

BRAZILIAN PETROLEUM CORP  
Form 20-F/A  
July 26, 2004

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**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 20-F/A**  
**(Amendment No. 1)**

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**ANNUAL REPORT**

**PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES**  
**EXCHANGE ACT OF 1934**

**for the fiscal year ended December 31, 2003**

**Commission File Number 1-15106**

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**(Exact name of registrant as specified in its charter)**

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**Brazilian Petroleum Corporation -PETROBRAS**  
**(Translation of registrant's name into English)**

**The Federative Republic of Brazil**  
**(Jurisdiction of incorporation or organization)**

Avenida República do Chile, 65

20035-900 - Rio de Janeiro - RJ

Brazil

(Address of principal executive offices)

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**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

<b>Title of each class:</b>	<b>Name of each exchange on which registered:</b>
<b>Common Shares, without par value*</b> <b>American Depositary Shares (as evidenced by</b> <b>American Depositary Receipts), each representing</b> <b>1 Common Share</b>	<b>New York Stock Exchange</b>
<b>Preferred Shares, without par value*</b> <b>American Depositary Shares (as evidenced by</b> <b>American Depositary Receipts), each representing</b> <b>1 Preferred Share</b>	<b>New York Stock Exchange</b>

\* Not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the Securities and Exchange Commission.

**Securities registered or to be registered pursuant to Section 12(g) of the Act: None**

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None**

**Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock**

**as of the close of the period covered by this Annual Report:**

**At December 31, 2003, there were outstanding:**

**634,168,418 Common Shares, without par value**

**462,369,507 Preferred Shares, without par value**

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

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Explanatory Note

This Amendment No. 1 to our annual report on Form 20-F for the fiscal year ended December 31, 2003 filed on June 30, 2004, or Amendment No. 1, is being filed solely for the purpose of amending Item 18 and Item 19, as follows:

to add the Report of Independent Registered Public Accounting Firm from PricewaterhouseCoopers Auditores Independentes dated February 13, 2003 with respect to the financial statements for the two years ended December 31, 2002 in Item 18 Financial Statements and to correct the numbering of the footnote on page F-126 in Item 18 Financial Statements. The other portions of Item 18 were filed as part of our original filing and are being refiled as part of this Amendment No. 1, without change; and

to add Exhibit 15.2 in Item 19 Exhibits, the consent of PricewaterhouseCoopers Auditores Independentes to the incorporation by reference in the Registration Statement on Form F-3 (No. 333-92044) of Petróleo Brasileiro S.A. - PETROBRAS of its report dated February 13, 2003.

This Amendment No. 1 consists of a cover page, this explanatory note, Item 18 (as amended), Item 19 (as amended), the signature page and the required certifications of our chief executive officer and the chief financial officer.

Except as described above, no change has been made to our annual report on Form 20-F. The filing of this amended annual report does not, and does not purport to, amend, update or restate the information in any other item of the annual report on Form 20-F filed on June 30, 2004 or reflect any events that have occurred after the annual report on Form 20-F was filed on June 30, 2004.

**ITEM 18. FINANCIAL STATEMENTS**

See pages F-3 through F-134, incorporated herein by reference.

**ITEM 19. EXHIBITS**

<u>No.</u>	<u>Description</u>
1.1	Amended By-Laws of Petróleo Brasileiro S.A.-Petrobras (together with an English version).
2.1	Deposit Agreement dated as of July 14, 2000, among Petrobras and Citibank, N.A., as depositary, and registered holders and beneficial owners from time to time of the American Depositary Shares, representing the common shares of Petrobras (incorporated by reference to exhibit of Petrobras Registration Statement on Form F-6 filed with the Securities and Exchange Commission on July 17, 2000 (File No. 333-123000)).
2.2	Amended and Restated Deposit Agreement dated as of February 21, 2001, among Petrobras and Citibank, N.A., as depositary, and the registered holders and beneficial owners from time to time of the American Depositary Shares, representing the preferred shares of Petrobras (incorporated by reference to exhibit 4.1 of Amendment No. 1 to Petrobras Registration Statement on Form F-1 filed with the Securities and Exchange Commission on July 3, 2001 (File No. 333-13660)).
2.3	Amendment No. 1, dated as of March 23, 2001, to the Amended and Restated Deposit Agreement, dated as of February 21, 2001, among Petrobras, Citibank N.A., as depositary, and the registered holders and beneficial owners from time to time of the American Depositary Shares representing the preferred shares of Petrobras (incorporated by reference to Exhibit 4.2 of Amendment No. 1 to Petrobras Registration Statement on Form F-1 filed with the Securities and Exchange Commission on July 3, 2001 (File No. 333-13660)).
2.4	Indenture, dated as of July 19, 2002, between Petrobras and JPMorgan Chase Bank, as Trustee (incorporated by reference to exhibit 4.4 of the Registration Statement of Petrobras International Finance Company and Petrobras on Form F-3, filed with the Securities and Exchange Commission on July 5, 2002, and amendments to which were filed on July 19, 2002 and August 14, 2002 (File No. 333-92044-01)).
2.5	Indenture, dated as of July 19, 2002, between Petrobras International Finance Company and JPMorgan Chase Bank, as Trustee (incorporated by reference to exhibit 4.5 of the Registration Statement of Petrobras International Finance Company and Petrobras on Form F-3, filed with the Securities and Exchange Commission on July 5, 2002, and amendments to which were filed on July 19, 2002 and August 14, 2002 (File No. 333-92044-01)).
2.6	First Supplemental Indenture, dated as of March 31, 2003, between Petrobras International Finance Company (PIFCo) and JPMorgan Chase Bank, as Trustee, relating to the 9.00% Global Step-Up Notes due 2008 (incorporated by reference to exhibit 2.6 of Petrobras annual report on Form 20-F for the fiscal year ended December 31, 2002, filed with the Securities and Exchange Commission on June 19, 2002 (File No. 1-15106)).
2.7	Second Supplemental Indenture, dated as of July 2, 2003, between Petrobras International Finance Company (PIFCo) and JPMorgan Chase Bank, as Trustee, relating to the 9.125% Global Notes due 2013.
2.8	Amended and Restated Second Supplemental Indenture, initially dated as of July 2, 2003, as amended and restated as of September 18, 2003, between Petrobras International Finance Company (PIFCo) and JPMorgan Chase Bank, as Trustee, relating to the 9.125% Global Notes due 2013.
2.9	Third Supplemental Indenture, dated as of December 10, 2003, between Petrobras International Finance Company (PIFCo) and JPMorgan Chase Bank, as Trustee, relating to the 8.375% Global Notes due 2018.

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The amount of long-term debt securities of Petrobras authorized under any given instrument does not exceed 10% of its total assets on a consolidated basis. Petrobras hereby agrees to furnish to the SEC, upon its request, a copy of any instrument defining the rights of holders of its long-term debt or of its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed.

- 4.1 Form of Concession Agreement for Exploration, Development and Production of crude oil and natural gas executed between Petrobras and ANP (incorporated by reference to Exhibit 10.1 of Petrobras Registration Statement on Form F-1 filed with the Securities and Exchange Commission on July 14, 2000 (File No. 333-12298)).
- 4.2 Purchase and Sale Agreement of natural gas, executed between Petrobras and Yacimientos Petroliferos Fiscales Bolivianos-YPFB (together with and English version) (incorporated by reference to Exhibit 10.2 to Petrobras Registration Statement on Form F-1 filed with the Securities and Exchange Commission on July 14, 2000 (File No. 333-12298)).
- 8.1 For our organizational structure, including a list of subsidiaries, their jurisdiction of incorporation and names under which they do business, see Item 4. Information on the Company Organizational Structure.
- 10.1 Consent letter of DeGolyer and MacNaughton.
- 12.1 Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 13.1 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 15.1 Ernst & Young Auditores Independentes S/S consent to the incorporation by reference in the Registration Statement (Form F-3 No. 333-92044) of Petroleo Brasileiro S.A. PETROBRAS ( Petrobras) of its report dated February 13, 2004, with respect to the consolidated financial statements for the year ended December 31, 2003 of Petrobras and its subsidiaries included in this Annual Report (Form 20-F) for the year ended December 31, 2003.
- 15.2 PricewaterhouseCoopers Auditores Independentes consent to the incorporation by reference in the Registration Statement (Form F-3 No. 333-92044) of Petroleo Brasileiro S.A. PETROBRAS ( Petrobras ) of its report dated February 13, 2003, with respect to the financial statements for the two years ended December 31, 2002 of Petrobras, which appears in Amendment No. 1 to the 2003 Annual Report on Form 20-F, filed with the Securities and Exchange Commission on July 26, 2004.

**SIGNATURES**

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant, Petróleo Brasileiro S.A.-PETROBRAS, hereby certifies that it meets all the requirements for filing on Form 20-F/A and has duly caused this annual report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Rio de Janeiro, on July 26, 2004.

Petróleo Brasileiro S.A. - PETROBRAS

By: /s/ JOSÉ EDUARDO DE BARROS DUTRA

Name: José Eduardo De Barros Dutra  
Title: Chief Executive Officer

By: /s/ JOSÉ SÉRGIO GABRIELLI DE AZEVEDO

Name: José Sérgio Gabrielli de Azevedo  
Title: Chief Financial Officer

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**PETRÓLEO BRASILEIRO S.A. PETROBRAS**

**AND SUBSIDIARIES**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Shareholders of

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS:**

We have audited the accompanying consolidated balance sheet of PETRÓLEO BRASILEIRO S.A. - PETROBRAS and subsidiaries as of December 31, 2003, and the related consolidated statements of income, shareholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of PETRÓLEO BRASILEIRO S.A. - PETROBRAS and subsidiaries at December 31, 2003, and the consolidated results of their operations and their cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Effective January 1, 2003, the Company adopted SFAS No. 143 - Accounting for Asset Retirement Obligations ( SFAS 143 ). Additionally, at December 31, 2003 the Company adopted FIN 46 Consolidation of Variable Interest Entities as discussed in Note 3.

ERNST & YOUNG

Auditores Independentes S/S

Paulo José Machado

Partner

Rio de Janeiro, Brazil

February 13, 2004



**Report of Independent Registered**

**Public Accounting Firm**

To the Board of Directors and Stockholders

PETRÓLEO BRASILEIRO S.A. - PETROBRAS

In our opinion, the accompanying consolidated balance sheet as of December 31, 2002 and the related consolidated statements of income, of cash flows and of changes in stockholders' equity for each of the two years in the period ended December 31, 2002 present fairly, in all material respects, the financial position, results of operations and cash flows of Petróleo Brasileiro S.A. - PETROBRAS and its subsidiaries at December 31, 2002 and for each of the two years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

February 13, 2003

PricewaterhouseCoopers

Audidores Independentes

Rio de Janeiro, Brazil

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## CONSOLIDATED BALANCE SHEETS

December 31, 2003, and 2002

Expressed in Millions of United States Dollars

	<b>As of December 31,</b>	
	<b>2003</b>	<b>2002</b>
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents (Note 5)	9,610	3,301
Accounts receivable, net (Note 7)	2,905	2,267
Inventories (Note 8)	2,947	2,540
Deferred income tax (Note 4)	256	271
Recoverable taxes	917	672
Advances to suppliers	504	794
Other current assets	761	477
	<u>17,900</u>	<u>10,322</u>
<b>Property, plant and equipment, net (Note 9)</b>	<u>30,805</u>	<u>18,224</u>
<b>Investments in non-consolidated companies and other investments (Note 10)</b>	<u>1,173</u>	<u>334</u>
<b>Other assets</b>		
Accounts receivable, net (Note 7)	528	369
Advances to suppliers	416	450
Petroleum and alcohol account receivable from Federal Government (Note 11)	239	182
Government securities (Note 6)	283	176
Marketable securities	340	208
Unrecognized pension obligation (Note 17)		61
Restricted deposits for legal proceedings and guarantees (Note 22 (a))	543	290
Recoverable taxes	467	156
Goodwill in PEPSA and PELSA (Note 19)	183	
Investment in PEPSA and PELSA (Note 19)		1,073
Prepaid expenses	190	100
Other assets	545	209
	<u>3,734</u>	<u>3,274</u>
<b>Total assets</b>	<u>53,612</u>	<u>32,154</u>

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## CONSOLIDATED BALANCE SHEETS

December 31, 2003, and 2002

Expressed in Millions of United States Dollars

	<b>As of December 31,</b>	
	<b>2003</b>	<b>2002</b>
<b>Liabilities and shareholders equity</b>		
<b>Current liabilities</b>		
Trade accounts payable	2,261	1,702
Income tax	148	119
Taxes payable, other than income taxes	2,157	1,682
Short-term debt (Note 12)	1,329	671
Current portion of long-term debt (Note 12)	1,145	727
Current portion of project financings (Note 14)	842	239
Current portion of capital lease obligations (Note 15)	378	349
Accrued interest	181	120
Dividends and interest on capital payable (Note 18)	1,139	307
Contingencies (Note 22)	84	318
Payroll and related charges	581	283
Advances from customers	258	119
Ventures under consortium agreements	166	106
Employee benefits obligation - Pension (Note 17)	160	89
Other payables and accruals	392	432
	<u>11,221</u>	<u>7,263</u>
<b>Long-term liabilities</b>		
Long-term debt (Note 12)	11,888	6,987
Project financings (Note 14)	5,066	3,800
Employee benefits obligation - Pension (Note 17)	1,895	1,363
Employee benefits obligation - Health care (Note 17)	1,580	1,060
Capital lease obligations (Note 15)	1,242	1,907
Deferred income tax (Note 4)	1,122	259
Provision for abandonment of wells (Note 3 (a))	396	
Thermoelectric liabilities (Note 3 (b))	1,142	
Contingencies (Note 22)	271	50
Other liabilities	270	300
	<u>24,872</u>	<u>15,726</u>
<b>Minority interest</b>	367	(136)
<b>Shareholders equity</b>		
Shares authorized and issued (Note 18)		

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Preferred share - 2003 - 462,369,507 shares (2002 - 451,935,669 shares)	2,973	2,459
Common share - 2003 and 2002 - 634,168,418 shares	4,289	3,761
Capital reserve (Note 18)	118	89
Retained earnings		
Appropriated (Note 18)	10,696	5,585
Unappropriated	14,957	16,085
Accumulated other comprehensive income		
Cumulative translation adjustments	(14,450)	(17,306)
Amounts not recognized as net periodic pension cost, net of tax (Note 17)	(1,588)	(1,361)
Unrealized gains (losses) on securities, net of tax	157	(11)
	<u>17,152</u>	<u>9,301</u>
<b>Total liabilities and shareholders equity</b>	<b>53,612</b>	<b>32,154</b>

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF INCOME

December 31, 2003, 2002 and 2001

Expressed in Millions of United States Dollars (except number of shares and earnings per share)

	<b>Year ended December 31,</b>		
	<b>2003</b>	<b>2002</b>	<b>2001</b>
<b>Sales of products and services</b>	42,690	32,987	34,145
Less:			
Value-added and other taxes on sales and services	(6,348)	(5,241)	(8,627)
Contribution of intervention in the economic domain charge - CIDE	(5,545)	(5,134)	
Specific parcel price - PPE			(969)
<b>Net operating revenues</b>	<b>30,797</b>	<b>22,612</b>	<b>24,549</b>
Cost of sales	15,416	11,506	12,807
Depreciation, depletion and amortization	1,785	1,930	1,729
Exploration, including exploratory dry holes	512	435	404
Selling, general and administrative expenses	2,091	1,741	1,751
Impairment (Note 9 (b))	70	75	145
Research and development expenses	201	147	132
<b>Total costs and expenses</b>	<b>20,075</b>	<b>15,834</b>	<b>16,968</b>
Equity in results of non-consolidated companies (Note 10)	141	(178)	(8)
Financial income (Note 13)	602	1,142	1,375
Financial expense (Note 13)	(1,247)	(774)	(808)
Monetary and exchange variation on monetary assets and liabilities, net (Note 13)	509	(2,068)	(915)
Employee benefit expense	(595)	(451)	(594)
Other taxes	(333)	(360)	(295)
Loss on government securities (Note 6)			(1,099)
Other expenses, net	(1,026)	(857)	(445)
	(1,949)	(3,546)	(2,789)
<b>Income before income taxes and minority interest and accounting change</b>	<b>8,773</b>	<b>3,232</b>	<b>4,792</b>



**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF INCOME

December 31, 2003, 2002 and 2001

Expressed in Millions of United States Dollars (except number of shares and earnings per share)

	Year ended December 31,		
	2003	2002	2001
<b>Income tax expense (Note 4)</b>			
Current	(2,599)	(1,269)	(1,196)
Deferred	(64)	116	(193)
	<u>(2,663)</u>	<u>(1,153)</u>	<u>(1,389)</u>
<b>Minority interest in results of consolidated subsidiaries</b>	(248)	232	88
<b>Income before effect of change in accounting principle</b>	5,862	2,311	3,491
Cumulative effect of change in accounting principle, net of taxes	697		
<b>Net income for the year</b>	<u>6,559</u>	<u>2,311</u>	<u>3,491</u>
<b>Net income applicable to each class of shares</b>			
Common/ADS	3,793	1,349	2,038
Preferred/ADS	2,766	962	1,453
<b>Net income for the year</b>	<u>6,559</u>	<u>2,311</u>	<u>3,491</u>
<b>Basic and diluted earnings per share (Note 18 (b))</b>			
Common/ADS and Preferred/ADS			
Before effect of change in accounting principle	5.35	2.13	3.21
After effect of change in accounting principle	5.98	2.13	3.21
<b>Weighted average number of shares outstanding</b>			
Common/ADS	634,168,418	634,168,418	634,168,418
Preferred/ADS	462,369,507	451,935,669	451,935,669

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

December 31, 2003, 2002 and 2001

Expressed in Millions of United States Dollars

	<b>Year ended December 31,</b>		
	<b>2003</b>	<b>2002</b>	<b>2001</b>
<b>Cash flows from operating activities</b>			
Net income for the year	6,559	2,311	3,491
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation, depletion and amortization	1,805	1,951	1,731
Dry hole costs	207	198	194
Loss on property, plant and equipment	119	99	811
Loss on government securities			1,099
Minority interest in loss (income) of subsidiaries	248	(232)	(88)
Deferred income taxes	64	(116)	193
Foreign exchange and monetary loss (gain)	(138)	2,714	807
Accretion expense asset retirement obligation	43		
Impairment of oil and gas properties	70	75	145
Provision for uncollectible accounts	25	56	421
Gain on exchange of businesses with Repsol-YPF			(500)
Cumulative effect of change in accounting principle, net of taxes	(697)		
Equity in the results of non-consolidated companies	(141)	178	8
Others	1	2	(93)
Decrease (increase) in assets			
Accounts receivable, net	(477)	(541)	(102)
Petroleum and Alcohol Account	(15)	(157)	1,173
Interest receivable on government securities	(157)	(10)	(243)
Inventories	244	(1,139)	232
Advances to suppliers	562	(797)	(240)
Prepaid expenses	96	(31)	(206)
Recoverable taxes	(365)	(190)	(422)
Others	90	(266)	(47)
Increase (decrease) in liabilities			
Trade accounts payable	(156)	669	(64)
Payroll and related charges	222	95	84
Taxes payable, other than income taxes	60	441	212
Employee postretirement benefits, net of unrecognized pension obligation	535	177	(61)
Risk management activities	41	68	123
Accrued interest	62	158	58
Contingencies	(78)	365	37
Abandonment	(29)		
Other liabilities	(231)	209	(10)
<b>Net cash provided by operating activities</b>	<b>8,569</b>	<b>6,287</b>	<b>8,743</b>

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

December 31, 2003, 2002 and 2001

Expressed in Millions of United States Dollars

	<b>Year ended December 31,</b>		
	<b>2003</b>	<b>2002</b>	<b>2001</b>
<b>Cash flows from investing activities</b>			
Additions to property, plant and equipment	(6,551)	(4,911)	(4,254)
Investment in Perez Compan S.A - PEPSA		(1,073)	
Investments in thermoelectric plants		(447)	(15)
Investment in non-consolidated companies	(73)	(153)	(207)
Dividends received from non-consolidated companies	13	11	24
Restricted deposits for legal proceedings	(188)	(84)	(140)
Effect on cash from merger with subsidiaries and affiliates	231		
Effect on cash of FIN 46 adoption	1,049		
Others		1	
<b>Net cash used in investing activities</b>	<b>(5,519)</b>	<b>(6,656)</b>	<b>(4,592)</b>
<b>Cash flows from financing activities</b>			
Short-term debt, net issuances and repayments	321	(367)	(1,648)
Proceeds from issuance of long-term debt	4,629	1,937	2,347
Principal payments on long-term debt	(1,315)	(1,173)	(1,023)
Project financing funding (payments)	(208)	(746)	760
Payment of finance lease obligations	(108)	(247)	(465)
Dividends paid to shareholders	(941)	(999)	(1,702)
Dividends paid to minority interests	(2)	(19)	(23)
<b>Net cash provided by (used) in financing activities</b>	<b>2,376</b>	<b>(1,614)</b>	<b>(1,754)</b>
Increase (decrease) in cash and cash equivalents	5,426	(1,983)	2,397
Effect of exchange rate changes on cash and cash equivalents	883	(2,076)	(863)
Cash and cash equivalents at beginning of year	3,301	7,360	5,826
<b>Cash and cash equivalents at end of year</b>	<b>9,610</b>	<b>3,301</b>	<b>7,360</b>

**Year ended December 31,**

<b>2003</b>	<b>2002</b>	<b>2001</b>
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**Supplemental cash flow information:**

Cash paid during the year for

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Interest	622	200	393
Income taxes	2,384	812	951
Withholding income tax on financial investments	47	120	178
	<u>        </u>	<u>        </u>	<u>        </u>
Non-cash investing and financing transactions during the year			
Capital lease obligations		144	406
Project finance expenditures funded by special purpose companies		946	1,121
Net assets acquired in purchased business combination with Repsol-YPF			424
Transfer of Government securities to PETROS		313	2,140
Consolidation of merchant type thermoelectrics	1,142		
Exchange of BR shares for PETROBRAS preferred shares	130		
Recognition of asset retirement obligation FAS 143	114		
	<u>        </u>	<u>        </u>	<u>        </u>

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

December 31, 2003, 2002 and 2001

Expressed in Millions of United States Dollars (except per-share amounts)

	<b>Year ended December 31,</b>		
	<b>2003</b>	<b>2002</b>	<b>2001</b>
<b>Preferred shares</b>			
Balance at January 1	2,459	1,882	1,882
Capital increase with issue of preferred shares	130		
Capital increase with undistributed earnings reserve	384	577	
Balance at December 31	<u>2,973</u>	<u>2,459</u>	<u>1,882</u>
<b>Common shares</b>			
Balance at January 1	3,761	2,952	2,952
Capital increase with undistributed earnings reserve	528	809	
Balance at December 31	<u>4,289</u>	<u>3,761</u>	<u>2,952</u>
<b>Capital reserve fiscal incentive</b>			
Balance at January 1	89	128	37
Transfer from (to) unappropriated retained earnings	29	(39)	91
Balance at December 31	<u>118</u>	<u>89</u>	<u>128</u>
<b>Accumulated other comprehensive income</b>			
<b>Cumulative translation adjustments</b>			
Balance at January 1	(17,306)	(11,854)	(9,159)
Change in the year	2,856	(5,452)	(2,695)
Balance at December 31	<u>(14,450)</u>	<u>(17,306)</u>	<u>(11,854)</u>
<b>Amounts not recognized as net periodic pension cost</b>			
Balance at January 1	(1,361)	(1,867)	(1,516)
(Increase) decrease in additional minimum liability	(344)	724	(524)
Tax effect on above	117	(218)	173
Balance at December 31	<u>(1,588)</u>	<u>(1,361)</u>	<u>(1,867)</u>

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

December 31, 2003, 2002 and 2001

Expressed in Millions of United States Dollars (except per-share amounts)

	Year ended December 31,		
	2003	2002	2001
<b>Unrecognized gains (losses) on securities</b>			
Balance at January 1	(11)	13	65
Unrealized gains (losses)	254	(36)	(77)
Tax effect on above	(86)	12	25
Balance at December 31	157	(11)	13
<b>Appropriated retained earnings</b>			
Legal reserve			
Balance at January 1	643	768	648
Transfer from (to) unappropriated retained earnings, net of gain or loss on translation	446	(125)	120
Balance at December 31	1,089	643	768
Unrealized income reserve			
Balance at January 1			1,471
Transfer from (to) unappropriated retained earnings			(1,471)
Undistributed earnings reserve			
Balance at January 1	4,778	5,886	3,648
Capital increase	(912)	(1,386)	
Transfer from unappropriated retained earnings, net of gain or loss on translation	5,506	278	2,238
Balance at December 31	9,372	4,778	5,886

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

December 31, 2003, 2002 and 2001

Expressed in Millions of United States Dollars (except per-share amounts)

	Year ended December 31,		
	2003	2002	2001
Statutory reserve			
Balance at January 1	164	215	221
Transfer from (to) unappropriated retained earnings, net of gain or loss on translation	71	(51)	(6)
Balance at December 31	235	164	215
Total appropriated retained earnings	10,696	5,585	6,869
<b>Unappropriated retained earnings</b>			
Balance at January 1	16,085	15,124	14,456
Net income for the year	6,559	2,311	3,491
Dividends (per share: 2003 - US\$ 1.49 to common and preferred shares; 2002 - US\$ 1.19 to common and preferred shares; 2001 - US\$ 1.62 to common and preferred shares)	(1,635)	(1,287)	(1,851)
Appropriation (to) from fiscal incentive reserve	(29)	39	(91)
Appropriation to reserves	(6,023)	(102)	(881)
Balance at December 31	14,957	16,085	15,124
Total shareholders' equity	17,152	9,301	13,247
<b>Comprehensive income (loss) is comprised as follows:</b>			
Net income for the year	6,559	2,311	3,491
Cumulative translation adjustments	2,856	(5,452)	(2,695)
Amounts not recognized as net periodic pension cost	(227)	506	(351)
Unrealized gain on available-for-sale securities	168	(24)	(52)
Total comprehensive income (loss)	9,356	(2,659)	393



**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Expressed in Millions of United States Dollars

(except when specifically indicated)

**1. The Company and its operations**

PETRÓLEO BRASILEIRO S.A. - PETROBRAS is Brazil's national oil company and, directly or through its subsidiaries (collectively, PETROBRAS or the Company), is engaged in the exploration, exploitation and production of oil from reservoir wells, shale and other rocks, and in the refining, processing, trade and transport of oil and oil derivatives, natural gas and other fluid hydrocarbons, in addition to other energy related activities. Additionally, PETROBRAS may promote the research, development, production, transport, distribution and marketing of all sectors of energy, as well as other related or similar activities.

PETROBRAS was incorporated under Law No. 2,004 on October 3, 1953. Until November of 1995, PETROBRAS was the exclusive agent of the Brazilian Federal Government (the Federal Government) for purposes of exploiting the Federal Government's constitutional and statutory control over activities involving exploration, production, refining, distribution, import, export, marketing and transportation of hydrocarbons and oil products in Brazil and its continental waters. When adopted in 1953, the relevant provisions of the Brazilian constitution and statutory law gave the Federal Government a monopoly in these areas subject only to the right of companies then engaged in oil refining and the distribution of oil and oil products to continue those activities in Brazil. Therefore, except for limited competition from those companies in their grandfathered activities, PETROBRAS had a monopoly over its businesses for approximately 42 years. As a result of a change in the Brazilian constitution in November of 1995, and the subsequent and ongoing implementation of that change, PETROBRAS has ceased to be the Federal Government's exclusive agent in Brazil's hydrocarbons sector and up to 2001 had been operating in an environment of gradual deregulation and increasing competition.

In accordance with Law No. 9,478 (Petroleum Law) and Law No. 9,990, dated August 6, 1997 and July 21, 2000, respectively, the fuel market in Brazil was totally liberalized beginning January 1, 2002 permitting other companies to produce and sell on the domestic market, and also to import and export oil products.

The Company also has oil and gas operations in international locations, with the most significant international operations being in other Latin American countries.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Expressed in Millions of United States Dollars

(except when specifically indicated)

**2. Summary of significant accounting policies**

In preparing these consolidated financial statements, the Company has followed accounting policies that are in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ). The preparation of these financial statements requires the use of estimates and assumptions that affect the assets, liabilities, revenues and expenses reported in the financial statements, as well as amounts included in the notes thereto.

Estimates adopted by management include: oil and gas reserves, pension and health care liabilities, environmental obligations, depreciation, depletion and amortization, abandonment costs, contingencies and income taxes. While the Company uses its best estimates and judgments, actual results could differ from those estimates as future confirming events occur.

**(a) Basis of financial statements preparation**

The accompanying consolidated financial statements of PETRÓLEO BRASILEIRO S.A. - PETROBRAS (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) and the rules and regulations of the Securities and Exchange Commission (SEC). U.S. GAAP differs in certain respects from Brazilian accounting practice as applied by PETROBRAS in its statutory financial statements prepared in accordance with Brazilian Corporate Law and regulations promulgated by the Brazilian Securities Commission (CVM).

The U.S. dollar amounts for the years presented have been translated from the Brazilian Real amounts in accordance with Statement of Financial Accounting Standards SFAS No. 52 - Foreign Currency Translation ( SFAS 52 ) as applicable to entities operating in non-hyperinflationary economies. Transactions occurring in foreign currencies are first remeasured to the Brazilian Real and then translated to the U.S. dollar, with remeasurement gains and losses being recognized in the statements of income. While PETROBRAS has selected the U.S. Dollar as its reporting currency, the functional currency of PETROBRAS is the Brazilian Real.

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Expressed in Millions of United States Dollars

(except when specifically indicated)

**2. Summary of significant accounting policies** Continued

**(a) Basis of financial statements preparation** Continued

The Company has translated all assets and liabilities into U.S. dollars at the current exchange rate (R\$ 2.8892 and R\$ 3.5333 to US\$ 1.00 at December 31, 2003 and 2002, respectively), and all accounts in the statements of income and cash flows (including amounts relative to local currency indexation and exchange variances on assets and liabilities denominated in foreign currency) at the average rates prevailing during the year. The net translation gain/ (loss) in the amount of US\$ 2,856 in 2003 (2002 - US\$ (5,452) and 2001 - US\$ (2,695)) resulting from this remeasurement process was excluded from income and presented as a cumulative translation adjustment ( CTA ) within Other Comprehensive Income in the statement of changes in shareholders' equity.

**(b) Basis of consolidation**

The consolidated financial statements include the accounts of the Company and all majority-owned subsidiaries in which (a) the Company directly or indirectly has either a majority of the equity of the subsidiary or otherwise has management control, or (b) the Company has determined itself to be the primary beneficiary of a variable interest entity in accordance with FIN 46 (Note 3(b)). Intercompany accounts and transactions are eliminated.

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Expressed in Millions of United States Dollars

(except when specifically indicated)

**2. Summary of significant accounting policies** Continued**(b) Basis of consolidation** Continued

The following majority-owned subsidiaries and variable interest entities are consolidated:

<u>Subsidiary companies</u>	<u>Activity</u>
Petrobras Química S.A. - PETROQUISA	Petrochemical
Petrobras Distribuidora S.A. - BR	Distribution
BRASPETRO Oil Services Company - BRASOIL	International operations
BRASPETRO Oil Company - BOC	International operations
PIB - Petrobras Internacional - BRASPETRO B.V. (1)	International operations
Petrobras Energia Ltda.	Energy
Petrobras Negócios Eletrônicos S.A.	Corporate
Petrobras Gás S.A. - GASPETRO	Gas transportation
Petrobras International Finance Company - PIFCO	Marketing
Petrobras Transporte S.A. - TRANSPETRO	Transportation
Downstream Participações S.A.	Refining and distribution
Petrobras Netherlands BV	Explorations and Production
UTE Nova Piratininga Ltda.	Energy
TERMOR Participações S.A.	Energy
TERMORIO S. A. (3)	Energy
TERMOBAHIA Ltda. (3)	Energy
Ibiritermo S. A. (3)	Energy
EVM Leasing Co. (2)	Explorations and Production
Companhia Petrolífera Marlim (2)	Explorations and Production
NovaMarlim Petroleo S.A. (2)	Explorations and Production
Nova Transportadora do Sudeste S.A.(2)	Transportation
Nova Transportadora do Nordeste S.A.(2)	Transportation
Barracuda e Caratinga Holding Company B.V. (2)	Explorations and Production
Cayman Cabiunas Investments Co. Ltda. (2)	Explorations and Production
Langstrand Holdings S.A.(2)	Explorations and Production
Albacora Japan Petroleum Limited Company (2)	Explorations and Production
Companhia de Recuperação Secundaria (2)	Explorations and Production
PDET ONSHORE S.A. (2)	Explorations and Production
MPX Termoceaná Ltda. (4)	Energy
SFE - Sociedade Fluminense de Energia Ltda. (4)	Energy
Consórcio Macaé Merchant (4)	Energy



**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Expressed in Millions of United States Dollars

(except when specifically indicated)

**2. Summary of significant accounting policies** Continued

**(b) Basis of consolidation** Continued

- (1) Parent Company of Petrobras Energia S.A.-PEPSA. (former Perez Companc S.A.-PECOM) and Petrolera Entre Lomas S.A. PELSA (former Petrolera Perez Companc S.A.)
- (2) Consolidated according to FIN 46, commencing December 31, 2003. Formerly were special purpose entities formed in connection with project finance transactions.
- (3) Consolidated according to FIN 46, commencing December 31, 2003. Formerly were accounted for as capital leases pursuant to SFAS 13. See Notes 15 and 16.
- (4) Consolidated according to FIN 46, commencing December 31, 2003. Formerly were not consolidated to PETROBRAS financial statements, see Note 16.

**(c) Cash equivalents**

Cash equivalents consist of highly liquid investments that are readily convertible into cash and have an original maturity of three months or less at date of acquisition.

**(d) Accounts receivable**

Accounts receivable is stated at estimated realizable values. An allowance for doubtful accounts is provided in an amount considered by management to be sufficient to meet probable future losses related to uncollectible accounts.

**(e) Inventories**

Inventories are stated as follows:

Raw materials comprise principally crude oil inventories, which are stated at the lower of average cost or market value.

Oil products and fuel alcohol are stated, respectively, at average refining and purchase cost, adjusted when applicable to their realizable value.

Materials and supplies are stated at average purchase cost, not exceeding replacement value and imports in transit are stated at identified cost.

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Expressed in Millions of United States Dollars

(except when specifically indicated)

**2. Summary of significant accounting policies** Continued

**(f) Investments in non-consolidated companies**

The Company uses the equity method of accounting for all long-term investments for which it owns between 20% and 50% of the investee's outstanding voting stock or has the ability to exercise significant influence over operating and financial policies of the investee. The equity method requires periodic adjustments to the investment account to recognize the Company's proportionate share in the investee's results, reduced by receipt of investee's dividends.

**(g) Government and marketable securities**

The Company holds National Treasury Bonds Series B (NTN-B) issued by the Federal Government which are accounted for as available-for-sale securities in accordance with SFAS No. 115 - Accounting for Certain Investments in Debt and Equity Securities ( SFAS 115 ). The Company has maintained junior trust notes received in connection with the structured finance program as held-to-maturity, and additionally has certain available-for-sale investments in companies with publically traded shares.

**(h) Property, plant and equipment**

**Costs incurred in oil and gas producing activities**

The successful efforts method of accounting is used for oil and gas exploration, development and production activities.

**Property acquisition costs**

Costs of acquiring developed or undeveloped leaseholds including lease bonus, brokerage, and other fees are capitalized. The costs of undeveloped properties that become productive are transferred to a producing property account.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Expressed in Millions of United States Dollars

(except when specifically indicated)

**2. Summary of significant accounting policies** Continued

**(h) Property, plant and equipment** Continued

**Exploratory costs**

Exploratory wells that find oil and gas in an area requiring a major capital expenditure before production can begin are evaluated annually to assure that commercial quantities of reserves have been found or that additional exploration work is underway or planned. Exploratory costs related to areas where commercial quantities have been found are capitalized, and exploratory costs where additional work is underway or planned continue to be capitalized pending final evaluation. Exploratory well costs not meeting either of these tests are charged to expense. All other exploratory costs (including geological and geophysical costs) are expensed as incurred. Exploratory dry holes are expensed.

**Development costs**

Costs of development wells including dry holes, platforms, well equipment and attendant production facilities are capitalized.

**Production costs**

Costs incurred with producing wells are expensed as incurred.

**Abandonment costs**

Through December 31, 2002, the Company recorded abandonment costs in accordance with SFAS No. 19 - Financial Accounting and Reporting by Oil and Gas Production Companies ( SFAS 19 ). Under SFAS 19, the estimated costs of dismantlement and removal of oil and gas related facilities are accrued over the properties' production lives using the unit-of-production method and recognized as accumulated depreciation, depletion and amortization as the expense is recorded. Effective January 1, 2003, the Company adopted SFAS 143 for abandonment costs (see Note 3(a) for information related to the new accounting policy for abandonment costs commencing from January 1, 2003).



**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Expressed in Millions of United States Dollars

(except when specifically indicated)

**2. Summary of significant accounting policies** Continued**(h) Property, plant and equipment** Continued**Depreciation, depletion and amortization**

Depreciation, depletion and amortization of leasehold costs of producing properties are recorded using the unit-of-production method applied on a field by field basis as a ratio of proved reserves produced. Leased production platforms are depreciated on a straight-line basis over the estimated useful lives of the platforms. Depreciation, depletion and amortization of all other capitalized costs (both tangible and intangible) of proved oil and gas producing properties are recorded using the unit-of-production method applied on a field by field basis as a ratio of proved developed reserves produced. Prior to January 1, 2003, estimated dismantlement, restoration and abandonment costs and estimated salvage values are taken into account in determining amortization and depreciation provisions.

Other plant and equipment are depreciated on a straight-line basis over the following estimated useful lives:

Building and improvements	25 years
Equipment and other assets	3-25 years
Platforms	10-25 years
Pipelines	30 years

**Impairment**

In accordance with SFAS No. 144 - Impairment of Long-Lived Assets ( SFAS 144 ), management reviews long-lived assets, primarily property, plant and equipment to be used in the business and capitalized costs relating to oil and gas producing activities, whenever events or changes in circumstances indicate that the carrying value of an asset or group of assets may not be recoverable on the bases of undiscounted future cash flows. The reviews are carried out at the lowest level of assets to which the Company is able to attribute identifiable future cash flows. The net book value of the underlying assets is adjusted to their fair value using a discounted future cash flows model, if the sum of the expected undiscounted future cash flows is less than the book value.

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

Expressed in Millions of United States Dollars

(except when specifically indicated)

**2. Summary of significant accounting policies** Continued

**(h) Property, plant and equipment** Continued

**Maintenance and repairs**

The actual costs of major maintenance, including turnarounds at refineries and vessels, as well as other expenditures for maintenance and repairs, are expensed as incurred.

**Capitalized interest**

Interest is capitalized in accordance with SFAS No. 34 - Capitalization of Interest Cost ( SFAS 34 ). Interest is capitalized on specific projects when a construction process involves considerable time and involves major capital expenditures. Capitalized interest is allocated to property, plant and equipment and amortized over the estimated useful lives of the related assets. Interest is capitalized at the Company's weighted average cost of borrowings.

**(i) Revenues, costs and expenses**

Revenues from sales of crude oil and oil products, petrochemical products and others are recognized on an accrual basis when the title is transferred to the customer. Revenues from sales of natural gas are accounted for when the natural gas is transferred to the customer. Subsequent adjustments to revenue based on production sharing agreements or volumetric delivery differences are not significant. Costs and expenses are accounted for on an accrual basis.

**(j) Income taxes**

The Company accounts for income taxes in accordance with SFAS No. 109 - Accounting for Income Taxes ( SFAS 109 ), which requires an asset and liability approach to recording current and deferred taxes. The effects of differences between the tax bases of assets and liabilities and the amounts recognized in the financial statements have been treated as temporary differences for the purpose of recording deferred income taxes.



**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Expressed in Millions of United States Dollars

(except when specifically indicated)

**2. Summary of significant accounting policies** Continued

**(j) Income taxes** Continued

PETROBRAS records the tax benefit of all net operating losses as a deferred tax asset and recognizes a valuation allowance for any part of this benefit which management believes that will not be recovered against future taxable income using a more likely than not criterion.

**(k) Employee postretirement benefits**

The Company sponsors a contributory defined-benefit pension plan covering substantially all of its employees, which is accounted for by the Company in accordance with SFAS No. 87 - Employers' Accounting for Pensions ( SFAS 87 ).

In addition, the Company provides certain health care benefits for retired employees and its dependents. The cost of such benefits is recognized in accordance with SFAS No. 106 - Postretirement Benefits Other Than Pensions ( SFAS 106 ).

The Company also contributes to the national pension, social security and redundancy plans at rates based on payroll, and such contributions are expensed as incurred. Further indemnities may be payable upon involuntary severance of employees but, based on current operating plans, management does not believe that any amounts payable under this plan will be significant.

**(l) Environmental and remediation costs**

Environmental costs relating to current operations are expensed or capitalized, as appropriate, depending on whether such costs are expected to provide future economic benefits. Liabilities are recognized when the costs are considered probable and can be reasonably estimated.



**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Expressed in Millions of United States Dollars

(except when specifically indicated)

**2. Summary of significant accounting policies** Continued

**(m) Accounting for the effect of Federal Government regulation**

As provided in the Petroleum Law, the fuel market in Brazil was totally liberalized as of January 1, 2002 permitting other companies to produce and sell on the domestic market and, also, import and export oil products. Additionally, as of January 1, 2002, PETROBRAS is no longer required to charge the prices established by the Federal Government on the sale of oil products, and the realization price is no longer established by a formula adjusted to the international market. Therefore the specific parcial price (Parcela de Preço Específico - PPE) is no longer collected.

Considering the liberation of the market and current legislation, as from January 1, 2002, the Petroleum and Alcohol Account will no longer be used to reimburse expenses related to the supply of oil products and fuel alcohol to PETROBRAS and third parties. The movements in the account during 2002 relate only to (i) payments and adjustments mandated by the Agência Nacional do Petróleo - ANP ( ANP ) with no impact on the income statement and (ii) adjustments resulting from the audit of the account by the ANP.

The impact of Federal Government regulation on the Company's balance sheet and operating structure has been recorded in the Petroleum and Alcohol Account as of, and for the years ended, December 31, 2003, 2002 and 2001 (see Note 11). The impact of this regulation is recorded in the income statement to correspond with underlying transactions when compliance with applicable law has occurred and collection is reasonably assured.

The *Contribuição de Intervenção no Domínio Econômico* (Contribution of Intervention in the Economic Domain Charge - CIDE) on the importation and sale of fuels was established by Law No. 10,336 dated December 19, 2001.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Expressed in Millions of United States Dollars

(except when specifically indicated)

**2. Summary of significant accounting policies** Continued

**(m) Accounting for the effect of Federal Government regulation** Continued

The CIDE is a per-transaction payment to the Brazilian Government required to be made by producers, blenders and importers upon sales and purchases of specified oil and fuel products at a set amount for different products based on the unit of measurement typically used for such products.

The Company's income statement for the year ended December 31, 2001 were impacted by Federal Government regulation in the amount of US\$ 1,066.

**(n) Compensated absences**

The liability for future compensation of employees for vacations is accrued as earned.

**(o) Earnings per share**

Earnings per share are computed using the two-class method, which is an earnings allocation formula that determines earnings per share for both preferred shares, which are participating securities and common shares. The preferred shares participate in dividends and undistributed earnings with the common shares at a predetermined formula. Such formula allocates the net income, as if all of the net income for each year had been distributed, first to the preferred shares in an amount equal to the preferred shares' priority minimum annual dividend of the higher of 3% of their shareholders equity or 5% of their paid-in capital as stated in the statutory accounting records, then to common shares in an amount equal to the preferred shares' priority dividend on a per share basis and any remaining net income is allocated equally to the common and preferred shares. Each American Depositary Share (ADS) for common shares represent one share of the Company's common shares or one share of the Company's preferred shares and, in each case, is presented together with earnings per share.

**(p) Research and development costs**

Research and development costs are charged to expense when incurred.



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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**2. Summary of significant accounting policies** Continued

**(q) Accounting for derivatives and hedging activities**

The Company adopted SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ), as amended by SFAS No. 137 Accounting for Derivative Instruments and Hedging Activities Deferral of the Effective Date of SFAS No. 133 ( SFAS 137 ) and SFAS No. 138 Accounting for Certain Derivative Instruments and Certain Hedging Activities ( SFAS 138 ), on January 1, 2001. SFAS 133 requires that all derivative instruments be recorded in the balance sheet of the Company as either an asset or a liability measured at fair value. SFAS 133 requires that changes in the derivative's fair value be recognized in earnings/losses unless specific hedge accounting criteria is met. For derivatives accounted for as hedges, fair value adjustments are recorded to earnings/losses or other comprehensive income, a component of shareholders' equity, depending upon the type of hedge and the degree of hedge effectiveness. The Company has determined that none of its derivative financial instruments that had been previously treated as hedges qualified for hedge accounting under the new standard. The net-of-tax cumulative-effect recorded on January 1, 2001 to recognize the Company's derivative financial instruments were not significant.

The Company may use derivative financial instruments to mitigate the risk of unfavorable price movements on crude oil purchases. These instruments are marked-to-market on a current basis and associated gains and losses are recognized currently in the income statement.

The Company may also use derivative financial instruments to mitigate the risk of unfavorable exchange-rate movements affecting its foreign currency-denominated indebtedness. Gains and losses from changes in the fair value of these contracts are recognized in income currently, in the same line item as foreign exchange gains and losses arising on the Company's outstanding debt balance.

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**2. Summary of significant accounting policies** Continued

**(q) Accounting for derivatives and hedging activities** Continued

PEPSA also uses derivative instruments such as swaps, options, futures, and other instruments, principally to mitigate the impact of changes in crude oil prices, exchange rates and interest rates. PEPSA's crude oil derivative instruments and interest rate swap instruments are designed to mitigate specific exposures and thus qualify as cash flow hedges under SFAS 133. As cash flow hedges, the gains and losses associated with the derivative instrument are deferred and recorded in other comprehensive income until the underlying hedge transaction impacts earnings, with the exception of any ineffective portions. Derivative instruments not qualifying for hedge accounting are marked-to-market through earnings on a current basis.

**(r) Recently issued accounting pronouncements**

EITF Issue 86-12, *Accounting by Insureds for Claims-Made Insurance Policies*, EITF Issue 03-3, *Accounting for Claims-Made Insurance Policies by the Insured Entity*, and EITF Abstracts Topic D-79, *Accounting for Retroactive Insurance Contracts Purchased by Entities Other than Insurance Enterprises*, address various aspects of the accounting for retroactive insurance contracts and claims-made insurance policies by the insured entity. EITF Issue 03-8 finished discussion in November of 2003 and has the purpose to codify the guidance set forth in the aforementioned pronouncements. The Company contracts claims made insurance policies on a prospective basis only and records provisions, as applicable, for all probable losses that may result under SFAS No. 5 - *Accounting for Contingencies* ( SFAS 5 ).

**(s) Reclassifications**

Certain prior years' amounts have been reclassified to conform with the current year's presentation. These reclassifications had no impact on the Company's net income or shareholders' equity.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

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**3. Accounting change**

**(a) SFAS No. 143 - Accounting for asset retirement obligations**

As of January 1, 2003, PETROBRAS adopted SFAS No. 143 - Accounting for Asset Retirement Obligations ( SFAS 143 ). The primary impact of SFAS 143 is to change the method of accruing for upstream site restoration costs. These costs were previously accrued ratably over the productive lives of the assets in accordance with SFAS No. 19 - Financial Accounting and Reporting by Oil and Gas Producing Companies ( SFAS 19 ). At the end of 2002, the cumulative amount accrued under SFAS 19 was US\$ 1,166.

This provision for abandonment was recognized as a component of accumulated depreciation, depletion and amortization as of December 31, 2002, with no separate provision for abandonment liability being disclosed on the face of the financial statements. Under SFAS 143, the fair value of asset retirement obligations are recorded as liabilities on a discounted basis when they are incurred, which is typically at the time the related assets are installed. Amounts recorded for the related assets will be increased by the amount of these obligations and depreciated over the related useful lives of such assets. Over time, the amounts recognized as liabilities will be accreted for the change in their present value until the related assets are retired or sold.

The cumulative adjustment for the change in accounting principle reported in the first quarter of 2003 was an after-tax income of US\$ 697 (net of US\$ 359 deferred income tax effects). The effect of this accounting change on the balance sheet, was a US\$ 1,056 reduction to the abandonment provision, and a US\$ 359 increase in deferred income tax liabilities, see Note 4. Additionally, the change in accounting principle resulted in a US\$ 16 increase to property, plant and equipment at original asset acquisition date, with accumulated depreciation through January 1, 2003 of US\$ 9 on proved developed properties. Further, on January 1, 2003, PETROBRAS established an abandonment liability with respect to proved undeveloped reserves in the amount of US\$ 44.

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**3. Accounting change** Continued**(a) SFAS No. 143 - Accounting for asset retirement obligations** Continued

This adjustment is due to the difference in the method of accruing site restoration costs under SFAS 143 compared with the method required by SFAS 19. Under SFAS 19, site restoration costs are accrued on a unit-of-production basis of accounting as the oil and gas are produced. The SFAS 19 method matches the accruals with the revenues generated from production and results in most of the costs being accrued in early field life, when production is at the highest level. Because SFAS 143 requires accretion of the liability as a result of the passage of time using an effective interest method of allocation, a significant portion of costs will be accrued towards the end of field life, when production is at the lowest level. The cumulative income adjustment described above results from reversing the higher liability accumulated under SFAS 19 in order to adjust it to the lower present value amount resulting from transition to SFAS 143. This amount being reversed in transition, which was previously charged to operating earnings under SFAS 19, will again be charged to earnings under SFAS 143 in future years.

Measurement of assets retirement obligations is based on currently enacted laws and regulations, existing technology and site-specific costs. There are no assets legally restricted to be used in the settlement of asset retirement obligations.

A summary of the annual changes in the abandonment provision are presented as follows:

	<u>Assets</u>	<u>Liabilities</u>
Balance as of December 31, 2002		1,166
Reversion of provision		(1,056)
Assets related to proved developed property	16	
Accumulated depreciation	(9)	
Assets related to proved undeveloped property	44	44
	<u>51</u>	<u>154</u>
Balance as of January 1, 2003	51	154
PEPSA acquisition	11	28
Depreciation and impairment	(29)	
Accretion expenses		43
Liabilities incurred	114	114
Liabilities settled		(14)
Cumulative translation adjustment	15	71
	<u>15</u>	<u>71</u>

Balance as of December 31, 2003	162	396
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## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

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**3. Accounting change** Continued**(a) SFAS No. 143 - Accounting for asset retirement obligations** Continued

The following unaudited pro-forma financial information presents the asset retirement obligation as if FAS 143 adoption had occurred at January 1, 2001 using current rates and assumptions.

	<u>Assets</u>	<u>Liabilities</u>
Beginning balance as of January 1, 2001		1,588
Reversal of provision	97	(1,333)
	<u>97</u>	<u>(1,333)</u>
Asset retirement obligation balances at January 1, 2001	97	255
Depreciation	(2)	
Liabilities settled		(14)
Actualization of provision, at net present value		33
Cummulative translation adjustment	(15)	(39)
	<u>80</u>	<u>235</u>
Balance as of December 31, 2001	80	235
Depreciation	(2)	
Liabilities settled		(30)
Actualization of provision, at net present value		29
Cummulative translation adjustment	(27)	(80)
	<u>51</u>	<u>154</u>
Balance as of December 31, 2002	51	154

The following unaudited pro-forma summary financial information presents the consolidated results of operations as if the adoption of FAS 143 had occurred at the beginning of the periods presented.

<u>2002</u>		<u>2001</u>	
As reported	Pro forma (unaudited)	As reported	Pro forma (unaudited)

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Net operating revenues	22,612	22,612	24,549	24,549
Cost of sales	11,506	11,506	12,807	12,807
Depreciation, depletion and amortization	1,930	1,651	1,729	1,649
Exploration, including exploratory dry holes	435	464	404	437
Impairment	75	75	145	145
Others	(5,434)	(5,434)	(4,672)	(4,672)
Income tax expense	(1,153)	(1,238)	(1,389)	(1,405)
Minority interest	232	232	88	88
Cummulative effect of change in accounting principle, net of tax				816
Net income for the year	2,311	2,476	3,491	4,338
Basic and diluted earnings per share	2.13	2.28	3.21	3.99

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**3. Accounting change** Continued

**(b) Interpretation No. 46 (FIN 46) - Consolidation of Variable Interest Entities**

The Financial Accounting Standards Board (FASB) issued Interpretation No. 46 (FIN 46) - Consolidation of Variable Interest Entities in January of 2003. FIN 46 provides guidance on when certain entities should be consolidated or the interests in those entities disclosed by enterprises that do not control them through a majority voting interest. Under FIN 46, entities are required to be consolidated by an enterprise that has a controlling financial interest in such entities when equity investors of that enterprise do not have significant capital risk, the obligation to absorb the majority of expected losses, or the right to receive the majority of expected returns from such entities. Entities identified with these characteristics are called variable interest entities and the interest that enterprises have in these entities are called variable interests. These interests may derive from certain guarantees, leases, loans or other arrangements that result in risks and rewards to the enterprise with the controlling financing interest in such entities, irrespective of such enterprises' voting interest in such entities.

The interpretation requires that if a business enterprise has a controlling financial interest in a variable entity, the assets, liabilities and results of the activities of the variable interest entity must be included in the consolidated financial statements with those of the business enterprise. This interpretation applies immediately to variable interest entities created after January 31, 2003. For variable interest entities created before February 1, 2003, FIN 46 must be adopted in the first reporting period ending after December 15, 2003.

The Company adopted FIN 46 in its December 31, 2003 annual financial statements. Such adoption resulted in the consolidation of a number of special purpose entities related to project financing arrangements in which the Company has an interest, and which were deemed to be variable interest entities for which the Company was the primary beneficiary. These entities are detailed above in Note 2 (b). Prior to adoption of FIN 46, a significant portion of the Company's share of commitments and debt obligations, as well as fixed asset contributions, were already included in the consolidated financial statements as the project financing transactions qualified as capital leases.

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**3. Accounting change** Continued

**(b) Interpretation No. 46 (FIN 46) - Consolidation of Variable Interest Entities** Continued

Thus, adoption of FIN 46 related to the special purpose companies formed in connection with project finance arrangements did not have a significant impact on the Company's financial condition. While PETROBRAS does not have specific assets set aside and established as collateral for these special purpose entities, the Company does have certain contractual obligations relating to the debt of the special purpose entities.

Three thermoelectric plants were also consolidated at December 31, 2003 as a result of the adoption of FIN 46. However, as these thermoelectric plants had previously been accounted for as capital leases, their consolidation did not have a material impact on the Company's financial condition.

Furthermore, PETROBRAS has determined that it is the primary beneficiary of three additional plants for which it has certain contractual obligations to bear energy market risk. The effect of the consolidation of these three thermoelectrics was an increase in fixed assets of US\$ 1,142 and an increase in liabilities of US\$ 1,142. Results of operations for these companies will only be consolidated in 2004.

**(c) EITF 01-08 - Determining whether an arrangement contains a lease**

EITF 01-08 Determining Whether an Arrangement Contains a Lease, expands former guidance respective to determination of whether an arrangement contains a lease that is within the scope of SFAS No. 13 - Accounting for Leases, ( SFAS 13 ) and offers specific guidance related to transportation and other energy contracts that may qualify as leases. Adoption of this EITF in 2003 did not have a significant impact on the Company's accounting for its energy and transportation contracts.

**(d) EITF 02-6 - Classification in the statement of cash flows of payments made to settle an asset retirement obligation**

PETROBRAS has adopted the presentation outlined in EITF 02-6 - Classification in the Statement of Cash Flows of Payments made to Settle an Asset Retirement Obligation within the Scope of SFAS 143, with immaterial changes to prior classification of such costs as investment activities.



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**4. Income taxes**

Income taxes in Brazil comprise federal income tax and social contribution, which is an additional federal income tax. The statutorily enacted tax rates applicable in the years are presented as follows:

	Year ended December 31, - %		
	2003	2002	2001
Federal income tax rate	25	25	25
Social contribution	9	9	9 to 12
Composite tax rate	34	34	34 to 37

During 2001, the Company recognized a benefit in the amount of US\$ 111, relating to the reversal of a tax provision established in previous years in connection with the privatization of certain affiliates of PETROQUISA included in the National Privatization Program (PND) due to expiration of the statute of limitations.

Also during 2001, certain changes were introduced in the Brazilian tax legislation, including a requirement that earnings from foreign subsidiaries be included in the determination of current taxes payable in Brazil. As a result, the Company recorded a provision of US\$ 100 relating to income taxes on its foreign subsidiaries undistributed taxable income generated since 1996.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**4. Income taxes** Continued

Substantially all of the Company's taxable income is generated in Brazil and is therefore subject to the Brazilian statutory tax rate. The following table reconciles the tax calculated based upon statutory tax rates to the income tax expense recorded in this consolidated financial statements.

	Year ended December 31,		
	2003	2002	2001
Income before income taxes, minority interest and accounting changes	8,773	3,232	4,792
Tax expense at statutory rates	(2,983)	(1,099)	(1,629)
Adjustments to derive effective tax rate:			
Reversal of income tax			111
Non-deductible postretirement health-benefits	(107)	(73)	(73)
Tax on unremitted earnings of foreign subsidiaries			(100)
Foreign income subject to different tax rates			94
Change in valuation allowance	150	(204)	(38)
Tax benefit on interest on shareholders' equity	364	241	307
Income taxes regarding abandonment liabilities adjustments related to the year ended December 31, 2002	(61)		
Others	(26)	(18)	(61)
Income tax expense per consolidated statement of income	(2,663)	(1,153)	(1,389)

TBG, a subsidiary of GASPETRO, has accumulated tax loss and negative income tax and social contribution carryforwards amounting to US\$ 469 (US\$ 768 in 2002) as of December 31, 2003, which could be offset against future taxable income to a limit of 30% of annual income, based on Law No. 9,249/95, which in the opinion of the TBG management, will occur within the useful life of the Bolivia-Brazil Gas Pipeline project.

However, considering the long estimated term for utilization, these tax credits, totaling US\$ 159 (US\$ 239 - 2002), were provided for in a valuation allowance in the consolidated financial statements for December 31, 2003 and 2002. The accounting recognition of these credits is reviewed annually.





**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**4. Income taxes** Continued

The major components of the deferred income tax accounts in the consolidated balance sheet are as follows:

	<b>As of December 31,</b>	
	<b>2003</b>	<b>2002</b>
<b>Current Assets</b>		
Inventories	13	39
Lease obligations	82	96
Provision for profit sharing	97	41
Provision for loss on Energy		70
Provision for INSS	23	12
Other temporary differences	41	13
	<u>256</u>	<u>271</u>
<b>Net current deferred tax assets</b>		
<b>Non-current Assets</b>		
Employees post-retirement benefits, net of unrecognized pension obligation	764	531
Deferred assets	130	51
Tax loss carryforwards	69	243
Investments	65	2
Lease obligations	330	618
Project financing	109	706
Provision for notification from INSS	47	26
Other temporary differences	289	140
Valuation allowance	(54)	(239)
	<u>1,749</u>	<u>2,078</u>
<b>Liabilities</b>		
Capitalized exploration and development costs	1,635	670
Property, plant and equipment	1,131	1,638
Other temporary differences	105	29
	<u>2,871</u>	<u>2,337</u>

<b>Net long-term deferred tax liabilities</b>	<b>(1,122)</b>	<b>(259)</b>
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As a result of the NTN-P swap transaction in 2001, described in Note 6, the income tax on interest on government securities held-to-maturity, which payment had been deferred, became payable and the corresponding provision for income tax and social contribution was transferred to current liabilities on December 28, 2001.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**4. Income taxes** Continued

Although realization of net deferred tax assets is not assured, management believes that, except where a valuation allowance has been provided, such realization is more likely than not to occur. The amount of the deferred tax asset considered realizable could, however, be reduced if estimates of future taxable income are reduced. Tax loss carryforwards do not expire and are available for offset against future taxable income, limited to 30% of taxable income in any individual year. The following presents the changes in the valuation allowance for the years ended December 31, 2003, 2002 and 2001:

	<u>Year ended December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Balance at January 1,	(239)	(170)	(147)
Reductions (additions)	80	(69)	(23)
Balance at December 31,	<u>(159)</u>	<u>(239)</u>	<u>(170)</u>

**5. Cash and cash equivalents**

	<u>As of December 31,</u>	
	<u>2003</u>	<u>2002</u>
Cash	765	661
Investments - local currency	4,926	2,216
Investments - U.S. dollars	3,919	424
	<u>9,610</u>	<u>3,301</u>

Cash includes US\$ 1,049 at December 31, 2003, as a result of incorporation of certain special purpose entities pursuant to the FIN 46 consolidation. See Note 12 relating to repurchased securities held in an exclusive fund.



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**6. Government securities**

On December 28, 2001, PETROBRAS entered into a contract with the Federal Government to exchange the restricted National Treasury Bonds Series P (NTN-P) for unrestricted National Treasury Notes - Series B (NTN-B) with a face value of US\$ 3,239. The NTN-P had previously been accounted for as held-to-maturity securities. The NTN-B were created on July 4, 2001 by means of Federal Decree No. 3,859. The exchange was accounted for at fair value and a loss of US\$ 1,099 was recorded in the results of operations for 2001. The NTN-B were classified as available-for-sale, and on December 28, 2001, the Company transferred NTN-B notes with a fair value of US\$ 1,475 to PETROS, the Company's current pension plan for employees (see Note 17) to increase pension assets.

On December 30, 2002, the Company effectively transferred a portion of the NTN-B with a fair value of US\$ 388 to PETROS to further increase plan assets.

The Company has retained title to NTN-B amounting to US\$ 283 as of December 31, 2003 (US\$ 176 as of December 31, 2002). These bonds have been advanced to PETROS and the Company intends to utilize them to provide incentives for participants to migrate from the PETROS Plan to the PETROBRAS VIDA, the Company's new pension plan for employees (see Note 17). Accordingly, as the Company still has the risks and rewards relating to the bonds, they are accounted for as securities available-for-sale and their corresponding earnings will be recorded on an amortized cost basis, with changes in fair value presented in the statement of shareholders' equity as a component of other comprehensive income.

The NTN - B are denominated in reais, earn interest at 6% annually plus the variation of the IPCA (Consumer Price Index - Adjusted) and mature in 2031.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**7. Accounts receivable, net**

Accounts receivable consisted of the following:

	<u>As of December 31,</u>	
	<u>2003</u>	<u>2002</u>
Trade		
Third parties	3,730	2,827
Related parties (Note 26)	483	510
	<u>4,213</u>	<u>3,337</u>
Less: allowance for uncollectible accounts	(780)	(701)
	<u>3,433</u>	<u>2,636</u>
Less: long-term accounts receivable, net	(528)	(369)
Current accounts receivable, net	<u>2,905</u>	<u>2,267</u>

	<u>As of December 31,</u>		
	<u>2003</u>	<u>2002</u>	<u>2001</u>
Allowance for uncollectible accounts			
Balance at January 1,	(701)	(708)	(312)
Additions	(79)	(56)	(421)
Write-offs		63	25
Balance at December 31	<u>(780)</u>	<u>(701)</u>	<u>(708)</u>
Allowance on short-term receivables	<u>(106)</u>	<u>(77)</u>	<u>(66)</u>
Allowance on long-term receivables	<u>(674)</u>	<u>(624)</u>	<u>(642)</u>



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**7. Accounts receivable, net** Continued

At December 31, 2003 and 2002, long-term receivables include US\$ 581 and US\$ 569 respectively relating to payments made by the Company to suppliers and subcontractors on behalf of certain contractors. These contractors had been hired by the subsidiary BRASOIL for the construction/conversion of vessels into FPSO ( Floating Production, Storage and Offloading ) and FSO ( Floating, Storage and Offloading ) and failed to make the payments to their suppliers and subcontractors. The Company made the payments to avoid further delays in the construction/conversion of the vessels and consequent losses to BRASOIL.

Based on opinions from the legal advisers of BRASOIL, these payments can be reimbursed, since they represent a right of BRASOIL with respect to the contractors, for which reason judicial action was filed with international courts to seek financial reimbursement. However, as a result of the uncertainties with regards to the probability of receiving all the amounts disbursed, the Company recorded a provision for uncollectible accounts for all credits that are not backed by collateral. The balances of this provision amounted US\$ 509 and US\$ 497 as of December 31, 2003 and 2002.

The Company prevailed in the lawsuit filed with an American court by the insurance companies Fidelity & Guaranty Company and American Home Assurance Company, which had attempted to obtain, since 1997, a legal ruling in the United States to exempt the insurance companies from the obligation to pay the sum insured for the construction of platforms P-19 and P-31. As a result of a court decision by the first level of the Federal District Court of the Southern District of New York, the Company was entitled to receive losses and damages in the amount of US\$ 237, plus interest and reimbursement of legal expenses through the settlement date. This decision is pending appeal to the Appeals Court of the State of New York, and therefore the Company has not recognized this amount in the financial statements.



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**8. Inventories**

	<b>As of December 31,</b>	
	<b>2003</b>	<b>2002</b>
Products		
Oil products	858	982
Fuel alcohol	67	86
	<u>925</u>	<u>1,068</u>
Raw materials, mainly crude oil	1,280	990
Materials and supplies	708	482
Others	34	
	<u>2,947</u>	<u>2,540</u>

At December 31, 2003 and 2002, there were no inventories requiring an obsolescence provision.

**9. Property, plant and equipment, net**

**(a) Composition of balance**

Property, plant and equipment, at cost, are summarized as follows:

	<b>As of December 31,</b>	
	<b>2003</b>	<b>2002</b>

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	Accumulated			Accumulated		
	Cost	depreciation	Net	Cost	depreciation	Net
Buildings and improvements	587	(298)	289	383	(215)	168
Oil and gas assets	25,741	(12,305)	13,436	17,465	(10,374)	7,091
Equipment and other assets	11,597	(5,574)	6,023	6,635	(3,491)	3,144
Capital lease platforms, vessels and thermoelectric plants	2,743	(994)	1,749	3,351	(852)	2,499
Rights and concessions	531	(83)	448	121	(4)	117
Land	136		136	105		105
Materials	294		294	184		184
Expansion projects -						
Construction and installations in progress:						
Exploration and production	4,817		4,817	3,477		3,477
Supply	2,442		2,442	1,105		1,105
Gas and Energy	1,020		1,020	243		243
Distribution	106		106	64		64
Corporate	31		31			
Other	14		14	27		27
	<u>50,059</u>	<u>(19,254)</u>	<u>30,805</u>	<u>33,160</u>	<u>(14,936)</u>	<u>18,224</u>

During 2003, the Company capitalized US\$ 184 of interest cost (2002 - US\$ 139; 2001 - US\$ 123).

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**9. Property, plant and equipment** Continued

**(a) Composition of balance** Continued

The property, plant and equipment account at December 31, 2003 and 2002, respectively, includes US\$ 678 and US\$ 292 of assets under construction that are intended to be sold or transferred into structured financing deals. These assets include natural gas pipelines and other oil and gas projects at 2003, and thermoelectric plants, natural gas pipelines and other oil and gas projects at 2002. Additionally, the property, plant and equipment account at December 31, 2003 and 2002, respectively, includes US\$ 978 and US\$ 653 of assets under agreements with investors.

The property, plant and equipment balance at December 31, 2003, includes US\$ 5,775 of assets consolidated as a result of the adoption of FIN 46. Of this amount, US\$ 3,718 was previously included in the property, plant and equipment balance at December 31, 2002 for special purpose project financing entities and certain thermoelectric plants accounted for as capital leases. The increase to property, plant and equipment resulting from the adoption of FIN 46 is related to the consolidation of three thermoelectric plants which were previously only recognized as guarantees; see Note 16.

**(b) Impairment**

For the years ended December 31, 2003, 2002 and 2001, the Company recorded impairment charges of US\$ 70, US\$ 75 and US\$ 145, respectively. During 2003, US\$ 65 of the impairment charge was related to producing properties in Brazil, principle amounts were related to the Company's Fazenda Belem on-shore field (US\$ 15) in Rio Grande do Norte, and the Lamarão on-shore field (US\$ 4) in Bahia. During 2002, US\$ 75 of the impairment charge was related to producing properties in Brazil, primarily recorded in the Company's Voador field (US\$ 42) in the Campos basin, Caravelas field (US\$ 15) in the Santos basin and Massape field (US\$ 4) in the Reconcavo basin.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

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**NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION**

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**9. Property, plant and equipment** Continued

**(b) Impairment** Continued

During 2001, US\$ 129 of the impairment charge was related to producing properties in Brazil and was primarily recorded in the Company's Voador field (US\$ 88) in the Campos basin and Caravelas field (US\$ 30) in the Santos basin. The remaining US\$ 16 were recorded in the international segment primarily in the Company's Upia field (US\$13) located in Colombia. These charges were recorded based upon the Company's annual assessment of the fields using pricing and other assumptions consistent with those used in the Company's overall strategic plan.

**(c) Return of exploration areas to the ANP**

During 2003, PETROBRAS returned to the ANP the rights to over twenty two exploratory concessions where it had not made any oil or gas discoveries.

Thus, total concessions returned are as follows: 113 (one hundred and thirteen) of the 115 (one hundred and fifteen) concessions granted to the Company on August 6, 1998; 2 (two) of the 5 (five) exploratory concessions areas acquired under the BID 1 in June of 1999; and 50% of the original areas related to 8 (eight) exploratory concession areas acquired under the BID 2, in June of 2000.

**(d) 5th ANP auction of exploratory blocks**

The Company acquired 88 (eighty-eight) new exploratory concessions of the 908 (nine hundred and eight) blocks offered by ANP in the 5th bid for exploratory blocks held in August of 2003. The Company has exclusive rights over 85 (eighty-five) of these concessions and the other 3 (three) were acquired under a consortium. The Company is not the operator of the consortium. The costs incurred by the Company in subscription bonus totaled US\$ 7.

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

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**10. Investments in non-consolidated companies and other investments**

PETROBRAS conducts portions of its business through investments in companies accounted for using the equity and cost methods. These non-consolidated companies are primarily engaged in the petrochemicals and products transportation businesses.

	<u>Total ownership</u>	<u>Investments</u>	
		<u>2003</u>	<u>2002</u>
Equity method	20% - 50% (a)	664	131
Investments available-for-sale	8% - 16%	331	85
Investments at cost		178	118
<b>Total</b>		<b>1,173</b>	<b>334</b>

(a) As described further in this Note, certain thermoelectrics with ownership of 10% to 50% are also accounted for as equity investments due to particularities of control.

During 2003, the Company acquired PEPSA and PELS A (see Note 19), that hold interests in other companies that are recorded according to equity method or at cost. The balance of those investments as of December 31, 2003 amounted to US\$ 401 of which US\$ 348 was recorded using the equity method. Those companies operate mainly in exploration and production, refining, transport and commercialization, electricity generation, transmission and distribution, and petrochemicals.

At December 31, 2003 and 2002, the Company had investments in companies with publicly traded shares: BRASKEM S.A., Petroquímica União S.A. - PQU and Companhia Petroquímica do Sul S.A. - COPESUL. The Company's investments in these companies with publicly traded shares amounts to less than 20% of the investee's total voting shares, are classified as available for sale and have been recorded at market value. The Company has recorded unrealized gains (losses) for the difference between the fair value and the cost of the investment on these investments of US\$ 207 and US\$ (16) as of December 31, 2003 and 2002, respectively. These holding (losses) gains are reflected as a component of shareholder's equity, net of tax, with changes in the unrealized balance recorded as a component of comprehensive income.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

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**10. Investments in non-consolidated companies and other investments** Continued

The Company also has investments in companies for the purpose of developing, constructing, operating, maintaining and exploring thermoelectric plants included in the federal government's Priority Thermoelectric Energy Program, with equity interests of between 10% and 50%. The balance of the investments as of December 31, 2003 and 2002 includes US\$ 46 and US\$ 38 respectively, and are included as equity method investments due to the Company's ability to influence such operations.

The Company's investment in equity of non-consolidated companies generated equity gains (losses) in results of non-consolidated companies of US\$ 141 for the year ended December 31, 2003 (2002 - US\$ (178); 2001 - US\$ (8)).

**11. Receivable from Federal Government**

**(a) Deregulation of the Brazilian fuel market**

In accordance with the Petroleum Law and subsequent legislation, the fuel market in Brazil was deregulated in its entirety as of January 1, 2002. Therefore, as of that date, the Petroleum and Alcohol account would no longer be used to reimburse expenses in connection with the Federal Government's regulation of the prices of oil products and fuel alcohol. Accordingly, the Petroleum and Alcohol account will only include changes in amounts with triggering events having occurred before December 31, 2001, in accordance with Law No. 10,453, of May 13, 2002, and ANP regulations. See additional discussion at Note 2 respective to market regulation in Brazil and the effect of such on the historical financial statements.

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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(except when specifically indicated)

**11. Receivable from Federal Government** Continued**(b) Changes in the petroleum and alcohol account**

The following summarizes the changes in the Petroleum and Alcohol Account for the years ended December 31, 2003 and 2002:

	<u>Year ended December 31,</u>	
	<u>2003</u>	<u>2002</u>
Opening balance	182	81
Advances (collections) - PPE		(6)
Reimbursements to third parties: principally subsidies paid to fuel alcohol producers	5	253
Financial income	10	2
Result of audit conducted by the Federal Government		(29)
Translation gain (loss)	42	(119)
	<u>239</u>	<u>182</u>
Ending balance	<u>239</u>	<u>182</u>

**(c) Certification by the Federal Government**

The Federal Government certified the balance of the Petroleum and Alcohol Account as of June 30, 1998.

The changes in the Petroleum and Alcohol Account in the period July 1, 1998 to December 20, 2002 are subject to audits by the ANP. The results of the audit will be the basis for the settlement of the account with the Federal Government.

The settlement of the account with the Federal Government should have been completed by December 31, 2002, according to the provisions of Law No. 10,453 of May 13, 2002, amended by Decree No. 4,491 of November 29, 2002. On June 26, 2003 Provisional Measure 123, article 11, which was converted to Law No. 10,742 dated October 6, 2003, extended the term of settlement of accounts involving reciprocal debits and



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credits between PETROBRAS and the Federal Government to June 30, 2004, and in so doing, automatically extending the term for certification of the outstanding balance in the Petroleum and Alcohol Account.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**11. Receivable from Federal Government** Continued**(d) National Treasury Bonds Series H (NTN-H)**

On June 30, 1998, the Company and the Federal Government reached an agreement whereby the Federal Government issued National Treasury Bonds - H (NTN-H) into a federal depository on behalf of the Company to support the balance of the Petroleum and Alcohol account. On June 27, 2003, the National Treasury Secretary issued Administrative Instruction 348, authorizing the cancellation of 138,791 NTN-H, which expired on June 30, 2003 and were held in guarantee of payment of an outstanding balance in the Petroleum and Alcohol Account and the issue of new 138,791 NTN-H, with the same terms as the cancelled bonds but expiring on June 30, 2004. The value of the outstanding bonds at December 31, 2003 was US\$ 59, at which time the balance of the Petroleum and Alcohol Account was US\$ 239. The legal, valid, and binding nature of the account is not affected by any difference between the balance of the account and the value of the outstanding bonds.

The Brazilian Government, upon the Company's consent, can effect the cancellation of all or a portion of the bonds' outstanding balance. The NTN-H will mature on June 30, 2004 and currently PETROBRAS has no other rights on those bonds; withdrawal or transfers are not allowed.

**12. Financings****(a) Short-term debt**

The Company's short-term borrowings are principally sourced from commercial banks and include import and export financing denominated in United States dollars, as follows:

	<b>As of December 31,</b>	
	<b>2003</b>	<b>2002</b>
	<u>          </u>	<u>          </u>
Import - oil and equipment	872	286
Working capital	447	385
Others	10	
	<u>          </u>	<u>          </u>

1,329

671

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**12. Financings** Continued**(a) Short-term debt** Continued

The weighted average annual interest rates on outstanding short-term borrowings were 3.79 % and 3.86% at December 31, 2003 and 2002, respectively.

**(b) Long-term debt****Composition**

	<u>As of December 31,</u>	
	<u>2003</u>	<u>2002</u>
Foreign currency		
Notes	5,462	2,234
Financial institutions	3,591	2,240
Sale of future receivables	1,767	900
Suppliers credits	728	876
Senior exchangeable notes	338	338
Repurchased securities (1)	(207)	
	<u>11,679</u>	<u>6,588</u>
Local currency		
Debentures	666	500
National Economic and Social Development Bank - BNDES (state-owned company, see Note 26)	358	403
Debentures (state-owned company, see Note 26)	262	188
Others	68	35
	<u>1,354</u>	<u>1,126</u>
Total (2)	13,033	7,714
Current portion of long-term debt	(1,145)	(727)

11,888	6,987
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- (1) At December 31, 2003, the Company had amounts invested abroad in an exclusive investment fund that held debt securities of some of the PETROBRAS group companies in the total amount of US\$ 920. These securities are considered to be extinguished, and thus the related amounts, together with applicable interest have been removed from the presentation of marketable securities and long-term debt, US\$ 207, and project finance, US\$ 713. See also Note 14.
  - (2) Includes US\$ 375 related to thermoelectric plants consolidated under FIN 46. See additional discussion at Note 16.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Expressed in Millions of United States Dollars

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**12. Financings** Continued**(b) Long-term debt** Continued**Composition of foreign currency denominated debt by currency**

	<b>As of December 31,</b>	
	<b>2003</b>	<b>2002</b>
Currencies		
United States dollars	10,621	5,522
Japanese Yen	628	764
EURO	429	297
Others	1	5
	<u>11,679</u>	<u>6,588</u>

**Maturities of the principal of long-term debt**

The long-term portion at December 31, 2003 becomes due in the following years:

2005	1,136
2006	1,322
2007	1,992
2008	1,384
2009 and thereafter	6,054
	<u>11,888</u>

As of December 31, 2003, US\$ 1,923 was related to PEPSA s.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**12. Financings** Continued**(b) Long-term debt** Continued**Composition of long-term debt by annual interest rate**

Interest rates on long-term debt were as follows:

	<b>As of December 31,</b>	
	<b>2003</b>	<b>2002</b>
	<u>          </u>	<u>          </u>
<b>Foreign currency</b>		
6% or less	4,365	3,080
Over 6% to 8%	2,154	1,220
Over 8% to 10%	4,990	2,287
Over 10% to 15%	170	1
	<u>11,679</u>	<u>6,588</u>
<b>Local currency</b>		
6% or less	668	235
Over 6% to 8%		390
Over 10% to 15%	686	501
	<u>1,354</u>	<u>1,126</u>
	<u>13,033</u>	<u>7,714</u>

On March 31, 2003, the Company issued Global Step-up Notes in an aggregate principal amount of US\$ 400 due April of 2008. The notes will bear interest from March 31, 2003 at a rate of 9.00% per annum until April 1, 2006 and at a rate of 12.375% per annum thereafter, with interest payable semiannually. The Company used the proceeds from this issuance principally to repay trade-related debt.

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On July 2, 2003, the Company issued Global Notes in an aggregate principal amount of US\$ 500 due July of 2013. The notes will bear interest at the rate of 9.125% per annum, payable semiannually. On September 18, 2003, the Company issued an additional US\$ 250 in Global Notes, which form a single fungible series with the Company's US\$ 500 Global Notes due July of 2013. The Company used the proceeds from these issuances principally to repay trade-related debt.

On December 10, 2003, the Company issued Global Notes in an aggregate principal amount of US\$ 750 due December of 2018. The notes will bear interest at the rate of 8.375% per annum, payable semiannually. The Company used the proceeds from this issuance principally to repay trade-related debt.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**12. Financings** Continued

**(b) Long-term debt** Continued

**Composition of long-term debt by annual interest rate**

On October 24, 2003, Petrobras Energía S.A. issued US\$ 100 notes - Series R, with a 9.375% annual coupon payable semiannually, and a 9.5% annual yield to maturity, and due date of 2013.

**Structured finance of exports**

Respective to the Senior and Junior Notes issued pursuant to the structured finance program, PETROBRAS and Petrobras Finance Ltd. - PFL have certain contracts (Master Export Contract and Prepayment Agreement) between themselves and special purpose entity not related to PETROBRAS, PF Export Receivables Master Trust ( PF Export ), relating to the prepayment of export receivables to be generated by PFL by means of sales on the international market of fuel oil and other products acquired from PETROBRAS.

As stipulated in the contracts, PFL assigned the rights to future receivables in the amount of US\$ 1,800 (1<sup>st</sup> and 2<sup>nd</sup> tranches) to PF Export, which, in turn, issued and delivered to PFL the following securities, also in the amount of US\$ 1,800:

US\$ 1,500 in Senior Trust Certificates, which were negotiated by PFL on the international market at face value. The amount was transferred to PETROBRAS as prepayment for exports to be made to PFL, according to the prepayment agreement.

US\$ 300 in Junior Trust Certificates, which are held in the portfolio of PFL. If PF Export incurs any losses on the receipt of the value of the exports transferred by PFL, these losses will be compensated by the Junior Trust Certificates.

The assignment of rights to future export receivables represents a liability of PFL, which will be settled by the transfer of the receivables to PF Export as and when they are generated. This liability will bear interest on the same basis as the Senior and Junior Trust Certificates, as described above.



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## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

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**12. Financings** Continued**(b) Long-term debt** Continued**Structured finance of exports** Continued

In May of 2003, the PF Export Trust issued to the Company additional US\$ 750 in Senior Trust Certificates and US\$ 150 in Junior Trust Certificates. The Senior Trust Certificates consist of Series 2003-A of US\$ 550 bearing annual interest of 6.436% and due in June of 2015 and Series 2003-B of US\$ 200 bearing annual interest due of 5.548% due in June of 2013. The Junior Trust Certificates were issued with complementary terms as the new Senior Trust Certificates as they form a 20% guarantee to the senior trust certificates and expire ratably. These two new issuances complement the initial structured finance export prepayment program commenced in December of 2001.

**(c) Issue of non-convertible debentures**

During 2002, PETROBRAS issued the following book-entry, non-convertible debentures, without guarantee or preference, in a single issue:

<u>Issue date</u>	<u>Quantity</u>	<u>Period</u>	<u>Index</u>	<u>Interest</u>
August 29	750,000	10 years	IGPM	11% p.a.
October 4 and 23	775,000	8 years	IGPM	10.3% p.a.

The proceeds of these issuances were used for general corporate purposes. There were no additional issuances in 2003 on non-convertible debentures.

**(d) Guarantees and covenants**

Financial institutions abroad do not require guarantees from the Company. The financing granted by BNDES National Bank for Social and Economic Development is guaranteed by a lien on the assets being financed (vessels).

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**12. Financings** Continued

**(d) Guarantees and covenants** Continued

At December 31, 2003 and 2002, GASPETRO had secured certain debentures issued to finance the purchase of the transportation rights in the Bolivia/Brazil pipeline with 3,000 shares of its interest in TBG, a subsidiary of GASPETRO responsible for the operation of the pipeline.

The Company's debt agreements contain affirmative covenants regarding, among other things, provision of information; financial reporting; conduct of business; maintenance of corporate existence; maintenance of government approvals; compliance with applicable laws; maintenance of books and records; maintenance of insurance; payment of taxes and claims; and notice of certain events. The Company's debt agreements also contain negative covenants, including, without limitation, limitations on the incurrence of indebtedness; limitations on the incurrence of liens; limitations on transactions with affiliates; limitations on the disposition of assets; limitation on consolidations, mergers, sales and/or conveyances; negative pledge restrictions; change in ownership limitations; ranking; use of proceeds limitations; and required receivables coverages.

The Federal Government guarantees TBG's Multilateral Credit Agency debt, which had an outstanding balance of US\$ 463 and US\$ 487 at December 31, 2003 and 2002, respectively. During 2000, the Federal Government, the Company, TBG, PETROQUISA and Banco do Brasil S.A. entered into an agreement whereby the revenues of TBG will serve as a counter-guarantee to this debt until the debt has been extinguished.

PETROBRAS entered into standby purchase agreements in support of the obligations of its wholly-owned subsidiary under the note issuances in 2001, 2002 and 2003 and their respective indentures. PETROBRAS has the obligation to purchase from the noteholders any unpaid amounts of principal, interest or other amounts due under the notes and the indenture applies, subject to certain limitations, irrespective of whether any such amounts are due at maturity of the notes or otherwise.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**12. Financings** Continued**(e) Lines of credit**

At December 31, 2003 and 2002, the Company had fully utilized all available lines of credit for the purchase of imports. Outstanding lines of credit at December 31, 2003 and 2002 were US\$ 1,689 and US\$ 2,771, respectively. Lines of credit are included in short-term debt and in suppliers' credits.

**13. Financial income (expenses), net**

Financial expenses, financial income and monetary and exchange variation on monetary assets and liabilities, net, allocated to income for the years ended December 2003, 2002 and 2001 are shown as follows:

	<b>Year ended December 31,</b>		
	<b>2003</b>	<b>2002</b>	<b>2001</b>
<b>Financial expenses</b>			
Loans and financings	(808)	(527)	(610)
Capitalized interest	184	139	123
Leasing	(117)	(51)	(88)
Project financing	(410)	(226)	(153)
Other	(96)	(109)	(80)
	<u>(1,247)</u>	<u>(774)</u>	<u>(808)</u>
<b>Financial income</b>			
Investments	243	801	893
Advances to suppliers	36	35	34
Government Securities	24	70	243
Other	299	236	205
	<u>602</u>	<u>1,142</u>	<u>1,375</u>
<b>Monetary and exchange variation</b>			



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Monetary and exchange variation on monetary assets	(269)	958	179
Monetary and exchange variation on monetary liabilities	778	(3,026)	(1,094)
	<u>509</u>	<u>(2,068)</u>	<u>(915)</u>
	<u>(136)</u>	<u>(1,700)</u>	<u>(348)</u>

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**14. Project financings**

Since 1997, the Company has utilized project financing to provide capital for the continued development of the Company's exploration and production and related projects.

Through 2002 and the majority of 2003, the Company's arrangements with respect to these projects were considered capital leasing transactions for accounting purposes. Effective December 31, 2003, the Company adopted FIN 46 and the project financing special purpose entities were consolidated on a line by line basis. Thus at year-end 2002, the project finance obligation represents the present value of the future value of capital lease commitments, while at December 31, 2003, the project finance obligation represents the debt of the consolidated SPE with the third party lender.

As the assets related to the project finance special purpose entities and the related capital lease obligations were already recorded in the accounts of the Company at December 31, 2003, the adoption of FIN 46 related to the project finance entities did not have a material impact on the financial statements.

The Company's responsibility under these contracts is to complete the development of the oil and gas fields, operate the fields, pay for all operating expenses related to the projects and remit a portion of the net proceeds generated from the fields to fund the special purpose companies debt and return on equity payments. At the conclusion of the term of each financing project, the Company will have the option to purchase the leased or transferred assets from the consolidated special purpose company.

The following summarizes the liabilities related to the projects that were in progress at December 31, 2003 and 2002:

	<u>As of December 31,</u>	
	<u>2003</u>	<u>2002</u>
Barracuda/Caratinga	2,555	1,481
Cabiúnas	857	673
Espadarte/Voador/Marimbá (EVM)	826	575
Marlim	680	635

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Nova Marlim	475	508
Albacora	126	123
Pargo, Carapeba, Garoupa and Cherne (PCGC)	76	44
Malhas project	286	
Langstrand Holdings S.A.	700	
PDET ONSHORE	40	
Repurchased securities	(713)	
	<u>5,908</u>	<u>4,039</u>
Current portion of project financings	(842)	(239)
	<u>5,066</u>	<u>3,800</u>

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

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**14. Project financings** Continued

PETROBRAS has received certain advances in the amount of US\$ 593 which are recorded as project finance obligations and are related to assets under agreements with investors, which are included to the property, plant and equipment balance; see Note 9. Such asset and obligation amounts are presented gross as the obligation can only be settled through delivery of the fully constructed asset.

At December 31, 2003, the long-term portion of project financings becomes due in the following years:

2005	1,295
2006	838
2007	1,231
2008	569
2009 and thereafter	1,133
	<u>5,066</u>

As of December 31, 2003, the amounts of cash outlay commitments assumed related to consolidated structured project financings are presented as follows:

Cabiúnas	185
Nova Transportadora do Sudeste - NTS	370
Nova Transportadora do Nordeste - NTN	470
	<u>1,025</u>

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**14. Project financings** Continued

**Barracuda/Caratinga**

On June 23, 2000 the Company completed its project finance negotiations with the Barracuda Caratinga Leasing Company B. V. (BCLC), a special purpose entity formed by a group of international financial institutions for the sole purpose of raising US\$ 2,500 for the development of the Barracuda and Caratinga oil and gas fields located in the Campos Basin. Permanent funding for this project has been raised from two governmental institutions (Japan's Bank of International Cooperation - JBIC and the BNDES) and from a syndicate of commercial banks. In conjunction with this project, the Company will contribute US\$ 1,035 of drilling services through a drilling services contract signed with the Halliburton Company.

From early 2003, KBR has been announcing to the market its intention to file a Chapter 11 case with the U.S. courts, specifically limited to its asbestos business; such filing was completed in the second half of December 2003. As informed by KBR in its official announcements to the market, the bankruptcy protection proceedings would not directly impact the remaining businesses, including its obligations under the Barracuda/Caratinga Project EPC contract.

In the capacity as Owner's Representative under the project, at June 17, 2003, PETROBRAS, on behalf of BCLC, finalized negotiations with KBR involving claims made by KBR for time extensions and project cost increases. After formal approval from the project sponsors, as contractually defined, such negotiations resulted in an amendment to the original agreement, as approved on November 7, 2003. The objectives of such amendment are to mitigate the risks involved, especially the risk related to the bankruptcy protection filed by KBR, and ensures asset construction completion in the shortest period. The original package of guarantees has been maintained and new guarantees are expected to be provided by KBR.

On January 12, 2004, KBR officially announced that the judge responsible for its Chapter 11 filing accepted the position advanced by KBR whereby bankruptcy proceedings should be limited to its asbestos business, without prejudice to the development of other businesses of the company, including the Barracuda/Caratinga project.

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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**14. Project financings** Continued

**Cabiúnas**

On March 1, 2000, the Company completed its project finance negotiations with the Cayman Cabiúnas Investment Co. Ltd., a special purpose entity formed by the Mitsui and Sumitomo banks for the sole purpose of raising US\$ 850 for the expansion of the Cabúnas Complex located in Macaé, in the state of Rio de Janeiro. Permanent financing was provided by JBIC, a syndicate of commercial banks led by the Bank of Tokyo-Mitsubishi and the special purpose company's equity investors.

**Espadarte/Voador/Marimbá (EVM)**

On June 23, 2000, the Company completed its project finance negotiations with the EVM Leasing Corporation (EVMLC), a special purpose entity formed by a group of international financial institutions for the sole purpose of raising US\$ 1,600 for the development of the Espadarte, Voador and Marimbá oil and gas fields located in the Campos Basin. Permanent funding for the EVM project was provided by a syndicate of international financial institutions, Japanese trading companies, JBIC and BNDES. Bridge financing in the amount of US\$ 300 for this project was prepaid in December of 1999. Upon closing of the agreement, the Company sold previously identified oil and gas assets to EVM, who leased them back to the Company.

**Marlim**

On December 14, 1998, the Company entered into a consortium agreement with Companhia Petrolífera Marlim (CPM), a single purpose entity formed in November of 1998 by a group of international financial institutions for the sole purpose of raising US\$ 1,500 for the expansion and continued development of the Marlim oil field. In December of 1999, CPM raised US\$ 200 through a medium term note program, and an additional US\$ 300 in 2000. Upon closing of the consortium agreement, the Company sold certain assets to CPM, who leased them back to the Company. Effective June 30, 1999 PETROBRAS conveyed its remaining assets in the Marlim field to CPM, that also leased them back to the Company. Additionally, in June of 1999, the shareholders of CPM and the Company entered into a Stock Option Agreement granting to the Company a call option at the end of the lease and to the shareholders of CPM a put option to the Company in the case of default.

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**14. Project financings** Continued

**Nova Marlim**

On December 6, 2001, the Company entered into a consortium agreement with Nova Marlim Petróleo S.A., a special purpose entity formed by a group of international financial institutions for the sole purpose of raising US\$ 933 for the complementary development and production optimization of the Marlim oil field.

**Albacora**

During 2000, the Company finalized negotiations for two separate financing projects related to the Albacora oil field located in the Campos basin. On November 28, 2000, the Company completed its negotiations related to a project financing arrangement with the Albacora Japan Petroleum Limited Company (AJP), a special purpose corporation formed in December of 1998 for the sole purpose of providing financing for the continued development of the Albacora oil field. AJP's operations commenced in December of 2000 with the purchase of certain oil and gas assets from the Company. AJP provided these assets exclusively to the Company in return for minimum proceeds of US\$ 208 to be generated from the field's production.

Permanent financing was provided by JBIC, the Japan National Oil Company (JNOC) and certain Japanese trading companies. In addition, in December of 2000, PETROS, the Company's pension plan, agreed to provide funding for the development of this oil field. During 2000, PETROS advanced US\$ 240 for the continued development of the field, and this amount has been classified together with the AJP financing transaction. AJP does not have any further funding needs.

**Pargo, Carapeba, Garoupa, Cherne and Congro (PCGC)**

The PCGC is an offshore development project in the Pargo, Carapeba, Garoupa, Cherne and Congro fields. The project is a secondary extraction project using water-injection technology to reestablish the appropriate level of pressure in the reservoirs to maximize the recovery of oil and gas in these fields. In addition, the PCGC project includes equipment for new oil reserves in the Congro field. Management estimates total costs of the PCGC project to be US\$ 134.



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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

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**14. Project financings** Continued

**Malhas Project**

In order to implement a pipeline network for the transportation of gas in the Southeast and Northeast regions (MALHAS Project), the Company, through its subsidiaries GASPETRO and TRANSPETRO, entered into a consortium with the SPCs Nova Transportadora do Sudeste (NTS) and Nova Transportadora do Nordeste (NTN). NTS and NTN will participate in the consortium by acquiring assets related to the transportation of natural gas (gas pipelines, citygates and accessories), in the amount of up to US\$ 1,000, US\$ 92 of which had already been allocated, to be integrated in the existing gas pipeline network of PETROBRAS. Funds to be allocated to the project by NTS and NTN will derive from own capital (10%) and from financing operations obtained in the financial market.

In addition to NTS and NTN, the MALHAS consortium also includes the wholly-owned subsidiary of the Company, Transportadora Nordeste Sudeste (TNS), to which existing gas transportation assets belong, and by TRANSPETRO, which is responsible for the activities involved in the operation and maintenance of the consortium assets. Upon commencement of operations, the consortium will transport the natural gas of PETROBRAS, which will pay the consortium a fee for the services provided. Revenues arising from this project will be shared among the consortium members in accordance with pre-defined contractual terms, and NTS and NTN will receive funds in an amount necessary to fulfill their financial obligations. The Company is committed to making prepayments for transportation capacity to cover any cash shortfalls of the consortium, so that it may transfer to NTS and NTN the funds necessary for the fulfillment of their financial obligations under the agreement. The MALHAS consortium was not operational as of December 31, 2003 and, accordingly, the Company did not make any payments for gas transportation services.

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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**14. Project financings** Continued

**Langstrand Project**

Through a financing structure that involves the SPC Langstrand Holdings S.A., the Company will sell to this company assets related to the production of oil, located in the Campos Basin, and subsequently will lease such assets back through a leasing agreement. The funds necessary for Langstrand to acquire the assets from PETROBRAS will be provided by shareholders capital (equivalent to US\$ 70) and from the financing operations obtained in the international financial markets through the issuance of Medium Term Notes backed by Langstrand receivables (lease payments to be made by PETROBRAS).

Lease payments are due on a semi-annual basis from June of 2004. Langstrand revenues will arise solely from the semi-annual lease payments to be made by PETROBRAS for the use of the assets and PETROBRAS also ensures the payment of additional lease payments in the event that Langstrand revenues are not sufficient to cover its financial obligations related to the project. In an event of default, PETROBRAS is committed to acquire the SPC for the remaining balance of its obligations.

**15. Capital leases**

In 2002, the Company leased certain offshore platforms, vessels and thermoelectric plants, which are accounted for as capital leases. At December 31, 2003, the Company continued to lease these offshore platforms and vessels, and continued to account for such as capital leases. However, pursuant to the adoption of FIN 46, three thermoelectric plants which were previously accounted for as capital leases have been consolidated by the Company. At December 31, 2003, assets under capital lease had a net book value of US\$ 1,749 (US\$ 2,499 at December 31, 2002, including thermoelectrics).

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

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**15. Capital leases** Continued

The following is a schedule by year of the future minimum lease payments at December 31, 2003:

2004	388
2005	333
2006	286
2007	268
2008	232
2009 and thereafter	518
	<hr/>
Estimated future lease payments	2,025
Less amount representing interest at 6.2% to 12.0% annual	(400)
Less amount representing executory costs	(5)
	<hr/>
Present value of minimum lease payments	1,620
Less current portion	(378)
	<hr/>
Long-term portion	1,242
	<hr/>

**16. Thermoelectric plant obligations**

As a result of adopting FIN 46 at December 31, 2003, the Company now consolidates six thermoelectric plants. Previously, three of these thermoelectric were accounted for as capital leases, while the other three were considered contractual obligations concerning third-party interests, with amounts equal to contingency payments required to be funded under the contracts recognized to the extent the related payments are deemed probable and can be estimated in accordance with the provisions of SFAS 5.

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**16. Thermoelectric plant obligations** Continued

The consolidation of the three thermoelectrics formerly treated as capital leases resulted in US\$ 375 being reclassified from capital lease obligations to long-term debt obligations (see Note 15). The impact of changing the obligations related to these three plants from the minimum value of future lease payments to the debt outstanding with third party lenders was immaterial. At December 31, 2003, the consolidation of the three thermoelectrics previously accounted for as contractual obligations concerning third party interests resulted in an increase to assets and long-term obligations of US\$ 1,142.

At December 31, 2002, the Company had commitments with thermoelectric plants related to (a) the supply of natural gas for the production of energy and the purchase of all or a portion of the energy generated by these plants and (b) commitments to reimburse certain allocations as defined per the Consortium Agreements. At December 31, 2002 the provision for future losses on energy business recorded by the Company amounted to US\$ 205. On May 7, 2003, the Executive Board authorized an increase in the above-mentioned accounting provision for US\$ 205, in the first quarter of 2003 especially considering that the originally expected sales of energy available through Power Purchase Agreements (PPA s) in 2003 and the technical supply level of thermopower plants were not confirmed, principally as a result of a retraction in demand following the energy rationing program and of the lack of a well defined regulatory framework for the energy sector. The provisions accrued at year-end 2002 and in the first quarter of 2003, respective to 2003 exposure was substantially utilized during the course of the year.

At December 31, 2003 as a result of adoption of FIN 46, the Company has consolidated the thermoelectric plants and recognized a corresponding liability. Thus, it is no longer necessary to recognize any additional liability for future payments expected to be made under the agreements with the sponsors of the thermoelectric plants. The Company will recognize any losses from operations of the plant if and when incurred.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**17. Employees postretirement benefits and other benefits****(a) Employees postretirement benefits balances**

The balances related to Employees Postretirement Benefits are represented as follows:

	As of December 31,			
	2003		2002	
	Pension benefits	Health care benefits	Pension benefits	Health care benefits
Current liabilities	160		89	
Long-term liabilities	1,895	1,580	1,363	1,060
Employees postretirement benefits obligations	2,055	1,580	1,452	1,060
Accumulated other comprehensive income	2,407		2,061	
Tax effect	(819)		(700)	
Net balance recorded in shareholders' equity	1,588		1,361	
Other assets: Unrecognized pension obligations			61	

**(b) Pension plan - Fundação Petrobras de Seguridade Social - PETROS****The Fundação Petrobras de Seguridade Social (PETROS) and the current benefits plan (the PETROS Plan)**

The Fundação Petrobras de Seguridade Social (PETROS) was established by PETROBRAS as a private, legally separate nonprofit pension entity with administrative and financial autonomy. As such, PETROS has the following principle objectives:

- (i) institute, manage and execute benefit plans for the companies or entities with which it has signed agreements;
- (ii) provide administration and execution services for benefit plans focused on post-retirement payments; and
- (iii) promote the well-being of its members, especially with respect to post-retirement payments.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

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**17. Employees postretirement benefits and other benefits** Continued

**(b) Pension plan - Fundação Petrobras de Seguridade Social PETROS** Continued

**The Fundação Petrobras de Seguridade Social (PETROS) and the current benefits plan (the PETROS Plan)** Continued

The PETROS plan is a contributory defined-benefit pension plan introduced by PETROBRAS in July of 1970, to supplement the social security pension benefits of employees of PETROBRAS and its subsidiaries and affiliated companies. In order to fund its objectives, PETROS receives monthly contributions from the sponsoring companies of the PETROS Plan amounting to 12.93% of the salaries of participants in the plan. Additionally PETROS is funded by income resulting from the investment of these contributions. The Company's funding policy is to contribute to the plan annually the amount determined by actuarial calculations. In the calendar 2003 year, contributions paid totaled US\$ 402 (US\$ 311 in 2002), and was deducted from the balance of the provision for benefit obligation established at December 31, 2003. In the 2003 and 2002 financial years, these contributions were included in the cost of operations.

The Company's liability related to future benefits to plan participants is calculated on an annual basis by an independent actuary, based on the Projected Unit Credit method. The assets that guarantee the pension plan are presented as a reduction to the net actuarial liabilities.

The actuarial gains and losses arising from the difference between the actuarial assumptions and the fair value of plan assets are respectively recorded as amounts not recognized as net periodic pension cost, in shareholders' equity. These gains and losses are amortized during the average remaining service period of the active employees of approximately 15 years at December 31, 2003, in accordance with the procedure established by SFAS 87.

The relation between contributions by the sponsors and participants of the PETROS Plan, considering only those attributable to the Company and subsidiaries in the 2003 financial year, was 1.01 (0.94 in 2002). The Company's best estimate of contributions expected to be paid in 2004 respective to the pension plan approximates US\$ 122.

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

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**17. Employees postretirement benefits and other benefits** Continued

**(b) Pension plan - Fundação Petrobras de Seguridade Social PETROS** Continued

**The Fundação Petrobras de Seguridade Social (PETROS) and the current benefits plan (the PETROS Plan)** Continued

According to Constitutional Amendment No. 20, the computation of any deficit in the defined-benefit plan in accordance with the actuarial method of the current plan (which differs from the method defined in SFAS 87), must be equally shared between the sponsor and the participants.

Therefore, in the event that the deficit computed for December 31, 2003 in accordance with the projected credit unit method (SFAS 87), is reflected as a technical deficit in the methods adopted by the PETROS Plan, and results in additional financial contributions, these additional required contributions shall be divided equally between the Company and the participants.

**Plan assets**

Plan assets are invested primarily in government securities, investment funds, equity instruments and properties.

The table below describes the types of plan assets:

	<u>As of December 31,</u>	
	<u>2003</u>	<u>2002</u>
Government securities	50%	50%
Investments funds	23%	26%

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Equity instruments	13%	9%
Other	14%	15%
	<u>    </u>	<u>    </u>
	100%	100%
	<u>    </u>	<u>    </u>

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**17. Employees postretirement benefits and other benefits** Continued**(b) Pension plan - Fundação Petrobras de Seguridade Social PETROS** Continued**Plan assets** Continued

Plan assets includes the following securities of related parties:

	<b>As of December 31,</b>	
	<b>2003</b>	<b>2002</b>
PETROBRAS common shares	30	4
PETROBRAS preferred shares	75	35
Government controlled companies	43	22
Government securities	2,662	1,633
Securities of other related parties	184	56
	<b>2,994</b>	<b>1,750</b>

In addition, PETROS has agreed to provide certain financing for the continued development of the Albacora oil and gas field located in the Campos Basin (see Note 14).

The Company uses 6% as the expected long-term rate of return on PETROS assets. The PETROS portfolio of investments as of December 31, 2003 was comprised of 71% securities, 50% of which were held-to-maturity government securities that earn interest at 6% annually plus the IPCA (Consumer Price Index) variation and 23% of which were Investments Funds that earn interest approximate to the CDI (Certificado de Depósito Interbancário, or Interbank Deposit Certificate), which has been yielding more than 6% annually. Thus, the Company considers a 6% long term interest rate appropriate to calculate the expected return on assets, as such aligns with the composition of the PETROS asset portfolio.

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PETROS intends to change its investment strategy for the 2004-2008 years to reflect the evolution of and opportunities expected in the Brazilian economy for 2004 and beyond. PETROS will continue to maintain plan assets in various sectors, but percentages by asset type are expected to differ depending on yields achievable in the market while minimizing risk exposure.

PETROS has a significant volume of investments in government securities, mainly NTN-B bonds, which by an agreement with the Supplementary Social Security Department will be held-to-maturity. Thus, the percentage of assets allocated in this investment will remain the same over the short term.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

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**17. Employees postretirement benefits and other benefits** Continued

**(b) Pension plan - Fundação Petrobras de Seguridade Social PETROS** Continued

**PETROBRAS VIDA plan**

In May of 2001, the Board of Directors of PETROBRAS approved the creation of a mixed social security plan, for current and new employees, based on defined contribution formula for programmable benefits and a defined benefit formula for risk benefits.

The new plan, PETROBRAS VIDA, was approved by the Coordination and Control Department of State Companies (DEST) and by the Supplementary Social Security Department (SPC) in October of 2001, and ratified by PETROBRAS Board of Directors.

The migration process of participants in the current plan to PETROBRAS VIDA has been temporarily suspended pursuant to a Federal Justice ruling. Therefore the impact of migration to the new plan will only be computed and recognized in the Company's financial statements in accordance with the requirements of SFAS No. 88 - Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits ( SFAS 88 ), when the issues being litigated have been resolved and the migration process finalized.

In August of 2002, pursuant to closure of the PETROS Plan, PETROBRAS took out a group life insurance policy to cover employees beginning employment with the Company subsequent to closure of the PETROS plan; this policy will remain in effect until a new private pension plan is implemented.

**TRANSPETRO**

TRANSPETRO maintains a defined-contribution private pension scheme with PETROS called Plano TRANSPETRO, which receives monthly contributions equivalent to 5.32% of the payroll of the members and is equal to the contributions made by the participants.





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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

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**17. Employees postretirement benefits and other benefits** Continued

**(b) Pension plan - Fundação Petrobras de Seguridade Social PETROS** Continued

**PETROBRAS ENERGIA PEPSA**

**Defined contribution plan**

Petrobras Energia sponsors a defined contribution plan applicable to all of its employees with salaries above a specified level. Through this plan, Petrobras Energia provides additional funds at amounts equivalent to contributions made by employees which are in excess of legally required amounts. These funds are recognized in accordance with the accrual method of accounting. Due to significant changes in the macroeconomic scenario in 2002 and the uncertainties with regard to the Argentine economic conditions, PEPSA has temporarily suspended this benefit as from January of 2002. This benefit will be reinstated when a provisional savings means considered adequate to this end is identified.

All employees joining PEPSA prior to May 31, 1995 that have participated in the defined contribution plan without interruption and that have worked for a required number of years are entitled to this benefit. The benefit is based on the latest salary amount paid to the employees that participate in the plan, considering the number of years worked.

The plan is of a supplemental nature: the benefit received by the employee corresponds to an amount defined in conformity with the plan's provisions, after deducting the benefits vested in accordance with the contribution plan and the government-sponsored pension scheme, so as the aggregate amount of benefits granted to each employee under the three plans is equivalent to that defined in the plan.

As from retirement, the employees are entitled to a fixed monthly payment.

The plan requires contributions to a fund, payable by PEPSA and not by the employees, who must contribute to the social security system based on their total salary. The fund's assets have been transferred to a trust and invested mainly in bonds, notes, mutual investment funds and fixed term deposits. The Bank of New York is the trustee and Watson Wyatt is the managing agent. PEPSA determines the liability relating to this plan using actuarial calculation methods.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**17. Employees postretirement benefits and other benefits** Continued**(c) Health care benefits - Assistência Multidisciplinar de Saúde (AMS)**

PETROBRAS and its subsidiaries maintain a health care benefit plan (AMS), which offers defined benefits and covers all employees (active and inactive) together with their dependents. The plan is managed by the Company, with the employees contributing fixed amounts to cover principal risks and a portion of the costs relating to other types of coverage in accordance with participation tables defined by certain parameters including salary levels.

The Company's commitment related to future benefits to plan participants is calculated on an annual basis by an independent actuary, based on the Projected Unit Credit method. The health care plan is not funded or otherwise collateralized by assets. Instead, the Company makes benefit payments based on annual costs incurred by plan participants.

The actuarial gains and losses arising from the differences between the actuarial assumptions and the costs effectively incurred are respectively included or excluded when defining the net actuarial liability. These gains and losses are amortized over the average remaining service period of the active employees.

For measurement purposes, a 5.82% annual rate of increase in the per capita cost of covered health care benefits was assumed upon adoption of SFAS 106. The annual rate was assumed to decrease to 2.7% after 50 years.

Assumed health care cost trend rates have a significant effect on the amounts reported for the postretirement health care plans. A one-percentage-point change in assumed health care cost rates would have the following effects:

	<u>One percentage point-increase</u>	<u>One percentage point-decrease</u>
Effect on total of services and interest cost component	80	(62)
Effect on postretirement benefit obligation	567	(448)



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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**17. Employees postretirement benefits and other benefits** Continued**(d) Funded status of the plans**

The funded status of the plans at December 31, 2003 and 2002, based on the report of the independent actuary, and amounts recognized in the Company's balance sheets at those dates, are as follows:

	As of December 31,			
	2003		2002	
	Pension	Health	Pension	Health
	benefits	care	benefits	care
		benefits		benefits
Change in benefit obligation:				
Benefit obligation at beginning of year	5,215	1,868	6,460	1,948
Service cost	97	36	54	21
Interest cost	678	243	255	144
Actuarial loss	909	533	975	479
Benefits paid	(402)	(77)	(311)	(52)
Acquisitions/Mergers - GASPETRO	25	6		
Gain (loss) on translation	1,246	464	(2,218)	(667)
<b>Benefit obligation at end of year (1)</b>	<b>7,768</b>	<b>3,073</b>	<b>5,215</b>	<b>1,873</b>
Change in plan assets:				
Fair value of plan assets at beginning of year	3,715		4,299	
Actual return on plan assets	1,162		754	
Company contributions	98	77	377	52
Employee contributions	95		72	
Benefits paid	(402)	(77)	(311)	(52)
Acquisitions/Mergers - GASPETRO	32			
Loss on translation	891		(1,476)	

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Fair value of plan assets at end of year	5,591		3,715	
<b>Reconciliation:</b>				
Funded status	(2,177)	(3,073)	(1,500)	(1,873)
Unrecognized actuarial loss	2,529	1,493	2,109	813
Unrecognized transition obligation			61	
<b>Net amount recognized</b>	<b>352</b>	<b>(1,580)</b>	<b>670</b>	<b>(1,060)</b>
<b>Amounts recognized in the balance sheet consist of:</b>				
Employees postretirement benefits	(2,055)	(1,580)	(1,452)	(1,060)
Unrecognized pension obligations			61	
Accumulated other comprehensive income	2,407		2,061	
<b>Net amount recognized</b>	<b>352</b>	<b>(1,580)</b>	<b>670</b>	<b>(1,060)</b>

- (1) Accumulated benefit obligation, measured at December 31, 2003. While PETROBRAS is anticipating migration to a new plan, such plan to date has no participants. Similarly, the Transpetro plan has no participants to date and the PEPSA plan is defined contribution. Thus, the accumulated benefit obligation disclosed above is aggregate to all PETROBRAS group companies.

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**17. Employees postretirement benefits and other benefits** Continued**(d) Funded status of the plans** Continued

As discussed in Note 6, on December 30, 2002, the Company transferred to PETROS NTN-B notes with a fair value of US\$ 388.

Net periodic benefit cost includes the following components:

	As of December 31,			
	2003		2002	
	Health		Health	
	Pension	Care	Pension	Care
	benefits	benefits	benefits	benefits
Service cost-benefits earned during the year	97	36	54	21
Interest cost on projected benefit obligation	678	243	255	144
Expected return on plan assets	(493)		(164)	
Amortization of initial transitory obligation	75		74	
Gain (loss) on translation	50	87	(13)	(51)
Recognized actuarial loss	273		154	
	680	366	360	114
Employee contributions	(101)		(71)	
Net periodic benefit cost	579	366	289	114

The main assumptions adopted in 2003 and 2002 for the actuarial calculation are summarized as follows:

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	2003		2002	
	Pension benefits	Health care benefits	Pension benefits	Health care benefits
Discount rates	Inflation: 5% + 6%	Inflation: 5% + 6%	Inflation: 5% + 6%	Inflation: 5% + 6%
Rates of increase in compensation levels	Inflation: 5% + 2%	Inflation: 5% + 2%	Inflation: 5% + 2%	Inflation: 5% + 2%
Expected long-term rate of return on assets	Inflation: 5% + 6%	Not applicable	Inflation: 5% + 6%	Not applicable

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Expressed in Millions of United States Dollars

(except when specifically indicated)

**17. Employees postretirement benefits and other benefits** Continued

**(d) Funded status of the plans** Continued

The determination of the expense and liability relating to the Company's pension plan involves the use of judgment in the determination of actuarial assumptions. These include estimates of future mortality, withdrawal, changes in compensation and discount rate to reflect the time value of money as well as the rate of return on plan assets. These assumptions are reviewed at least annually and may differ materially from actual results due to changing market and economic conditions, regulatory events, judicial rulings, higher or lower withdrawal rates or longer or shorter life spans of participants. As of December 31, 2002, the Company decided to change the assumptions related to the estimate of future mortality, adopting a new mortality table (GAM-71) more suitable for the evolution observed in the average life expectancy of the population made up of Company retired employees.

The Company and its actuarial consultants had been reviewing the basis for estimating the assumed discount rate for its actuarial obligations in light of the recent development of a secondary bond market in Brazil for high-grade long-term government securities. According to the requirements of SFAS 87, and subsequent interpretations, the discount rate should be based on current prices for settling the pension obligation. Applying the precepts of SFAS 87 in historically inflationary environments such as Brazil creates certain issues as the ability for a company to settle a pension obligation at a future point in time may not exist as long-term financial instruments of suitable grade may not exist locally as they do in the United States.

Although the Brazilian market has been demonstrating signs of stabilization under the present economic model, as reflected in market interest rates, it is not yet prudent to conclude that market interest rates will be stable. Although SFAS 87 offers limited guidance, the Company considers it appropriate to use actuarial assumptions which include an estimate of long-term inflation; i.e. nominal rates. Considering that the rate of return offered on high grade long-term government securities, a nominal rate of approximately 9.2% at December 31, 2003, the Company has decided not to change the discount interest rate that has been used historically, as it deems such to be consistent with the requirements of SFAS 87, and subsequent interpretations, for measurement of defined benefit obligations. The Company may adopt different assumptions in the future, which may have a significant impact on the amount of pension liability and expense.

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**18. Shareholders' equity**

The Company's subscribed and fully paid-in capital at December 31, 2003 consisted of 634,168,418 common shares and 462,369,507 preferred shares and, at December 31, 2002, consisted of 634,168,418 common shares and 451,935,669 preferred shares. The preferred shares do not have any voting rights and are not convertible into common shares and vice-versa. Preferred shares have priority in the receipt of dividends and return of capital.

The Extraordinary Shareholders' Meeting, held jointly with the General Shareholders' Meeting on March 22, 2002, approved the increase of the Company's capital stock from US\$ 4,834 to US\$ 6,220 with the capitalization of the revenue reserve constituted in prior years, without issuing new shares.

During the same meeting, PETROBRAS shareholders approved a reform of the Company's by-laws to adjust them to the modifications introduced by Law No. 10,303, of October 31, 2001. The principal change introduced by the new by-laws include an amendment that requires preferred shares to be given priority in the case of repayment of capital and the receipt of dividends, of at least 3% of the book value of the shares or 5% calculated on the portion of capital represented by this class of shares, whichever is larger, and participation on an equal footing with common shares in capital increases resulting from the incorporation of reserves and income.

On June 10, 2002 at an Extraordinary Shareholders Meeting, the Company's shareholders approved an amendment to the Company's by-laws, to adjust them to the modifications introduced by Law No. 10,438 of April 26, 2002. This amendment authorized a change in the corporate purpose of the Company, to include activities related with energy and its sale, in addition to providing more flexible means of borrowings. The Company is also authorized to increase capital, irrespective of an amendment to the by-laws, as a result of a resolution by the Board of Directors, up to R\$ 30,000 million, by means of issuing up to 200 million shares, such that preferred shares do not exceed two-thirds of common shares.

In a Special Meeting of Preferred Shareholders held on June 10, 2002, the Company's shareholders ratified a resolution taken by the Extraordinary Shareholders' Meeting authorizing the issue of preferred shares, without maintaining proportion with common shares.

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**18. Shareholders' equity** Continued

On December 20, 2002, the Board of Directors approved the Company's share buyback program, as facilitated by its by-laws, with the main purpose of, defending the price of its share at times when it is undervalued by the market. The definition and implementation of the share buyback program is not intended to jeopardize the investment program or replace the payment of dividends by the Company.

On January 29, 2003, the Board of Directors of the Company, approved the issuance of 9,866,828 preferred shares of the Company in connection with the public offer by the Company to acquire publicly traded shares of Petrobras Distribuidora - BR, at an issue price of US\$ 12.38 (R\$ 45.08) per share, under the terms of the capital increase approved during the meeting of the Board of Directors of the Company held on November 7, 2002. As a result, the capital of the Company increased by US\$ 122. This minority interest acquisition, accounted for as a purchase business combination under SFAS No. 141 - Business Combinations ( SFAS 141 ), did not have a material impact to the financial statements. See also Note 20.

The Extraordinary Shareholders' Meeting, held jointly with the General Shareholders' Meeting on March 27, 2003, approved an increase in the Company's capital by capitalizing revenue reserves accrued during previous years, to the amount of US\$ 912, without issuing new shares, in accordance with Art. 169, paragraph 1 of Law No. 6,404/76.

On May 9, 2003, the Board of Directors of the Company approved the issue of 567,010 preferred shares of the Company in connection with the public offer by the Company to acquire publicly traded shares of Petrobras Distribuidora - BR, at an issue price of R\$ 45.08 per share. As a result, the capital of the Company increased by US\$ 8.

The management of PETROBRAS will propose to the General Extraordinary Meeting, to be held together with the General Ordinary meeting on March 29, 2004, an increase in the Company's capital to R\$ 32,896,138 thousand, through the capitalization of revenue reserves accrued during previous financial years, in the amount of R\$ 13,033,504 thousand, and without the issuance of new shares, in accordance with article 169, paragraph 1, Law No. 6,404/76. This capitalization will be made in order to bring the Company's capital in line with the investment requirements of an oil company given intensive use of capital and extended operating cycles. Additionally, the Company's management will propose an increase in authorized capital from R\$ 30,000 million to R\$ 60,000 million at the General Extraordinary Meeting.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

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**18. Shareholders' equity** Continued

Current Brazilian law requires that the Federal Government retain ownership of 50% plus one share of the Company's voting shares.

**(a) Dividends and interest on shareholders' equity**

In accordance with the Company's by-laws, holders of preferred and common shares are entitled to a minimum dividend of 25% of annual net income as adjusted under Brazilian Corporate Law. In addition, the preferred shareholders have priority in the receipt of an annual dividend of at least 3% of the book value of the shares or 5% of the paid-in capital in respect of the preferred shares as stated in the statutory accounting records. As of January 1, 1996 amounts attributed to shareholders as interest (see below) can be deducted from the minimum dividend computation. Dividends are paid in Brazilian reais. The Company paid US\$ 212 in dividends during the year ended December 31, 2003 (2002 - US\$ 602 - 2001 - US\$ 424)

Brazilian corporations are permitted to attribute interest on shareholders' equity, which may either be paid in cash or be used to increase capital stock. The calculation is based on shareholders' equity amounts as stated in the statutory accounting records and the interest rate applied may not exceed the Taxa de Juros de Longo Prazo (long-term interest rate or the TJLP) as determined by the Brazilian Central Bank. Such interest may not exceed the greater of 50% of net income or 50% of retained earnings plus revenue reserves. Interest on shareholders' equity, is subject to withholding tax at the rate of 15%, except for untaxed or exempt shareholders, as established by Law No. 9,249/95. The Company paid US\$ 731 in interest on shareholders' equity during the year ended December 31, 2003 (2002 - US\$ 416 - 2001 - US\$ 1,301).

On November 13, 2003, the PETROBRAS Board of Directors approved the distribution of remuneration to shareholders in the form of interest on shareholders' equity amounting to R\$ 3,290 million (US\$ 1,139), in accordance with article 8 and 9, of the Company's by-laws, article 9 of Law No. 9,249/95 and Decrees No. 2,673/98 and No. 3,381/00. This provision for interest on shareholders' equity resulted in an income tax benefit in the amount of US\$ 364.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

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**18. Shareholders' equity** Continued

**(a) Dividends and interest on shareholders' equity** Continued

This remuneration was made available to shareholders at February 13, 2004, based on the shareholdings on November 25, 2003, corresponding to R\$ 3.00 (US\$ 1.03 calculated by the year-end exchange rate) per common and preferred share, and was deducted from the dividend calculated on adjusted net income for the 2003 financial year.

The General Shareholders' Meeting held on March 27, 2003 approved the proposed dividends for the 2002 financial year amounting to US\$ 781; such amount included US\$ 307 which was accrued in the 2002 financials, and interest on shareholders' equity approved by the Board of Directors on January 31, 2003, amounting to US\$ 310, and the balance of dividends, amounting to US\$ 164, both of which amount were reflected in the 2003 financial statements. These amounts, paid in Brazilian reais, were monetarily restated as from December 31, 2002 up to the date of payment.

The dividends proposal submitted by the Board of Directors for approval at the General Shareholders' Meeting to be held on March 29, 2004, amounting to US\$ 1,955, corresponding to R\$ 5.15 per share (US\$ 1.78 per share calculated by year-end exchange rate), include the portion of interest on shareholders' equity approved by the Board of Directors on November 13, 2003, amounting to US\$ 1,139, corresponding to R\$ 3.00 per share (US\$ 1.04 per share calculated by year-end exchange rate), and also includes the portion of interest on equity approved by the Board of Directors on February 13, 2004, amounting to US\$ 436, corresponding to R\$ 1.15 (US\$ 0.40 calculated by the year-end exchange rate) per common and preferred share, to be made available based on the shareholders of record as of March 29, 2004, which is the intended date of the General Shareholders' Meeting that will discuss this subject.

The balance of dividends (US\$ 380) and the additional portion of the interest on shareholders' equity (US\$ 436) have been excluded from the US GAAP financials, but will be paid on a date to be established by the General Shareholders' Meeting. These amounts are paid in Brazilian reais and will be monetarily restated as from December 31, 2003 up to the initial date of payment, according to the variation in the SELIC rate.

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**18. Shareholders' equity** Continued**(a) Dividends and interest on shareholders' equity** Continued

Brazilian law permits the payment of dividends only from retained earnings as stated in the statutory accounting records. At December 31, 2003, the Company had appropriated all such retained earnings.

In addition, at December 31, 2003, the undistributed reserve in appropriated retained earnings, amounting to US\$ 9,372, may be used for dividend distribution purposes, if so approved by the shareholders, however, the Company's stated intent is to use such reserve to fund working capital and capital expenditures.

A withholding tax of 15% was payable on distributions dividends earned from January 1, 1994 through December 31, 1995. No withholding tax is payable on distributions of dividends earned since January 1, 1996.

**(b) Basic and diluted earnings per share**

Basic and diluted earnings per share amounts have been calculated as follows:

	Year ended December 31,		
	2003	2002	2001
Income before effect of change in accounting principle	5,862	2,311	3,491
Cumulative effect of change in accounting principle, net of taxes	697		
Net income for the period	6,559	2,311	3,491
Less priority preferred share dividends	(226)	(77)	(117)
Less common shares dividends, up to the priority preferred shares dividends on a per-share basis	(309)	(107)	(164)

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Remaining net income to be equally allocated to common and preferred shares	6,024	2,127	3,210
	<b>_____</b>	<b>_____</b>	<b>_____</b>
Weighted average number of shares outstanding			
Common/ADS	634,168,418	634,168,418	634,168,418
Preferred/ADS	462,369,507	451,935,669	451,935,669
	<b>_____</b>	<b>_____</b>	<b>_____</b>
Basic and diluted earnings per share			
Common and Preferred			
Before effect of change in accounting principle	5.35	2.13	3.21
After effect of change in accounting principle	5.98	2.13	3.21

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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**18. Shareholders' equity** Continued

(c) **Capital reserves**

**AFRMM**

Relates to the Merchant Marine (AFRMM) freight surcharges levied in accordance with relevant legislation. These funds are used to purchase, enlarge or repair vessels of the Company's transport fleet.

**Fiscal incentive reserve**

This reserve consists of investments in tax incentives in the Northeast Investment Fund (FINOR), arising from allocations of part of the Company's income tax.

(d) **Appropriated retained earnings**

Brazilian Law and the Company's by-laws require that certain appropriations be made from retained earnings to reserve accounts annually. The purpose and basis of appropriation to such reserves is as follows:

**Legal reserve**

This reserve is a requirement for all Brazilian corporations and represents the annual appropriation of 5% of net income as stated in the statutory accounting records up to a limit of 20% of capital stock. The reserve may be used to increase capital or to compensate for losses, but may not be distributed as cash dividends.

**Undistributed earnings reserve**



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This reserve is established in accordance with Article 196 of Law No. 6,404/76 to fund the Company's annual investment program. For the year ended December 31, 2002, the Company's management retained US\$ 1,834 of which US\$ 1,831 relates to net income for the year and US\$ 3 to the remaining balance of retained earnings, to fund the Company's capital expenditure budget for 2003. This proposal was approved at the General Shareholders' Meeting held on March 27, 2003.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Expressed in Millions of United States Dollars

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**18. Shareholders' equity** Continued

**(d) Appropriated retained earnings** Continued

**Undistributed earnings reserve** Continued

The proposal for appropriation of income for the year ended December 31, 2003 includes a retention of earnings in the amount of US\$ 4,603, of which US\$ 3,773 relates to net income for the year and US\$ 830 to the remaining balance of retained earnings, to be approved by the General Shareholders' Meeting to be held on March 29, 2004. This proposal is intended to cover partially the annual investment program established in the capital budget for 2004.

**Statutory reserve**

This reserve is provided through an amount equivalent to a minimum of 0.5% of subscribed and fully paid in capital at year-end. The reserve is used to fund the costs incurred with research and technological development programs. The accumulated balance of this reserve cannot exceed 5% of the capital stock, according to Article 55 of the Company's by-laws.

**19. International acquisitions**

**(a) Acquisition of an interest in Petrobras Energia Participaciones S.A. - PEPSA - (formerly known as Perez Companc S.A.) and Petrolera Entre Lomas S.A. - PELS A (formerly known as Petrolera Perez Companc S.A.)**

On October 17, 2002, the Company signed the Final Share Acquisition Agreement with the Perez Companc family and the Fundación Perez Companc, completing the acquisition of a controlling interest of Perez Companc S.A. (currently known as Petrobras Energia Participaciones S.A. - PEPSA), and Petrolera Perez Companc S.A. (currently known as Petrolera Entre Lomas S.A. - PELS A). In October of 2002, in accordance with Argentine legislation, the necessary documentation was submitted to the Argentine antitrust agency (CNDC - Comisión Nacional de Defensa de la Competencia) in order to obtain approval for the transaction.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

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**19. International acquisitions** Continued

**(a) Acquisition of an interest in Petrobras Energia Participaciones S.A. - PEPSA - (formerly known as Perez Companc S.A.) and Petrolera Entre Lomas S.A. - PELSA (formerly known as Petrolera Perez Companc S.A.)** Continued

On May 13, 2003, the Argentine antitrust agency (Comisión Nacional de Defensa de la Competencia), an agency reporting to the Argentine Secretariat of Competition, Deregulation and Consumer Protection (Secretaria de la Competencia, la Deregulación y la Defensa del Consumidor), approved the purchase of 58.62% of the capital stock of PEPSA and 39.67% of the capital stock of PELSA capital stock by PETROBRAS Participações S.L., a company controlled by PETROBRAS. As a result of the purchase of a 39.67% interest in the capital stock of PELSA, together with the purchase of 58.62% of PEPSA's interest in the capital stock of PELSA, the Company has a controlling interest in PELSA equal to 50.73% and thus has consolidated the entity.

The purchase price to be paid for PEPSA and PELSA was based on an economic valuation model of expected future earnings of those companies, which considered relevant factors, including the potential effects of the economic situation of Argentina. The Company paid US\$ 739 in cash and US\$ 338 in bonds to the Perez Companc family for the shares of PEPSA and PELSA.

The acquisition was consummated principally to expand PETROBRAS operations into geographical markets where the Company had little activity. Through the acquisition of PEPSA and PELSA, PETROBRAS was able to gain immediate access to the Argentine market and brand recognition. The goodwill of US\$ 183 generated by the transaction is attributed principally to downstream activities.

The acquisition of PEPSA and PELSA was recorded using the purchase method of accounting and the financial statements of PEPSA and PELSA were included in the consolidated PETROBRAS financial statements, beginning on May 13, 2003. The purchase price for PEPSA and PELSA was allocated based on the fair market value of the assets acquired and the liabilities assumed as of the acquisition date as determined by independent appraisers.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**19. International acquisitions** Continued**(a) Acquisition of an interest in Petrobras Energia Participaciones S.A. - PEPSA - (formerly known as Perez Companc S.A.) and Petrolera Entre Lomas S.A. - PELSAs (formerly known as Petrolera Perez Companc S.A.)** Continued

PEPSA operates principally in the areas of oil field exploration and production, refining, transport and commercialization, electricity generation, transmission and distribution, and petrochemicals. Its activities are primarily based in Argentina, but PEPSA also operates in Bolivia, Brazil, Ecuador, Peru and Venezuela. PELSAs operates primarily in the oil and gas exploration and production industry in Argentina.

The following unaudited pro forma summary financial information presents the consolidated results of operations as if the acquisition of PEPSA and PELSAs had occurred at the beginning of the periods presented.

**Consolidated income statements data for the year ended December 31.**

	2003		2002	
	As reported	Pro forma (unaudited)	As reported	Pro forma (unaudited)
Net operating revenues	30,797	31,350	22,612	23,736
Costs and expenses	(20,075)	(20,435)	(15,834)	(16,675)
Financial expenses, net	(136)	(341)	(1,700)	(2,442)
Others	(1,813)	(1,797)	(1,846)	(1,832)
Income tax expense	(2,663)	(2,665)	(1,153)	(1,108)
Minority interest	(248)	(260)	232	382
Cumulative effect of change in accounting principles, net of taxes	697	697		
Net income for the year	6,559	6,549	2,311	2,061
Basic and diluted earnings per share	5.98	5.97	2.13	1.90

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**19. International acquisitions** Continued

**(b) Acquisition of Petrolera Santa Fe**

On October 24, 2002, the Company completed the acquisition of 100% of Petrolera Santa Fe Southern Cone, Inc., a holding company incorporated in the British Virgin Islands, parent company of Petrolera Santa Fe S.R.L (Santa Fe), an Argentine oil and gas exploration company, for US\$ 90, paid in cash on the same date. The purchase price was less than the estimated fair market value of the net assets acquired, resulting in a reduction in the acquisition value assigned to Santa Fe's long-lived assets. In 2002, Santa Fe produced approximately 10.2 thousand barrels of oil equivalents per day. The acquisition did not have significant effects on results of operations on a pro-forma basis.

**20. Petrobras Distribuidora - BR**

On November 7, 2002, the Board of Directors of the Company approved a public offer by the Company to acquire the publicly traded shares of Petrobras Distribuidora S.A. - BR, to cancel its quoted company registration by means of an exchange for preferred share to be issued by the Company.

In addition the Board of Directors approved the valuation appraisal of BR that determined the value of R\$ 45.40 (US\$ 11.66) for each 1,000 share lot of BR stock, the valuation appraisal by the Company that established a value of R\$ 64.90 (US\$ 16.66) for each share issued by the Company together with the swap ratio of the Company and BR shares at the rate of 0.7 PETROBRAS shares for 1,000 BR shares, which will be agreed together with a premium, defined by the specific formula.

On January 29, 2003, a public auction was held in which implementation of the condition for canceling the registration of the quote company of BR was verified. On February 5, 2003, CVM cancelled the registration of the quoted company of BR.

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**21. Accounts - temporary agreement on price stabilization in Argentina**

In January 2003, pursuant to government actions seeking to stabilize the economic environment in Argentina, the hydrocarbon producing and refining companies signed a temporary agreement aimed at stabilizing the prices of crude oil, gasoline and diesel oil in the Argentine market. This agreement, considering renewals, extends to February 29, 2004. Under this agreement, deliveries of crude oil must be billed and paid based on a reference WTI (West Texas Intermediate) price of US\$ 28.50 per barrel. Positive or negative differences between the actual WTI, up to the limit of US\$ 36.00 per barrel, and the reference price are to be realized based on amounts generated in periods during which the actual WTI price is lower than US\$ 28.50 per barrel. As long as average market WTI prices remain higher than the reference price, the refining companies will, otherwise, record a liability to be realized when the WTI price is lower than the reference price. At December 31, 2003, the amount payable by Argentine companies within the PETROBRAS system related to the price difference on the acquisition of crude oil, amounted to US\$ 10.

**22. Commitments and contingencies**

PETROBRAS is subject to a number of commitments and contingencies arising in the normal course of its business. Additionally, the operations and earnings of the Company have been, and may be in the future, affected from time to time in varying degrees by political developments and laws and regulations, such as the Federal Government's continuing role as the controlling shareholder of the Company, the status of the Brazilian economy, forced divestiture of assets, tax increases and retroactive tax claims, and environmental regulations. The likelihood of such occurrences and their overall effect upon the Company are not predictable.

The Company currently has several contracts to purchase crude oil, diesel fuel and other oil products, which require the Company to purchase a minimum of approximately 147,000 barrels per day at respective current market prices.

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**22. Commitments and contingencies** Continued

PETROBRAS provided guarantees to the ANP for the minimum exploration program defined in the concession contracts for exploration areas, totaling US\$ 907. Out of this total, US\$ 704 represents a pledge on the oil to be extracted from previously identified fields already in production, for areas in which the Company had already made commercial discoveries or investments at the time where Law No. 9,478 of August 6, 1997 came into force. For areas whose concessions were obtained by bidding from the ANP, PETROBRAS has given bank guarantees totaling US\$ 203 through December 31, 2003.

PETROBRAS has guaranteed that it will purchase specified volumes of natural gas that run through TBG pipeline.

In 1993, the Company signed a contract with Yacimientos Petrolíferos Fiscales Bolivianos, the Bolivian state oil company for the purchase of natural gas. Under this contract, the Company is required to purchase 80% of the natural gas transported through the Bolivia/Brazil natural gas pipeline over a 20 year term at contract prices ranging from US\$ 1.07 per MMBTU to US\$ 1.17 MMBTU, based upon throughput. The pipeline achieved an average throughput of 24.64 million cubic meters per day during 2003.

The Company has exclusive supply contracts with certain service stations. These contracts are typically for seven years and require the Company to sell product at market prices.

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**22. Commitments and contingencies** Continued**(a) Litigation**

The Company is a defendant in numerous legal actions involving civil, tax, labor, corporate and environment issues arising in the normal course of its business. Based on the advice of its internal legal counsel and management's best judgment, the Company has recorded accruals in amounts sufficient to provide for losses that are considered probable and reasonably estimable. At December 31, 2003 and 2002, the respective claims by type are as follows:

	<u>As of December 31,</u>	
	<u>2003</u>	<u>2002</u>
Labor claims	22	13
Tax claims	39	13
Civil claims	90	24
Commercials claims and other contingencies	109	
	<u>260</u>	<u>50</u>
Contractual contingencies - thermoelectric plants (see Note 16)		205
Contingencies for joint liability	95	113
	<u>355</u>	<u>368</u>
<b>Total</b>	<b>355</b>	<b>368</b>
Current Contingencies	(84)	(318)
Long-term Contingencies	271	50

As of December 31, 2003 and 2002, in accordance with Brazilian law, the Company had paid US\$ 543 and US\$ 290, respectively, into federal depositories to provide collateral for these and other claims until they are settled. These amounts are reflected in the balance sheet as restricted deposits for legal proceedings and guarantees.



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The Company is a party to several contracts related to the acquisition and upgrade of production Platform P-36, which was lost in its entirety in 2001. Pursuant to those contracts, the Company had an obligation to pay the insurance proceeds to a Security Agent for distribution according to specified clauses established in the contracts. The Company contends that it is entitled to the insurance proceeds under the contractual arrangements, and other parties contend that they are also entitled to such proceeds. The issue is subject to international proceedings in a British court. Pending determination of the issue by the international court, the Company committed to deposit cash collateral in the amount of US\$ 175, in order to facilitate the issuance of a guarantee by a Security Agent, for the payment of creditors. At December 31, 2003, this amount was included in the balance sheet as restricted deposits for legal proceedings and guarantees.

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**22. Commitments and contingencies** Continued

**(a) Litigation** Continued

On May 28, 1981, Kallium Mineração S.A. brought an action against Petromisa, a former subsidiary of PETROBRAS, in the Federal Court of the State of Rio de Janeiro alleging damages of approximately US\$ 450 relating to the rescission of a contract to develop a potassium salt mine. On August 10, 1999, a decision was handed down that considered most of the plaintiff's petitions to be without grounds (losses, damages and loss of profit), requiring only the Company to reimburse all expenses incurred as a result of the prospecting research carried out, in accordance with amounts to be calculated in the final award. No award for loss of profit was established in the decision. In September of 1999 both parties filed appeals with the appeals court in the state of Rio de Janeiro. Based on the opinion of its legal advisers, management does not expect an unfavorable outcome in this case and considers the risk of loss with respect to this lawsuit to be remote.

On August 8, 1993, Indústria Bahiana de Adubos, Importação e Exportação Ltda. filed a lawsuit against the Company in the State Court of Bahia claiming approximately US\$ 129 in damages. The claim is based upon the Company's refusal to sell fertilizers to the plaintiff due to the plaintiff's payment default under prior contracts with the Company. The plaintiff claims that such refusal harmed its financial condition and, ultimately, caused its bankruptcy. On December 9, 1993, the trial court decided in favor of the plaintiff. However, the Company appealed and the decision was reversed by the State Court of Appeals. Subsequently, the plaintiff filed a special appeal, which was also found to be without grounds on June 25, 2002 by the 3rd Panel of the Appeals Court. This Court dismissed the case and the lawsuit was extinguished.

On November 23, 1992, PORTO SEGURO IMÓVEIS LTDA., a minority shareholder of PETROQUISA, filed a suit against PETROBRAS in the State Court of Rio de Janeiro related to alleged losses resulting from the sale of a minority holding by PETROQUISA in various petrochemical companies included in the National Privatization Program introduced by Law No. 8,031/90.

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**22. Commitments and contingencies** Continued

**(a) Litigation** Continued

In this suit, the plaintiff claims that PETROBRAS, as the majority shareholder in PETROQUISA, should be obliged to reinstate the loss caused to the net worth of PETROQUISA, as a result of the acts that approved the minimum sale price of its holding in the capital of privatized companies. A decision was handed down on January 14 of 1997 that considered PETROBRAS liable with respect to PETROQUISA for losses and damages in an amount equivalent to US\$ 3,406.

In addition to this amount, PETROBRAS was required to pay the plaintiff 5% of the value of the compensation as a premium (see art. 246, paragraph 2 of Law No. 6,404/76), in addition to attorneys' fees of approximately 20% of the same amount. However, since the award would be payable to PETROQUISA and PETROBRAS holds 99.0% of its capital, the effective disbursement if the ruling is not reversed will be restricted to 25% of the total award. PETROBRAS filed an appeal with the State Court of Rio de Janeiro, and received a favorable decision from the Third Civil Court on February 11, 2003, which, by a majority vote, accepted PETROBRAS' appeal to reverse the judgment and ruled the plaintiff's case to be without grounds, the revising judge's decision that held the case to be partially with grounds to reduce the amount of compensation to US\$ 1,538 being overruled. Based on its legal counsels advice, PETROBRAS' Administration does not expect to obtain an unfavorable decision in the case and assesses the risk of loss to be remote.

The Fisherman's Federation of the State of Rio de Janeiro (FEPERJ) filed a civil suit against the Company with the Rio de Janeiro State Court for compensation of miscellaneous damages amounting to US\$ 224, which it is claiming in the name of its members, as a result of the oil spill in Guanabara Bay on January 18, 2000. A decision was handed down on February 7, 2002 which ruled the claim partially without grounds, rejecting pain and suffering, and requiring the Company to pay compensation for material damages and loss of profit to be calculated at the award phase. The ruling expressly declares that it is not reasonable to consider an award based on the amount claimed, since it was without economic base.

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**22. Commitments and contingencies** Continued

**(a) Litigation** Continued

Based on its legal counsels opinion, the Company's Administration believes it is possible that the Company will not prevail in this case, but that any possible negative judgment would be in an amount far below the originally filed complaint. As such, the Company assesses the risk of loss related to this case as possible.

The São Paulo tax authorities filed a tax suit against the Company, alleging that the Company did not pay ICMS levied on interstate sales of naphtha. However, during the period in which according to the State of São Paulo, the Company should have paid the ICMS, the Company was subject to a different tax regime (federal) on these sales, and for this reason enjoyed a tax holiday. The value of the matter in controversy is US\$ 60. There is no guarantee that the final result of the legal case will be favorable to PETROBRAS, but even in the case of an unfavorable ruling, management does not believe that the award could have a material negative impact on the financial position of PETROBRAS. The Company assesses its risk of loss in the matter as possible.

PETROBRAS is a defendant in four labor claims filed by the UNIONS OF PETROLEUM WORKERS of three federal states (Rio de Janeiro, São Paulo and Sergipe), alleging that official inflation rates for 1987, 1989 and 1990 (understatement of the official inflation rate - Bresser, Summer and Collor Plans) were not fully included in the workers' salaries.

The law suits are at different stages. Based on past favorable decisions in similar cases and on a final understanding of the TST, management does not expect an unfavorable decision in these suits. Three identical cases have been decided in favor of PETROBRAS. Management assesses risk of loss to be remote.

The Company was sued in court by certain small oil distribution companies under the allegation that it does not pass on to state governments the State Value-Added Tax (ICMS) collected according to the legislation upon fuel sales. These suits were filed in the states of Goiás, Tocantins, Bahia, Pará, Maranhão and in the Federal District.

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**22. Commitments and contingencies** Continued

**(a) Litigation** Continued

Of the total amount related to in legal actions approximately US\$ 394 up to December 31, 2003, US\$ 32 were effectively withdrawn from the Company's accounts as a result of judicial rulings of advance relief.

The Company, with the support of the state and federal authorities, has succeeded in stopping the execution of other withdrawals, and is making all efforts possible to obtain reimbursement of the amounts that were previously withdrawn from its accounts.

**(b) Notification from the INSS - joint liability**

The Company received various tax assessments related to social security amounts payable as a result of irregularities in presentation of documentation required by the INSS, to eliminate its joint liability in contracting civil construction and other services, stipulated in paragraphs 5 and 6 of article 219 and paragraphs 2 and 3 of article 220 of Decree No. 3,048/99.

The Company made a provision for this contingency in the amount of US\$ 105 at December 31, 2002, as it considers the chance of success in a defense filed against the INSS to be remote.

On September 29, 2003, the Company received additional INSS tax assessments related to the joint liability for irregularities in presentation of contractors' documentation related to periods subsequent to past notifications. At December 31, 2003 the balance of contingencies associated with this joint liability was US\$ 193.

Internally, procedures were revised to improve the inspection of contracts and require the presentation of documents, as stipulated in the legislation, to substantiate the payment of INSS amounts due by contractors. PETROBRAS continues to analyze each tax assessment received in order to recover amounts, as permitted through administrative processes of the INSS.



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**22. Commitments and contingencies** Continued

**(c) Tax assessments - internal revenue service of Rio de Janeiro**

The Internal Revenue Service of Rio de Janeiro filed two Tax Assessments against the Company in connection with Withholding Tax (IRRF) on foreign remittances of payments related to charter of vessels of movable platform types for the years 1998 through 2002.

The Internal Revenue Service, based on Law No. 9,537/97, Article 2, considers that drilling and production platforms cannot be classified as sea-going vessels and therefore should not be chartered but leased. Based on this interpretation, overseas remittances for servicing chartering agreements would be subject to withholding tax at the rate of 15% or 25%.

The Company disagrees with the Internal Revenue Service's interpretation as to charter contracts, given that the Federal Supreme Court has already ruled that, in the context of its judgment with respect to the IPI (Federal VAT) tax, offshore platforms are to be classified as sea-going vessels. Additionally, the 1994 and 1999 Income Tax Regulations support the non-taxation (RIR/1994) and the zero tax rate (RIR/1999) for the remittances in question.

On June 27, 2003, the Internal Revenue Service served a tax assessment notice on the Company amounting to R\$ 3,064 million (US\$ 1,066) covering the period from 1999 to 2002. Using the same arguments, on February 17, 2003, another tax assessment notice had already been issued for R\$ 93 million (US\$ 32) with respect to 1998, against which, on March 20, 2003, the Company filed an appeal. According to the fiscal authorities, the Company should have withheld that tax, incident on remittances made to abroad for payment of the hiring of vessels of the mobile platform type, used in oil exploration and production.

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**22. Commitments and contingencies** Continued

**(c) Tax assessments - internal revenue service of Rio de Janeiro** Continued

PETROBRAS has defended itself against these tax assessments: i) the smaller in value has been confirmed by the first administrative level, and the corresponding appeal has been already filed by the Company, and waits judgment; ii) no first level decision has been issued so far with regard to the other one, with greater value. Based on its legal counsels advice, the Company's Administration does not expect to obtain an unfavorable decision in this case, and thus has assessed risk of loss to be remote.

**(d) Environmental matters**

The Company is subject to various environmental laws and regulations. These laws regulate the discharge of oil, gas or other materials into the environment and may require the Company to remove or mitigate the environmental effects of the disposal or release of such materials at various sites.

During 2000 the Company implemented an environmental excellence and operational safety program -PEGASO - (Programa de Excelência em Getão Ambiental e Segurança Operacional). Scheduled to be concluded in December 2003, the Company made expenditures of approximately US\$ 2,400 from 2000 to December 31, 2003 under this program.

During the years ended December 31, 2003 and 2002 the Company made expenditures of approximately US\$ 766 and US\$ 677 respectively, under this program, including US\$ 225 and US\$ 234 through the Programa de Integridade de Dutos (Pipeline Integrity Program) through which it conducts inspections of, and improvements to, the Company's pipelines.

The Company believes that future payments related to environmental clean up activities resulting from these incidents, if any, will not be material.



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**22. Commitments and contingencies** Continued

**(d) Environmental matters** Continued

On January 18, 2000, a pipeline from one of the Company's terminals to a refinery in the Guanabara Bay ruptured, causing a release of crude oil into the bay. On January 19, 2001, the Rio de Janeiro State Prosecutor filed a criminal lawsuit against the Company. The Company is contesting the legal basis for the criminal lawsuit. Additionally, the Federal Prosecutor has filed criminal lawsuits against the former president of the Company (that finished) and 9 other employees. The Company cannot predict if the outcome of these proceedings will have a material adverse effect on the financial condition, results of operations or cash flows of the Company.

In addition, as a result of the spill, on January 27, 2000, the National Council for the Environment enacted a resolution that obligated the Instituto Brasileiro do Meio Ambiente e dos Recursos Naturais Renováveis (IBAMA), state environmental agencies and local environmental agencies and non-governmental agencies to evaluate the control and prevention measures and environmental licensing status of all industrial facilities for the production of oil and oil products in Brazil. This resolution also mandated that the Company perform an independent environmental audit of all of our industrial installations located in the State of Rio de Janeiro.

Since 2000, the Company implemented independent environmental audits in all of the Company's plants located in Brazil that was concluded during December of 2003. The Company implemented 80% of the auditors recommendations and intend to implement the remaining 20% during 2004.

On July 16, 2000, an oil spill occurred at the Presidente Getúlio Vargas refinery releasing crude oil in the surrounding area. The Federal and State of Paraná Prosecutors have filed a civil lawsuit against the Company seeking US\$ 1,176 in damages, that have already been contested by the Company. Additionally, there are two other actions pending, one by the Instituto Ambiental do Paraná (Paraná Environmental Institute) and by another civil association called AMAR that have already been contested by the Company. The Company cannot predict whether these proceedings will have a material adverse effect on the financial condition, results of operations or cash flow of the Company.

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**22. Commitments and contingencies** Continued

**(d) Environmental matters** Continued

On November 4, 2000, the Cypriot flag vessel Vergina II chartered by PETROBRAS collided with the south pier at the Company's Almirante Barroso terminal in São Sebastião and spilled oil in the São Sebastião canal. As a result of the accident, the Company was fined approximately US\$ 30 by various local environmental agencies. The Company is currently contesting these fines.

On February 16, 2001, the Company's Araucária-Paranaguá pipeline ruptured and as a result fuel oil was spilled into the Sagrado, Meio, Neves and Nhundiaquara Rivers located in the state of Paraná. As a result of the accident, the Company was fined approximately US\$ 80 by the Instituto Ambiental do Paraná (Paraná Environmental Institute), which the Company is contesting through administrative proceedings.

On March 15, 2001, a spill resulting from the accident involving the P-36 platform occurred, causing a release of diesel fuel and crude oil. The Company was fined by the Brazilian Environmental Institute (IBAMA) US\$ 3 in April of 2001 for the spill and improper use of chemicals to disperse the oil. The Company is currently contesting these fines.

On May 12, 2003, the rupture of a connection socket on a production line at well FZB-71, on the Belém Farm field, in the city of Aracati-CE, resulted in the spill of approximately 7 (seven) thousand liters of oil at an area located far from any communities or water sources. The Company's Contingency Plan was immediately activated and cleaning work for the area was carried out. PETROBRAS was charged with a penalty of US\$ 0.04 by the Environment Superintendency of the State of Ceará (Semace) and up to 90% of this amount can be reduced by compliance with a Commitment Term entered into with the referred environmental entity.

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**22. Commitments and contingencies** Continued

**(d) Environmental matters** Continued

On June 3, 2003, a fault in the connection of one of the unloading arms of vessel Nordic Marita, anchored at the Maritime Terminal Almirante Barroso (Tebar), in São Sebastião, on the North coast of São Paulo, caused a spill of approximately 27 thousand liters of oil from Campos Basin. As a result of this accident, PETROBRAS was charged with a penalty of US\$ 0.17 by the Brazilian Institute for the Environment and Renewable Resources (IBAMA) and of US\$ 0.12 by Basic Sanitation, Technology and Environment Protection Agency of the State of São Paulo (CETESB). An appeal was filed against both charges based on the understanding that the Company acted in the most efficient possible manner in order to minimize possible impacts on the environment.

On August 26, 2003, the rupture of a pipeline between Transpetro's terminal in Cabiúnas (Macaé) and Duque de Caxias Refinery caused the spill of 20 (twenty) liters of oil in an area of the city of Cachoeiras de Macacu. The Company immediately determined that the oil located in the service area of the pipeline should be removed, and took preventive measures to protect a creek, near to the Soarinhos River, with checks and oil-absorbing materials. In spite of the effective procedures adopted by PETROBRAS and the non-absence of environmental damages, the Company received a fine from IBAMA in the amount of US\$ 0.69, but filed an administrative proceeding with this entity.

The Company's management considers that any expenses incurred to correct or mitigate possible environmental impacts should not have a significant effect on operations or cash flows.

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## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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**22. Commitments and contingencies** Continued**(e) Minimum payments under operating leases and service contracts**

The Company is committed to make the following minimum payments related to operating leases as of December 31, 2003:

2005	954
2006	525
2007	349
2008	312
2009 and thereafter	856
	2,996
Minimum operating lease payment commitments	2,996

The Company paid US\$ 1,205, US\$ 1,355, and US\$ 1,284 in rental expense on operating leases at December 31, 2003, 2002 and 2001, respectively.

Additionally, the company is committed to make the following minimum long-term payments related to services contracted as of December 31, 2003:

2005	172
2006	90
2007	56
2008	44
2009 and thereafter	107
	469
Minimum service contract payment commitments	469

**23. Derivative instruments, hedging and risk management activities**

The Company is exposed to a number of market risks arising from the normal course of business. Such market risks principally involve the possibility that changes in interest rates, currency exchange rates or commodity prices will adversely affect the value of the Company's financial assets and liabilities or future cash flows and earnings. The Company maintains an overall risk management policy that is developed under the direction of the Company's executive officers.

The Company may use derivative and non-derivative instruments to implement its overall risk management strategy. However, by using derivative instruments, the Company exposes itself to credit and market risk. Credit risk is the failure of a counterparty to perform under the terms of the derivative contract. Market risk is the adverse effect on the value of a financial instrument that results from a favorable change in interest rates, currency exchange rates, or commodity prices. The Company addresses credit risk by restricting the counterparties to such derivative financial instruments to major financial institutions. Market risk is managed by the Company's executive officers. The Company does not hold or issue financial instruments for trading purposes.

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**23. Derivative instruments, hedging and risk management activities** Continued

**(a) Foreign currency risk management**

The Company's foreign currency risk management strategy may involve the use of derivative instruments to protect against foreign exchange rate volatility, which may impair the value of certain of the Company's obligations. The Company currently uses zero cost foreign exchange collars to implement this strategy.

During 2000, the Company entered into three zero cost foreign exchange collars to reduce its exposure to variations between the U.S. Dollar and the Japanese Yen, and between the U.S. Dollar and EURO relative to long-term debt denominated in foreign currencies with a notional amount of approximately US\$ 470. The Company does not use hedge accounting for these derivative instruments.

These collars establish a ceiling and a floor for the associated exchange rates. If the exchange rate falls below the defined floor, the counterparties will pay to the Company the difference between the actual rate and the floor rate on the notional amount. Conversely, if the exchange rate increases above the defined ceiling, the Company will pay to the counterparties the difference between the actual rate and the ceiling rate on the notional amount. The contracts expire upon the maturity date of each note.

As of December 31, 2002 and 2001, the Company had a fair value obligation of US\$ 80 and US\$ 119, respectively, associated with its EURO and Japanese Yen zero cost collar contracts. The Yen zero cost collar contracts were settled on September 8, 2003, with a cash payment of US\$ 68.

As of December 31, 2003 the Company had a fair value asset of US\$ 26 associated with its Euro zero cost collar contracts.

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**23. Derivative instruments, hedging and risk management activities** Continued

**(b) Commodity price risk management**

The Company is exposed to commodity price risks as a result of the fluctuation of crude oil and oil product prices. The Company's commodity risk management activities primarily consist of futures contracts traded on stock exchanges and options and swaps entered into with major financial institutions. The futures contracts provide economic hedges to anticipated crude oil purchases and sales, generally forecast to occur within a 30 to 360 day period, and reduce the Company's exposure to volatile commodity prices.

The Company's exposure on these contracts is limited to the difference between contract value and market value on the volumes hedged. Crude oil future contracts are marked to market and related gains and losses are recognized currently into earnings, irrespective of when physical crude sales occur. For the years ended December 31, 2003, 2002 and 2001, the Company consummated commodity derivative transaction activities on 72.47%, 42.01% and 21.20%, respectively, of its total import and export traded volumes.

The open positions on the futures market, compared to spot market value, resulted in recognized losses of US\$ 2, US\$ 4 and US\$ 6 during the years ended December 31, 2003, 2002 and 2001, respectively.

A long-term operation was executed on January of 2001 by the sale of put options for 52 million barrels of West Texas Intermediate (WTI) oil over a period extending from 2004 to 2007, with the objective to obtain price protection for this quantity of oil and to provide the funding institutions of the Barracuda/Caratinga project with a minimum guaranteed margin to cover the debt servicing. The puts were structured to ensure that the financial institutions participating in the financing of the development of the fields receive the price required to generate the minimum required return on investment. The Company accounts for the put options on a mark to market basis. During 2003, 2002 and 2001, the Company realized a net gain of US\$ 7 and US\$ 8 and US\$ 5, respectively.



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**23. Derivative instruments, hedging and risk management activities** Continued

**(b) Commodity price risk management** Continued

The fair value of oil products is based on usual market conditions, at values prevailing at the closing of the period, considered relevant for underlying quotations. Option contracts are valued using the Black & Scholes model, considering parameters advised by financial institutions of international reputation.

**(c) Interest rate risk management**

The Company's interest rate risk is a function of the Company's long-term debt and, to a lesser extent, short-term debt. The Company's foreign currency floating rate debt is principally subject to fluctuations in LIBOR and the Company's floating rate debt denominated in Reais is principally subject to fluctuations in the Brazilian long-term interest rate (TJLP), as fixed by the Brazilian Central Bank. The Company currently does not utilize derivative financial instruments to manage its exposure to fluctuations in interest rates. However, the Company has been studying various forms of derivatives to reduce exposure to interest rate fluctuations and may use these financial instruments in the future.

**(d) Risk Management activity at PEPSA**

PEPSA also uses derivative instruments such as options, swaps and others, mainly to mitigate the impact of changes in crude oil prices, interest rates and future exchange rates. Such derivative instruments are designed to mitigate specific exposures, and are assessed periodically to assure high correlation of the derivative instrument to the risk exposure identified and to assure that the derivative is highly effective in offsetting changes in cash flows inherent in the covered risk. PEPSA qualifies for hedge accounting treatment for its crude oil derivative instruments and its interest rate swap derivative instruments.

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**23. Derivative instruments, hedging and risk management activities** Continued

**(d) Risk Management activity at PEPSA** Continued

PEPSA consummated commodity derivative transactions, referenced to WTI, for 40% of its total sales volume (corresponding to 11,963 thousand boe) at December 31, 2003. The operations settled in the year generated a loss in the approximate amount of US\$ 67. At December 31, 2003, the open positions on the futures market, when compared to their market value, represented a negative result of approximately US\$ 187, if liquidated on that date. These transactions were accounted for as cash flow hedges in accordance with SFAS No. 133 - Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ).

Additionally, PEPSA holds an interest rate contract to manage the volatility of the LIBOR rate implied in a Class C negotiable instrument, establishing the respective interest rate at 7.93% annually. If this instruments were to be liquidated, considering the rates used at the date, a net loss of approximately US\$ 6 would be recorded. This contract qualifies for hedge accounting in accordance with SFAS 133.

**24. Financial instruments**

In the normal course of its business, the Company uses various types of financial instruments. These instruments include recorded assets and liabilities, and also items such as derivatives, which principally involve off-balance sheet risk.

**(a) Concentrations of credit risk**

Substantial portions of the Company's assets including financial instruments are located in Brazil and substantially all of the Company's revenues and net income are generated in Brazil. The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of its cash equivalents, government securities, the Petroleum and Alcohol Account, trade receivables and future contracts.

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**24. Financial instruments** Continued

**(a) Concentrations of credit risk** Continued

The Company takes several measures to reduce its credit risk to acceptable levels. All cash equivalents in Brazil are maintained with federal banks in accordance with federal law. Time deposits in U.S. dollars are placed with creditworthy institutions in the United States. Additionally, all of the Company's available for sale securities and derivative contracts are either exchange traded or maintained with creditworthy financial institutions. The Company monitors its credit risk associated with trade receivables by routinely assessing the creditworthiness of its customers. At December 31, 2003 and December 31, 2002, the Company's trade receivables were primarily maintained with large distributors.

As described in Note 11, the National Treasury Notes, NTN-H may be used in the settlement of the Petroleum and Alcohol Account.

**(b) Fair value**

Fair values are derived either from quoted market prices where available, or, in their absence, the present value of expected cash flows. The fair values reflect the cash that would have been received or paid if the instruments were settled at year end. Fair values of cash and cash equivalents, trade receivables, the Petroleum and Alcohol Account, short-term debt and trade payables approximate their carrying values. The fair value for the Company's available for sale government securities equals their carrying value as disclosed in Note 6.

The fair values of other long-term receivables and payables do not differ materially from their carrying values.

The Company's debt included US\$ 11,888 and US\$ 7,346 at December 31, 2003 and December 31, 2002 and had estimated fair values of US\$ 12,690 and US\$ 6,791, respectively. The Company's project finance obligation, resulting from FIN 46 consolidation was US\$ 5,066 at December 31, 2003, and had an estimated fair value of US\$ 5,115.

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**24. Financial instruments** Continued

**(b) Fair value** Continued

The call and put portion of the Company's zero cost foreign exchange collars at December 31, 2003 have a fair value of US\$ 31 and US\$ 5, respectively (US\$ 8 and US\$ 88 at December 31, 2002).

**25. Segment information**

The following segment information has been prepared in accordance with SFAS No. 131 - Disclosure about Segments of an Enterprise and Related information ( SFAS 131 ). The Company operates under the following segments, which are described as follows:

Exploration and Production - This segment includes the Company's exploration, development and production activities in Brazil, as well as sales of crude oil and natural gas in the domestic and foreign markets.

Supply - This segment includes the Company's refining, logistic, transportation and commercialization activities for oil, oil products and fuel alcohol. Additionally, this segment includes petrochemical and fertilizers division, which includes investments in domestic petrochemical companies and the Company's two domestic fertilizer plants.

Distribution - This segment represents the oil product and fuel alcohol distribution activities conducted by the Company's majority owned subsidiary, Petrobras Distribuidora S.A. - BR in Brazil.

Gas and Energy - This segment currently encompasses the commercialization and transportation of natural gas produced in or imported into Brazil. Additionally, this segment includes the Company's domestic electric energy commercialization activities as well as investments in domestic natural gas transportation companies, state owned natural gas distributors and thermoelectric companies.

International - This segment represents the Company's international activities conducted in 13 countries, which include Exploration and Production, Supply, Distribution and Gas and Energy.



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**25. Segment information** Continued

The items that cannot be attributed to the other areas are allocated to the group of corporate entities, especially those linked with corporate financial management, overhead related with central administration and other expenses, including actuarial expenses related with the pension and health-care plans.

The accounting information by business area was prepared based on the assumption of controllability, for the purpose of attribution to the business areas only items over which these areas have effective control.

The main criteria used to record the results and assets by business segments are summarized as follows:

Net operating revenues: these were considered to be the revenues from sales to third parties, plus revenues between the business segments, based on the internal transfer prices established by the areas;

The operating income includes net operating revenue, the costs of products and services sold, calculated per business segment, based on the internal transfer price and the other operating costs of each segment, as well as operating expenses, based on the expenses actually incurred in each segment;

Assets: covers the assets relating to each segment.

In periods prior to January 1, 2002, revenue and net income from the gas and energy activities of the international segment were added to revenue and net income from the exploration and production activities of the international segment, as our management did not separate our gas and energy operations abroad. In addition, the changes in our accounting systems adopted in connection with our new business segment reporting does not permit the practicable separation of revenue and cost information for those prior periods. We do not believe this classification of the gas and energy revenue and net income information materially changes the overall segment presentation.

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

(except when specifically indicated)

**25. Segment information** Continued

The following presents the Company's assets by segment:

	As of December 31, 2003							
	Exploration		International			Corporate	Eliminations	Total
	and Production	Supply	Gas and Energy	(see separate disclosure)	Distribution			
<b>Current assets</b>	2,057	4,871	528	1,738	1,208	9,466	(1,968)	17,900
Cash and cash equivalents	1,042	575	109	445	33	7,406		9,610
Other current assets	1,015	4,296	419	1,293	1,175	2,060	(1,968)	8,290
<b>Investments in non-consolidated companies and other investments</b>	6	463	151	449	22	82		1,173
<b>Property, plant and equipment, net</b>	16,742	4,980	4,174	4,181	442	336	(50)	30,805
<b>Non current assets</b>	970	285	751	306	208	4,479	(3,265)	3,734
Petroleum and Alcohol Account						239		239
Government securities						283		283
Other assets	970	285	751	306	208	3,957	(3,265)	3,212
<b>Total assets</b>	19,775	10,599	5,604	6,674	1,880	14,363	(5,283)	53,612



**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

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**25. Segment information** Continued

As of December 31, 2003

	<b>International</b>						
	<b>Exploration</b>						
	<b>and</b>		<b>Gas and</b>				
	<b>Production</b>	<b>Supply</b>	<b>Energy</b>	<b>Distribution</b>	<b>Corporate</b>	<b>Eliminations</b>	<b>Total</b>
<b>Current assets</b>	806	463	167	71	670	(439)	1,738
Cash and cash equivalents	178	42	4	5	216		445
Other current assets	628	421	163	66	454	(439)	1,293
<b>Investments in non-consolidated companies and other investments</b>	128	121	199		1		449
<b>Property, plant and equipment, net</b>	3,301	565	202	64	49		4,181
<b>Non current assets</b>	166	12		15	1,664	(1,551)	306
Other assets	166	12		15	1,664	(1,551)	306
<b>Total assets</b>	4,401	1,161	568	150	2,384	(1,990)	6,674

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

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**25. Segment information** Continued

As of December 31, 2002

	Exploration		International					Total
	and		Gas and	(see separate			Eliminations	
	Production	Supply	Energy	disclosure)	Distribution	Corporate		
<b>Current assets</b>	1,181	4,323	819	736	973	3,249	(959)	10,322
Cash and cash equivalents	1	509	16	211	59	2,505		3,301
Other current assets	1,180	3,814	803	525	914	744	(959)	7,021
<b>Investments in non-consolidated companies and other investments</b>	7	168	70	11	16	62		334
<b>Property, plant and equipment, net</b>	11,611	3,186	1,881	1,024	296	226		18,224
<b>Non current assets</b>	385	211	556	1,092	141	1,943	(1,054)	3,274
Petroleum and Alcohol Account						182		182
Government securities						176		176
Other assets	385	211	556	1,092	141	1,585	(1,054)	2,916
<b>Total assets</b>	13,184	7,888	3,326	2,863	1,426	5,480	(2,013)	32,154

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

(except when specifically indicated)

**25. Segment information** Continued

	As of December 31, 2002						
	International						
	Exploration						
	and		Gas and				
	Production	Supply	Energy	Distribution	Corporate	Eliminations	Total
<b>Current assets</b>	374	215	37	109	201	(200)	736
Cash and cash equivalents	90	16		35	70		211
Other current assets	284	199	37	74	131	(200)	525
<b>Investments in non-consolidated companies and other investments</b>	9			2			11
<b>Property, plant and equipment, net</b>	835	126	11	49	3		1,024
<b>Non current assets</b>	420	8	(9)		1,275	(602)	1,092
Other assets	420	8	(9)		1,275	(602)	1,092
<b>Total assets</b>	1,638	349	39	160	1,479	(802)	2,863

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

(except when specifically indicated)

**25. Segment information** Continued

Revenues and net income by segment are as follows:

	Year ended December 31, 2003							
	Exploration and Production	Supply	Gas and Energy	International (see separate Disclosure)	Distribution	Corporate	Eliminations	Total
<b>Net operating revenues to third parties</b>	2,369	17,024	1,229	2,298	7,877			30,797
<b>Inter-segment net operating revenues</b>	13,329	6,695	250	129	138		(20,541)	
<b>Net operating revenues</b>	15,698	23,719	1,479	2,427	8,015		(20,541)	30,797
Cost of sales	(6,154)	(19,944)	(1,045)	(1,398)	(7,257)		20,382	(15,416)
Depreciation, depletion and amortization	(955)	(397)	(87)	(288)	(29)	(29)		(1,785)
Exploration, including exploratory dry holes and impairment	(452)			(130)				(582)
Selling, general and administrative expenses	(123)	(732)	(149)	(208)	(416)	(554)	91	(2,091)
Research and development expenses	(92)	(50)	(6)			(53)		(201)
<b>Costs and expenses</b>	<b>(7,776)</b>	<b>(21,123)</b>	<b>(1,287)</b>	<b>(2,024)</b>	<b>(7,702)</b>	<b>(636)</b>	<b>20,473</b>	<b>(20,075)</b>
Equity in results of non-consolidated companies		25	56	62		(2)		141

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Financial income (expenses), net	(317)	146	(78)	(129)	(62)	506	(202)	(136)
Employee benefit expense						(595)		(595)
Other taxes	(9)	(24)	(19)	(25)	(48)	(208)		(333)
Other expenses, net	(224)	(100)	(387)	(55)	(1)	(259)		(1,026)
<b>Income (loss) before income taxes and minority interest and accounting change</b>	<b>7,372</b>	<b>2,643</b>	<b>(236)</b>	<b>256</b>	<b>202</b>	<b>(1,194)</b>	<b>(270)</b>	<b>8,773</b>
Income tax benefits (expense)	(2,506)	(874)	196	(154)	(63)	698	40	(2,663)
Minority interest	(59)	(31)	(156)	(1)	(1)			(248)
<b>Income before effect of change in accounting principle</b>	<b>4,807</b>	<b>1,738</b>	<b>(196)</b>	<b>101</b>	<b>138</b>	<b>(496)</b>	<b>(230)</b>	<b>5,862</b>
Cumulative effect of change in accounting principle, net of taxes	697							697
<b>Net income (loss)</b>	<b>5,504</b>	<b>1,738</b>	<b>(196)</b>	<b>101</b>	<b>138</b>	<b>(496)</b>	<b>(230)</b>	<b>6,559</b>

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

(except when specifically indicated)

**25. Segment information** Continued

Year ended December 31, 2003

	International						Total
	Exploration and Production	Supply	Gas and Energy	Distribution	Corporate	Eliminations	
<b>Net operating revenues to third parties</b>	535	998	159	592	14		2,298
<b>Inter-segment net operating revenues</b>	534	633	3	29		(1,070)	129
<b>Net operating revenues</b>	1,069	1,631	162	621	14	(1,070)	2,427
Cost of sales	(300)	(1,478)	(103)	(585)	(14)	1,082	(1,398)
Depreciation, depletion and amortization	(223)	(46)	(11)	(4)	(4)		(288)
Exploration, including exploratory dry holes and impairment	(130)						(130)
Selling, general and administrative expenses	(59)	(34)	(2)	(32)	(81)		(208)
<b>Costs and expenses</b>	(712)	(1,558)	(116)	(621)	(99)	1,082	(2,024)
Equity in results of non-consolidated companies	2	6	(2)		56		62
Financial income (expenses), net	(100)	(11)			(18)		(129)
Other taxes	(3)	(5)		(5)	(12)		(25)
Other expenses, net	(73)	(9)	7		20		(55)
<b>Income (loss) before income taxes and minority interest</b>	183	54	51	(5)	(39)	12	256
Income tax benefits (expense)	(132)	(2)			(20)		(154)
Minority interest	3	(2)	(1)	(1)			(1)

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<b>Net income (loss)</b>	54	50	50	(6)	(59)	12	101
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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

(except when specifically indicated)

**25. Segment information** Continued

Year ended December 31, 2002

	Year ended December 31, 2002							
	Exploration and Production	Supply	Gas and Energy	International (see separate disclosure)	Distribution	Corporate	Eliminations	Total
<b>Net operating revenues to third parties</b>	2,346	12,073	747	986	6,460			22,612
<b>Inter-segment net operating revenues</b>	10,700	5,269	170	99	102		(16,340)	
<b>Net operating revenues</b>	13,046	17,342	917	1,085	6,562		(16,340)	22,612
Cost of sales	(4,829)	(15,242)	(594)	(812)	(5,861)		15,832	(11,506)
Depreciation, depletion and amortization	(1,378)	(358)	(45)	(106)	(24)	(19)		(1,930)
Exploration, including exploratory dry holes and impairment	(449)			(61)				(510)
Selling, general and administrative expenses	(177)	(584)	(54)	(90)	(442)	(394)		(1,741)
Research and development expenses	(74)	(37)	(5)			(31)		(147)
<b>Costs and expenses</b>	(6,907)	(16,221)	(698)	(1,069)	(6,327)	(444)	15,832	(15,834)
Equity in results of non-consolidated companies		11	(94)	(95)				(178)
Financial income (expenses), net	(943)	(13)	(18)	31	5	(762)		(1,700)
Employee benefit expense		(2)			(14)	(435)		(451)
Other taxes		(18)	(9)	(12)	(36)	(285)		(360)
Other expenses, net	(160)	5	(495)	14	(10)	(231)	20	(857)



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<b>Income (loss) before income taxes and minority interest</b>	5,036	1,104	(397)	(46)	180	(2,157)	(488)	3,232
Income tax benefits (expense)	(1,623)	(386)	(104)	(64)	(58)	914	168	(1,153)
Minority interest		(7)	311	(4)	(31)	(37)		232
<b>Net income (loss)</b>	<b>3,413</b>	<b>711</b>	<b>(190)</b>	<b>(114)</b>	<b>91</b>	<b>(1,280)</b>	<b>(320)</b>	<b>2,311</b>

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

(except when specifically indicated)

**25. Segment information** Continued

Year ended December 31, 2002

	International						Total
	Exploration and Production	Supply	Gas and Energy	Distribution	Corporate	Eliminations	
<b>Net operating revenues to third parties</b>	96	473	36	377	4		986
<b>Inter-segment net operating revenues</b>	188	445				(534)	99
<b>Net operating revenues</b>	284	918	36	377	4	(534)	1,085
Cost of sales	(75)	(848)	(30)	(391)	(2)	534	(812)
Depreciation, depletion and amortization	(87)	(13)		(5)	(1)		(106)
Exploration, including exploratory dry holes and impairment	(61)						(61)
Selling, general and administrative expenses	(29)	(9)		(19)	(33)		(90)
<b>Costs and expenses</b>	(252)	(870)	(30)	(415)	(36)	534	(1,069)
Equity in results of non-consolidated companies					(95)		(95)
Financial income (expenses), net	6	(7)	(6)		38		31
Other taxes	(1)	(3)		(4)	(4)		(12)
Other expenses, net	9	(2)		1	6		14
<b>Income (loss) before income taxes and minority interest</b>	46	36		(41)	(87)		(46)
Income tax benefits (expense)	(50)				(14)		(64)
Minority interest	(1)	(4)			1		(4)
<b>Net income (loss)</b>	(5)	32		(41)	(100)		(114)



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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

(except when specifically indicated)

**25. Segment information** Continued

	Year ended December 31, 2001							
	Exploration and Production	Supply	Gas and Energy	International (see separate disclosure)	Distribution	Corporate	Eliminations	Total
<b>Net operating revenues to third parties</b>	308	15,969	659	777	6,836			24,549
<b>Inter-segment net operating revenues</b>	9,796	5,757	177	71	100		(15,901)	
<b>Net operating revenues</b>	10,104	21,726	836	848	6,936		(15,901)	24,549
Cost of sales	(3,766)	(17,279)	(600)	(541)	(6,310)		15,689	(12,807)
Depreciation, depletion and amortization	(1,228)	(301)	(62)	(101)	(28)	(9)		(1,729)
Exploration, including exploratory dry holes and impairment	(463)			(86)				(549)
Selling, general and administrative expenses	(128)	(745)	(46)	(57)	(414)	(361)		(1,751)
Research and development expenses	(63)	(40)	(3)			(26)		(132)
<b>Costs and expenses</b>	(5,648)	(18,365)	(711)	(785)	(6,752)	(396)	15,689	(16,968)
Equity in results of non-consolidated companies		28	8	(44)				(8)
Financial income (expenses), net	(372)	(112)	(242)	12	(1)	364	3	(348)
Employee benefit expense						(594)		(594)
Other taxes		(14)	(3)	(2)	(36)	(240)		(295)
Other expenses, net	(458)	333	(26)	90	60	(1,543)		(1,544)

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<b>Income (loss) before income taxes and minority interest</b>	3,626	3,596	(138)	119	207	(2,409)	(209)	4,792
Income tax benefits (expense)	(1,187)	(1,058)	(38)	(91)	(101)	1,001	85	(1,389)
Minority interest			122	(4)	(28)	(2)		88
<b>Net income (loss)</b>	<b>2,439</b>	<b>2,538</b>	<b>(54)</b>	<b>24</b>	<b>78</b>	<b>(1,410)</b>	<b>(124)</b>	<b>3,491</b>

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

(except when specifically indicated)

**25. Segment information** Continued

Year ended December 31, 2001

	International						Total
	Exploration and Production	Supply	Gas and Energy	Distribution	Corporate	Eliminations	
<b>Net operating revenues to third parties</b>	217	469		90	1		777
<b>Inter-segment net operating revenues</b>	178	160				(267)	71
<b>Net operating revenues</b>	395	629		90	1	(267)	848
Cost of sales	(129)	(597)		(76)	(1)	262	(541)
Depreciation, depletion and amortization	(94)	(6)		(1)			(101)
Exploration, including exploratory dry holes and impairment	(86)						(86)
Selling, general and administrative expenses	(36)	(9)		(7)	(5)		(57)
<b>Costs and expenses</b>	(345)	(612)		(84)	(6)	262	(785)
Equity in results of non-consolidated companies					(44)		(44)
Financial income (expenses), net	13	(1)					12
Other taxes		(1)		(1)			(2)
Other expenses, net	100				(10)		90
<b>Income (loss) before income taxes and minority interest</b>	163	15		5	(59)	(5)	119
Income tax benefits (expense)	(58)	(8)		(29)	4		(91)
Minority interest		(4)					(4)
<b>Net income (loss)</b>	105	3		(24)	(55)	(5)	24

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

(except when specifically indicated)

**25. Segment information** Continued

Capital expenditures incurred by segment for the years ended December 31, 2003, 2002 and 2001 are as follows:

	Year ended December 31,		
	2003	2002	2001
Exploration and Production	3,658	3,156	2,866
Supply	1,451	945	642
Gas and Energy	694	268	192
International			
Exploration and Production	428	224	318
Supply	18	8	3
Distribution	33	2	2
Gas and Energy	1	4	3
Distribution	106	139	86
Corporate	162	165	142
	<u>6,551</u>	<u>4,911</u>	<u>4,254</u>

The Company's gross sales, classified by geographic destination, are as follows:

	Year ended December 31,		
	2003	2002	2001
Brazil	34,025	27,410	30,122
International	8,665	5,577	4,023
	<u>42,690</u>	<u>32,987</u>	<u>34,145</u>



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The total amounts sold of products and services to the two major customers in 2003, 2002 and 2001 were US\$ 3,498, US\$ 2,693, US\$ 2,907 and US\$ 2,688, US\$ 2,549, US\$ 2,871, respectively.

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

(except when specifically indicated)

**26. Related party transactions**

The Company is controlled by the Federal Government and has numerous transactions with other state-owned companies in the ordinary course of business.

Transactions with major related parties resulted in the following balances:

	As of December 31,			
	2003		2002	
	Assets	Liabilities	Assets	Liabilities
PETROS (Pension fund)	283	38	176	21
Banco do Brasil S.A.	6,164	230	1,859	141
BNDES (Note 12 (b))		1,299		599
Federal Government	94		79	
ANP				
Restricted deposits for legal proceedings	297		290	
Government securities (Note 6)	38		28	
Petroleum and Alcohol Account - Receivable from Federal Government (Note 11)	239		182	
Others	941	57	721	26
	<u>8,056</u>	<u>1,624</u>	<u>3,335</u>	<u>787</u>
Current	<u>6,872</u>	<u>128</u>	<u>2,380</u>	<u>62</u>
Long-term	<u>1,184</u>	<u>1,496</u>	<u>955</u>	<u>725</u>

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

(except when specifically indicated)

**26. Related party transactions** Continued

These balances are included in the following balance sheet classifications:

	As of December 31,			
	2003		2002	
	Assets	Liabilities	Assets	Liabilities
<b>Assets</b>				
Current				
Cash and cash equivalents	6,128		1,859	
Accounts receivable (Note 7)	284		329	
Other current assets	460		192	
Other				
Accounts receivable (Note 7)	199		181	
Government securities	38		28	
Petroleum and Alcohol Account - receivable from Federal Government (Note 11)	239		182	
Restricted deposits for legal proceedings	297		290	
Pension Fund	283		176	
Other assets	128		98	
<b>Liabilities</b>				
Current				
Current portion of long-term debt		59		45
Current liabilities		69		17
Short-term debt				
<b>Long-term</b>				
Long-term debt		1,212		546
Other liabilities		284		179
	8,056	1,624	3,335	787

**PETRÓLEO BRASILEIRO S.A. - PETROBRAS****AND SUBSIDIARIES**

## NOTES TO THE CONSOLIDATED FINANCIAL INFORMATION

Expressed in Millions of United States Dollars

(except when specifically indicated)

**26. Related party transactions** Continued

The principal amounts of business and financial operations carried out with related parties are as follows:

	Year ended December 31,					
	2003		2002		2001	
	Income	Expense	Income	Expense	Income	Expense
<b>Sales of products and services</b>						
BRASKEM S.A.	754		631		929	
Centrais Elet. do Norte do Brasil S.A. - Eletronorte	205		159		120	
COPEL S.A.	545		265		433	
Manaus Energia S.A.	425		272		214	
Petroquímica União S.A.	543		350		428	
Others	729	(164)	638	(308)	834	
<b>Financial income</b>						
<b>Petroleum and Alcohol Account -</b>						
Receivable from Federal Government (Note 11)	10		2		16	
Government securities (Note 6)	71		84		243	
Others	155		760		863	
Financial expenses		(178)		(234)		(118)
Other expenses, net				(29)		(405)
	<u>3,437</u>	<u>(342)</u>	<u>3,161</u>	<u>(571)</u>	<u>4,080</u>	<u>(523)</u>

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**PETRÓLEO BRASILEIRO S.A. - PETROBRAS**

**AND SUBSIDIARIES**

SUPPLEMENTARY INFORMATION ON OIL AND GAS EXPLORATION AND

PRODUCTION ACTIVITIES (UNAUDITED)

Expressed in Millions of United States Dollars

(except when specifically indicated)

In accordance with SFAS 69 - Disclosures About Oil and Gas Producing Activities ( SFAS 69 ), this section provides supplemental information on oil and gas exploration and producing activities of the Company. The information included in items (i) through (iii) provides historical cost information pertaining to costs incurred in exploration, property acquisitions and development, capitalized costs and results of operations. The information included in items (iv) and (v) present information on PETROBRAS' estimated net proved reserve quantities, standardized measure of estimated discounted future net cash flows related to proved reserves, and changes in estimated discounted future net cash flows.

Beginning in 1995, the Federal Government of Brazil undertook a comprehensive reform of the country's oil and gas regulatory system. On November 9, 1995, the Brazilian Constitution was amended to authorize the Federal Government to contract with any state or privately-owned company to carry out the activities related to the upstream and downstream segments of the Brazilian oil and gas sector. This amendment eliminated PETROBRAS' effective monopoly. The amendment was implemented by the Petroleum Law, which liberated the fuel market in Brazil beginning January 1, 2002.

The Petroleum Law established a new regulatory framework ending PETROBRAS' exclusive agency and enabling competition in all aspects of the oil and gas industry in Brazil. As provided in the Petroleum Law, PETROBRAS was granted the exclusive right for a period of 27 years to exploit the petroleum reserves in all fields where the Company had previously commenced production. However, the Petroleum Law established a procedural framework for PETROBRAS to claim exclusive exploratory (and, in case of success, development) rights for a period of up to three years with respect to areas where the Company could demonstrate that it had established prospects. To perfect its claim to explore and develop these areas, the Company had to demonstrate that it had the requisite financial capacity to carry out these activities, alone or through financing or partnering arrangements.

The International geographic includes activities in Angola, Argentina, Bolivia, Colombia, Ecuador, Mexico, Nigeria, Peru, The United States of America and Venezuela. The Company has immaterial non-consolidated companies involved in exploration and production activities; the amounts related to such are in the line item titled Company's share of unconsolidated affiliates .

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**(i) Capitalized costs relating to oil and gas producing activities**

The following table summarizes capitalized costs for oil and gas exploration and production activities with the related accumulated depreciation, depletion and amortization, and asset retirement obligation assets:

	<b>As of December 31, 2003</b>		
	<b>Brazil</b>	<b>International</b>	<b>Worldwide</b>
Unproved oil and gas properties	1,253	650	1,903
Proved oil and gas properties	11,924	3,835	15,759
Support equipment	10,336	516	10,852
<b>Gross capitalized costs</b>	<b>23,513</b>	<b>5,001</b>	<b>28,514</b>
Depreciation and depletion	(11,458)	(1,830)	(13,288)
	12,055	3,171	15,226
Construction and installations in progress	4,687	130	4,817
	16,742	3,301	20,043
Company's share by unconsolidated affiliates		78	78
<b>Net capitalized costs</b>	<b>16,742</b>	<b>3,379</b>	<b>20,121</b>

  

	<b>As of December 31, 2002</b>		
	<b>Brazil</b>	<b>International</b>	<b>Worldwide</b>
Unproved oil and gas properties	538	337	875
Proved oil and gas properties	10,049	1,192	11,241
Support equipment	8,062	15	8,077
<b>Gross capitalized costs</b>	<b>18,649</b>	<b>1,544</b>	<b>20,193</b>

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Depreciation and depletion	(10,514)	(709)	(11,223)
	<u>8,135</u>	<u>835</u>	<u>8,970</u>
Construction and installations in progress	3,476		3,476
	<u>3,476</u>	<u></u>	<u>3,476</u>
Net capitalized costs	11,611	835	12,446
	<u>11,611</u>	<u>835</u>	<u>12,446</u>

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**(ii) Costs incurred in oil and gas property acquisition, exploration and development activities**

Costs incurred are summarized below and include both amounts expensed and capitalized:

	As of December 31, 2003		
	Brazil	International (1)	Worldwide
Property acquisitions			
Proved		2,255	2,255
Unproved	7	6	13
Exploration costs	827	96	923
Development costs	3,025	285	3,310
	<u>3,859</u>	<u>2,642</u>	<u>6,501</u>

	As of December 31, 2002		
	Brazil	International	Worldwide
Property acquisitions			
Proved		15	15
Unproved	12	4	16
Exploration costs	725	104	829
Development costs	2,691	82	2,773
	<u>3,428</u>	<u>205</u>	<u>3,633</u>

	As of December 31, 2001		
	Brazil	International	Worldwide



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Property acquisitions			
Unproved	62	121	183
Exploration costs	528	110	638
Development costs	2,411	119	2,530
	<u>3,001</u>	<u>350</u>	<u>3,351</u>

(1) Includes PEPSA as of December 31, 2003. See also Note 19 for more information.

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**(iii) Results of operations for oil and gas producing activities**

The Company's results of operations from oil and gas producing activities for the years ending December 31, 2003, 2002 and 2001 are shown in the following table. The Company transfers substantially all of its Brazilian crude oil and gas production to the supply segment in Brazil. The prices calculated by the Company's model may not be indicative of the price the Company would have realized had this production been sold in an unregulated spot market. Additionally, the prices calculated by the Company's model may not be indicative of the future prices to be realized by the Company after January 1, 2002, when full price deregulation began. Gas prices used are contracted prices to third parties.

Production costs are lifting costs incurred to operate and maintain productive wells and related equipment and facilities, including such costs as operating labor, materials, supplies, fuel consumed in operations and the costs of operating natural liquid gas plants. Production costs also include administrative expenses and depreciation and amortization of equipment associated with production activities.

Exploration expenses include the costs of geological and geophysical activities and non-productive exploratory wells. Depreciation and amortization expenses relate to assets employed in exploration and development activities. In accordance with SFAS 69, income taxes are based on statutory tax rates, reflecting allowable deductions. Interest income and expense are excluded from the results reported in this table.

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**(iii) Results of operations for oil and gas producing activities** Continued

	As of December 31, 2003		
	Brazil	International (1)	Worldwide
Net operating revenues:			
Sales to third parties	2,369	535	2,904
Intersegment	13,329	534	13,863
	15,698	1,069	16,767
Production costs	(6,154)	(355)	(6,509)
Exploration expenses	(387)	(87)	(474)
Depreciation, depletion, amortization	(955)	(217)	(1,172)
Impairment of oil and gas properties	(65)	(5)	(70)
Results before income taxes	8,137	405	8,542
Income tax expense	(2,767)	(103)	(2,870)
	5,370	302	5,672
Company's share of unconsolidated affiliates		3	3
Results of operations	5,370	305	5,675

(1) Includes PEPSA from June 1, 2003.

	As of December 31, 2002		
	Brazil	International	Worldwide
Net operating revenues:			
Sales to third parties	2,346	96	2,442
Intersegment	10,700	188	10,888
	13,046	284	13,330

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Production costs	(4,829)	(75)	(4,904)
Exploration expenses	(392)	(43)	(435)
Depreciation, depletion, amortization	(1,378)	(87)	(1,465)
Impairment of oil and gas properties	(57)	(18)	(75)
	<u>        </u>	<u>        </u>	<u>        </u>
Results before income taxes	6,390	61	6,451
Income tax expense	(2,173)	(58)	(2,231)
	<u>        </u>	<u>        </u>	<u>        </u>
Results of operations	4,217	3	4,220
	<u>        </u>	<u>        </u>	<u>        </u>

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**(iii) Results of operations for oil and gas producing activities** Continued

	As of December 31, 2001		
	Brazil	International	Worldwide
Net operating revenues:			
Sales to third parties	308	217	525
Intersegment	9,796	178	9,974
	10,104	395	10,499
Production costs	(3,766)	(112)	(3,878)
Exploration expenses	(334)	(70)	(404)
Depreciation, depletion, amortization	(1,228)	(94)	(1,322)
Impairment of oil and gas properties	(129)	(16)	(145)
Results before income taxes	4,647	103	4,750
Income tax expense	(1,580)	(43)	(1,623)
Results of operations	3,067	60	3,127

**(iv) Reserve quantities information**

The Company's estimated net proved oil and gas reserves and changes thereto for the years 2003, 2002 and 2001 are shown in the following table. Proved reserves are estimated by the Company's reservoir engineers in accordance with the reserve definitions prescribed by the Securities and Exchange Commission.

Proved oil and gas reserves are the estimated quantities of crude oil, natural gas and natural gas liquids which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved reserves do not include additional quantities recoverable beyond the term of the concession or contract, or that may result from extensions of currently proved areas, or from application of secondary or tertiary recovery processes not yet tested and determined to be economic.

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Proved developed reserves are the quantities expected to be recovered from existing wells with existing equipment and operating methods. Proved undeveloped reserves are those volumes which are expected to be recovered as a result of future investments in drilling, re-equipping existing wells and installing facilities necessary to deliver the production from these reserves.

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**(iv) Reserve quantities information** Continued

In some cases, substantial new investments in additional wells and related facilities will be required to recover these proved reserves. Due to the inherent uncertainties and the limited nature of reservoir data, estimates of reserves are subject to change as additional information becomes available.

A summary of the annual changes in the proved reserves of crude oil and natural gas follows:

	Oil (millions of barrels)			Gas (billions of cubic feet)		
	Brazil	International	Worldwide	Brazil	International	Worldwide
<b>Worldwide Net Proved Developed and Undeveloped Reserves</b>						
Reserves January 1, 2001	8,227.4	128.9	8,356.3	6,266.8	2,173.2	8,440.0
Revisions of previous estimates	(949.6)	(0.3)	(949.9)	401.1	13.0	414.1
Extensions, discoveries and improved recovery	877.6	2.2	879.8	835.3	65.5	900.8
Sales of reserves in place	(31.6)	(20.2)	(51.8)	(194.0)	(38.8)	(232.8)
Production for the year	(471.0)	(14.6)	(485.6)	(423.9)	(50.7)	(474.6)
Reserves at December 31, 2001	7,652.8	96.0	7,748.8	6,885.3	2,162.2	9,047.5
Revisions of previous estimates	822.0	3.1	825.1	787.0	(49.8)	737.2
Extensions, discoveries and improved recovery	888.2	10.8	899.0	102.2	9.2	111.4
Sales of reserves in place		23.6	23.6		71.5	71.5
Production for the year	(529.8)	(11.8)	(541.6)	(446.7)	(48.1)	(494.8)
Reserves at December 31, 2002	8,833.2	121.7	8,954.9	7,327.8	2,145.0	9,472.8
Revisions of previous estimates	(682.1)	(10.8)	(692.9)	459.3	(294.8)	164.5

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Extensions, discoveries and improved recovery	1,439.8	55.5	1,495.3	778.3	80.1	858.4
Purchase of reserves in place - PEPSA		602.8	602.8		1,346.9	1,346.9
Sales of reserves in place		(7.7)	(7.7)		(49.5)	(49.5)
Production for the year	(539.5)	(40.8)	(580.3)	(454.0)	(136.8)	(590.8)
<b>Reserves at December 31, 2003</b>	<b>9,051.4</b>	<b>720.7*</b>	<b>9,772.1</b>	<b>8,111.4</b>	<b>3,090.9*</b>	<b>11,202.3</b>
<b>Net proved Developed Reserves</b>						
At January 1, 2001	3,780.8	80.1	3,860.9	3,614.3	1,368.4	4,982.7
At December 31, 2001	3,899.4	66.6	3,966.0	3,946.0	1,336.8	5,282.8
At December 31, 2002	3,912.9	94.7	4,007.6	3,892.5	2,043.9	5,936.4
<b>At December 31, 2003</b>	<b>3,629.5</b>	<b>404.1</b>	<b>4,033.6</b>	<b>4,398.1</b>	<b>2,548.4</b>	<b>6,946.5</b>

(\*) Includes reserves of 253.2 million barrels of oil and 565.7 billions of cubic feet of gas attributable to a consolidated subsidiary in which there is a 41.38 % minority interest.



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**(v) Standardized measure of discounted future net cash flows relating to proved oil and gas quantities and changes therein**

The standardized measure of discounted future net cash flows, related to the above proved oil and gas reserves, is calculated in accordance with the requirements of SFAS 69. Estimated future cash inflows from production in Brazil are computed by applying year-end prices based upon the Company's internal pricing methodology for oil and gas to year-end quantities of estimated net proved reserves. Estimated future cash inflows from production related to the Company's International segment are computed by applying year-end prices for oil and gas to year-end quantities of estimated net proved reserves. Future price changes are limited to those provided by contractual arrangements in existence at the end of each reporting year. Future development and production costs are those estimated future expenditures necessary to develop and produce year-end estimated proved reserves based on year-end cost indicators, assuming continuation of year-end economic conditions. Estimated future income taxes are calculated by applying appropriate year-end statutory tax rates. These rates reflect allowable deductions and are applied to estimated future pre-tax net cash flows, less the tax basis of related assets. Discounted future net cash flows are calculated using 10% midperiod discount factors. This discounting requires a year-by-year estimate of when the future expenditures will be incurred and when the reserves will be produced.

The information provided does not represent management's estimate of PETROBRAS' expected future cash flows or value of proved oil and gas reserves. Estimates of proved reserve quantities are imprecise and change over time as new information becomes available. Moreover, probable and possible reserves, which may become proved in the future, are excluded from the calculations.

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**(v) Standardized measure of discounted future net cash flows relating to proved oil and gas quantities and changes therein** Continued

The arbitrary valuation prescribed under SFAS 69 requires assumptions as to the timing and amount of future development and production costs. The calculations are made as of December 31 each year and should not be relied upon as an indication of PETROBRAS' future cash flows or the value of its oil and gas reserves.

	<u>Brazil</u>	<u>International</u>	<u>Worldwide</u>
<b>At December 31, 2003</b>			
Future cash inflows	216,112	20,881	236,993
Future production costs	(86,666)	(5,212)	(91,878)
Future development costs	(18,727)	(1,799)	(20,526)
Future income tax expenses	(38,982)	(4,651)	(43,633)
	<u>71,737</u>	<u>9,219</u>	<u>80,956</u>
10 percent midyear annual discount for timing of estimated cash flows	(36,215)	(4,013)	(40,228)
Company's share by unconsolidated affiliates		91	91
	<u>35,522</u>	<u>5,297*</u>	<u>40,819</u>
<b>At December 31, 2002</b>			
Future cash inflows	210,063	6,759	216,822
Future production costs	(84,191)	(1,625)	(85,816)
Future development costs	(13,798)	(358)	(14,156)
Future income tax expenses	(37,934)	(1,906)	(39,840)
	<u>74,140</u>	<u>2,870</u>	<u>77,010</u>
10 percent midyear annual discount for timing of estimated cash flows	(36,932)	(1,364)	(38,296)
	<u>37,208</u>	<u>1,506</u>	<u>38,714</u>
<b>At December 31, 2001</b>			
Future cash inflows	129,989	5,217	135,206
Future production costs	(56,087)	(1,356)	(57,443)
Future development costs	(9,650)	(277)	(9,927)
Future income tax expenses	(21,810)	(1,526)	(23,336)

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Undiscounted future net cash flows	42,442	2,058	44,500
10 percent midyear annual discount for timing of estimated cash flows	(21,531)	(1,023)	(22,554)
	<u>          </u>	<u>          </u>	<u>          </u>
Standardized measure of discounted future net cash flows	20,911	1,035	21,946
	<u>          </u>	<u>          </u>	<u>          </u>

(\*) Includes US\$ 1,459 attributable to a consolidated subsidiary in which there is a 41.38% minority interest.

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**(v) Standardized measure of discounted future net cash flows relating to proved oil and gas quantities and changes therein** Continued

The following are the principal sources of change in the standardized measure of discounted net cash flows:

	Brazil			International			Worldwide		
	2003	2002	2001	2003	2002	2001	2003	2002	2001
<b>Balance at January 1</b>	37,208	20,911	31,621	1,506	1,035	1,375	38,714	21,946	32,996
Sales and transfers of oil and gas, net of production costs	(9,151)	(7,921)	(6,338)	(774)	(223)	(283)	(9,925)	(8,144)	(6,621)
Development costs incurred	3,025	2,691	2,411	273	82	119	3,298	2,773	2,530
Purchases of reserves				3,473	168		3,473	168	
Sales of reserves			(550)	(49)		(163)	(49)		(713)
Extensions, discoveries and improved recovery, less related costs	6,294	3,908	2,629	535	121	95	6,829	4,029	2,724
Revisions of previous quantity estimates	(4,766)	6,189	(3,944)	(349)	(45)	163	(5,115)	6,144	(3,781)
Net changes in prices and production costs	(1,398)	18,500	(15,446)	630	613	(507)	(768)	19,113	(15,953)
Changes in future development costs	1,549	(673)	(339)	(347)	13	(147)	1,202	(660)	(486)
Accretion of discount	3,721	3,149	5,670	597	(26)	(14)	4,318	3,123	5,656
Net change in income taxes	(960)	(9,546)	5,197	(198)	(232)	397	(1,158)	(9,778)	5,594
<b>Balance at December 31</b>	<b>35,522</b>	<b>37,208</b>	<b>20,911</b>	<b>5,297</b>	<b>1,506</b>	<b>1,035</b>	<b>40,819</b>	<b>38,714</b>	<b>21,946</b>

\* \* \*