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REPORT OF INDEPENDENT AUDITORS

The Board of Trustees
Partnership in Environmental Management for the Seas of East Asia

Report on the Financial Statements

We have audited the accompanying financial statements of Partnership in Environmental Management for the Seas of East Asia (PEMSEA) Trust Fund Account (The "Project"), which comprise the statements of financial position as at December 31, 2012 and 2011, and the statements of receipts and expenses, statements of changes in fund balance and statements of cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information. These financial statements were prepared from the accounts maintained in the Project.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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



Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Partnership in Environmental Management for the Seas of East Asia (PEMSEA) Trust Fund Account as at December 31, 2012 and 2011, and its financial performance and its cash flows for the years then ended, as carried in the accounts maintained for the Project, in accordance with Philippine Financial Reporting Standard for Small and Medium-sized Entities.

Limitation of Use

This report is intended solely for the information and use of the Board of Trustees and the management of PEMSEA, and is not intended to be and should not be used by anyone other than these specified parties.

Manabat Sanagustin & Co.

April 4, 2013
Makati City, Metro Manila

**PARTNERSHIP IN ENVIRONMENTAL MANAGEMENT
FOR THE SEAS OF EAST ASIA (PEMSEA)
(Trust Fund Account)**

**STATEMENTS OF FINANCIAL POSITION
(As Carried in the Accounts Maintained for the Project)**

		December 31	
	<i>Note</i>	2012	2011
ASSETS			
Current Assets			
Cash	4	\$1,417,218	\$1,028,340
Advances to Grantor	5	405	-
		\$1,417,623	\$1,028,340
LIABILITY AND FUND BALANCE			
Current Liability			
Accounts payable and accrued expense	6	\$171,919	\$ -
Fund Balance		1,245,704	1,028,340
		\$1,417,623	\$1,028,340

See Notes to the Financial Statements.

**PARTNERSHIP IN ENVIRONMENTAL MANAGEMENT
FOR THE SEAS OF EAST ASIA (PEMSEA)
(Trust Fund Account)**

**STATEMENTS OF RECEIPTS AND EXPENSES
(As Carried in the Accounts Maintained for the Project)**

	<i>Note</i>	Years Ended December 31	
		2012	2011
RECEIPTS			
Grants	7	\$561,518	\$232,255
Training fee		15,389	7,050
Interest from bank deposits	4	2,741	2,434
Publications		859	604
Others		1,000	-
		581,507	242,343
EXPENSES			
Training		210,435	179,792
Consultancy		136,644	84,247
Printing and distribution		11,070	4,902
Transportation		5,994	22,540
		364,143	291,481
EXCESS (DEFICIENCY) OF RECEIPTS OVER EXPENSES		\$217,364	(\$49,138)

See Notes to the Financial Statements.

**PARTNERSHIP IN ENVIRONMENTAL MANAGEMENT
FOR THE SEAS OF EAST ASIA (PEMSEA)
(Trust Fund Account)**

**STATEMENTS OF CHANGES IN FUND BALANCE
(As Carried in the Accounts Maintained for the Project)**

	Years Ended December 31	
	2012	2011
FUND BALANCE		
Balance at beginning of year	\$1,028,340	\$1,077,478
Excess (deficiency) of receipts over expenses	217,364	(49,138)
Balance at end of year	\$1,245,704	\$1,028,340

See Notes to the Financial Statements.

**PARTNERSHIP IN ENVIRONMENTAL MANAGEMENT
FOR THE SEAS OF EAST ASIA (PEMSEA)
(Trust Fund Account)**

**STATEMENTS OF CASH FLOWS
(As Carried in the Accounts Maintained for the Project)**

	Years Ended December 31		
	<i>Note</i>	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES			
Excess (deficiency) of receipts over expenses		\$217,364	(\$49,138)
Adjustments for:			
Interest income		(2,741)	(2,434)
Excess (deficiency) of receipts over expenses before working capital changes		214,623	(51,572)
Increase in advances to grantor		(405)	-
Increase in accounts payable and accrued expense		171,919	-
Cash generated from (absorbed by) operations		386,137	(51,572)
Interest received		2,741	2,434
NET INCREASE (DECREASE) IN CASH		388,878	(49,138)
CASH AT BEGINNING OF YEAR	<i>4</i>	1,028,340	1,077,478
CASH AT END OF YEAR	<i>4</i>	\$1,417,218	\$1,028,340

See Notes to the Financial Statements.

**PARTNERSHIP IN ENVIRONMENTAL MANAGEMENT
FOR THE SEAS OF EAST ASIA (PEMSEA)
(Trust Fund Account)**

NOTES TO THE FINANCIAL STATEMENTS

1. Reporting Entity

Partnerships in Environmental Management for the Seas of East Asia ("PEMSEA") was established as an international legal personality in 2009. Prior to that, commencing in 1993, PEMSEA was a project office for a project of the Global Environment Facility (GEF), implemented by the United Nations Development Programme (UNDP), and executed by the International Maritime Organization (IMO). PEMSEA's primary function is to facilitate and promote the implementation of the Sustainable Development Strategy for the Seas of East Asia (SDS-SEA). PEMSEA was organized primarily to cater activities that directly assist countries on national policy reforms, scaling up of Integrated Coastal Management (ICM) programmes at the national and local government levels, technical cooperation in integrated and ecosystem-based management of watersheds, estuaries and adjacent coastal seas. GEF has been a major donor to PEMSEA over the past 20 years, providing the necessary financial support to cover the incremental costs of addressing regional environmental issues that are of global significance via implementation of the SDS-SEA.

PEMSEA consists of the following key components, as defined in the Haikou Partnership Agreement of December 2006:

- The East Asian Seas (EAS) Partnership Council
- The Executive Committee
- The PEMSEA Resource Facility (PRF)
- The PEMSEA Partnership Fund
- The East Asian Seas Congress/Ministerial Forum

The PEMSEA Partnership Fund ("Trust Fund Account" or "the Project") is a mechanism for receiving financial contributions from donors, collaborative projects and programs, as well as proceeds from the sale of goods (i.e., publications, software) and services (i.e., training, project execution, etc.). The Trust Fund Account is designed to ensure the sustainability of the regional mechanism to operate on a self-sustaining basis. Throughout the years, PEMSEA has tapped the resources of governments, donors, the private sector and other funding resources to complement the funding it receives from GEF.

PEMSEA operates a regional project office in the Philippines (PEMSEA Resource Facility) and has no other legal and regulatory obligations to the Philippine government.

The registered address of PEMSEA's regional program office is at Department of Environment and Natural Resources Compound, Visayas Avenue, Quezon City, Philippines.

2. Basis of Preparation

Statement of Compliance

The accompanying financial statements have been prepared in compliance with Philippine Financial Reporting Standard (PFRS) for Small and Medium-sized Entities (SMEs). PFRSs are based on International Financial Reporting Standards (IFRS) issued by International Accounting Standard Board (IASB). PFRSs includes statements named PFRSs, Philippine Accounting Standard (PASs) and Philippine Interpretations from International Financial Reporting Interpretations Committee (IFRIC) issued by the Financial Reporting Standards Council (FRSC).

The financial statements of the Project were approved and authorized for issuance by its Board of Trustees (BOT) on April 4, 2013.

Basis of Measurement

The financial statements of the Project have been prepared using the historical cost basis.

Functional and Presentation Currency

These financial statements are presented in United States (US) Dollar, which is also the Project's functional currency. All financial information has been rounded off to the nearest US Dollar, except when otherwise indicated.

Use of Judgments, Assumptions, and Estimates

The preparation of the Project's financial statements requires management to make judgment, estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. The estimates and assumptions used in preparing the financial statements are based on management's evaluation of relevant facts and circumstances as of the date of the financial statements. Actual results could differ from these estimates. Estimates and underlying assumptions are reviewed on an ongoing basis and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Revisions to accounting estimates are recognized in a period in which the estimate is revised and in any future periods affected.

In particular, information about significant areas of estimation, uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements are as follows:

Judgments

In the process of applying the Project's accounting policies, management has made the judgement below, apart from those involving estimations, which has the most significant effect on the financial statements.

Determining Functional Currency

The Project considers factors, including but not limited to, the currency in which receipts and disbursements from the operating activities are usually made. Based on the economic substance of the underlying circumstances relevant to the Project, the functional currency has been determined to be the US Dollar.

3. Significant Accounting Policies

The accounting policies set out below have been applied consistently to all periods presented in these financial statements, unless otherwise stated.

Financial Assets and Liabilities

Financial assets and liabilities comprise cash and accounts payable and accrued expense.

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

Initial Recognition of Financial Instruments. Financial instruments are recognized initially at fair value, which is the fair value of the consideration given or received. The fair value of the consideration given or received is 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 rate of interest for similar instruments with similar maturities. The initial measurement of financial instruments, except for those designated at fair value through profit or loss (FVPL), includes transaction cost.

Subsequent to initial recognition, the Project classifies its financial assets in the following categories: held-to-maturity (HTM) investments, available-for-sale (AFS) financial assets, financial assets at FVPL, and loans and receivables. The Project classifies its financial liabilities as either financial liabilities at FVPL or other financial liabilities. The classification depends on the purpose for which the financial assets are acquired or the financial liabilities are incurred and whether they are quoted in an active market. Management determines the classification of its financial assets at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

The Project has no HTM investments, AFS financial assets and financial assets at FVPL and liabilities as at December 31, 2012 and 2011.

Loans and Receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not designated as AFS financial assets or financial asset at FVPL. Receivables are carried at cost or amortized cost, less impairment in value. Amortization is determined using the effective interest method. Gains and losses are recognized in profit or loss when the financial asset are derecognized or impaired, as well as through the amortization process.

Cash

Cash includes cash on hand and cash in banks which are stated at face value.

Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses are recognized initially at the transaction price including transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortized cost using the effective interest rate method.

Revenue Recognition

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

Grants are recognized in the period received and all the requirements of the grantor are satisfied.

Training fee pertains to registration fee and exhibit fee from seminars and trainings conducted and is recognized when rendered.

Publication fee pertains to proceeds from the publication of books, technical reports, brochures, magazines, and others and is recognized when earned.

Interest income is recognized as it accrues.

Expense Recognition

Expenses are recognized when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably and are recognized when incurred.

Foreign Currency Transactions

Transactions in foreign currencies are translated to the functional currency at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are retranslated to the functional currency at the exchange rate at that date. Resulting exchange differences arising on the settlement of or on translating such monetary assets and liabilities are recognized in the statements of receipts and expenses.

Events After the Reporting Date

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

4. Cash

This account consists of:

	2012	2011
Cash in banks	\$1,416,218	\$1,028,340
Petty cash fund	1,000	-
	<u>\$1,417,218</u>	<u>\$1,028,340</u>

Cash in banks earn interest at prevailing bank deposit rates.

5. Advances to Grantor

Advances to Grantor account pertains to advances made to a particular project whenever disbursement for that project is necessary and the fund is not yet received from the Grantor. As at December 31, 2012, the advance pertained to the YEOSU World Expo 2012 where PEMSEA has an exhibit and all related expenses are charged to YEOSU approved budget.

6. Accounts payable and Accrued Expense

	2012	2011
Accounts payable	\$165,919	\$ -
Accrued expense	6,000	-
	\$171,919	\$ -

Accounts payable and accrued expense represent the amount due arising from expenses related to various projects. This includes technical services, project evaluation services, consultancy services and others.

7. Grants

This account consists of grants from the following partners:

	2012	2011
Korea International Cooperation Agency	\$224,995	\$ -
United Nations Environment Programme	120,553	16,300
International Maritime Organization	100,995	-
Timor Leste	99,980	99,980
Korea Marine Environment Management Organization	14,995	-
Korean Maritime Institute	-	106,980
Stockholm Environment Institute	-	8,995
	\$561,518	\$232,255

The Grants cover the following Projects:

Korea International Cooperation Agency (KOICA)

Funding Agreement Regarding the Implementation of the Yeosu Project

The Organizing Committee, KOICA and PEMSEA for the Seas of East Asia have mutually agreed to implement the project under the Yeosu Project entitled "PEMSEA-Yeosu Project on Port Safety Health and Environmental Management."

United Nations Environment Programme (UNEP)

Small Scale Funding Agreement

Under this Agreement, PEMSEA facilitates the participation of Project Partners and Project Steering Committee members in the meeting and organizes all logistics for the successful Project Inception leading to approval of the 2012 work plan and budget for the project activities.

Project Cooperation Agreement

UNEP and PEMSEA have agreed to cooperate to implement the project entitled "Global foundations for reducing nutrient enrichment and oxygen depletion from land based pollution, in support of Global Nutrient Cycle."

International Maritime Organization (IMO)

Project on Strengthening Oil Spill Preparedness and Response in a Subregional Sea are: Environmental Sensitivity Mapping in the Gulf of Thailand

The specific project objective is to develop Gulf of Thailand (GoT) sensitivity maps for planning and response to oil spill incidents covering the coastal and marine resources of the Gulf, existing economic activities along the coast and offshore and gazetted areas, as well as locations of emergency services, spill response equipment and related services.

Timor Leste

Sustainable Development Strategy for the Seas of East Asia (SDS-SEA)

In line with the commitment on the SDS-SEA, the Government of Timor-Leste expressed its support to the continuous implementation of the SDS-SEA and announced their provision of financial support to PEMSEA, amounting to US\$ 100,000 on an annual basis.

Korea Marine Environment Management Organization (KOEM)

Cooperation on Conducting Research on Monitoring and Analysis of Waters in the East Asian Seas Relating to Climate Change

KOEM and PEMSEA collaborates on the proposed activities on conducting research through monitoring and analysis of waters in the East Asian Seas region in relation to climate change, analysis of gaps and needs in ocean monitoring, and identification of collaborative areas for KOEM to work within the East Asia Seas (EAS) region.

Korean Maritime Institute (KMI)

Cooperation on the Implementation of the Sustainable Development Strategy for the Seas of East Asia in 2010

PEMSEA and KMI have agreed to collaborate on the promotion of integrated river basin and coastal area management among countries of the region.

Cooperation on the Implementation of the Sustainable Development Strategy for the Seas of East Asia at the Lesser Developed Countries in 2010

KMI provides technical and financial assistance to PEMSEA for the implementation of project activities related to the implementation of the SDS-SEA in lesser developed countries (LDCs) of PEMSEA.

Integrated Land and Sea-use Zoning of Manila Bay

PEMSEA and KMI have agreed to collaborate on the integrated land and sea-use zoning of Manila Bay. The project aims to develop a "macro-scale" land and sea-use zoning plan for Manila Bay, with a specific focus on the different scenarios for sea level rise, flooding and storm surges as a consequence of climate change, variability and extremes in the coastal areas over the next 50 years.

Stockholm Environment Institute (SEI)

Regional Climate Change Adaptation Knowledge Platform for Asia (or Adaptation Platform)

The adaptation platform seeks to facilitate climate change adaptation at local, national, and regional levels and to strengthen adaptive capability of countries in South and South East Asian countries, while bridging existing and emerging networks and knowledge.