

BRAZILIAN PETROLEUM CORP
Form 6-K
July 23, 2003

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16 of the
Securities Exchange Act of 1934

For the month of July, 2003

Commission File Number 1-15106

PETRÓLEO BRASILEIRO S.A. - PETROBRAS

(Exact name of registrant as specified in its charter)

Brazilian Petroleum Corporation - PETROBRAS

(Translation of Registrant's name into English)

Avenida República do Chile, 65
20035-900 - Rio de Janeiro, RJ
Federative Republic of Brazil
(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover Form 20-F or Form 40-F.

Form 20-F Form 40-F

Indicate by check mark whether the registrant by furnishing the information contained in this Form is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes No

**Petróleo Brasileiro S.A. -
PETROBRAS and Subsidiaries
Consolidated Financial Information
As of March 31, 2003 and 2002 and
Report of Independent Accountants**

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PANASSOL/SAMUEL GLEASON

Report of Independent Accountants

To the Board of Directors and Stockholders of
Petróleo Brasileiro S.A. - PETROBRAS

We have reviewed the accompanying unaudited consolidated balance sheet of Petróleo Brasileiro S.A. - PETROBRAS and its subsidiaries at March 31, 2003 and the unaudited consolidated statements of income, of cash flows and of changes in stockholders' equity for the three-month periods ended March 31, 2003 and 2002. This financial information is the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial information taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying financial information as of March 31, 2003 and for the three-month periods ended March 31, 2003 and 2002, for it to be in conformity with accounting principles generally accepted in the United States of America.

We previously audited in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of Petróleo Brasileiro S.A. - PETROBRAS and its subsidiaries as of December 31, 2002, and the related consolidated statements of income, of cash flows and of changes in stockholders' equity for the year then ended (not presented herein), and in our report dated February 13, 2003, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet information as of December 31, 2002 is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

As described in Note 7, PETROBRAS has been subject to significant Brazilian Federal Government regulations. As from January 1, 2003 the Company adopted SFAS No. 143 - Accounting for Asset Retirement Obligations, see Note 3.

PricewaterhouseCoopers
Auditores Independentes
Rio de Janeiro, Brazil

May 14, 2003

**Petróleo Brasileiro S.A. - PETROBRAS
and Subsidiaries**

**Consolidated Balance Sheets
Expressed in Millions of United States Dollars**

| | March 31, 2003 | December 31, 2002 |
|--|---------------------------|------------------------------|
| Assets | (unaudited) | |
| Current assets | | |
| Cash and cash equivalents | 4,501 | 3,301 |
| Accounts receivable, net | 2,555 | 2,267 |
| Inventories | 3,059 | 2,540 |
| Deferred income tax | 141 | 135 |
| Recoverable taxes | 802 | 672 |
| Advances to suppliers | 960 | 794 |
| Other current assets | 571 | 488 |
| | 12,589 | 10,197 |
| Property, plant and equipment, net | 20,939 | 18,224 |
| Investments in non-consolidated companies and other investments | 364 | 334 |
| Other assets | | |
| Accounts receivable, net | 221 | 188 |
| Advances to suppliers | 442 | 450 |
| Petroleum and Alcohol Account - Receivable from Federal Government | 199 | 182 |
| Government securities | 200 | 176 |
| Marketable securities | 200 | 208 |
| Unrecognized pension obligation | 49 | 61 |
| Restricted deposits for legal proceedings and guarantees | 329 | 290 |
| Receivables from non-consolidated companies | 206 | 181 |
| Recoverable taxes | 72 | 128 |
| Investment in Perez Companc S.A | 1,073 | 1,073 |
| Other assets | 415 | 326 |
| | 3,406 | 3,263 |
| Total assets | 37,298 | 32,018 |

**Petróleo Brasileiro S.A. - PETROBRAS
and Subsidiaries**

**Consolidated Balance Sheets
Expressed in Millions of United States Dollars (except number of shares)**

(continued)

| Liabilities and stockholders equity | March 31, 2003 | December 31, 2002 |
|---|---------------------------|------------------------------|
| | (unaudited) | |
| Current liabilities | | |
| Trade accounts payable | 1,675 | 1,702 |
| Income tax | 849 | 119 |
| Taxes payable, other than income taxes | 1,835 | 1,682 |
| Short-term debt | 810 | 671 |
| Current portion of long-term debt | 722 | 727 |
| Current portion of project financings | 418 | 239 |
| Capital lease obligations | 350 | 349 |
| Employee postretirement benefits | 93 | 89 |
| Payroll and related charges | 287 | 283 |
| Dividends payable | 512 | 307 |
| Accrued interest | 133 | 120 |
| Other payables and accruals | 809 | 657 |
| | 8,493 | 6,945 |
| Long-term liabilities | | |
| Employees postretirement benefits | 2,645 | 2,423 |
| Project financings | 3,918 | 3,800 |
| Long-term debt | 7,330 | 6,987 |
| Capital lease obligations | 1,761 | 1,907 |
| Deferred income taxes | 583 | 123 |
| Contingencies | 485 | 368 |
| Other liabilities | 464 | 300 |
| | 17,186 | 15,908 |
| Minority interest | (93) | (136) |
| Commitments and contingencies (Note 15) | | |
| Stockholders equity | | |
| Shares authorized and issued (Note 12) | | |
| Preferred stock - 2003 - 461,802,497 shares (2002 - 451,935,669 shares) | 2,965 | 2,459 |
| Common stock - 2003 and 2002 - 634,168,418 shares | 4,289 | 3,761 |
| Capital reserve | 94 | 89 |
| Accumulated other comprehensive income | | |
| Cumulative translation adjustments | (16,747) | (17,306) |
| Amounts not recognized as net periodic pension cost | (1,434) | (1,361) |
| Unrealized gains (losses) on available-for-sale securities | (7) | (11) |
| Retained earnings | | |
| Appropriated | 4,960 | 5,585 |
| Unappropriated | 17,592 | 16,085 |
| | 11,712 | 9,301 |

| | | |
|--|--------|--------|
| Total liabilities and stockholders equity | 37,298 | 32,018 |
|--|--------|--------|

The accompanying notes are an integral part of this interim consolidated financial information.

Petróleo Brasileiro S.A. - PETROBRAS and Subsidiaries

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

| | Three-month period ended March 31, | |
|---|---|-------------|
| | 2003 | 2002 |
| Sales of products and services | 9,578 | 7,476 |
| Less: | | |
| Value-added and other taxes on sales and services | (1,387) | (1,230) |
| CIDE (Note 7) | (1,148) | (1,517) |
| Net operating revenues | 7,043 | 4,729 |
| Cost of sales | (3,092) | (2,476) |
| Depreciation, depletion and amortization | (413) | (402) |
| Exploration, including exploratory dry holes | (67) | (99) |
| Selling, general and administrative expenses | (460) | (453) |
| Research and development expenses | (45) | (38) |
| Total costs and expenses | (4,077) | (3,468) |
| Equity in results of non-consolidated companies | 11 | (76) |
| Financial income | 227 | 287 |
| Financial expense | (252) | (212) |
| Monetary and exchange variation on monetary assets and liabilities, net | 181 | 45 |
| Employee benefit expense | (116) | (151) |
| Other taxes | (67) | (73) |
| Other expenses, net | (296) | (60) |
| | (312) | (240) |
| Income before income taxes and minority interest and accounting change | 2,654 | 1,021 |

Petróleo Brasileiro S.A. - PETROBRAS and Subsidiaries

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

(continued)

| | Three-month period Ended March 31, | |
|---|---------------------------------------|-------------|
| | 2003 | 2002 |
| Income tax expense | | |
| Current | (916) | (334) |
| Deferred | (67) | (23) |
| | (983) | (357) |
| Minority interest in results of consolidated subsidiaries | (59) | (51) |
| Income before effect of change in accounting principle | 1,612 | 613 |
| Cumulative effect of change in accounting principle, net of taxes | 697 | |
| Net income for the period | 2,309 | 613 |
| Net income applicable to each class of shares | | |
| Common/ ADS | 1,336 | 358 |
| Preferred/ADS | 973 | 255 |
| Net income for the period | 2,309 | 613 |
| Basic and diluted earnings per share (Note 13) | | |
| Common/ADS and Preferred/ADS | | |
| Before effect of change in accounting principle | 1.47 | 0.56 |
| After effect of change in accounting principle | 2.11 | 0.56 |
| Weighted average number of shares outstanding | | |
| Common/ADS | 634,168,418 | 634,168,418 |
| Preferred/ADS | 461,802,497 | 451,935,669 |

The accompanying notes are an integral part of this interim consolidated financial information.

Petróleo Brasileiro S.A. - PETROBRAS and Subsidiaries

Consolidated Statements of Cash Flows
Expressed in Millions of United States Dollars
(Unaudited)

| | Three-month period ended March 31, | |
|--|---------------------------------------|------|
| | 2003 | 2002 |

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| | | |
|--|---|-------------|
| Cash flows from operating activities | | |
| Net income for the period | 2,309 | 613 |
| Adjustments to reconcile net income to net cash provided by operating activities | | |
| Depreciation, depletion and amortization | 317 | 444 |
| Loss on property, plant and equipment | 34 | 65 |
| Foreign exchange and monetary loss | 92 | 98 |
| Cumulative effect of change in accounting principle, net of taxes | (697) | |
| Others | 122 | 147 |
| Decrease (increase) in assets | | |
| Accounts receivable, net | (211) | (240) |
| Petroleum and Alcohol Account | (7) | 10 |
| Inventories | (366) | (229) |
| Advances to suppliers | (90) | (79) |
| Others | (158) | 88 |
| Increase (decrease) in liabilities | | |
| Trade accounts payable | (95) | 25 |
| Taxes payable, other than income taxes | 27 | 556 |
| Income taxes | 729 | (847) |
| Contingencies | 120 | (14) |
| Other liabilities | 130 | 91 |
| Net cash provided by operating activities | 2,256 | 728 |
| | Three-month period ended March 31, | |
| | 2003 | 2002 |
| Cash flows from investing activities | | |
| Additions to property, plant and equipment | (875) | (1,100) |
| Investment in thermoelectric plants | (163) | |
| Others | (29) | (65) |
| Net cash used in investing activities | (1,067) | (1,165) |
| Cash flows from financing activities | | |
| Short-term debt, net issuances and repayments | 137 | (359) |
| Proceeds from issuance of long-term debt | 434 | 532 |
| Principal payments on long-term debt | (309) | (295) |
| Project financing payments | (12) | (56) |
| Payment of finance lease obligations | (104) | (73) |
| Dividends and interest on capital paid | (332) | (141) |
| Net cash used in financing activities | (186) | (392) |
| Increase (decrease) in cash and cash equivalents | 1,003 | (829) |
| Effect of exchange rate changes on cash and cash equivalents | 197 | (86) |

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| | | |
|--|-------|-------|
| Cash and cash equivalents at beginning of period | 3,301 | 7,360 |
| Cash and cash equivalents at end of period | 4,501 | 6,445 |

**Petróleo Brasileiro S.A. - PETROBRAS
and Subsidiaries**

Consolidated Statements of Changes in Stockholders' Equity
Expressed in Millions of United States Dollars
(except number of shares and per-share amounts)
(Unaudited)

| | Three-month period ended March 31, | |
|--|---|-------------|
| | 2003 | 2002 |
| Preferred stock (Note 12) | | |
| Balance at January 1 | 2,459 | 1,882 |
| Capital increase with issue of preferred shares | 122 | |
| Capital increase with undistributed earnings reserve | 384 | 577 |
| Balance at March 31 | 2,965 | 2,459 |
| Common stock (Note 12) | | |
| Balance at January 1 | 3,761 | 2,952 |
| Capital increase with undistributed earnings reserve | 528 | 809 |
| Balance at March 31 | 4,289 | 3,761 |
| Capital reserve - fiscal incentive | | |
| Balance at January 1 | 89 | 128 |
| Transfer from unappropriated retained earnings | 5 | 3 |
| Balance at March 31 | 94 | 131 |
| Accumulated other comprehensive income | | |
| Cumulative translation adjustments | | |
| Balance at January 1 | (17,306) | (11,854) |
| Change in the period | 559 | (231) |
| Balance at March 31 | (16,747) | (12,085) |
| Amounts not recognized as net periodic pension cost | | |
| Balance at January 1 | (1,361) | (1,867) |
| Decrease in additional minimum liability | (111) | 4 |
| Tax effect on above | 38 | (1) |
| Balance at March 31 | (1,434) | (1,864) |

**Petróleo Brasileiro S.A. - PETROBRAS
and Subsidiaries**

Consolidated Statements of Changes in Stockholders' Equity
Expressed in Millions of United States Dollars
(except number of shares and per-share amounts)
(Unaudited)

(continued)

| | Three-month period ended March 31, | |
|---|---|-------------|
| | 2003 | 2002 |
| Unrecognized gains (losses) on available-for-sale securities | | |
| Balance at January 1 | (11) | 13 |
| Unrealized gains | 5 | 20 |
| Tax effect on above | (1) | (6) |
| Balance at March 31 | (7) | 27 |
| Appropriated retained earnings | | |
| Legal reserve | | |
| Balance at January 1 | 643 | 768 |
| Transfer from (to) unappropriated retained earnings | 34 | (1) |
| Balance at March 31 | 677 | 767 |
| Undistributed earnings reserve | | |
| Balance at January 1 | 4,778 | 5,886 |
| Capital increase | (912) | (1,386) |
| Transfer from (to) unappropriated retained earnings | 244 | (24) |
| Balance at March 31 | 4,110 | 4,476 |
| Three-month period ended March 31, | | |
| | 2003 | 2002 |
| Statutory reserve | | |
| Balance at January 1 | 164 | 215 |
| Transfer from (to) unappropriated retained earnings | 9 | (1) |
| Balance at March 31 | 173 | 214 |
| Total appropriated retained earnings | 4,960 | 5,457 |
| Unappropriated retained earnings | | |
| Balance at January 1 | 16,085 | 15,124 |

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| | | |
|---|-------|-------|
| Net income for the period | 2,309 | 613 |
| Dividends (per share: 2002 - US\$ 1.19 to common and preferred shares; 2001 - US\$ 1.62 to common and preferred shares) | (510) | (989) |
| Appropriation from (to) reserves | (292) | 22 |

| | | |
|---------------------|--------|--------|
| Balance at March 31 | 17,592 | 14,770 |
|---------------------|--------|--------|

| | | |
|----------------------------|--------|--------|
| Total stockholders' equity | 11,712 | 12,656 |
|----------------------------|--------|--------|

Comprehensive income is comprised as follows:

| | | |
|---|-------|-------|
| Net income for the period | 2,309 | 613 |
| Cumulative translation adjustments | 559 | (231) |
| Amounts not recognized as net periodic pension cost | (73) | 3 |
| Unrealized gain on available-for-sale securities | 4 | 14 |

| | | |
|----------------------------|-------|-----|
| Total comprehensive income | 2,799 | 399 |
|----------------------------|-------|-----|

The accompanying notes are an integral part of this interim consolidated financial information.

Petróleo Brasileiro S.A. - PETROBRAS and Subsidiaries

Notes to Consolidated Financial Information

Expressed in Millions of United States Dollars
(except when specifically indicated)

1 Basis of Financial Statement Preparation

The accompanying unaudited consolidated financial information of Petróleo Brasileiro S.A. - PETROBRAS (the Company) has been prepared pursuant to U.S. generally accepted accounting principles (U.S. GAAP) and the rules and regulations of the Securities and Exchange Commission (SEC). Although certain information normally included in annual financial statements prepared in accordance with U.S. GAAP has been condensed or omitted, management believes that the disclosures are adequate to make the information presented not misleading. The unaudited consolidated financial information should be read in conjunction with the consolidated financial statements for the year ended December 31, 2002 and the notes thereto.

The consolidated financial information as of March 31, 2003 and for the three-month periods ended March 31, 2003 and 2002, included in this report, is unaudited. However, in management's opinion, such consolidated financial information reflects all normal recurring adjustments that are necessary for a fair presentation. The results for the interim periods are not necessarily indicative of trends or of results to be expected for the full year ending December 31, 2003.

Pursuant to Rule 436 (c) under the Securities Act of 1933 (the Act), this is not a report and should not be considered a part of any registration statement prepared or certified within the meanings of Sections 7 and 11 of the Act and therefore, the independent accountant's liability under section 11 does not extend to the information included herein.

2 Recently Issued Accounting Pronouncements

The FASB has recently issued (i) Interpretation No. 46 (FIN 46) - Consolidation of Variable Interest Entities in January 2003, (ii) SFAS No. 145 - Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections ("SFAS 145") in April 2002 and (iii) SFAS No. 146 - Accounting for Costs Associated with Exit or Disposal Activities ("SFAS 146") in July 2002.

FIN 46 provides guidance on when certain entities should be consolidated or the interests in those entities should be disclosed by enterprises that do not control them through majority voting interest. Under FIN 46, entities are required to be consolidated by interposes that lack majority voting interest when equity investors of those entities have significant capital risk, the obligation to absorb expected losses, or the right to receive expected returns. 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, which finance the variable interest entities, despite the voting interest in the 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 beginning after June 15, 2003. The Company is evaluating the impact of this interpretation on its financial condition, results of operations and cash flows.

There have been no variable interest entities created after January 31, 2003 in which the Company has an interest. The Company is reviewing its financial arrangements entered into before February 1, 2003 to identify any that might qualify as variable interest entities. There is a reasonable possibility that certain project finance arrangements in which the Company has an interest might be variable interest entities. These arrangements involve operating entities and the other investors are third parties independent from the corporation. The Company's share of commitments and debt obligations as well as fixed asset contributions of these entities is included in the consolidated balance sheet. The variable interests arise primarily because of certain guarantees extended by the corporation to the arrangements. These guarantees are disclosed in note 9.

SFAS 145 addresses how to report gains or losses resulting from the early extinguishment of debt. Under current accounting rules, any gains or losses are reported on early extinguishment of debt as extraordinary items. SFAS 145 requires an evaluation of whether the debt extinguishment is truly extraordinary in nature. If the debt is routinely extinguished early, the gain or loss would be included in income from continuing operations. This statement became effective for the Company as from 2003. Adoption of SFAS 145 did not have a significant impact on the Company's financial condition, results of operations and cash flows.

SFAS 146 requires recognition of costs associated with exit or disposal activities when they are incurred rather than when an exit or disposal plan occurs. Examples of costs covered by this guidance include lease termination costs, employee severance costs that are associated with a restructuring, discontinued operations, plant closings or other exit or disposal activities. The provisions of this statement are effective for fiscal years beginning after December 31, 2002 and will impact any exit or disposal activities initiated after January 1, 2003. Adoption of SFAS 146 did not have a significant impact on the Company's financial condition, results of operations and cash flows.

3 Accounting change

In August 2001 the FASB issued SFAS No. 143. 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. Under SFAS 143, the fair value of asset retirement obligations are recorded as liabilities on a discounted basis when they are incurred, which are typically at the time the related assets are installed. Amounts recorded for the related assets will be increased by the amount of these obligations. Over time, the liabilities will be accreted for the change in their present value and the initial capitalized costs will be depreciated over the useful lives of the related assets.

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\$ 7 increase in property, plant and equipment, a US\$ 1,056 reduction to the accrued liability and a US\$ 359 increase in deferred income tax liabilities.

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, the majority of the 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.

4 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 evolving 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 counterpart 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 change in interest rates, currency exchange rates, or commodity prices. The Company addresses credit risk by restricting the counterparts 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.

(a) Foreign Currency Risk Management

The Company's foreign currency risk management strategy may use derivative instruments to protect against foreign exchange rate volatility, which may impair the value of certain of the Company's assets. 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 treats these instruments as non-hedge 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 counterpart 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 counterpart 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 March 31, 2003 and December 31, 2002, the Company had a balance fair value obligation of US\$ 71 and US\$ 80, respectively, associated with its EURO and Japanese Yen zero cost collar contracts.

(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 hedge anticipated crude oil purchases and sales, generally forecasted to occur within a 30 to 360 day period to reduce the Company's exposure to volatile commodity prices.

The Company's exposure on these contracts is limited to the differential on the volumes hedged between the contract value and the market value. Gains and losses on hedge transactions are recognized concurrently with gains and losses resulting from the underlying hedged transaction. During the first three months of 2003 and 2002, the Company carried out hedging activities on 28.5% and 34.9%, respectively, of its total traded volume (imports and exports) and recognized a loss of US\$ 13 and a gain of US\$ 27, respectively.

(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.

5 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 for the three-month period ended March 31, 2003 and 2002, are 25% for federal income tax and 9% for social contribution, respectively, which represent an aggregate rate of 34%.

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 information.

| | Three-month period ended March 31, | |
|---|---|-------------|
| | 2003 | 2002 |
| Income before income taxes and minority interest | 2,654 | 1,021 |
| Tax expense at statutory rates | (902) | (347) |
| Adjustments to derive effective tax rate: | | |
| Non-deductible postretirement health-benefits | (23) | (21) |
| Foreign income subject to different tax rates | | (28) |
| Income taxes regarding abandonment liabilities adjustments related to the year ended December 31, 2002 | (43) | |
| Others | (15) | 39 |
| Income tax expense per consolidated statement of income | (983) | (357) |

6 Inventories

| | March 31, 2003 | December 31, 2002 |
|---------------------------------|---------------------------|------------------------------|
| Products | | |
| Oil products | 1,143 | 982 |
| Fuel alcohol | 112 | 86 |
| | 1,255 | 1,068 |
| Raw materials, mainly crude oil | 1,166 | 990 |
| Materials and supplies | 638 | 482 |

3,059

2,540

7 Receivable from Federal Government**(a) Background**

The Petroleum and Alcohol Account - Receivable from the Federal Government (the Petroleum and Alcohol Account) has been used to accumulate the impact of the Federal Government's regulation policies for the Brazilian oil and gas industry on the Company. The Petroleum and Alcohol Account accrues financial income on its outstanding balance at the Referential Rate Index - TR, which was 1.28% per month for the three-month period ended March 31, 2003 and 0.60% per month for the three-month period ended March 31, 2002.

As provided in the applicable regulations, the Petroleum and Alcohol Account is a legal, valid and binding receivable from the Federal Government and collectibility of the receivable is not subject to future operations. The applicable regulations also provide that the Company has the right to offset amounts owed to the Federal Government relating to the regulation policies of the Brazilian oil and gas industry against the receivable. These increases and decreases in the Petroleum and Alcohol Account have been recognized in accordance with applicable law when the underlying transaction occurred.

According to specific legislation, until December 31, 2001, the Specific Parcel Price-PPE was presented as an adjustment to sales of basic oil products (gasoline, diesel oil and LPG). The amount of PPE for any period increased or decreased the balance of the Petroleum and Alcohol Account.

After December 31, 2001 the expenses related to alcohol programs, approved by the Interministerial Council for Sugar and Alcohol are supported by a portion of the financial resources derived from collection of the CIDE, as stipulated in Law No. 10453 of May 13, 2002.

(b) Deregulation of the Brazilian fuel market

In accordance with the Petroleum Law and subsequent legislation, the fuel market in Brazil was totally deregulated as of January 1, 2002. Therefore, as of that date, the Petroleum and Alcohol accounts would no longer be used to reimburse expenses in connection with the Federal Government's regulation of the price 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. 10453, of May 13, 2002, and ANP regulations.

(c) Changes in the Petroleum and Alcohol Account

The following summarizes the changes in the Petroleum and Alcohol Account for the period ended March 31, 2003:

| | Three-month period ended March 31, 2003 |
|---|--|
| Opening balance | 182 |
| Reimbursements to third parties: subsidies paid to fuel alcohol producers | 5 |
| Translation loss | 12 |
| Ending balance | 199 |

(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 account. The value of the outstanding bonds at March 31, 2003 was US\$ 49, at which time the balance of the Petroleum and Alcohol Account was US\$ 199. 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, 2003 and currently has no other rights on those bonds; withdrawal or transfers are not allowed.

(e) Certification by the Federal Government

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

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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. 10453 of May 13, 2002, amended by Decree No. 4491 of November 29, 2002. The Company is permanently in contact with ANP and STN in order to effect settlement of the account, but settlement has not yet been achieved.

After completion of the audit, the amount of the notes used to guarantee the debit balance in existence on June 30, 2003, or of the securitized credits, will be adjusted to the new amount calculated, as established in Provisional Measure No. 2181-45 of August 24, 2001.

8 Financings

(a) Short-term debt

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

| | March 31, 2003 | December 31, 2002 |
|----------------------------|-------------------|----------------------|
| Import - oil and equipment | 334 | 286 |
| Working capital | 476 | 385 |
| | 810 | 671 |

(b) Long-term debt

• Composition

| | March 31, 2003 | December 31, 2002 |
|--|-------------------|----------------------|
| Foreign currency | | |
| Notes | 2,643 | 2,234 |
| Financial institutions | 2,214 | 2,240 |
| Securitization of receivables | 900 | 900 |
| Suppliers credits | 758 | 876 |
| Senior exchangeable notes | 338 | 338 |
| | 6,853 | 6,588 |
| Local currency | | |
| Debentures | 563 | 500 |
| National Economic and Social Development | | |
| Bank - BNDES (related party) | 402 | 403 |
| Debentures (related party) | 198 | 188 |
| Others | 36 | 35 |
| | 1,199 | 1,126 |
| Current portion of long-term debt | 8,052 | 7,714 |
| | (722) | (727) |
| | 7,330 | 6,987 |

● **Composition of foreign currency debt by currency**

| | March 31, 2003 | December 31, 2002 |
|-----------------------|---------------------------|------------------------------|
| Currencies | | |
| United States dollars | 5,810 | 5,522 |
| Japanese Yen | 738 | 764 |
| EURO | 304 | 297 |
| Others | 1 | 5 |
| | 6,853 | 6,588 |

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

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

| | |
|---------------------|--------------|
| 2004 | 465 |
| 2005 | 401 |
| 2006 | 772 |
| 2007 | 1,334 |
| 2008 and thereafter | 4,358 |
| | 7,330 |

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

Interest rates on long-term debt were as follows:

| | March 31, 2003 | December 31, 2002 |
|-------------------------|---------------------------|------------------------------|
| Foreign currency | | |
| 6% or less | 2,999 | 3,080 |
| Over 6% to 8% | 1,192 | 1,220 |
| Over 8% to 10% | 2,661 | 2,287 |
| Over 10% to 15% | 1 | 1 |
| | 6,853 | 6,588 |
| Local currency | | |
| 6% or less | 249 | 235 |
| Over 6% to 8% | 390 | 390 |
| Over 8% to 10% | | |
| Over 10% to 15% | 560 | 501 |
| | 1,199 | 1,126 |

8,052

7,714

9 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.

The Company's arrangements with respect to these projects are considered leasing transactions for accounting purposes. 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 unconsolidated special purpose company. Because the Company had commenced development or construction activities on each of these projects prior to completing the financing arrangement, and because of the Company's continuing involvement in these projects, the Company continues to reflect the assets related to the projects as a component of property, plant and equipment and the related obligation as a component of project financing.

The following summarizes the name of the fields where the projects were in progress at March 31, 2003 and December 31, 2002:

| | March 31, 2003 | December 31, 2002 |
|--|---------------------------|------------------------------|
| Barracuda/Caratinga | 1,580 | 1,481 |
| Cabiúnas | 841 | 673 |
| Marlim | 699 | 635 |
| Espadarte/Voador/Marimbá (EVM) | 538 | 575 |
| Nova Marlim | 533 | 508 |
| Albacora | 103 | 123 |
| Pargo, Carapeba, Garoupa and Cherne (PCGC) | 42 | 44 |
| | 4,336 | 4,039 |
| Current portion of project financings | (418) | |