department of Finance (DOF), Department of Budget and Management (DBM), Department of Environment and Natural Resources (DENR), Department of Public Works and Highways (DPWH), National Irrigation Administration (NIA), and NPC.

San Roque is a power project of NPC approved by the National Economic Development Authority (NEDA) as one of the projects for development by the Government. San Roque is located in San Manuel, at the lower Agno River in Pangasinan. The project was bid out by NPC on a Build-Operate-Transfer (BOT) basis which gave rise to a Power Purchase Agreement (PPA) between NPC and the Consortium (Marubeni Corporation, Sithe Philippine Holdings, Ltd., and Italian Thai Development Public Company, Limited). As signatory to this PPA,

NPC becomes responsible for the disbursement of the cost of the non-power component of the Project estimated at \$400 million.

SRMP is the non-power component of the project. It is a project serving several purposes: (i) annual generation of 1000 GWh energy; (ii) irrigation of about 87,000 hectares service areas in Pangasinan; (iii) flood forecasting and control; and (iv) water quality and environmental protection. As the Project encompasses several functional areas, its implementation was a multi-agency effort with NPC tasked to lead in the Project development. To ensure that the agencies meet their obligations in the implementation of the Project and the terms of the PPA, the agencies entered into the MOA.

The MOA provided, among others, that:

1. DOF shall (i) secure the financing of the \$400 million for disbursement to the Consortium through NPC, (ii) ensure the timely transfer of the \$400 million fund to NPC, and (iii) ensure that the advances to be made by NPC for SMRP non-power component shall not be offset against any receivables of the Government from NPC;
2. NIA, DENR, DPWH shall (i) include SRMP as a priority project in their programs, (ii) cause the inclusion in their annual budget, over and above its ceiling, their share in the \$400 million non-power cost, (iii) give authority to DBM and BTr to remit funds directly to NPC's account; (iv) coordinate with NPC and the Consortium in the implementation of Project matters under their jurisdiction;
3. DBM shall ensure the inclusion of each agency's contribution to SRMP, as defined in the MOA, in the agencies' respective annual budgets from 1999 to 2000;
4. NPC shall, among others, disburse to the Consortium the \$400 million non-power component funding in accordance with the schedule.

Certain amendments to the above MOA were made in September 1998, major of which follow:

1. NPC to borrow for the \$400 million non-power component of the Project, with repayments to NPC made over the same debt service period as the said loan;
2. DOF shall secure the full government guarantee for the NPC financing of the \$400 million non-power cost component of SRMP;
3. Longer spread of the agency's budget allocation for the contribution to the \$400 million non-power component (from years 1999 to 2000 to years 1999 to 2014)

Advances for BNPP

NPC's advances for the preservation and maintenance of the mothballed Bataan Nuclear Power Plant amounted to P4.377 billion as of December 2010.

7. OTHER RECEIVABLES

The following comprise this account:

	<u>2010</u>	<u>2009</u>
Interest receivable	7,341,024,702	6,855,385,705
Bond swap receivable	219,052,316	177,325,745
Lease receivable	16,361,519	20,877,678
Due from officers & employees	919,769	768,614
Other receivables, net	8,695,022,656	4,827,761,977
	16,272,380,962	11,882,119,719

Interest receivable represents interest income accruing on short-term placements/time deposits with authorized government depository banks.

Other receivables, net represents transferred accounts from NPC consisting of other receivables, net of allowance for bad debts, from various private corporations, government agencies, suppliers and persons. These transferred account balances are subject to validation upon submission of supporting documents/further details by NPC.

8. ASSETS HELD FOR SALE

This account represents the generation plants with a total carrying amount of P20.60 billion scheduled for privatization in 2011.

<u>Generating Plants</u>	<u>Bid Schedule</u>
Angat Hydro Electric Power Plant	TBA
Power Barge 101 – 104	July 2011
Malaya Thermal Power Plant	TBA
Bataan Thermal Power Plant (Decom)	Dec. 2011
Sucac Thermal Power Plant	TBA

Power Plants classified under this account, which are identified based on the corporation's work plan for the year, are taken out from the property, plant and equipment account as shown in Note 10.

9. OTHER CURRENT ASSETS

This account consists of the following:

	2010	2009
Assets in trust with NPC	5,445,774,824	12,392,156,293
Guaranty deposits	878,524,530	878,524,530
Inventory and prepaid expenses	452,903,475	256,036,712
Advances to contractors	57,237,568	56,921,776
Other advances	9,327,467	(567,172,376)
	6,843,767,864	13,016,466,935

Assets in trust with NPC represents the following current assets held by NPC as part of its working capital as "Operator" under the Operations and Management Agreement with PSALM. These consist of the following: *Cash and Cash Equivalents* of P0.213 billion; *Materials, Supplies & Equipment* of P5.295 billion and transferred balances of personnel-related accounts from NPC, amounting to negative P0.062 billion.

Guaranty deposits includes the marginal and guaranty deposits for Letters of Credit and for the Nomura bonds issuance.

The abnormal balance of the *Other Advances* account in 2009 was corrected with the adjustment of the PNOC-EDC account in 2010

10. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consists of PSALM-acquired and NPC-transferred property, plant and equipment, as follows:

PSALM –acquired:
(In pesos)

	Furniture, Fixtures/ Equipment	Transportation Equipment	Total
COST			
Jan. 1, 2010	155,565,089	15,823,718	171,388,807
Additions/Adjustments	6,114,335		6,114,335
Balance, Dec. 31, 2010	161,679,424	15,823,718	177,503,142
ACCUM DEPRECIATION			
Jan. 1, 2010	95,076,198	8,698,089	103,774,287
Provision/ Adjustment	8,749,604	1,423,736	10,173,340
Balance, Dec. 31, 2010	103,825,802	10,121,825	113,947,627
Carrying amount, Dec. 31, 2010	57,853,622	5,701,893	63,555,515
Cost	155,565,089	15,823,718	171,388,807
Accum. Depreciation	95,076,198	8,698,089	103,774,287
Carrying amount, Dec 31, 2009	60,488,890	7,125,629	67,614,519

NPC—transferred assets:
(In million pesos)

	Electric Plants in Service	Electric Plants Leased to Others	Other Utility Plants	Non-Utility Properties	Total
COST					
Jan. 1, 2010	133,366	14,292	510	18,188	166,356
Additions/Adjustments/Sold	(56,657)	(457)	1,497	(12,328)	(67,945)
Balance, Dec. 31, 2010	76,709	13,835	2,007	5,860	98,411
ACCUM DEPRECIATION					
Jan. 1, 2010	99,118	13,205	426	17,207	129,956
Provision/ Adjustment/Sold	(54,684)	3	-	(12,562)	(67,243)
Balance, Dec. 31, 2010	44,434	13,208	426	4,645	62,713
Carrying amount, Dec. 31, 2010	32,275	627	1,581	1,215	35,698
Cost	133,366	14,292	510	18,188	166,356
Accum. Depreciation	99,118	13,205	426	17,207	129,956
Carrying amount, Dec. 31, 2009	34,248	1,087	84	981	36,400

Adjustment/sold include the following

- a. Plants Turned Over to Local Government Units (LGUs) in lieu of Real Property Tax (RPT)

<u>Power Plant</u>	<u>Book Value</u>
1. Bauang Diesel Power Plant	4,003,475,773
2. Iligan Diesel Power Plant 1 & 2	3,738,908,000
3. Navotas Land-based Gas Turbine	2,151,349,848
	<u>9,893,733,621</u>

1. Bauang Diesel Power Plant (BDPP)

The BDPP was constructed by First Private Power Corporation/Bauang Private Power Corporation (“*FPPC/BPCC*”) under a Fast Track BOT Agreement dated January 11, 1993 with NPC. The BOT Agreement expired on 25 July 2010.

The tax issue pertains to the unpaid RPT to the local government for nine (9) machineries and twelve (12) buildings. The amount of delinquent RPT from 1995 up to July 31, 2007 is P1,866,176,148.74.

Under Section 2.03 of the BOT Agreement, NPC is responsible for “the payment of all real estate taxes and assessments, rates and other charges with respect to the Site, the buildings and improvements thereon.”

However, NPC claimed exemption pursuant to Section 234 (c) of the Local Government Code (LGC), which provides that “[a]ll machineries and equipment that are actually, directly and exclusively used by x x x government-owned and –controlled corporations engaged in the x x x generation and transmission of electric power” are exempted from the payment of real property tax.

The Local Board of Assessment Appeals (LBAA) of the Province of La Union, the Central Board of Assessment Appeals (CBAA) and the Court of Tax Appeals (CTA) were one in rejecting NPC's claim for exemption from payment of RPT. The Warrant of Levy for the said assets was issued by the Provincial Treasurer of La Union on December 27, 2007, pursuant to Section 258 of the LGC.

On January 30, 2009, the Supreme Court, in G.R. No. 171470 entitled *NPC v. Central Board of Assessment Appeals (CBAA), et al.*, denied NPC's petition and affirmed the CTA's decision. NPC's motion for reconsideration was denied with finality on April 20, 2009. An Entry of Judgment was issued on June 4, 2009.

On February 10, 2009, the Provincial Government of La Union (PGLU) consolidated ownership of the BDPP in its name. Tax declarations for the properties in the name of the PGLU have been issued by the Provincial Assessor of La Union.

On March 25, 2010, the PSALM Board passed Resolution No. 2010-0325-005 authorizing the PSALM President or his duly authorized representative to negotiate, conclude, sign and execute such agreement and other documents as may be necessary to effect the turn-over of the BDPP to the Province consistent with the decision of the Supreme Court and other legal proceedings.

Simultaneous with the transfer of BDPP from BPC to NPC/PSALM, PSALM transferred possession of the BDPP in favor of the Province at noon of July 26, 2010 on an "as is where is" basis.

2. Iligan Diesel Power Plant 1 & 2, (IDPP 1 & 2)

IDPP 1 was constructed by Northern Mindanao Power Corporation (NMPC) on June 29, 1992 under a BOT Agreement. On 01 August 2003, IDPP 1 was turned over to NPC. IDPP 2 was constructed by NMPC on 19 November 1992 under another BOT Agreement. On February 28, 2006, IDPP 2 was also turned over to NPC.

IDPP 1&2 is the subject of a tax issue with the Iligan City Government (ICG) pertaining to the unpaid RPT of NPC to ICG, initially assessed at P110 million and stood at P392 million as of September 2008.

The ICG assessed RPT over IDPP I & II as follows: [i] Land, Building and Improvements at 35% assessment level and [ii] Machineries and Equipment at 60% assessment level. NPC protested the RPT assessment of ICG. The RPT assessment protest was denied by ICG and its treasurer. NPC appealed to the LBAA, which issued the Decision dated June 2, 2004 affirming the RPT assessment of ICG.

The LBAA Decision affirming ICG's assessment was appealed to the CBAA, which issued the Decision dated December 20, 2006 affirming the LBAA

Decision. NPC filed a petition for reconsideration that is currently pending resolution.

Meanwhile on April 25, 2007, ICG conducted a public auction and sold to itself (for lack of bidders) IDPP1 & 2.

NPC filed an Urgent Omnibus Manifestation and Motion questioning the propriety of the sale as the current administrative protest pending before the CBAA disallows the sale of the IDPP1 & 2.

On October 10, 2008, ICG scheduled yet another public auction to sell IDPP1 & 2. This prompted NPC to file on 08 October 2008 a Petition with the Regional Trial Court (Branch 3) of Iligan City to declare as a nullity the public auction/sale of IDPP1 & 2 held on April 25, 2007 and to prevent the re-sale thereof on October 10, 2008 and any further re-sale. The October 2008 sale did not push through for lack of interested bidders.

In October 2009, the PSALM Board (Resolution No. 2009-1016-005) authorized the PSALM President to take such steps as necessary to obtain the early resolution of the tax case with the ICG, including the possibility of entering into a compromise agreement with the ICG.

In April 2010, the PSALM Board (Board Resolution No. 2010-0416-002) authorized the PSALM President to cause NPC to move for the dismissal or take any other action to cause the dismissal of cases before the CBAA and the Regional Trial Court of Iligan City involving the tax claims of ICG against NPC for IDPP 1 & 2.

On June 29, 2010, PSALM, NPC and the ICG entered into a Compromise Agreement (CA) for the IDPP. Under the CA, PSALM and NPC relinquishes all rights, title, interest and claims in IDPP in favor of ICG and ICG acknowledges such relinquishment as full satisfaction and extinguishment of any and all real property tax liabilities, including interests and penalties, over IDPP.

During its meeting on December 9, 2010, the PSALM Board (Resolution No. 2010-1209-001) granted authority to PSALM Management to cause the formal turnover of the physical properties of IDPP 1 & 2 from PSALM/NPC to the ICG and authorized the PSALM President and CEO to execute the necessary transfer documents in favor of ICG.

Consistent with the intent of the CA among PSALM, NPC and ICG, PSALM transferred possession of the IDPP in favor of the ICG on December 16, 2010 on an "as is where is" basis.

3. Navotas Land-Based Gas Turbine (Navotas LBGT)

On preservation status from its turnover in 2005, this IPP was also assessed for RPT delinquencies and consolidated for ownership by the City Government of Navotas in 2007. The Court of Tax Appeals dismissed in March 2010 NPC's petition for review and denied its motion for

reconsideration in May 2010. PSALM Board approved the move of PSALM not to dispute the ownership of the Navotas plant by the City of Navotas as a result of non-payment of RPT by NPC.

b. Power Plants Sold

<u>Power Plant</u>	<u>Book Value</u>
1. Bacon Manito Geothermal P/P	3,411,918,537.87
2. Power Barge 117	1,326,856,135.19
3. Power Barge 118	1,257,487,791.16
4. Limay combined Cycle A & B	5,206,551,291.89
5. Naga Land-based Gas Turbine	121,836,904.99
	<u>11,324,650,661.10</u>

c. Power Plants transferred to Assets Held for Sale account

<u>Power Plant</u>
1. Angat Hydro Electric Power Plant
2. Power Barge 101 – 104
3. Malaya Thermal Power Plant
4. Bataan Thermal Power Plant (Decom)
5. Sucat Thermal Power Plant

11. BOT ELECTRIC PLANTS UNDER CAPITAL LEASE

This account represents the total computed capacity fees of remaining Build-Operate-Transfer (BOT) projects for the duration of the cooperation period, net of accumulated amortization, as follows:

Plant	Total Capacity fee	Accumulated Amortization	Net
Kalayaan 2 Unit 3	17,387,881,744	3,079,104,059	14,308,777,685
Kalayaan 2 Unit 4	17,387,881,743	3,079,104,059	14,308,777,684
Mindanao Coal Fired I	13,738,656,531	2,348,176,091	11,390,480,440
Mindanao Coal Fired 2	13,660,516,257	2,244,213,083	11,416,303,174
31 December 2010	62,174,936,275	10,750,597,292	51,424,338,983
31 December 2009	328,330,408,782	91,126,428,474	237,203,980,308

The decrease in the account was due to the following:

- a. De-recognition of the unamortized cost of the following power plants due to the transfer of their operations with the IPP Administrators:

<u>Power Plant</u>	<u>Unamortized cost</u>
1. San Roque Hydroelectric Power Plant	77,462,396,047
2. Bakun HEP Mini-Hydro Plant	26,950,846,923
3. Ilijan Combined Cycle Power Plant	74,934,337,698
	<u>179,347,580,668</u>

b. Cooperation period of the Bauang Diesel Power Plant ended in 2010.

The corresponding BOT lease obligations (Note 15) were not de-recognized because PSALM remains responsible for the said obligations with the concerned Independent Power Producer. However, a receivable from IPP Administrators (Note 5) is recognized.

12. INVESTMENT IN TRANSCO

This account represents the difference between the NPC assets and liabilities transferred to TransCo upon its separation from NPC and which represents PSALM's equity investment in TransCo. As provided for in the EPIRA, TransCo is wholly-owned by PSALM, which assumed the foreign loan obligations related to the transmission assets. The increase of P0.310 billion in 2010 represents advances made by PSALM for the Maranag-Bunawan Transmission and Northern Panay Backbone Projects pending the effectivity of the Credit Agricole Corporate and Investment Bank Facility (Calyon Facility), which should have funded these projects. The balance is subject to reconciliation with TransCo's reciprocal account *Equity from PSALM* due mainly to differences in booking the payments to Hyundai Corporation and the various adjustments made by TransCo in its books.

13. OTHER NON-CURRENT ASSETS

This account consists of the following:

	2010	2009
Stored energy- Leyte A & B	5,241,828,596	5,823,343,304
Other non-current receivables, net	4,523,050,806	4,523,050,806
Stored fuel – Ilijan natural gas	872,257,399	1,422,738,875
Universal charge (UC)	958,420,449	992,529,649
Various	2,662,174,410	2,446,499,991
	<u>14,257,731,660</u>	<u>15,208,162,625</u>

Stored energy refers to advance payments made to PNOC-EDC for the cost of contracted steam energy for Leyte A & B.

Other non-current receivables consists primarily of the receivable from Metropolitan Waterworks and Sewerage System (MWSS) which has accumulated since 1992. The amount represents energy and capacity losses incurred by the Angat Hydroelectric Power Plant (AHEPP) due to the

implementation of MWSS' Angat Water Supply Optimization Project (AWSOP). The Memorandum of Understanding between NPC and MWSS on 9 February 1990 provides that MWSS shall compensate NPC the energy and capacity losses, if any, which the latter may incur as a result of the operation of the former's Auxiliary Unit No. 5.

Stored fuel represents the difference between the actual gas lifted by NPC versus the contracted volume per the Gas Supply and Purchase Agreement with Shell Philippines Exploration B. V. (SPEX).

Universal charge refers to the charge imposed on all electricity end-users for various purposes as enumerated in Note 1. In May 2003, ERC approved the P0.0025/kWh for UC-watershed management. The UC for missionary electrification was first approved at P0.0168 effective February 2003 and increased to P0.0373/kWh effective July 2003.

At year-end, the composition of UC fund is as follow:

	2010	2009
Special Trust Fund (STF)	711,506,653	590,531,270
Receivables*	246,913,796	401,998,379
	958,420,449	992,529,649

Transactions affecting the UC are as follows (cumulative) since March 2003:

	2010	2009
Remittances by collecting entities (CEs):		
For missionary electrification	16,345,278,130	11,320,671,050
For watershed rehabilitation	881,341,559	743,396,074
Others (no identification of specific purpose)	226,081	226,081
	17,226,845,770	12,064,293,205
Interest earnings	150,844,954	135,422,136
	17,377,690,724	12,199,715,341
Disbursements to NPC	(16,666,184,071)	(11,609,184,071)
STF balance	711,506,653	590,531,270
Receivables from CEs*	246,449,168	401,297,586
Interest receivable	464,628	700,793
	958,420,449	992,529,649

Disbursements to NPC include disbursements for missionary electrification of P14.30 billion, watershed of P0.34 billion, and DAA for ICERA and GRAM of P2.03 billion. *Receivables from CEs* pertains to the difference between the reported collections of CEs versus their remittances to PSALM.

The same amount of UC is presented under Other Long-Term Liabilities in Note 18.

14. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Below is the breakdown of the account:

	2010	2009
Accounts payable:		
Check vouchers payable	6,861,173,783	10,589,944,486
Accounts payable - others	11,647,264,705	10,545,959,840
Fuel, oil and other oil products payables	2,487,147,756	7,678,156,177
Materials, supplies, equipment payables	366,693,216	491,465,709
Interest payable	7,799,286,636	10,246,226,458
Current portion – fixed O&M payable:		
Pagbilao	1,377,644,259	1,509,175,812
Sual	1,431,163,902	1,525,215,161
Ilijan	1,101,617,032	-
San Roque	413,075,532	-
Bakun	44,429,047	-
Performance/bidders bonds	827,056,312	837,034,558
Due to officers & employees	45,452,483	498,235,454
Guaranty deposits payable	305,552,150	388,235,053
Other payables:		
Guaranty fees payable	-	2,841,431,506
Financial assistance/benefits payable	1,057,506,094	1,044,658,646
Suppliers and contractors	5,600,826,113	960,448,393
Various	3,393,239	3,437,652
	41,369,282,259	49,159,624,905

15. BOT LEASE OBLIGATION

This account pertains to the outstanding balances of the liability set up for capital cost recovery fees of the BOT power plants during the cooperation period indicated in the BOT contracts.

	2010	2009
Total lease obligation	394,225,810,948	441,541,885,613
Less current portion	32,571,318,049	34,044,161,197
Non-current	361,654,492,899	407,497,724,416

Following are the details for 2010 (In pesos):

Name of IPP	Power Plant	Current	Non-current
Team Sual Corp.	Sual 1	4,774,147,337	50,405,752,326
	Sual 2	4,774,147,337	51,104,470,739
Team Energy Corp.	Pagbilao 1	4,147,132,500	56,597,055,520
	Pagbilao 2	4,147,132,500	56,473,288,816
San Roque Power Corp.	San Roque	6,107,329,866	39,134,053,071
Luzon Hydro Corp.	Bakun I	373,030,224	14,851,842,751
	Bakun II	384,652,727	14,395,584,970
KEPCO Ilijan Corp.	Ilijan Natural Gas	4,583,970,109	48,679,245,076
CBK Power Co. Ltd.	Kalayaan 2 Unit 3	1,151,837,441	6,114,589,524
	Kalayaan 2 Unit 4	1,156,431,189	6,040,743,135
Steag State Power Inc.	Mindanao Coal Fired I	485,753,409	8,923,695,209
	Mindanao Coal Fired 2	485,753,410	8,934,171,762
		32,571,318,049	361,654,492,899

16. LONG-TERM LIABILITIES

This account consists of:

	2010	2009
Bonds payable	266,695,208,303	275,650,171,114
Loans payable	37,724,325,474	46,176,636,147
Other long-term liabilities	6,086,200,144	6,804,712,855
	310,505,733,921	328,631,520,116
Add bond premium	15,815,162	-
Less bond discount	3,472,047,188	6,606,799,251
Net	307,049,501,895	322,042,746,070
Less current portion	40,957,574,926	43,019,049,633
Long-term	266,091,926,969	279,005,671,232

On a per bank/creditor basis, the amounts are summarized as follows:

	2010	2009
DBP/Morgan Stanley and UBS AG	52,662,000,000	55,627,200,000
Bank of New York/JP Morgan Chase Manhattan	53,371,550,000	52,563,085,000
Deutsche Bank	39,168,810,705	49,632,024,876
HSBC/Deutsche/Morgan	43,885,000,000	46,356,000,000
Bureau of Treasury	62,800,000,000	34,861,000,000
Citibank	6,448,800,000	26,677,432,680
Int'l Bank for Reconstruction and Dev't	8,655,303,390	11,258,699,020

Eximbank of Japan	8,156,545,732	10,224,544,604
US Bank	8,359,047,598	9,933,428,558
Asian Development Bank	7,699,872,288	8,819,821,690
Kreditanstalt fur Wiederaufbau	6,488,473,828	7,869,632,459
Overseas Economic Cooperation Fund	3,518,775,387	3,712,630,410
Japan Bank for International Cooperation	3,117,207,452	3,358,237,502
National Government	2,983,346,185	3,151,327,236
Instituto de Credito Oficial	883,485,082	1,073,838,634
Natixis/Credit National	781,101,178	1,024,683,186
Caliraya-Botocan-Kalayaan Power Corporation	559,460,023	886,441,683
Nordic Investment/Development Fund	332,439,309	465,775,305
Artigiancassa MCA	-	345,265,523
Eximbank of Korea	255,270,182	301,849,223
Banco de Oro/Development Bank of Phils.	150,000,000	250,000,000
Department of Energy	199,143,936	199,143,936
US Agency for International Development	30,101,646	39,458,591
	310,505,733,921	328,631,520,116
Add bond premium	15,815,162	-
Less bond discount	3,472,047,188	6,606,799,251
Net	307,049,501,895	322,024,720,865

Further details of the account follow:

<u>CREDITOR / PROJECT</u>		<u>MATURITIES</u>	<u>INTEREST RATES</u>	<u>CURR</u>	<u>ORIGINAL CURRENCY</u>	<u>PESO EQUIVALENT</u>
Asian Development Bank						
1288-PHI	Power Transmission Project Leyte-Mindanao	1997 to 2013	Cost of Qualified Borrowings	USD	37,268,313.74	1,635,519,948
1474-PHI	Interconnection Project Power Transmission	2000 to 2011	Cost of Qualified Borrowings	USD	655,637.98	28,772,673
1590-PHI	Reinforcement Project Power Sector Restructuring	2002 to 2017	Cost of Qualified Borrowings	USD	25,954,554.80	1,139,015,637
1662-PHI	Program Electricity Market & Transmission Development	2002 to 2013	Borrowings	USD	50,000,000.00	2,194,250,000
1984-PHI	Proj. Special Project	2009 to 2022	LIBOR + 0.60%	USD	33,026,589.22	1,449,371,868
SPIA	Implementation Agreement	1991 to 2026	FIXED at 9.65%	USD	28,459,465.00	1,248,943,622
#624P	Mindanao Power Project	1999 to 2011	FIXED at 7%	USD	91,114.04	3,998,540
International Bank for Reconstruction and Development						
3626-PH	Power Transmission Project	1999 to 2013	Cost of Qualified Borrowings + 0.50%	USD	14,923,451.80	654,915,682
3700-0-PH	Leyte-Cebu Geothermal	1999 to 2014	Cost of Qualified Borrowings + 0.50%	USD	42,897,299.24	1,882,547,977
3700-A-PH	Leyte-Cebu Geothermal	1999 to 2014	Cost of Qualified Borrowings + 0.50%	USD	4,219,942.11	185,192,160
3746-0-PH	Leyte-Luzon Geothermal	1999 to 2014	Cost of Qualified Borrowings + 0.50%	USD	29,889,368.25	1,311,694,925
3746-A-PH	Leyte-Luzon Geothermal	1999 to 2014	Cost of Qualified	USD	3,407,684.32	149,546,227

			Borrowings + .50%			
3996-0 PH	Transmission Grid Reinforcement Project	2001 to 2016	Cost of Qualified Borrowings + 0.50%	USD	16,579,981.70	727,612,497
3997-0 PH	Transmission Grid Reinforcement Project	2001 to 2016	LIBOR + 0.50%	USD	52,680,106.15	2,311,866,458
296-PHI	Bataan Thermal 2	1982 to 2022	Service Charge at 0.75%	USD	3,455,495.53	151,644,421
3996-A-PH	Transmission Grid Reinforcement Project	2001 to 2016	Cost of Qualified Borrowings + 0.50%	JPY	1,426,362,613.00	766,527,268
4887-PH	Bicol Power Restoration Project	2008 to 2025		USD	11,706,865.11	513,755,775
Overseas Economic Cooperation Fund (OECF)						
PH-C8	Extra High Voltage Transmission Line Project 1&2	1989 to 2004	FIXED at 3.50%	JPY	5,361,445,783.13	2,881,240,964
PH-009	Cagayan Electrification	2002 to 2012	FIXED at 3.20%	JPY	142,620,316.00	76,644,158
PH-013	Abulog River Hydro Electric Power	2002 to 2012	FIXED at 3.20%	JPY	17,233,018.00	9,255,650
PH-029	Power Plant Barge Project 1	2002 to 2012	FIXED at 3.20%	JPY	182,206,152.00	97,917,586
PH-031	Tongonan Geothermal	2002 to 2012	FIXED at 3.20%	JPY	166,192,209.00	89,311,693
PH-043	Mindanao Transmission Line Project	2002 to 2012	FIXED at 3.20%	JPY	86,188,220.00	46,317,549
PH-048	Extra High Voltage Transmission Line Project 1	2002 to 2012	FIXED at 3.20%	JPY	400,299,382.00	215,120,888
PH-057	Extra High Voltage Transmission Line Project 2	2002 to 2012	FIXED at 3.20%	JPY	55,769,575.00	29,970,570
PH-065	Power Plant Barge Project 2	2002 to 2012	FIXED at 3.20%	JPY	135,832,394.00	72,996,329
Japan Bank for International Cooperation						
	Electricity Market & Transmission Dev't Project	2009 to 2022	Tokyo Swap Reference Rate + 1.25%	JPY	2,764,361,034.00	1,485,567,620
	Leyte-Cebu Interconnection	2006 to 2015	FIXED at 3.69%	JPY	3,036,173,860.00	1,631,639,832
Eximbank of Japan						
	Leyte-Luzon Interconnection Project	1999 to 2014	Long-Term Prime Rate + 0.20%	JPY	1,335,224,130.00	717,549,447
Series A	San Roque Multi-Purpose Project	2004 to 2014	Long-Term Prime Rate + 0.20%	JPY	7,810,300,000.00	4,197,255,220
Series B	San Roque Multi-Purpose Project	2004 to 2014	LIBOR + 0.90%	USD	73,869,000.00	3,241,741,065
Kreditanstalt für Wiederaufbau						
8765224	Sucac 1&4 Rehabilitation Project	1998 to 2018	FIXED at 6.50%	EUR	8,819,785.01	511,842,991
8865164	Various Spare Parts	1999 to 2019	FIXED at 3.50%	EUR	5,141,680.62	298,389,722
9165432	Sucac 2&3 Rehabilitation	2002 to 2032	FIXED at 9.0%	EUR	21,630,714.31	1,255,306,059
	Sucac 2&3 Rehabilitation (Additional)	2006 to 2036	FIXED at 7.0%	EUR	5,475,936.07	317,787,735
9165861	Sucac/Sta.Mesa/Balintawak Transmission Project	2006 to 2023	FIXED at 9.0%	EUR	11,429,418.73	663,289,172
9165861	Sucac/Sta.Mesa/Balintawak Transmission Project	2006 to 2033	FIXED at 9.0%	EUR	25,565,105.35	1,483,632,541
	Northern Luzon Generation & Transmission Proj.	2010 to 2035	FIXED at 7.50%	EUR	21,928,140.04	1,272,566,715
	Northern Luzon Generation	2006 to 2025	FIXED at 7.50%	EUR	40,026.97	

	& Transmission Proj.					2,322,904
	Energy Sector Loan	2008 to 2035	FIXED at 7.0%	EUR	11,774,853.99	683,335,989
Natixis/Credit National						
1528	Navotas Gas Turbine	1997 to 2016	FIXED at 5.45%	EUR	5,488,164.60	318,497,400
1543	Sucat Gas Turbine	1999 to 2019	FIXED at 5.45%	EUR	1,852,255.52	107,492,870
467-OA1	Pielstick for Diesel Power Plant	2000 to 2022	FIXED at 3.0%	EUR	1,778,716.12	103,225,122
467-OB1	Bataan Gas Turbine	1999 to 2020	FIXED at 3.0%	EUR	3,270,925.52	189,823,256
747-OD1	Northern Luzon 230KV Transmission Line	2001 to 2016	FIXED at 3.10%	EUR	1,069,425.94	62,062,530
Instituto de Credito Oficial						
	Palawan Backbone Transmission Line	2003 to 2013	FIXED at 2.0%	USD	4,595,238.24	201,662,030
	200MW Mindanao Barge	2003 to 2023	FIXED at 1.25%	USD	15,536,585.45	681,823,052
Nordic Investment/ Development Fund						
	Leyte-Cebu HV Interconnection Project	2005 to 2034	Service Charge at 0.75%	EUR	3,683,892.05	213,789,149
PIL95/1	Leyte-Cebu HV Interconnection Project	2000 to 2014	LIBOR + 0.85%	USD	2,703,660.93	118,650,160
Eximbank of Korea						
94-2063	Transmission & Substation Project in Luzon	2004 to 2018	FIXED at 3.50%	KRW	3,272,250,000.00	125,654,400
	Mindanao Power Transmission	2002 to 2017	FIXED at 3.50%	KRW	3,375,411,000.00	129,615,782
National Government						
	New Money Bond (B)	1997 to 2009	LIBOR + 0.8125%	USD	67,981,000.00	2,983,346,185
Deutsche Bank						
	General Funding Requirements	2011	LIBOR + 4.25%	USD	292,533,000.00	12,837,810,705
	General Funding Requirements	2011	LIBOR + 4.25%	USD	100,000,000.00	4,388,500,000
	General Funding Requirements	2016	FIXED at 6.875%	USD	500,000,000.00	21,942,500,000
Citibank						
	General Funding Requirements	2015	FIXED at 4.65%	JPY	12,000,000,000.00	6,448,800,000
Bank of New York/JP Morgan Chase Manhattan						
	General Funding Requirements	2016	FIXED at 8.40%	USD	160,000,000.00	7,021,600,000
	General Funding Requirements	2028	FIXED at 9.625%	USD	300,000,000.00	13,165,500,000
	General Funding Requirements	2020	FIXED at 3.22%	JPY	24,750,000,000.00	13,300,650,000
	General Funding Requirements	2022	FIXED at 3.55%	JPY	37,000,000,000.00	19,883,800,000
US Bank						
	General Funding Requirements	2008 to 2018	FIXED at 5.40%	USD	190,476,190.00	8,359,047,598

Bureau of Treasury						
	General Funding Requirements	2011	MART + 0.625%	PhP	8,800,000,000.00	8,800,000,000
	General Funding Requirements	2012	FIXED at 9.875%	PhP	11,000,000,000.00	11,000,000,000
	General Funding Requirements	2012	FIXED at 10.375%	PhP	3,000,000,000.00	3,000,000,000
	General Funding Requirements	2011	FIXED at 5.25%	PhP	3,680,000,000.00	3,680,000,000
	General Funding Requirements	2016	FIXED at 5.875%	PhP	6,320,000,000.00	6,320,000,000
	General Funding (Liability management Program)	2015	FIXED at 6.875%	PhP	11,322,000,000.00	11,322,000,000
		2017	FIXED at 7.750%	PhP	18,678,000,000.00	18,678,000,000
Caliraya-Botocan-Kalayaan Power Corporation						
	General Funding Requirements	2006 to 2016		USD	12,748,320.00	559,460,023
US Agency for International Development						
492-H-032	Tiwi Geothermal 1&2	1985 to 2015	FIXED at 3.0%	USD	631,936.75	27,732,544
492-H-032	Tiwi Geothermal 1&2	2002 to 2012	FIXED at 3.0%	USD	53,984.32	2,369,102
Banco de Oro/Development Bank of Phils.						
	Leyte-Cebu Interconnection Uprating Project.	2006 to 2012	FIXED at 11.32%	PhP	150,000,000.00	150,000,000
Department of Energy						
	Gas Sale and Purchase Agreement			PhP	199,143,935.86	199,143,936
HSBC/Deutsche/Morgan						
	HSBC/Deutsche/Morgan \$1B	2019	FIXED AT 7.25%	USD	1,000,000,000.00	43,885,000,000
DBP/Morgan Stanley and UBS AG						
	DBP/MS/UBS NEW CASH OFFER	2024	FIXED at 7.39%	USD	600,000,000.00	26,331,000,000
	DBP/MS/UBS BOND EXCHANGE-2019	2019	FIXED AT 7.25%	USD	20,986,000.00	920,970,610
	DBP/MS/UBS BOND EXCHANGE-2024	2024	FIXED at 7.39%	USD	579,014,000.00	25,410,029,390
Total long-term liabilities						<u>310,505,733,921</u>

17. OTHER LONG-TERM LIABILITIES

This account consists of the following:

	2010	2009
Liability for the fixed O&M:		
Pagbilao	18,933,170,360	22,511,872,522
Sual	18,094,952,680	21,480,113,530

Ilijan	11,617,429,372	-
San Roque	6,618,011,210	-
Bakun	577,209,184	-
Deferred credits	1,200,569,416	1,223,259,999
Universal charge	958,420,449	992,529,649
	57,999,762,671	46,207,775,700

Liability for the Fixed O&M pertains to the obligation of PSALM to the IPPs for the fixed operating and maintenance expenses of the plants under IPP Administration Agreements. *Deferred credits* refer mostly to the unearned portion of (P1.07 billion) of the rent income from lease of land pertaining to sold plants. The details of the Universal Charge are in Note 13.

18. ASSUMED RURAL ELECTRIFICATION PROGRAM (REP) LOANS

Section 60 of the EPIRA provides that all outstanding financial obligations of the electric cooperatives (ECs) to NEA and other government agencies incurred for the purpose of financing the REP shall be assumed by PSALM in accordance with the program approved by the President of the Philippines within one (1) year from the effectivity of the Act which shall be implemented and completed within three (3) years from the effectivity of the Act. Section 2, Rule 31 of the Implementing Rules and Regulations of EPIRA states that the assumption covers all outstanding REP-related financial obligations of the ECs as of 26 June 2001.

The Act also provides that ERC shall ensure a reduction in the rates of ECs commensurate with the resulting savings due to the removal of the amortization payments of their loans. However, any EC which shall transfer ownership or control of its assets, franchise or operations within five years shall repay PSALM the total debts including accrued interests thereon.

To carry out the aforementioned objective and that of Executive Order (EO) No. 119, Restructuring Program for Electric Cooperatives, PSALM and NEA entered into a Memorandum of Agreement (MOA) on 3 October 2003 to lay down the operational legal framework upon which the financial obligations of ECs to NEA shall be lawfully assumed by PSALM. Article IV of the MOA provides that repayment of the assumed loan shall be for the period of 10 years in accordance with the amortization schedule as may be mutually agreed by the parties.

The condonation was subject to compliance with certain conditions required under Executive Order (EO) No. 119. On September 2, 2006, EO 460 was issued amending EO 119 by giving retroactive effect to the effectivity of the assumption by PSALM of the rural electrification loan obligations of the ECs to NEA and other government agencies.

The total amount of ECs' obligations to NEA assumed by PSALM amounted to P17.978 billion. The obligations of ECs to local government units and other government agencies amounted to P0.096 billion, putting the total loans assumed to-date by PSALM at P18.074 billion. Of this amount, the following remain outstanding:

	2010	2009
Current portion	4,330,150,640	3,363,769,334
Non-current	2,390,469,694	4,557,916,830
Total	6,720,620,334	7,921,686,164

19. DUE TO TRANSCO

This liability account corresponds to the amount of payment received by PSALM from NGCP concerning the concession fees for the TransCo transmission business. The initial amount set up represents the payments received from NGCP for the years 2009-2010.

This account will be offset by: (i) any remittances made by PSALM to TransCo; (ii) the receipt of dividends from TransCo; and (iii) the reduction in value of TransCo assets, represented by the amount of depreciation.

20. DUE TO GOCCs AND NATIONAL GOVERNMENT AGENCIES

This account consists of the following:

	2010	2009
Due to NGAs	33,610,733,852	19,530,356,400
Due to Other GOCCs	9,929,861,909	6,000,673,867
	43,540,595,761	25,531,030,267

The account *Due to National Government Agencies (NGAs)* consists mostly of liabilities to the National Treasury (P18.11 billion) and the BIR (P14.97 billion). *Due to Other GOCCs* is a reciprocal account between PSALM and NPC that is under continuing reconciliation.

21. CAPITAL FROM ASSET-DEBT TRANSFER

This account slightly decreased in 2010 by P0.067 billion due mainly to the closing of the receivable accounts transferred from NPC totaling P0.375 billion. The impact on PSALM's finances of writing-off these receivables from NPC was minimized by the cash savings resulting from the offsetting of rural electrification loans payable to NEA amounting to P0.308 billion against the P2.215 billion collections made by NEA on these loans already assumed by PSALM.

22. RETAINED EARNINGS

Derecognition of the concession income from PSALM's books resulted in the substantial decrease of P18.057 billion in this account. Other debit adjustments contributed significantly to the decrease in the account such as: loss of income resulting from the ERC mandated Deferred Accounting Adjustments and Mandatory Rate Reduction totaling P7.331 billion; net adjustments of P4.920 billion related to OMA transactions and asset-debt accounts transfers including elimination of reciprocal accounts with NPC; net loss for the year amounting to P5.459 billion; and loss on restatement of IPPA related accounts of P2.160 billion.

23. INCOME

	2010	2009
Dividend income	25,749,520,849	-
Income from IPPA	5,108,813,610	-
Gain/loss on sale/disposal of assets	(14,571,173,208)	16,254,531,911
Power generation	(14,549,024,195)	(12,738,836,707)
Concession fee income	-	18,056,954,781
	1,738,137,056	21,572,649,985

- Concession fee income was derecognized in 2010 and transferred to TransCo's books upon recommendation of COA and approval by the PSALM Board. In its stead, a dividend income of P25.749 billion was recognized for TransCo's remittance of profit by a subsidiary.
- Payments by IPPAs upon the successful turn-over of the management of IPP contracts to the winning bidders constituted another source of privatization revenue for PSALM in 2010. However, these revenues were almost fully negated by the losses incurred from: 1) the sale of generation plants; 2) the turn-over of generation plants to local government units that have levied these assets due to unpaid real property taxes; and 3) the continued operation of losing plants that remained unsold.
- PSALM closed the sale for five plants in 2010 - Limay Combined Cycle and Naga Land-Based Gas Turbine (NLBGT) in January, Power Barges 117 and 118 in February, and BacMan in September. The sales brought in P3.307 billion cash, but recorded a total book loss of P6.957 billion. Also, three power plants – Bauang, Iligan, and Navotas – were transferred to the local governments to satisfy the real property tax liabilities assessed on the plants' machineries and equipment. The transfers necessitated derecognition of the plants from the Corporation's books, resulting in loss of P7.736 billion. Details follow:

Gain/loss on sale/disposal of assets				
Particulars	Bid price	Carrying amount	Other accounts for close-out	Gain (loss)
<u>Sold plants</u>				
Limay combined cycle	589.5	4,533.2	126.5	(4,070.2)
Naga LBGT	47.0	121.8	1.2	(76.0)
PB 117	739.5	1,319.8		(580.3)
PB 118	651.2	1,257.5		(606.3)
BacMan	1,279.7	2,903.8		(1,624.1)
Subtotal	3,306.9	10,136.1	127.7	(6,956.9)
<u>Transferred plants</u>				
Buang		4,003.5		(4,003.5)
Iligan		1,581.4		(1,581.4)
Navotas		2,151.3		(2,151.3)
		7,736.2		(7,736.2)
Various adjustments to previously sold plants				(310.9)
Interest income from asset sale receivable				424.3
Fees from privatization				8.6
Total				(14,571.1)

- d. Power generation produced net utility revenue of P77.712 billion, but incurred variable and fixed costs of P92.261 billion, resulting in a loss of P14.549 billion. Grouped by plant, the losses were brought about mainly by the P21.649 billion loss incurred from the operation of IPP plants, particularly those plants that rely on oil-based fuel. Similarly, oil-based PSALM-owned and operated plants incurred losses amounting to P1.166 billion. The losses were partly offset by the P9.436 billion income of hydro-electric plants. Meanwhile, operations of plants prior to the closing of their sale, including BacMan, resulted in generation losses of P2.881 billion, offset in part by the profits from the operations of Iligan, San Roque and Amlan plants totaling P1.711 billion, resulting in net additional loss of P1.170 billion. Details follow:

Net utility revenue		77,712.0
Variable costs		
Fuel oil	19,720.5	
Natural gas	9,770.7	
Steam	1,181.9	
Coal	983.5	
Other power supply	9,145.2	
Pumping/station use	4,835.6	
Purchases from PEMC	<u>12,928.5</u>	(58,565.9)
Gross contribution margin		19,146.1
Fixed costs		
Depreciation	1,976.1	
Opex allocation	3,060.9	
Fixed O & M fees	25,034.3	
Amortization of leased plant	<u>5,055.6</u>	35,126.9
Net generation margin		(15,980.8)
Other income, net		<u>1,431.8</u>
Net loss from power generation		<u>(14,549.0)</u>

24. MAINTENANCE AND OTHER OPERATING EXPENSES (MOOE)

Total *Maintenance and Other Operating Expenses* decreased by P56.8 million, equivalent to 30.8%, due mainly to the decrease of P809.6 million in *Professional Services* and the decrease of P213.8 million in *Taxes, Insurance premiums and Other Fees*, although this was partly offset by the increase in *Bad Debts* of about P408.9 million.

With most of the generation assets sold, the need for consultancy and other professional services diminished as well as the usual outlays for insurance, taxes and other fees of generation assets. An allowance for validated uncollectible accounts was provided which led to the increase in *Bad Debts*. At P645.6 million this expense now represents the biggest MOOE outlay, 43.8%, in 2010, while *Professional Services* of P351.3 million now comprise only 23.8% and *Taxes, Insurance premiums and Other Fees* of P343.2 million accounts for 23.3%.

25. FINANCIAL EXPENSES

Financial expenses such as *Interest Expense* and other *Financial Charges* increased slightly, from P22.55 billion to P25.697 billion, due primarily from the effects of forex revaluation.

26. OTHER INCOME (EXPENSES)

Gain (Loss) on Foreign Exchange

As the Corporation translates its foreign currency transactions/monetary items in accordance with PAS 21, the resulting gains and losses from the exchange differences are recognized in profit or loss, as follows:

	2010	2009
Realized forex gain (loss) on foreign currency-related transactions	(269,604,784)	615,489,966
Unrealized forex gain (loss) on translation	19,474,443,365	16,626,700,608
	19,204,838,581	17,242,190,574

Miscellaneous Income

Miscellaneous income came primarily from the recognition of interest income of P510 million in 2010 from NPC advances to San Roque Multi-Purpose Project.

27. TAXES AND LICENSES

In compliance with the requirements set forth by Revenue Regulations No. 15-2010, below are the information on taxes, duties, and license fees paid or accrued during the taxable year.

The Corporation is a VAT-registered company with VAT output tax declaration of P4,737,648,715.22 for the year based on the amount reflected in the Sales account of P39,480,405,960.17.

The Corporation has a zero-rated/exempt sales amounting to P27,105,716,726.22 pursuant to the provisions of Sections 106 (A)(2) and 108 (B) of the National Internal Revenue Code, as amended.

The amount of VAT input taxes claimed are broken down as follows:

Beginning balance, Jan 2010	14,009,651,700.14
Current year's purchases:	
I. Goods for resale/manufacture or further processing	343,677,455.06
II. Capital goods not subject to amortization	103,672,923.52
III. Services lodged under cost of goods sold	5,420,585,228.21
IV. Services lodged under other accounts	1,622,444.12
	<u>5,869,558,050.91</u>
	19,879,209,751.05
Claims for tax credit/refund and other adjustments	-
Ending balance, December 2010	<u><u>19,879,209,751.05</u></u>

The landed cost of the Corporation's importations amounted to P177,142,927.02 for the year, with paid/accrued amount of P7,915,378.36 as customs duties and P818,916.00 as tariff fees.

The DST paid /accrued on the following transactions:

Transaction	Amount	DST
Loan instruments	P30.0 billion	150,000,000.00
	US\$1.5 billion	140,967,000.00

Other taxes and licenses pertain to:

Nature	In pesos
Real property tax	116,207,257.37
Transfer tax	194,667,294.39
Documentary stamps on bank transactions	16,111.30

The amount of withholding taxes paid/accrued for the year amounted to:

Nature	In pesos
i. Tax on compensation and benefits	22,930,901.65
ii. Creditable withholding taxes	4,635,858,613.98
iii. Final withholding taxes	85,307,640.14

The Corporation has received formal assessment notices from the Large Taxpayers' Office of the Bureau of Internal Revenue amounting to P10,418,631,231.61, inclusive of penalties, covering the taxable years 2006 (P315,472,516.55) and 2008 (P10,103,158,715.06) for alleged deficiency VAT and withholding tax liabilities, which assessments have been duly protested.

28. ORGANIZATIONAL DEVELOPMENT AND EFFICIENCY

An ISO certification program to enhance investor confidence on PSALM and, at the same time, effect a culture change in the organization and improve management systems was started in March 2008. Maintenance of effectivity of QMS certification was assured through the conduct of internal quality audits and quality management standards reviews/audits. PSALM successfully passed the surveillance audit conducted in May 2010 and migrated to ISO 9001:2008 in June 2010.

Towards the achievement of enhanced organizational efficiency, the internal audits of the following risk management, governance and control processes were undertaken in 2010 and recommendations provided to the different functional groups based on the results of these audit engagements:

1. Cognizant of the material effects of the amounts involved and the risks associated with the transfer of books from NPC to PSALM, the IAD included the process of Asset-Debt transfer in its Revised 2009 Risk-Based Audit Plan.
2. The process of debt-asset transfer brought some significant impact to the operations of PSALM. In view of this, IAD included in the audit plan the assessment of adequacy and compliance with the provisions contained in the Operations and Maintenance Agreement (OMA).
3. The IAD also undertook a review on management's compliance with the provisions of TransCo's Concession Agreement.
4. Recognizing the value of information that PSALM produces and maintains, an audit on the protection of information asset process was undertaken.
5. IAD conducted a review and evaluation of the borrowing and financing processes of PSALM centering on integral components of the corporate liability management program.

The focus on personnel development was evident with the substantial number and variety of training and development programs held in 2008. Seven (7) in-house training and development programs were conducted/facilitated while selected personnel were sent to forty-five (45) local External training programs and professional conventions/ conferences held within the country.

Gender and Development (GAD) was given more emphasis with the activities and programs undertaken to direct attention to the subject and institutionalize the creation of the PSALM GAD Focal point system.

Employee wellness continues to be given attention. An annual physical and medical examination for all PSALM officers and employees totaling two hundred forty-eight (248) personnel, including contractual personnel, was held on 22 – 26 November 2010. Vaccination activities and fitness program were undertaken and various fora on health concerns were conducted.

Strong logistic support was provided to the different departments within PSALM through the development and/or implementation of various Information and communications technology programs, systems and capability building activities. Key activities and programs relate to the development/upgrade of in-house information systems; development of the CY 2010-2012 Information Systems Strategic Plan; Information Technology Risk Management Plan (ITRMP); Disaster Recovery Plan (DRP); and implementation of ISTD learning programs and knowledge transfer.

29. CONTINGENCIES

A total of P1.519 billion of account balances with Land Bank of the Philippines and Philippine National Bank have been garnished representing claims against PSALM/NPC resulting from various civil cases.

Legal Proceedings Involving PSALM

PSALM is involved in various legal and administrative proceedings, including litigation and proceedings related to electricity charges and challenges to certain provisions of the EPIRA. Because of the nature of these proceedings, PSALM cannot predict the ultimate outcomes of these proceedings, some of which may be unfavorable.

On April 23, 2009 and May 7, 2009, respectively, PSALM was impleaded in two separate actions by NPC's employees to enjoin implementation of the Operations and Maintenance Agreement (OMA). The first case, ***G.R. 187359 (NECU and NEW vs. NPC and PSALM)***, seeks to enjoin implementation of the OMA in an effort to collect on a judgment rendered in the employees' favor against NPC for unpaid employment compensation-related claims. The second case, ***G.R. No. 187420 (PGEA-NPC vs. NPC, NPC Board, PSALM and PSALM Board)***, seeks to enjoin the OMA's implementation based on a claim that it violates the EPIRA. PSALM does not expect these cases to have a material adverse effect on its results of operations or financial condition. The two cases were consolidated in the First Division of the Supreme Court in the Resolution dated 9 September 2009 of the Third Division of the Supreme Court. PSALM has filed the Consolidated Comment on these cases in coordination with the Office of the Government Corporate Counsel. Court resolution of these cases is still pending.

The NPC Drivers and Mechanics Association (DAMA) were also successful in obtaining a judgment obligation against NPC under **GR 156208 (DAMA vs NPC)**. The judgment included back wages, wage adjustments, and other benefits accruing from January 31, 2003 to the date of their reinstatement or payment of separation pay. In all, these benefits amount to approximately P37 billion. Although PSALM was not a party to the case, the Supreme Court declared in the Resolution dated December 2, 2009 that the properties acquired by PSALM from NPC “may be used to satisfy our judgment.” PSALM filed a Motion for Reconsideration, which still awaits resolution.

There were cases that have been adversely decided against NPC, the settlement of which NPC negotiated with the claimants. NPC requested PSALM’s financial assistance for the final settlement of these cases. As of December 2010, the PSALM Board approved the settlement of the Marubeni claim against NPC out of the withdrawable balances of certain restricted/garnished cash accounts, which are part of the assets held in trust by NPC under the OMA.

Real Property Taxes

There were claims against PSALM/NPC resulting from the assessment of real property taxes by local government units on IPPs in prior years, which NPC did not pay nor recognize in their books, in view of their tax-exempt privilege as a government corporation engaged in power generation. The Supreme Court has decided, however, that the tax-exempt privilege of NPC as a government corporation does not transfer to the IPPs as private entities. However, under their contracts with the IPPs, NPC has assumed the obligation to pay taxes. The IPPs are now pressing PSALM/NPC as present/former owners for resolution of these claims. As of December 2010, the estimated aggregate amount due to LGUs as real property taxes amount to P30.9 billion.

While the liability is estimable and material in amount, the manner of its resolution and the final amount to be settled cannot be ascertained at this time and so is the likelihood of a material adverse effect on PSALM’s finances.

30. OTHER SUBSEQUENT EVENTS

To address the issue of the guarantee ceiling, PSALM has initiated talks with various banks on the viability of a non-guaranteed transaction. PSALM has forwarded to the DOF for a DOJ opinion various proposed structures for this transaction.

31. AUTHORITY FOR ISSUANCE

These financial statements have been approved for issue by the PSALM Board of Directors on May 18, 2011.