PETRO-CANADA

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2008

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

	Three months ended December 31,		Year ended December 31,	
	2008	2007	2008	2007
Revenue				
Operating	$ 5,134	$ 5,765	$ 27,585	$ 21,710
Investment and other income (expense) *(Notes 5 and 7)*	133	(331)	200	(460)
	5,267	5,434	27,785	21,250
Expenses				
Crude oil and product purchases	3,251	2,899	14,507	10,291
Operating, marketing and general *(Note 6)*	1,201	820	3,877	3,552
Exploration	116	183	587	490
Depreciation, depletion and amortization *(Notes 6 and 8)*	647	636	2,155	2,091
Unrealized (gain) loss on translation of foreign currency denominated long-term debt	475	(12)	664	(246)
Interest	86	43	242	165
	5,776	4,569	22,032	16,343
Earnings (loss) before income taxes	(509)	865	5,753	4,907
Provision for income taxes				
Current	164	93	2,629	1,797
Future *(Note 10)*	18	250	(10)	377
	182	343	2,619	2,174
Net earnings (loss)	$ (691)	$ 522	$ 3,134	$ 2,733
Earnings per share *(Note 9)*				
Basic	$ (1.43)	$ 1.08	$ 6.47	$ 5.59
Diluted	$ (1.43)	$ 1.07	$ 6.43	$ 5.53

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME *(unaudited)*
For the periods ended December 31
(millions of Canadian dollars)

	Three months ended December 31,		Year ended December 31,	
	2008	2007	2008	2007
Net earnings (loss)	$ (691)	$ 522	$ 3,134	$ 2,733
Other comprehensive income (loss), net of tax				
Change in foreign currency translation adjustment	252	(4)	214	(260)
Comprehensive income (loss)	$ (439)	$ 518	$ 3,348	$ 2,473

See accompanying Notes to Consolidated Financial Statements

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

	Three months ended December 31,		Year ended December 31,	
	2008	2007	2008	2007
Operating activities				
Net earnings	$ (691)	$ 522	$ 3,134	$ 2,733
Items not affecting cash flow from operating activities:				
Depreciation, depletion and amortization *(Notes 6 and 8)*	647	636	2,155	2,091
Future income taxes *(Note 10)*	18	250	(10)	377
Accretion of asset retirement obligations	22	20	79	70
Unrealized (gain) loss on translation of foreign currency denominated long-term debt	475	(12)	664	(246)
Gain on sale of assets *(Notes 5 and 7)*	(13)	(3)	(4)	(81)
Other	22	(1)	91	9
Exploration expenses	51	107	369	290
Settlement of Buzzard derivative contracts *(Note 17)*	-	(1,502)	-	(1,481)
(Increase) decrease in non-cash working capital related to operating activities	798	(619)	44	(423)
Cash flow from (used in) operating activities	1,329	(602)	6,522	3,339
Investing activities				
Expenditures on property, plant and equipment and exploration *(Note 10)*	(1,748)	(1,585)	(6,344)	(3,988)
Proceeds from sale of assets *(Note 7)*	17	6	250	183
Increase in other assets	(29)	(16)	(29)	(121)
Decrease in non-cash working capital related to investing activities	50	398	739	279
Cash flow used in investing activities	(1,710)	(1,197)	(5,384)	(3,647)
Financing activities				
Increase (decrease) in short-term notes payable *(Note 12)*	-	109	(109)	109
Proceeds from issue of long-term debt *(Note 12)*	-	995	1,482	995
Repayment of long-term debt *(Note 12)*	(2)	(1)	(998)	(7)
Proceeds from issue of common shares *(Note 13)*	4	4	21	37
Purchase of common shares *(Note 13)*	-	(104)	-	(839)
Dividends on common shares *(Note 16)*	(97)	(63)	(320)	(255)
Cash flow from (used in) financing activities	(95)	940	76	40
Increase (decrease) in cash and cash equivalents	(476)	(859)	1,214	(268)
Cash and cash equivalents at beginning of period	1,921	1,090	231	499
Cash and cash equivalents at end of period	$ 1,445	$ 231	$ 1,445	$ 231

See accompanying Notes to Consolidated Financial Statements

CONSOLIDATED BALANCE SHEET *(unaudited)*
As at December 31, 2008
(millions of Canadian dollars)

	December 31, 2008	December 31, 2007
Assets		
Current assets		
Cash and cash equivalents	$ 1,445	$ 231
Accounts receivable *(Note 11)*	2,844	1,973
Income taxes receivable	-	280
Inventories *(Note 4)*	1,289	668
Future income taxes	25	26
	5,603	3,178
Property, plant and equipment, net *(Notes 7 and 10)*	23,485	19,497
Goodwill	852	731
Other assets	437	446
	$ 30,377	$ 23,852
Liabilities and shareholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	$ 3,186	$ 3,512
Income taxes payable	1,018	-
Short-term notes payable *(Note 12)*	-	109
Current portion of long-term debt *(Note 12)*	3	2
	4,207	3,623
Long-term debt *(Note 12)*	4,746	3,339
Other liabilities *(Note 10)*	1,240	717
Asset retirement obligations	1,527	1,234
Future income taxes *(Notes 4 and 10)*	3,182	3,069
Shareholders' equity		
Common shares *(Note 13)*	1,388	1,365
Contributed surplus *(Note 13)*	22	24
Retained earnings	14,062	10,692
Accumulated other comprehensive income (loss)		
Foreign currency translation adjustment	3	(211)
	15,475	11,870
	$ 30,377	$ 23,852

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

	Three months ended December 31,		Year ended December 31,	
	2008	2007	2008	2007
Retained earnings at beginning of period	$ 14,850	$ 10,330	$ 10,692	$ 8,565
Cumulative effect of adopting new accounting standards *(Note 4)*	-	-	556	-
Net earnings (loss)	(691)	522	3,134	2,733
Dividends on common shares *(Note 16)*	(97)	(63)	(320)	(255)
Excess cost for normal course issuer bid *(Note 13)*	-	(97)	-	(351)
Retained earnings at end of period	$ 14,062	$ 10,692	$ 14,062	$ 10,692

See accompanying Notes to Consolidated Financial Statements

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

1. SEGMENTED INFORMATION
   Three months ended December 31,

	Upstream															
					International & Offshore											
	North American Natural Gas		Oil Sands		East Coast Canada		International		Downstream		Shared Services		Eliminations[4]		Consolidated	
	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
Revenue																
Sales to customers	$ 412	$ 331	$ 233	$ 153	$ 422	$ 656	$ 851	$ 1,043	$ 3,216	$ 3,582	$ -	$ -	$ -	$ -	$ 5,134	$ 5,765
Investment and other income (expense)[1]	8	-	11	1	13	(7)	31	(386)	20	(5)	50	66	-	-	133	(331)
Inter-segment sales	75	86	387	306	175	125	12	-	3	6	-	-	(652)	(523)	-	-
Segmented revenue									3,239	3,583	50	66	(652)	(523)	5,267	5,434
Expenses																
Crude oil and product purchases[2]	495 104	417 75	631 393	460 158	610 121	774 191	894 -	657 -	2,688	2,479	-	-	(55)	(4)	3,251	2,899
Inter-segment transactions	2	4	13	2	1	2	-	-	638	515	-	-	(654)	(523)	-	-
Operating, marketing and general					74	42					17	(34)	-	-	1,201	
Exploration	56	70	5	3	1	(1)	54	111	-	-	-	-	-	-	116	183
Depreciation, depletion and	151	123	336	159			119	105	504	425						820
amortization	179	259	117	37	105	91	154	162	92	86	-	1	-	-	647	636
Unrealized loss (gain) on translation of foreign currency denominated long-term debt											475	(12)	-		475	(12)
Interest	-										86	43			86	43
	-	-	-	-	-	-	-	-	- 3,922	- 3,505		(2)	(709)	- (527)	5,776	
	-	-	-	-	-	-	-	-	-	-			-	-		4,569
Earnings (loss) before income taxes	492 3	531 (114)	864 (233)	359 101	302	325	327	378	(683)	78	578 (528)	68	57	4	(509)	
Provision for income taxes																
Current	25	26	(22)	(8)	308 100	449 165	567 358	279 (157)	(308)	75	11	(8)	-	-	164	865 93
Future	(27)	(83)	(47)	(20)	(3)	(62)	16	466	82	(78)	(21)	26	18	1	18	250
	(2)	(57)	(69)	(28)	97	103	374	309	(226)	(3)	(10)	18	18	1	182	343
Net earnings (loss)	$ 5	$ (57)	$ (164)	$ 129	$ 211	$ 346	$ 193	$ (30)	$ (457)	$ 81	$ (518)	$ 50	$ 39	$ 3	$ (691)	$ 522
Expenditures on property, plant and equipment and exploration [3]	$ 566	$ 369	$ 374	$ 482	$ 82	$ 33	$ 312	$ 224	$ 401	$ 468	$ 13	$ 9	$ -	$ -	$ 1,748	$ 1,585
Cash flow from (used in) operating activities	$ 208	$ 164	$ 217	$ 107	$ 347	$ 261	$ 300	$ (868)	$ 528	$ 245	$ (271)	$ (511)	$ -	$ -	$ 1,329	$ (602)
Total assets	$ 4,605	$ 4,119	$ 4,566	$ 3,659	$ 2,149	$ 2,345	$ 8,277	$ 5,180	$10,057	$ 7,989	$ 734	$ 563	$ (11)	$ (3)	$30,377	$23,852

1 Investment and other income (expense) for the International segment includes losses on the Buzzard derivative contracts of $nil for the three months ended December 31, 2008 ($383 million for the three months ended December 31, 2007) (Notes 5 and 17).
2 Downstream crude oil and product purchases account for substantially all of the Downstream inventories recognized as an expense during the period.
3 Consolidated expenditures include capitalized interest in the amount of $14 million for the three months ended December 31, 2008 ($9 million for the three months ended December 31, 2007).
4 Eliminations relates to sales between segments recorded at transfer prices based on current market prices, and to unrealized inter-segment profits and losses on inventories. These figures were previously included in Shared Services.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited)*

(millions of Canadian dollars)

1. SEGMENTED INFORMATION
   Year ended December 31,

	Upstream																	
					International & Offshore													
	North American Natural Gas		Oil Sands		East Coast Canada		International		Downstream		Shared Services		Eliminations[4]		Consolidated			
	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007		
Revenue																		
Sales to customers	$ 1,931	$ 1,347	$ 1,915	$ 611	$ 2,605	$ 2,708	$ 4,892	$ 3,697	$16,242	$13,347	$ -	$ -	$ -	$ -	$27,585	$21,710		
Investment and other income (expense)[1]	(121)	66	10	(2)	20	(18)	164	(549)	38	(12)	89	55	-	-	200	(460)		
Inter-segment sales	421	324	1,510	1,065	789	477	12	-	15	18	-	-	(2,747)	(1,884)	-	-		
Segmented revenue	2,231	1,737	3,435	1,674	3,414	3,167	5,068	3,148	16,295	13,353	89	55	(2,747)	(1,884)	27,785	21,250		
Expenses																		
Crude oil and product purchases[2]	461	240	1,796	524	770	736	-	-	11,580	8,787	-	-	(100)	4	14,507	10,291		
Inter-segment transactions	7	10	40	13	8	8	-	-	2,692	1,853	-	-	(2,747)	(1,884)	-	-		
Operating, marketing and general	545	491	913	595	254	228	460	526	1,761	1,525	(56)	187	-	-	3,877	3,552		
Exploration	147	192	13	28	1	13	426	257	-	-	-	-	-	-	587	490		
Depreciation, depletion and amortization	575	584	202	149	389	410	663	640	325	299	1	9	-	-	2,155	2,091		
Unrealized loss (gain) on translation of foreign currency denominated long-term debt											664	(246)	-		664	(246)		
Interest											242	165			242	165		
	1,735	1,517	2,964	1,309	1,422	1,395	1,549	1,423	16,358	12,464	851	115	(2,847)	(1,880)	22,032	16,343		
Earnings (loss) before income taxes	496	220	471	365	1,992	1,772	3,519	1,725	(63)	889	(762)	(60)	100	(4)	5,753	4,907		
Provision for income taxes																		
Current	118	183	97	(13)	647	653	2,163	848	(294)	232	(102)	(106)	-	-	2,629	1,797		
Future	34	(154)	40	62	(23)	(110)	(328)	503	231	28	41	49	(5)	(1)	(10)	377		
	152	29	137	49	624	543	1,835	1,351	(63)	260	(61)	(57)	(5)	(1)	2,619	2,174		
Net earnings (loss)	$ 344	$ 191	$ 334	$ 316	$ 1,368	$ 1,229	$ 1,684	$ 374	$ -	$ 629	$ (701)	$ (3)	$ 105	$ (3)	$ 3,134	$ 2,733		
Expenditures on property, plant and equipment and exploration[3]	$ 1,023	$ 866	$ 1,063	$ 779	$ 276	$ 159	$ 2,115	$ 762	$ 1,834	$ 1,396	$ 33	$ 26	$ -	$ -	$ 6,344	$ 3,988		
Cash flow from (used in) operating activities	$ 1,055	$ 725	$ 622	$ 512	$ 1,850	$ 1,491	$ 2,380	$ 220	$ 464	$ 994	$ 151	$ (603)	$ -	$ -	$ 6,522	$ 3,339		
Total assets	$ 4,605	$ 4,119	$ 4,566	$ 3,659	$ 2,149	$ 2,345	$ 8,277	$ 5,180	$10,057	$ 7,989	$ 734	$ 563	$ (11)	$ (3)	$30,377	$23,852		

1 Investment and other income (expense) for the International segment includes losses on the Buzzard derivative contracts of $nil for the year ended December 31, 2008 ($535 million for the year ended December 31, 2007) (Notes 5 and 17).
2 Downstream crude oil and product purchases account for substantially all of the Downstream inventories recognized as an expense during the period.
3 Consolidated expenditures include capitalized interest in the amount of $37 million for the year ended December 31, 2008 ($30 million for the year ended December 31, 2007).
4 Eliminations relates to sales between segments recorded at transfer prices based on current market prices, and to unrealized inter-segment profits and losses on inventories. These figures were previously included in Shared Services.

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, 2007 audited Consolidated Financial Statements. The interim Consolidated Financial Statements are presented in accordance with Canadian generally accepted accounting principles (GAAP) and follow the accounting policies summarized in the notes to the annual Consolidated Financial Statements, except for changes as described in Note 4.

3. INTERNATIONAL FINANCIAL REPORTING STANDARDS

During 2008, the Canadian Accounting Standards Board (AcSB) confirmed that publicly accountable enterprises will be required to adopt International Financial Reporting Standards (IFRS) in place of Canadian GAAP for interim and annual reporting purposes. The required changeover date is for fiscal years beginning on or after January 1, 2011. At this time, the impact on the Company's Consolidated Financial Statements is not reasonably determinable.

4. CHANGES IN ACCOUNTING POLICIES

On January 1, 2008, the Company adopted Canadian Institute of Chartered Accountants (CICA) Handbook Section 1535, *Capital Disclosures*; Section 3031, *Inventories*; Section 3862, *Financial Instruments – Disclosure*; and Section 3863, *Financial Instruments – Presentation*.

As a result of adopting CICA Section 1535, *Capital Disclosures,* the Company now discloses details about its capital management strategy (Note 16).

As a result of adopting CICA Section 3031, *Inventories*, the Company now assigns costs to its crude oil and refined petroleum products inventories on a "first-in, first-out" (FIFO) basis. Previously, costs were assigned to these inventories on a "last-in, first-out" (LIFO) basis. In accordance with the transitional provisions of this new accounting standard, the Company has elected to adjust 2008 opening retained earnings by the difference in the measurement of 2008 opening inventory and has not restated prior period amounts. As such, the following balance sheet categories were impacted on January 1, 2008:

	Increase
Inventories	$ 812
Future income taxes liability	256
Retained earnings	556

As a result of adopting CICA Section 3862, *Financial Instruments – Disclosures*, the Company has expanded its financial risks and financial instruments disclosures (Note 17).

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

5. INVESTMENT AND OTHER INCOME (EXPENSE)

Investment and other income (expense) consist of the following amounts:

	Three months ended December 31,		Year ended December 31,	
	2008	2007	2008	2007
Foreign exchange gains (losses)	$ 82	$ 49	$ 128	$ (10)
Gain on sale of assets *(Note 7)*	13	3	4	81
Losses related to Buzzard derivative contracts *(Note 17)*	-	(383)	-	(535)
Gain (loss) on Downstream derivative contracts	17	(7)	24	(26)
Other	21	7	44	30
Total investment and other income (expense)	$ 133	$ (331)	$ 200	$ (460)

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

6. FORT HILLS PROJECT

In November 2008, the Company and its partners, UTS Energy Corporation (UTS) and Teck Cominco Limited (Teck), announced that the preliminary results from the Fort Hills project front-end engineering and design (FEED) work suggest that estimated costs have risen considerably and, therefore, a final investment decision on both the mining and upgrading portions of the project will be deferred until a cost estimate consistent with the current market environment can be established. As a result, the Company has recognized an $87 million ($64 million after-tax) impairment charge on certain property, plant and equipment and expenses of $129 million ($92 million after-tax) to reflect the termination or suspension of some agreements for the receipt of goods and services.

The impairment charge is included in depreciation, depletion and amortization, and the service agreement termination expenses are included in operating, marketing and general expenses, both in the Consolidated Statement of Earnings.

7. SALE OF ASSETS

In August 2008, the Company completed the sale of its pre-development assets in Denmark, which are part of the Company's International business segment, for net proceeds of $140 million, resulting in a gain on sale of $107 million ($82 million after-tax).

In June 2008, the Company completed the sale of its Minehead assets in Western Canada, which are part of the Company's North American Natural Gas business segment, resulting in a loss on sale of $153 million ($112 million after-tax).

The gains and losses on the sales of these assets are included in investment and other income (expense) in the Consolidated Statement of Earnings.

8. ASSET WRITE-DOWNS

In December 2007, the Company recognized a $150 million ($97 million after-tax) impairment expense due to a write-down of its coal bed methane assets in the U.S. Rockies' Powder River Basin. The assets have been written down to management's best estimate of fair value based on a discounted future cash flow valuation. These assets form part of the Company's North American Natural Gas business segment.

The impairment expense is included in depreciation, depletion and amortization in the Consolidated Statement of Earnings.

9. EARNINGS PER SHARE

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

	Three months ended December 31,		Year ended December 31,	
(millions)	2008	2007	2008	2007
Weighted-average number of common shares outstanding – basic	484.4	484.6	484.1	489.0
Effect of dilutive stock options	0.0[1]	4.6	3.6	5.0
Weighted-average number of common shares outstanding – diluted	484.4	489.2	487.7	494.0

1 1.6 million stock options were excluded from the diluted earnings per share calculation for the three months ended December 31, 2008 because their impact was anti-dilutive.

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

10. LIBYA EXPLORATION AND PRODUCTION SHARING AGREEMENTS

On June 19, 2008 the Company signed six new Exploration and Production Sharing Agreements (EPSAs) with the Libya National Oil Corporation (NOC) to convert its existing concession agreements and old EPSA into new EPSA IV agreements. The new EPSAs were ratified as of the signing, with an effective date of January 1, 2008. Earnings on properties covered by the old agreements were adjusted based on the financial terms of the new EPSAs for the period from January 1, 2008 until ratification. The new EPSAs have an expected duration of 30 years and enable the Company to implement jointly with the NOC the redevelopment of major fields and conduct a 100% operated exploration program in the Libyan Sirte Basin.

As part of the ratification, the Company agreed to pay a signature bonus of $1 billion US in several installments with the first installment of $500 million US paid on July 17, 2008 and the remaining installments to be paid through 2013. This cost was discounted to $954 million based on this payout schedule using the Company's estimated cost of debt at the time of acquisition. At December 31, 2008, $554 million of the discounted signature bonus cost was outstanding, with $30 million recorded in accounts payable and accrued liabilities and $524 million recorded in other liabilities.

Net earnings for the year ended December 31, 2008 includes a $230 million future income tax recovery, which the company recognized on ratification of the new EPSAs on June 19, 2008.

11. SECURITIZATION PROGRAM

On June 24, 2004, the Company entered into a securitization program, expiring on June 24, 2009, to sell an undivided interest of eligible accounts receivable up to $500 million to a third party on a revolving and fully serviced basis. The service liability has been estimated to be insignificant.

During the year ended December 31, 2008, the Company suspended all sales of receivables to the program and remitted all funds for receivables previously sold. As at December 31, 2008, there were no outstanding receivables sold under this program. As at December 31, 2007, $480 million of outstanding accounts receivable had been sold under the program for net proceeds of $479 million.

12. LONG-TERM DEBT

	Maturity	December 31, 2008	December 31, 2007
Debentures and notes			
6.80% unsecured senior notes ($900 million US)	2038	$ 1,090	$ -
5.95% unsecured senior notes ($600 million US)	2035	719	577
5.35% unsecured senior notes ($300 million US)	2033	320	248
7.00% unsecured debentures ($250 million US)	2028	296	237
7.875% unsecured debentures ($275 million US)	2026	332	267
9.25% unsecured debentures ($300 million US)	2021	365	294
6.05% unsecured debentures ($600 million US)	2018	729	-
5.00% unsecured senior notes ($400 million US)	2014	485	391
4.00% unsecured senior notes ($300 million US)	2013	351	275
Syndicated credit facilities	2013	-	995
Capital leases	2008-2022	62	57
		4,749	3,341
Current portion		(3)	(2)
		$ 4,746	$ 3,339

Interest on long-term debt and short-term notes payable, net of capitalized interest, was $83 million and $234 million for the three months and year ended December 31, 2008, respectively ($34 million and $151 million for the three months and year ended December 31, 2007, respectively). Interest is paid semi-annually. All debentures and notes are repayable in full upon maturity.

During the year, the Company filed a final shelf prospectus for the offering of up to $4 billion US of debt securities with the securities commission or equivalent regulatory authority in each of the provinces and territories of Canada and the United States. The Company completed a public offering of debt securities under this prospectus in the form of $600 million US 6.05% 10-year unsecured senior notes due May 15, 2018 and $900 million US 6.80% 30-year unsecured senior notes due May 15, 2038. The net proceeds of this offering were used to repay the Company's short-term notes payable and indebtedness outstanding under its syndicated credit facilities. The balance was added to the Company's working capital to fund future capital expenditures.

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

12. LONG-TERM DEBT, *continued*

At December 31, 2008, the Company had in place revolving, committed syndicated credit facilities totaling $3,570 million (December 31, 2007 – $2,200 million), which mature in 2013, and revolving bilateral demand credit facilities of $777 million (December 31, 2007 – $1,500 million). During 2008, the Company had drawings on its syndicated credit facilities and its demand credit facilities in the form of Canadian dollar Bankers' Acceptances. However, as of December 31, 2008, the Company had repaid all amounts previously drawn on its syndicated and demand credit facilities. A total of $348 million of the credit facilities was used for letters of credit and overdraft coverage.

Subsequent to December 31, 2008, the Company put in place a bilateral committed credit facility in the amount of $244 million.

13. SHAREHOLDERS' EQUITY

Changes in common shares and contributed surplus were as follows:

	Shares	Amount	Contributed Surplus
Balance at December 31, 2007	483,459,119	$ 1,365	$ 24
Issued under employee stock option and share purchase plans	1,138,348	23	(2)
Balance at December 31, 2008	484,597,467	1,388	22

The Company has a normal course issuer bid (NCIB) program for the repurchase of its outstanding common shares. This program was renewed in June 2008 to repurchase up to 24 million outstanding common shares during the period from June 22, 2008 to June 21, 2009, subject to certain conditions. During the three months and year ended December 31, 2008, the Company did not repurchase any common shares. During the three months and year ended December 31, 2007, the Company repurchased 2,000,000 common shares at a cost of $104 million and 15,998,000 common shares at a cost of $839 million, respectively. The excess of the purchase price over the carrying amount of the shares purchased was recorded as a $nil and $444 million reduction of contributed surplus and $97 million and $351 million reduction of retained earnings for the three months and year ended December 31, 2007, respectively.

14. STOCK-BASED COMPENSATION

The total stock-based compensation (recovery) expense recorded was $(20) million and $(161) million for the three months and year ended December 31, 2008, respectively, ($(68) million and $95 million for the three months and year ended December 31, 2007, respectively).

(a) Stock Options

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

	Stock Options	
	Number	Weighted-Average Exercise Price
Balance at December 31, 2007	21,035,064	$ 34
Granted	3,486,200	47
Exercised for common shares	(1,138,348)	17
Surrendered for cash payment	(897,604)	35
Forfeited	(347,410)	47
Expired	(4,000)	13
Balance at December 31, 2008	22,133,902	$ 37

14. STOCK-BASED COMPENSATION, *continued*

(b) Performance Share Units (PSUs)

Changes in the number of outstanding PSUs were as follows:

	PSUs
	Number
Balance at December 31, 2007	1,166,044
Granted	254,169
Redeemed	(584,137)
Forfeited	(7,704)
Balance at December 31, 2008	828,372

(c) Stock Appreciation Rights (SARs)

Changes in the number of outstanding SARs were as follows:

	SARs	
	Number	Weighted-Average Exercise Price
Balance at December 31, 2007	3,659,450	$ 44
Granted	4,107,330	47
Exercised	(139,680)	44
Forfeited	(419,746)	47
Expired	-	-
Balance at December 31, 2008	7,207,354	$ 46

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,	
	2008	2007	2008	2007
Pension Plans:				
Defined benefit plans				
Employer current service cost	$ 8	$ 13	$ 40	$ 43
Interest cost	25	24	95	90
Expected return on plan assets	(28)	(29)	(111)	(112)
Amortization of transitional asset	(3)	(2)	(7)	(6)
Amortization of net actuarial losses	13	11	49	44
	15	17	66	59
Defined contribution plans	10	8	27	22
	$ 25	$ 25	$ 93	$ 81
Other post-retirement plans:				
Employer current service cost	$ 2	$ 1	$ 6	$ 5
Interest cost	3	3	13	12
Amortization of transitional obligation	-	-	2	2
Amortization of net actuarial losses	-	-	2	2
	$ 5	$ 4	$ 23	$ 21

The Company contributed $67 million to its pension plans in 2008.

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

16. CAPITAL MANAGEMENT

The Company's capital management strategy is designed to maintain financial strength and flexibility to support profitable growth in all business environments. The Company's capital consists of debt, which is comprised of long-term debt and short-term notes payable, and shareholders' equity. The Company measures financial strength and flexibility using two key measures: debt-to-cash flow from operating activities, the key short-term measure, and debt-to-debt plus equity, the key long-term measure. These are calculated as follows:

	December 31, 2008	December 31, 2007
Long-term debt	$ 4,746	$ 3,339
Add: Current portion of long-term debt	3	2
Total long-term debt	4,749	3,341
Add: Short-term notes payable	-	109
Debt (A)	$ 4,749	$ 3,450
Shareholders' equity	15,475	11,870
Debt plus equity (B)	$ 20,224	$ 15,320
Cash flow from operating activities (C)	$ 6,522	$ 3,339
Debt-to-cash flow from operating activities (A/C) *(times)*	0.7	1.0
Debt-to-debt plus equity (A/B) *(%)*	23.5	22.5

At December 31, 2008, the debt-to-cash flow from operating activities ratio was within the Company's target range of no more than 2.0 times. Debt-to-debt plus equity was below the target range of 25% to 35%, providing the financial flexibility to fund the Company's capital program and profitable growth opportunities. The Company may exceed target ranges for short periods of time, but always with the goal to return back within the target ranges.

Financial covenants associated with the Company's various banking and debt arrangements are reviewed regularly and controls are in place to maintain compliance with these covenants. The Company complied with all financial covenants for the three months and year ended December 31, 2008.

The Company's priority uses of cash are to fund the capital program and profitable growth opportunities, and then to return cash to shareholders through dividends and a share buyback program.

The Company regularly reviews its dividend strategy to ensure the alignment of the dividend policy with shareholder expectations, and financial and growth objectives. Consistent with this objective, on July 23, 2008, the Company declared a 54% increase in its quarterly dividend to $0.20 per share commencing with the dividend paid on October 1, 2008. In June 2008, the Company renewed its NCIB program for the repurchase of its common shares from June 22, 2008 to June 21, 2009, entitling the Company to purchase up to 5% of its outstanding common shares, subject to certain conditions (Note 13). Due to an increasing capital program, the Company did not repurchase any of its shares in 2008.

Given the recent turmoil in financial markets, the Company continues to monitor its capital management strategy, and make adjustments as appropriate. The Company's capital management strategy has not changed significantly from the prior period.

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

17. FINANCIAL RISKS AND FINANCIAL INSTRUMENTS

Financial Risks

The Company is exposed to a number of financial risks in the normal course of its business operations, including market risks resulting from fluctuations in commodity prices, interest rates and foreign currency exchange rates, as well as credit risks and liquidity risks.

(a) Market Risks

The Company monitors its exposure to market fluctuations and may use derivative contracts to manage these risks as it considers appropriate. The Company does not use derivative contracts for speculative purposes.

Commodity Price Risk

The Company is exposed to commodity price risk as fluctuations in crude oil or natural gas prices could have a materially adverse effect on its financial condition, as well as on the value and amount of the Company's reserves. Prices for crude oil and natural gas fluctuate in response to changes in supply and demand, market uncertainty and a variety of other factors beyond the Company's control.

The margins realized from the Company's refined products are also affected by factors such as crude oil price fluctuations due to the impact on refinery feedstock costs, third-party refined product purchases and the demand for refined petroleum products. The Company's ability to maintain product margins in an environment of higher feedstock costs depends on its ability to pass higher costs on to customers. The Company enters into derivative contracts to reduce exposure in its Downstream operations to these margin fluctuations, including margins on fixed price product sales, and short-term price fluctuations on the purchase of foreign and domestic crude oil and refined petroleum products. The Company's exposure to these margin fluctuations is limited. As such, the fair value and commodity price risk of the outstanding derivative contracts are not significant.

Interest Rate Risk

The Company is exposed to interest rate risk as changes in market interest rates affect the fair values of fixed-interest rate liabilities and the cash flows of both floating-interest rate liabilities and future borrowings. Notes, debentures and capital leases all bear interest at fixed rates. Drawings on the syndicated and demand credit facilities bear interest at floating rates. The Company regularly reviews the mix of floating and fixed-rate debt for consistency with its financing objectives. Interest rate risk from the Company's financial instruments is not significant.

Foreign Currency Exchange Risk

The Company's functional currency is Canadian (Cdn) dollars, while crude oil, one of the Company's primary products, is priced by reference to U.S. dollar benchmark prices. Therefore, Cdn/U.S. dollar exchange rate fluctuations can have a significant impact on the Company's revenues, crude oil and product purchases, capital expenditures, long-term debt, cash and cash equivalents, accounts receivable, accounts payable and off-balance sheet commitments.

The Company is also exposed to foreign currency exchange risk from its self-sustaining foreign operations whose functional currency is different from the Company's functional currency. Gains and losses from the translation of financial instruments within these self-sustaining foreign operations into Canadian dollars are presented as a separate component of other comprehensive income (loss) in the Consolidated Statement of Comprehensive Income.

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

17. FINANCIAL RISKS AND FINANCIAL INSTRUMENTS, *continued*

The Company's outstanding U.S. dollar-denominated long-term debt (Note 12) partially mitigates the exposure to Cdn/U.S. dollar exchange rate fluctuations created from its U.S. dollar-denominated cash flows and other associated financial instruments. In addition, the Company may hold a significant amount of U.S. dollar cash and cash equivalents to meet immediate capital and/or operating funding requirements, and may have significant accounts receivable, other assets, accounts payable and accrued liabilities and other liabilities balances denominated in U.S. dollars. These can create additional exposure to foreign currency exchange risk. At December 31, 2008, the Company had the following U.S. dollar denominated financial instruments:

	December 31, 2008
Cash and cash equivalents	$ US 473
Accounts receivable	1,287
Other assets	11
Accounts payable and accrued liabilities	(338)
Long-term debt	(3,953)
Other liabilities	(493)
	$ US (3,013)

The Company does not have significant financial instruments denominated in other foreign currencies.

(b) Credit Risk

The Company is exposed to credit risk from its counterparties' abilities to fulfill their obligations to the Company. The Company manages this risk through the establishment of credit policies and limits, which are applied in the selection of counterparties. The Company ensures that it has no significant concentrations of credit risk and ensures that no customers represent more than 10% of the Company's consolidated revenues for any period.

The Company's maximum exposure to credit risk at December 31, 2008 is equal to the carrying amount of its financial assets recorded on the Consolidated Balance Sheet. The Company carries sufficient provisions to cover its expected losses arising from credit risk associated with all financial assets, including any derecognized securitized receivables. These provisions are not significant.

(c) Liquidity Risk

The Company is exposed to liquidity risk from the potential inability to generate or obtain sufficient cash and cash equivalents in a timely and cost-effective manner to discharge its financial liabilities as they come due. The Company manages liquidity risk by forecasting cash flows to identify financing requirements, by maintaining committed and demand credit facilities, and by maintaining access to additional financing at competitive rates through capital markets and highly rated financial institutions. Any debt issued by the Company is managed in accordance with specified liquidity and maturity profiles.

The liquidity risk associated with the Company's financial liabilities has not been significantly impacted by the recent turmoil in the financial markets due to the Company's continuing ability to generate cash flow, existing cash balances, significant credit facility capacity and lack of near-term refinancing commitments. For 2009 and beyond, spending on future large projects may result in annual capital expenditures exceeding operating cash flow. The Company anticipates that additional funding requirements will be met by existing cash balances and external financing as needed and that additional financial leverage can be managed in the context of the Company's capital management strategy (Note 16).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(unaudited)*

(millions of Canadian dollars, unless otherwise stated)

17. FINANCIAL RISKS AND FINANCIAL INSTRUMENTS, *continued*

Derivative Contracts

During 2004, the Company entered into a series of derivative contracts for the future sale of Dated Brent crude oil in connection with its acquisition of an interest in the Buzzard field in the U.K. sector of the North Sea. Some derivative contracts matured from July 1, 2007 to December 31, 2007. All remaining outstanding derivative contracts were settled in December 2007. This resulted in the following:

	Three months ended December 31, 2007	Year ended December 31, 2007
Unrealized losses at beginning of period	$ (1,502)	$ (1,481)
Net losses during current period *(Note 5)*	(383)	(535)
Maturities[1]	160	291
Settlement[2]	1,725	1,725
	$ -	$ -

1 Derivative contracts that matured from July 1, 2007 to December 31, 2007 resulted in realized losses of $160 million ($106 million after-tax) and $291 million ($193 million after-tax) for the three months and year ended December 31, 2007, respectively.
2 All remaining outstanding derivative contracts were settled, which resulted in realized losses of $1,725 million ($1,145 million after-tax).

Financial Instruments

Excluding debentures, senior notes and capital leases, which are recorded as long-term debt, the fair values of financial instruments equals or approximates their carrying amount. The fair value of debentures, senior notes and capital leases was $3,868 million at December 31, 2008 (December 31, 2007 – $2,500 million), compared with a carrying amount of $4,749 million at December 31, 2008 (December 31, 2007 – $2,346 million). The fair values of debentures, senior notes and capital leases are based on publicly quoted market values for instruments with similar terms and risks.