# PETRO-CANADA

## CONSOLIDATED FINANCIAL STATEMENTS

## DECEMBER 31, 2005

**CONSOLIDATED STATEMENT OF EARNINGS** *(unaudited)*
**For the period ended December 31, 2005**
*(millions of Canadian dollars, except per share amounts)*

| | Three months ended December 31, | | Year ended December 31, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| | | *(Note 4)* | | *(Note 4)* |
| Revenue | | | | |
| Operating | $ 4,805 | $ 3,710 | $17,585 | $14,270 |
| Investment and other income (Note 6) | 33 | (87) | (806) | (312) |
| | 4,838 | 3,623 | 16,779 | 13,958 |
| Expenses | | | | |
| Crude oil and product purchases | 2,429 | 1,794 | 8,846 | 6,740 |
| Operating, marketing and general (Note 7) | 806 | 672 | 2,962 | 2,572 |
| Exploration | 77 | 76 | 271 | 235 |
| Depreciation, depletion and amortization (Note 7) | 285 | 318 | 1,222 | 1,256 |
| Unrealized (gain) loss on translation of foreign currency denominated long-term debt | 7 | (52) | (88) | (77) |
| Interest | 52 | 34 | 164 | 142 |
| | 3,656 | 2,842 | 13,377 | 10,868 |
| Earnings from continuing operations before income taxes | 1,182 | 781 | 3,402 | 3,090 |
| Provision for income taxes | | | | |
| Current | 377 | 207 | 1,794 | 1,365 |
| Future | 137 | 140 | (85) | 27 |
| | 514 | 347 | 1,709 | 1,392 |
| Net earnings from continuing operations | 668 | 434 | 1,693 | 1,698 |
| Net earnings from discontinued operations (Note 4) | 46 | 7 | 98 | 59 |
| Net earnings | $ 714 | $ 441 | $ 1,791 | $ 1,757 |
| Earnings per share from continuing operations (Notes 5 and 8) | | | | |
| Basic (dollars) | $ 1.29 | $ 0.83 | $ 3.27 | $ 3.21 |
| Diluted (dollars) | $ 1.28 | $ 0.82 | $ 3.22 | $ 3.17 |
| Earnings per share (Notes 5 and 8) | | | | |
| Basic (dollars) | $ 1.38 | $ 0.85 | $ 3.45 | $ 3.32 |
| Diluted (dollars) | $ 1.36 | $ 0.83 | $ 3.41 | $ 3.28 |

**CONSOLIDATED STATEMENT OF RETAINED EARNINGS** *(unaudited)*
**For the period ended December 31, 2005**
*(millions of Canadian dollars)*

| | Three months ended December 31, | | Year ended December 31, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| Retained earnings at beginning of period | $ 6,355 | $ 5,006 | $ 5,408 | $ 3,810 |
| Net earnings | 714 | 441 | 1,791 | 1,757 |
| Dividends on common shares | (51) | (39) | (181) | (159) |
| Retained earnings at end of period | $ 7,018 | $ 5,408 | $ 7,018 | $ 5,408 |

See accompanying Notes to Consolidated Financial Statements

**CONSOLIDATED STATEMENT OF CASH FLOWS** *(unaudited)*
**For the period ended December 31, 2005**
*(millions of Canadian dollars)*

| | Three months ended December 31, | | Year ended December 31, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| | | *(Notes 3 and 4)* | | *(Notes 3 and 4)* |
| Operating activities | | | | |
| Net earnings | $ 714 | $ 441 | $ 1,791 | $ 1,757 |
| Less: Net earnings from discontinued operations | 46 | 7 | 98 | 59 |
| Net earnings from continuing operations | 668 | 434 | 1,693 | 1,698 |
| Items not affecting cash flow from continuing operating activities: | | | | |
| Depreciation, depletion and amortization | 285 | 318 | 1,222 | 1,256 |
| Future income taxes | 137 | 140 | (85) | 27 |
| Accretion of asset retirement obligations | 9 | 13 | 50 | 50 |
| Unrealized (gain) loss on translation of foreign currency denominated long-term debt | 7 | (52) | (88) | (77) |
| Gain on disposal of assets (Note 6) | (25) | - | (48) | (12) |
| Unrealized (gain) loss associated with the Buzzard derivative contracts (Note 16) | (10) | 66 | 889 | 333 |
| Other | 6 | 10 | 14 | 33 |
| Exploration expenses (Note 3) | 39 | 37 | 140 | 117 |
| Proceeds from sale of accounts receivable (Note 9) | - | - | 80 | 399 |
| (Increase) decrease in non-cash working capital related to continuing operating activities | 169 | (239) | (84) | 104 |
| Cash flow from continuing operating activities | 1,285 | 727 | 3,783 | 3,928 |
| Cash flow from discontinued operating activities (Note 4) | 60 | 66 | 204 | 233 |
| Cash flow from operating activities | 1,345 | 793 | 3,987 | 4,161 |
| Investing activities | | | | |
| Expenditures on property, plant and equipment and exploration (Notes 3 and 10) | (881) | (936) | (3,606) | (3,955) |
| Proceeds from sale of assets | 52 | 7 | 81 | 44 |
| Increase in deferred charges and other assets | (15) | (15) | (70) | (36) |
| Acquisition of Prima Energy Corporation (Note 11) | - | - | - | (644) |
| (Increase) decrease in non-cash working capital related to investing activities | 35 | (10) | 237 | 10 |
| | (809) | (954) | (3,358) | (4,581) |
| Financing activities | | | | |
| Increase (decrease) in short-term notes payable | - | 85 | (303) | 314 |
| Proceeds from issue of long-term debt (Note 12) | - | - | 762 | 533 |
| Repayment of long-term debt | (1) | (1) | (6) | (299) |
| Proceeds from issue of common shares (Note 13) | 3 | 8 | 64 | 39 |
| Purchase of common shares (Note 13) | (89) | (159) | (346) | (447) |
| Dividends on common shares | (51) | (39) | (181) | (159) |
| Increase in non-cash working capital related to financing activities | - | (8) | - | (26) |
| | (138) | (114) | (10) | (45) |
| Increase (decrease) in cash and cash equivalents | 398 | (275) | 619 | (465) |
| Cash and cash equivalents at beginning of period | 391 | 445 | 170 | 635 |
| Cash and cash equivalents at end of period | $ 789 | $ 170 | $ 789 | $ 170 |
| Cash and cash equivalents – discontinued operations (Note 4) | $ 68 | $ 206 | $ 68 | $ 206 |
| Cash and cash equivalents – continuing operations | $ 721 | $ (36) | $ 721 | $ (36) |

See accompanying Notes to Consolidated Financial Statements

**CONSOLIDATED BALANCE SHEET** *(unaudited)*
**As at December 31, 2005**
*(millions of Canadian dollars)*

| | December 31, 2005 | December 31, 2004 *(Note 4)* |
|---|---|---|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | $ 721 | $ - |
| Accounts receivable (Note 9) | 1,617 | 1,086 |
| Inventories | 596 | 549 |
| Assets of discontinued operations (Note 4) | 237 | 387 |
| | 3,171 | 2,022 |
| Property, plant and equipment, net | 15,921 | 14,318 |
| Goodwill | 737 | 853 |
| Deferred charges and other assets | 415 | 345 |
| Assets of discontinued operations (Note 4) | 411 | 598 |
| | $ 20,655 | $ 18,136 |
| Liabilities and shareholders' equity | | |
| Current liabilities | | |
| Outstanding cheques less cash and cash equivalents | $ - | $ 36 |
| Accounts payable and accrued liabilities | 2,854 | 2,188 |
| Income taxes payable | 82 | 272 |
| Liabilities of discontinued operations (Note 4) | 102 | 133 |
| Short-term notes payable | - | 299 |
| Current portion of long-term debt | 7 | 6 |
| | 3,045 | 2,934 |
| Long-term debt (Note 12) | 2,906 | 2,275 |
| Other liabilities | 1,888 | 646 |
| Asset retirement obligations | 923 | 834 |
| Future income taxes | 2,405 | 2,708 |
| Shareholders’ equity | | |
| Common shares (Note 13) | 1,362 | 1,314 |
| Contributed surplus (Note 13) | 1,422 | 1,743 |
| Retained earnings | 7,018 | 5,408 |
| Foreign currency translation adjustment | (314) | 274 |
| | 9,488 | 8,739 |
| | $ 20,655 | $ 18,136 |

See accompanying Notes to Consolidated Financial Statements

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

1. SEGMENTED INFORMATION FROM CONTINUING OPERATIONS (Notes 3 and 4)
Three months ended December 31,

| | Upstream | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | North American Natural Gas | | East Coast Oil | | Oil Sands | | International | | Downstream | | Shared Services | | Consolidated | |
| | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 |
| **Revenue** | | | | | | | | | | | | | | |
| Sales to customers | $ 658 | $ 471 | $ 367 | $ 198 | $ 191 | $ 111 | $ 551 | $ 434 | $3,038 | $2,496 | $ - | $ - | $ 4,805 | $ 3,710 |
| Investment and other income | 20 | 1 | 1 | (2) | - | - | 16 | (86) | (4) | 5 | - | (5) | 33 | (87) |
| Inter-segment sales | | 64 | 67 | | | | - | - | 3 | 5 | - | - | | |
| | 113 | | | 115 | 177 | 146 | | | | | | | | |
| Segmented revenue | | | | | | | | | 3,037 | 2,506 | - | (5) | 4,838 | 3,623 |
| **Expenses** | 791 | 536 | 435 | 311 | 368 | 257 | 567 | 348 | | | | | | |
| Crude oil and product purchases | 144 | 85 | 48 | - | 166 | 91 | - | - | 2,069 | 1,625 | 2 | (7) | 2,429 | 1,794 |
| Inter-segment transactions | | | | | 27 | 16 | - | - | 329 | 309 | - | - | | |
| Operating, marketing and general | 116 | 103 | | | 105 | 100 | | | 410 | 353 | | | 806 | 672 |
| | 2 | 4 | 2 | 1 | | | | | | | | | | |
| Exploration | 20 | 44 | 42 4 | 27 | 1 | 6 | 97 52 | 71 26 | | | 36 | 18 | 77 | 76 |
| Depreciation, depletion and amortization | | | | - | | | | | - | - | - 1 | - - | 285 | 318 |
| Unrealized (gain) loss on translation of foreign currency denominated | 89 | 89 | 61 | 58 | 43 | 29 | 40 | 70 | 51 | 72 | | | | |
| long-term debt | | | | | | | | | | | 7 | (52) | 7 | (52) |
| Interest | - | | | | | | | | | | 52 | 34 | 52 | 34 |
| | - | - | - | - 86 | - | - | - | - | - 2,859 | - 2,359 | 98 | (7) | 3,656 | 2,842 |
| | 371 | 325 | 157 | - | 342 | 242 | 189 | 167 | - | - | | | | |
| **Earnings (loss) from continuing operations before income taxes** | 420 | | | | 26 | 15 | | | | | (98) | 2 | 1,182 | 781 |
| | | 211 | 278 | 225 | | | 378 | 181 | 178 | 147 | | | | |
| **Provision for income taxes** | | | | | | | | | | | | | | |
| Current | | | | | (18) | (36) | 265 | 107 | (3) | | (38) | (21) | 377 | 207 |
| Future | | | | 3 | | | (45) | 38 | | | | | 137 | 140 |
| | 88 | 52 | 83 | 69 | | | | | | 36 | | | | |
| | 34 122 | 28 | 15 | | 29 | 41 5 | 220 | 145 | 70 | 19 | 34 (4) | 11 (10) | 514 | 347 |
| | | 80 | 98 | 72 | 11 | | | | 67 | 55 | | | | |
| **Net earnings (loss) from continuing operations** | $ 298 | $ 131 | $ 180 | $ 153 | $ 15 | $ 10 | $ 158 | $ 36 | $ 111 | $ 92 | $ (94) | $ 12 | $ 668 | $ 434 |
| **Expenditures on property, plant and equipment and exploration from continuing operations** | $ 182 | $ 195 | $ 89 | $ 78 | $ 109 | $ 132 | $ 163 | $ 205 | $ 320 | $ 308 | $ 6 | $ 5 | $ 869[1] | $ 923[1] |
| **Cash flow from continuing operating activities** | $ 482 | $ 231 | $ 165 | $ 243 | $ 120 | $ 141 | $ 235 | $ 154 | $ 324 | $ 193 | $ (41) | $ (235) | $ 1,285 | $ 727 |

(1) Expenditures include capitalized interest in the amount of $8 million for the three months ended December 31, 2005 ($7 million for the three months ended December 31, 2004).

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

1. SEGMENTED INFORMATION FROM CONTINUING OPERATIONS (Notes 3 and 4)
Year ended December 31,

| | Upstream | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | North American Natural Gas | | East Coast Oil | | Oil Sands | | International | | Downstream | | Shared Services | | Consolidated | |
| | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 | 2005 | 2004 |
| **Revenue** | | | | | | | | | | | | | | |
| Sales to customers | $2,073 | $1,770 | $1,284 | $ 914 | $ 749 | $ 412 | $2,183 | $1,767 | $11,296 | $9,407 | $ - | $ - | $17,585 | $14,270 |
| Investment and other income | 21 | 3 | (2) | (3) | 4 | - | (851) | (335) | | 13 | (21) | 10 | (806) | (312) |
| Inter-segment sales | | | | | | | - | - | 43 | 14 | - | - | | |
| Segmented revenue | 345 2,439 | 215 1,988 | 346 1,628 | 527 1,438 | 660 1,413 | 548 960 | 1,332 | 1,432 | 11,352 13 | 9,434 | (21) | 10 | 16,779 | 13,958 |
| **Expenses** | | | | | | | | | | | | | | |
| Crude oil and product purchases | 466 | 359 | 48 | - | 571 | 291 | - | - | 7,762 | 6,093 | (1) | (3) | 8,846 | 6,740 |
| Inter-segment transactions | | | | | 80 | 49 | - | - | 1,271 | 1,241 | - | - | | |
| Operating, marketing and general | | | | | | | | | 1,436 | 1,328 | | 64 | 2,962 | 2,572 |
| Exploration | 7 426 118 | 9 379 119 | 6 158 4 | 5 120 2 | 423 32 | 362 16 | 364 117 | 319 98 | | | 155 | | 271 | 235 |
| Depreciation, depletion and amortization | | | | | | 69 | | | - | - | - 1 | - 1 | 1,222 | 1,256 |
| Unrealized (gain) loss on translation of foreign currency denominated long-term debt | 364 | 321 | 259 | 268 | 133 | | 249 | 320 | 216 | 277 | (88) | (77) | (88) | (77) |
| Interest | | | | | | | | | | | 164 | 142 | 164 | 142 |
| | - 1,381 | - 1,187 | - | - | - 1,239 | - | - | - | - 10,685 | - 8,939 | | | 13,377 | 10,868 |
| | - | - | 475 | 395 | - | 787 | 730 | 737 | - | - | 231 | 127 | | |
| **Earnings (loss) from continuing operations before income taxes** | 1,058 | 801 | 1,153 | 1,043 | 174 | 173 | 602 | 695 | 667 | 495 | (252) | (117) | 3,402 | 3,090 |
| **Provision for income taxes** | | | | | | | | | | | | | | |
| Current | | | | | (45) | (71) | 1,015 | | | | (112) | (74) | 1,794 | 1,365 |
| Future | 311 73 | 330 (29) | 361 17 | 323 9 | 104 | 124 | (304) | 631 (52) | 264 (12) | 226 (45) | 37 | 20 | | 27 |
| | | | | | 59 | 53 | | | | | (75) | (54) | (85) 1,709 | 1,392 |
| | 384 | 301 | 378 | 332 | | | 711 | 579 | 252 | 181 | | | | |
| **Net earnings (loss) from continuing operations** | $ 674 | $ 500 | $ 775 | $ 711 | $ 115 | $ 120 | $ (109) | $ 116 | $ 415 | $ 314 | $ (177) | $ (63) | $ 1,693 | $ 1,698 |
| **Expenditures on property, plant and equipment and exploration from continuing operations** | $ 713 | $ 666 | $ 314 | $ 275 | $ 772 | $ 397 | $ 696 | $1,707 | $1,053 | $ 839 | $ 12 | $ 9 | $ 3,560[1] | $ 3,893[1] |
| **Cash flow from continuing operating activities** | $1,219 | $ 899 | $1,002 | $1,018 | $ 340 | $ 384 | $ 722 | $ 789 | $ 663 | $ 879 | $ (163) | $ (41) | $ 3,783 | $ 3,928 |

[1] Expenditures include capitalized interest in the amount of $35 million for the year ended December 31, 2005 ($20 million for the year ended December 31, 2004).

*(millions of Canadian dollars, unless otherwise stated)*

## 2. BASIS OF PRESENTATION

The note disclosure requirements for annual Consolidated Financial Statements provide additional disclosure to that required for interim Consolidated Financial Statements. Accordingly, these interim Consolidated Financial Statements should be read in conjunction with the Consolidated Financial Statements included in the Company's 2004 Annual Report. 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 the change described in Note 3.

## 3. CHANGES IN ACCOUNTING POLICIES

*Statement of Cash Flows*

Effective January 1, 2005, the Company changed the presentation of cash flow in the Consolidated Statement of Cash Flows. Previously, all exploration expenses were classified as investing activities. With the change, general and administrative and geological and geophysical exploration expenses are treated as a reduction of cash flow from operating activities. All prior periods have been restated to reflect this change. The change results in a decrease in cash flow from operating activities and an increase in cash flow from investing activities by $38 million and $131 million for the three months and the year ended December 31, 2005, respectively ($39 million and $118 million for the three months and the year ended December 31, 2004).

## 4. DISCONTINUED OPERATIONS

On December 20, 2005, the Company reached an agreement to sell its producing assets in Syria for $676 million (Euro 484 million) before adjustments. Accordingly, the producing assets in Syria have been classified as held for sale and presented as discontinued operations in the International segment. The sale is expected to close in the first quarter of 2006. The amount of the gain to be recorded will be determined upon closing of the sale.

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

| | Three months ended December 31, | | Year ended December 31, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| Revenue | $ 118 | $ 94 | $ 464 | $ 419 |
| Expenses | | | | |
| Operating, marketing and general | 26 | 30 | 104 | 118 |
| Depreciation, depletion and amortization | 16 | 34 | 145 | 146 |
| | 42 | 64 | 249 | 264 |
| Earnings from discontinued operations before income taxes | 76 | 30 | 215 | 155 |
| Provision for income taxes | 30 | 23 | 117 | 96 |
| Net earnings from discontinued operations | $ 46 | $ 7 | $ 98 | $ 59 |

4. DISCONTINUED OPERATIONS (continued)

The assets and liabilities of the discontinued operations are comprised of the following:

| | Year ended December 31, 2005 | Year ended December 31, 2004 |
|---|---|---|
| Current assets[1] | $ 237 | $ 387 |
| Property, plant and equipment, net | 300 | 465 |
| Goodwill | 111 | 133 |
| Total assets | 648 | 985 |
| Current liabilities | 102 | 133 |
| Net assets of discontinued operations | $ 546 | $ 852 |

[1] Includes cash and cash equivalents of $68 million as at December 31, 2005 (December 31, 2004 - $206 million).

5. STOCK DIVIDEND

In July 2005, the Company effected a two-for-one stock-split in the form of a stock dividend. Common shareholders of record at the close of business on September 3, 2005 received one additional common share for each common share held. Information related to common shares, stock options and performance share units has been restated to reflect the above.

6. INVESTMENT AND OTHER INCOME

Investment and other income includes a net gain of $2 million and a net loss of $882 million on derivative contracts (see Note 16) for the three months and the year ended December 31, 2005, respectively (a net loss of $75 million and a net loss of $345 million for the three months and the year ended December 31, 2004) and net gains on disposal of assets of $25 million and $48 million for the three months and the year ended December 31, 2005, respectively ($nil and $12 million for the three months and the year ended December 31, 2004).

7. ASSET WRITE-DOWNS

Petro-Canada announced in September 2003 it would cease the Oakville refining operations and expand the existing terminalling facilities. The shutdown of the refinery was completed in April 2005. The total charge to earnings related to the shutdown over the three years was $195 million after-tax. The following expenses have been recorded in the Downstream segment:

| | Three months ended December 31, | | | | Year ended December 31, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2005 | | 2004 | | 2005 | | 2004 | |
| | Pre-Tax | After-Tax | Pre-Tax | After-Tax | Pre-Tax | After-Tax | Pre-Tax | After-Tax |
| Operating, marketing and general expenses (de-commissioning and employee related costs) | $ - | $ - | $ 1 | $ 1 | $ (4) | $ (2) | $ 3 | $ 2 |
| Depreciation and amortization expenses (asset write-downs and increased depreciation) | - | - | 16 | 10 | 1 | - | 71 | 44 |
| | $ - | $ - | $ 17 | $ 11 | $ (3) | $ (2) | $ 74 | $ 46 |

8. EARNINGS PER SHARE

The following table provides the common shares used in calculating earnings per share from continuing operations and earnings per share:

| | Three months ended December 31, | | Year ended December 31, | |
|---|---|---|---|---|
| *(millions)* | 2005 | 2004 | 2005 | 2004 |
| Weighted-average number of common shares outstanding – basic | 516.2 | 521.2 | 518.4 | 529.3 |
| Effect of dilutive stock options | 6.9 | 7.0 | 7.0 | 6.9 |
| Weighted-average number of common shares outstanding – diluted | 523.1 | 528.2 | 525.4 | 536.2 |

9. SECURITIZATION PROGRAM

During 2004, the Company entered into a securitization program, expiring in 2009, to sell an undivided interest of eligible accounts receivable to a third party, on a revolving and fully serviced basis.

In March 2005, Petro-Canada increased the limit to sell eligible accounts receivable under the program from $400 million to $500 million. During the year ended December 31, 2005, the Company sold an additional $80 million of outstanding receivables for net proceeds of $80 million. As at December 31, 2005, $480 million (December 31, 2004 - $400 million) of outstanding accounts receivable had been sold under the program.

10. FORT HILLS OIL SANDS MINING PROJECT

In June 2005, the Company acquired a 60% interest in the Fort Hills oil sands mining project for $300 million, which was previously wholly-owned by UTS Energy Corporation (UTS). As part of the acquisition, Petro-Canada became the project operator. To pay for their investment, Petro-Canada will fund a portion of UTS' share of next $2.5 billion of development capital.

In November 2005, the Company and UTS finalized agreements with Teck Cominco Limited (Teck Cominco) whereby Teck Cominco acquired a 15% interest in the Fort Hills oil sands mining project with Petro-Canada and UTS holding interests of 55% and 30%, respectively. Petro-Canada remains the project operator.

11. ACQUISITION OF PRIMA ENERGY CORPORATION

On July 28, 2004, Petro-Canada acquired all the common shares of Prima Energy Corporation, an oil and gas company with operations in the U.S. Rockies, for a total acquisition cost of $644 million, net of cash acquired. The results of operations were included in the Consolidated Financial Statements from the date of acquisition.

The acquisition was accounted for using the purchase method of accounting. The allocation of fair value to the assets acquired and liabilities assumed was:

| | |
|---|---|
| Property, plant and equipment | $ 688 |
| Goodwill | 193 |
| Current assets, excluding cash of $74 million | 36 |
| Deferred charges and other assets | 2 |
| Total assets acquired | 919 |
| Current liabilities | 41 |
| Future income taxes | 217 |
| Asset retirement obligations and other liabilities | 17 |
| Total liabilities assumed | 275 |
| Net assets acquired | $ 644 |

Goodwill, which is not tax deductible, was assigned to Petro-Canada's North American Natural Gas business segment.

12. LONG-TERM DEBT

| | Maturity | December 31, 2005 |
|---|---|---|
| Debentures and notes | | |
| 5.95% unsecured senior notes ($600 million US) [1] | 2035 | $ 700 |
| 5.35% unsecured senior notes ($300 million US) | 2033 | 350 |
| 7.00% unsecured debentures ($250 million US) | 2028 | 292 |
| 7.875% unsecured debentures ($275 million US) | 2026 | 321 |
| 9.25% unsecured debentures ($300 million US) | 2021 | 350 |
| 5.00% unsecured senior notes ($400 million US) | 2014 | 466 |
| 4.00% unsecured senior notes ($300 million US) | 2013 | 350 |
| Capital leases | 2007-2017 | 77 |
| Retail licensee trust loans | 2012-2014 | 7 |
| | | 2,913 |
| Current portion | | (7) |
| | | $ 2,906 |

[1] In May 2005, the Company issued $600 million US 5.95% notes due May 15, 2035. The proceeds were used primarily to repay existing short-term notes payable.

13. SHAREHOLDERS' EQUITY

Changes in common shares and contributed surplus were as follows:

| | Shares | Amount | Contributed Surplus |
|---|---|---|---|
| Balance at January 1, 2005 | 519,928,022 | $ 1,314 | $ 1,743 |
| Issued under employee stock option and share purchase plans | 3,544,282 | 64 | - |
| Repurchased under normal course issuer bid | (8,333,400) | (22) | (324) |
| Stock-based compensation | - | 6 | 3 |
| Balance at December 31, 2005 | 515,138,904 | $ 1,362 | $ 1,422 |

In June 2005, the Company renewed its normal course issuer bid to repurchase up to 26 million of its common shares during the period from June 22, 2005 to June 21, 2006, subject to certain conditions. The Company purchased 2,000,000 shares at a cost of $89 million and 8,333,400 shares at a cost of $346 million during the three months and the year ended December 31, 2005, respectively (4,806,376 shares at a cost of $159 million and 13,736,164 shares at a cost of $447 million during the three months and the year ended December 31, 2004). The excess of the purchase price over the carrying amount of the shares purchased, which totaled $83 million and $324 million for the three months and the year ended December 31, 2005, respectively, was recorded as a reduction of contributed surplus.

14. STOCK-BASED COMPENSATION

Changes in the number of outstanding stock options and performance share units (PSUs) were as follows:

| | Stock Options | | PSUs |
|---|---|---|---|
| | Number | Weighted-Average Exercise Price *(dollars)* | Number |
| Balance at January 1, 2005 | 18,074,698 | $ 21 | 565,860 |
| Granted | 4,185,800 | 35 | 642,940 |
| Exercised | (3,544,282) | 18 | - |
| Cancelled | (354,599) | 29 | (49,833) |
| Balance at December 31, 2005 | 18,361,617 | $ 24 | 1,158,967 |

The total stock-based compensation expense recorded was $13 million and $99 million during the three months and the year ended December 31, 2005, respectively ($1 million and $12 million for the three months and the year ended December 31, 2004).

Compensation expense has not been recorded for stock options issued prior to 2003. The following table presents the pro forma net earnings and the pro forma earnings per share computed assuming the fair value based accounting method had been used to account for the compensation cost of stock options granted in 2002.

| | Three months ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2005 | 2004 | 2005 | | 2004 | |
| | Net earnings | | Earnings per share *(dollars)* | | | |
| | | | Basic | Diluted | Basic | Diluted |
| Net earnings as reported | $ 714 | $ 441 | $ 1.38 | $ 1.36 | $ 0.85 | $ 0.83 |
| Pro forma adjustment | 2 | 2 | - | - | 0.01 | - |
| Pro forma net earnings | $ 712 | $ 439 | $ 1.38 | $ 1.36 | $ 0.84 | $ 0.83 |

| | Year ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2005 | 2004 | 2005 | | 2004 | |
| | Net earnings | | Earnings per share *(dollars)* | | | |
| | | | Basic | Diluted | Basic | Diluted |
| Net earnings as reported | $ 1,791 | $ 1,757 | $ 3.45 | $ 3.41 | $ 3.32 | $ 3.28 |
| Pro forma adjustment | 8 | 9 | 0.01 | 0.02 | 0.02 | 0.02 |
| Pro forma net earnings | $ 1,783 | $ 1,748 | $ 3.44 | $ 3.39 | $ 3.30 | $ 3.26 |

15. 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 December 31, | | Year ended December 31, | |
|---|---|---|---|---|
| | 2005 | 2004 | 2005 | 2004 |
| Pension Plans: | | | | |
| Defined benefit plans | | | | |
| Employer current service cost | $ 12 | $ 12 | $ 36 | $ 31 |
| Interest cost | 23 | 21 | 86 | 81 |
| Expected return on plan assets | (23) | (22) | (88) | (79) |
| Amortization of transitional assets | (3) | (2) | (6) | (5) |
| Amortization of net actuarial losses | 8 | 7 | 34 | 30 |
| | 17 | 16 | 62 | 58 |
| Defined contribution plan | 5 | 4 | 16 | 13 |
| | $ 22 | $ 20 | $ 78 | $ 71 |
| Other post-retirement plans: | | | | |
| Employer current service cost | $ 1 | $ 1 | $ 4 | $ 4 |
| Interest cost | 3 | 4 | 12 | 13 |
| Amortization of transitional obligation | 1 | - | 2 | 3 |
| | $ 5 | $ 5 | $ 18 | $ 20 |

The Company contributed $112 million to its pension plans in 2005.

16. FINANCIAL INSTRUMENTS AND DERIVATIVES

Investment and other income 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 a gain of $10 million and a loss of $889 million for the three months and the year ended December 31, 2005, respectively (a loss of $66 million and a loss of $333 million for the three months and the year ended December 31, 2004).

Unrealized gains and losses on all derivative contracts increased investment and other income by $1 million and decreased investment and other income by $889 million for the three months and the year ended December 31, 2005, respectively (decreased investment and other income by $72 million and $338 million for the three months and the year ended December 31, 2004). As at December 31, 2005, accounts receivable, accounts payable and accrued liabilities, and other liabilities have been increased by $5 million, $1 million, and $1,222 million, respectively, as a result of unrealized mark-to-market amounts on derivative contracts.

17. VARIABLE INTEREST ENTITIES

Accounting Guideline 15 (AcG 15), *Consolidation of Variable Interest Entities* (VIEs), provides criteria for the identification of VIEs and further criteria for determining what entity, if any, should consolidate them. Entities in which equity investors do not have the characteristic of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support are subject to consolidation by a company if that company is deemed the primary beneficiary. The primary beneficiary is the party that is subject to a majority of the risk of loss from the variable interest entity's activities, or is entitled to receive a majority of the variable interest entity's residual returns, or both. The Company determined that certain retail licensee agreements would constitute VIEs, even though the Company has no ownership in these entities. The Company, however, is not the primary beneficiary and, therefore, consolidation is not required. In certain of these retail licensee arrangements, the Company has provided loan guarantees. Management is of the opinion that the Company's maximum exposure to loss from these arrangements would not be material.