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Report of Independent Auditors

The Stockholders and the Board of Directors
Philippine Long Distance Telephone Company
Ramon Cojuangco Building
Makati Avenue, Makati City, Philippines

We have audited the accompanying consolidated balance sheets of Philippine Long Distance Telephone Company and Subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of income, changes in equity and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the Philippines. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Philippine Long Distance Telephone Company and Subsidiaries as of December 31, 2004 and 2003, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with accounting principles generally accepted in the Philippines.

/s/ SyCip Gorres Velayo & Co.
Betty C. Siy-Yap
Partner
CPA Certificate No. 57794
SEC Accreditation No. 0098-A
Tax Identification No. 102-100-627
PTR No. 9404045, January 3, 2005, Makati City

March 1, 2005

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF DECEMBER 31, 2004 AND 2003
AND FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
December 31, 2004 and 2003
(in million pesos, except par value)

	2004	2003*
		(As restated – Note 2)
ASSETS		
Noncurrent Assets		
Property, plant and equipment (Notes 2, 8 and 18)	**194,525**	194,790
Investments in associates – at equity (Notes 2, 9, 10 and 18)	**8**	1,180
Investments-available-for-sale (Notes 2 and 25)	**104**	117
Investment properties (Notes 2 and 11)	**743**	761
Goodwill and intangible assets (Notes 2, 3, 10 and 12)	**3,864**	372
Deferred income tax assets (Notes 2 and 6)	**12,738**	10,761
Derivative assets (Notes 2 and 25)	**4,116**	1,360
Notes receivable (Notes 2, 13 and 25)	**286**	–
Prepayments (Note 18)	**997**	1,022
Other noncurrent assets (Note 2)	**1,237**	1,148
Total Noncurrent Assets	**218,618**	211,511
Current Assets		
Cash and cash equivalents (Notes 2, 14 and 25)	**27,321**	19,372
Short-term investments (Notes 2 and 25)	**3,873**	1,662
Trade and other receivables (Notes 2, 15 and 25)	**10,404**	16,908
Inventories and supplies (Notes 2 and 16)	**2,140**	2,676
Derivative assets (Notes 2 and 25)	**335**	262
Prepayments (Note 18)	**1,271**	2,699
Other current assets (Notes 2 and 21)	**1,511**	557
Total Current Assets	**46,855**	44,136
	265,473	255,647

	2004	2003*
EQUITY AND LIABILITIES		
Equity (Notes 2, 7 and 17)		
Preferred stock, Php10 par value, authorized 822,500,000 shares; issued and outstanding 449,682,057 shares as of December 31, 2004 and 450,492,426 shares as of December 31, 2003	**4,497**	4,505
Common stock, Php5 par value, authorized 234,000,000 shares; issued and outstanding 170,213,722 shares as of December 31, 2004 and 169,476,120 shares as of December 31, 2003	**851**	847
Stock options issued (Note 22)	**181**	286
Equity portion of convertible preferred stock (Note 18)	**1,459**	1,536
Capital in excess of par value	**50,528**	49,690
Deficit (Note 7)	**(10,220)**	(36,735)
Cumulative translation adjustments	**362**	549
Total Equity Attributable to Equity Holders	**47,658**	20,678
Minority interest	**857**	771
Total Equity	**48,515**	21,449

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (*continued*)
December 31, 2004 and 2003
(in million pesos, except par value)

	2004	2003* (As restated – Note 2)
Noncurrent Liabilities		
Interest-bearing financial liabilities – net of current portion (Notes 2, 8, 18, 23 and 25)	**135,988**	166,110
Deferred income tax liabilities (Notes 2 and 6)	**1,943**	1,934
Derivative liabilities (Notes 2 and 25)	**5,903**	2,591
Provision for onerous contract and assessment – net of current portion (Notes 21, 23 and 24)	**3,951**	3,632
Pension and other benefits (Notes 2 and 22)	**2,908**	3,687
Customers' deposits	**2,174**	2,176
Other noncurrent liabilities (Notes 2, 17 and 19)	**7,159**	5,811
Total Noncurrent Liabilities	**160,026**	185,941
Current Liabilities		
Accounts payable (Notes 2 and 25)	**7,029**	5,192
Accrued expenses and other current liabilities (Notes 2, 20, 25 and 26)	**14,811**	11,819
Unearned revenues (Note 2)	**2,892**	3,106
Derivative liabilities (Notes 2 and 25)	**474**	91
Provision for onerous contracts and assessments (Notes 23 and 24)	**597**	394
Current portion of interest-bearing financial liabilities (Notes 2, 8, 18, 23 and 25)	**28,501**	26,238
Dividends payable (Notes 2, 7, 18 and 25)	**652**	577
Income tax payable (Notes 2 and 6)	**1,976**	840
Total Current Liabilities	**56,932**	48,257
	265,473	255,647

See accompanying Notes to Consolidated Financial Statements.
* *Audited balances as of December 31, 2003 were restated to effect changes in accounting policies as discussed in Note 2.*

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31, 2004, 2003 and 2002
(in million pesos, except per share amounts)

	2004	2003*	2002*
		(As restated – Note 2)	
INCOME (Notes 2 and 4)			
Service revenues	**115,254**	100,604	82,093
Non-service revenues (Note 5)	**6,269**	10,714	12,145
Other income (Note 5)	**4,729**	965	857
	126,252	112,283	95,095
EXPENSES (Notes 2 and 4)			
Depreciation and amortization (Note 8)	**21,405**	23,606	22,082
Financing costs (Note 5)	**19,420**	25,386	21,766
Compensation and benefits (Notes 5 and 22)	**12,025**	14,859	11,026
Cost of sales (Notes 5, 21 and 23)	**11,122**	16,094	17,281
Selling and promotions	**5,708**	4,399	3,647
Maintenance (Note 21)	**5,671**	4,931	3,867
Provisions (Notes 5, 15, 16, 21 and 23)	**4,845**	4,839	4,696
Professional and other service fees (Note 21)	**2,174**	1,765	1,863
Taxes and licenses (Note 24)	**1,997**	1,783	1,085
Rent	**1,907**	2,201	2,651
Insurance and security services (Note 21)	**1,644**	1,528	1,354
Asset impairment (Notes 5, 8 and 9)	**1,412**	5,822	16,713
Other expenses (Notes 5 and 21)	**4,002**	3,394	2,526
	93,332	110,607	110,557
INCOME (LOSS) BEFORE INCOME TAX	**32,920**	1,676	(15,462)
PROVISION FOR (BENEFIT FROM) INCOME TAX (Notes 2 and 6)	**4,948**	(545)	888
NET INCOME (LOSS) FOR THE YEAR	**27,972**	2,221	(16,350)
ATTRIBUTABLE TO:			
Equity holders	**28,044**	2,123	(16,353)
Minority interest	**(72)**	98	3
	27,972	2,221	(16,350)
Earnings Per Common Share (Note 7)			
Basic	**156.22**	3.76	(105.18)
Diluted	**156.22**	3.76	(105.18)

See accompanying Notes to Consolidated Financial Statements.

* *Audited balances as of December 31, 2003 and 2002 were restated to effect changes in accounting policies as discussed in Note 2.*

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
For the Years Ended December 31, 2004, 2003 and 2002
(in million pesos)

	Preferred Stock	Common Stock	Stock Options Issued	Equity Portion of Convertible Preferred Stock	Capital in Excess of Par Value	Retained Earnings (Deficit)	Cumulative Translation Adjustments	Equity Attributable to Equity Holders of PLDT	Minority Interest	Total Equity
Balances at January 1, 2002										
As previously reported	4,242	845	–	–	48,905	32,383	–	86,375	927	87,302
Effect of changes in accounting policies (Note 2)	(113)	–	279	1,547	304	(48,479)	472	(45,990)	(380)	(46,370)
As restated	4,129	845	279	1,547	49,209	(16,096)	472	40,385	547	40,932
Changes in equity:										
Net income (loss) for the year										
As previously reported	–	–	–	–	–	3,003	–	3,003	(43)	2,960
Effect of changes in accounting policies (Note 2)	–	–	–	–	–	(19,356)	–	(19,356)	46	(19,310)
As restated	–	–	–	–	–	(16,353)	–	(16,353)	3	(16,350)
Cash dividends	–	–	–	–	–	(1,443)	–	(1,443)	–	(1,443)
Currency translation differences (Note 25)	–	–	–	–	–	–	29	29	–	29
Issuance of capital stock – net (Note 17)	417	2	–	38	348	–	–	729	–	729
Cancelled option shares (Note 22)	–	–	(7)	–	7	–	–	–	–	–
Cost of share-based payments	–	–	76	–	–	–	–	76	–	76
Partial redemption of Series IV Preferred Stock (Note 17)	(72)	–	–	–	–	–	–	(72)	–	(72)
Minority interest	–	–	–	–	–	–	–	–	(21)	(21)
Balances at December 31, 2002* (As restated – Note 2)	4,474	847	348	1,509	49,564	(33,892)	501	23,351	529	23,880
Balances at January 1, 2003										
As previously reported	4,584	847	–	–	48,953	33,703	–	88,087	849	88,936
Effect of changes in accounting policies (Note 2)	(110)	–	348	1,509	611	(67,595)	501	(64,736)	(320)	(65,056)
	4,474	847	348	1,509	49,564	(33,892)	501	23,351	529	23,880
Effect of changes in accounting policy on provisions and contingencies (Note 2)	–	–	–	–	–	(3,469)	–	(3,469)	–	(3,469)
As restated	4,474	847	348	1,509	49,564	(37,361)	501	19,882	529	20,411
Changes in equity:										
Net income for the year										
As previously reported	–	–	–	–	–	11,182	–	11,182	93	11,275
Effect of changes in accounting policies (Note 2)	–	–	–	–	–	(9,059)	–	(9,059)	5	(9,054)
As restated	–	–	–	–	–	2,123	–	2,123	98	2,221
Cash dividends	–	–		–	–	(1,497)	–	(1,497)	–	(1,497)
Currency translation differences (Note 25)	–	–	–	–	–	–	48	48	–	48
Issuance of capital stock – net (Note 17)	31	–	–	27	74	–	–	132	–	132
Cancelled option shares (Note 22)	–	–	(52)	–	52	–	–	–	–	–
Cost of share-based payments	–	–	(10)	–	–	–		(10)	–	(10)
Minority interest	–	–	–	–	–	–	–	–	144	144
Balances at December 31, 2003* (As restated – Note 2)	4,505	847	286	1,536	49,690	(36,735)	549	20,678	771	21,449
Balances at January 1, 2004										
As previously reported	4,616	847	–	–	49,017	39,665	–	94,145	784	94,929
Effect of changes in accounting policies (Note 2)	(111)	–	286	1,536	673	(76,400)	549	(73,467)	(13)	(73,480)
As restated	4,505	847	286	1,536	49,690	(36,735)	549	20,678	771	21,449
Changes in equity:										
Net income (loss) for the year	–	–	–	–	–	28,044	–	28,044	(72)	27,972
Cash dividends	–	–	–	–	–	(1,529)	–	(1,529)	–	(1,529)
Currency translation differences (Note 25)	–	–	–	–	–	–	17	17	–	17
Net loss on available-for-sale financial assets (Note 25)	–	–	–	–	–	–	(5)	(5)	–	(5)
Net loss on cash flow hedges (Note 25)	–	–	–	–	–	–	(199)	(199)	–	(199)
Issuance of capital stock – net (Note 17)	(8)	2	–	(77)	447	–	–	364	–	364
Exercised shares	–	2	(114)	–	386	–	–	274	–	274
Cancelled option shares (Note 22)	–	–	(5)	–	5	–	–	–	–	–
Cost of share-based payments	–	–	14	–	–	–	–	14	–	14
Minority interest	–	–	–	–	–	–	–	–	158	158
Balances at December 31, 2004	4,497	851	181	1,459	50,528	(10,220)	362	47,658	857	48,515

See accompanying Notes to Consolidated Financial Statements.

* *Audited balances as of December 31, 2003 and 2002 were restated to effect changes in accounting policies as discussed in Note 2.*

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31, 2004, 2003 and 2002
(in million pesos)

	2004	2003*	2002*
		(As restated – Note 2)	
CASH FLOWS FROM OPERATING ACTIVITIES			
Income (loss) before income tax	**32,920**	1,676	(15,462)
Adjustments for:			
Depreciation and amortization	**21,405**	23,606	22,082
Interest on loans and related items – net of capitalized interest	**11,853**	12,121	13,420
Gain on debt exchange and debt restructuring	**(4,419)**	(101)	(189)
Provision for doubtful accounts	**3,949**	4,092	4,136
Accretion on financial liabilities – net	**3,452**	2,667	2,324
Foreign exchange losses – net	**2,684**	9,490	7,744
Asset impairment	**1,412**	5,822	16,713
Interest income	**(942)**	(513)	(237)
Loss on derivative transactions – net	**781**	460	13
Provision for inventory obsolescence	**577**	337	560
Provision for onerous contracts	**319**	410	–
Dividends on preferred stock subject to mandatory redemption	**284**	254	240
Equity in net losses of associates	**74**	79	134
Others	**654**	772	921
Operating income before working capital changes	**75,003**	61,172	52,399
Decrease (increase) in:			
Trade and other receivables	**2,296**	(3,910)	2,807
Inventories and supplies	**7**	1,578	176
Prepayments	**119**	365	(440)
Other current assets	**(873)**	(316)	802
Increase (decrease) in:			
Accounts payable	**1,841**	(3,526)	(3,135)
Accrued expenses and other current liabilities	**1,589**	733	1,709
Unearned revenues	**(213)**	655	197
Pension and other benefits	**(779)**	1,674	476
Cash generated from operations	**78,990**	58,425	54,991
Income taxes paid	**(5,478)**	(2,453)	(353)
Net cash provided by operating activities	**73,512**	55,972	54,638
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to property, plant and equipment	**(20,567)**	(17,132)	(15,561)
Proceeds from disposal of property, plant and equipment	**112**	226	233
Interest paid – capitalized to property, plant and equipment	**(595)**	(887)	(1,343)
Proceeds from disposal of investments in associates	**2**	108	1
Payments for purchase of investments – net of cash acquired	**(1,366)**	(236)	(34)
Purchase of investment properties	**(2)**	(16)	–
Increase in short-term investments	**(2,212)**	(1,662)	–
Investments in notes receivable	**(286)**	–	–
Interest received	**954**	484	229
Decrease (increase) in other noncurrent assets	**21**	(495)	(727)
Net cash used in investing activities	**(23,939)**	(19,610)	(17,202)

PHILIPPINE LONG DISTANCE TELEPHONE COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (*continued*)
For the Years Ended December 31, 2004, 2003 and 2002
(in million pesos)

	2004	2003*	2002*
		(As restated – Note 2)	
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from long-term debt	**12,131**	15,361	32,566
Payments of long-term debt	**(39,548)**	(31,030)	(38,516)
Proceeds from notes payable	**457**	3,135	8,058
Payments of notes payable	**(2,412)**	(1,698)	(13,802)
Payments of obligation under capital lease	**(136)**	(139)	(38)
Interest paid – net of capitalized portion	**(12,310)**	(12,647)	(14,527)
Cash dividends paid	**(1,456)**	(1,349)	(1,341)
Proceeds from issuance of capital stock	**281**	95	464
Increase (decrease) in:			
Accrual of capital expenditures under long-term financing	**839**	1,615	(5,454)
Advance payment under receivable purchase facility	**–**	(369)	2,530
Customers' deposits	**(4)**	(93)	(164)
Other noncurrent liabilities	**601**	(818)	(531)
Redemption of preferred stock	**–**	–	(72)
Net cash used in financing activities	**(41,557)**	(27,937)	(30,827)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	**(69)**	(28)	90
NET INCREASE IN CASH AND CASH EQUIVALENTS	**7,949**	8,397	6,699
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**19,372**	10,975	4,276
CASH AND CASH EQUIVALENTS AT END OF YEAR	**27,321**	19,372	10,975

See accompanying Notes to Consolidated Financial Statements.

* *Audited balances as of December 31, 2003 and 2002 were restated to effect changes in accounting policies as discussed in Note 2.*

1. Corporate Information

The Philippine Long Distance Telephone Company, or PLDT, or Parent Company, was incorporated under the old Corporation Law of the Philippines (Act 1459, as amended) on November 28, 1928, following the merger of four telephone companies under common U.S. ownership. In 1967, effective control of PLDT was sold by General Telephone and Electronics Corporation (a major shareholder since PLDT's incorporation) to a group of Filipino businessmen. In 1981, in furtherance of the then existing policy of the Philippine government to integrate the Philippine telecommunications industry, PLDT purchased substantially all of the assets and liabilities of the Republic Telephone Company.

The common shares of PLDT are listed and traded on the Philippine Stock Exchange, or PSE, and prior to October 19, 1994, were listed and traded on the American Stock Exchange and Pacific Exchange in the United States. On October 19, 1994, an American Depositary Receipts, or ADRs, facility was established pursuant to which Citibank N.A., as depositary, issued ADRs evidencing American Depositary Shares, or ADSs, with each ADS representing one PLDT common share. JP Morgan Chase Bank has been appointed as successor depositary for PLDT's ADRs effective February 10, 2003. The ADSs are listed and traded on the New York Stock Exchange and the Pacific Exchange in the United States.

PLDT's charter, like those of all other Philippine corporations, was initially limited to a period of 50 years but has since been extended twice for 25 years each, the last extension being for an additional 25-year period to 2028. Under its amended charter (Republic Act No. 7082), which became effective on August 24, 1991, PLDT is authorized to provide virtually every type of telecommunications service, both within the Philippines and between the Philippines and other countries.

PLDT operates under the jurisdiction of the Philippine National Telecommunications Commission, or NTC, which jurisdiction extends, among other things, to approving major services offered by PLDT and certain rates charged by PLDT.

The registered office address of PLDT is Ramon Cojuangco Building, Makati Avenue, Makati City, Philippines.

Our consolidated financial statements as of December 31, 2004 and 2003 and for the years ended December 31, 2004, 2003 and 2002 were reviewed by and authorized for issuance by the Board of Directors on March 1, 2005.

2. Summary of Significant Accounting Policies

Basis of Preparation

Our consolidated financial statements have been prepared in conformity with Philippine Generally Accepted Accounting Principles, or Philippine GAAP, under the historical cost convention as modified by the revaluation of derivative financial instruments, available-for-sale financial assets and investment properties that are measured at fair value. The carrying values of recognized assets and liabilities that are hedged are adjusted to record changes in the fair values attributable to the risks that are being hedged.

Our consolidated financial statements are presented in Philippine pesos and all values are rounded to the nearest million except when otherwise indicated.

Changes in Accounting Policies

In recent years, the Philippine Accounting Standards Council, or ASC, has been adopting the IAS issued by the International Accounting Standards Council, or IASC, with no local equivalent standards and has been replacing existing local standards.

The International Accounting Standards Board, or IASB, has assumed from the IASC the responsibility for setting IAS. The standards issued by the IASB are designated as International Financial Reporting Standards, or IFRS. Upon its adoption, the IASB also adopted the IAS issued by the IASC. The IASB carried on improvements in certain IAS in preparation for the full adoption of IFRS effective January 1, 2005.

The ASC has re-named the new standards "Philippine Accounting Standards", or PAS, and "Philippine Financial Reporting Standards", or PFRS, to correspond with the adopted IAS and IFRS of the IASB. ASC standards were previously designated as "Statements of Financial Accounting Standards", or SFAS.

The accounting policies adopted are consistent with those of the previous financial year except that we have adopted the following new accounting standards effective beginning January 1, 2004 and accounting standards intended to be mandatory beginning on or after January 1, 2005.

Philippine Accounting Standards, or PAS/Philippine Financial Reporting Standards, or PFRS, effective January 1, 2004

PAS 12, "Income Taxes". PAS 12 prescribes the accounting treatment for current and noncurrent deferred income taxes. This standard requires the use of the balance sheet liability method in accounting for deferred income taxes. It requires the recognition of a deferred tax liability and, subject to certain conditions, a deferred tax asset, for all temporary differences with certain exceptions. This standard provides for the recognition of a deferred tax asset when it is probable that taxable income will be available against which the deferred tax asset can be used. It also provides for the recognition of a deferred tax liability with respect to asset revaluations and fair value adjustments arising from business combinations. Our adoption of this standard did not have any material effect in our consolidated statements of income and only affected certain classifications of the following accounts in our consolidated balance sheets as at December 31, 2003 and 2002.

	Increase (Decrease)	
	2003	2002
	(in million pesos)	
Noncurrent assets		
Deferred income tax assets	196	12
Current assets		
Deferred income tax assets	(6,523)	(4,439)
Prepayments	1,907	1,262
Noncurrent liabilities		
Deferred income tax liabilities	(4,420)	(3,165)

PAS 17, "Leases". PAS 17 requires the capitalization of finance leases, which transfer substantially all the risks and benefits incidental to ownership of leased item, at the inception of the lease at the fair value of leased property or, if lower, at the present value of the minimum lease payments. PAS 17 also requires that a lease, where the lessor retains substantially all the risks and benefits of ownership of the asset, be classified as operating leases, which should be recognized as an expense in the income statement on a straight-line basis over the lease term. Our adoption of this standard reduced our consolidated net income by Php89 million (Php55 million after tax effect), Php18 million (Php15 million after tax effect) and Php125 million (Php88 million after tax effect) for the years ended December 31, 2004, 2003 and 2002, respectively, and have increased (decreased) the following accounts in our consolidated balance sheets as at December 31, 2003 and 2002.

	Increase (Decrease)	
	2003	2002
	(in million pesos)	
Noncurrent assets		
Property, plant and equipment	83	103
Deferred income tax assets	49	44
Equity	(562)	(547)
Noncurrent liabilities		
Deferred income tax liabilities	(181)	(185)
Other noncurrent liabilities	499	623
Current liabilities		
Accounts payable	124	39
Accrued expenses and other current liabilities	252	217

Philippine Accounting Standards, or PAS/Philippine Financial Reporting Standards, or PFRS, effective January 1, 2005

We have elected to early adopt the following standards which are mandatory for financial years beginning on or after January 1, 2005.

PAS 19, "Employee Benefits". PAS 19 requires the use of the projected unit credit method in measuring retirement benefit expense and a change in the manner of computing benefit expense relating to past service cost and actuarial gains and losses. Past service cost is recognized as an expense on a straight-line basis over the average period until the benefits become vested. On the initial adoption of this standard, the effect of the change in accounting policy includes all actuarial gains and losses that arose in earlier periods even if they fall inside the 10% corridor. In subsequent periods, portion of actuarial gains or losses is recognized as income or expense if the cumulative unrecognized actuarial gains and losses at the end of the previous reporting period exceeded the greater of: (i) 10% of the present value of the defined benefit obligation at that date (before deducting plan assets); and (ii) 10% of the fair value of any planned assets at that date by dividing the excess determined by the expected average remaining working lives of the employees participating in that plan is recognized immediately as income or expense. Our adoption of this standard reduced our consolidated net income by Php28 million (Php19 million after tax effect) for the year ended December 31, 2004 by Php1,548 million (Php1,112 million after tax effect) for the year ended December 31, 2003 and by Php433 million (Php301 million after tax effect) for the year ended December 31, 2002, and have increased (decreased) the following accounts in our consolidated balance sheets as at December 31, 2003 and 2002.

	Increase (Decrease)	
	2003	2002
	(in million pesos)	
Noncurrent assets		
Deferred income tax assets	3	–
Prepayments	(1,183)	–
Current assets		
Prepayments	(642)	(19)
Equity	(3,059)	(1,946)
Noncurrent liabilities		
Deferred income tax liabilities	(1,339)	(906)
Pension and other benefits	2,416	2,833
Current liabilities		
Accrued expenses and other current liabilities	160	–

PAS 21, "The Effects of Changes in Foreign Exchange Rates". PAS 21 requires the recognition of foreign exchange gains and losses in the period they are incurred. Upon the adoption of PAS 21, we adjusted previously recorded undepreciated capitalized foreign exchange losses, net of exchange losses that qualify as borrowing cost and income tax effect, against beginning retained earnings, to the extent that such capitalized amounts do not meet the conditions for capitalization under the new accounting standard, and restated prior years' consolidated financial statements. Further, PAS 21 requires the determination of the functional currency of an entity. Exchange differences from any retranslation are taken directly as a separate component of equity. On disposal of an entity with functional currency other than the Philippine peso, the deferred cumulative amount recognized in equity relating to that particular foreign operation shall be recognized in the consolidated income statement. Our adoption of this standard increased our consolidated net income by Php3,649 million (Php2,477 million after tax effect) for the year ended December 31, 2004, and decreased our consolidated net income by Php875 million (Php596 million after tax effect) for the year ended December 31, 2003 and Php1,520 million (Php946 million after tax effect) for the year ended December 31, 2002, and have increased (decreased) the following accounts in our consolidated balance sheets as at December 31, 2003 and 2002.

	Increase (Decrease)	
	2003	2002
	(in million pesos)	
Noncurrent assets		
Property, plant and equipment	(52,460)	(53,070)
Investments in associates	(343)	(344)
Deferred income tax assets	10,496	8,520
Equity	(37,111)	(36,590)
Noncurrent liabilities		
Deferred income tax liabilities	(5,205)	(8,309)
Other noncurrent liabilities	9	5

PAS 27, "Consolidated and Separate Financial Statements". PAS 27 supersedes SFAS 27/IAS 27, "Consolidated Financial Statements and Accounting for Investments in Subsidiaries". Under the revised PAS 27, the exclusion of a subsidiary from consolidation when there are severe long-term restrictions that significantly impair a subsidiary's ability to transfer funds to the parent company under the superseded standard was removed. Consequently, Pilipino Telephone Corporation, or Piltel, was required to be included in our consolidated financial statements retrospectively. Our adoption of this standard increased our consolidated net income by Php10,275 million for the year ended December 31, 2004 and decreased our consolidated net income by Php3,445 million and Php17,581 million for the years ended December 31, 2003 and 2002, respectively. Presented below is the summarized statements of income of Piltel before PAS 27 application for the years ended December 31, 2003 and 2002:

	2003	2002
	(in million pesos, except per share amounts)	
Statements of Income		
Revenues and other income	4,484	2,968
Expenses	(7,752)	(24,797)
Income tax	(79)	–
Net loss before PAS adjustments	(3,347)	(21,829)
Basic earnings per share	(2.77)	(13.66)

In addition, the consolidation of Piltel has increased (decreased) the following accounts in our consolidated balance sheets as at December 31, 2003 and 2002:

	Increase (Decrease)	
	2003	2002
	(in million pesos)	
Noncurrent assets		
Property, plant and equipment	3,054	4,946
Other noncurrent assets	(531)	373
Current assets		
Cash and cash equivalents	109	98
Trade and other receivables	(920)	(1,393)
Inventories and supplies	251	81
Prepayments	(151)	239
Other current assets	49	2
Equity	(19,446)	(16,424)
Noncurrent liabilities		
Interest-bearing financial liabilities – net of current portion	23,364	21,629
Customers' deposits	(17)	(17)
Other noncurrent liabilities	(3,012)	(2,895)
Current liabilities		
Accounts payable	(2,180)	57
Accrued expenses and other current liabilities	1,903	1,116
Unearned revenues	1,097	423
Current portion of interest-bearing financial liabilities	68	452
Dividends payable	5	5
Income tax payable	79	–

PAS 32, "Financial Instruments: Disclosure and Presentation". PAS 32 covers the disclosure and presentation of all financial instruments. This standard requires more comprehensive disclosures about a company's financial instruments, whether recognized or unrecognized in the financial statements. New disclosure requirements include terms and conditions of financial instruments used, types of risks associated with both recognized and unrecognized financial instruments (market risk, price risk, credit risk, liquidity risk, and cash flow risk), fair value information of both recognized and unrecognized financial assets and financial liabilities, and our financial risk management policies and objectives. This standard also requires financial instruments to be classified as liabilities or equity in accordance with their substance and not their legal form. Consequently, we have designated PLDT's Convertible Preferred Stock Series V, VI and VII as compound instruments consisting of liability and equity components. The total fair value of the Convertible Preferred Stock Series V, VI and VII was determined at issue date, of which the aggregate fair value of the liability component of the Series V, VI and VII Convertible Preferred Stock as of date of issuance is included as a financial liability under *Interest-bearing Financial Liabilities* account in the consolidated balance sheets. The residual amount was assigned as the equity component.

Our adoption of this standard reduced our consolidated net income by Php2,281 million (Php1,574 million after tax effect) for the year ended December 31, 2004, Php2,474 million (Php1,775 million after tax effect) for the year ended December 31, 2003 and Php1,991 million (Php1,353 million after tax effect) for the year ended December 31, 2002, and have increased (decreased) the following accounts in our consolidated balance sheets as at December 31, 2003 and 2002.

	Increase (Decrease)	
	2003	2002
	(in million pesos)	
Equity	(14,481)	(12,811)
Noncurrent liabilities		
Deferred income tax liabilities	1,747	2,448
Interest-bearing financial liabilities	12,734	10,363

PAS 39, "Financial Instruments: Recognition and Measurement". PAS 39 establishes the accounting and reporting standards for recognizing and measuring our financial assets and financial liabilities. This standard requires a financial asset or financial liability to be recognized initially at cost, which is the fair value of the consideration given (in the case of an asset) or received (in the case of a liability). Subsequent to initial recognition, we are to continue to measure financial assets at their fair values, except for loans and receivables and held-to-maturity investments, which are measured at cost or amortized cost using the effective interest rate method. Financial liabilities are subsequently measured at cost or amortized cost, except for liabilities classified as "at fair value through profit and loss" and derivatives, which are measured at fair value.

PAS 39 also covers the accounting for derivative instruments. This standard has expanded the definition of a derivative instrument to include derivatives (derivative-like provisions) embedded in non-derivative contracts. Under this standard, every derivative instrument is recorded in the balance sheet as either an asset or liability measured at its fair value. Derivatives that are not designated and do not qualify as hedges are adjusted to fair value through income. If the derivative is designated and qualifies as a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings, or recognized in equity until the hedged item is recognized in earnings.

Our adoption of this standard increased our consolidated net income by Php2,707 million (Php2,105 million after tax effect) for the year ended December 31, 2004 and decreased our consolidated net income by Php2,843 million (Php2,034 million after tax effect) for the year ended December 31, 2003 and Php1,307 million (Php865 million after tax effect) for the year ended December 31, 2002 and have increased (decreased) the following accounts in our consolidated balance sheets as at December 31, 2003 and 2002.

	Increase (Decrease)	
	2003	2002
	(in million pesos)	
Noncurrent assets		
Derivative assets	1,361	271
Other noncurrent assets	(20)	–
Current assets		
Inventories and supplies	4	–
Derivative assets	235	55
Other current assets	(39)	–
Equity	1,045	3,078

	Increase (Decrease)	
	2003	2002
	(in million pesos)	
Noncurrent liabilities		
Interest-bearing financial liabilities – net of current portion	(2,634)	(4,963)
Deferred income tax liabilities	584	1,394
Derivative liabilities	2,591	750
Current liabilities		
Accounts payable	3	–
Derivative liabilities	(5)	175
Accrued expenses and other current liabilities	(43)	(108)

PAS 40, "Investment Property". PAS 40 prescribes the accounting treatment for investment properties which is defined as land and/or building held to earn rentals or for capital appreciation or both. An investment property is initially recognized at cost. Subsequent to initial recognition, an investment property is either carried at (i) cost, less accumulated depreciation or any accumulated impairment losses, or (ii) fair value, wherein fair value movements are recognized as income or expense. Transfers to or from investment property classification are made only when there is evidence of a change in use.

Our adoption of this standard, where we opted to carry our investment properties at fair value subsequent to initial recognition, decreased our net income by Php17 million (Php12 million after tax effect) for the year ended December 31, 2004 and Php26 million (Php18 million after tax effect) for the year ended December 31, 2003, and Php15 million (Php10 million after tax effect) for the year ended December 31, 2002, and have increased (decreased) the following accounts in our consolidated balance sheets as at December 31, 2003 and 2002.

	Increase (Decrease)	
	2003	2002
	(in million pesos)	
Noncurrent assets		
Property, plant and equipment	(414)	(402)
Investment properties	761	776
Deferred income tax assets	(111)	(120)
Equity	236	254

PFRS 2, "Share-Based Payment". PFRS 2 requires an entity to recognize goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognize a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction. In line with our adoption of PFRS 2, we recognized in our consolidated statements of income the costs of employees' and directors' share options and other share-based incentives by using an option-pricing model, further details of which are given in *Note 22 – Employee Benefits*.

Our adoption of this standard decreased our consolidated net income by Php674 million (Php477 million after tax effect) for the year ended December 31, 2004 and Php76 million (Php76 million after tax effect) for the year ended December 31, 2002, and increased our net income by Php10 million (Php10 million after tax effect) for the year ended December 31, 2003, and have increased (decreased) the following accounts in our consolidated balance sheets as at December 31, 2003 and 2002.

	Increase (Decrease)	
	2003	2002
	(in million pesos)	
Equity		
Stock options issued	286	348
Capital in excess of par value	59	7
Deficit	(345)	(355)

PFRS 3, "Business Combinations", PAS 36, "Impairment of Assets" and PAS, 38 "Intangible Assets". PFRS 3 requires all business combinations within its scope to be accounted for by applying the purchase method. In addition, this standard requires the acquirer to initially measure separately the identifiable assets, liabilities and contingent liabilities at their fair values, at acquisition date, irrespective of the extent of any minority interest.

PFRS 3 also requires goodwill in a business combination to be recognized by an acquirer as an asset from the acquisition date, initially measured as the excess of the cost of the business combination over the acquirer's interest in the net fair value of the acquiree's identifiable assets and liabilities. Further, the amortization of goodwill acquired in a business combination is prohibited; instead, goodwill is to be tested annually, or more frequently, if events or changes in circumstances indicate that the asset might be impaired.

Moreover, the useful lives of intangible assets are assessed at the individual asset level as having either a finite or indefinite life. Where an intangible asset has a finite life, it will be amortized over its useful life. Amortization periods and methods for intangible assets with finite useful lives are reviewed annually or earlier where an indicator of impairment exists. Intangibles assessed as having indefinite useful lives are not amortized, as there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the Group. However, intangibles with indefinite useful lives are reviewed annually to ensure their carrying values do not exceed the recoverable amounts regardless whether an indicator of impairment is present.

Our adoption of this standard decreased our net income by Php156 million (Php107 million after tax effect) for the year ended December 31, 2004 and Php2 million (Php1 million after tax effect) for the year ended December 31, 2003 and have increased (decreased) the following accounts in our consolidated balance sheets as at December 31, 2003.

	Increase (Decrease)
	(in million pesos)
Noncurrent assets	
Goodwill and intangible assets	312
Other noncurrent assets	(172)
Equity	41
Noncurrent liabilities	
Deferred income tax liabilities	99

PFRS 5, "Non-Current Assets Held-for-Sale and Discontinued Operations". Under the superseded SFAS 35/IAS 35, we would have previously recognized a discontinued operation at the earlier of when (a) we enter into a binding agreement; and (b) the board of directors have approved and announced a formal disposal plan. PFRS 5 now requires an operation to be classified as discontinued when the criteria to be classified as held for sale have been met or we have disposed of the operation.

In addition to these standards referred to above, we have adopted the following standards during the year and comparative figures have been amended as required:

- PAS 1 – "Presentation of Financial Statements";
- PAS 2 – "Inventories";
- PAS 8 – "Accounting Policies, Changes in Accounting Estimates and Errors";
- PAS 10 – "Events After the Balance Sheet Date";
- PAS 24 – "Related Party Disclosures";
- PAS 28 – "Investments in Associates";
- PAS 31 – "Interests in Joint Ventures"; and
- PAS 33 – "Earnings Per Share"

Following additional guidelines from PAS 16, "Property, Plant and Equipment", we have recognized the initial settlement of the net present value of legal and constructive obligations associated with the retirement of a tangible long-lived asset that resulted from the acquisition, construction or development and the normal operation of a long-lived asset in the period in which it is incurred. The asset retirement obligations were recognized in the period in which they are incurred if a reasonable estimate of fair values can be made. The related asset retirement costs are capitalized as part of the carrying amount of the corresponding property, plant and equipment which are being depreciated on a straight-line basis over the useful lives of the related assets or the contract periods, whichever is lower.

We are legally required under various lease agreements to dismantle the installations and restore the leased sites to their original state at the end of the lease contract term. Our adoption of this standard reduced our consolidated net income by Php114 million (Php77 million after tax effect), Php107 million (Php73 million after tax effect) and Php41 million (Php28 million after tax effect) for the years ended December 31, 2004, 2003 and 2002, respectively, and have increased (decreased) the following accounts in our consolidated balance sheets as at December 31, 2003 and 2002.

	Increase (Decrease)	
	2003	2002
	(in million pesos)	
Noncurrent assets		
Property, plant and equipment	183	91
Deferred income tax assets	126	62
Equity	(143)	(70)
Noncurrent liabilities		
Deferred income tax liabilities	58	29
Other noncurrent liabilities	394	194

We will adopt PAS 16, "Property, Plant and Equipment" in 2005, which requires us to determine the depreciation charge separately for each significant part of an item of property, plant and equipment. The impact of this requirement cannot be quantified until a detailed inspection of property, plant and equipment is performed in 2005.

Adoption of the above standards involved changes in accounting policies and we have accordingly restated our comparative consolidated financial statements retroactively in accordance with the transitional provisions in these standards. Reconciliations of the effects of these new standards, as they apply to us, on our equity and net income are set out below.

	Equity			Net income		
				For the Years Ended		
	December 31,			December 31,		
	2003	2002	2001	2003	2002	2001
	(in million pesos, except per share amounts)					
As previously reported	94,929	88,936	87,302	11,182	3,003	2,699
PAS 16 – Property, Plant and Equipment	(143)	(70)	(43)	(73)	(28)	(18)
PAS 17 – Leases	(562)	(547)	(458)	(15)	(88)	(90)
PAS 19 – Employee Benefits	(3,059)	(1,946)	(1,645)	(1,112)	(301)	(179)
PAS 21 – The Effects of Changes in Foreign Exchange Rates	(37,111)	(36,590)	(37,592)	(596)	946	8,369
PAS 27 – Consolidated and Separate Financial Statements	(19,446)	(16,424)	952	(3,445)	(17,581)	(8,321)
PAS 32 – Financial Instruments: Disclosure and Presentation	(14,481)	(12,811)	(11,792)	(1,775)	(1,353)	(3,590)
PAS 39 – Financial Instruments: Recognition and Measurement	1,045	3,078	3,943	(2,034)	(865)	3,988
PAS 40 – Investment Property	236	254	265	(18)	(10)	49
PFRS 2 – Share-Based Payment	–	–	–	10	(76)	(119)
PFRS 3 – Business Combinations, PAS 36 – Impairment of Assets and PAS 38 – Intangible Assets	41	–	–	(1)	–	–
As restated	21,449	23,880	40,932	2,123	(16,353)	2,788

	2003	2002	2001
Earnings per common share, as previously reported	55.74	8.03	7.10
Earnings per share impact of restated items:			
PAS 16 – Property, Plant and Equipment	(0.43)	(0.16)	(0.11)
PAS 17 – Leases	(0.09)	(0.52)	(0.54)
PAS 19 – Employee Benefits	(6.57)	(1.78)	(1.06)
PAS 21 – The Effects of Changes in Foreign Exchange Rates	(3.52)	7.06	49.62
PAS 27 – Consolidated and Separate Financial Statements	(20.34)	(103.98)	(49.34)
PAS 32 – Financial Instruments: Disclosure and Presentation	(10.40)	(8.36)	(19.81)
PAS 39 – Financial Instruments: Recognition and Measurement	(10.57)	(5.12)	23.65
PAS 40 – Investment Property	(0.11)	0.10	6.69
PFRS 2 – Share-Based Payment	0.06	(0.45)	(0.71)
PFRS 3 – Business Combinations, PAS 36 – Impairment of Assets and PAS 38 – Intangible Assets	(0.01)	–	–
Earnings per common share, as restated	3.76	(105.18)	15.49

In 2003, we adopted SFAS 37/IAS 37, "Provisions, Contingent Liabilities and Contingent Assets", which became effective in the Philippines for financial statements covering periods beginning on or after January 1, 2003. SFAS 37/IAS 37 requires that provisions be recognized when (i) an enterprise has a present obligation (legal or constructive) as a result of a past event; (ii) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and (iii) a reliable estimate can be made of the amount of the obligation. SFAS 37/IAS 37 also provides that present obligations under onerous contracts are required to be recognized and measured as a provision. The standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceeded the economic benefits expected to be received under it. The unavoidable costs under a contract reflect the least net cost of exiting from the contract.

SFAS 37/IAS 37 prescribes the retroactive adjustment to the opening balance of retained earnings for the period in which the standard is first adopted. As allowed under the transitory provisions, we elected not to adjust the opening balance of retained earnings for the earliest period presented and not to restate comparative information.

We made a reasonable estimate of the amount necessary in the event the obligations stated below, shall be settled and have made the appropriate provisions in our consolidated financial statements as of December 31, 2003:

(i) NTC supervision and regulation fees;
(ii) Local business tax assessments; and
(iii) Air Time Purchase Agreement with ACeS International Limited, or AIL.

The effect of the application of SFAS 37/IAS 37 was a reduction of Php3,469 million in the beginning deficit of 2003.

Basis of Consolidation

Our consolidated financial statements include the financial statements of PLDT and those of the following subsidiaries (collectively, the PLDT Group), which were all incorporated in the Philippines except for PLDT Global Corporation, which was incorporated in the British Virgin Islands.

		Percentage of Ownership		
		December 31,		
Name of Subsidiary/Investee	**Principal Activity**	**2004**	2003	2002
Wireless				
Smart Communications, Inc., or Smart, and subsidiaries	Cellular mobile services	**100.0**	100.0	100.0
Pilipino Telephone Corporation, or Piltel, and subsidiaries	Cellular mobile and telecommunications services	**92.1**	57.6	57.6
Telesat, Inc., or Telesat	Satellite communications services	**94.4**	94.4	94.4
ACeS Philippines Cellular Satellite Corporation, or ACeS Philippines	Satellite phone services	**100**	100	100
Mabuhay Satellite Corporation (formerly Mabuhay Philippines Satellite Corporation), or Mabuhay Satellite	Satellite communications services	**67.0**	67.0	67.0
Fixed Line				
PLDT Clark Telecom, Inc., or Clark Telecom	Telecommunications services	**100.0**	100.0	100.0
Subic Telecommunications Company, Inc., or Subic Telecom	Telecommunications services	**100.0**	100.0	100.0
Smart-NTT Multimedia, Inc., or SNMI	Data and network services	**100.0**	100.0	100.0
PLDT Global Corporation, or PLDT Global, and subsidiaries	Telecommunications services	**100.0**	100.0	100.0
PLDT-Maratel, Inc. (formerly Maranao Telephone Company, Inc.), or Maratel	Telecommunications services	**97.5**	97.5	97.5
Bonifacio Communications Corporation, or BCC	Telecommunications, infrastructure and related value-added services	**75.0**	75.0	37.5
Information and Communications Technology				
ePLDT, Inc., or ePLDT, and subsidiaries (including Vocativ, Inc., see *Note 18 – Interest-bearing Financial Liabilities*)	Information and communications infrastructure for internet-based services, e-commerce, call centers and IT-related services	**100.0**	100.0	100.0

Subsidiaries are consolidated from the date when control is transferred to the PLDT Group and cease to be consolidated from the date when control is transferred out of the PLDT Group.

We prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances. Intercompany balances and transactions, including intercompany profits and unrealized profits and losses, are eliminated.

Minority interests represent the equity interests in Piltel, Telesat, Mabuhay Satellite, Maratel and BCC not held by the PLDT Group.

Changes in Piltel Shareholding

To integrate the PLDT Group's wireless holdings, on July 2, 2004, Smart entered into a Sale and Purchase Agreement with PLDT to acquire the latter's 59.3 million shares of Piltel Series K, Class I Convertible Preferred Stock for Php2,066 million. On July 9, 2004, Smart converted a total of 4.8 million shares of Piltel Series K, Class I Convertible Preferred Stock into 820.3 million shares of Piltel common stock, equivalent to 32.7% of the total outstanding shares of common stock of Piltel after such conversion. Such initial conversion resulted in the dilution of PLDT's direct ownership in Piltel from 57.6% to 30.5%. On December 28, 2004, Smart converted its remaining 54.5 million shares of Piltel Series K, Class I Convertible Preferred Stock into 9,260 million shares of Piltel common stock. After the full conversion, Smart now holds a total of 10,080 million shares of common stock of Piltel, equivalent to 85.6% of the resulting total outstanding shares of common stock after such conversion. In aggregate therefore, ownership of Piltel by PLDT and Smart is 92.1%. Transactions of entities under common control were accounted for at historical cost.

ePLDT investments in ePLDT Ventus, Inc., or Ventus and netGames, Inc., or netGames

In the second half of 2004, ePLDT made investments in Ventus and netGames, which are newly incorporated companies.

Ventus is a wholly owned call center subsidiary of ePLDT which was incorporated and registered with the SEC on October 5, 2004. ePLDT subscribed to 70 million shares at a total par value of Php70 million. Ventus has a 400-seat call center facility located in Iloilo province which is expected to commence full commercial operations in April 2005. Ventus will be expanding in Metro Manila with a 678-seat facility to accommodate current and new client requirements. This facility is expected to be completed by May 2005.

ePLDT owns 63% of netGames, a publisher for Massively Multi-player Online Game in the Philippines. netGames is the Philippine licensee of Khan Online, the country's first full 3D online game. netGames was incorporated on June 21, 2004. netGames is expected to commence full commercial operations in the first quarter of 2005.

Investments in Associates

Investments in associates in which we exercise significant influence and which are neither a subsidiary nor a joint venture of the PLDT Group are accounted for under the equity method of accounting. Under the equity method, our investments in associates are carried in the consolidated balance sheets at cost plus post-acquisition changes in our share in net assets of the investees, less impairment in value, if any. The consolidated statements of income reflect our share of the results of operations of the associate. Where there has been a change recognized directly in the associates' equity, we recognize our share of any changes and disclose this, when applicable in the consolidated statements of changes in equity.

Foreign Currency Translation

The functional and presentation currency of the PLDT Group (except for Mabuhay Satellite) is the Philippine peso. Transactions in foreign currencies are initially recorded in the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the consolidated statements of income except for foreign exchange losses that qualified as borrowing costs during construction period. For income tax purposes, exchange gains or losses are treated as taxable income or deductible expenses in the period such are realized. Non-

monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of initial transaction.

The functional currency of Mabuhay Satellite is United States dollars. As at the reporting date, the assets and liabilities of this subsidiary are translated into the presentation currency of the PLDT Group at the rate of exchange ruling at the balance sheet date and, its income and expenses are translated at the weighted average exchange rate for the year. The exchange differences arising on retranslation are taken directly to a separate component of equity as cumulative translation adjustments. On disposal of this subsidiary, the deferred cumulative amount of translation adjustments recognized in equity relating to this particular subsidiary shall be recognized in the consolidated statements of income.

Property, Plant and Equipment

Property, plant and equipment, except for land, are stated at cost less accumulated depreciation and amortization and any impairment in value. Land is stated at cost less any impairment in value.

The initial cost of property, plant and equipment comprises its purchase price and any costs directly attributable in bringing the asset to its working condition and location for its intended use. Expenditures incurred after the assets have been put into operation, such as repairs and maintenance and overhaul costs, are normally charged to income in the period the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as additional costs of property, plant and equipment. Cost also includes asset retirement obligation, interest on borrowed funds used during the construction period and qualified borrowing costs from foreign exchange losses related to foreign currency-denominated liabilities used to acquire such assets. When assets are sold or retired, their costs and accumulated depreciation, amortization and impairment losses, if any, are eliminated from the accounts and any gain or loss resulting from their disposal is included in the consolidated statement of income of such period.

Depreciation and amortization are calculated on a straight-line basis over the following estimated useful lives of the assets:

	Estimated Useful Lives
Buildings	25 years
Cable and wire facilities	20 – 25 years
Central office equipment	15 – 20 years
Information origination/termination equipment	5 – 15 years
Communications satellite	15 years
Vehicles and other work equipment	3 – 10 years
Furniture	3 – 10 years
Cellular facilities	10 years
Land improvements	10 years

Useful lives, depreciation and amortization method are reviewed periodically to ensure that the periods and method of depreciation and amortization are consistent with the expected pattern of economic benefits from items of property, plant and equipment.

Property under construction is stated at cost. This includes cost of construction, plant and equipment and other direct costs. Property under construction is not depreciated until such time that the relevant assets are completed and put into operational use.

Borrowing Costs

Borrowing costs are generally expensed as incurred. Borrowing costs are capitalized if they are directly attributable to the acquisition, construction or production of a qualifying asset. Capitalization of borrowing costs commences when the activities for use are in progress and expenditures and borrowing costs are being incurred. Borrowing costs are capitalized until the assets are ready for their intended use. If the resulting carrying amount of the asset exceeds its recoverable amount, an impairment loss is recorded. Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds, as well as exchange differences arising from foreign currency borrowings used to finance these projects to the extent that they are regarded as an adjustment to interest cost. Borrowing costs are treated as deductible expenses for income tax reporting purposes in the period they are realized.

Asset Retirement Obligations

The net present value of legal obligations associated with the retirement of an item of property, plant and equipment that resulted from the acquisition, construction or development and the normal operation of property, plant and equipment is recognized in the period in which it is incurred.

Investment Properties

Initially, investment properties are measured at cost including transaction costs. Subsequent to initial recognition investment properties are stated at fair value. Gains or losses arising from changes in the fair values of investment properties are included in the consolidated statements of income in the year in which they arise.

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

Goodwill

Goodwill is initially measured at cost being the excess of the acquisition cost over the fair value of identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Upon adoption of PFRS 3, goodwill is no longer amortized. Goodwill is reviewed for impairment, annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

As at acquisition date, any goodwill acquired is allocated to each of the cash-generating units expected to benefit from the combination's synergies. Impairment is determined by assessing the recoverable amount of the cash-generating unit, to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognized. Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in such circumstance is measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained.

Intangible Assets

Intangible assets acquired separately are capitalized at cost while those acquired arising from business combinations are initially recognized at fair value as at the date of acquisition. Subsequently, intangible assets are measured at cost. The useful lives of intangible assets are now assessed at the individual asset level as having either a finite or indefinite life. Where an intangible asset has a finite life, it is amortized over its useful life. Periods and method of amortization for intangible assets with finite useful lives are reviewed annually or earlier where an indicator of impairment exists. Intangible assets assessed as having indefinite useful lives are not amortized, as there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the Group. However, intangibles with indefinite useful lives are reviewed annually to ensure the carrying value does not exceed the recoverable amount regardless of whether an indicator of impairment is present.

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

Intangible assets created within the business are not capitalized and expenditure is charged against profits in the year in which the expenditure is incurred.

Asset Impairment

Property, plant and equipment, investments, goodwill and other long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognized in the consolidated statements of income. The recoverable amount is the higher of an asset's net selling price or value in use. The net selling price is the amount obtainable from the sale of an asset in an arm's–length transaction while value in use is the present value of estimated future cash flows expected to arise from the continuing use of an asset or from its disposal at the end of its useful life. Recoverable amounts are estimated for individual assets or, if it is not possible, for the cash-generating unit to which the asset belongs. Reversal of impairment losses recognized in prior years is recorded when there is an indication that the impairment losses recognized for the asset no longer exist or have decreased. The reversal is recorded as income. However, the increased carrying amount of an asset due to a reversal of an impairment loss is recognized to the extent it does not exceed the carrying amount that would have been determined had the impairment loss not been recognized for that asset in prior years.

Cash and Cash Equivalents

Cash includes cash on hand and in banks. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less from the date of acquisition and that are subject to an insignificant risk of change in value.

Receivables

Receivables are stated at face value, net of allowance for doubtful accounts.

Allowance for Doubtful Accounts

We estimate the allowance for doubtful accounts related to our trade receivables based on two methods. The amounts calculated using each of these methods are combined to determine the total amount we reserve. First, we evaluate specific accounts where we have information that certain customers are unable to meet their financial obligations. In these cases, we use judgment, based on the best available facts and circumstances, including but not limited to, the length of our relationship with the customer and the customer's current credit status based on third party credit reports and known market factors, to record specific reserves for customers against amounts due to reduce our receivable amounts that we expect to collect. These specific reserves are re-evaluated and adjusted as additional information received impacts the amounts estimated. Second, a provision is established as a certain percentage of age of status of receivables. This percentage is based on a collective assessment of historical collection, write-off, experience and changes in our customer payment terms. Full allowance is provided for receivables from permanently disconnected subscribers and carriers. Such permanent disconnections generally occur within 105 days from due date. Partial allowance is provided for active subscribers and carriers based on the age status of receivables.

Inventories and Supplies

Inventories and supplies which include, among others, cellular phone units, materials, spare parts, terminal units and accessories, are valued at the lower of cost or net realizable value.

Cost is determined using the moving average method. Net realizable value is the current replacement cost.

Financial Assets and Liabilities

Financial assets or financial liabilities are recognized initially at cost, which is the fair value of the consideration given (in the case of an asset) or received (in the case of a liability). Transaction costs are included in the initial measurement of all financial assets and liabilities, except for financial instruments measured at fair value through profit and loss. The fair value of the consideration given or received are determined by reference to the transaction price or other market prices. If such market prices are not reliably determinable, the fair value of the consideration is estimated as the sum of all future cash payments or receipts, discounted using the prevailing market rates of interest for similar instruments with similar maturities.

We recognize a financial asset or a financial liability in our consolidated balance sheets when we become a party to the contractual provisions of the instrument and derecognize a financial asset when we no longer control the contractual rights that comprise the financial instrument, which is normally the case when the instrument is sold, or all the cash flows attributable to the instrument are passed through to an independent third party. A financial liability (or a part of a financial liability) is derecognized when the obligation is extinguished. In the case of a regular way purchase or sale of financial assets, recognition and derecognition, as applicable, are done using settlement date accounting.

After initial recognition, the following financial assets and liabilities are measured at amortized cost using the effective interest rate method: (a) loans and receivables; (b) held-to-maturity investments; (c) investments in unquoted equity securities and derivatives linked thereon; and (d) financial liabilities other than liabilities measured at fair values through profit and loss.

Amortizations of discounts and premiums are taken directly to net profit or loss for the year. Changes in the fair value of financial assets and liabilities measured at fair value of (a) all derivatives (except for those eligible for hedge accounting); (b) other items intended to be actively traded; and (c) any item designated as held "at fair value through profit and loss" at origination, are taken directly to net profit or loss for the year. Changes in the fair value of available-for-sale securities are recognized in equity, except for the foreign exchange fluctuations on available-for-sale debt securities and the interest component which is taken directly to net profit or loss for the year based on the asset's effective yield.

Financial assets and liabilities include financial instruments which may be a primary instrument, such as receivables, payables and equity securities, or a derivative instrument, such as financial options, futures and forwards, interest rate swaps and currency swaps.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Financial instruments that contain both liability and equity elements are classified separately as financial liabilities, financial assets or equity instruments. Interest, dividends, gains and losses relating to a financial instrument or a component that is a financial liability, are reported as expense or income. Distributions to holders of financial instruments classified as equity are charged directly to equity net of any related income tax benefits. Financial instruments are offset when we have a legally enforceable right to offset and we intend to settle either on a net basis or to realize the asset and settle the liability simultaneously.

We use derivative financial instruments such as long-term currency swaps, foreign currency options, interest rate swaps and forward currency contracts to hedge our risks associated with foreign currency and interest rate fluctuations. Such derivative financial instruments are stated at fair value.

Our criteria for a derivative instrument to be classified as a hedge includes: (1) the hedge transaction is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, (2) the effectiveness of the hedge can be reliably measured, (3) there is adequate documentation of the hedging relationships at the inception of the hedge, and (4) for cash flow hedges, the forecast transaction that is subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect profit or loss.

For purposes of hedge accounting, hedges are classified as either fair value hedges where they hedge the exposure to changes in the fair value of a recognized asset or liability and firm commitment; or cash flow hedges where they hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a forecasted transaction.

In relation to fair value hedges which meet the conditions for special hedge accounting, any gain or loss from re-measuring the hedging instrument at fair value is recognized immediately in the consolidated statements of income. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognized in the consolidated statements of income.

In relation to cash flow hedges, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognized directly in equity and the ineffective portion is recognized in net profit or loss. The gains or losses that are accumulated in equity are transferred to the consolidated statement of income in the same period in which the hedged item affects the net profit or loss.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to net profit or loss for the year.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognized in equity is kept in equity until the forecast transaction occurs. If the forecast transaction is no longer expected to occur, any net cumulative gain or loss previously recognized in equity is transferred to net profit or loss for the year.

Provisions

We recognize provisions when we have obligations, legal or constructive, as a result of past events, if it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an additional provision.

Retirement Benefits

We have funded, noncontributory retirement plans, administered by our respective Fund's Trustees, covering permanent employees. Retirement costs are actuarially determined using the projected unit credit of accrued benefit valuation method. This method reflects services rendered by employees to the date of valuation and incorporates assumptions concerning employees' projected salaries. Retirement costs include current service cost plus amortization of past service cost, experience adjustments and changes in actuarial assumptions over the expected average remaining working lives of the covered employees.

Share-Based Payment Transactions

Certain of our employees (including directors) receive remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares ("equity-settled transactions").

Equity-settled transactions

The cost of equity-settled transactions with employees is measured by reference to the fair value of the stock options at the date at which they are granted. Fair value is determined using an option-pricing model, further details of which are given in *Note 22 – Employee Benefits*. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of PLDT ("market conditions").

The cost of equity-settled transactions is recognized, together with a corresponding increase in equity, over the period in which the performance conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("vesting date"). The cumulative expense recognized for equity-settled transactions at each reporting date until the vesting date reflects the extent to which the vesting period has expired and the number of awards that will ultimately vest, in the opinion of the Board of Directors at that date, based on the best available estimate.

No expense is recognized for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity-settled award are modified, an expense, as a minimum, is recognized as if the terms had not been modified. An expense is recognized for any increase in the value of the transactions as a result of the modification, as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expense not yet recognized for the award is recognized immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share, see *Note 7 – Earnings Per Common Share*.

Cash-settled transactions

Our Long-term Incentive Plan, or LTIP, grants share appreciation rights, or SARs, to our eligible key executives and advisors. Under the LTIP, we recognize the services we receive from the eligible key executives and advisors, and our liability to pay for those services, as the eligible key executives and advisors render services during the vesting period. We measure our liability, initially and at each reporting date until settled, at the fair value of the SARs, by applying an option valuation model, taking into account the terms and conditions on which the SARs were granted, and the extent to which the eligible key executives and advisors have rendered service to date. We recognize any changes in fair value at each reporting date until settled, in profit and loss for the period.

Leases

Lease obligations having provisions for bargain purchase options, ownership transfer at the end of the lease term, or minimum lease payments, which approximate the fair market value of the property are capitalized. The related obligations are recognized as liabilities. Finance lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability.

A finance lease gives rise to a depreciation expense for the asset as well as a borrowing cost for each period. Finance charges are charged directly to current operations. The depreciation policy for leased assets is consistent with that for depreciable assets that are owned.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased assets and liabilities over the lease term on the same bases as the lease income. Operating lease payments are recognized as an expense in the consolidated statements of income on a straight-line basis over the lease term. For income tax reporting purposes, expenses that should have been incurred under lease agreement are considered as deductible expenses.

Revenue Recognition

Revenues for services are stated at amounts invoiced to customers and exclude value-added tax. We provide wireless communication services, fixed line communication services, and information and communications technology services. We provide such services to mobile, business, residential and payphone customers. Revenues, which exclude value-added tax, represent the value of fixed consideration that have been received or are receivable. Revenues are recognized when there is evidence of an arrangement, collectibility is reasonably assured and the delivery of the product or

service has occurred.

Subscriptions

We provide telephone and data communication services under prepaid and postpaid payment arrangements. Revenues include fees for installation and activation.

Air time, traffic and value-added services

Prepaid service revenues collected in advance are deferred and recognized based on the earlier of actual usage or upon expiration of the usage period. Interconnection revenues for call termination, call transit, and network usage are recognized in the period the traffic occurs. Revenues related to local, long distance, network-to-network, roaming and international call connection services are recognized when the call is placed or connection is provided, net of amounts payable to other telecommunication carriers for terminating calls in their territories. Revenues related to products and value-added services are recognized upon delivery of the product or service.

Cellular handset and equipment sales

Sales of cellular handsets and communication equipment are recognized upon delivery to the customer.

Income Taxes

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

Deferred income tax liabilities and assets are recognized for all taxable temporary differences. Deferred income tax assets are recognized for all deductible temporary differences, carryforward of unused tax credits from excess minimum corporate income tax and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carryforward of unused tax credits and unused tax losses can be utilized. Deferred income tax, however, is not recognized when it arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

Deferred tax liabilities are not provided on non-taxable temporary differences associated with investments in domestic subsidiaries and associates. With respect to investments in other subsidiaries and associates, deferred tax liabilities are recognized except when the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

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

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

Income tax relating to items recognized directly in equity is recognized in equity and not in the consolidated statements of income.

Earnings Per Common Share

Basic earnings per common share, or EPS, is calculated by dividing the net income or loss for the period attributable to common shareholders (net income or loss adjusted for dividends on all series of preferred shares) by the weighted average number of common shares outstanding during the period, after giving retroactive effect to any stock dividend declarations.

Diluted EPS is calculated in the same manner assuming that, at the beginning of the period or at the time of issuance during the period, all outstanding options are exercised and convertible preferred shares are converted to common shares and appropriate adjustments to net income are effected for the related expenses on preferred shares. Outstanding stock options will have a dilutive effect under the treasury stock method only when the average market price of the underlying common share during the period exceeds the exercise price of the option.

Where the effect of the assumed conversion of the preferred shares and the exercise of all outstanding options have an anti-dilutive effect, basic and diluted EPS are stated at the same amount.

If the required dividends to be declared on each series of convertible preferred shares divided by the number of equivalent common shares, assuming such convertible preferred shares are converted to common shares, would decrease the basic EPS, then such convertible preferred shares would be deemed dilutive. As such, the diluted EPS will be calculated by dividing net income attributable to common shareholders (net income less dividends on the non-dilutive preferred shares) by the weighted average common shares including the common share equivalent arising from dilutive convertible preferred shares.

3. Management's Use of Estimates

Our consolidated financial statements prepared in Philippine GAAP requires management to make estimates and assumptions that affect amounts reported in our consolidated financial statements and related notes. In preparing these consolidated financial statements, we have made our best estimates and judgments of certain amounts, giving due consideration to materiality. We believe the following represent a summary of these significant estimates and judgments and related impact and associated risks in our consolidated financial statements.

Estimating useful lives of property, plant and equipment

We estimate the useful lives of our property, plant and equipment based on the period over which our assets are expected to be available for use. The estimated useful lives of our property, plant and equipment are reviewed periodically and are updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of our assets. In addition, our estimation of the useful lives of our property, plant and equipment is based on our collective assessment of industry practice, internal technical evaluation and experience with similar assets. It is possible, however, that future results of operations could be materially affected by changes in our estimates brought about by changes in factors mentioned above. The amounts and timing of recorded expenses for any period would be affected by changes in these factors and circumstances. A reduction in the estimated useful lives of our property, plant and equipment would increase our recorded operating expenses and decrease our noncurrent assets. Property, plant and equipment amounted to Php194,525 million as at December 31, 2004.

Asset impairment

Philippine GAAP requires that an impairment review be performed when certain impairment indicators are present. In case of goodwill and intangible assets with indefinite life, such assets are subject to yearly impairment test and whenever there is an indication that such asset may be impaired.

Purchase accounting requires extensive use of accounting estimates and judgment to allocate the purchase price to the fair market values of the assets and liabilities purchased, including intangible assets and contingent liabilities. Our business acquisitions have resulted in goodwill, which in the past affected our results of operations for the amount of periodic amortization expense. However, we no longer amortize goodwill under Philippine GAAP effective January 1, 2004. Instead, goodwill is subject to a periodic impairment test.

Determining the fair value of property, plant and equipment, investments and intangible assets, which require the determination of future cash flows expected to be generated from the continued use and ultimate disposition of such assets, requires us to make estimates and assumptions that can materially affect our consolidated financial statements. Future events could cause us to conclude that property, plant and equipment, investments and intangible assets associated with an acquired business is impaired. Any resulting impairment loss could have a material adverse impact on our financial condition and results of operations.

The preparation of the estimated future cash flows involves significant judgment and estimations. While we believe that our assumptions are appropriate and reasonable, significant changes in our assumptions may materially affect our assessment of recoverable values and may lead to future additional impairment charges under Philippine GAAP.

Total intangible assets as of December 31, 2004 and 2003 amounted to Php3,774 million and Php312 million, respectively. Total asset impairment amounted to Php1,412 million in 2004, Php5,822 million in 2003 and Php16,713 million in 2002.

Investment properties

We have adopted the fair value approach in determining the carrying value of our investment properties. While we have opted to rely on independent appraisers to determine the fair value of our investment properties, such fair value was determined based on recent prices of similar properties, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices. The amounts and timing of recorded changes in fair value for any period would differ if we made different judgments and estimates or utilized different basis for determining fair value.

Total investment properties as of December 31, 2004 and 2003 amounted to Php743 million and Php761 million, respectively.

Deferred tax assets

We review the carrying amounts at each balance sheet date and reduce deferred tax assets to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax assets to be utilized. However, there is no assurance that we will generate sufficient taxable profit to allow all or part of our deferred tax assets to be utilized.

Unrecognized deferred tax assets as of December 31, 2004 and 2003 amounted to Php13,824 million and Php18,958 million, respectively.

Financial assets and liabilities

Philippine GAAP requires that we carry certain of our financial assets and liabilities at fair value, which requires extensive use of accounting estimates and judgment. In addition, certain liabilities acquired through debt exchange and restructuring are required to be carried at fair value at the time of the debt exchange and restructuring, see *Note 25 – Financial Assets and Liabilities*. While significant components of fair value measurement were determined using verifiable objective evidence (i.e., foreign exchange rates, interest rates, volatility rates), the amount of changes in fair value would differ if we utilized different valuation methodology. Any changes in fair value of these financial assets and liabilities would affect directly our profit and loss and equity.

Financial assets and liabilities carried at fair value as of December 31, 2004 amounted to Php46,439 million and Php187,724 million, respectively. Total gain on debt exchange in 2004 amounted to Php4,419 million.

Financial asset and liabilities carried at fair value as of December 31, 2003 amounted to Php39,681 million and Php211,589 million, respectively. Total gain on debt restructuring in 2003 amounted to Php101 million.

Estimating allowances for doubtful accounts

We estimate the allowance for doubtful accounts related to our trade receivables based on two methods. The amounts calculated using each of these methods are combined to determine the total amount we reserve. First, we evaluate specific accounts where we have information that certain customers are unable to meet their financial obligations. In these cases, we use judgment, based on the best available

facts and circumstances, including but not limited to, the length of our relationship with the customer and the customer's current credit status based on third party credit reports and known market factors, to record specific reserves for customers against amounts due to reduce our receivable amounts that we expect to collect. These specific reserves are re-evaluated and adjusted as additional information received impacts the amounts estimated. Second, a provision is established as a certain percentage of age of status of receivables. This percentage is based on a collective assessment of historical collection, write-off, experience and changes in our customer payment terms. Full allowance is provided for receivables from permanently disconnected subscribers and carriers. Such permanent disconnections generally occur within 105 days from due date. Partial allowance is provided for active subscribers and carriers based on the age status of receivables.

The amounts and timing of recorded expenses for any period would differ if we made different judgments or utilized different estimates. An increase in our allowance for doubtful accounts would increase our recorded operating expenses and decrease our current assets.

Provision for doubtful accounts amounted to Php3,949 million in 2004, Php4,092 million in 2003 and Php4,136 million in 2002. Trade and other receivables, net of allowance for doubtful accounts, amounted to Php10,404 million and Php16,908 million as of December 31, 2004 and 2003, respectively.

Revenue recognition

Our revenue recognition policies require us to make use of estimates and assumptions that may affect the reported amounts of our revenues and receivables.

Our agreements with domestic and foreign carriers for inbound and outbound traffic subject to settlements require traffic reconciliations before actual settlement is done, which may not be the actual volume of traffic as measured by us. Initial recognition of revenues are based on our observed traffic adjusted by our normal experience adjustments, which historically are not material in our consolidated financial statements. Differences between the amounts initially recognized and actual settlements are taken up in the accounts upon reconciliation. However, there is no assurance that such use of estimates may not result to material adjustments in future periods.

Revenues under a multiple element arrangement specifically applicable to our wireless business were split into separately identifiable components and recognized when the related components were delivered in order to reflect the substance of the transaction. The fair value of components was determined using verifiable objective evidence. Revenue for handset sales has been quantified and identified separately using the residual value method from our cellular service revenue.

Pension and other retirement benefits

The determination of our obligation and cost for pension and other retirement benefits is dependent on our selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions are described in *Note 22 – Employee Benefits* and include among others, discount rates, expected returns on plan assets and rates of compensation increase. In accordance with Philippine GAAP, actual results that differ from our assumptions are accumulated and amortized over future periods and therefore, generally affect our recognized expense and recorded obligation in such future periods. While we believe that our assumptions are reasonable and appropriate, significant differences in our actual experience or significant changes in our assumptions may materially affect our pension and other retirement obligations.

Unrecognized actuarial gain as of December 31, 2004 amounted to Php176 million.

Contingencies

We are currently involved in various legal proceedings. Our estimate of the probable costs for the resolution of these claims has been developed in consultation with outside counsel handling our defense in these matters and is based upon an analysis of potential results. We currently do not believe these proceedings will have a material adverse effect on our consolidated financial position. It is possible, however, that future results of operations could be materially affected by changes in our estimates or in the effectiveness of our strategies relating to these proceedings, see *Note 24 – Provisions and Contingencies.*

Outstanding provisions to cover these contingencies amounted to Php4,548 million as of December 31, 2004.

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4. Segment Information

Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by management in deciding how to allocate resources and in assessing performance. Generally, financial information is required to be reported on the basis that it is used internally for evaluating segment performance and deciding how to allocate resources to segments. We have organized our business into three main segments:

- Wireless — wireless telecommunications services provided through our cellular service providers, Smart and Piltel, and satellite and VSAT operators, namely PLDT's subsidiaries Mabuhay Satellite, ACeS Philippines and Telesat;

- Fixed Line — fixed line telecommunications services primarily provided through PLDT. We also provide fixed line services through PLDT's subsidiaries Clark Telecom, Subic Telecom, Maratel, BCC which together account for approximately 3% of our consolidated fixed lines in service, and PLDT Global; and

- Information and Communications Technology — information and communications infrastructure and services for internet applications, internet protocol-based solutions and multimedia content delivery provided by PLDT's subsidiary, ePLDT, call center services provided by ePLDT's subsidiaries, ePLDT Ventus, Inc., Parlance Systems, Inc. and Vocativ Systems, Inc., internet access services provided by ePLDT's subsidiary, Infocom Technologies, Inc., and e-commerce, call centers and IT-related services provided by other investees of ePLDT, as described in *Note 9 – Investments in Associates*.

The segment assets and liabilities and results of operations of the segments in 2003 and 2002 have been restated to reflect the effects of the change in accounting policies.

The segment assets as of December 31, 2004, 2003 and 2002 and results of operations of our reportable segments for the years ended December 31, 2004, 2003 and 2002 reported under Philippine GAAP are as follows:

	Wireless	Fixed Line	Information and Communications Technology	Total
		(in million pesos)		
As of and for the year ended December 31, 2004				
Revenues				
External revenues	78,850	45,215	2,187	126,252
Service	68,185	45,055	2,014	115,254
Non-service	6,111	–	158	6,269
Other income	4,554	160	15	4,729
Inter-segment revenues	1,207	3,595	228	5,030
Segment revenues	80,057	48,810	2,415	131,282
Result				
Income (loss) before income tax	31,676	1,866	(622)	32,920
Provision for income tax	4,307	569	72	4,948
Net income (loss) for the year	27,369	1,297	(694)	27,972
Assets and liabilities				
Segment assets	88,971	160,153	3,603	252,727
Investments in associates – at equity	(32,962)	32,962	8	8
Total assets	56,009	193,115	3,611	252,735
Segment liabilities	58,534	155,390	1,091	215,015
Other segment information				
Capital expenditures	14,742	5,902	517	21,162
Provisions	417	4,431	(3)	4,845
Depreciation and amortization	10,940	10,125	340	21,405
Asset impairment	430	366	616	1,412
As of and for the year ended December 31, 2003 (As restated – Note 2)				
Revenues				
External revenues	64,814	45,851	1,618	112,283
Service	53,665	45,596	1,343	100,604
Non-service	10,548	–	166	10,714
Other income	601	255	109	965
Inter-segment revenues	966	1,324	275	2,565
Segment revenues	65,780	47,175	1,893	114,848
Result				
Income (loss) before income tax	11,277	(9,140)	(461)	1,676
Provision for (benefit from) income tax	1,652	(2,130)	(67)	(545)
Net income (loss) for the year	9,625	(7,010)	(394)	2,221
Assets and liabilities				
Segment assets	78,391	163,280	2,035	243,706
Investments in associates – at equity	(21,346)	22,077	449	1,180
Total assets	57,045	185,357	2,484	244,886

	Wireless	Fixed Line	Information and Communications Technology	Total
		(in million pesos)		
Segment liabilities	57,011	174,567	686	232,264
Other segment information				
Capital expenditures	11,589	6,377	53	18,019
Provisions	160	4,597	82	4,839
Depreciation and amortization	13,526	9,767	313	23,606
Asset impairment	2,589	2,846	387	5,822
As of and for the year ended December 31, 2002 (As restated – Note 2)				
Revenues				
External revenues	48,010	46,494	591	95,095
Service	35,745	45,746	602	82,093
Non-service	12,095	–	50	12,145
Other income	170	748	(61)	857
Inter-segment revenues	1,628	817	423	2,868
Segment revenues	49,638	47,311	1,014	97,963
Result				
Loss before income tax	4,015	10,793	654	15,462
Provision for (benefit from) income tax	359	530	(1)	888
Net loss for the year	4,374	11,323	653	16,350
Assets and liabilities				
Segment assets	72,189	169,702	2,530	244,421
Investments in associates – at equity	(15,294)	20,169	126	5,001
Total assets	56,895	189,871	2,656	249,422
Segment liabilities	53,145	178,058	929	232,132
Other segment information				
Capital expenditures	7,166	9,085	653	16,904
Provisions	992	3,659	45	4,696
Depreciation and amortization	11,041	10,623	418	22,082
Asset impairment	4,756	11,957	–	16,713

5. Revenues and Expenses

Non-service Revenues

	2004	2003	2002
		(As restated – Note 2)	
		(in million pesos)	
Sale of handsets and SIM-pack	**6,111**	10,548	12,095
Point of product sales	**158**	166	50
	6,269	10,714	12,145

Other Income

	2004	2003	2002
		(As restated – Note 2)	
		(in million pesos)	
Gain on debt exchange and debt restructuring transactions (Note 18)	**4,419**	101	189
Miscellaneous income	**310**	864	668
	4,729	965	857

Financing Costs

	2004	2003	2002
		(As restated – Note 2)	
		(in million pesos)	
Interest on loans and related items	**12,448**	13,008	14,763
Accretion on financial liabilities – net (Notes 2, 18 and 25)	**3,452**	2,667	2,324
Foreign exchange losses – net (Notes 18 and 26)	**2,699**	9,358	5,970
Hedge costs (Note 25)	**1,011**	1,054	315
Loss (gain) on derivative transactions – net (Notes 2 and 25)	**991**	525	(547)
Dividends on preferred stock subject to mandatory redemption (Note 17)	**284**	254	240
Financing charges (Note 7)	**146**	263	243
Interest income	**(942)**	(513)	(237)
Capitalized interest (Notes 2 and 8)	**(595)**	(887)	(1,343)
Capitalized foreign exchange gains (losses) (Notes 2 and 8)	**(74)**	(345)	38
	19,420	25,386	21,766

Compensation and Benefits

	2004	2003	2002
		(As restated – Note 2)	
		(in million pesos)	
Salaries and benefits	**10,139**	11,899	9,704
Incentive plans (Note 22)	**660**	15	–
Manpower rightsizing program, or MRP	**566**	1,890	324
Pension and other benefits (Note 22)	**660**	1,055	998
	12,025	14,859	11,026

Over the past years, PLDT has been implementing MRP in line with its continuing effort to reduce the cost base of the fixed line business. The MRP cost charged to operations for the years ended December 31, 2004, 2003 and 2002 amounted to Php566 million, Php1,890 million, including a loss on settlement of Php442 million, and Php324 million, primarily representing charges relating to 745, 1,862 and 374 PLDT employees affected by the program, respectively; unrecognized past service costs, which are normally amortized over the estimated remaining average working lives of employees, in respect of employees who availed of the MRP are recognized as loss on settlement. The decision to implement the MRP was anchored on the challenges being faced by the fixed line business as significant changes in technology, increasing competition, and shifting market preferences to cellular use have reshaped the future of the fixed line business. The MRP was implemented under the New Labor Code and is in compliance with all other relevant labor laws and regulations.

Cost of Sales

	2004	2003	2002
		(As restated – Note 2)	
		(in million pesos)	
Cost of cellular handsets sold	**10,839**	15,887	17,231
Cost of satellite airtime (Notes 21 and 23)	**283**	207	50
	11,122	16,094	17,281

Provisions

	2004	2003	2002
		(As restated – Note 2)	
		(in million pesos)	
Doubtful accounts (Note 15)	**3,949**	4,092	4,136
Inventory obsolescence (Note 16)	**577**	337	560
Onerous contracts (Notes 21 and 23)	**319**	410	–
	4,845	4,839	4,696

Asset Impairment

	2004	2003	2002
		(As restated – Note 2)	
		(in million pesos)	
Investments in associates (Notes 8 and 9)	**1,047**	1,615	20
Property, plant and equipment (Note 8)	**365**	2,799	16,693
Other assets	**–**	1,408	–
	1,412	5,822	16,713

Other Expenses

	2004	2003	2002
		(As restated – Note 2)	
		(in million pesos)	
Operating expenses	**3,425**	2,330	2,389
Equity in net losses of associates	**74**	79	134
Others	**503**	985	3
	4,002	3,394	2,526

6. Income Taxes

The net components of deferred income tax recognized in the consolidated balance sheets are as follows:

	2004	2003
		(As restated – Note 2)
	(in million pesos)	
Net assets	**12,738**	10,671
Net liabilities	**(1,943)**	(1,934)

The components of net deferred tax assets and liabilities are as follows:

	2004	2003
		(As restated – Note 2)
	(in million pesos)	
Net assets		
Unrealized foreign exchange losses	**10,011**	12,520
Interest charges capitalized	**(4,558)**	(4,766)
Allowance for doubtful accounts	**4,068**	2,959
Unearned revenues	**1,939**	147
Derivative instruments	**1,798**	1,331
Foreign exchange differential capitalized	**(1,520)**	(1,642)
Unamortized past service cost	**1,130**	1,146
Preferred stock subject to mandatory redemption	**(1,042)**	(1,748)
Pension and other benefits	**761**	859
Taxes and duties capitalized	**(582)**	(646)
Investment properties	**(106)**	(111)
Provisions for unrealized assets	**453**	451
Allowance for inventory losses	**190**	76
Others	**196**	185
	12,738	10,761
Net liabilities		
Derivative instruments	**(2,938)**	(1,838)
NOLCO	**1,063**	–
Allowance for doubtful accounts	**798**	565
Unearned revenues	**673**	388
Foreign exchange differential capitalized	**(644)**	(756)
Interest charges capitalized	**(485)**	(555)
Unrealized foreign exchange losses	**432**	580
Allowance for inventory losses	**203**	189
Provisions for unrealizable assets	**(1,217)**	(86)
Others	**172**	(421)
	(1,943)	(1,934)

Provision for (benefit from) income tax consists of:

	2004	2003	2002
		(As restated – Note 2)	
		(in million pesos)	
Current	**7,355**	1,706	728
Deferred	**(2,407)**	(2,251)	160
	4,948	(545)	888

The reconciliation between the provision for (benefit from) income tax at the applicable statutory tax rates and the actual provision for (benefit from) income tax follows:

	2004	2003	2002
		(As restated – Note 2)	
		(in million pesos)	
Provision at statutory tax rate	**10,534**	536	(4,948)
Tax effects of:			
Income not subject to tax	**(2,213)**	(6,638)	(2,918)
Income subject to final tax	**(201)**	(243)	(130)
Income subject to lower tax rate	**58**	(49)	(119)
Non–deductible expenses	**1,231**	1,431	919
Equity share in net losses of investees including provision for decline in value of investments in associates	**24**	542	43
Write-off (reversal) of deferred income tax assets	**(4,485)**	3,879	8,041
Others	**–**	(3)	–
Actual provision for (benefit from) income tax	**4,948**	(545)	888

Mabuhay Satellite and Subic Telecom are registered as Subic Bay Freeport Enterprises while Clark Telecom is registered as a Clark Special Economic Zone Enterprise under R.A. No. 7227, otherwise known as the Bases Conversion and Development Act of 1992, or the Act. As registrants, Mabuhay Satellite, Subic Telecom and Clark Telecom are entitled to all the rights, privileges and benefits established thereunder including tax and duty-free importation of capital equipment and special income tax rate of 5% of gross income, as defined in the Act.

On December 22, 2000, the Philippine Board of Investments, or BOI, approved ePLDT's registration as a new information technology service firm in the field of services related to its internet data center on a pioneer status. As such, ePLDT enjoys, among other incentives, a six-year income tax holiday from January 2001.

On May 3, 2001, the BOI awarded Smart pioneer status for its expansion projects entitling it to a three-year income tax holiday which expired in May 2004. The tax incentive was availed on the basis of incremental income generated from said expansion project. In addition, on July 12, 2001, the BOI awarded Smart pioneer status for its payment infrastructure projects entitling it to enjoy a six-year income tax holiday. In this case, the tax incentive is availed for the entire taxable income of the project.

In 2004 and 2003, tax incentives availed amounted to Php2,208 million and Php6,425 million, respectively.

Smart's deferred income tax assets and liabilities as of December 31, 2004 have been recorded to the extent that such deferred tax assets are expected to be utilized against sufficient future taxable profit.

Certain deferred income tax assets have not been recognized as it is not probable that taxable profits will be sufficient against which they can be utilized. The components of deductible temporary differences for which no deferred tax asset is recognized in the consolidated balance sheets are as follows:

	2004	2003
		(As restated – Note 2)
	(in million pesos)	
Asset impairment	**10,090**	11,384
Unrealized foreign exchange losses	**1,938**	1,792
Allowance for doubtful accounts	**746**	733
Unearned revenues on co-location fees	**470**	251
Minimum corporate income tax, or MCIT	**305**	79
NOLCO	**29**	4,317
Provision for other assets	**133**	5
Unearned revenues on sale of prepaid cards	**73**	351
Others	**40**	46
	13,824	18,958

Our consolidated unutilized NOLCO as at December 31, 2004 is detailed as follows:

Year Incurred	**Year Expiring**	**(in million pesos)**
2002	2005	3,329
2003	2006	4
2004	2007	80
		3,413
Tax benefit at 32%		1,092
Unrecognized deferred income tax assets as at December 31, 2004		(29)
		1,063

7. Earnings Per Common Share

The following table presents information necessary to calculate the earnings per common share:

	2004	2003	2002
		(As restated – Note 2)	
	(in million pesos)		
Net income (loss)	**28,044**	2,123	(16,353)
Less dividends on preferred shares	**1,529**	1,486	1,433
Net income applicable to common shares	**26,515**	637	(17,786)
	(In Thousands, Except Per Share Amounts)		
Outstanding common shares at beginning of year	**169,476**	169,361	168,895
Effect of issuance of common shares during the year	**252**	52	200
Weighted average number of common shares	**169,728**	169,413	169,095
Earnings per common share	**Php156.22**	Php3.76	(Php105.18)

The computations of diluted earnings per share were anti-dilutive for the years ended December 31, 2004, 2003 and 2002; therefore, the amounts reported for basic and diluted earnings per share were the same.

Dividends Declared

	Date			Amount	
Class	**Approved**	**Record**	**Payable**	**Per Share**	**Total**
					(in million pesos)
Preferred Shares Subject to Mandatory Redemption					
Series V	February 19, 2004	March 17, 2004	April 15, 2004	Php4.675	12
	June 8, 2004	June 25, 2004	July 15, 2004	4.675	12
	August 3, 2004	September 2, 2004	October 15, 2004	4.675	12
	December 1, 2004	December 20, 2004	January 15, 2005	4.675	10
Series VI	February 19, 2004	March 17, 2004	April 15, 2004	US$0.09925	26
	June 8, 2004	June 25, 2004	July 15, 2004	0.09925	27
	August 3, 2004	September 2, 2004	October 15, 2004	0.09925	27
	December 1, 2004	December 20, 2004	January 15, 2005	0.09925	26
Series VII	February 19, 2004	March 17, 2004	April 15, 2004	JP¥10.179725	20
	June 8, 2004	June 25, 2004	July 15, 2004	10.179725	20
	August 3, 2004	September 2, 2004	October 15, 2004	10.179725	20
	December 1, 2004	December 20, 2004	January 15, 2005	10.179725	21
Charged to income					233
10% Cumulative Convertible Preferred Stocks					
Series DD	January 27, 2004	February 12, 2004	February 27, 2004	Php1.00	2
Series CC	January 27, 2004	February 25, 2004	March 31, 2004	1.00	17
Series A, I, R, W, AA and BB	June 29, 2004	July 28, 2004	August 31, 2004	1.00	130
Series B, F, Q, V and Z	August 3, 2004	September 1, 2004	September 30, 2004	1.00	91
Series E, K, O and U	October 10, 2004	October 19, 2004	October 29, 2004	1.00	45
Series C, D, J, T and X	October 10, 2004	October 27, 2004	November 29, 2004	1.00	58
Series G, N, P and S	November 10, 2004	December 1, 2004	December 29, 2004	1.00	27
Series H, L, M and Y	December 9, 2004	December 29, 2004	January 31, 2005	1.00	40
					410
Convertible Preferred Stocks					
Series III	February 19, 2004	March 17, 2004	April 15, 2004	US$1.029412	268
	June 8, 2004	June 25, 2004	July 15, 2004	1.029412	267
	August 3, 2004	September 2, 2004	October 15, 2004	1.029412	268
	December 1, 2004	December 19, 2004	January 15, 2005	1.029412	268
					1,071
Cumulative Non-Convertible Redeemable Preferred Stock					
Series IV*	January 27, 2004	February 17, 2004	March 15, 2004		12
	May 4, 2004	May 26, 2004	June 15, 2004		12
	August 3, 2004	August 25, 2004	September 15, 2004		12
	November 11, 2004	November 25, 2004	December 15, 2004		12
Total					48
Charged to retained earnings					1,529

* Dividends are declared based on total amounts, not per share amounts.

Proposed Dividend Declaration

Class	Date			Amount	
	Approved	Record	Payable	Per Share	Total
					(in million pesos)
10% Cumulative Convertible Preferred Stock – Series DD	January 25, 2005	February 8, 2005	February 28, 2005	Php1.00	3
Common Stock	March 1, 2005	March 31, 2005	May 12, 2005	Php14.00	2,380

Retained earnings available for cash dividends amounted to Php10,126 million as of December 31, 2004. Reconciliation of consolidated deficit to Parent Company retained earnings is shown below:

	(in million pesos)
Deficit in the consolidated financial statements	(10,221)
Adjustments relating to:	
PAS 27 – Consolidated and Separate Financial Statements	20,269
PAS 36 – Impairment of Assets	(2,025)
PAS 40 – Investment Property	2,103
Retained earnings in the separate financial statements of the Parent Company	10,126

8. Property, Plant and Equipment

This account consists of:

	Cable and wire facilities	Central office equipment	Cellular facilities	Buildings	Vehicles, furniture, and other work equipment	Communications satellite	Information origination/ termination equipment	Land and land improvements	Property under construction	Total
					(in million pesos)					
At December 31, 2003 (As restated – Note 2)										
Cost	96,087	73,532	57,617	18,680	24,303	15,496	5,685	2,508	12,954	306,862
Accumulated depreciation, amortization and impairment	(25,175)	(31,097)	(25,669)	(4,237)	(14,220)	(9,079)	(2,246)	(270)	(79)	(112,072)
Net book value	70,912	42,435	31,948	14,443	10,083	6,417	3,439	2,238	12,875	194,790
Year Ended December 31, 2004										
Net book value - beginning	70,912	42,435	31,948	14,443	10,083	6,417	3,439	2,238	12,875	194,790
Additions/Transfers – net	7,277	2,127	9,516	596	4,760	1,127	1,024	58	(2,966)	23,519
Disposals/Retirement	(134)	(547)	(1,131)	(43)	(67)	–	(43)	(39)	(10)	(2,014)
Impairment losses	(127)	(220)	–	–	(6)	–	–	–	(12)	(365)
Depreciation and amortization	(5,061)	(3,804)	(7,321)	(824)	(3,155)	(742)	(463)	(35)	–	(21,405)
Net book value – ending	72,867	39,991	33,012	14,172	11,615	6,802	3,957	2,222	9,887	194,525
At December 31, 2004										
Cost	102,958	76,117	64,092	19,083	28,474	15,709	6,108	2,563	9,972	325,076
Accumulated depreciation, amortization and impairment	(30,091)	(36,126)	(31,080)	(4,911)	(16,859)	(8,907)	(2,151)	(341)	(85)	(130,551)
Net book value	72,867	39,991	33,012	14,172	11,615	6,802	3,957	2,222	9,887	194,525

Substantially all our telecommunications equipment is purchased from outside the Philippines. A significant source of financing for such purchases are foreign loans requiring repayment in currencies other than Philippine pesos, principally in U.S. dollars (see *Note 18 – Interest-bearing Financial Liabilities*). Interest, using an average capitalization rate of 7%, and net foreign exchange losses capitalized to property, plant and equipment qualified as borrowing costs for the years ended December 31, 2004, 2003 and 2002 were as follows:

	2004	2003	2002
		(in million pesos)	
Interest	**595**	887	1,343
Foreign exchange losses (gains)	**74**	345	(38)

As of December 31, 2004, 2003 and 2002, the undepreciated capitalized net foreign exchange losses qualified as borrowing costs amounted to Php5,528 million, Php6,105 million and Php6,406 million, respectively, on a consolidated basis.

In 2004 and 2003, additional depreciation and amortization charges of Php2,297 million and Php5,251 million, respectively, were recognized due to a change in the estimated useful lives of certain of Smart's network assets owing to continuing network upgrade and expansion.

Asset impairment and retirements recognized in 2004, 2003 and 2002 amounted to Php366 million, Php2,799 million and Php16,693 million, respectively.

In 2004, certain assets with net book values aggregating Php366 million were retired. These assets relate primarily to certain international facility equipment of PLDT Global and Subic Telecom in relation to our strategic direction to functionally integrate our international fixed line business.

In 2003, asset impairment charges and retirements of Php2,799 million mainly consisted of Php974 million asset impairment charges of ACeS Philippines and Php1,438 million impairment charges of Piltel and asset retirements amounting to Php387 million by ePLDT. In June 2003, ACeS Philippines recognized an impairment provision of Php974 million in respect of certain ground equipment in relation to the business of ACeS International Limited, or AIL, after having determined certain factors which raised substantial doubt about AIL's ability to continue as a going concern. See *Note 9 – Investments in Associates* for further discussion. Piltel carried out an impairment review on its E.O. 109 fixed wireline network assets (postpaid service) in December 2003. This resulted in an asset impairment charge of Php1,438 million based on the forecasted discounted cash flows from continued use of these assets. The cash flows were discounted at a nominal rate of 8% on a pre-tax basis. In 2003, ePLDT retired certain assets with net book values aggregating Php387 million primarily resulting from the abandonment of a reloadable chip-based cash card project and a change in software platform and selected applications.

In 2002, asset impairment and write-off charges of Php16,713 million were recognized for E.O. 109 and AMPS/CDMA assets of Piltel. Earlier in December 2002, Piltel recognized impairment losses in respect of its AMPS/CDMA and E.O. 109, assets valued at Php4,737 million and Php4,218 million, respectively. For the AMPS/CDMA assets, the impairment resulted from Piltel's decision to deactivate all its AMPS/CDMA cell sites as the revenues generated from its AMPS/CDMA postpaid and prepaid services could no longer support the cost of operating the network. Piltel's revenues from its AMPS/CDMA postpaid and prepaid services declined considerably in 2002 with the sustained success of Piltel's and other cellular operators' prepaid service. The E.O. 109 assets written-off brought down the net book value of these assets to their recoverable value, which was estimated using the net present value of future cash flows from the E.O. 109 postpaid service. Cash flows from the E.O. 109 prepaid or limited mobility service were no longer considered in computing the recoverable value of the E.O. 109 assets as Piltel had terminated this service in February 2003. Revenues from the E.O. 109 prepaid or limited mobility service, which uses N-AMPS cellular technology, were likewise unfavorably affected by the success of Piltel's and other cellular operators' prepaid service. N-AMPS or E.O. 109-limited mobility service assets of Php7,742 million were also written off in December 2002, with the decommissioning of all the N-AMPS cellsites in February 2003.

Certain property, plant and equipment have been restated to include the following amounts for capitalized leases as of December 31, 2004 and 2003:

	2004			2003		
	Central office equipment	**Vehicles, furniture and other network equipment**	**Total**	Central office equipment	Vehicles, furniture and other network equipment	Total
			(in million pesos)			
Cost	**361**	**863**	**1,224**	361	574	935
Less accumulated depreciation	**269**	**410**	**679**	245	153	398
	92	**453**	**545**	116	421	537

The following table describes all changes to the asset retirement obligation as of December 31, 2004 and 2003, respectively:

	2004	2003
	(in million pesos)	
Asset retirement obligation at beginning of year	**395**	194
Liability recognition in transition	**177**	166
Accretion expense	**66**	35
Asset retirement obligation at end of year	**638**	395

9. Investments in Associates – At Equity

This account consists of:

	2004	2003 (As restated – Note 2)
	(in million pesos)	
ACeS International Limited (Note 8)	**1,614**	1,614
Stradcom International Holdings, Inc.	**616**	629
Mabuhay Space Holdings Limited	**885**	885
BayanTrade Dotcom, Inc.	**97**	97
ePDS, Inc.	**6**	6
Airborne Access Corporation	**2**	2
Digital Paradise, Inc. (Note 10)	**–**	34
Ad Tel, Inc.	**–**	2
	3,220	3,269
Less accumulated impairment	**3,212**	2,089
Total cost and accumulated impairment and equity losses of associates	**8**	1,180

Investment of ACeS Philippines in AIL

As of December 31, 2004, ACeS Philippines has a 20% investment in AIL, a company incorporated under the laws of the island of Bermuda. AIL owns the Garuda I satellite and the related system control equipment in Batam, Indonesia.

In December 1998, AIL and its 95% owned subsidiary, PT Asia Cellular Satellite, entered into an Amended and Restated Credit Agreement, or Amended Agreement, to amend the original Credit Agreement entered into by PT Asia Cellular Satellite and its bank creditors in 1997. Under the Amended Agreement, AIL has, among others, assigned to the banks as collateral all of its tangible properties, including the Garuda Satellite, the system control facilities and system control equipment. On September 30, 2002, PT Asia Cellular Satellite, AIL, as guarantor, P.T. Bank Internasional Indonesia, as security agent, and various banks signed a Rescheduling Agreement, which amended the terms of the Amended and Restated Credit Agreement dated December 29, 1998, moving the principal repayment dates to agreed periods with the final maturity date on January 31, 2012 (see *Note 21 – Related Party Transactions)*.

In 2003, AIL has incurred recurring significant operating losses, negative operating cash flows, and significant levels of debt. The financial condition of AIL was partly due to the National Service Providers', or NSPs, inability to generate the amount of revenues originally expected as the growth in subscriber numbers have been significantly lower than budgeted. These factors raise substantial doubt about AIL's ability to continue as a going concern. On this basis, we recognized an impairment provision in respect of our investment in AIL amounting to Php1,614 million.

Investment in Stradcom International Holdings, Inc,. or SIHI

ePLDT has 22.5% interest in convertible securities of SIHI, the parent company of Stradcom Corporation, which has an existing concession agreement with the Philippine Government for the modernization of the Philippine Land Transportation Office, including the computerization of driver's license issuance, vehicle registration and traffic adjudication systems. SIHI has been incurring losses from the start of operations with recorded capital deficiency since then. On this basis, we recognized an impairment provision in respect of our investment in SIHI of Php616 million in 2004.

Investment of Mabuhay Satellite in Mabuhay Satellite Space Holdings Limited, or MSHL

In 1996, Mabuhay Satellite entered into a Joint Venture Agreement, or JVA, with Space Systems/Loral Inc., or SS/L, to form MSHL for the purpose of providing high-power Ku-Band satellite transmission services using the payload which was added by SS/L aboard Agila II. Under the terms of the JVA, SS/L is required to convey title to the Additional Payload to MSHL in consideration for SS/L's 35% equity interest in MSHL and Mabuhay Satellite is required to pay SS/L US$19 million for a 65% equity interest in MSHL.

In 2000, SS/L filed a Notice of Default and Termination against Mabuhay Satellite arising from the latter's failure to amicably resolve its unpaid obligation to SS/L under the JVA. In 2002, the arbitration panel handed down its decision and provided for payment by Mabuhay Satellite to SS/L of the principal amount of US$10 million plus accrued interest at 9% per annum. On June 30, 2003, Mabuhay Satellite and SS/L concluded a US$15 million settlement agreement under which Mabuhay Satellite leased two transponders on a life-term basis to SS/L and had offset the lease charges due from SS/L and its receivables from Loral Skynet Network Services, Inc. (formerly known as the Loral Cyberstar, Inc.), among others, for a full and final settlement of the arbitration decision. The agreement was subsequently approved by Mabuhay Satellite's creditors in March 2004.

In accordance with the settlement agreement, Mabuhay Satellite and SS/L shall proceed to dissolve the joint venture under a separate agreement, for which each of the parties shall receive title over such number of transponders owned by the joint venture in proportion to their respective interests. On the basis of the joint venture dissolution, we recognized an impairment provision in respect of our investment in MSHL of Php423 million in 2004.

Investment in BayanTrade Dotcom, Inc., or BayanTrade

BayanTrade was incorporated and registered with the SEC on August 8, 2000 to provide: (a) business-to-business electronic purchasing marketplace to link buyers and suppliers of good services over the Internet; (b) electronic catalogue purchasing facilities over the Internet to buyers and suppliers; (c) link-up with similar horizontal markets and vertical markets across the Asia-Pacific Region and the world; and (d) such facilitating services incidental to the business.

Investment in ePDS, Inc., ePDs

On June 30, 2003, ePLDT signed a Joint Venture Agreement with DataPost Pte Ltd. (DataPost), a subsidiary of Singapore Post, and G3 Worldwide ASPAC (Spring), pursuant to which the parties formed ePDS, a bills printing company which will do laser printing and enveloping services for statements, bills and invoices, and other value-added services to companies in the Philippines. ePLDT has a 50% interest in ePDS, while DataPost has a 30% interest. Spring, the largest international mail services provider, owns the remaining 20%. ePDS has an initial paid-up capital of Php11 million.

Investment in Airborne Access Corporation

On August 31, 2003, ePLDT signed a Memorandum of Agreement with Airborne Access to acquire a 20% interest at a purchase price of Php2 million. Airborne Access, a pioneering wireless internet service provider, caters primarily to mobile professionals by delivering wireless internet access to its subsidiaries through more than 44 hotspots throughout Metro Manila.

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10. Business Combinations

Acquisition of Wolfpac Mobile, Inc.

In October 2003, Smart acquired a majority 80%-interest in Wolfpac Mobile, Inc., or Wolfpac, for a total consideration of Php180 million of which Php90 million was paid in 2003 and the balance in April 2004. Prior to the acquisition, Wolfpac (then known as “Wolfpac Communications, Inc.”) was one of Smart’s leading content providers and the only Philippine content provider to have been nominated twice at the annual GSM Congress for successes in application developments. The acquisition provides Smart with the opportunity to have a direct link to the content development community, a key differentiator in wireless communication service. The purchase consideration has been allocated to the assets and liabilities on the basis of fair values at the date of acquisition.

The fair values of the identifiable acquired assets and liabilities of Wolfpac are as follows:

	(in million pesos)
Property, plant and equipment	6
Intangible assets – technology applications	317
Cash and cash equivalents	7
Receivables	1
Prepayments and other current assets	1
	332
Accounts payable	(3)
Deferred income tax liabilities – intangible assets	(101)
Due to related parties	(3)
	(107)
Fair value of net assets	225

Fair value of intangible assets was determined by discounting Wolfpac's cash flows for the next three years from acquisition date at 8% per annum. The net cash outflow on acquisition was Php173 million, representing cash payment of Php180 million and cash acquired from Wolfpac of Php7 million.

Acquisition of Meridian Telekoms, Inc., or Meridian

On September 2, 2004, Smart entered into a Sale and Purchase Agreement to acquire 100% of Meridian Telekoms, Inc., a company primarily engaged in providing wireless broadband and data services to small and medium-scale enterprises in the Philippines, for a total consideration of US$45 million of which payments of US$11 million and US$7 million were made in 2004 and US$4 million in January 2005; the balance of US$23 million is payable on December 31, 2005. The acquisition aims to strengthen Smart's position in the wireless data segment and is in line with Smart's overall strategy of providing the widest range of innovative wireless services.

The purchase consideration has been allocated to the assets and liabilities on the basis of fair values at the date of acquisition.

	(in million pesos)
Property, plant and equipment	219
Intangible asset – franchise	3,638
Cash and cash equivalents	4
Receivables	28
Inventories and supplies	10
Prepayments and other current assets	14
	3,913
Accounts payable	(27)
Deferred income tax liabilities – intangible assets	(1,164)
Due to related parties	(13)
Unearned revenues and other liabilities	(86)
	(1,290)
Fair value of net assets	2,623

Carrying values of current assets and liabilities approximate their realizable values. Property, plant and equipment are stated at replacement cost, net of accumulated depreciation, while fair value of the intangible asset was determined by using comparable market values.

As of December 31, 2004, the net cash outflow on acquisition was Php948 million, representing cash payments of Php1,004 million, cash acquired from Meridian of Php5 million and cost directly related to business combination of Php51 million.

Acquisition in Digital Paradise, Inc.

As of June 24, 2004, ePLDT has a 67.79% equity interest in Digital Paradise, an internet cafe business which owns and operates the Netopia Internet Cafe chain of stores. ePLDT's investment in debt securities of Netopia Computer Technologies, Inc. (Netopia) amounting to Php24 million as of December 31, 2002 was assigned to Digital Paradise in exchange for a 41% equity interest in Digital Paradise in 2003. As of December 31, 2004, Digital Paradise operates 125 Internet cafe chains nationwide.

ePLDT's subscriptions liability to Digital Paradise as of December 31, 2004, amounted to Php106 million, payable in six equal monthly installments until June 2005.

11. Investment Properties

	2004	2003 (As restated – Note 2)
	(in million pesos)	
Beginning balance	**761**	792
Additions (subsequent expenditures)	**13**	–
Net loss from fair value adjustment	**(31)**	(31)
Closing balance as at December 31	**743**	761

Investment properties are stated at fair values, which have been determined based on latest valuations performed by an independent firm of appraisers. The valuation undertaken was based on an open market value, supported by market evidence in which assets could be exchanged between a knowledgeable willing buyer and a knowledgeable willing seller in an arm's-length transaction at the date of valuation, in accordance with international valuation standards.

12. Goodwill and Intangible Assets

This account includes intangible assets – technology application arising from the acquisition of Wolfpac and intangible assets – franchise arising from acquisition of Meridian as discussed in *Note 10 – Business Combinations*.

Movements in the goodwill and intangible assets during the years are as follows:

	2004			2003		
	Goodwill	Intangible assets	Total	Goodwill	Intangible assets	Total
			(in million pesos)			
Cost						
Beginning balance	**498**	**317**	**815**	498	–	498
Additions	**30**	**3,638**	**3,668**	–	317	317
Ending Balance	**528**	**3,955**	**4,483**	498	317	815
Accumulated amortization and impairment						
Beginning balance	**(438)**	**(5)**	**(443)**	(402)	–	(402)
Additions	**–**	**(176)**	**(176)**	(36)	(5)	(41)
Ending Balance	**(438)**	**(181)**	**(619)**	(438)	(5)	(443)
Net balance	**90**	**3,774**	**3,864**	60	312	372

13. Notes Receivable

Investment of ePLDT in Debt Securities of Technology Support Services, Inc. (Formerly First Advance Multi-Media Entertainment Corp., or FAME)

On June 1, 2004, ePLDT and FAME entered an agreement whereby ePLDT would grant a seven-year non-interest bearing loan to FAME amounting to US$3.1 million. At the option of ePLDT, the loan is convertible into 20% of the total outstanding capital stock of FAME at any time during the life of the outstanding loan.

On August 20, 2004, FAME changed its corporate name into Technology Support Services, Inc., or TSSI.

On September 14, 2004, ePLDT entered into a second agreement with TSSI whereby ePLDT would grant another seven-year non-interest bearing loan to TSSI amounting to US$3.1 million. At the option of ePLDT, the loan is convertible into another 20% of the outstanding capital stock of TSSI at any time during the life of the outstanding loan. As of December 31, 2004, total loan of ePLDT to TSSI amounts to US$5.1 million. The remaining balance of the loan of US$1.1 million would be released to TSSI subject to meeting certain conditions.

ePLDT has not yet converted its investment in debt securities to TSSI's shares of stock as of December 31, 2004. TSSI would be the systems integrator for the internet and mobile telephone gaming project.

The fair value of the debt instrument was computed as the present value of estimated future cash flows. The cost of the instrument approximates the fair value computed as of December 31, 2004.

14. Cash and Cash Equivalents

This account consists of:

	2004	2003 (As restated – Note 2)
	(in million pesos)	
Cash on hand and in banks	**4,750**	2,736
Temporary investments	**22,571**	16,636
	27,321	19,372

Cash in banks earns interest at prevailing bank deposit rates. Temporary investments are made for varying periods of up to two months depending on our immediate cash requirements, and earn interest at prevailing short-term deposit rates. Due to the short-term nature of such transactions, the carrying value approximates the fair value of our temporary investments.

15. Trade and Other Receivables

This account consists of receivables from:

	2004	2003 (As restated – Note 2)
	(in million pesos)	
Customers and carriers	**27,280**	30,245
Others	**1,192**	877
	28,472	31,122
Less allowance for doubtful accounts	**18,068**	14,214
	10,404	16,908

Receivables from carriers represent receivables arising from interconnection agreements with other telecommunications carriers. The aforementioned receivable balances are shown net of related payables to the same telecommunications carriers because an established right of offset exists.

On October 10, 2002, PLDT entered into a Receivables Purchase Deed, or RPD, with a foreign financial institution, or the Purchaser, under which PLDT agreed (1) to sell its receivables from certain eligible foreign carriers for an advance payment of US$50 million, of which, US$28 million remains outstanding as of December 31, 2004, and (2) to service, administer and collect the receivables on behalf of the Purchaser. Under the RPD, the Purchaser has no recourse to PLDT should an eligible carrier fail or refuse to settle the assigned/purchased receivables, except when PLDT commits a breach of its representations and warranties under the RPD.

Sale of receivables under the RPD amounted to US$10 million (Php576 million) and US$11 million (Php616 million) for the years ended December 31, 2004 and 2003, respectively. Loss on sale of receivables under the RPD amounted to US$1 million (Php75 million) and US$2 million (Php86 million) for the years ended December 31, 2004 and 2003, respectively.

16. Inventories and Supplies

This account consists of:

	2004	2003 (As restated – Note 2)
	(in million pesos)	
Terminal and cellular phone units:		
At net realizable value	**1,357**	1,112
At cost	**1,895**	1,601
Spare parts and supplies		
At net realizable value	**389**	1,078
At cost	**985**	1,318
Others (At cost)	**394**	486
	2,140	2,676

17. Equity

The movement of PLDT's capital account follows:

	Preferred Stock - Php10 par value					**Common Stock –** Php5 par value	
	Series A to EE	**III**	**IV**				
	NNo. of Shares			**Total Preferred Stock**	**Amount**	**No. of Shares**	**Amount**
				(in million shares and pesos)			
Authorized				823	Php8,230	234	Php1,170
Outstanding							
Balance at January 1, 2002	372	5	36	413	Php4,129	168	Php845
Issuance	37	–	7	44	440	–	–
Conversion	(3)	–	–	(3)	(23)	1	2
Redemption	–	–	(7)	(7)	(72)	–	–
Balance at December 31, 2002 (As restated – Note 2)	406	5	36	447	Php4,474	169	Php847
Balance at January 1, 2003	406	5	36	447	Php4,474	169	Php847
Issuance	5	–	–	5	52	–	–
Conversion	(1)	–	–	(1)	(21)	–	–
Balance at December 31, 2003 (As restated – Note 2)	410	5	36	451	Php4,505	169	Php847
Balance at January 1, 2004	410	5	36	451	Php4,505	169	Php847
Issuance	1	–	–	1	9	–	2
Conversion	(2)	–	–	(2)	(17)	1	2
Balance at December 31, 2004 (As restated – Note 2)	409	5	36	450	Php4,497	170	Php851

Preferred Stock

The preferred stock is non-voting, except as specifically provided by law, and is preferred as to liquidation.

The Series A to EE 10% Cumulative Convertible Preferred Stocks earn cumulative dividends at an annual rate of 10%. After the lapse of one (1) year from the last day of the year of issuance of a particular series of 10% Cumulative Convertible Preferred Stock, any holder of such series may convert all or any of the shares of 10% Cumulative Convertible Preferred Stock held by him into fully paid and non-assessable shares of Common Stock of PLDT, at a conversion price equivalent to 10% below the average of the high and low daily sales price of a share of Common Stock on the PSE, or if there shall have been no such sales on the PSE on any day, the average of the bid and the asked prices of a share of Common Stock of PLDT at the end of such day on such Exchange, in each such case averaged over a period of thirty (30) consecutive trading days prior to the conversion date, but in no case shall the conversion price be less than the price set by the Board of Directors which as of December 31, 2004, was Php5.00 per share. The number of shares of Common Stock issuable at any time upon conversion of one share of SIP Cumulative Convertible Preferred Stock shall be determined by dividing Php10.00 by the then applicable conversion price.

In case the shares of Common Stock at anytime outstanding shall be subdivided into a greater or consolidated into a lesser number of shares, then the minimum conversion price per share of Common Stock shall be proportionately decreased or increased, as the case may be and in the case of a stock dividend, such price shall be proportionately decreased, provided, however, that in every case the minimum conversion price shall not be less than the par value per share of Common Stock. In the event the relevant effective date for any such subdivision or consolidation of shares or stock dividend occurs during the period of thirty (30) trading days preceding the presentation of any shares of 10% Cumulative Convertible Preferred Stock for conversion, a similar adjustment shall be made in the sales prices applicable to the trading days prior to such effective date utilized in calculating the conversion price of the shares presented for conversion.

In case of any other reclassification or change of outstanding shares of Common Stock, or in case of any consolidation or merger of PLDT with or into another corporation, the Board of Directors shall make such provisions, if any, for adjustment of the minimum conversion price and the sales price utilized in calculating the conversion price as the Board of Directors, in it sole discretion, shall deem appropriate.

At PLDT's option, the Series A to EE 10% Cumulative Convertible Preferred Stock are redeemable at par value plus accrued dividends five years after the year of issuance.

On January 27, 2004, the Board of Directors designated 1 million shares of serial preferred stock as Series EE 10% Cumulative Convertible Preferred Stock for issuance throughout 2004.

The Series III Convertible Preferred Stock earns cumulative dividends at an annual rate of US$3.50 a share payable quarterly, free and clear of Philippine withholding taxes. It is convertible into Common Stock at the option of the holder at any time, at the conversion price of US$29.19 per Common Stock (equivalent to a conversion ratio of 1.7129 shares of Common Stock for each share of Series III Convertible Preferred Stock, each share of Series III Convertible Preferred Stock being valued for this purpose at its reference amount of US$50 a share), subject to adjustment in certain events; and are not redeemable. Upon liquidation of PLDT, holders of the Series III Convertible Preferred Stock will be entitled to receive liquidating distributions equivalent to Php11 per share, plus accrued and unpaid

dividends to the date of distribution, subject to the prior rights of creditors.

The Series IV Cumulative Non-Convertible Redeemable Preferred Stock earns cumulative dividends at an annual rate of 13.5% based on the paid-up subscription price. It is redeemable at the option of PLDT at any time one year after subscription and at the actual amount paid for such stock, plus accrued dividends. On February 26, 2002, the Board of Directors called for the payment of a portion of the balance of the subscription price of the Series IV Cumulative Non-Convertible Redeemable Preferred Stock amounting to Php72 million, which was paid on March 5, 2002. On March 22, 2002, PLDT redeemed 60 million shares out of the 360 million subscribed shares of its Series IV Cumulative Non-Convertible Preferred Stock and paid Php72 million, representing the redemption price plus unpaid dividends up to the date of redemption.

The provisions of certain subscription agreements involving preferred stock have an effect on the ability of PLDT to, without written consent, sell certain assets and pay cash dividends unless all dividends for all past quarterly dividend periods have been paid and provision has been made for the currently payable dividends.

18. Interest-bearing Financial Liabilities

This account consists of the following:

	2004	2003
		(As restated – Note 2)
	(in million pesos)	
Long-term Portion of Interest-bearing Financial Liabilities		
Long-term debt	**121,012**	152,646
Obligations under capital lease	**601**	729
Preferred stock subject to mandatory redemption	**14,375**	12,735
	135,988	166,110
Interest-bearing Financial Liabilities Maturing Within One Year		
Notes payable		
Bank loans	**58**	200
Commercial paper	–	1,933
Obligation under capital lease maturing within one year	**425**	295
Long-term debt maturing within one year	**28,018**	23,810
	28,501	26,238

Unamortized debt discount, representing debt issuance costs and any difference between the fair value of consideration given or received on initial recognition, included in following financial liabilities are as follows:

	2004	2003
		(As restated – Note 2)
	(in million pesos)	
Long-term debt	**10,440**	7,904
Obligation under capital lease (Note 8)	**741**	714
Preferred stock subject to mandatory redemption	**6,182**	7,772
Total unamortized debt discount	**17,363**	16,390

The following table describes all changes to unamortized debt discount as of December 31, 2004 and 2003.

	2004	2003
		(As restated – Note 2)
	(in million pesos)	
Unamortized debt discount at beginning of year	**16,390**	17,416
Additions during the year (Note 18)	**7,765**	91
Accretion during the year charged to financing cost (Note 5)	**(3,452)**	(2,667)
Revaluations	**474**	1,595
Settlement during the year (Note 18)	**(3,814)**	(45)
Unamortized debt discount at end of year	**17,363**	16,390

Long-Term Debt

Long-term debt consists of:

Description	Interest Rates	**2004**		2003 (As restated – Note 2)	
		(in millions)			
U.S. Dollars					
Export Credit Agencies-Supported Loans:					
Kreditanstalt für Wiederaufbau, or KfW	5.65% - 8.03% and US$ LIBOR + 0.55% - 2.5%	**US$351**	**Php19,793**	US$398	Php22,099
Finnish Export Credit or Finnvera	6.36% - 7.75% and US$ LIBOR + 1.30% - 1.425%	**159**	**8,964**	242	13,427
Nippon Export and Investment Insurance of Japan, or NEXI	US$ LIBOR +1%	**74**	**4,179**	58	3,218
Japan Bank for International Cooperation, or JBIC/Co-financing Banks	6.56% - 7.95% and US$ LIBOR + 0.65% - 1.55%	**44**	**2,459**	66	3,644
Others	5.83% - 7.89% and US$ LIBOR + 0.15% - 4.30% and CXC's cost + 0.20%	**104**	**5,871**	146	8,116
		US$732	**Php41,266**	US$910	Php50,504
Fixed Rate Notes	7.85% - 11.375%	**1,220**	**68,795**	1,401	77,880
Term Loans:					
Debt Exchange Facility	2.25% and US$ LIBOR + 1%	**155**	**8,721**	–	–
GSM Network Expansion Facilities	4.49% and US$ LIBOR + 3.25%	**125**	**7,046**	30	1,682
Nederlandse Financierings-Maatshappij Voor Ontiwikkelingslanded N.V., or FMO	US$ LIBOR + 1.95% - 2.05%	**51**	**2,862**	75	4,161
Multi-currency Term Loan	US$ LIBOR + 3.65%	**–**	**–**	52	2,872
Others	5.83% and LIBOR + 0.40% - 3.625%	**33**	**1,863**	42	2,364
Restructured Loans	3M US$ LIBOR + 1%	**85**	**4,815**	132	7,310

Description	Interest Rates	2004		2003 (As restated – Note 2)	
		(in millions)			
Satellite Acquisition Loans	US$ LIBOR + 1.75% and 5.6%	**72**	**4,064**	85	4,722
		US$2,473	**Php139,432**	US$2,727	Php151,495
Japanese Yen					
JBIC's Overseas Investment Loan, or OIL	2.125%	**JP¥9,760**	**5,363**	JP¥9,760	5,068
Export Credit Agency-Supported Loan: NEXI Supported Loan	JP¥ LIBOR + 1.70%	**2,205**	**1,212**	–	–
Multicurrency Term Loan	JP¥ LIBOR + 3.85%	–	–	10,566	5,487
Restructured Loans	JP¥ LIBOR + 1%	–	–	13,407	6,963
		JP¥11,965	**6,575**	JP¥33,733	17,518
Philippine Pesos					
Peso Fixed Rate Corporate Notes	14% - 15.816%	–	**1,675**	–	2,173
Term Loans:					
JBIC 4 Program	11.18%	–	**680**	–	1,284
Secured Term Loans	11.6% - 24% and 91-day T-Bill + 4% and 90-day PHIBOR + 3%	–	**305**	–	130
Other Unsecured Term Loans	12.81% - 17.5%	–	–	–	542
Restructured Loans	90-day T-Bill + 1%	–	**363**	–	3,314
		–	**3,023**	–	7,443
			149,030		176,456
Less portion maturing within one year			**28,018**		23,810
Total long-term debt			**Php121,012**		Php152,646

Note: Amounts presented are net of unamortized debt discount and debt issuance cost.

The scheduled maturities of our outstanding consolidated long-term debt at nominal values as of December 31, 2004 are as follows:

	U.S. Dollar Loans		**JP¥ Loans**		**Php Loans**	**Total**
	In U.S. Dollar	**In Php**	**In JP¥**	**In Php**	**In Php**	**In Php**
	(in millions)					
Year						
2005	448	25,282	3,420	1,879	870	28,031
2006	410	23,131	3,418	1,878	852	25,861
2007	487	27,439	3,418	1,879	78	29,396
2008	100	5,583	1,709	939	67	6,589
2009	251	14,137	–	–	56	14,193
2010 and onwards	962	54,186	–	–	1,214	55,400

Export Credit Agencies-Supported Loans

In order to obtain imported components for our network infrastructure in connection with our expansion and service improvement programs, we have obtained loans extended and/or guaranteed by various export credit agencies. These financings account for a significant portion of our indebtedness.

Kreditanstalt für Wiederaufbau, or KfW

KfW, a German state-owned development bank, is PLDT's largest single creditor. As of December 31, 2004, we owed US$351 million aggregate principal amount of debt to KfW, as follows:

- US$262 million provided under various export credit agency-backed facilities, of which US$152 million was in connection with our expansion and service improvement programs and US$110 million in connection with the US$149 million refinancing facility discussed below; and

- US$89 million provided for the 15% downpayment portion and credit facilities without guarantee/insurance cover from the export credit agencies, of which US$30 million was in connection with the US$149 million refinancing facility discussed in the following paragraphs.

On January 25, 2002, PLDT signed two loan agreements with KfW, which provided PLDT with a US$149 million facility to refinance in part the repayment installments under its existing loans from KfW due from January 2002 to December 2004. The facility is composed of a nine-year loan, inclusive of a three-year disbursement period and a two-year grace period during which no principal is payable. It partly enjoys the guarantee of HERMES, the export credit agency of the Federal Republic of Germany. We have drawn US$140 million (Php7,885 million) under this facility as of December 31, 2004. PLDT waived further disbursements under this refinancing facility effective September 1, 2004. Thus, the undrawn portion of US$9 million was cancelled.

Of the amounts outstanding under these KfW loans, US$83 million of our KfW loans will mature in 2005, US$57 million in 2006, US$78 million in 2007, US$58 million in 2008, US$44 million in 2009 and US$31 million in 2010. Principal amortization on these loans is generally payable in equal semi-annual installments.

Finnish Export Credit, plc or Finnvera

As of December 31, 2004, US$162 million aggregate principal amount of Smart's debts provided by various banks under export credit agency-backed facilities in connection with Smart's Phases 1, 2, 3, 4, part of 5A and 5B GSM expansion programs are covered by guarantees from Finnvera, the Finnish export credit agency, for 95% of political risk and 50% of commercial risk.

Of the amounts outstanding under these Finnvera guaranteed loans, US$95 million will mature in 2005 and US$67 million will mature in 2006. Principal amortization on these loans is generally payable in equal semi-annual installments.

Nippon Export and Investment Insurance of Japan, or NEXI

On November 28, 2002, Smart signed a US$100 million term loan facility supported by NEXI of which US$60 million was drawn on November 28, 2003 and US$40 million on April 5, 2004. This loan is payable semi-annually over four years in eight equal installments starting May 28, 2004 with final repayment due in November 2007. Outstanding balance as of December 31, 2004 is US$75 million.

Japan Bank for International Cooperation, or JBIC/Co-financing Banks

As of December 31, 2004, PLDT owed US$44 million aggregate principal amount of debt to JBIC (formerly the Export-Import Bank of Japan) and its co-financing banks under various facilities. Of the amounts outstanding under these loans, US$14 million will mature in 2005, US$13 million in 2006, US$10 million in 2007, US$4 million in 2008 and US$3 million in 2009.

Other Export Credit Agency Supported Loans

PLDT has also obtained loans extended and/or guaranteed by other export credit agencies, including the Export-Import Bank of the United States, and the respective export credit agencies of France, Italy, Israel, Sweden, Denmark, Canada, Australia, the United Kingdom and Singapore, in the aggregate outstanding principal amount of US$104 million as of December 31, 2004. Smart, likewise, obtained loans guaranteed by export credit agencies of Norway and Italy amounting to US$8 million. Of the

amounts outstanding under these loans, US$40 million will mature in 2005, US$33 million in 2006, US$24 million in 2007, US$4 million in 2008, US$2 million in 2009 and US$1 million in 2010.

Fixed Rate Notes

PLDT has the following non-amortizing fixed rate notes outstanding as of December 31, 2004 and 2003:

Principal Amount	**Interest Rate**	**Maturity Date**	**2004**		2003 (As restated – Note 2)	
			(in millions)			
US$300,000,000	8.350%	March 6, 2017	**US$296**	**Php16,658**	US$294	Php16,362
US$250,000,000	11.375%	May 15, 2012	**242**	**13,661**	243	13,511
US$183,913,000	7.850%	March 6, 2007	**183**	**10,315**	199	11,090
US$175,000,000	10.500%	April 15, 2009	**174**	**9,777**	174	9,663
US$129,827,000	9.250%	June 30, 2006	**129**	**7,289**	175	9,702
US$110,557,000	9.875%	August 1, 2005	**110**	**6,223**	138	7,675
US$ 88,263,000	10.625%	May 15, 2007	**86**	**4,872**	98	5,438
US$ 77,002,000	10.625%	June 2, 2004	**–**	**–**	77	4,278
			US$1,220	**Php68,795**	US$1,398	Php77,719

US$283 Million Term Loan Facility (Debt Exchange Facility)

On July 2, 2004, Smart acquired from Piltel's creditors approximately US$289 million, or 69.4%, in the aggregate of the outstanding restructured Piltel debt, in exchange for Smart debt. Smart paid cash of US$1.5 million (Php84 million) and issued new debt of US$283.3 million at fair value of Php8,390 million, net of debt discount amounting to Php7,464 million. As of December 31, 2004, unamortized discount amounted to Php7,238 million.

The breakdown of the total amount of Smart debt issued to participating Piltel creditors are as follows:

- 2007 Facility for US$0.2 million payable in full in December 2007;
- 2008 Facility for US$2.9 million payable in full in December 2008; and
- 2014 Facility for US$280.1 million payable in full in June 2014.

Interest for the above facilities is payable every quarter at a floating rate of three months US$ LIBOR plus 1.00% for the 2007 and 2008 facilities, and a fixed rate of 2.25% per annum for the 2014 facility. Furthermore, a portion of the 2014 facility amounting to US$144 million has a variable yield option whereby the creditor has an option to elect for an early repayment at a discount either in December 2007 at 52.5% of the relevant debt amount or in December 2008 at 57.5% of the relevant debt amount.

GSM Network Expansion Facilities

On September 13, 2004, Smart signed a US$104 million 5-year term loan facility supported by Finnish Export Credit PLc as the lender with ABN AMRO Bank, Banque National de Paribas, Calyon, DBS Bank and Sumitomo Mitsui Banking Corporation as the Lead Arrangers. The full amount of the facility was drawn in November 2004. The loan will be payable over five years in ten equal payments starting May 2005 with final repayment in November 2009.

On June 8, 2001, Smart signed its GSM Phase 5A financing comprised of US$195 million loans, of which US$30 million is owed to Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden N.V., or FMO, of the Netherlands, US$15 million to Nordic Investment Bank and US$150 million to Finnvera. Of the amounts owed to FMO and Nordic Investment Bank, US$22 million remained outstanding as of December 31, 2004, are payable over five to six years, with final repayments due in March 2007 and June 2007.

Local Exchange Transfer Loans

In connection with the transfer to PLDT of Smart's local exchange business, PLDT entered into loan agreements with Nederlandse Financierings-Maatschappij Voor Ontwikkelingslanden N.V., or FMO, of the Netherlands, Exportkreditnamden, or EKN, of Sweden and Export Credits Guarantee Department, or ECGD, of the United Kingdom for loans in the principal amounts of US$135 million, US$36 million and US$27 million, respectively. Approximately US$51 million of the FMO loan and US$25 million of the EKN and ECGD loans were outstanding as of December 31, 2004. The FMO loan will mature on September 1, 2007, and the EKN and ECGD loans on December 31, 2007.

Multicurrency Refinancing Facility

On September 4, 2002, PLDT signed a loan agreement with a syndicate of banks for a US$145 million multicurrency term loan facility consisting of Japanese yen and U.S. dollar commitments of JP¥10,914 million and US$53 million, respectively. This facility was split into two tranches. Tranche A was drawn on June 18, 2003 in the amount of JP¥7,723 million and US$34 million to refinance a portion of the Japanese yen syndicated term loan which matured on the same date. Tranche B was drawn on December 22, 2003 in the amount of JP¥3,191 million and US$19 million to refinance a portion of US$52 million principal amount outstanding under the U.S. dollar term loan which matured on the same date. The outstanding balances of Tranches A and B of this multicurrency term loan amounting to US$36 million and JP¥7,276 million originally with final maturity in December, 2006 were prepaid on December 20, 2004.

Restructured Loans

On June 4, 2001, Piltel completed the restructuring of approximately Php41 billion of indebtedness and other claims owed to banks, trade creditors, bondholders and preferred shareholders, representing 98% of its total liabilities as of that date.

As a result of the restructuring:

a. 50% of the financial debt of each participating creditor was released in consideration for the allotment of Piltel Class I Series K Convertible Preferred Stock. One (1) Piltel Class I Series K Convertible Preferred Stock was exchanged for every Php340 worth of debt for which it is being exchanged (converted into Pesos at an exchange rate of Php47.05 = US$1.00 for dollar-denominated debt and Php1.00 = JP¥2.39522 for yen-denominated debt), which shares were immediately and mandatorily converted into PLDT Convertible Preferred Stock. One PLDT Series V, VI or VII convertible preferred share was issued for every five (5) Piltel Class I Series K Convertible Preferred Stock.

b. Approximately half of the remaining 50% of all participating creditors' (except for bondholders and preferred shareholders) financial debt became their participation in a Tranche B Loan in the same currency as their previous financial debt and the other half became their participation in a Tranche C Loan also in the same currency as their previous financial debt. In the case of bondholders and preferred shareholders, the remaining 50% of their financial debt became a participation in the Conversion Notes Facility and in a single Tranche Peso loan (the Term Notes Facility), respectively.

On July 2, 2004, Smart acquired from Piltel's creditors US$289 million or 69.4% of Piltel's total outstanding restructured debt at that time, in exchange for US$283.3 million in new debt of Smart and US$1.5 million in cash. A gain on debt exchange transaction amounting to Php4,419 million was recognized in our consolidated statement of income representing the difference between the fair value of Piltel's debt cancelled and/or exchanged for a cash and Smart's debt amounting to Php12,893 million (net of debt discount of Php3,359 million) and Smart's consideration for the debt exchange including cash of Php84 million (US$1.5 million) and fair value of newly issued debt amounting to Php8,390 million (net of debt discount of Php7,464 million). This portion of Piltel's debt has been eliminated in consolidation as of December 31, 2004.

Piltel's residual long-term debt to third parties consists of:

Description	**2004**		2003 (As restated – Note 2)	
	(in millions)			
Restructured debts				
Philippine Pesos				
10 year Tranche B		**Php241**		Php2,166
15 year Tranche C		**241**		2,166
15 year Term Notes Facility		**–**		294
		482		4,626
U.S. Dollars				
10 year Tranche B	**US$10**	**548**	US$35	1,932
15 year Tranche C	**10**	**548**	35	1,932
15 year Conversion Notes Facility	**99**	**5,606**	122	6,768
	US$119	**6,702**	US$192	10,632
Japanese Yen				
10 year Tranche B	**JP¥–**		JP¥7,822	4,062
15 year Tranche C	**–**		7,822	4,062
	JP¥–	**–**	JP¥15,644	8,124
Total		**7,184**		23,382
Less unamortized discount (Note 2)		**2,006**		5,796
		5,178		17,586
Unrestructured debt				
U.S. Dollars				
Convertible bonds	**US$1**	**52**	US$1	51
Total		**5,230**		17,637
Less current portion		**59**		69
		Php5,171		Php17,568

The following is a summary of the key economic terms relating to the restructuring of the financial debt taking the form of Tranche B Loan, Tranche C Loan, Term Notes Facility and Conversion Notes Facility.

	Tranche B Loans	Tranche C Loans	Term Notes Facility	Conversion Notes Facility
Final maturity	10 years from June 4, 2001	15 years from June 4, 2001	15 years plus 10 days from June 4, 2001	15 years from June 4, 2001
Amortization	Years 1 and 2 – 0.00% Years 3 to 9 – 0.10% Year 10 – 99.30%	Years 1 and 2 – 0.00% Years 3 and 4 – 0.10% Year 5 – 2.00% Years 6 to 14 – 10.00% Year 15 – 7.80%	Years 1 and 2 – 0.00% Years 3 to 14 – 0.10% Year 15 – 98.80%	Years 1 and 2 – 0.00% Years 3 and 4 – 0.10% Year 5 – 1.05% Years 6 to 9 – 5.05% Year 10 – 54.65% Years 11 to 14 – 5.00% Year 15 – 3.90%
Interest rate	**Peso facility** – Philippines 91-day treasury bill rate, or T-Bill Rate, or the average of the 91-day T-Bill Rate and the 90-day Philippine inter-bank offered rate, or PHIBOR, if 90-day PHIBOR is different from the T-Bill Rate by more than 2.50%, plus 1.00% p.a. **U.S. dollar facilities** – London interbank rate for U.S. dollar deposits, or LIBOR, for three-month U.S. dollar deposits plus 1.00% p.a. **Yen facility** – LIBOR interbank rate for Yen deposits for three-month deposits plus 1.00% p.a.		181-day T-Bill Rate or the average of the 181-day T-Bill Rate and the 6-months PHIBOR, if 6-months PHIBOR is different from the T-Bill Rate by more than 2.50%, plus 1.00% p.a.	LIBOR for three-month deposits plus 1.00% p.a.
Interest payment dates	Quarterly in arrears		Semi-annually	

Under the terms of the restructuring, PLDT issued a LOS for the benefit of Piltel and its creditors under which PLDT has agreed to cover any funding shortfalls of Piltel up to a maximum amount of US$150 million less all amounts paid or committed to be paid to or on behalf of Piltel or any of its subsidiaries or affiliates on or after March 23, 2000. Under the LOS, PLDT shall provide funding to Piltel in the event that the cash flow from Piltel's operations fall short of the amount required by it to discharge in full its obligations to any creditor of Piltel and all its operating and financing subsidiaries and affiliates. PLDT is subject to contractual restrictions limiting the amount of financial support it can provide to Piltel up to US$150 million. As of December 31, 2004 and 2003, the undrawn balance available under the PLDT LOS is US$50 million, approximately Php2,831 million and Php2,793 million, respectively, due to prior investments made from March 23, 2000 to December 31, 2004 aggregating to US$100 million through PLDT's subscription to Class I Series J preferred shares of Piltel.

Piltel's restructured obligations are secured by substantially all present and future assets of Piltel under the Mortgage Trust Indenture, or MTI, dated June 4, 2001 between Piltel and Chase Manhattan Bank as security agent for the creditors, which established the security arrangements relating to the restructured debts. The participating creditors (other than the participating holders of the Peso Term Note Facility) will share equally in first ranking security, while non-participating creditors and the participating holders of the Peso Term Note Facility will share equally in second ranking security created under the MTI. Such mortgage was approved by at least two-thirds of Piltel's stockholders at its annual meeting on April 18, 2001 and the NTC on May 18, 2001.

Satellite Acquisition Loans

Mabuhay Satellite has an existing Credit Agreement with the Export-Import Bank of the United States to finance a portion of the cost of purchasing the Agila II Satellite. In 2003, Export-Import Bank of the United States approved, in principle, the re-profiling of Mabuhay Satellite's US$42 million debt with them by extending the maturity of the loan by 1 and ½ years to July 15, 2007 and reducing the interest rate by 1%, to 5.6% from 6.6%. The revised repayment terms have been approved by the majority of the

local creditor banks.

Mabuhay Satellite also has an existing Omnibus Agreement with a syndicate of local banks, or the Banks, which includes issuance of irrevocable standby Letters of Credit with an aggregate stated value not exceeding US$31 million (Php1,763 million) in favor of U.S. Ex-Im Bank, as security under the Credit Agreement and a term loan to Mabuhay Satellite in the aggregate amount of US$41 million (Php2,301 million), which will mature on various dates from 2004 to 2007.

Mabuhay Satellite has constituted in favor of the Banks: (a) a first mortgage on its leasehold rights under a lease agreement entered into with the Subic Bay Metropolitan Authority and the components of the satellite system; (b) an assignment of its rights under its purchase contract for the satellite system; (c) an assignment of its rights under the transponder lease contracts to be entered into with its shareholders and other parties and the revenues therefrom; and (d) an assignment of the applicable proceeds of insurance to be taken on the satellite system.

JBIC JP¥9,760 Million Overseas Investment Term Loan

On July 26, 2002, PLDT signed a loan agreement with JBIC for a credit facility of JP¥9,760 million under JBIC's OIL program. The loan, which was drawn on July 31, 2002, will be amortized semi-annually beginning March 21, 2005 and will mature on March 21, 2008.

NEXI Supported JP¥5,615 Million Syndicated Term Loan Facility

On June 11, 2003, PLDT signed a JP¥5,615 million syndicated term loan facility supported by NEXI, of which JP¥2,520 million was drawn and JP¥2,205 million was outstanding as of December 31, 2004. The undrawn balance of JP¥3,095 million was cancelled at the end of the Availability Period on December 3, 2004. This loan is amortized semi-annually beginning December 2004 and will mature in June 2008.

Php2,770 Million Peso Fixed Rate Corporate Notes

In connection with PLDT's service improvement and expansion programs, PLDT has entered into two loan agreements, pursuant to each of which PLDT issued fixed rate corporate notes in three tranches. Interest on each tranche is payable semi-annually.

Under the first loan agreement, PLDT borrowed an aggregate amount of Php1,500 million, of which Php230 million matured on November 11, 2002, Php500 million matured on November 9, 2004, and Php770 million will mature on November 9, 2006.

Under the second loan agreement, PLDT borrowed an aggregate amount of Php1,270 million, of which Php360 million matured on June 9, 2003, Php100 million will mature on June 9, 2005, and Php810 million on June 9, 2010.

JBIC 4 Program of the Development Bank of the Philippines

In connection with the Asia Pacific Cable Network 2 project, PLDT entered into a loan agreement with Citibank, N.A., as facility agent, and a syndicate of banks in the aggregate principal amount of Php1,700 million, of which about Php680 million was outstanding as of December 31, 2004. The loan, which is funded under the JBIC Facility for Private Sector Development of the Development Bank of the Philippines, will mature on October 26, 2005 and since April 2002 is payable in quarterly installments as set forth below:

Quarterly Payment Number	Percentage of Principal Payable on Each Quarterly Payment Date
Payments 1–7	3.500%
Payments 8–11	8.875%
Payments 12–15	10.000%

Secured Term Loans

Php150 Million Term Loan Facility

On March 4, 2002, ePLDT entered into a three-year loan facility with Philippine Bank of Communications amounting to Php150 million. The loan is payable in seven quarterly installments, with a grace period of one year, beginning year 2003. The loan facility was fully drawn on December 31, 2002. The quarterly principal payments of Php15 million started in June 2003 with a balloon payment of Php45 million in March 2005. Interest on this loan is equivalent to 91-day T-bill rate plus 4% per annum payable quarterly in arrears. The loan is secured by ePLDT's deed of assignment of receivables of a subsidiary from a foreign customer and an investment in an associate with an original cost of Php629 million. As of December 31, 2004, the investment in this associate has been fully provided for as disclosed in *Note 9 – Investments in Associates*. As of December 31, 2004, the outstanding balance of this loan amounted to Php45 million which will mature in 2005.

Php100 Million Term Loan Facility

On March 15, 2004, ePLDT entered into another three-year term loan facility with Asia United Bank amounting to Php100 million for the payment of its outstanding short-term bank loan facility and for other working capital requirements. The loan facility was fully drawn as of December 31, 2004. The loan is to be repaid in nine equal quarterly installments starting March 2005 with final repayment in March 2007. Interest on the loan is equivalent to 90-day PHIBOR plus 3% per annum payable quarterly in arrears. The loan is secured by a Mortgage Trust Indenture Agreement, or MTIA, on a parcel of land with a carrying value of Php279 million as of December 31, 2004. As of December 31, 2004, the outstanding balance of this loan amounted to Php100 million, of which Php44 million will mature in 2005.

Php149 Million Term Loan Facility

As of December 31, 2004, Vocativ, Inc., a wholly-owned call center subsidiary of ePLDT, has an outstanding 5-year term loan facility of Php149 million with Asia United Bank for the payment of its additional capital expenditures and working capital requirements. The loan is to be repaid in fourteen equal quarterly installments starting April 2006 with final repayment in July 2009. Interest on the loan is equivalent to 90-day PHIBOR plus 3% per annum payable quarterly in arrears. The loan is secured by a Mortgage Participation Certificate against the MTIA between ePLDT and Asia United Bank Corporation – Trust and Investments Group dated March 15, 2004 on a parcel of land, which excludes the buildings and improvements.

Unsecured Term Loans

Php1,000 Million Term Loan Facility

On June 14, 2001, Smart signed its GSM Phase 5A financing of Php1,000 million term loan. The outstanding balance under this facility of Php467 million was prepaid on June 28, 2004.

Debt Covenants

Our debt instruments contain restrictive covenants, including covenants that could prohibit us from paying dividends on common stock under certain circumstances, and require us to comply with specified financial ratios and other financial tests, calculated in conformity with accounting principles generally accepted in the Philippines, at relevant measurement dates, principally at the end of each quarterly period. We have complied with all of our maintenance ratios as required under our loan covenants and other debt instruments. In addition, we are required to comply with certain ratios for the incurrence of capital expenditures in excess of US$10 million and incurrence of indebtedness.

The principal factors that can negatively affect our ability to comply with financial ratios and other financial tests are depreciation of the peso relative to the U.S. dollar, poor operating performance of PLDT and its consolidated subsidiaries, impairment or similar charges in respect of investments or other long-lived assets that may be recognized by PLDT and its consolidated subsidiaries and increases in our interest expenses. Interest expense may increase as a result of various factors including issuance of new debt, the refinancing of lower cost indebtedness by higher cost indebtedness, depreciation of the peso, the lowering of PLDT's credit ratings or the credit ratings of the Philippines, increase in reference interest rates, and general market conditions. Since approximately 98% of PLDT's total debt is denominated in foreign currencies, principally in U.S. dollars, many of these financial ratios and other tests are negatively affected by any weakening of the peso.

PLDT's debt instruments contain a number of other negative covenants that, subject to certain exceptions and qualifications, restrict PLDT's ability to take certain actions without lenders' approval, including: (a) incurring additional indebtedness; (b) prepaying other debt; (c) making investments; (d) extending loans; (e) extending guarantees or assuming the obligations of other persons; (f) paying dividends or other distributions or redeeming, repurchasing or otherwise acquiring shares of PLDT's capital stock; (g) disposing of all or substantially all of its assets or of assets in excess of specified thresholds of its tangible net worth; (h) entering into management contracts providing for the management of its business or operations by a third party; (i) creating any lien or security interest; (j) permitting set-off against amounts owed to PLDT; (k) merging or consolidating with any other company; (l) entering into transactions with stockholders and affiliates; and (m) entering into sale and leaseback transactions.

Further, certain of PLDT debt instruments contain provisions wherein PLDT may be required to repurchase or prepay certain indebtedness in case of change in control of PLDT.

PLDT's debt instruments also contain customary and other default provisions that permit the lender to accelerate amounts due or terminate their commitments to extend additional funds under the debt instruments. These default provisions include: (a) cross-defaults and cross-accelerations that permit a lender to declare a default if PLDT is in default under another debt instrument; in some cases, the cross-default provision is triggered upon a payment or other default permitting the acceleration of PLDT's debt, whether or not the defaulted debt is accelerated. In other cases, the cross-default provision requires the defaulted loan to be accelerated. In some debt instruments, the cross-default provision will be triggered only if the principal amount of the defaulted indebtedness exceeds a threshold amount specified in these debt instruments; (b) failure by PLDT to meet certain financial ratio covenants referred to above; (c) the occurrence of any material adverse change in circumstances that a lender reasonably believes materially impairs PLDT's ability to perform its obligations under its debt instrument with the lender; (d) the revocation, termination or amendment of any of the permits or franchises of PLDT in any manner unacceptable to the lender; (e) the abandonment, termination or amendment of the project financed by a loan in a manner unacceptable to the lender; (f) the nationalization or sustained discontinuance of all or a substantial portion of PLDT's business; and (g)

other typical events of default, including the commencement of bankruptcy, insolvency, liquidation or winding up proceedings by PLDT.

Smart's debt instruments contain certain restrictive covenants, including covenants that prohibit Smart from paying dividends, redeeming preferred stock, making distributions to PLDT or otherwise providing funds to PLDT or any affiliate without the consent of its lenders. Also, Smart's debt instruments contain certain restrictive covenants that require Smart to comply with specified financial ratios and other financial tests at semi-annual measurement dates. Smart has maintained compliance with all of its financial covenants. The agreements also contain customary and other default provisions that permit the lender to accelerate amounts due under the loans or terminate their commitments to extend additional funds under the loans. These default provisions include: (a) cross-defaults and cross-accelerations that permit a lender to declare a default if Smart is in default under another loan agreement. These cross-default provisions are triggered upon a payment or other default permitting the acceleration of Smart debt, whether or not the defaulted debt is accelerated; (b) failure by Smart to comply with certain financial ratio covenants; (c) any reduction in PLDT's ownership of Smart's shares below 51%; (d) any reduction in First Pacific's and Metro Pacific Corporation's collective direct and/or indirect ownership of PLDT's common stock below 17.5% of the total common stock outstanding; and (e) the occurrence of any material adverse change in circumstances that the lender reasonably believes materially impairs Smart's ability to perform its obligations under its loan agreements.
As of December 31, 2004, Piltel is not in compliance with the terms of convertible bonds with principal amount of US$0.7 million (approximately US$0.9 million redemption price at the option of the holders). Piltel may not be able to restructure or otherwise pay the claims of its unrestructured debt. However, default on and acceleration of Piltel's unrestructured indebtedness does not create a cross-default under Piltel's restructured indebtedness or any indebtedness of PLDT or Smart.

The Credit and Omnibus Agreements of Mabuhay Satellite impose negative covenants which, among others, restrict material changes in Mabuhay Satellite's nature of business and ownership structure, any lien upon or with respect to any of its assets or to any right to receive income, acquisition of capital stock, declaration and payment of dividends, merger, consolidation and sale with another entity and incurring or guaranteeing additional long-term debt beyond prescribed amounts.

ePLDT's loan agreement imposes negative covenants which, among other things, restrict ePLDT in regard to payment of cash dividends or any other income or any capital distribution to PLDT, voluntary suspension of its entire business operations for a period of 60 consecutive days, dissolution of its legal existence, and creation of any encumbrances on the shares pledged. One of ePLDT's loan agreement also requires ePLDT to comply with specified financial ratios and other financial tests at quarterly measurement dates. The agreement also contains customary and other default provisions that permit the lender to accelerate amounts due under the loan or terminate their commitments to extend additional funds under the loan. As of December 31, 2004, ePLDT has complied with all of its financial covenants.

Obligations Under Capital Lease

The future minimum payments for capitalized leases are as follows as of December 31, 2004:

Year	(in million pesos)
2005	673
2006	379
2007	258
2008	6
2009	7
2010 and onwards	443
Total minimum lease payments	1,766
Less amount representing interest	740
Present value of net minimum lease payments	1,026
Less capital lease maturing within one year	425
Long-term portion of obligations under capital lease	601

Municipal Telephone Projects

In 1993, PLDT entered into two lease agreements with the Philippine Department of Transportation and Communications, or DOTC, covering telecommunications facilities in Bohol and Batangas established under the Municipal Telephone Act. Under these agreements, PLDT was granted the exclusive right to perform telecommunications management services, to expand services, and to promote the use of the DOTC-contracted facilities in certain covered areas for a period of 15 years. Title to the properties shall be transferred to PLDT upon expiration of the lease term. As of December 31, 2004, PLDT's aggregate remaining obligation under this agreement was approximately Php858 million. In case of cancellation, PLDT is liable to pay Php100 million under each of the two contracts as liquidated damages.

On June 1, 2004, PLDT served the DOTC a notice of termination of the lease agreement in respect of the telecommunications system in Bohol which state of deterioration, obsolescence and disrepair have made it impossible for PLDT to continue managing, operating, and maintaining the system. Since 2002, PLDT has been advising the DOTC of the need to review the viability of the system as it has infused more than Php200 million for upgrades and maintenance to keep the system operable. Further, the enactment of R.A. No. 7925, which negated the DOTC's warranty to grant PLDT the exclusive right to provide telecommunication services in the areas stipulated, prevented PLDT from achieving the originally projected profitability thereby rendering it impossible for PLDT to continue fulfilling its obligation under the lease agreement. Although several discussions have been held since then to seek a mutually acceptable agreement, no amenable arrangement has been reached. On June 30, 2004, the DOTC advised PLDT that the request for termination of the lease agreement in Bohol has been referred to the Department of Justice, or DOJ, as government agencies are required to refer all interpretation of contracts and agreements to the DOJ secretary as attorney-general of the national government. As of the date of this report, negotiations are on-going in efforts to reach a mutually beneficial arrangement for both parties. As of December 31, 2004, the net book value of the telecommunications system in Bohol, including PLDT's additional capital expenditure relating to the telecommunications system, and corresponding capital lease obligation amounted to Php42 million and Php735 million, respectively.

Other Long-term Capital Lease Obligations

The PLDT Group has various long-term lease contracts for a period of three years covering various office equipment. In particular, Smart and Piltel have capital lease obligations aggregating Php906 million as of December 31, 2004 in respect of office equipment and facilities.

Under the terms of certain loan agreements and other debt instruments, PLDT may not create, incur, assume or permit or suffer to exist any mortgage, pledge, lien or other encumbrance or security interest over the whole or any part of its assets or revenues or suffer to exist any obligation as lessee for the rental or hire of real or personal property in connection with any sale and leaseback transaction.

Preferred Stock Subject to Mandatory Redemption

The movement of PLDT's preferred stock subject to mandatory redemption follows:

	2004				2003			
	Series V	**Series VI**	**Series VII**	**Total**	**Series V**	**Series VI**	**Series VII**	**Total**
	(in million pesos)							
Beginning balance	**2,053**	**5,435**	**5,247**	**12,735**	1,717	4,347	4,177	10,241
Issuance	**–**	**–**	**–**	**–**	–	282	–	282
Conversion	**(339)**	**(18)**	**–**	**(357)**	–	(8)	–	(8)
Accretion	**390**	**751**	**457**	**1,598**	336	607	375	1,318
Revaluation	**–**	**74**	**325**	**399**	–	207	695	902
Ending balance	**2,104**	**6,242**	**6,029**	**14,375**	2,053	5,435	5,247	12,735

As of December 31, 2004, PLDT had issued 3 million shares of Series V Convertible Preferred Stock, 5 million shares of Series VI Convertible Preferred Stock and 4 million shares of Series VII Convertible Preferred Stock in exchange for Series K, Class I Convertible Preferred Stock of Piltel, pursuant to the debt restructuring plan of Piltel. Shares of Series V, VI and VII Convertible Preferred Stock are entitled to receive annual dividends of Php18.70 per share, US$0.397 per share and JP¥40.7189 per share, respectively. Each share of Series V, VI and VII PLDT Convertible Preferred Stock is convertible at any time at the option of the holder into one PLDT common share. On the date immediately following the seventh anniversary of the issue date of the Series V and Series VI Convertible Preferred Stock and on the eighth anniversary of the issue date of the Series VII Convertible Preferred Stock, the remaining outstanding shares under these series will be mandatorily converted to PLDT common shares. Under a put option exercisable for 30 days, holders of common shares received on mandatory conversion will be able to require PLDT to purchase such PLDT common shares for Php1,700 per share, US$36.132 per share, and JP¥4,071.89 per share for Series V, VI and VII, respectively.

PLDT's Convertible Preferred Stock Series V, VI and VII were designated as compound instruments consisting of liability and equity components. The total fair value of the Convertible Preferred Stock Series V, VI and VII was determined at issue date, of which the aggregate fair value of the liability component of the issued Series V, VI and VII Convertible Preferred Stock as of date of issuance is included under the "Interest-bearing Financial Liabilities" account in the consolidated balance sheets. The residual amount was assigned as the equity component.

The difference between the aggregate fair value of the Series V, VI and VII Convertible Preferred Stock at issue date and the aggregate redemption value is accreted over the period up to the call option date using the effective interest rate method. Accretions added to "Preferred Stock Subject to Mandatory Redemption" and charged to interest for the years ended December 31, 2004 and 2003 amounted to Php1,598 million and Php1,318 million, respectively.

"Preferred Stock Subject to Mandatory Redemption" amounted to Php14,375 million and Php12,735 million as of December 31, 2004 and 2003, respectively, after revaluation of Series VI and VII to the exchange rates at balance sheet dates and after giving effect to the above accretions, conversions and additional issuances. As of December 31, 2004 and 2003, 1,060,940 shares and 676,571 shares, respectively, of the Convertible Preferred Stock have been converted into PLDT common shares. The aggregate redemption value of the outstanding Series V, VI and VII Convertible Preferred Stock

amounted to Php22,016 million and Php21,898 million as of December 31, 2004 and 2003, respectively.

The corresponding dividends on these shares charged as interest expense amounted to Php284 million, Php254 million and Php240 million for the years ended December 31, 2004, 2003 and 2002, respectively.

Notes Payable

On April 28, 2003 and May 14, 2003, PLDT issued, at a discount, Php1,600 million and Php400 million One-Year Peso Notes, respectively, under its Php2 billion Peso Notes program registered with the Philippine Securities and Exchange Commission. Net proceeds of the issue totaled Php1,803 million. The Php1,600 million One-Year Peso Note matured on April 22, 2004 and the Php400 million One-Year Peso Note matured on May 11, 2004.

Parlance Systems, Inc., a wholly-owned call center subsidiary of ePLDT, Inc., has availed of a local bank's Export Packing and Credit Loan facility amounting to US$950,000 as of December 31, 2004. The said facility can be availed by an export Letter of Credit with an 80% loan value. It has a 90-day term from the date it was granted by the bank and is supported by a Deed of Assignment of Receivables. Interest is based on the prevailing bank rate to be collected in arrears on a monthly basis.

19. Other Noncurrent Liabilities

This account consists of:

	2004	2003 (As restated – Note 2)
	(in million pesos)	
Asset retirement obligation (Note 8)	**638**	395
Prepayment received under receivable purchase facility (Note 15)	**1,644**	2,058
Capital expenditures under long-term financing	**3,970**	3,130
Unearned revenues	**85**	35
Others	**822**	193
	7,159	5,811

20. Accrued Expenses and Other Current Liabilities

This account consists of:

	2004	2003 (As restated – Note 2)
	(in million pesos)	
Accrued utilities and related expenses	**4,457**	4,101
Accrued taxes and related expenses	**2,886**	2,406
Accrued interest on various loans (Notes 18 and 21)	**2,235**	2,377
Accrual for payment for unused sick leave and other employee benefits	**1,624**	1,521
Payable in installment purchase of equity investment (Note 10)	**1,561**	–
Others	**2,048**	1,414
	14,811	11,819

21. Related Party Transactions

a. Air Time Purchase Agreement between PLDT and AIL and Related Agreements

In March 1997, PLDT entered into a National Service Provider, or Founder NSP, Air Time Purchase Agreement with PT Asia Cellular Satellite (assigned and transferred to AIL), as amended in December 1998, under which PLDT was granted the exclusive right to sell ACeS services in the Philippines. In exchange, the Air Time Purchase Agreement states that PLDT has to purchase from PT Asia Cellular Satellite at least US$5 million worth of air time annually over ten years, commencing on the commercial operations date, which has been set as January 1, 2002. The commercial operations date is defined as the earlier of:

- the day on which PT Asia Cellular Satellite places the Garuda I satellite in commercial operation; and
- the date of final acceptance of the Garuda I satellite and associated equipment under the terms of the Spacecraft Contract, dated August 28, 1995, between PT Asia Cellular Satellite and Martin Marietta Overseas Corporation.

However, the commercial operations date may not occur without the consent of PLDT if there is a constructive total loss or partial loss of the satellite under its launch insurance contract and the satellite cannot provide commercial service in the Philippines.

In the event that PT Asia Cellular Satellite's aggregate billing revenue is less than US$45 million in any given year, the Air Time Purchase Agreement states that PLDT has to make supplemental air time purchase payments not to exceed US$15 million per year during the ten-year term.

PLDT and the other founder NSPs are endeavoring to amend the Air Time Purchase Agreement due to the occurrence of partial satellite loss, changes in the primary business of ACeS and other events affecting the business.

In March 2003, PLDT, together with the other founder NSPs, entered into a Standstill Agreement with AIL suspending the application and enforcement of the minimum and supplemental air time payments under the original Air Time Purchase Agreement. In lieu of these payments, the parties agreed that AIL shall provide PLDT and the other founder shareholders, with unlimited use of air time for the year 2003 in exchange for a fixed fee in the amount of US$3.8 million for PLDT. Moreover, PLDT was also obliged to purchase from AIL 13,750 satellite phone units for the year 2003 at US$395 F.O.B. per unit, subject to quarterly price adjustments. The parties to the Standstill Agreement also agreed to negotiate in good faith and use their best efforts to reach an agreement on a revised Air Time Purchase Agreement before November 15, 2003 that will cover, among other matters, the amended minimum and supplemental air time payment provisions subject to the approval of AIL's creditors.

On February 10, 2004, notwithstanding the on-going negotiations, AIL advised PLDT of the termination of the Standstill Agreement and the reinstatement of the terms under the original Air Time Purchase Agreement following the lapse of the deadline set in the Standstill Agreement for the establishment of a revised Air Time Purchase Agreement. Negotiations are continuing with the relevant parties towards an amicable settlement of this matter. See *Note 24 – Provisions and Contingencies* for further discussion.

PLDT also entered into a Founder NSP Operating Agreement with PT Asia Cellular Satellite on March 12, 1997, under which PLDT may:

- authorize distributors to resell ACeS services in the Philippines upon prior approval from PT Asia Cellular Satellite; and

- appoint agents to solicit and bill PLDT's or its authorized distributors' subscribers for ACeS services and to sell terminals on behalf of PLDT.

Under an Assignment and Assumption Agreement dated December 29, 1998, PT Asia Cellular Satellite agreed to assign and transfer to AIL of PT Asia Cellular Satellite's rights under the Founder NSP Air Time Purchase Agreement and Founder NSP Operating Agreement.

Under an Acknowledgment of Assignment of Air Time Purchase Agreement entered into on December 29, 1998, by and among PLDT, P.T. Bank Internasional Indonesia and AIL, PLDT consented to the assignment by AIL of the Founder NSP Air Time Purchase Agreement to P.T. Bank Internasional Indonesia, as security agent, for the benefit of the secured parties under the Security Agreement dated as of December 29, 1998, which was executed in connection with the Amended and Restated Credit Agreement dated December 29, 1998 among PT Asia Cellular Satellite, AIL, P.T. Bank Internasional Indonesia and various banks.

On September 30, 2002, PT Asia Cellular Satellite, AIL, as guarantor, P.T. Bank Internasional Indonesia, as security agent, and various other banks signed a Rescheduling Agreement, which amended the terms of the Amended and Restated Credit Agreement dated December 29, 1998, moving the principal repayment dates to agreed periods with the final maturity date on January 30, 2012.

b. Transactions with Major Stockholders, Directors and Officers

Transactions to which PLDT or its subsidiary was a party, in which a director or key officer or owner of more than 10% of the common stock of PLDT, or any member of the immediate family of a director or key officer or owner of more than 10% of the common shares of PLDT had a direct or indirect material interest in PLDT or its subsidiary, as of December 31, 2004 and 2003 and for the three years ended December 31, 2004, 2003 and 2002 are as follows:

1. Agreements with NTT Communications and/or its Affiliates

PLDT is a party to the following agreements with NTT Communications and/or its affiliates:

- *Advisory Services Agreement*. On March 24, 2000, PLDT entered into an agreement with NTT Communications, as amended on December 31, 2003, under which NTT Communications provides PLDT with technical, marketing and other consultants for various business areas of PLDT starting April 1, 2000;

- *Domestic Fiber Optic Network Submerged Plant Maintenance Agreement*. On July 4, 2000, PLDT entered into an agreement with NTT World Engineering Marine Corporation, or NTT WEMC, for the submarine cable repair and other allied services for the maintenance of PLDT's domestic fiber-optic network, or DFON, submerged plant for a period of five years up to July 4, 2005. Under the agreement, PLDT shall pay NTT WEMC a fixed annual standing charge of US$2 million, excluding cost for the use of a remotely operated submersible vehicle at US$5,000 for every day of use and repair cost computed at US$19,000 per day of actual repair;

- *Arcstar Licensing Agreement and Arcstar Service Provider Agreement.* On March 24, 2000, PLDT entered into an agreement with NTT Worldwide Telecommunications Corporation under which PLDT markets managed data and other services under NTT Communications' "Arcstar" brand to its corporate customers in the Philippines. PLDT also entered into a Trade Name and Trademark Agreement with NTT Communications under which PLDT has been given the right to use the tradename "Arcstar" and its related trademark, logo and symbols, solely for the purpose of PLDT's marketing, promotional and sales activities for the Arcstar services within the Philippines; and

- *Conventional International Telecommunications Services Agreement*. On March 24, 2000, PLDT entered into an agreement with NTT Communications under which PLDT and NTT Communications agreed to cooperative arrangements for conventional international telecommunications services to enhance their respective international businesses.

Total fees under these agreements amounted to Php336 million, Php288 million and Php289 million for the years ended December 31, 2004, 2003 and 2002, respectively. As of December 31, 2004 and 2003, outstanding obligations of PLDT amounted to Php49 million and Php40 million, respectively.

2. *Agreement between Smart and Asia Link B.V., or ALBV.* Smart has an existing Technical Assistance Agreement with ALBV for the latter to provide technical support services and assistance in the operations and maintenance of cellular business for a period of five years, subject to renewal upon mutual agreement between the parties. The agreement provides for quarterly payments of technical service fees equivalent to 2% of the net revenues of Smart. In January 2003, the agreement was amended, reducing the technical service fees to be paid by Smart to ALBV to 1% of net revenues effective January 1, 2003.

Smart also has an existing Services Agreement with ALBV for a period of 25 years starting January 1, 1999, which shall automatically expire unless renewed by mutual agreement of both parties. Under the agreement, ALBV provides advice and assistance to Smart in sourcing capital equipment and negotiating with international suppliers, arranging international financing and other services therein consistent with and for the furtherance of the objectives of the services. Service agreement fees were paid for the whole 25-year period.

ALBV is a subsidiary of the First Pacific Group.

Total fees under these agreements amounted to Php507 million for the year ended December 31, 2004 and Php429 million for each of the years ended December 31, 2003 and 2002. Outstanding obligations of Smart under the Technical Service Agreement amounted to Php267 million and Php228 million as of December 31, 2004 and 2003, respectively.

3. *Agreements relating to insurance companies.* Gotuaco del Rosario and Associates, or Gotuaco, acts as the broker for certain insurance companies to cover certain properties of the PLDT Group. Insurance premiums are remitted to Gotuaco and the broker's fees are settled between Gotuaco and the insurance companies. In addition, PLDT has an insurance policy with Malayan Insurance Co., Inc., or Malayan, wherein premiums are directly paid to Malayan. Total payments to Gotuaco and Malayan covering the 12-month period ending July 31, 2005 amounted to Php440 million. Two directors of PLDT have a direct/indirect interest in or serve as director/officer of Gotuaco and Malayan.

Compensation of key management personnel of the Group

The aggregate compensation and benefits paid to the directors, the chief executive officer and other key advisors and officers, as a group, for 2004, 2003 and 2002 amounted to approximately Php396 million, Php280 million and Php197 million, respectively.

Each of the directors, including the members of the advisory board of PLDT, is entitled to a director's fee in the amount of Php125,000 for each meeting of the board attended, except Manuel V. Pangilinan, our Chairman, who has waived his right to receive a director's fee. Each of the members or advisors of the audit, executive compensation, nomination and finance committees is entitled to a fee in the amount of Php50,000 for each committee meeting attended.

There are no agreements between PLDT and any of its directors and key officers providing for benefits upon termination of employment, except for such benefits to which they may be entitled under PLDT's retirement plan.

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22. Employee Benefits

Executive Stock Option Plan, or ESOP

On April 27, 1999 and December 10, 1999, the Board of Directors and stockholders, respectively, approved the establishment of an ESOP and the amendment of the Seventh Article of the Articles of Incorporation of PLDT denying the pre-emptive right of holders of common stock to subscribe for any issue of up to 1,289,745 common stock pursuant to the ESOP. The ESOP covers management executives, which include officers with rank of Vice President up to the President, executives with the rank of Manager up to Assistant Vice President, and advisors/consultants engaged by PLDT. The ESOP

seeks to motivate option holders to achieve PLDT's goals, reward option holders for the creation of shareholder value, align the option holders' interests with those of the stockholders of PLDT and retain the option holders to serve the long-term interests of PLDT. The ESOP is administered by the Executive Compensation Committee of the Board of Directors. About 1.3 million common stock of PLDT have been reserved as underlying shares of options under the ESOP in 1999.

Movements in the number of stock option plan outstanding are as follows:

	2004	2003
Balance at beginning of year	**900,118**	1,226,395
Exercised shares*	**(336,745)**	–
Cancelled	**(26,784)**	(326,277)
Balance at end of year	**536,589**	900,118

* Based on date of payment of exercised shares

Since the date of the grant on December 10, 1999 up to December 31, 2003, there were no officers or executives who exercised their options. Instead, there were cancellations of options due to officer resignations and retirements of officers and executives.

For the year ended December 31, 2004, 336,745 shares were exercised by certain officers and executives at an exercise price of Php814 per share. Of the 336,745 exercised shares, 1,649 shares were unissued as of December 31, 2004.

The fair value of the ESOP plan was estimated at the date of grant using an option pricing model, which considered annual volatility of 40%, risk-free interest rate, expected life of option, exercise share price of Php814 and weighted average share price Php870 for the 1999 Grant and Php315 for the 2002 Grant as at valuation date. Total fair value of shares granted as of December 31, 2004 and 2003 amounted to Php359 million and Php364 million, respectively. The fair value of the options recognized as an expense for the years ended December 31, 2004 and 2002 amounted to Php14 million and Php76 million, respectively and recovery of Php10 million for the year ended December 31, 2003 due to cancellation of option before vesting period.

LTIP

On August 3, 2004, PLDT's Board of Directors approved the establishment of an LTIP for eligible key executives and advisors of PLDT and it subsidiaries and affiliates. The LTIP is a four-year cash plan covering the period January 1, 2004 to December 31, 2007. The awards payment at the end of the four-year period (without interim payments) is contingent upon the achievement of the approved target increase in PLDT's common share price by the end of the plan period and the cumulative consolidated net income target for the plan period. The target increase in the PLDT base share price, which is the average of the closing prices of PLDT shares ten trading days before or after December 31, 2003, is approximately 15% per annum compounded for the plan period.

The fair value of the LTIP was estimated using an option pricing model, which considered annual stock volatility, risk-free interest rate, expected life of option of four years and weighted average share price Php1,360 as at valuation date. The fair value of the options recognized as an expense for the year ended December 31, 2004 amounted to Php661 million.

Pension

Defined Benefit Plans

We have defined benefit pension plans, covering substantially all of our employees, except Smart, of which require contributions to be made to separate administrative fund.

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

	2004	2003	2002
		(in million pesos)	
Change in benefit obligation:			
Benefit obligation at beginning of year	**6,008**	8,012	6,654
Service cost	**401**	532	461
Interest cost	**539**	718	795
Benefits paid	**(819)**	–	(495)
Actuarial loss (gain)	**787**	(1,236)	597
Curtailment	**–**	274	–
Settlement	**–**	(2,275)	–
Liabilities of newly acquired subsidiaries	**8**	–	–
Benefits paid from assets	**–**	(17)	–
Benefit obligation at end of year	**6,924**	6,008	8,012
Change in plan assets:			
Fair value of plan assets at beginning of year	**3,928**	2,915	2,781
Actual return on plan assets	**376**	303	369
Employer's contribution	**883**	2,704	470
Benefits paid	**(819)**	–	(495)
Settlement	**–**	(2,275)	–
Benefits paid from assets	**–**	(17)	–
Actual gains (losses) on plan assets	**81**	298	(210)
Fair value of plan assets at end of year	**4,449**	3,928	2,915
Funded status	**2,475**	2,080	5,097
Unrealized net transition obligation	**(120)**	(177)	(264)
Unrecognized net actuarial loss (gain)	**(176)**	528	(807)
Accrued benefit cost	**2,179**	2,431	4,026
Components of net periodic benefit cost:			
Service cost	**401**	532	461
Interest cost	**539**	718	795
Expected return on plan assets	**(376)**	(303)	(369)
Amortizations of unrecognized net transition obligation	**56**	64	64
Recognition of transitional liability	**4**	3	2
Net periodic benefit cost	**624**	1,014	953

The weighted average assumptions used to determine pension benefits at December 31, 2004 and 2003 are as follows:

	2004	2003
Discount rate	**9%**	9%
Rate of increase in compensation	**7%**	7%
Rate of return on plan assets	**9%**	9%

As of December 31, 2004, our plan assets include investments in shares of stock of PLDT and Piltel aggregating Php448 million, which represent about 5% of our total plan assets.

Defined Contribution Plan

Smart maintains a trustee-managed, tax-qualified, multi-employer plan covering substantially all permanent and regular employees. The plan has a defined contribution format wherein Smart's obligation is limited to specified contribution to the plan. It is being financed by the participating companies (Smart and its subsidiary, I-Contacts) and employees' contribution is optional.

	2004	2003	2002
		(in millions)	
Expense recognized for defined benefit plans	**624**	1,014	953
Expense recognized for defined contribution plan	**36**	41	45
	660	1,055	998

23. Contractual Obligations and Commercial Commitments

Contractual Obligations

The following table discloses our contractual obligations outstanding as at December 31, 2004:

	Payments Due by Period				
	Total	**Within 1 year**	**2–3 years**	**4–5 years**	**After 5 years**
			(in million pesos)		
Long-term debt[1]	159,470	28,031	55,257	20,782	55,400
Long-term lease obligations:					
Operating lease	5,712	1,435	2,439	723	1,115
Capital lease	1,766	673	637	13	443
Unconditional purchase obligations[2]	12,302	4,405	2,263	2,253	3,381
Other long-term obligations	22,016	–	–	22,016	–
Total contractual cash obligations	**201,266**	**34,544**	**60,596**	**45,787**	**60,339**

[1] Includes unamortized debt discount and debt issuance costs.
[2] Based on the original Air Time Purchase Agreement with AIL.

Long-term Debt

For a discussion of our long-term debt, see *Note 18 – Interest-bearing Financial Liabilities*.

Long-term Operating Lease Obligations

Domestic Fiber Optic Network Submerged Plant Agreement. As discussed in *Note 21 – Related Party Transactions*, PLDT entered into an agreement with NTT World Engineering Marine Corporation on July 4, 2000, for the submarine cable repair and other allied services in relation to the maintenance of PLDT's DFON submerged plant for a period of five years up to July 4, 2005. Under this agreement, PLDT shall pay NTT World Engineering Marine Corporation a fixed annual standing charge of US$2 million, excluding cost for the use of a remotely-operated submersible vehicle at US$5,000 for every day of use and repair cost computed at US$19,000 per day of actual repair. As of December 31, 2004, PLDT's aggregate remaining obligation under this agreement was approximately Php69 million.

Digital Passage Service Contracts. PLDT has existing Digital Passage Service Contracts with foreign telecommunication administrations for several dedicated circuits to various destinations for 10 to 25 years expiring at various dates. As of December 31, 2004, PLDT's aggregate remaining obligation under these contracts amounted to approximately Php30 million.

License Agreement with Mobius Management Systems (Australia) Pty Ltd., or Mobius. PLDT entered into a license agreement with Mobius pursuant to which Mobius has granted PLDT a non-exclusive, non-assignable and non-transferable license for the use of computer software components. Under this agreement, Mobius is also required to provide maintenance services for a period of one year at no additional maintenance charge. PLDT may purchase maintenance services upon expiration of the first year for a fee of 15% of the current published license fee. As of December 31, 2004, PLDT's aggregate remaining obligation under this agreement was approximately Php45 million.

Other Long-term Operating Lease Obligations. The PLDT Group has various long-term lease contracts for periods ranging from two to ten years covering certain offices, warehouses, cell sites telecommunication equipment locations and various office equipment. In particular, Smart has lease obligations aggregating Php3,185 million as of December 31, 2004 in respect of office and cell site rentals with over 2,000 lessors nationwide.

Long-term Capital Lease Obligations.

For a discussion of our long-term capital lease obligations, see *Note 18 – Interest-bearing Financial Liabilities*.

Unconditional Purchase Obligations

Air Time Purchase Agreement with AIL. As discussed in *Note 21 – Related Party Transactions*, PLDT is a party to a Founder NSP Air Time Purchase Agreement with AIL in March 1997, which was amended in December 1998, under which PLDT is granted the exclusive right to sell AIL services in the Philippines. In exchange, the Air Time Purchase Agreement states that PLDT has to purchase from AIL a minimum of US$5 million worth of air time annually over ten years commencing on the date of the commercial operations of the Garuda I satellite. In the event AIL's aggregate billing revenue is less than US$45 million in any given year, the Air Time Purchase Agreement also states that PLDT has to make supplemental air time purchase payments not to exceed US$15 million per year during the ten-year term.

PLDT and the other founder NSPs are endeavoring to amend the Air Time Purchase Agreement due to the occurrence of partial satellite loss, changes in the primary business of ACeS and other events affecting the business.

In March 2003, PLDT, together with the other founder NSPs, entered into a Standstill Agreement with AIL suspending the application and enforcement of the minimum and supplemental air time payments under the original Air Time Purchase Agreement. In lieu of these payments, the parties agreed that AIL shall provide PLDT and the other founder shareholders, with unlimited use of air time for the year 2003 in exchange for a fixed fee in the amount of US$3.8 million for PLDT. PLDT is also obliged to purchase from AIL 13,750 satellite phone units for the year 2003 at US$395 F.O.B. per unit, subject to quarterly price adjustment. The parties to the Standstill Agreement also agreed to negotiate in good faith and use their best efforts to reach agreement on a revised Air Time Purchase Agreement before November 15, 2003 that will cover, among others, the amended minimum and supplemental air time payment provisions subject to the approval of AIL's creditors.

As of December 31, 2004, PLDT's aggregate remaining minimum obligation under the original Air Time Purchase Agreement was approximately Php11,962 million. Negotiations are continuing with the relevant parties towards an amicable settlement of this matter. See *Note 21 – Related Party Transactions* and *Note 24 – Provisions and Contingencies* for further details relating to the Air Time Purchase Agreement with AIL.

International Affiliate Agreement with VeriSign, Inc., or VeriSign. On September 15, 2000, ePLDT entered into an agreement with VeriSign for the non-exclusive, non-transferable right and license to use the VeriSign software, brand and Certification Practice Statement for the purpose of approving, issuing, suspending or revoking digital certificates for users of the internet or similar open systems in the Philippines for a period of seven years. Under this agreement, ePLDT is required to pay VeriSign a certain percentage of the revenue derived from the services subject to minimum annual royalty payments aggregating to US$11 million, which was subsequently reduced to US$1 million, for the seven-year contract period. In addition, ePLDT was required to pay an annual support fee of US$0.5 million during the first year and US$0.3 million in each year thereafter.

Effective July 1, 2003, VeriSign has agreed to amend the agreement and issued Addendum 6 to write-off all past due invoices and payments owed to VeriSign, which were invoiced or scheduled to be invoiced under the agreement prior to this Addendum 6. All royalty payments and annual support fees due through June 2003 will be part of the write-off in the amount of US$0.8 million. For contract year 4 (September 2003 to August 2004), the annual support fee will be reduced from US$0.3 million to US$40,000 and for contract years 5-7 (September 2004 to August 2007) from US$0.3 million to US$0.16 million. In addition, VeriSign agreed to reduce the affiliate revenue sharing rates from 50% of suggested retail price to 25% of suggested retail price for both enterprise and internet products for 12 months starting July 2003 and negotiable thereafter.

Effective July 1, 2004, VeriSign has agreed to amend the Agreement and issued Addendum 8 as extension of Addendum 6. Annual support fee for year 5 (September 2004 to August 2005) will remain at US$40,000 and affiliate revenue sharing rates will remain at 25%. As of December 31, 2004, ePLDT's aggregate remaining minimum obligation under this agreement was approximately Php18 million pertaining to annual support fee.

License Purchase Agreement with I-Contact Solutions Pte. Ltd. On April 2, 2003, iPlus Intelligent Network Inc., or iPlus, a wholly-owned subsidiary of ePLDT and the Philippines' pioneer in IP-based IT response center, entered into an Application Services Provider, or ASP, and Reseller Contract with I-Contact Solutions Pte. Ltd., or I-Contact, of Singapore. Under the agreement, iPlus will purchase licenses of the CosmoCall Universe ™ IP-based contact center solution. CosmoCall Universe supports multi-channel customer interactions including telephone, web chat, web voice, web video, web collaboration, e-mail and voicemail in one high capacity, high availability, multi-tenant platform. CosmoCall Universe is a complete, unified contact center suite that includes ACD, IVR, CTI, predictive dialing, multimedia recording and a complement of other management applications. The aggregate value of these licenses is US$2.1 million and these licenses will be delivered quarterly over a two-year period. Further to the agreement, I-Contact will appoint iPlus as the exclusive reseller and ASP for the Philippine market and will provide iPlus with all the necessary support in terms of sales, marketing, and technical services. Effective March 30, 2004, I-Contact has agreed to amend the Contract and waived all financial obligations and committed seats requirement over the two-year period. iPlus will pay all its remaining obligations pertaining only to the 300 seats delivered by I-Contact. As of December 31, 2004, iPlus has paid all its obligations to I-Contact.

Other Unconditional Purchase Obligations. The PLDT Group has various purchase contracts for periods ranging from two to three years covering the use of a fraud management system, satellite hub and remote very small aperture terminal, or VSAT, network systems.

Other Long-term Obligations

Mandatory Conversion and Purchase of Shares. As discussed in *Note 9 – Investments in Associates* and *Note 18 – Interest-bearing Financial Liabilities*, as of December 31, 2004, PLDT had issued a total of 3 million shares of Series V Convertible Preferred Stock, 5 million shares of Series VI Convertible Preferred Stock and 4 million shares of Series VII Convertible Preferred Stock in exchange for Series K Class I Convertible Preferred Stock of Piltel, pursuant to the debt restructuring plan of Piltel.

Each share of Series V, VI, and VII Convertible Preferred Stocks is convertible at any time at the option of the holder into one PLDT common share. On the date immediately following the seventh anniversary of the issue date of the Series V and Series VI Convertible Preferred Stocks and on the eighth anniversary of the issue date of the Series VII Convertible Preferred Stock, the remaining outstanding shares under these series will be mandatorily converted to PLDT common shares. Under a put option exercisable for 30 days, holders of common shares received on mandatory conversion will be able to require PLDT to purchase such PLDT common shares for Php1,700 per share, US$36.132 per share, and JP¥4,071.89 per share for Series V, VI and VII, respectively.

As of December 31, 2004, 515,818 shares of Series V Convertible Preferred Stock and 545,122 shares of Series VI Convertible Preferred Stock had been converted to PLDT common shares. The aggregate value of the put option based on outstanding shares as of December 31, 2004 was Php22,016 million, of which Php13,419 million is payable on June 4, 2008 and Php8,597 million on June 4, 2009, if all of the outstanding shares of Series V, VI and VII Convertible Preferred Stocks were mandatorily converted and all the underlying common shares were put to PLDT. The market value of the underlying common shares was Php14,685 million, based on the market price of PLDT common shares of Php1,360 per share as of December 31, 2004.

Commercial Commitments

As of December 31, 2004, our outstanding commercial commitments, in the form of letters of credit, amounted to Php1,504 million. These commitments will expire within one year.

In October 1998, Smart entered into a Frame Supply Contract with Nokia Telecommunications OY for the supply of hardware, software and documentation for its GSM cellular network. In the same month, Smart and Nokia (Philippines), Inc., or Nokia, signed a Frame Services Contract that covers the design, planning, installation, commissioning, integration, acceptance testing, training and handling over of the GSM network. In August 2001, Smart issued a Master Purchase Order, or MPO, in the amount of US$200 million in favor of Nokia for the purchase of additional equipment to expand Smart's GSM cellular network. The US$200 million MPO was completed in November 2003. On May 30, 2003, Smart entered into a Technical Support Services Agreement, or TSSA, with Nokia in the amount of US$8 million. This TSSA has been fully served as of December 31, 2003.

In January 2004, Smart signed a new MPO in favor of Nokia amounting to US$117 million (Phase 7 under the Frame Supply Contract between Smart and Nokia). This MPO has been completed as of December 31, 2004.

On June 23, 2004 and May 30, 2004, Smart signed a TSSA with Nokia in the amount of US$10 million and US$8 million, respectively which was valid until December 31, 2004.

On December 14, 2004, Smart signed another MPO in favor of Nokia for US$70 million (Phase 8 for GSM 900/1800 and WCDMA equipment under the same Frame Supply Contract). Smart, however, is under no legal obligation to incur these expenditures.

As of December 31, 2004, Smart had no guarantee obligations, standby repurchase obligations or other commercial commitments.

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24. Provisions and Contingencies

NTC supervision and regulation fees, or SRF

Since 1976, PLDT has received assessments from NTC for permit, SRF and other charges pursuant to Section 40 of Commonwealth Act 146, otherwise known as the Public Service Act. As of December 31, 2004, PLDT has paid, since 1994, a total amount of Php1,718 million in SRF, of which Php1,508 million was paid under protest.

PLDT is contesting the manner by which these assessments were calculated and the basis for such calculations. The case is now with the Supreme Court and upon the rules and practice of court, stands submitted for decision.

Smart and Piltel have similarly received assessments from NTC for permit, SRF and other charges which were paid under protest. Total payments amounted to Php122 million each in 2004 and 2003.

We have made a reasonable estimate of the amount necessary to pay or settle the contested assessment in the event of an unfavorable judgment against us and have made the appropriate provisions in our consolidated financial statements as of December 31, 2004.

Local business and franchise tax assessments

PLDT is presently a party to several cases involving the issue of exemption of PLDT from local franchise and business taxes. PLDT believes, based on the opinion of its legal counsel, that it is exempt from payment of local franchise and business taxes.

The Local Government Code of 1991, or R.A. No. 7160, which took effect on January 1, 1992, extended to local government units, or LGUs, power to tax businesses within their territorial jurisdiction granted under Batas Pambansa No. 337 and withdrew tax exemptions previously granted to franchise grantees under Section 12 of R.A. No. 7082.

PLDT believes, based on the opinion of its legal counsel, that Public Telecommunications Policy Act, or R.A. No. 7925, which took effect on March 16, 1995, and the grant of local franchise and business taxes exemption privileges to other franchise holders subsequent to the effectivity of R.A. No. 7160, implicitly restored its local franchise and business taxes exemption privilege under Section 12 of R.A. No. 7082, or the PLDT Franchise pursuant to Section 23 thereof or the quality of treatment clause.

To confirm this position, PLDT sought and obtained on June 2, 1998 a ruling from the Bureau of Local Government Finance, or BLGF, of the Philippine Department of Finance, which ruled that PLDT is exempt from the payment of local franchise and business taxes imposable by LGUs under R.A. No. 7160.

By virtue of the BLGF Ruling, PLDT stopped paying local franchise and business taxes starting with the fourth quarter of 1998 and has filed with certain LGUs claims for tax refund covering the period from the second quarter of 1995 to the third quarter of 1998. PLDT has received assessments for local franchise and business tax from several cities and provinces following PLDT's decision to stop payment of local franchise and business taxes.

Following a decision of the Supreme Court on March 25, 2003, a judgment in the amount of Php4 million against PLDT involving the City of Davao became final and executory on April 9, 2003, pursuant to which PLDT was declared not exempt from the local franchise tax. Although PLDT believes that it is not liable to pay local franchise and business taxes, PLDT has taken steps to arrive at compromise settlements with several LGUs in order to maintain and preserve its good standing and relationship with these LGUs. PLDT has paid a total amount of Php329 million as of December 31, 2004 for local franchise tax covering up to end of 2004 to certain LGUs who have agreed to a compromise settlement.

PLDT continues to contest remaining assessments amounting to Php3.7 million, a number of which were based on the gross revenues of PLDT derived from its operations within the entire Philippines. PLDT claims that assuming that it is liable for local franchise tax, R.A. No. 7160 provides that local franchise tax shall be based on the gross receipts of the preceding year received or collected for services rendered within the jurisdiction of the taxing authority. Therefore, the use by some LGUs of gross revenues as the basis for computation of franchise tax is in gross violation of the law because it pertains to all income earned regardless of whether it was received or not, unlike gross receipts which are essentially the amount of money or its equivalent actually or constructively received. Moreover, gross revenues refer to all income earned by PLDT within and outside the jurisdiction of the local taxing authority; thus, the use thereof as a basis of computation will exceptionally overstate the franchise tax.

In a petition recently filed with the Supreme Court involving another LGU, PLDT has appealed to the Supreme Court for a re-examination of its decision in the City of Davao case in light of the strong dissenting opinion in that case concurred in by four (4) other Justices of the Supreme Court.

Smart has, likewise, received assessments for local franchise and business taxes from certain cities and provinces in the aggregate amount of Php313 million, which Smart continues to contest. Smart believes, based on the opinion of its legal counsel, that Smart is not liable to pay the local franchise and business taxes by virtue of (i) the opinion issued by the BLGF dated August 13, 1998; and (ii) Smart's exemption under its legislative franchise which took effect after the effective date of R.A. No. 7160.

Smart has recently been declared exempt from payment of local franchise tax to the City of Makati in a decision dated August 3, 2004 by the Regional Trial Court of Makati. The City of Makati has filed their motion for reconsideration and Smart has filed its opposition.

Piltel also received assessments from the local government of the City of Makati in the aggregate amount of Php45 million covering the period from 1999 to 2001. Piltel has formally protested the assessments, based on: (1) Piltel's belief that the opinion rendered by the BLGF for Smart should likewise hold true for Piltel; and (2) the effective date of the legislative franchise of Piltel (R.A. 7293) which came after the effectivity of R.A. 7160. The franchise tax prescribed under Section 137 of the Local Government Code is deemed part of the Piltel franchise (the later law) which states, among other things, that Piltel shall pay only a franchise tax equivalent to three percent of all gross receipts of the business transacted under its franchise and such percentage shall be in lieu of all taxes on the franchise or earnings thereof.

Piltel's protest of the assessments was denied by the City of Makati on December 18, 2001. Piltel then filed a petition with the Makati RTC, appealing the local franchise business taxes. On December 10, 2002, the Makati RTC rendered its judgment granting Piltel's petition and enjoining the City of Makati from assessing and collecting any further annual local franchise business taxes from Piltel. The City of Makati filed its motion for reconsideration of this judgment with the Makati RTC, which was subsequently denied. On April 1, 2003, the City of Makati filed a Petition for Review with the Court of Appeals. On July 12, 2004, the Court of Appeals rendered a decision upholding the Makati RTC that Piltel is exempt from payment of the local Franchise tax.

The City of Makati appealed to the Supreme Court, which issued a resolution dated October 13, 2004 denying with finality the appeal of the City of Makati on the grounds of technicality. The Supreme Court ruled, however, that the petition failed to sufficiently show that the Court of Appeals committed any reversible error in the questioned judgment to warrant the exercise of the discretionary appellate jurisdiction of the Supreme Court.

We have made a reasonable estimate of the amount necessary to pay or settle the contested assessment in the event of an unfavorable judgment against us and have made the appropriate provisions in our consolidated financial statements as of December 31, 2004.

Piltel's BIR Assessment

In 2003, the BIR issued final assessment notices, or FANs, against Piltel for deficiency taxes and penalties for taxable years 1998 and 1999, in the amounts of Php233.6 million and Php284.2 million, respectively. Piltel filed protest letters dated June 5, 2003 and September 24, 2003 with the BIR for the 1998 and the 1999 deficiency tax assessments, respectively.

With respect to the 1998 deficiency tax assessment, the BIR denied on March 16, 2003 the administrative protest filed by Piltel. On July 1, 2003, however, Piltel filed with the BIR an Application for Compromise Settlement for the 1998 deficiency tax assessments based on BIR Revenue Regulations, or RR, No. 30-2002 issued on December 16, 2002, which implements Sections 7(c), 204(a) and 290 of

the National Internal Revenue Code, NIRC, of 1997 on compromise settlement of internal revenue tax liabilities, superseding RR Nos. 6-2000 and 7-2001. Under said RR 30-2003, Piltel is allowed to apply for compromise settlement on the basis of financial incapacity. If approved, Piltel would be permitted to settle its 1998 deficiency tax liabilities by paying an amount corresponding the compromise rates ranging from ten percent (10%) to forty percent (40%) of its assessed deficiency taxes for 1998. Meanwhile, with respect to the 1999 deficiency tax assessment, the BIR favorably considered the administrative protest filed by Piltel. Accordingly, the BIR issued a revised FAN dated February 17, 2004, which was received by Piltel on March 22, 2004. Hence, as early as December 31, 2003, Piltel paid and settled the 1999 expanded withholding tax assessment and the revised 1999 fringe benefit tax, or FBT, assessment amounting to Php26.1 million and Php5.6 million, respectively. On May 28, 2004, Piltel also filed with the BIR an Application for Compromise Settlement for the 1999 deficiency tax assessments, particularly the value added tax, or VAT, and income tax assessments, similarly based on RR No. 30-2002 on the grounds of financial incapacity.

Moreover, on August 5, 2004, PILTEL received a Preliminary Assessment Notice, or PAN, dated July 19, 2004 in connection with Letter Notice, or LN, BOC-AID/LTS-1-41-01-02. The said LN, which is similar to a tax assessment notice, indicated a discrepancy between the importation per Bureau of Customs, or BOC, data and the importation per 2001 VAT returns amounting to Php175.5 million, which resulted in VAT and income tax deficiency assessments amounting to Php82.4 million and Php26.5 million, respectively. On August 20, 2004, Piltel filed an administrative protest in connection with the assessments. Supplemental protest letter was also filed last October 5, 2004 to further support its position against the said tax assessments after the Informal Conference held with the examiners last September 21, 2004. To date, Piltel has not received any response from the BIR. Piltel intends to apply for compromise settlement, based on the same grounds of financial incapacity, any resulting deficiency tax arising from this LN once the BIR has finalized the assessment.

Air Time Purchase Agreement with AIL

In March 1997, PLDT entered into a Founder NSP Air Time Purchase Agreement with PT Asia Cellular Satellite (assigned and transferred to AIL), as amended in December 1998. The agreement states that PLDT has to purchase at least US$5 million worth of air time annually over ten years commencing on the date of the Garuda satellite's commercial operations and has to make supplemental air time purchase payments not to exceed US$15 million per year during the ten-year term in the event revenues generated are less than US$45 million in any given year. The air time payment obligations shall remain in effect until all indebtedness incurred by AIL have been fully repaid. See *Note 21 – Related Party Transactions* and *Note 23 – Contractual Obligations and Commercial Commitments* for detailed discussion of the terms of the agreement.

The Garuda satellite was launched on February 12, 2000 and was available for service beginning October 1, 2000. Pre-commercial operations began on January 1, 2001 and full commercial operations began on January 1, 2002.

We believe that the payment obligations under the Air Time Purchase Agreement exceeded the economic benefits expected to be received under it as a result of the delay in the launch of the satellite, unavailability of competitive handsets and competitions from cellular services, occurrence of a partial satellite loss, changes in the primary business of AIL and other factors affecting its business. Accordingly, we started negotiations with AIL for the revision of the payment obligations under the Air Time Purchase Agreement in 2000.

As a result of these negotiations, the effective date of Air Time Purchase Agreement became January 1, 2002. In 2002, billings for satellite air time were reduced to actual air time usage, less amount for marketing assistance to service providers. In March 2003, PLDT, together with the founder NSPs, entered into a Standstill Agreement with AIL. Payments made to AIL under the Air Time Purchase Agreement based on billings of actual usage and the Standstill Agreement amounted to US$1 million in 2002, US$3.8 million in 2003 and US$0.4 million for the first quarter of 2004.

On February 10, 2004, AIL advised PLDT of the termination of the Standstill Agreement and the reinstatement of the terms under the original Air Time Purchase Agreement effective January 1, 2002 following the lapse of the deadline set in the Standstill Agreement for the establishment of a revised Air Time Purchase Agreement. Negotiations are continuing with the relevant parties towards an amicable settlement of this matter.

On June 21, 2004, AIL also sent PLDT a letter citing PLDT in default under the Air Time Purchase Agreement for non-payment of outstanding amounts and for repudiation of its obligations thereunder. PLDT maintains, however, that the termination of the Standstill Agreement and reinstatement of the terms under the original Air Time Purchase Agreement are premature, considering that the discussions or negotiations on the terms of the proposed revised Air Time Purchase Agreement were still pending between the parties, such that it is highly inequitable for AIL to have unilaterally decided to invoke the provisions of the Standstill Agreement and declared PLDT in default. Furthermore, PLDT maintains its position that the Air Time Purchase Agreement has been rendered ineffective by various events, circumstances and technical problems encountered in the operation of the business of AIL. The substantial changes in the circumstances under which AIL must operate, changes which were not contemplated by the parties at the time the commitments were made, have rendered the commitments under the Air Time Purchase Agreement unrealistic and the performance of the same impossible.

As of December 31, 2004, PLDT's aggregate remaining minimum obligation under the original Air Time Purchase Agreement was approximately Php11,962 million.

We made a reasonable estimate of the amount necessary in the event such obligation would be settled and have made the appropriate provisions in our consolidated financial statements as of December 31, 2004 with due consideration of AIL's existing indebtedness and of PLDT's share as one of the founder NSPs. Total indebtedness of AIL amounted to US$195 million as of January 1, 2003.

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25. Financial Assets and Liabilities

Our financial assets and liabilities are recognized initially at cost which is the fair value of the consideration given (in the case of asset) or received (in the case of a liability). Transaction costs (debt issuance costs) are included in the initial measurement of all financial assets and liabilities except for financial instruments measured at fair value through profit and loss. Subsequent to initial recognition, assets and liabilities are either valued at amortized cost using the effective interest rate method or at fair value depending on classification.

The following table sets forth the carrying values and estimated fair values of our financial assets and liabilities recognized as of December 31, 2004 and 2003. There are no material unrecognized financial assets and liabilities as of December 31, 2004 and 2003.

	Carrying Value		Fair Value	
	2004	2003	**2004**	2003
		(in millions of pesos)		
Noncurrent Financial Assets				
Investments – available-for-sale	**104**	117	**104**	117
Derivative assets	**4,116**	1,360	**4,116**	1,360
Notes receivable	**286**	–	**286**	–
Total noncurrent financial assets	**4,506**	1,477	**4,506**	1,477
Current Financial Assets				
Cash and cash equivalents	**27,321**	19,372	**27,321**	19,372
Short-term investments	**3,873**	1,662	**3,873**	1,662
Trade and other receivables	**10,404**	16,908	**10,404**	16,908
Derivative assets	**335**	262	**335**	262
Total current financial assets	**41,933**	38,204	**41,933**	38,204
Total Financial Assets	**46,439**	39,681	**46,439**	39,681
Noncurrent Financial Liabilities				
Preferred stock subject to mandatory redemption*	**14,375**	12,735	**15,716**	17,798
Long-term debt – net of current portion*	**121,012**	152,646	**129,359**	158,149
Obligation under capital lease*	**601**	729	**601**	729
Derivative liabilities	**5,903**	2,591	**5,903**	2,591
Total noncurrent financial liabilities	**141,891**	168,701	**151,579**	179,267
Current Financial Liabilities				
Obligation under capital lease*	**425**	295	**425**	295
Notes payable*	**58**	2,133	**58**	2,133
Accounts payable	**7,029**	5,192	**7,029**	5,192
Derivative liabilities	**474**	91	**474**	91
Current portion of long-term debt*	**28,018**	23,810	**28,159**	24,611
Total current financial liabilities	**36,004**	31,521	**36,145**	32,322
Total Financial Liabilities	**177,895**	200,222	**187,724**	211,589

* Included under "Interest-bearing Financial Liabilities in the consolidated balance sheets.

The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

Interest-bearing Financial Liabilities:

Long-term debt: Fair value is based on the following:

Debt Type	Fair Value Assumptions
Fixed Rate Loans:	
U.S. dollar notes/convertible debt	Quoted market price.
Other loans in all other currencies	Estimated fair value is based on the discounted value of future cash flows using the applicable rates for similar types of loans.
Variable Rate Loans	The carrying value approximates fair value because of recent and regular repricing based on market conditions.

Preferred stock subject to mandatory redemption: The fair values were determined using an independent third party valuation model.

Derivative instruments:

Forward foreign exchange contracts and bifurcated foreign currency forwards: The fair values were determined using forward exchange market rates at the balance sheet date.

Foreign currency options: The fair values were computed using an option pricing model.

Foreign currency and interest rate swaps: The fair values were computed as the present value of estimated future cash flows.

Due to the short-term nature of the transactions, the fair value of cash and cash equivalents, short-term investments, trade and other receivables, notes payable and accounts payable approximate amount of consideration at the time of initial recognition.

Financial assets and liabilities carried at amortized cost

Unamortized debt discount, representing debt issuance cost and any difference between the fair value of consideration given or received on initial recognition, included in following financial liabilities amounted to Php17,363 million and Php16,390 million as at December 31, 2004 and 2003, respectively, see *Note 18 – Interest-bearing Financial Liabilities*.

Financial assets and liabilities carried at fair value

The following financial assets and liabilities carried at fair value as of December 31, 2004 and 2003.

	2004	2003
	(in million pesos)	
Investments – available-for-sale	**104**	117
Derivative instruments	**(1,926)**	(1,060)
	(1,822)	(943)

Derivative Financial Instruments

Our derivative financial instruments are accounted for as either cash flow hedges or transactions not designated as hedges. Cash flow hedges refer to those transactions that hedge our exposure to variability in cash flows attributable to a particular risk associated with a recognized asset or liability. Changes in the fair value of these instruments are recognized as cumulative translation adjustments in equity until the hedged item is recognized in earnings. For transactions that are not designated as hedges, any gains or losses arising from the changes in fair value are recognized directly to income for the

period.

The table below sets out the information about our derivative financial instruments as of December 31, 2004 and 2003:

	Maturity	**2004** Notional Amount	**2004** Mark-to-market Gain (Loss)	2003 Notional Amount	2003 Mark-to-market Gain (Loss)
			(in millions)		
PLDT					
Cash flow hedges:					
Long-term currency swaps					
	2017	**US$300**	**Php748**	US$300	Php687
	2012	**250**	**282**	250	563
	2009[1]	**–**	**–**	175	110
Long-term foreign currency options	2009	**US$175**	**Php672**	US$–	Php–
Short-term foreign currency options		**76**	**(198)**	**–**	**–**
Transactions not designated as hedges:					
Long-term foreign currency options		**175**[2]	**(22)**	–	–
Short-term foreign currency options		**–**	**–**	79	247
Short-term options		**76**[3]	**117**	–	–
Interest rate swap		**125**	**(3,468)**	125	(2,587)
Forward foreign exchange contracts		**87**	**6**	125	(11)
		JP¥14	**1**	–	–
				–	–
Bifurcated embedded derivatives		**US$1**	**(1)**	3	(12)
			(1,863)		(1,003)
Smart					
Transactions not designated as hedges:					
Forward foreign exchange contracts		**US$–**	**–**	US$42	(82)
Bifurcated embedded derivatives		**88**	**(63)**	48	25
			(63)		(57)
Net liabilities			**(Php1,926)**		(Php1,060)

[1] Re-classified as long-term currency options starting July 1, 2004;
[2] Non-hedged portion of 2009 long-term foreign currency options based on the same notional amount as hedged portion; and
[3] Non-hedged portion of short-term foreign currency options based on the same notional amount as hedged portion.

	2004	2003
	(in million pesos)	
Presented as:		
Noncurrent assets	**4,116**	1,360
Current assets	**335**	262
Noncurrent liabilities	**(5,903)**	(2,591)
Current liabilities	**(474)**	(91)
Net liabilities	**(1,926)**	(1,060)

Cumulative translation adjustments as of December 31, 2004 and 2003 consists of:

	2004	2003
	(in million pesos)	
Cumulative translation adjustment – beginning	**549**	501
Movement of cumulative translation adjustment		
Currency translation differences	**17**	48
Net loss on cash flow hedges	**(159)**	–
Net loss on available-for-sale financial assets	**(5)**	–
Net loss on cash flow hedges removed from cumulative translation adjustments and taken to profit or loss	**(133)**	–
Deferred income tax effects on cash flow hedge	**93**	–
	(187)	48
Cumulative translation adjustments – ending	**362**	549

Analysis of gain (loss) on derivative transaction for the years ended December 31, 2004, 2003 and 2002 are as follows:

	2004	2003	2002
		(in million pesos)	
Net mark-to-market loss – ending	**(1,926)**	(1,060)	(599)
Net mark-to-market loss – beginning	**(1,060)**	(599)	(587)
Net change	**(866)**	(461)	(12)
Net loss charged to cumulative translation adjustments	**(292)**	–	–
Gain (loss) on contracts entered into and terminated during the year	**167**	(64)	(74)
Gain on terminated interest swap agreement	**–**	–	633
Net gain (loss) on derivative transactions	**(991)**	(525)	547

PLDT

Cash Flow Hedges

Long Term Currency Swaps

PLDT entered into long-term principal-only currency swap agreements with various foreign counterparties to hedge the currency risk on its fixed rate notes maturing in 2009, 2012 and 2017. As of December 31, 2004, 2003 and 2002, these long-term currency swaps have an aggregate notional amount of US$550 million, US$725 million and US$550 million, respectively. Under the swaps, PLDT effectively exchanges the principal of its U.S. dollar-denominated fixed rate notes into peso-denominated loan exposures at agreed swap exchange rates. The agreed swap exchange rates are reset to the lowest U.S. dollar/Philippine Peso spot exchange rate during the term of the swaps, subject to a minimum exchange rate. In March and April 2004, PLDT entered into amendments to keep the lowest reset exchange rate and unwind the downward resettable feature of US$550 million of its long-term principal-only currency swap agreements in order to lower the running hedging cost of the swaps. As of December 31, 2004, 2003 and 2002, the outstanding swap contracts have an average exchange rate of Php50.76, Php51.22 and Php51.27, respectively.

In order to manage hedge costs, these swaps included credit-linkage feature with PLDT as the reference entity. The specified credit events include bankruptcy, failure to pay, obligation acceleration, moratorium/repudiation, and restructuring of PLDT bonds or all or substantially all of PLDT's obligations. Upon the occurrence of any of these credit events, subject to agreed threshold amounts where applicable, the obligations to both PLDT and its counterparty under the swap contracts terminate without further settlements to either party, including any mark-to-market value of the swaps. In March 2004, PLDT amended an additional US$150 million of the long-term currency swaps to include this credit-linkage feature. As of December 31, 2004, 2003 and 2002, US$725 million, US$575 million and US$400 million of PLDT's long-term currency swaps/options, respectively, have been structured to include credit-linkage with PLDT as the reference entity. The semi-annual fixed or floating swap cost payments that PLDT is required to make to its counterparties averaged to about 2.95%, 2.10% and 2.35% per annum as at December 31, 2004, 2003 and 2002, respectively. As cash flow hedges, any movements in the fair value of these instruments will be taken as a cumulative translation adjustment under equity in our consolidated balance sheets.

Long Term Currency Options

To manage hedging costs, the currency swap agreement relating to the 2009 fixed rate notes has been structured to include currency option contracts. If the Philippine Peso to U.S. dollar spot exchange rate on maturity date settles beyond Php90.00 to US$1.00, PLDT will have to purchase U.S. dollar at an exchange rate of Php52.50 to US$1.00 plus the excess above the agreed threshold rate. On the other hand, if on maturity, the Philippine Peso to US$1.00 spot exchange rate is lower than the exchange rate of Php52.50 to US$1.00, PLDT will have the option to purchase at the prevailing Philippine Peso to U.S. dollar spot exchange rate. In July 2004, PLDT and its counterparty, agreed to re-document and re-classify the transaction into long-term currency option contracts. The net semi-annual floating hedge cost payments that PLDT is required to pay under these transactions was approximately 3.94% and 2.30% per annum as at December 31, 2004 and 2003, respectively.

The option currency contract relating to PLDT's option to purchase U.S. dollar at Php52.50 to US$1.00 or prevailing spot rate at maturity whichever is lower, qualifies as a cash flow hedge. The option currency contract relating to the counterparty's option to purchase foreign currency from PLDT at Php90.00 to US$1.00 is not designated as a hedge. Please refer to discussion below (under transactions not designated as hedges).

Short Term Currency Options

PLDT utilized structures incorporating currency options to hedge the maturing principal on its fixed rate notes due June 2004 and June 2005. Under the terms of the contracts, PLDT will have the option to purchase U.S. dollar at an agreed Philippine Peso to U.S. dollar spot exchange rate or prevailing spot rate at maturity whichever is lower.

Transactions Not Designated as Hedges

Due to the amounts of PLDT's foreign currency hedging requirements and the large interest differential between the Philippine Peso and the U.S. dollar, the costs to book long-term hedges can be significant. In order to manage such hedging costs, PLDT utilizes structures that include currency option contracts, and fixed-to-floating coupon-only swaps that may not qualify for hedge accounting.

Long Term Currency Options

With reference to the above-mentioned hedge on the PLDT's 2009 fixed rate notes, PLDT simultaneously sold a currency option contract with the same notional amount of US$175 million with the same maturity that gives the counterparty a right to purchase foreign currency at Php90.00 to US$1.00. Together with the long-term currency option contract classified under cash flow hedges, PLDT has the obligation to purchase U.S. dollar at an exchange rate of Php52.50 to US$1.00 plus the excess above the agreed threshold rate. In exchange for this condition, the overall net hedging cost for the transaction is reduced.

Short Term Currency Options

In order to manage hedge costs, currency option contracts that hedge PLDT's fixed rate notes due June 2004 and June 2005 have features similar to that of the long-term currency option contracts. PLDT simultaneously sold currency option contracts with the same notional amounts with same maturity. Together with the other short term currency option contracts classified under cash flow hedges, PLDT has the obligation to buy U.S. dollar at the agreed strike price plus the excess above the agreed threshold rate should the Philippine Peso to U.S. dollar spot exchange rate on maturity date settle beyond that agreed threshold. In exchange for this condition, the overall net hedging cost for the transactions is reduced.

PLDT also entered into short term U.S. dollar subsidized forwards and Japanese yen currency option contracts to hedge other short-term foreign currency obligations.

Interest Rate Swap

A portion of PLDT's currency swap agreements to hedge its 2017 fixed rate notes carry fixed rate swap cost payments. To effectively lower the running cost of such swap agreements, PLDT, in April 2003, entered into an agreement to swap the coupon on US$125 million of its 2012 fixed rate notes into a floating rate Japanese yen amount. Under this agreement, PLDT is entitled to receive a fixed coupon rate of 11.375% provided the Japanese yen to U.S. dollar exchange rate stays above JP¥99.90/US$1.00. Below this level, a reduced fixed coupon rate of 3% will be due to PLDT. In order to mitigate the risk of the Japanese yen strengthening below the agreed threshold, PLDT, in December 2003, entered into an overlay swap transaction to effectively lower the portion of the coupon indexed to the U.S. dollar to Japanese yen rate to 3%. Both swap agreements include a credit-linkage feature with PLDT as the reference entity.

Forward Foreign Exchange Contracts

PLDT entered into short-term U.S. dollar and Japanese yen forward foreign exchange contracts to hedge short-term foreign currency obligations.

Bifurcated Embedded Derivatives

Derivative instruments include derivatives (or derivative-like provisions) embedded in non-derivative contracts. PLDT's outstanding bifurcated embedded derivative transactions cover service contracts denominated in U.S. dollars to be paid out to a Japanese company.

Smart

Smart uses forward exchange contracts to hedge foreign currency-denominated assets, liabilities and firm commitments. These forward contracts have maturities ranging from one to six months.

Cash deposits, presented as prepayment for forward purchase contract under "Short-term Investment", amounting to Php3,873 million and Php1,662 million collateralize certain of the forward exchange contracts outstanding as of December 31, 2004 and 2003, respectively. The embedded foreign currency derivatives bifurcated from these prepaid forwards are presented as derivative assets or derivative liabilities.

Smart's other embedded derivatives were bifurcated from service and purchase contracts. As of December 31, 2004 and 2003, outstanding contracts included a service contract with foreign equipment supplier and various suppliers covering handset importations payable in U.S. dollars.

Financial Risk Management Objectives and Policies

The main purpose of our financial instruments is to fund our operations. We also enter into derivative transactions, the purpose of which is to manage the currency risks and interest rate risks arising from our operations and our sources of financing. It is, and has been throughout the year under review, our policy that no trading in financial instruments shall be undertaken.

The main risks arising from our financial instruments are liquidity risk, foreign currency risk, interest rate risk and credit risk. Our Board reviews and agrees with policies for managing each of these risks and they are summarized below. We also monitor the market price risk arising from all financial instruments. Our accounting policies in relation to derivatives are set out in *Note 2 – Summary of Significant Accounting Policies*.

Liquidity Risk

We seek to manage our liquidity profile to be able to finance our capital expenditures and service our maturing debts. To cover our financing requirements, we intend to use internally generated funds and proceeds from debt and equity issues and sales of certain assets.

As part of our liquidity risk management program, we regularly evaluate our projected and actual cash flow information and continuously assess conditions in the financial markets for opportunities to pursue fund-raising initiatives. These initiatives may include bank loans, export credit agency-guaranteed facilities, and debt capital and equity market issues.

Foreign Currency Risk

The following table shows our consolidated foreign currency-denominated monetary assets and liabilities and their peso equivalents as of December 31, 2004 and 2003:

	2004		2003	
	U.S. Dollar(1)	Php Equivalent	U.S. Dollar(2)	Php Equivalent
	(in millions)			
Noncurrent Financial Assets				
Derivative assets	**US$73**	**Php4,113**	US$24	Php1,334
Notes receivable	**5**	**286**	–	–
Total noncurrent financial assets	**78**	**4,399**	24	1,334
Current Financial Assets				
Cash and cash equivalents	**251**	**14,142**	146	8,116
Short-term investments	**69**	**3,888**	30	1,668
Trade and other receivables	**146**	**8,226**	195	10,839
Derivative assets	**6**	**338**	5	277
Total current financial assets	**472**	**26,594**	376	20,900
Total Financial Assets	**US$ 550**	**Php30,993**	US$ 400	Php22,234
Noncurrent Financial Liabilities				
Interest-bearing financial liabilities	**US$2,330**	**Php131,275**	US$2,772	Php156,177
Derivative liabilities	**105**	**5,916**	47	2,612
Total noncurrent financial liabilities	**2,435**	**137,191**	2,819	158,789
Current Financial Liabilities				
Accounts payable	**46**	**2,592**	71	3,947
Accrued expenses and other current liabilities	**77**	**4,338**	71	3,947
Derivative liabilities	**8**	**451**	2	111
Interest-bearing financial liabilities	**483**	**27,213**	405	22,512
Total current financial liabilities	**614**	34,594	549	30,517
Total Financial Liabilities	**US$3,049**	**Php171,785**	US$3,368	Php189,306

(1) The exchange rate used was Php56.341 to US$1.00.
(2) The exchange rate used was Php55.586 to US$1.00.

In translating the foreign currency-denominated monetary assets and liabilities into peso amounts, the exchange rates used were Php56.341 to US$1.00 and Php55.586 to US$1.00, the Philippine peso-U.S. dollar exchange rates as at December 31, 2004 and 2003, respectively.

As at February 28, 2005, the peso–dollar exchange rate was Php54.685 to US$1.00. Using this exchange rate, our consolidated net foreign currency–denominated liabilities as of December 31, 2004 would have decreased by Php5,031 million.

While a certain percentage of our revenues is either linked to or denominated in U.S. dollars, substantially all of our indebtedness, a substantial portion of our capital expenditures and a portion of our operating expenses are denominated in foreign currencies, mostly in U.S. dollars.

As of December 31, 2004, approximately 98% of our total consolidated debts were denominated in foreign currencies. Of our foreign currency-denominated debts, 7% are in Japanese yen, and the balance in U.S. dollars. Thus, a weakening of the peso against the U.S. dollar or Japanese yen will increase both the principal amount of our unhedged foreign currency-denominated debts (representing 62% of our consolidated foreign-currency debts), and interest expense on our debt in peso terms. In addition, many of our financial ratios and other financial tests will be negatively affected. If, among other things, the value of the peso against the U.S. dollar substantially drops from its current level, we may be unable to maintain compliance with these ratios, which could result in acceleration of some or all of our indebtedness. For further information on our loan covenants, see *Note 18 – Interest-bearing Financial Liabilities* to the accompanying consolidated financial statements.

To manage our foreign exchange risks, stabilize cash flows, and improve investment and cash flow planning, we enter into foreign exchange forward contracts, foreign currency swap contracts, currency options and other hedging products aimed at reducing and/or managing the adverse impact of changes in foreign exchange rates on our operating results and cash flows. However, these hedges do not cover all of our exposure to foreign exchange risks.

Specifically, we use forward foreign exchange contracts, foreign currency swap contracts and currency option contracts to manage the foreign exchange risk associated with our foreign currency-denominated loans.

Interest Rate Risk

On a limited basis, we enter into interest rate swap agreements in order to manage our exposure to interest rate fluctuations. We make use of hedging instruments and structures solely for reducing or managing financial risks associated with our liabilities and not for trading or speculative purposes.

The following table sets out the carrying amount, by maturity, of our financial instruments that are exposed to interest rate risk:

Year ended December 31, 2004

	Below 1 year	1-2 years	2-3 years	3-5 years	Over 5 years	In U.S. Dollar	In Php	Discount/ Debt Issuance Cost	Carrying Value	Fair Value	
										In U.S. Dollar	In Php
								(in millions)			
Liabilities:								In Php	In Php		
Long-term Debt											
Fixed Rate											
US$ Notes (in millions)	110	130	272	175	550	1,237	69,725	930	68,795	1,307	73,662
Interest rate	9.875%	9.25%	7.85% to 10.625%	10.5%	8.35% to 11.375%	–	–	–	–	–	–
US$ Fixed Loans (in millions)	86	71	65	103	282	607	34,190	7,340	26,850	576	32,452
Interest rate	4.49% to 8.03%	4.49% to 7.75%	4.49% to 7.95%	4.49% to 7.89%	2.25% to 6.56%	–	–	–	–	–	–
Japanese Yen (in millions)	–	–	–	95	–	95	5,363		5,363	96	5,414
Interest rate	–	–	–	2.125%	–	–	–	–	–	–	–
Philippine Peso (in millions)	14	14	–	–	14	42	2,371	5	2,366	45	2,537
Interest rate	11.18% to 14%	11.6% to 24%	–	–	15%	–	–	–	–	–	–
Variable Rate											
U.S. Dollar (in millions)	119	165	157	99	273	813	45,832	2,045	43,787	814	45,832
Interest rate	0.20% over CXC's cost to 3.25% over LIBOR	0.425% to 3.25% over LIBOR	0.20% over CXC's cost to 3.25% over LIBOR	0.15% to 4.30% over LIBOR	0.5% to 3.625% over LIBOR	–	–	–	–	–	–
Japanese Yen (in millions)	–	–	–	22	–	22	1,212	–	1,212	22	1,212
Interest rate	–	–	–	1.7% over JP¥ LIBOR	–	–	–	–	–	–	–
Philippine Peso (in millions)	2	2	2	1	7	14	777	120	657	13	777
Interest rate	1% over 91-day T-bill rate to 11.25%	1% over 91-day T-bill rate to 11.25%	1% over 91-day T-bill rate to 11.25%	1% over 91-day T-bill rate	1% over 91-day T-bill rate	–	–	–	–	–	–
						2,830	**159,470**	**10,440**	**149,030**	**2,873**	**161,886**
Interest rate swap (fixed to floating)											
U.S. Dollar (US$125 million)	–	–	–	–	–	(62)	(3,468)	–	–	(62)	(3,468)
Japanese Yen (JP¥15,037 million)					–	–	–	–	–	–	–
Fixed Rate on US$ notional	–	–	–	–	11.375%	–	–	–	–	–	–
Variable Rate on JP¥ notional	–	–	–	–	8.11% over LIBOR	–	–	–	–	–	–

Year ended December 31, 2003

	Below 1 year	1-2 years	2-3 years	3-5 years	Over 5 years	In U.S. Dollar	In Php	Discount/ Debt Issuance Cost (in millions) In Php	Carrying Value In Php	Fair Value In U.S. Dollar	Fair Value In Php
Liabilities:											
Long-term Debt											
Fixed Rate											
US$ Notes (in millions)	77	138	175	300	725	1,415	78,666	787	77,879	1,444	80,273
Interest rate	10.625%	9.875%	9.25%	7.85% to 10.625%	8.35% to 11.375%	–	–	–	–	–	–
US$ Fixed Loans (in millions)	60	90	48	119	19	336	18,723	250	18,473	319	19,974
Interest rate	5.60% to 8.01%	5.60% to 8.03%	5.60% to 7.75%	6.6% to 7.95%	5.65% to 6.56%	–	–	–	–	–	–
Japanese Yen (in millions)	–	–	–	91	–	91	5,068	–	5,068	92	5,120
Interest rate	–	–	–	2.125%	–	–	–	–	–	–	–
Philippine Peso (in millions)	14	30	14	–	15	73	4,043	19	4,024	79	4,385
Inte rest rate	12.81% to 17.5%	11.18% to 16.8%	15.816% to 16.8%	–	15%	–	–	–	–	–	–
Variable Rate										–	
U.S. Dollar (in millions)	82	162	210	274	338	1,066	59,337	4,194	55,143	1,024	59,337
Interest rate	0.425% to 3.25% over LIBOR	0.425% to 3.25% over LIBOR	0.425% to 3.65% over LIBOR	0.15% to 4.30% over LIBOR	0.65% to 3.625% over LIBOR	–	–	–	–	–	–
Japanese Yen (in millions)	–	–	103	15	130	248	13,792	1,342	12,450	248	13,792
Interest rate	–	–	3.85% over JP¥ LIBOR	1.0% over JP¥ LIBOR	1.0% over JP¥ LIBOR	–	–	–	–	–	–
Philippine Peso (in millions)	1	1	1	8	74	85	4,731	1,312	3,419	85	4,731
Interest rate	1.0% over 91-day T-bill rate to 11%	1.0% over 91-day T-bill rate to 11%	1.0% over 91-day T-bill rate	1.0% over 91-day T-bill rate	1.0% over 91-day T-bill rate	–	–	–	–	–	–
						3,314	**184,360**	**7,904**	**176,456**	**3,291**	**187,612**
Interest rate swap (fixed to floating)											
U.S. Dollar (US$125 million)	–	–	–	–	–	–	–			–	–
Japanese Yen (JP¥15,037 million)	–	–	–	–	–	(46)	(2,582)	–	–	(46)	(2,582)
Fixed Rate on US$ notional	–	–	–	–	11.375%	–	–	–	–	–	–
Variable Rate on JP¥ notional	–	–	–	–	8.16% over LIBOR	–	–	–	–	–	–

Fixed rate financial instruments are subject to fair value interest rate risk while floating rate financial instruments are subject to cash flow interest rate risk.

Repricing of floating rate financial instruments is mostly done on intervals of three months or six months. Interest on fixed rate financial instruments is fixed until maturity of instrument. Financial instruments that are not subject to interest rate risk were not included in the above tables.

Credit Risk

We trade only with recognized, creditworthy third parties. It is our policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis to reduce our exposure to bad debts.

With respect to credit risk arising from our other financial assets, which comprise cash and cash equivalents, certain derivative instruments, our exposure to credit risk arises from default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments.

We have no significant concentrations of credit risk.

26. Other Matters

a. Interconnection Agreements

PLDT has existing interconnection agreements with nine International Gateway Facilities, or IGF operators, six Inter Exchange Carriers, or IXCs, six Cellular Mobile Telephone Systems, or CMTS operators, 70 LECs (including members of the Philippine Association of Private Telephone Companies, Inc.), and 12 paging and trunk radio operators. These interconnection agreements include provisions for settlement and payment of charges. Settlements with interconnecting IGF operators and CMTS operators for local calls are in the form of access charges. Settlement with interconnecting IXCs and LECs for toll calls are based on hauling and access charges, and to some extent, revenue sharing. Settlement also involves payment of access charges, but settlement for toll calls is on a revenue-sharing basis. LEC to LEC interconnection with hauling from one service area to another service area is settled based on trunk charges, while overlay LEC to LEC interconnection in a given service area is without charges. Paging and trunk radio interconnection settlements are based on fixed charges.

b. U.S. Federal Communications Commission, or U.S. FCC, Ruling versus Philippine Telecommunications Companies

Effective as of February 1, 2003, PLDT stopped terminating traffic sent directly by each of AT&T and MCI, because PLDT's termination rate agreements with AT&T and MCI lapsed in December 2002 without either agreeing with PLDT on any provisional arrangement or final agreement on new termination rates. In orders dated February 7 and 26, 2003, the NTC confirmed that "absent any provisional or interim agreement" with U.S. carriers, there would be no provision of termination services between the parties "who are thereby encouraged to seek other routes or options to terminate traffic to the Philippines." Upon petitions of AT&T and MCI, on March 10, 2003, the International Bureau of the U.S. FCC issued an Order which directed all facilities-based carriers subject to U.S. FCC jurisdiction to suspend payments for termination services to Philippine carriers, including PLDT, Smart and Subic Telecom, until such time as the U.S. FCC issued a Public Notice that AT&T's and MCI's circuits on the U.S.–Philippine route were fully restored. The Order also removed the Philippines from the list of U.S.–international routes approved for the provision of International Simple Resale, or ISR. In response to the International Bureau's Order, the NTC issued a Memorandum Order dated March 12, 2003, directing all affected Philippine carriers "(1) not to accept terminating traffic via direct circuits from U.S. facilities-based carriers who do not pay Philippine carriers for services rendered; and (2) to take all measures necessary to collect payments for services rendered in order to preserve the viability, efficiency, sustained growth and development and continued competitiveness of the Philippine telecommunications industry."

On October 17, 2003, based on negotiations between the NTC and the U.S. FCC to resolve the issue regarding termination rates, the NTC, in the expectation that the U.S. FCC would fully lift the March 10, 2003 Order, lifted its March 12, 2003 Order and directed all Philippine carriers to immediately accept terminating traffic via direct circuits from U.S. facilities-based carriers at mutually acceptable final or interim termination rates and other terms and conditions agreed upon by the parties.

On November 17, 2003, after Smart reached interim agreements with each of AT&T and MCI on September 30 and November 12, 2003, respectively, the International Bureau of the U.S. FCC lifted its March 10, 2003 Order with respect to Smart and ordered the U.S. carriers to resume making payments to Smart.

On January 15, 2004, after PLDT reached interim agreements with each of MCI and AT&T and reopened its circuits with these carriers on November 12, 2003 and January 9, 2004, respectively, the International Bureau of the U.S. FCC lifted its March 10, 2003 Order also with respect to PLDT and ordered the U.S. carriers to resume making payments to PLDT.

On May 13, 2004, the U.S. FCC partially dismissed and partially denied applications by Philippine carriers, including PLDT, and certain U.S. carriers for review of the March 10, 2003 Order of the International Bureau of the U.S. FCC. In particular, the U.S. FCC affirmed the March 10, 2003 Order's finding that "Philippine carriers engaged in collective action to "whipsaw" AT&T and MCI." The U.S. FCC stated, however, that the findings of the March 10, 2003 Order were not findings under the U.S. anti-trust laws and that the U.S. Department of Justice is independently "investigating the possibility of anticompetitive practices among Philippine carriers under its authority pursuant to U.S. anti-trust laws." The U.S. FCC also upheld the March 10, 2003 Order in respect of the suspension of payments for termination services to the Philippine carriers pending restoration of the circuits. In addition, the U.S. FCC denied a request to modify the March 10, 2003 Order of the International Bureau of the U.S. FCC to restore the Philippines to the list of U.S.-international routes approved for the provision of ISR. The U.S. FCC stated that it was dismissing this request as moot because of the U.S. FCC's recently adopted International Settlements Policy Reform Order which eliminated ISP.

Although not included in the initial list of countries exempted from the U.S. FCC's International Settlements Policy, or ISP, the U.S. FCC identified the U.S.–Philippines route as eligible for being removed from the ISP in accordance with its newly established procedures for doing so. Under this procedure, the U.S. FCC asked for public comment on the removal of the Philippines from the ISP. In comments filed in June and July 2004, removal was reported by several Philippine and U.S. carriers, including AT&T and MCI, and was opposed by one U.S. carrier, International Access, Inc. In November 2004, the U.S. FCC exempted a number of additional countries from the ISP, but not the Philippines. Instead, the U.S. FCC stated that it would rule separately regarding the Philippines after reviewing the issues raised by International Access, Inc. These issues are still pending before the U.S. FCC.

On July 6, 2004, PLDT filed with the U.S. FCC a Petition for Reconsideration of the Commission's May 13, 2004 Order on the grounds that the Order should have vacated as moot the International Bureau's March 10, 2003 Order.

c. Investigation by U.S. Department of Justice

In January 2004, PLDT received a grand jury subpoena seeking documents and a PLDT employee was subpoenaed to testify before the grand jury in connection with a criminal investigation being conducted by the U.S. Department of Justice with respect to alleged antitrust violations relating to the provision of international termination services in the Philippines. The U.S. Department of Justice has also requested testimony and documents from Smart in connection with this investigation. Further, in March 2004, PLDT (U.S.) Ltd., a subsidiary of PLDT Global, received a grand jury subpoena seeking documents, in response to which PLDT (U.S.) Ltd. produced documents. In February 2005, two former employees of PLDT U.S. Ltd. testified before the grand

jury in the U.S. DOJ matter. A PLDT employee was also scheduled to reappear for testimony in February, but his appearance has been postponed. At this time, the PLDT Group cannot predict the outcome of this investigation.