PETRO-CANADA

CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2007

CONSOLIDATED STATEMENT OF EARNINGS *(unaudited)*
For the periods ended June 30
(millions of Canadian dollars, except per share amounts)

	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
Revenue				
Operating	$ 5,529	$ 4,836	$ 10,396	$ 9,251
Investment and other income (expense) *(Note 5)*	(51)	(106)	(77)	(333)
	5,478	4,730	10,319	8,918
Expenses				
Crude oil and product purchases	2,522	2,578	4,830	4,678
Operating, marketing and general	986	782	1,813	1,603
Exploration	100	78	242	175
Depreciation, depletion and amortization	516	312	957	647
Unrealized gain on translation of foreign currency denominated long-term debt	(124)	(73)	(141)	(71)
Interest	41	42	83	87
	4,041	3,719	7,784	7,119
Earnings from continuing operations before income taxes	1,437	1,011	2,535	1,799
Provision for income taxes *(Note 6)*				
Current	606	626	1,097	1,158
Future	(14)	(87)	3	115
	592	539	1,100	1,273
Net earnings from continuing operations	845	472	1,435	526
Net earnings from discontinued operations *(Note 4)*	-	-	-	152
Net earnings	$ 845	$ 472	$ 1,435	$ 678
Earnings per share from continuing operations *(Note 7)*				
Basic	$ 1.71	$ 0.93	$ 2.90	$ 1.03
Diluted	$ 1.70	$ 0.92	$ 2.87	$ 1.02
Earnings per share *(Note 7)*				
Basic	$ 1.71	$ 0.93	$ 2.90	$ 1.33
Diluted	$ 1.70	$ 0.92	$ 2.87	$ 1.32

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME *(unaudited) (Note 3)*
For the periods ended June 30
(millions of Canadian dollars)

	Three months ended June 30, 2007	Three months ended June 30, 2006	Six months ended June 30, 2007	Six months ended June 30, 2006
Net earnings	$ 845	$ 472	$ 1,435	$ 678
Other comprehensive income, net of tax				
Change in foreign currency translation adjustment	(203)	38	(196)	93
Comprehensive income	$ 642	$ 510	$ 1,239	$ 771

See accompanying Notes to Consolidated Financial Statements

CONSOLIDATED STATEMENT OF CASH FLOWS *(unaudited)*
For the periods ended June 30
(millions of Canadian dollars)

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Operating activities				
Net earnings	$ 845	$ 472	$ 1,435	$ 678
Less: Net earnings from discontinued operations	-	-	-	152
Net earnings from continuing operations	845	472	1,435	526
Items not affecting cash flow from continuing operating activities:				
Depreciation, depletion and amortization	516	312	957	647
Future income taxes	(14)	(87)	3	115
Accretion of asset retirement obligations	17	14	34	27
Unrealized gain on translation of foreign currency denominated long-term debt	(124)	(73)	(141)	(71)
Gain on sale of assets	(8)	(18)	(70)	(20)
Unrealized loss associated with the Buzzard derivative contracts *(Note 12)*	40	108	128	327
Other	7	7	7	13
Exploration expenses	71	19	163	47
Decrease in non-cash working capital related to continuing operating activities	85	45	85	74
Cash flow from continuing operating activities	1,435	799	2,601	1,685
Cash flow from discontinued operating activities *(Note 4)*	-	-	-	15
Cash flow from operating activities	1,435	799	2,601	1,700
Investing activities				
Expenditures on property, plant and equipment and exploration	(768)	(752)	(1,484)	(1,511)
Proceeds from sale of assets *(Note 4)*	12	18	94	663
Increase in other assets	(15)	(23)	(32)	(32)
Increase in non-cash working capital related to investing activities	(92)	(82)	(151)	(70)
Cash used in investing activities	(863)	(839)	(1,573)	(950)
Financing activities				
Repayment of long-term debt	(1)	(2)	(3)	(4)
Proceeds from issue of common shares *(Note 9)*	18	11	24	33
Purchase of common shares *(Note 9)*	(428)	(350)	(515)	(826)
Dividends on common shares	(64)	(51)	(129)	(101)
Cash used in financing activities	(475)	(392)	(623)	(898)
Increase (decrease) in cash and cash equivalents	97	(432)	405	(148)
Cash and cash equivalents at beginning of period	807	1,073	499	789
Cash and cash equivalents at end of period	$ 904	$ 641	$ 904	$ 641

See accompanying Notes to Consolidated Financial Statements

CONSOLIDATED BALANCE SHEET *(unaudited)*
As at June 30, 2007
(millions of Canadian dollars)

	June 30, 2007	December 31, 2006
Assets		
Current assets		
Cash and cash equivalents	$ 904	$ 499
Accounts receivable	1,746	1,600
Inventories	737	632
Future income taxes	200	95
	3,587	2,826
Property, plant and equipment, net	18,463	18,577
Goodwill	734	801
Other assets *(Note 3)*	362	442
	$ 23,146	$ 22,646
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities *(Note 12)*	$ 3,573	$ 3,319
Income taxes payable	157	22
Current portion of long-term debt *(Note 8)*	4	7
	3,734	3,348
Long-term debt *(Notes 3 and 8)*	2,528	2,887
Other liabilities *(Note 12)*	1,682	1,826
Asset retirement obligations	1,159	1,170
Future income taxes	2,973	2,974
Shareholders' equity		
Common shares *(Note 9)*	1,365	1,366
Contributed surplus *(Note 9)*	26	469
Retained earnings	9,826	8,557
Accumulated other comprehensive income *(Note 3)*		
Foreign currency translation adjustment	(147)	49
	11,070	10,441
	$ 23,146	$ 22,646

CONSOLIDATED STATEMENT OF RETAINED EARNINGS *(unaudited)*
For the periods ended June 30
(millions of Canadian dollars)

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Retained earnings at beginning of period	$ 9,090	$ 7,174	$ 8,557	$ 7,018
Cumulative effect of adopting new accounting standards *(Note 3)*	-	-	8	-
Net earnings	845	472	1,435	678
Dividends on common shares	(64)	(51)	(129)	(101)
Charges for normal course issuer bid *(Note 9)*	(45)	-	(45)	-
Retained earnings at end of period	$ 9,826	$ 7,595	$ 9,826	$ 7,595

See accompanying Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited)*
(millions of Canadian dollars)

1. SEGMENTED INFORMATION FROM CONTINUING OPERATIONS
Three months ended June 30,

	Upstream													
					International & Offshore									
	North American Natural Gas		Oil Sands		East Coast Canada		International		Downstream		Shared Services		Consolidated	
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
Revenue														
Sales to customers	$ 359	$ 357	$ 147	$ 132	$ 780	$ 531	$ 911	$ 611	$ 3,332	$ 3,205	$ -	$ -	$ 5,529	$ 4,836
Investment and other income (expense) (1)	4	2	2	-	(6)	3	(39)	(111)	(1)	5	(11)	(5)	(51)	(106)
Inter-segment sales	83	83	221	208	109	35	-	-	3	3	-	-		
Segmented revenue	446	442	370	340	883	569	872	500	3,334	3,213	(11)	(5)	5,478	4,730
Expenses														
Crude oil and product purchases	62	66	124	90	211	127	-	-	2,121	2,299	4	(4)	2,522	2,578
Inter-segment transactions	2	-	6	6	2	3	-	-	406	320	-	-		
Operating, marketing and general	120	118	156	128	59	61	115	70	358	388	178	17	986	782
Exploration	41	24	5	6	5	2	49	46	-	-	-	-	100	78
Depreciation, depletion and amortization	109	98	40	24	111	54	180	76	72	57	4	3	516	312
Unrealized gain on translation of foreign currency denominated long-term debt	-	-	-	-	-	-	-	-	-	-	(124)	(73)	(124)	(73)
Interest	-	-	-	-	-	-	-	-	-	-	41	42	41	42
	334	306	331	254	388	247	344	192	2,957	3,064	103	(15)	4,041	3,719
Earnings (loss) from continuing operations before income taxes	112	136	39	86	495	322	528	308	377	149	(114)	10	1,437	1,011
Provision for income taxes														
Current *(Note 6)*	41	82	(16)	5	187	109	368	308	61	56	(35)	66	606	626
Future *(Note 6)*	(10)	(43)	21	(20)	(26)	(41)	(35)	63	57	(46)	(21)	-	(14)	(87)
	31	39	5	(15)	161	68	333	371	118	10	(56)	66	592	539
Net earnings (loss) from continuing operations	$ 81	$ 97	$ 34	$ 101	$ 334	$ 254	$ 195	$ (63)	$ 259	$ 139	$ (58)	$ (56)	$ 845	$ 472
Expenditures on property, plant and equipment and exploration from continuing operations (2)	$ 116	$ 121	$ 106	$ 76	$ 48	$ 81	$ 172	$ 175	$ 319	$ 294	$ 7	$ 5	$ 768	$ 752
Cash flow from continuing operating activities	$ 247	$ 167	$ 160	$ 54	$ 346	$ 259	$ 356	$ 186	$ 320	$ 277	$ 6	$ (144)	$ 1,435	$ 799
Total assets from continuing operations	$ 4,032	$ 3,701	$ 2,985	$ 2,770	$ 2,369	$ 2,452	$ 5,766	$ 5,290	$ 7,293	$ 6,036	$ 701	$ 526	$ 23,146	$ 20,775

(1) Investment and other income (expense) for the International segment includes unrealized losses relating to the Buzzard derivative contracts of $40 million for the three months ended June 30, 2007 ($108 million for the three months ended June 30, 2006) *(Notes 5 and 12)*.
(2) Consolidated expenditures include capitalized interest in the amount of $7 million for the three months ended June 30, 2007 ($7 million for the three months ended June 30, 2006).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited)*
(millions of Canadian dollars)

1. SEGMENTED INFORMATION FROM CONTINUING OPERATIONS *(Note 4)*
Six months ended June 30,

	Upstream													
					International & Offshore									
	North American Natural Gas		Oil Sands		East Coast Canada		International		Downstream		Shared Services		Consolidated	
	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006	2007	2006
Revenue														
Sales to customers	$ 708	$ 808	$ 313	$ 248	$ 1,381	$ 919	$ 1,575	$ 1,315	$ 6,419	$ 5,961	$ -	$ -	$ 10,396	$ 9,251
Investment and other income (expense) [1]	65	1	-	-	(6)	(1)	(129)	(334)	(4)	2	(3)	(1)	(77)	(333)
Inter-segment sales	168	178	443	363	238	157	-	-	7	7	-	-		
Segmented revenue	941	987	756	611	1,613	1,075	1,446	981	6,422	5,970	(3)	(1)	10,319	8,918
Expenses														
Crude oil and product purchases	103	136	254	201	387	172	-	-	4,079	4,171	7	(2)	4,830	4,678
Inter-segment transactions	4	2	10	17	4	5	-	-	838	681	-	-		
Operating, marketing and general	244	223	287	263	118	108	277	160	710	742	177	107	1,813	1,603
Exploration	97	72	24	12	9	1	112	90	-	-	-	-	242	175
Depreciation, depletion and amortization	217	198	79	61	214	119	298	156	141	110	8	3	957	647
Unrealized gain on translation of foreign currency denominated long-term debt	-	-	-	-	-	-	-	-	-	-	(141)	(71)	(141)	(71)
Interest	-	-	-	-	-	-	-	-	-	-	83	87	83	87
	665	631	654	554	732	405	687	406	5,768	5,704	134	124	7,784	7,119
Earnings (loss) from continuing operations before income taxes	276	356	102	57	881	670	759	575	654	266	(137)	(125)	2,535	1,799
Provision for income taxes														
Current *(Note 6)*	102	166	(10)	(10)	325	233	626	668	117	92	(63)	9	1,097	1,158
Future *(Note 6)*	(19)	(46)	35	(15)	(34)	(46)	(71)	251	94	(40)	(2)	11	3	115
	83	120	25	(25)	291	187	555	919	211	52	(65)	20	1,100	1,273
Net earnings (loss) from continuing operations	$ 193	$ 236	$ 77	$ 82	$ 590	$ 483	$ 204	$ (344)	$ 443	$ 214	$ (72)	$ (145)	$ 1,435	$ 526
Expenditures on property, plant and equipment and exploration from continuing operations [2]	$ 321	$ 334	$ 196	$ 195	$ 86	$ 134	$ 329	$ 296	$ 540	$ 545	$ 12	$ 6	$ 1,484	$ 1,510
Cash flow from continuing operating activities	$ 406	$ 408	$ 229	$ 107	$ 827	$ 605	$ 633	$ 489	$ 534	$ 292	$ (28)	$ (216)	$ 2,601	$ 1,685
Total assets from continuing operations	$ 4,032	$ 3,701	$ 2,985	$ 2,770	$ 2,369	$ 2,452	$ 5,766	$ 5,290	$ 7,293	$ 6,036	$ 701	$ 526	$ 23,146	$ 20,775

(1) Investment and other income (expense) for the International segment includes unrealized losses relating to the Buzzard derivative contracts of $128 million for the six months ended June 30, 2007 ($327 million for the six months ended June 30, 2006) *(Notes 5 and 12)*.
(2) Consolidated expenditures include capitalized interest in the amount of $13 million for the six months ended June 30, 2007 ($14 million for the six months ended June 30, 2006).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited)*
(millions of Canadian dollars, unless otherwise stated)

2. BASIS OF PRESENTATION

The note disclosure requirements for annual financial statements provide additional disclosure to that required for interim financial statements. Accordingly, these interim Consolidated Financial Statements should be read in conjunction with the December 31, 2006 audited Consolidated Financial Statements. The interim Consolidated Financial Statements are presented in accordance with Canadian generally accepted accounting principles and follow the accounting policies summarized in the notes to the annual Consolidated Financial Statements, except for changes as described in Note 3.

3. CHANGES IN ACCOUNTING POLICIES

The Company adopted Canadian Institute of Chartered Accountants (CICA) Handbook Section 1530, *Comprehensive Income;* Section 3855, *Financial Instruments – Recognition and Measurement;* Section 3861*, Financial Instruments – Presentation and Disclosure;* and Section 3865, *Hedges* on January 1, 2007.

As a result of adopting CICA Section 1530, *Comprehensive Income,* a new Statement of Comprehensive Income forms part of the Company's Consolidated Financial Statements. Gains and losses from the translation into Canadian dollars of assets and liabilities, including associated long-term debt, of the Company's self-sustaining foreign operations are now presented as a separate component of other comprehensive income (loss) in the Consolidated Statement of Comprehensive Income. Accumulated other comprehensive income (loss) is presented as a separate component of shareholders' equity in the Consolidated Balance Sheet. Previously, these gains and losses were deferred and included in the foreign currency translation adjustment as part of shareholders' equity.

As a result of adopting CICA Section 3855, *Financial Instruments – Recognition and Measurement*, long-term debt is measured at fair value when initially recognized and, after initial recognition, at amortized cost using the effective interest method. Transaction costs and premiums or discounts directly attributable to the issuance of long-term debt are now added to the fair value on initial recognition. Previously, these amounts were deferred and amortized using the straight line method over the term of the debt. Unamortized amounts were separately presented in other assets on the Consolidated Balance Sheet. In accordance with the transitional provisions, prior periods have not been restated as a result of adopting this new accounting standard. To recognize the cumulative prior period effect, the following balance sheet categories were impacted on January 1, 2007:

	Increase / (Decrease)
Other assets	$ (101)
Long-term debt	(112)
Future income taxes liability	3
Retained earnings	8

There is no other material impact on the Consolidated Financial Statements for adoption of these new standards.

4. DISCONTINUED OPERATIONS

On January 31, 2006, the Company completed the sale of its mature producing assets in Syria for net proceeds of $640 million, resulting in a gain on sale of $134 million.

The accounting for discontinued operations results in a reduction of the Consolidated Statement of Earnings balances as follows:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Revenue (1)	$ -	$ -	$ -	$ 168
Expenses				
Operating, marketing and general	-	-	-	6
	-	-	-	6
Earnings from discontinued operations before income taxes	-	-	-	162
Provision for income taxes	-	-	-	10
Net earnings from discontinued operations	$ -	$ -	$ -	$ 152

(1) Revenue includes the gain on sale of $134 million.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited)*
(millions of Canadian dollars, unless otherwise stated)

5. INVESTMENT AND OTHER INCOME (EXPENSE)

Investment and other income (expense) includes net losses on derivative contracts (Note 12) of $48 million and $141 million for the three and six months ended June 30, 2007, respectively ($110 million and $334 million for the three and six months ended June 30, 2006) and net gains on sales of assets of $8 million and $70 million for the three and six months ended June 30, 2007, respectively ($18 million and $20 million for the three and six months ended June 30, 2006).

6. INCOME TAXES

The provisions for future income taxes for the three and six months ended June 30, 2007 and June 30, 2006 were reduced by $18 million and $63 million respectively due to reductions in the Canadian federal and provincial income tax rates. The adjustments were allocated to the segments as a decrease (increase) to the tax provisions as follows: North American Natural Gas - $1 million ($6 million for the three and six months ended June 30, 2006), Oil Sands - $7 million ($44 million for the three and six months ended June 30, 2006), East Coast Canada - $5 million ($37 million for the three and six months ended June 30, 2006), International - $nil ($(64) million for the three and six months ended June 30, 2006), Downstream - $6 million ($41 million for the three and six months ended June 30, 2006) and Shared Services $(1) million ($(1) million for the three and six months ended June 30, 2006).

The provision for future income taxes for the three and six months ended June 30, 2007 was reduced by $30 million as a result of the increase in the U.K. supplemental corporate income tax rate and the resulting impact of 2005 qualifying capital expenditures being deducted at the increased rate. The provision for future income taxes for the six months ended June 30, 2006 includes a $242 million charge due to the enacted increase in the U.K. supplemental corporate income tax rate. The adjustments were allocated to the Company's International business segment.

The provision for current taxes for the three and six months ended June 30, 2006 was increased by $70 million due to the Quebec government enacting retroactive tax legislation. The adjustment was allocated to Shared Services.

7. EARNINGS PER SHARE

The following table provides the common shares used in calculating earnings per share amounts:

	Three months ended June 30,		Six months ended June 30,	
(millions)	2007	2006	2007	2006
Weighted-average number of common shares outstanding - basic	493.1	505.3	495.1	508.8
Effect of dilutive stock options	5.2	6.4	5.1	6.7
Weighted-average number of common shares outstanding - diluted	498.3	511.7	500.2	515.5

8. LONG-TERM DEBT

	Maturity	June 30, 2007 *(Note 3)*	December 31, 2006
Debentures and notes			
5.95% unsecured senior notes ($600 million US)	2035	$ 622	$ 699
5.35% unsecured senior notes ($300 million US)	2033	271	349
7.00% unsecured debentures ($250 million US)	2028	255	291
7.875% unsecured debentures ($275 million US)	2026	287	321
9.25% unsecured debentures ($300 million US)	2021	316	349
5.00% unsecured senior notes ($400 million US)	2014	420	466
4.00% unsecured senior notes ($300 million US)	2013	298	349
Capital leases	2007-2022	63	70
		2,532	2,894
Current portion		(4)	(7)
		$ 2,528	$ 2,887

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited)*
(millions of Canadian dollars, unless otherwise stated)

9. SHAREHOLDERS' EQUITY

Changes in common shares and contributed surplus were as follows:

	Shares	Amount	Contributed Surplus
Balance at December 31, 2006	497,538,385	$ 1,366	$ 469
Issued under employee stock option and share purchase plans	1,237,235	27	(1)
Repurchased under normal course issuer bid	(10,000,000)	(28)	(442)
Balance at June 30, 2007	488,775,620	$ 1,365	$ 26

In June 2007, the Company renewed its normal course issuer bid (NCIB) program to repurchase up to 25 million of its outstanding common shares during the period from June 22, 2007 to June 21, 2008, subject to certain conditions. During the three and six months ended June 30, 2007, the Company purchased 8,000,000 common shares at a cost of $428 million and 10,000,000 common shares at a cost of $515 million, respectively (7,100,000 common shares at a cost of $350 million and 15,886,800 common shares at a cost of $826 million during the three and six months ended June 30, 2006). The excess of the purchase price over the carrying amount of the shares purchased was recorded as a reduction of contributed surplus and retained earnings.

10. STOCK-BASED COMPENSATION

The total stock-based compensation expense (recovery) recorded was $153 million and $139 million for the three and six months ended June 30, 2007, respectively ($(3) million and $62 million for the three and six months ended June 30, 2006).

(a) Stock Option and Performance Share Unit (PSU) Plans

Changes in the number of outstanding stock options and PSUs were as follows:

	Stock Options		PSUs
	Number	Weighted-Average Exercise Price	Number
Balance at December 31, 2006	20,714,733	$ 31	1,482,986
Granted	3,323,800	44	242,139
Exercised for common shares	(1,237,235)	20	n/a
Surrendered for cash payment	(451,565)	32	n/a
Cancelled/Expired	(222,750)	43	(555,358)
Balance at June 30, 2007	22,126,983	$ 34	1,169,767

(b) Stock Appreciation Rights (SAR)

Commencing 2007, the Company approved the issuance of SARs to certain employees, which entitle the holder to receive a cash payment equal to the difference between the stated exercise price and the market price of the Company's common shares on date of surrender. The vesting period and other terms are similar to the terms of the Company's existing stock option plan. At the time of grant the exercise price approximates the market price. The following SARs have been granted:

	SARs	
	Number	Weighted-Average Exercise Price
Balance at December 31, 2006	-	$ -
Granted	3,650,000	44
Cancelled	(72,650)	44
Balance at June 30, 2007	3,577,350	$ 44

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited)*
(millions of Canadian dollars, unless otherwise stated)

11. EMPLOYEE FUTURE BENEFITS

The Company maintains pension plans with defined benefit and defined contribution provisions and provides certain health care and life insurance benefits to its qualifying retirees. The expenses associated with these plans are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2007	2006	2007	2006
Pension Plans:				
Defined benefit plans				
Employer current service cost	$ 10	$ 10	$ 20	$ 20
Interest cost	22	21	44	42
Expected return on plan assets	(28)	(25)	(56)	(50)
Amortization of transitional asset	(2)	(2)	(3)	(4)
Amortization of net actuarial losses	11	13	22	26
	13	17	27	34
Defined contribution plans	5	4	9	8
	$ 18	$ 21	$ 36	$ 42
Other post-retirement plans:				
Employer current service cost	$ 2	$ 1	$ 3	$ 2
Interest cost	3	3	6	6
Amortization of transitional obligation	-	1	2	2
	$ 5	$ 5	$ 11	$ 10

The Company expects to contribute $115 million to its pension plans in 2007.

12. FINANCIAL INSTRUMENTS AND DERIVATIVES

Investment and other income (expense) includes unrealized gains and losses on the outstanding derivative contracts associated with the 2004 acquisition of an interest in the Buzzard field in the U.K. sector of the North Sea. These contracts resulted in unrealized losses of $40 million and $128 million for the three and six months ended June 30, 2007, respectively ($108 million and $327 million for the three and six months ended June 30, 2006).

Investment and other income (expense) includes unrealized losses on all derivative contracts of $45 million and $125 million for the three and six months ended June 30, 2007, respectively ($108 million and $327 million for the three and six months ended June 30, 2006). As at June 30, 2007, accounts receivable, accounts payable and other liabilities include $2 million, $499 million, and $1,114 million, respectively, relating to unrealized mark-to-market amounts on derivative contracts.

13. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2007, Canada's Accounting Standards Board (AcSB) issued CICA Handbook section 3031, *Inventories*. This new standard provides considerable guidance when determining the cost of inventory. Where costs of inventory items cannot be specifically identified, costs must be assigned consistently on either a "first-in, first-out" (FIFO) or weighted average cost basis. A "last-in first-out" (LIFO) cost basis is no longer acceptable. The standard is effective for fiscal periods beginning on or after January 1, 2008 and requires the retroactive application to prior period financial statements. Converting the cost of crude oil and refined products from a LIFO to FIFO costing basis will significantly increase inventories, future income taxes (liability), and retained earnings. The impact of adoption will be based upon December 31, 2007 amounts.