



## **Cenovus Energy Inc.**

Consolidated Financial Statements

For the Year Ended December 31, 2012

(Canadian Dollars)

# Report of Management

## ***Management's Responsibility for the Consolidated Financial Statements***

The accompanying Consolidated Financial Statements of Cenovus Energy Inc. are the responsibility of Management. The Consolidated Financial Statements have been prepared by Management in Canadian dollars in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and include certain estimates that reflect Management's best judgments.

The Board of Directors has approved the information contained in the Consolidated Financial Statements. The Board of Directors fulfills its responsibility regarding the financial statements mainly through its Audit Committee which is made up of three independent directors. The Audit Committee has a written mandate that complies with the current requirements of Canadian securities legislation and the United States *Sarbanes - Oxley Act of 2002* and voluntarily complies, in principle, with the Audit Committee guidelines of the New York Stock Exchange. The Audit Committee meets with Management and the independent auditors on at least a quarterly basis to review and approve interim Consolidated Financial Statements and Management's Discussion and Analysis prior to their public release as well as annually to review the annual Consolidated Financial Statements and Management's Discussion and Analysis and recommend their approval to the Board of Directors.

## ***Management's Assessment of Internal Control over Financial Reporting***

Management is also responsible for establishing and maintaining adequate internal control over financial reporting. The internal control system was designed to provide reasonable assurance to Management regarding the preparation and presentation of the Consolidated Financial Statements.

Internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the design and effectiveness of internal control over financial reporting as at December 31, 2012. In making its assessment, Management has used the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") framework in Internal Control - Integrated Framework to evaluate the design and effectiveness of internal control over financial reporting. Based on our evaluation, Management has concluded that internal control over financial reporting was effective as at December 31, 2012.

PricewaterhouseCoopers LLP, an independent firm of Chartered Accountants, was appointed to audit and provide independent opinions on both the Consolidated Financial Statements and internal control over financial reporting as at December 31, 2012, as stated in their Auditor's Report dated February 13, 2013. PricewaterhouseCoopers LLP has provided such opinions.

(signed)

**Brian C. Ferguson**  
President &  
Chief Executive Officer  
Cenovus Energy Inc.

**February 13, 2013**

(signed)

**Ivor M. Ruste**  
Executive Vice-President &  
Chief Financial Officer  
Cenovus Energy Inc.

# Independent Auditor's Report

## ***To the Shareholders of Cenovus Energy Inc.***

We have completed an integrated audit of Cenovus Energy Inc.'s 2012 and 2011 Consolidated Financial Statements and its internal control over financial reporting as at December 31, 2012 and an audit of its 2010 Consolidated Financial Statements. Our opinions, based on our audits, are presented below.

## ***Report on the Consolidated Financial Statements***

We have audited the accompanying Consolidated Financial Statements of Cenovus Energy Inc., which comprise the Consolidated Balance Sheets as at December 31, 2012 and December 31, 2011 and the Consolidated Statements of Earnings and Comprehensive Income, Shareholders' Equity and Cash Flows for each of the three years in the period ended December 31, 2012, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

## ***Management's Responsibility for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of these Consolidated Financial Statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

## ***Auditor's Responsibility***

Our responsibility is to express an opinion on these Consolidated Financial Statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. Canadian generally accepted auditing standards require that we comply with ethical requirements.

An audit involves performing procedures to obtain audit evidence, on a test basis, about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting principles and policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion on the Consolidated Financial Statements.

## ***Opinion***

In our opinion, the Consolidated Financial Statements present fairly, in all material respects, the financial position of Cenovus Energy Inc. as at December 31, 2012 and December 31, 2011 and its financial performance and cash flows for each of the three years in the period ended December 31, 2012 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

## ***Report on Internal Control over Financial Reporting***

We have also audited Cenovus Energy Inc.'s internal control over financial reporting as at December 31, 2012, based on criteria established in Internal Control – Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO").

## ***Management's Responsibility for Internal Control over Financial Reporting***

Management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Report of Management.

### ***Auditor's Responsibility***

Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting 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 effective internal control over financial reporting was maintained in all material respects.

An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control, based on the assessed risk, and performing such other procedures as we consider necessary in the circumstances.

We believe that our audit provides a reasonable basis for our audit opinion on the Company's internal control over financial reporting.

### ***Definition of Internal Control over Financial Reporting***

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

### ***Inherent Limitations***

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

### ***Opinion***

In our opinion, Cenovus Energy Inc. maintained, in all material respects, effective internal control over financial reporting as at December 31, 2012 based on criteria established in Internal Control – Integrated Framework, issued by COSO.

(signed)

**PricewaterhouseCoopers LLP**  
Chartered Accountants  
Calgary, Alberta, Canada

**February 13, 2013**

# CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME

For the years ended December 31,  
(\$ millions, except per share amounts)

	Notes	2012	2011	2010
<b>Revenues</b>	1			
Gross Sales		17,229	16,185	13,090
Less: Royalties		387	489	449
		<b>16,842</b>	15,696	12,641
<b>Expenses</b>	1			
Purchased Product		9,223	9,090	7,551
Transportation and Blending		1,798	1,369	1,065
Operating		1,682	1,406	1,286
Production and Mineral Taxes		37	36	34
(Gain) Loss on Risk Management	31	(393)	(248)	(324)
Depreciation, Depletion and Amortization	16	1,585	1,295	1,302
Goodwill Impairment	19	393	-	-
Exploration Expense	15	68	-	3
General and Administrative		352	295	246
Finance Costs	5	455	447	498
Interest Income	6	(109)	(124)	(144)
Foreign Exchange (Gain) Loss, net	7	(20)	26	(51)
(Gain) Loss on Divestiture of Assets	17	-	(107)	(116)
Other (Income) Loss, net		(5)	4	(13)
<b>Earnings Before Income Tax</b>		<b>1,776</b>	2,207	1,304
Income Tax Expense	8	783	729	223
<b>Net Earnings</b>		<b>993</b>	1,478	1,081
<b>Other Comprehensive Income (Loss), Net of Tax</b>				
Foreign Currency Translation Adjustment		(24)	48	71
<b>Comprehensive Income</b>		<b>969</b>	1,526	1,152
<b>Net Earnings per Common Share</b>	9			
Basic		\$ 1.31	\$ 1.96	\$ 1.44
Diluted		\$ 1.31	\$ 1.95	\$ 1.43

See accompanying Notes to Consolidated Financial Statements.

# CONSOLIDATED BALANCE SHEETS

As at December 31,  
(\$ millions)

	Notes	2012	2011
<b>Assets</b>			
<b>Current Assets</b>			
Cash and Cash Equivalents	10	1,160	495
Accounts Receivable and Accrued Revenues	11	1,464	1,405
Current Portion of Partnership Contribution Receivable	12	384	372
Inventories	13	1,288	1,291
Risk Management	31	283	232
Assets Held for Sale	14	-	116
		<b>4,579</b>	3,911
<b>Current Assets</b>			
Exploration and Evaluation Assets	1,15	1,285	880
Property, Plant and Equipment, net	1,16	16,152	14,324
Partnership Contribution Receivable	12	1,398	1,822
Risk Management	31	5	52
Income Tax Receivable		-	29
Other Assets	18	58	44
Goodwill	1,19	739	1,132
<b>Total Assets</b>		<b>24,216</b>	<b>22,194</b>
<b>Liabilities and Shareholders' Equity</b>			
<b>Current Liabilities</b>			
Accounts Payable and Accrued Liabilities	20	2,650	2,579
Income Tax Payable		217	329
Current Portion of Partnership Contribution Payable	12	386	372
Risk Management	31	17	54
Liabilities Related to Assets Held for Sale	14	-	54
		<b>3,270</b>	3,388
<b>Current Liabilities</b>			
Long-Term Debt	21	4,679	3,527
Partnership Contribution Payable	12	1,426	1,853
Risk Management	31	1	14
Decommissioning Liabilities	22	2,315	1,777
Other Liabilities	23	151	128
Deferred Income Taxes	8	2,568	2,101
<b>Total Liabilities</b>		<b>14,410</b>	12,788
Shareholders' Equity		<b>9,806</b>	9,406
<b>Total Liabilities and Shareholders' Equity</b>		<b>24,216</b>	<b>22,194</b>
Commitments and Contingencies	33		

See accompanying Notes to Consolidated Financial Statements.

Approved by the Board of Directors

(signed)

**Michael A. Grandin**  
Director  
Cenovus Energy Inc.

(signed)

**Colin Taylor**  
Director  
Cenovus Energy Inc.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(\$ millions)

	Share Capital (Note 25)	Paid in Surplus (Note 25)	Retained Earnings	AOCI <sup>(1)</sup>	Total
<b>Balance as at January 1, 2010</b>	3,681	4,083	45	-	7,809
Net Earnings	-	-	1,081	-	1,081
Other Comprehensive Income (Loss)	-	-	-	71	71
Total Comprehensive Income for the Year	-	-	1,081	71	1,152
Common Shares Issued Under Option Plans	35	-	-	-	35
Dividends on Common Shares	-	-	(601)	-	(601)
<b>Balance as at December 31, 2010</b>	3,716	4,083	525	71	8,395
Net Earnings	-	-	1,478	-	1,478
Other Comprehensive Income (Loss)	-	-	-	48	48
Total Comprehensive Income for the Year	-	-	1,478	48	1,526
Common Shares Issued Under Option Plans	64	-	-	-	64
Stock-Based Compensation Expense	-	24	-	-	24
Dividends on Common Shares	-	-	(603)	-	(603)
<b>Balance as at December 31, 2011</b>	3,780	4,107	1,400	119	9,406
Net Earnings	-	-	993	-	993
Other Comprehensive Income (Loss)	-	-	-	(24)	(24)
Total Comprehensive Income for the Year	-	-	993	(24)	969
Common Shares Issued Under Option Plans	49	-	-	-	49
Stock-Based Compensation Expense	-	47	-	-	47
Dividends on Common Shares	-	-	(665)	-	(665)
<b>Balance as at December 31, 2012</b>	<b>3,829</b>	<b>4,154</b>	<b>1,728</b>	<b>95</b>	<b>9,806</b>

(1) Accumulated Other Comprehensive Income.

See accompanying Notes to Consolidated Financial Statements.

# CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31,  
(\$ millions)

	Notes	2012	2011	2010
<b>Operating Activities</b>				
Net Earnings		993	1,478	1,081
Depreciation, Depletion and Amortization		1,585	1,295	1,302
Goodwill Impairment		393	-	-
Exploration Expense		68	-	-
Deferred Income Taxes	8	474	575	141
Cash Tax on Divestiture of Assets		-	13	-
Unrealized (Gain) Loss on Risk Management	31	(57)	(180)	(46)
Unrealized Foreign Exchange (Gain) Loss	7	(70)	(42)	(69)
(Gain) Loss on Divestiture of Assets	17	-	(107)	(116)
Unwinding of Discount on Decommissioning Liabilities	5,22	86	75	75
Other		171	169	44
		<b>3,643</b>	<b>3,276</b>	<b>2,412</b>
Net Change in Other Assets and Liabilities		(113)	(82)	(55)
Net Change in Non-Cash Working Capital		(110)	79	234
<b>Cash From Operating Activities</b>		<b>3,420</b>	<b>3,273</b>	<b>2,591</b>
<b>Investing Activities</b>				
Capital Expenditures – Exploration and Evaluation Assets	15	(654)	(527)	(350)
Capital Expenditures – Property, Plant and Equipment	16	(2,795)	(2,265)	(1,851)
Proceeds From Divestiture of Assets		76	173	309
Cash Tax on Divestiture of Assets		-	(13)	-
Net Change in Investments and Other		(13)	(28)	4
Net Change in Non-Cash Working Capital		50	130	95
<b>Cash (Used in) Investing Activities</b>		<b>(3,336)</b>	<b>(2,530)</b>	<b>(1,793)</b>
<b>Net Cash Provided (Used) before Financing Activities</b>		<b>84</b>	<b>743</b>	<b>798</b>
<b>Financing Activities</b>				
Net Issuance (Repayment) of Short-Term Borrowings		3	(9)	-
Net Issuance (Repayment) of Revolving Long-Term Debt		-	-	(58)
Issuance of Long-Term Debt		1,219	-	-
Proceeds on Issuance of Common Shares		37	48	28
Dividends Paid on Common Shares	9	(665)	(603)	(601)
Other		(2)	6	-
<b>Cash From (Used in) Financing Activities</b>		<b>592</b>	<b>(558)</b>	<b>(631)</b>
<b>Foreign Exchange Gain (Loss) on Cash and Cash Equivalents Held in Foreign Currency</b>		<b>(11)</b>	<b>10</b>	<b>(22)</b>
<b>Increase (Decrease) in Cash and Cash Equivalents</b>		<b>665</b>	<b>195</b>	<b>145</b>
<b>Cash and Cash Equivalents, Beginning of Year</b>		<b>495</b>	<b>300</b>	<b>155</b>
<b>Cash and Cash Equivalents, End of Year</b>		<b>1,160</b>	<b>495</b>	<b>300</b>

Supplementary Cash Flow Information 32

See accompanying Notes to Consolidated Financial Statements.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

All amounts in \$ millions, unless otherwise indicated  
For the year ended December 31, 2012

### 1. DESCRIPTION OF BUSINESS AND SEGMENTED DISCLOSURES

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Cenovus Energy Inc., and its subsidiaries, (together "Cenovus" or the "Company") are in the business of the development, production and marketing of crude oil, natural gas and natural gas liquids ("NGLs") in Canada with refining operations in the United States ("U.S.").

Cenovus began independent operations on December 1, 2009, as a result of the plan of arrangement ("Arrangement") involving Encana Corporation ("Encana") whereby Encana was split into two independent energy companies, one a natural gas company, Encana, and the other an oil company, Cenovus. In connection with the Arrangement, Encana common shareholders received one share in each of the new Encana and Cenovus in exchange for each Encana share held.

Cenovus was incorporated under the *Canada Business Corporations Act* and its shares are publicly traded on the Toronto ("TSX") and New York ("NYSE") stock exchanges. The executive and registered office is located at 2600, 500 Centre Street S.E., Calgary, Alberta, Canada, T2G 1A6. Information on the Company's basis of presentation for these Consolidated Financial Statements is found in Note 2.

The Company's reportable segments are as follows:

- **Oil Sands**, includes the development and production of Cenovus's bitumen assets at Foster Creek, Christina Lake and Narrows Lake as well as heavy oil assets at Pelican Lake. This segment also includes the Athabasca natural gas assets and projects in the early stages of development such as Grand Rapids and Telephone Lake. Certain of the Company's operated oil sands properties, notably Foster Creek, Christina Lake and Narrows Lake, are jointly owned with ConocoPhillips, an unrelated U.S. public company.
- **Conventional**, which includes the development and production of conventional crude oil, NGLs and natural gas in Alberta and Saskatchewan, including the carbon dioxide enhanced oil recovery project at Weyburn and emerging tight oil opportunities.
- **Refining and Marketing**, which is focused on the refining of crude oil products into petroleum and chemical products at two refineries located in the U.S. The refineries are jointly owned with and operated by Phillips 66, an unrelated U.S. public company. This segment also markets Cenovus's crude oil and natural gas, as well as third-party purchases and sales of product that provide operational flexibility for transportation commitments, product type, delivery points and customer diversification.
- **Corporate and Eliminations**, which primarily includes unrealized gains and losses recorded on derivative financial instruments, gains and losses on divestiture of assets, as well as other Cenovus-wide costs for general and administrative and financing activities. As financial instruments are settled, the realized gains and losses are recorded in the operating segment to which the derivative instrument relates. Eliminations relate to sales and operating revenues and purchased product between segments, recorded at transfer prices based on current market prices, and to unrealized intersegment profits in inventory.

The tabular financial information which follows presents the segmented information first by segment, then by product and geographic location.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

All amounts in \$ millions, unless otherwise indicated  
For the year ended December 31, 2012

### A) Results of Operations - Segment and Operational Information

For the years ended December 31,	Oil Sands			Conventional			Refining and Marketing		
	2012	2011	2010	2012	2011	2010	2012	2011	2010
<b>Revenues</b>									
Gross Sales	4,088	3,291	2,702	2,068	2,328	2,284	11,356	10,625	8,228
Less: Royalties	215	284	279	172	205	170	-	-	-
	<b>3,873</b>	<b>3,007</b>	<b>2,423</b>	<b>1,896</b>	<b>2,123</b>	<b>2,114</b>	<b>11,356</b>	<b>10,625</b>	<b>8,228</b>
<b>Expenses</b>									
Purchased Product	-	-	-	-	-	-	9,506	9,149	7,674
Transportation and Blending	1,653	1,231	935	145	138	130	-	-	-
Operating	584	438	367	513	488	434	587	481	488
Production and Mineral Taxes	-	-	-	37	36	34	-	-	-
(Gain) Loss on Risk Management	(80)	70	(10)	(252)	(152)	(258)	(4)	14	(10)
<b>Operating Cash Flow</b>	<b>1,716</b>	<b>1,268</b>	<b>1,131</b>	<b>1,453</b>	<b>1,613</b>	<b>1,774</b>	<b>1,267</b>	<b>981</b>	<b>76</b>
Depreciation, Depletion and Amortization	482	347	375	905	778	799	146	130	96
Goodwill Impairment	-	-	-	393	-	-	-	-	-
Exploration Expense	-	-	3	68	-	-	-	-	-
<b>Segment Income (Loss)</b>	<b>1,234</b>	<b>921</b>	<b>753</b>	<b>87</b>	<b>835</b>	<b>975</b>	<b>1,121</b>	<b>851</b>	<b>(20)</b>

For the years ended December 31,	Corporate and Eliminations			Consolidated		
	2012	2011	2010	2012	2011	2010
<b>Revenues</b>						
Gross Sales	(283)	(59)	(124)	17,229	16,185	13,090
Less: Royalties	-	-	-	387	489	449
	<b>(283)</b>	<b>(59)</b>	<b>(124)</b>	<b>16,842</b>	<b>15,696</b>	<b>12,641</b>
<b>Expenses</b>						
Purchased Product	(283)	(59)	(123)	9,223	9,090	7,551
Transportation and Blending	-	-	-	1,798	1,369	1,065
Operating	(2)	(1)	(3)	1,682	1,406	1,286
Production and Mineral Taxes	-	-	-	37	36	34
(Gain) Loss on Risk Management	(57)	(180)	(46)	(393)	(248)	(324)
	<b>59</b>	<b>181</b>	<b>48</b>	<b>4,495</b>	<b>4,043</b>	<b>3,029</b>
Depreciation, Depletion and Amortization	52	40	32	1,585	1,295	1,302
Goodwill Impairment	-	-	-	393	-	-
Exploration Expense	-	-	-	68	-	3
<b>Segment Income (Loss)</b>	<b>7</b>	<b>141</b>	<b>16</b>	<b>2,449</b>	<b>2,748</b>	<b>1,724</b>
General and Administrative	352	295	246	352	295	246
Finance Costs	455	447	498	455	447	498
Interest Income	(109)	(124)	(144)	(109)	(124)	(144)
Foreign Exchange (Gain) Loss, net	(20)	26	(51)	(20)	26	(51)
(Gain) Loss on Divestiture of Assets	-	(107)	(116)	-	(107)	(116)
Other (Income) Loss, net	(5)	4	(13)	(5)	4	(13)
	<b>673</b>	<b>541</b>	<b>420</b>	<b>673</b>	<b>541</b>	<b>420</b>
<b>Earnings Before Income Tax</b>				<b>1,776</b>	<b>2,207</b>	<b>1,304</b>
Income Tax Expense				783	729	223
<b>Net Earnings</b>				<b>993</b>	<b>1,478</b>	<b>1,081</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

All amounts in \$ millions, unless otherwise indicated  
For the year ended December 31, 2012

### B) Financial Results by Upstream Product

For the years ended December 31,	Oil Sands			Crude Oil and NGLs Conventional			Total		
	2012	2011	2010	2012	2011	2010	2012	2011	2010
<b>Revenues</b>									
Gross Sales	4,037	3,217	2,610	1,559	1,492	1,229	5,596	4,709	3,839
Less: Royalties	215	282	276	166	193	153	381	475	429
	<b>3,822</b>	<b>2,935</b>	<b>2,334</b>	<b>1,393</b>	<b>1,299</b>	<b>1,076</b>	<b>5,215</b>	<b>4,234</b>	<b>3,410</b>
<b>Expenses</b>									
Transportation and Blending	1,651	1,229	934	126	104	86	1,777	1,333	1,020
Operating	548	409	339	294	244	199	842	653	538
Production and Mineral Taxes	-	-	-	34	27	28	34	27	28
(Gain) Loss on Risk Management	(62)	87	14	(23)	43	5	(85)	130	19
<b>Operating Cash Flow</b>	<b>1,685</b>	<b>1,210</b>	<b>1,047</b>	<b>962</b>	<b>881</b>	<b>758</b>	<b>2,647</b>	<b>2,091</b>	<b>1,805</b>

For the years ended December 31,	Oil Sands			Natural Gas Conventional			Total		
	2012	2011	2010	2012	2011	2010	2012	2011	2010
<b>Revenues</b>									
Gross Sales	40	63	78	496	825	1,042	536	888	1,120
Less: Royalties	-	2	1	6	12	17	6	14	18
	<b>40</b>	<b>61</b>	<b>77</b>	<b>490</b>	<b>813</b>	<b>1,025</b>	<b>530</b>	<b>874</b>	<b>1,102</b>
<b>Expenses</b>									
Transportation and Blending	2	2	1	19	34	44	21	36	45
Operating	25	24	23	215	240	231	240	264	254
Production and Mineral Taxes	-	-	-	3	9	6	3	9	6
(Gain) Loss on Risk Management	(18)	(17)	(24)	(229)	(195)	(263)	(247)	(212)	(287)
<b>Operating Cash Flow</b>	<b>31</b>	<b>52</b>	<b>77</b>	<b>482</b>	<b>725</b>	<b>1,007</b>	<b>513</b>	<b>777</b>	<b>1,084</b>

For the years ended December 31,	Oil Sands			Other Conventional			Total		
	2012	2011	2010	2012	2011	2010	2012	2011	2010
<b>Revenues</b>									
Gross Sales	11	11	14	13	11	13	24	22	27
Less: Royalties	-	-	2	-	-	-	-	-	2
	<b>11</b>	<b>11</b>	<b>12</b>	<b>13</b>	<b>11</b>	<b>13</b>	<b>24</b>	<b>22</b>	<b>25</b>
<b>Expenses</b>									
Transportation and Blending	-	-	-	-	-	-	-	-	-
Operating	11	5	5	4	4	4	15	9	9
Production and Mineral Taxes	-	-	-	-	-	-	-	-	-
(Gain) Loss on Risk Management	-	-	-	-	-	-	-	-	-
<b>Operating Cash Flow</b>	<b>-</b>	<b>6</b>	<b>7</b>	<b>9</b>	<b>7</b>	<b>9</b>	<b>9</b>	<b>13</b>	<b>16</b>

For the years ended December 31,	Oil Sands			Total Upstream Conventional			Total		
	2012	2011	2010	2012	2011	2010	2012	2011	2010
<b>Revenues</b>									
Gross Sales	4,088	3,291	2,702	2,068	2,328	2,284	6,156	5,619	4,986
Less: Royalties	215	284	279	172	205	170	387	489	449
	<b>3,873</b>	<b>3,007</b>	<b>2,423</b>	<b>1,896</b>	<b>2,123</b>	<b>2,114</b>	<b>5,769</b>	<b>5,130</b>	<b>4,537</b>
<b>Expenses</b>									
Transportation and Blending	1,653	1,231	935	145	138	130	1,798	1,369	1,065
Operating	584	438	367	513	488	434	1,097	926	801
Production and Mineral Taxes	-	-	-	37	36	34	37	36	34
(Gain) Loss on Risk Management	(80)	70	(10)	(252)	(152)	(258)	(332)	(82)	(268)
<b>Operating Cash Flow</b>	<b>1,716</b>	<b>1,268</b>	<b>1,131</b>	<b>1,453</b>	<b>1,613</b>	<b>1,774</b>	<b>3,169</b>	<b>2,881</b>	<b>2,905</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### C) Geographic Information

For the years ended December 31,	Canada			United States			Consolidated		
	2012	2011	2010	2012	2011	2010	2012	2011	2010
<b>Revenues</b>									
Gross Sales	8,069	7,513	6,466	9,160	8,672	6,624	17,229	16,185	13,090
Less: Royalties	387	489	449	-	-	-	387	489	449
	<b>7,682</b>	7,024	6,017	<b>9,160</b>	8,672	6,624	<b>16,842</b>	15,696	12,641
<b>Expenses</b>									
Purchased Product	1,884	1,867	1,456	7,339	7,223	6,095	9,223	9,090	7,551
Transportation and Blending	1,798	1,369	1,065	-	-	-	1,798	1,369	1,065
Operating	1,118	947	814	564	459	472	1,682	1,406	1,286
Production and Mineral Taxes	37	36	34	-	-	-	37	36	34
(Gain) Loss on Risk Management	(385)	(255)	(322)	(8)	7	(2)	(393)	(248)	(324)
	<b>3,230</b>	3,060	2,970	<b>1,265</b>	983	59	<b>4,495</b>	4,043	3,029
Depreciation, Depletion and Amortization	1,439	1,165	1,216	146	130	86	1,585	1,295	1,302
Goodwill Impairment	393	-	-	-	-	-	393	-	-
Exploration Expense	68	-	3	-	-	-	68	-	3
<b>Segment Income (Loss)</b>	<b>1,330</b>	1,895	1,751	<b>1,119</b>	853	(27)	<b>2,449</b>	2,748	1,724

The Oil Sands and Conventional segments operate in Canada. Both of Cenovus's refining facilities are located and carry on business in the U.S. The marketing of Cenovus's crude oil and natural gas produced in Canada, as well as the third party purchases and sales of product, is undertaken in Canada. Physical product sales that settle in the U.S. are considered to be export sales undertaken by a Canadian business. The Corporate and Eliminations segment is attributed to Canada, with the exception of the unrealized risk management gains and losses, which have been attributed to the country in which the transacting entity resides.

#### Export Sales

Sales of crude oil, natural gas and NGLs produced or purchased in Canada that have been delivered to customers outside of Canada were \$671 million (2011 - \$700 million; 2010 - \$646 million).

### D) Exploration and Evaluation Assets, Property, Plant and Equipment, Goodwill and Total Assets

#### By Segment

As at December 31,	Exploration and Evaluation Assets		Property, Plant and Equipment	
	2012	2011	2012	2011
Oil Sands	1,110	741	7,764	6,224
Conventional	175	139	4,929	4,668
Refining and Marketing	-	-	3,088	3,200
Corporate and Eliminations	-	-	371	232
<b>Consolidated</b>	<b>1,285</b>	880	<b>16,152</b>	14,324
	Goodwill		Total Assets	
	2012	2011	2012	2011
Oil Sands	739	739	11,972	10,524
Conventional	-	393	5,304	5,566
Refining and Marketing	-	-	5,018	4,927
Corporate and Eliminations	-	-	1,922	1,177
<b>Consolidated</b>	<b>739</b>	1,132	<b>24,216</b>	22,194

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### By Geographic Region

As at December 31,	Exploration and Evaluation Assets		Property, Plant and Equipment	
	2012	2011	2012	2011
Canada	1,285	880	13,065	11,124
United States	-	-	3,087	3,200
<b>Consolidated</b>	<b>1,285</b>	<b>880</b>	<b>16,152</b>	<b>14,324</b>

  

As at December 31,	Goodwill		Total Assets	
	2012	2011	2012	2011
Canada	739	1,132	19,744	17,536
United States	-	-	4,472	4,658
<b>Consolidated</b>	<b>739</b>	<b>1,132</b>	<b>24,216</b>	<b>22,194</b>

### E) Capital Expenditures

For the years ended December 31,	2012	2011	2010
<b>Capital</b>			
Oil Sands	2,211	1,415	857
Conventional	848	788	526
Refining and Marketing	118	393	656
Corporate	191	127	76
	<b>3,368</b>	<b>2,723</b>	<b>2,115</b>
<b>Acquisition Capital</b>			
Oil Sands <sup>(2)</sup>	69	44	23
Conventional	45	25	25
Refining and Marketing	-	-	38
Corporate	-	2	-
<b>Total <sup>(1)</sup></b>	<b>3,482</b>	<b>2,794</b>	<b>2,201</b>

(1) Includes expenditures on property, plant and equipment and exploration & evaluation assets.

(2) 2012 asset acquisition included the assumption of a decommissioning liability of \$33 million.

### Major Customers

In connection with the marketing and sale of Cenovus's own and purchased crude oil, natural gas and refined products for the year ended December 31, 2012, Cenovus had three customers (2011 – two; 2010 – two) which individually accounted for more than 10 percent of its consolidated gross sales. Sales to these customers, recognized as major international energy companies with investment grade credit ratings, were approximately \$3,928 million, \$3,300 million and \$2,839 million, respectively (2011 – \$7,324 million and \$2,683 million; 2010 – \$5,376 million and \$2,295 million).

## 2. BASIS OF PREPARATION AND STATEMENT OF COMPLIANCE

In these Consolidated Financial Statements, unless otherwise indicated, all dollars are expressed in Canadian dollars. All references to C\$ or \$ are to Canadian dollars and references to US\$ are to U.S. dollars.

These Consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). These Consolidated Financial Statements have been prepared in compliance with IFRS.

These Consolidated Financial Statements have been prepared on a historical cost basis, except as detailed in the Company's accounting policies disclosed in Note 3.

These Consolidated Financial Statements of Cenovus were approved by the Board of Directors on February 13, 2013.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

All amounts in \$ millions, unless otherwise indicated  
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### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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#### A) Principles of Consolidation

The Consolidated Financial Statements include the accounts of Cenovus and its subsidiaries. Subsidiaries are entities over which the Company has the power to govern the financial and operating policies. Subsidiaries are consolidated from the date of acquisition of control and continue to be consolidated until the date that there is a loss of control. All intercompany transactions, balances and unrealized gains and losses from intercompany transactions are eliminated on consolidation.

Investments in jointly controlled partnerships and unincorporated joint operations carry on certain of Cenovus's development, production and crude oil refining businesses and are accounted for using the proportionate consolidation method, whereby Cenovus's proportionate share of revenues, expenses, assets and liabilities are included in the consolidated accounts.

#### B) Segment Reporting

Management has determined the operating segments based on information regularly reviewed for the purposes of decision making, allocating resources and assessing performance by Cenovus's chief operating decision makers. The Company evaluates the financial performance of its operating segments primarily based on operating cash flow.

#### C) Foreign Currency Translation

##### *Functional and Presentation Currency*

The Company's presentation currency is Canadian dollars. The accounts of the Company's foreign operations that have a functional currency different from the Company's presentation currency are translated into the Company's presentation currency at period end exchange rates for assets and liabilities and at the average rate over the period for revenues and expenses. Translation gains and losses relating to the foreign operations are recognized in other comprehensive income ("OCI") as cumulative translation adjustments.

When the Company disposes of an entire interest in a foreign operation or loses control, joint control, or significant influence over a foreign operation, the foreign currency gains or losses accumulated in OCI related to the foreign operation are recognized in net earnings. When the Company disposes of part of an interest in a foreign operation which continues to be a subsidiary, a proportionate amount of gains and losses accumulated in OCI is allocated between controlling and non-controlling interests.

##### *Transactions and Balances*

Transactions in foreign currencies are translated to the respective functional currencies at exchange rates in effect at the dates of the transactions. Monetary assets and liabilities of Cenovus that are denominated in foreign currencies are translated into its functional currency at the rates of exchange in effect at the period end date. Any gains or losses are recorded in the Consolidated Statements of Earnings and Comprehensive Income.

#### D) Revenue and Interest Income Recognition

##### *Sales of Product*

Revenues associated with the sales of Cenovus's crude oil, natural gas, NGLs and petroleum and refined products are recognized when the significant risks and rewards of ownership have been transferred to the customer, the sales price and costs can be measured reliably and it is probable that the economic benefits will flow to the Company. This is generally met when title passes from the Company to its customer. Revenues from crude oil and natural gas production represent the Company's share, net of royalty payments to governments and other mineral interest owners.

Purchases and sales of products that are entered into in contemplation of each other with the same counterparty are recorded on a net basis. Revenues associated with the services provided as agent are recorded as the services are provided.

##### *Interest Income*

Interest income is recognized as the interest accrues using the effective interest method.

#### E) Transportation and Blending

The costs associated with the transportation of crude oil, natural gas and NGLs, including the cost of diluent used in blending, are recognized when the product is sold.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*All amounts in \$ millions, unless otherwise indicated  
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### **F) Production and Mineral Taxes**

Costs paid to non-mineral interest owners based on production of crude oil, natural gas and NGLs are recognized when the product is sold.

### **G) Exploration Expense**

Costs incurred prior to obtaining the legal right to explore (pre-exploration costs) are expensed in the period in which they are incurred as exploration expense.

Costs incurred after the legal right to explore is obtained, are initially capitalized. If it is determined that the field/project/area is not technically feasible or commercially viable or if the Company decides not to continue the exploration and evaluation activity, the unrecoverable accumulated costs are expensed as exploration expense.

### **H) Employee Benefit Plans**

The Company provides employees with a pension plan that includes either a defined contribution or defined benefit component, and other post-employment benefit plans ("OPEB").

Accruals for obligations under the employee defined benefit pension plan and the related costs are recorded net of plan assets.

The cost of the defined benefit pension plan and other post-employment benefits is actuarially determined using the projected unit credit method based on length of service and reflects Management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected future health care costs.

Pension expense for the defined benefit pension plan includes the cost of pension benefits earned during the current year, the interest cost on pension obligations, the expected return on pension plan assets, the amortization of adjustments arising from pension plan amendments and the amortization of the excess of the net actuarial gain or loss over 10 percent of the greater of the benefit obligation and the fair value of plan assets. Amortization is calculated on a straight-line basis over a period covering the non-vested expected average remaining service lives of employees and recognized immediately for vested benefits covered by the plans.

Pension expense for the defined contribution pension is recorded as the benefits are earned.

### **I) Income Taxes**

Income taxes comprise current and deferred taxes. Current and deferred income taxes are provided for on a non-discounted basis at amounts expected to be paid using the tax rates and laws that have been enacted or substantively enacted at the Consolidated Balance Sheet date.

Cenovus follows the liability method of accounting for income taxes, where deferred income taxes are recorded for the effect of any temporary difference between the accounting and income tax basis of an asset or liability, using the substantively enacted income tax rates expected to apply when the assets are realized or liabilities are settled. Deferred income tax balances are adjusted to reflect changes in income tax rates that are substantively enacted with the adjustment being recognized in net earnings in the period that the change occurs, except when it relates to items charged or credited directly to equity or OCI, in which case the deferred income tax is also recorded in equity or OCI, respectively.

Deferred income tax is provided on temporary differences arising from investments in subsidiaries except in the case where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax assets are recognized only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

Deferred income tax assets and liabilities are only offset where they arise within the same entity and tax jurisdiction.

Deferred income tax assets and liabilities are presented as non-current.

### **J) Net Earnings per Share Amounts**

Basic net earnings per common share is computed by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted net earnings per share is calculated giving effect to the potential dilution that would occur if stock options or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments. The treasury stock method assumes that proceeds received from the exercise of in-the-money stock options are used to repurchase common shares at the average market price. For those contracts that may be settled in cash or in shares at the holder's option, the more dilutive of cash settlement and share settlement is used in calculating diluted earnings per share.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### **K) Cash and Cash Equivalents**

Cash and cash equivalents include short-term investments, such as money market deposits or similar type instruments, with a maturity of three months or less.

### **L) Inventories**

Product inventories are valued at the lower of cost and net realizable value on a first-in, first-out or weighted average cost basis. The cost of inventory includes all costs incurred in the normal course of business to bring each product to its present location and condition. Net realizable value is the estimated selling price in the ordinary course of business less any expected selling costs. If the carrying amount exceeds net realizable value, a write-down is recognized. The write-down may be reversed in a subsequent period if the circumstances which caused it no longer exist.

### **M) Assets (Disposal Group) Held for Sale**

Non-current assets or disposal groups are classified as held for sale when their carrying amount will be principally recovered through a sales transaction rather than through continued use and a sales transaction is highly probable. Assets held for sale are recorded at the lower of carrying value and fair value less cost to sell.

### **N) Exploration and Evaluation ("E&E") Assets**

Costs incurred after the legal right to explore an area has been obtained and before technical feasibility and commercial viability of the area have been established are capitalized as E&E assets. These costs include license acquisition, geological and geophysical, drilling, sampling, decommissioning and other directly attributable internal costs. E&E assets are not depreciated and are carried forward until technical feasibility and commercial viability of the field/project/area is established or the assets are determined to be impaired.

Once technical feasibility and commercial viability have been established for a field/project/area, the carrying value of the E&E assets associated with that field/area/project is tested for impairment. The carrying value, net of any impairment loss, is then reclassified as property, plant and equipment.

E&E costs are subject to regular technical, commercial and management review to confirm the continued intent to develop the resources. If a field/project/area is determined to no longer be technically feasible or commercially viable, and Management decides not to continue the exploration and evaluation activity, the unrecoverable costs are charged to exploration expense in the period in which the determination occurs.

Any gains or losses from the divestiture of E&E assets are recognized in net earnings.

### **O) Property, Plant and Equipment**

#### ***Development and Production Assets***

Development and production assets are stated at cost less accumulated depreciation, depletion, amortization and net impairment losses. Development and production assets are capitalized on an area-by-area basis and include all costs associated with the development and production of the crude oil and natural gas properties, as well as any E&E expenditures incurred in finding commercial reserves of crude oil or natural gas transferred from E&E assets. Capitalized costs include internal costs, decommissioning liabilities, and, for qualifying assets, borrowing costs directly associated with the acquisition of, the exploration for, and the development of crude oil and natural gas reserves.

Costs accumulated within each area are depleted using the unit-of-production method based on estimated proved reserves determined using estimated future prices and costs. For the purpose of this calculation, natural gas is converted to oil on an energy equivalent basis. Costs subject to depletion include estimated future costs to be incurred in developing proved reserves.

Exchanges of development and production assets are measured at fair value unless the transaction lacks commercial substance or the fair value of neither the asset received, nor the asset given up, can be reliably measured. When fair value is not used, the carrying amount of the asset given up is used as the cost of the asset acquired.

Expenditures related to renewals or betterments that improve the productive capacity or extend the life of an asset are capitalized. Maintenance and repairs are expensed as incurred. Land is not depreciated.

Any gains or losses from the divestiture of development and production assets are recognized in net earnings.

#### ***Other Upstream Assets***

Other upstream assets include pipelines and information technology assets used to support the upstream business. These assets are depreciated on a straight-line basis over their useful lives of three to 35 years.



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### Refining Assets

The refining assets are stated at cost less accumulated depreciation and net impairment losses.

The initial acquisition costs of refining property, plant and equipment are capitalized when incurred. Costs include the cost of constructing or otherwise acquiring the equipment or facilities, the cost of installing the asset and making it ready for its intended use, the associated decommissioning costs and, for qualifying assets, borrowing costs. Routine maintenance and repair costs are expensed in the period in which they are incurred.

Capitalized costs are not subject to depreciation until the asset is available for use, after which they are depreciated on a straight-line basis over the estimated service life of each component of the refinery. The major components are depreciated as follows:

Land Improvements and Buildings	25 to 40 years
Office Equipment and Vehicles	3 to 20 years
Refining Equipment	5 to 35 years

The residual value, method of amortization and the useful life of each component are reviewed annually and adjusted if appropriate.

### Other Assets

Costs associated with office furniture, fixtures, leasehold improvements, information technology and aircraft are carried at cost and depreciated on a straight-line basis over the estimated service lives of the assets, which range from three to 25 years. The residual value, method of amortization and the useful lives of the assets are reviewed annually and adjusted, if appropriate. Assets under construction are not subject to depreciation until they are available for use. Expenditures related to renewals or betterments that improve the productive capacity or extend the life of an asset are capitalized. Maintenance and repairs are expensed as incurred. Land is not depreciated.

## P) Impairment

### Non-Financial Assets

Property, plant and equipment and E&E assets are assessed for impairment at least annually or when facts and circumstances suggest that the carrying amount may exceed its recoverable amount. The recoverable amount is determined as the greater of an asset's or cash-generating unit's ("CGU") value-in-use ("VIU") and fair value less costs to sell ("FVLCTS"). VIU is estimated as the discounted present value of the future cash flows expected to arise from the continuing use of a CGU or asset.

The impairment test is performed at the CGU for development and production assets and other upstream assets. E&E assets are allocated to a related CGU containing development and production assets for the purposes of testing for impairment. Corporate assets are allocated to the CGUs to which they contribute to the future cash flows. For refining assets, the impairment test is performed at each refinery independently.

Impairment losses on PP&E are recognized in the Consolidated Statements of Earnings and Comprehensive Income as additional depreciation, depletion and amortization and are separately disclosed. An impairment of E&E assets is recognized as exploration expense in the Consolidated Statements of Earnings and Comprehensive Income.

Goodwill is assessed for impairment at least annually. To assess impairment, the recoverable amount of the CGU to which the goodwill relates is compared to the carrying amount. If the recoverable amount of the CGU is less than the carrying amount, an impairment loss is recognized. An impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the CGU and then to reduce the carrying amounts of the other assets in the CGU. Goodwill impairments are not reversed.

Impairment losses recognized in prior periods, other than goodwill impairments, are assessed at each reporting date for any indicators that the impairment losses may no longer exist or may have decreased. In the event that an impairment loss reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but only to the extent that the carrying amount does not exceed the amount that would have been determined had no impairment loss been recognized on the asset in prior periods. The amount of the reversal is recognized in net earnings.

### Financial Assets

At each reporting date, the Company assesses whether there are any indicators that its financial assets are impaired. An impairment loss is only recognized if there is objective evidence of impairment, the loss event has an impact on future cash flow and the loss can be reliably estimated.

Evidence of impairment may include default or delinquency by a debtor or indicators that the debtor may enter bankruptcy. For equity securities, a significant or prolonged decline in the fair value of the security below cost is evidence that the assets are impaired.

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An impairment loss on a financial asset carried at amortized cost is calculated as the difference between the amortized cost and the present value of the future cash flows discounted at the asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account. Impairment losses on financial assets carried at amortized cost are reversed through net earnings in subsequent periods if the amount of the loss decreases.

### **Q) Borrowing Costs**

Borrowing costs are recognized as an expense in the period in which they are incurred unless there is a qualifying asset. Borrowing costs directly associated with the acquisition, construction or production of a qualifying asset are capitalized when a substantial period of time is required to make the asset ready for its intended use. Capitalization of borrowing costs ceases when the asset is in the location and condition necessary for its intended use.

### **R) Government Grants**

Government grants are recognized at fair value when there is reasonable assurance that the grants will be received and the Company will comply with the conditions of the grant. Grants related to assets are recorded as a reduction of the asset's carrying value and are depreciated over the useful life of the asset. Grants related to income are treated as a reduction of the related expense in the Consolidated Statements of Earnings and Comprehensive Income.

### **S) Leases**

Leases in which substantially all of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Operating lease payments are recognized as an expense on a straight-line basis over the lease term.

Leases where the Company assumes substantially all the risks and rewards of ownership are classified as finance leases within property, plant and equipment.

### **T) Business Combinations and Goodwill**

Business combinations are accounted for using the acquisition method of accounting in which the identifiable assets acquired, liabilities assumed and any non-controlling interest are recognized and measured at their fair value at the date of acquisition. Any excess of the purchase price plus any non-controlling interest over the fair value of the net assets acquired is recognized as goodwill. Any deficiency of the purchase price over the fair value of the net assets acquired is credited to net earnings.

At acquisition, goodwill is allocated to each of the CGUs to which it relates. Subsequent measurement of goodwill is at cost less any accumulated impairment losses.

### **U) Provisions**

#### **General**

A provision is recognized if, as a result of a past event, the Company has a present obligation, legal or constructive, that can be estimated reliably, and it is more likely than not that an outflow of economic benefits will be required to settle the obligation. Where applicable, provisions are determined by discounting the expected future cash flows at a pre-tax credit-adjusted rate that reflects the current market assessments of the time value of money and the risks specific to the liability. The increase in the provision due to the passage of time is recognized as a finance cost in the Consolidated Statements of Earnings and Comprehensive Income.

#### **Decommissioning Liabilities**

Decommissioning liabilities include those legal or constructive obligations where the Company will be required to retire tangible long-lived assets such as producing well sites, crude oil and natural gas processing facilities and refining facilities. The amount recognized is the present value of estimated future expenditures required to settle the obligation using a credit-adjusted risk-free rate. A corresponding asset equal to the initial estimate of the liability is capitalized as part of the cost of the related long-lived asset. Changes in the estimated liability resulting from revisions to expected timing or future decommissioning costs are recognized as a change in the decommissioning liability and the related long-lived asset. The amount capitalized in property, plant and equipment is depreciated over the useful life of the related asset. Increases in the decommissioning liabilities resulting from the passage of time are recognized as a finance cost in the Consolidated Statements of Earnings and Comprehensive Income.

Actual expenditures incurred are charged against the accumulated liability.

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### **V) Share Capital**

Common shares are classified as equity. Transaction costs directly attributable to the issue of common shares are recognized as a deduction from equity, net of any income taxes.

### **W) Dividends**

Dividends are accrued when declared by the Board of Directors.

### **X) Stock-Based Compensation**

Cenovus has a number of cash and stock-based compensation plans which include stock options with associated tandem stock appreciation rights, stock options with associated net settlement rights, performance share units and deferred share units.

#### ***Tandem Stock Appreciation Rights***

Stock options with associated tandem stock appreciation rights ("TSARs") are accounted for as liability instruments which are measured at fair value at each period end using the Black-Scholes-Merton valuation model. The fair value is recognized as compensation costs over the vesting period. When options are settled for cash, the liability is reduced by the cash settlement paid. When options are settled for common shares, the cash consideration received by the Company and the previously recorded liability associated with the option are recorded as share capital.

#### ***Net Settlement Rights***

Stock options with associated net settlement rights ("NSRs") are accounted for as equity instruments which are measured at fair value on the grant date using the Black-Scholes-Merton valuation model and are not revalued at each reporting date. The fair value is recognized as compensation costs over the vesting period of the options, with a corresponding increase recorded as paid in surplus in Shareholders' Equity. On exercise, the cash consideration received by the Company and the associated paid in surplus are recorded as share capital.

#### ***Performance and Deferred Share Units***

Performance share units ("PSUs") and deferred share units ("DSUs") are accounted for as liability instruments and are measured at fair value based on the market value of Cenovus's common shares at each period end. The fair value is recognized as compensation costs over the vesting period. Fluctuations in the fair values are recognized as compensation costs in the period they occur.

### **Y) Financial Instruments**

Financial instruments are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets and liabilities are not offset unless the Company has the legal right to offset and intends to settle on a net basis or settle the asset and liability simultaneously. A financial asset is derecognized when the rights to receive cash flows from the asset have expired or have been transferred and the Company has transferred substantially all the risks and rewards of ownership. A financial liability is derecognized when the obligation is discharged, cancelled or expired. When an existing financial liability is replaced by another from the same counterparty with substantially different terms, or the terms of an existing liability are substantially modified, this exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference in the carrying amounts of the liabilities is recognized in the Consolidated Statements of Earnings and Comprehensive Income.

Financial instruments are classified as either "fair value through profit and loss", "loans and receivables", "held-to-maturity investments", "available for sale financial assets" or "financial liabilities measured at amortized cost". The Company determines the classification of its financial assets at initial recognition. Financial instruments are initially measured at fair value except in the case of "financial liabilities measured at amortized cost" which are initially measured at fair value net of directly attributable transaction costs.

The Company's consolidated financial assets include cash and cash equivalents, accounts receivable and accrued revenues, partner loans receivable, the Partnership Contribution Receivable, risk management assets and long-term receivables. The Company's financial liabilities include accounts payable and accrued liabilities, partner loans payable, the Partnership Contribution Payable, derivative financial instruments, short-term borrowings and long-term debt.

#### ***Fair Value through Profit or Loss***

Financial assets and financial liabilities at "fair value through profit or loss" are either "held-for-trading" or have been "designated at fair value through profit or loss". In both cases the financial assets and financial liabilities are measured at fair value with changes in fair value recognized in net earnings.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Risk management assets and liabilities are derivative financial instruments classified as "held-for-trading" unless designated for hedge accounting. Derivative instruments that do not qualify as hedges, or are not designated as hedges, are recorded using mark-to-market accounting whereby instruments are recorded in the Consolidated Balance Sheets as either an asset or liability with changes in fair value recognized in net earnings as a (gain) loss on risk management. The estimated fair value of all derivative instruments is based on quoted market prices or, in their absence, third-party market indications and forecasts.

Derivative financial instruments are used to manage economic exposure to market risks relating to commodity prices, foreign currency exchange rates and interest rates. Derivative financial instruments are not used for speculative purposes. Policies and procedures are in place with respect to required documentation and approvals for the use of derivative financial instruments. Where specific financial instruments are executed, the Company assesses, both at the time of purchase and on an ongoing basis, whether the financial instrument used in the particular transaction is effective in offsetting changes in fair values or cash flows of the transaction.

### **Loans and Receivables**

"Loans and receivables" are financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, these assets are measured at amortized cost at the settlement date using the effective interest method of amortization. "Loans and receivables" comprise cash and cash equivalents, accounts receivable and accrued revenue, partner loans receivable, the Partnership Contribution Receivable and long-term receivables. Gains and losses on "loans and receivables" are recognized in net earnings when the "loans and receivables" are derecognized or impaired.

### **Held to Maturity Investments**

"Held-to-maturity investments" are measured at amortized cost using the effective interest method of amortization.

### **Available for Sale Financial Assets**

"Available for sale financial assets" are measured at fair value, with changes in the fair value recognized in OCI. When an active market is non-existent, fair value is determined using valuation techniques. When fair value cannot be reliably measured, such assets are carried at cost.

### **Financial Liabilities Measured at Amortized Cost**

These financial liabilities are measured at amortized cost at the settlement date using the effective interest method of amortization. Financial liabilities measured at amortized cost comprise accounts payable and accrued liabilities, partner loans payable, the Partnership Contribution Payable, short-term borrowings and long-term debt. Long-term debt transaction costs, premiums and discounts are capitalized within long-term debt or as a prepayment and amortized using the effective interest method.

## **Z) Reclassification**

Certain information provided for prior years has been reclassified to conform to the presentation adopted in 2012.

## **AA) Recent Accounting Pronouncements**

### **New and Amended Standards Adopted**

The Company did not adopt any new standards, amendments or interpretations effective during the year ended December 31, 2012.

### **New Standards and Interpretations not Yet Adopted**

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after January 1, 2012, and have not been applied in preparing the Consolidated Financial Statements for the year ended December 31, 2012. The standards and interpretations applicable to the Company are as follows and will be adopted on their respective effective date:

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### Joint Arrangements, Consolidation, Associates and Disclosures

In May 2011, the IASB issued the following new and amended standards:

- IFRS 10, "Consolidated Financial Statements" ("IFRS 10") replaces IAS 27, "Consolidated and Separate Financial Statements" ("IAS 27") and Standing Interpretations Committee ("SIC") 12, "Consolidation – Special Purpose Entities". IFRS 10 revises the definition of control to include three elements: (1) power over an investee; (2) exposure to variable returns from its involvement with the investee and (3) the ability to use its power to affect returns from the investee. IFRS 10 provides guidance on participating and protective rights and also addresses the notion of "de facto" control. It also includes guidance related to an investor with decision making rights to determine if it is acting as a principal or agent.
- IFRS 11, "Joint Arrangements" ("IFRS 11") replaces IAS 31, "Interest in Joint Ventures" ("IAS 31") and SIC 13, "Jointly Controlled Entities – Non-Monetary Contributions by Venturers". Under IFRS 11, a joint arrangement is classified as either a "joint operation" or a "joint venture" depending on the rights and obligations of the parties to the arrangement. Under a joint operation, parties have rights to the assets and obligations for the liabilities of the arrangement and account for their share of assets, liabilities, revenues and expenses. Under a joint venture, parties have the rights to the net assets of the arrangement and account for the arrangement as an investment using the equity method.
- IFRS 12, "Disclosure of Interest in Other Entities" ("IFRS 12") replaces the disclosure requirements previously included in IAS 27, IAS 31, and IAS 28, "Investments in Associates". It sets out the extensive disclosure requirements relating to an entity's interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities.
- IAS 27, "Separate Financial Statements" has been amended to conform to the changes made in IFRS 10, but retains the current guidance for separate financial statements.
- IAS 28, "Investments in Associates and Joint Ventures" has been amended to conform to the changes made in IFRS 10 and IFRS 11.

The above standards are effective for annual periods beginning on or after January 1, 2013 and must be adopted concurrently. It is anticipated that the application of these five standards will not have a significant impact on the Consolidated Financial Statements.

Cenovus performed a comprehensive review of its interests in other entities and identified two individually significant interests, FCCL Partnership ("FCCL") and WRB Refining LP ("WRB"), for which it shares joint control. Cenovus reviewed these joint arrangements considering their structure, the legal forms of any separate vehicles, the contractual terms of the arrangements and other facts and circumstances. The application of the Company's accounting policy under IFRS 11 requires judgment in determining the classification of its joint arrangements. It was determined that Cenovus has the rights to the assets and obligations for the liabilities of FCCL and WRB. As a result, these joint arrangements will be classified as joint operations under IFRS 11 and the Company's share of the assets, liabilities, revenues and expenses will be recognized in the Consolidated Financial Statements.

In determining the classification of its joint arrangements under IFRS 11, the Company considered the following:

- The intention of the transaction creating FCCL and WRB was to form an integrated North American heavy oil business. The integrated business was structured, initially on a tax neutral basis, through two partnerships due to the assets residing in different tax jurisdictions. Partnerships are "flow-through" entities which have a limited life.
- The partnership agreements require the partners (Cenovus and ConocoPhillips or Phillips 66 or respective subsidiaries) to make contributions if funds are insufficient to meet the obligations or liabilities of the partnership. The past and future development of FCCL and WRB is dependent on funding from the partners by way of partnership notes payable and loans. The partnerships do not have any third party borrowings.
- FCCL operates like most typical western Canadian working interest relationships where the operating partner takes product on behalf of the participants. WRB has a very similar structure modified only to account for the operating environment of the refining business.
- Cenovus and Phillips 66, either directly or through wholly-owned subsidiaries, provide marketing services, purchase necessary feedstock, and arrange for transportation and storage on the partners' behalf as the agreements prohibit the partnerships from undertaking these roles themselves. In addition, the partnerships do not have employees and as such are not capable of performing these roles.
- In each arrangement, output is taken by one of the partners, indicating that the partners have rights to the economic benefits of the assets and the obligation for funding the liabilities of the arrangements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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For the year ended December 31, 2012

### Employee Benefits

In June 2011, the IASB amended IAS 19, "Employee Benefits" ("IAS 19"). The amendments require the recognition of changes in defined benefit obligations and fair value of plan assets when they occur, eliminating the "corridor approach", and accelerates the recognition of past service costs. In order for the net defined benefit liability or asset to reflect the full value of the plan deficit or surplus, all actuarial gains and losses are to be recognized immediately through OCI. In addition, entities will be required to calculate net interest on the net defined benefit liability or asset using the same discount rate used to measure the defined benefit obligation. The amendments also enhance financial statement disclosures.

The amendments to IAS 19 require retrospective application. Based on Cenovus's preliminary assessment, when the amendments are applied for the first time for the year ending December 31, 2013, net earnings for the year ended December 31, 2012 would increase by \$1 million and other comprehensive income after tax would decrease by \$3 million (2011 – \$nil and decrease \$12 million, respectively). Shareholders' equity as at December 31, 2012 would decrease by \$24 million (January 1, 2012 – decrease \$22 million) with corresponding adjustments, being recognized in other liabilities and deferred income taxes.

### Fair Value Measurement

In May 2011, the IASB issued IFRS 13, "Fair Value Measurement" ("IFRS 13") which provides a consistent and less complex definition of fair value, establishes a single source for determining fair value and introduces consistent requirements for disclosures related to fair value measurement. IFRS 13 is effective for annual periods beginning on or after January 1, 2013 and applies prospectively from the beginning of the annual period in which the standard is adopted. Early adoption is permitted. IFRS 13 will not have a significant impact on the Consolidated Financial Statements.

### Financial Instruments

The IASB intends to replace IAS 39, "Financial Instruments: Recognition and Measurement" ("IAS 39") with IFRS 9, "Financial Instruments" ("IFRS 9"). IFRS 9 will be published in three phases, of which the first phase has been published.

The first phase addresses accounting for financial assets and financial liabilities. The second phase will address impairment of financial instruments and the third phase will address hedge accounting.

For financial assets, IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value and replaces the multiple rules in IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. Although the classification criteria for financial liabilities will not change under IFRS 9, the approach to the fair value option for financial liabilities may require different accounting for changes to the fair value of a financial liability as a result of changes to an entity's own credit risk.

IFRS 9 is effective for annual periods beginning on or after January 1, 2015 with different transitional arrangements depending on the date of initial application. The Company is currently evaluating the impact of adopting IFRS 9 on its Consolidated Financial Statements.

### Presentation of Items of Other Comprehensive Income

In June 2011, the IASB issued an amendment to IAS 1, "Presentation of Financial Statements" ("IAS 1") requiring companies to group items presented within OCI based on whether they may be subsequently reclassified to profit or loss. This amendment to IAS 1 is effective for annual periods beginning on or after July 1, 2012 with full retrospective application. Early adoption is permitted. The adoption of this amendment will not have a significant impact on the Consolidated Financial Statements.

### Offsetting Financial Assets and Financial Liabilities

In December 2011, the IASB issued the following amended standards:

- IFRS 7, "Financial Instruments: Disclosures" ("IFRS 7"), has been amended to provide more extensive quantitative disclosures for financial instruments that are offset in the Consolidated Balance Sheets or that are subject to enforceable master netting or similar arrangements.
- IAS 32, "Financial Instruments: Presentation" ("IAS 32"), has been amended to clarify the requirements for offsetting financial assets and liabilities. The amendments clarify that the right to offset must be available on the current date and cannot be contingent on a future event.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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The amendments to IFRS 7 are effective for annual periods beginning on or after January 1, 2013 and the amendments to IAS 32 are effective for annual periods beginning on or after January 1, 2014, both requiring retrospective application. It is anticipated that IFRS 7 and IAS 32 will not have significant impacts on the Consolidated Financial Statements.

### 4. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

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The timely preparation of the Consolidated Financial Statements in accordance with IFRS requires that Management make estimates and assumptions and use judgment regarding the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenues and expenses during the period. Such estimates primarily relate to unsettled transactions and events as of the date of the Consolidated Financial Statements. The estimated fair value of financial assets and liabilities, by their very nature, are subject to measurement uncertainty. Accordingly, actual results may differ from estimated amounts as future confirming events occur.

#### A) Critical Judgments in Applying Accounting Policies

Critical judgments are those judgments made by Management in the process of applying accounting policies that have the most significant effect on the amounts recognized in the Company's Consolidated Financial Statements.

##### *Exploration and Evaluation Assets*

The application of the Company's accounting policy for exploration and evaluation expenditures requires judgment in determining whether it is likely that future economic benefit exists when activities have not reached a stage where technical feasibility and commercial viability can be reasonably determined. Factors such as drilling results, future capital programs, future operating costs as well as estimated economically recoverable reserves are considered. If it is determined that an E&E asset is no longer technically feasible or commercially viable or Management decides not to continue the exploration and evaluation activity, the unrecoverable costs are charged to exploration expense.

##### *Identification of CGUs*

The Company's upstream and refining assets are grouped into CGUs. CGUs are defined as the lowest level of integrated assets for which there are separately identifiable cash flows that are largely independent of cash flows from other assets or groups of assets. The classification of assets and allocation of corporate assets into CGUs requires significant judgment and interpretations. Factors considered in the classification include the integration between assets, shared infrastructures, the existence of common sales points, geography, geologic structure and the manner in which Management monitors and makes decisions about its operations. The recoverability of the Company's upstream, refining and corporate assets are assessed at the CGU level and therefore could have a significant impact on impairment losses.

#### B) Key Sources of Estimation Uncertainty

Critical accounting estimates are those estimates that require Management to make particularly subjective or complex judgments about matters that are inherently uncertain. Estimates and underlying assumptions are reviewed on an ongoing basis and any revisions to accounting estimates are recognized in the period in which the estimates are revised. The following are the key assumptions about the future and other key sources of estimation at the end of the reporting period that changes to could result in a material adjustment to the carrying amount of assets and liabilities within the next financial year.

##### *Reserves*

There are a number of inherent uncertainties associated with estimating reserves. Reserve estimates are dependent upon variables including the recoverable quantities of hydrocarbons, the cost of the development of the required infrastructure to recover the hydrocarbons, production costs, estimated selling price of the hydrocarbons produced, royalty payments and taxes. Changes in these variables could significantly impact the reserves estimates which would have a significant impact on the impairment test and depreciation, depletion and amortization expense of the Company's crude oil and natural gas assets. The Company's crude oil and natural gas reserves are evaluated and reported to the Company by independent qualified reserves evaluators.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### Impairment of Assets

Property, plant and equipment, E&E assets and goodwill are assessed for impairment at least annually and when circumstances suggest that the carrying amount may exceed the recoverable amount. Assets are tested for impairment at the CGU level. These calculations require the use of estimates and assumptions and are subject to change as new information becomes available. For the Company's upstream assets, these estimates include future commodity prices, expected production volumes, quantity of reserves and discount rates as well as future development and operating costs. Recoverable amounts for the Company's refining assets utilizes assumptions such as refinery throughput, future commodity prices, operating costs, transportation capacity and supply and demand conditions. Changes in assumptions used in determining the recoverable amount could affect the carrying value of the related assets.

For impairment testing purposes, goodwill has been allocated to each of the CGUs to which it relates.

At December 31, 2012, the recoverable amounts of Cenovus's upstream CGUs were determined based on fair value less costs to sell. Key assumptions in the determination of cash flows from reserves include reserves as estimated by Cenovus's independent qualified reserves evaluators, crude oil and natural gas prices and the discount rate.

### Oil and Natural Gas Prices

The future prices used to determine cash flows from crude oil and natural gas reserves are as follows:

	2013	2014	2015	2016	2017	Average Annual % Change to 2024
WTI (US\$/barrel)	92.50	92.50	93.60	95.50	97.40	2%
AECO (\$/Mcf)	3.35	3.85	4.35	4.70	5.10	3%

### Discount Rate

Evaluations of discounted future cash flows are initiated using the discount rate of 10 percent which is an industry standard rate used by independent qualified reserve evaluators in preparing their reserve reports. Based on the individual characteristics of the asset, other economic and operating factors are also considered which may increase or decrease the implied discount rate. Changes in the economic conditions could significantly change the estimated recoverable amount.

### Decommissioning Costs

Provisions are recognized for the future decommissioning and restoration of the Company's upstream crude oil and natural gas assets and refining assets at the end of their economic lives. Assumptions have been made to estimate the future liability based on past experience and current economic factors which Management believes are reasonable. However, the actual cost of decommissioning is uncertain and cost estimates may change in response to numerous factors including changes in legal requirements, technological advances, inflation and the timing of expected decommissioning and restoration. In addition, Management determines the appropriate discount rate at the end of each reporting period. This discount rate, which is credit adjusted, is used to determine the present value of the estimated future cash outflows required to settle the obligation and may change in response to numerous market factors.

### Income Tax Provisions

Tax regulations and legislation and the interpretations thereof in the various jurisdictions in which Cenovus operates are subject to change. As a result, there are usually a number of tax matters under review. As such, income taxes are subject to measurement uncertainty.

Deferred income tax assets are recognized to the extent that it is probable that the deductible temporary differences will be recoverable in future periods. The recoverability assessment involves a significant amount of estimation including an evaluation of when the temporary differences will reverse, an analysis of the amount of future taxable earnings, the availability of cash flow to offset the tax assets when the reversal occurs and the application of tax laws. There are some transactions for which the ultimate tax determination is uncertain. To the extent that assumptions used in the recoverability assessment change, there may be a significant impact on the Consolidated Financial Statements of future periods.



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 5. FINANCE COSTS

For the years ended December 31,	2012	2011	2010
Interest Expense – Short-Term Borrowings and Long-Term Debt	230	213	227
Interest Expense – Partnership Contribution Payable (Note 12)	118	138	165
Unwinding of Discount on Decommissioning Liabilities	86	75	75
Other	21	21	31
	<b>455</b>	<b>447</b>	<b>498</b>

### 6. INTEREST INCOME

For the years ended December 31,	2012	2011	2010
Interest Income – Partnership Contribution Receivable (Note 12)	(102)	(120)	(144)
Other	(7)	(4)	-
	<b>(109)</b>	<b>(124)</b>	<b>(144)</b>

### 7. FOREIGN EXCHANGE (GAIN) LOSS, NET

For the years ended December 31,	2012	2011	2010
Unrealized Foreign Exchange (Gain) Loss on translation of:			
U.S. Dollar Debt Issued from Canada	(69)	78	(182)
U.S. Dollar Partnership Contribution Receivable Issued from Canada	(15)	(107)	91
Other	14	(13)	22
Unrealized Foreign Exchange (Gain) Loss	(70)	(42)	(69)
Realized Foreign Exchange (Gain) Loss	50	68	18
	<b>(20)</b>	<b>26</b>	<b>(51)</b>

### 8. INCOME TAXES

The provision for income taxes is as follows:

For the years ended December 31,	2012	2011	2010
Current Tax			
Canada	188	150	82
United States <sup>(1)</sup>	121	4	-
Total Current Tax	309	154	82
Deferred Tax	474	575	141
	<b>783</b>	<b>729</b>	<b>223</b>

(1) Includes \$68 million of withholding tax on a U.S. dividend in 2012.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

All amounts in \$ millions, unless otherwise indicated  
For the year ended December 31, 2012

The following table reconciles income taxes calculated at the Canadian statutory rate with the recorded income taxes:

For the years ended December 31,	2012	2011	2010
<b>Earnings Before Income Tax</b>	<b>1,776</b>	2,207	1,304
Canadian Statutory Rate	<b>25.2%</b>	26.7%	28.2%
<b>Expected Income Tax</b>	<b>448</b>	589	368
Effect of Taxes Resulting from:			
Foreign Tax Rate Differential	<b>146</b>	82	(22)
Non-Deductible Stock-Based Compensation	<b>10</b>	18	34
Multi-Jurisdictional Financing	<b>(27)</b>	(50)	(93)
Foreign Exchange Gains (Losses) Not Included in Net Earnings	<b>14</b>	(9)	28
Non-Taxable Capital (Gains) Losses	<b>(7)</b>	(8)	(13)
Recognition of Capital Losses	<b>(22)</b>	26	(107)
Adjustments Arising from Prior Year Tax Filings	<b>33</b>	31	26
Withholding Tax on Foreign Dividend	<b>68</b>	-	-
Goodwill Impairment	<b>99</b>	-	-
Other	<b>21</b>	50	2
<b>Total Tax</b>	<b>783</b>	729	223
<b>Effective Tax Rate</b>	<b>44.1%</b>	33.0%	17.1%

The Canadian statutory tax rate decreased to 25.2 percent in 2012 from 26.7 percent in 2011 and 28.2 percent in 2010 as a result of tax legislation enacted in 2007. The U.S. statutory tax rate has increased to 38.5 percent in 2012 from 37.5 percent in 2011 and 2010 as a result of the allocation of taxable income to U.S. states.

The analysis of deferred income tax liabilities and deferred income tax assets is as follows:

As at December 31,	2012	2011
<b>Deferred Income Tax Liabilities</b>		
Deferred Tax Liabilities to be Settled Within 12 Months	<b>140</b>	117
Deferred Tax Liabilities to be Settled After More Than 12 Months	<b>2,428</b>	1,984
<b>Net Deferred Income Tax Liability</b>	<b>2,568</b>	2,101

For the purposes of the above table, deferred income tax liabilities are shown net of offsetting deferred income tax assets where these occur in the same entity and jurisdiction. The deferred income tax liabilities to be settled within 12 months represents Management's estimate of the timing of the reversal of temporary differences and does not correlate to the current income tax expense of the subsequent year.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

All amounts in \$ millions, unless otherwise indicated  
For the year ended December 31, 2012

The movement in deferred income tax liabilities and assets, without taking into consideration the offsetting of balances within the same tax jurisdiction, is as follows:

<b>Deferred Income Tax Liabilities</b>	<b>Property, Plant and Equipment</b>	<b>Timing of Partnership Items</b>	<b>Net Foreign Exchange Gains</b>	<b>Risk Management</b>	<b>Other</b>	<b>Total</b>
As at January 1, 2010	1,678	9	61	17	-	1,765
Charged/(Credited) to Earnings	83	116	66	38	54	357
Charged/(Credited) to Held for Sale	2	-	-	-	-	2
Charged/(Credited) to OCI	(112)	-	-	-	1	(111)
As at December 31, 2010	1,651	125	127	55	55	2,013
Charged/(Credited) to Earnings	725	38	(15)	16	75	839
Charged/(Credited) to OCI	18	-	-	-	2	20
As at December 31, 2011	2,394	163	112	71	132	2,872
Charged/(Credited) to Earnings	418	(104)	(85)	2	(32)	199
Charged/(Credited) to OCI	(17)	-	-	-	(1)	(18)
<b>As at December 31, 2012</b>	<b>2,795</b>	<b>59</b>	<b>27</b>	<b>73</b>	<b>99</b>	<b>3,053</b>

<b>Deferred Income Tax Assets</b>	<b>Unused Tax Losses</b>	<b>Risk Management</b>	<b>Other</b>	<b>Total</b>
As at January 1, 2010	(242)	(33)	(9)	(284)
Charged/(Credited) to Earnings	(47)	(12)	(161)	(220)
Charged/(Credited) to OCI	8	-	-	8
As at December 31, 2010	(281)	(45)	(170)	(496)
Charged/(Credited) to Earnings	(270)	29	(21)	(262)
Charged/(Credited) to OCI	(13)	-	-	(13)
As at December 31, 2011	(564)	(16)	(191)	(771)
Charged/(Credited) to Earnings	244	11	20	275
Charged/(Credited) to OCI	11	-	-	11
<b>As at December 31, 2012</b>	<b>(309)</b>	<b>(5)</b>	<b>(171)</b>	<b>(485)</b>

<b>Net Deferred Income Tax Liabilities</b>	<b>Total</b>
Net Deferred Income Tax Liabilities as at January 1, 2010	1,481
Charged/(Credited) to Earnings	137
Charged/(Credited) to Held for Sale	2
Charged/(Credited) to OCI	(103)
Net Deferred Income Tax Liabilities as at December 31, 2010	1,517
Charged/(Credited) to Earnings	577
Charged/(Credited) to OCI	7
Net Deferred Income Tax Liabilities as at December 31, 2011	2,101
Charged/(Credited) to Earnings	474
Charged/(Credited) to OCI	(7)
<b>Net Deferred Income Tax Liabilities as at December 31, 2012</b>	<b>2,568</b>

The allocation of deferred income tax expense is comprised of:

<b>As at December 31,</b>	<b>2012</b>	2011	2010
Credited/(Charged) to Net Deferred Income Tax Liabilities	474	577	137
Credited/(Charged) to Liabilities Related to Assets Held for Sale	-	(2)	4
<b>Deferred Income Tax Expense</b>	<b>474</b>	<b>575</b>	<b>141</b>

No tax liability has been recognized in respect of temporary differences associated with investments in subsidiaries. As no taxes are expected to be paid in respect of these differences related to Canadian subsidiaries, the amounts have not been determined. There are no taxable temporary differences associated with investments in non-Canadian subsidiaries.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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For the year ended December 31, 2012

The approximate amounts of tax pools available are as follows:

As at December 31,	2012	2011
Canada	4,895	4,471
United States	1,607	2,740
	<b>6,502</b>	<b>7,211</b>

At December 31, 2012, the above tax pools included \$13 million (2011 – \$78 million; 2010 – \$236 million) of Canadian non-capital losses and \$791 million (2011 – \$1,479 million; 2010 – \$607 million) of U.S. federal net operating losses. These losses expire no earlier than 2029.

Also included in the December 31, 2012 tax pools are Canadian net capital losses totaling \$512 million (2011 – \$759 million; 2010 – \$983 million) which are available for carry forward to reduce future capital gains. Of these losses, \$406 million are unrecognized as a deferred income tax asset at December 31, 2012 (2011 – \$286 million; 2010 – \$415 million). Recognition is dependent on the level of future capital gains.

## 9. PER SHARE AMOUNTS

### A) Net Earnings per Share

For the years ended December 31,  
(\$ millions, except earnings per share)

	2012	2011	2010
Net Earnings – Basic and Diluted	993	1,478	1,081
Weighted Average Number of Shares – Basic	755.6	754.0	751.9
Dilutive Effect of Cenovus TSARs	2.9	3.7	2.1
Dilutive Effect of NSRs	-	-	-
Weighted Average Number of Shares – Diluted	758.5	757.7	754.0
Basic Earnings per share	\$1.31	\$1.96	\$1.44
Diluted Earnings per share	\$1.31	\$1.95	\$1.43

### B) Dividends per Share

The dividends paid in 2012 were \$665 million or \$0.88 per share, (2011 – \$603 million, \$0.80 per share; 2010 – \$601 million, \$0.80 per share). The Cenovus Board of Directors declared a first quarter 2013 dividend of \$0.242 per share, payable on March 28, 2013, to common shareholders of record as of March 15, 2013.

## 10. CASH AND CASH EQUIVALENTS

As at December 31,	2012	2011
Cash	339	232
Short-Term Investments	821	263
	<b>1,160</b>	<b>495</b>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 11. ACCOUNTS RECEIVABLE AND ACCRUED REVENUES

As at December 31,	2012	2011
Accruals	965	801
Trade	232	251
Joint Operations with Partners	30	30
Prepays and Deposits	45	34
Interest	23	28
Other	169	261
	<b>1,464</b>	<b>1,405</b>

### 12. PARTNERSHIP CONTRIBUTION RECEIVABLE AND PAYABLE

Cenovus has two significant joint operations, FCCL and WRB (Note 29). Through its interests in these joint operations, Cenovus's Consolidated Balance Sheets include a Partnership Contribution Receivable and Payable which arose when Cenovus became a 50 percent partner of an integrated North American oil business. The integrated business consists of an upstream entity, FCCL, and a refining entity, WRB. On formation of the upstream entity Cenovus contributed assets, primarily Foster Creek and Christina Lake properties, with a fair value of US\$7.5 billion and a note receivable of an equal amount was contributed by the partner ("Partnership Contribution Receivable"). For the refining entity, the partner contributed its Wood River and Borger refineries, located in Illinois and Texas, respectively, for a fair value of US\$7.5 billion and Cenovus contributed a note payable of an equal amount ("Partnership Contribution Payable").

#### Partnership Contribution Receivable

This note receivable is denominated in US\$ and bears interest at a rate of 5.3 percent per annum. Equal payments of principal and interest are payable quarterly, with final payment due January 2, 2017. The current and long-term Partnership Contribution Receivable shown in the Consolidated Balance Sheets represent Cenovus's 50 percent share of this promissory note, net of receipts to date.

#### Mandatory Receipts – Partnership Contribution Receivable

	2013	2014	2015	2016	2017	Thereafter	Total
US\$	386	407	429	452	117	-	<b>1,791</b>
C\$ equivalent	384	405	427	450	116	-	<b>1,782</b>

#### Partnership Contribution Payable

This note payable is denominated in US\$ and bears interest at a rate of 6.0 percent per annum. Equal payments of principal and interest are payable quarterly, with final payment due January 2, 2017. The current and long-term Partnership Contribution Payable amounts shown in the Consolidated Balance Sheets represent Cenovus's 50 percent share of this promissory note, net of payments to date.

#### Mandatory Payments – Partnership Contribution Payable

	2013	2014	2015	2016	2017	Thereafter	Total
US\$	388	412	437	464	121	-	<b>1,822</b>
C\$ equivalent	386	410	435	462	119	-	<b>1,812</b>

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### 13. INVENTORIES

As at December 31,	2012	2011
<b>Product</b>		
Refining and Marketing	1,056	1,079
Oil Sands	202	186
Conventional	1	1
<b>Parts and Supplies</b>	29	25
	<b>1,288</b>	<b>1,291</b>

During the year ended December 31, 2012, approximately \$12,378 million of produced and purchased inventory was recognized as an expense (2011 – \$11,576 million; 2010 – \$9,692 million). Inventory costs include purchased product, the cost of condensate blended with heavy oil and related operating costs.

### 14. ASSETS AND LIABILITIES HELD FOR SALE

As at December 31,	2012	2011
<b>Assets Held for Sale</b>		
Property, Plant and Equipment	-	116
<b>Liabilities Related to Assets Held for Sale</b>		
Decommissioning Liabilities	-	54
Deferred Income Taxes	-	-
	-	54

#### Non-Core Natural Gas Assets

At December 31, 2011, the Company classified certain non-core natural gas assets located in Northern Alberta as assets held for sale. The assets were recorded at the lesser of fair value less costs to sell and their carrying amount. This resulted in an impairment loss of approximately \$2 million which has been recorded as additional depreciation, depletion and amortization in the Consolidated Statements of Earnings and Comprehensive Income. These assets and the related liabilities were reported in the Conventional segment.

In January 2012, the Company completed the sale of these natural gas assets to an unrelated third party for net proceeds of \$64 million.

### 15. EXPLORATION AND EVALUATION ASSETS

	E&E
<b>COST</b>	
As at December 31, 2010	713
Additions	527
Transfers to Property, Plant and Equipment (Note 16)	(356)
Divestitures	(3)
Change in Decommissioning Liabilities	(1)
As at December 31, 2011	880
Additions <sup>(1)</sup>	687
Transfers to Property, Plant and Equipment (Note 16)	(218)
Exploration Expense	(68)
Divestitures	(11)
Change in Decommissioning Liabilities	15
<b>As at December 31, 2012</b>	<b>1,285</b>

(1) 2012 asset acquisition included the assumption of a decommissioning liability of \$33 million.

E&E assets consist of the Company's evaluation projects which are pending the determination of technical feasibility and commercial viability. All of the Company's E&E assets are located within Canada.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Additions to E&E assets for the year ended December 31, 2012 include \$37 million of internal costs directly related to the evaluation of these projects (year ended December 31, 2011 – \$15 million).

For the year ended December 31, 2012, \$218 million of E&E assets were transferred to property, plant and equipment – development and production assets, following the determination of technical feasibility and commercial viability of the projects (year ended December 31, 2011 – \$356 million).

### Impairment

The impairment of E&E assets and any subsequent reversal of such impairment losses are recognized in exploration expense in the Consolidated Statements of Earnings and Comprehensive Income. For the year ended December 31, 2012, \$68 million of previously capitalized E&E costs related primarily to the Roncott assets within the Conventional segment were deemed not to be technically feasible and commercially viable and were recognized as exploration expense. There were no impairment losses for the years ended December 31, 2011 and 2010.

## 16. PROPERTY, PLANT AND EQUIPMENT, NET

	Upstream Assets		Refining Equipment	Other <sup>(1)</sup>	Total
	Development & Production	Other Upstream			
<b>COST</b>					
As at December 31, 2010	21,720	153	2,950	450	25,273
Additions	1,704	41	391	131	2,267
Transfers from E&E Assets (Note 15)	356	-	-	-	356
Transfers and Reclassifications	(326)	-	(5)	(2)	(333)
Change in Decommissioning Liabilities	403	-	10	1	414
Exchange Rate Movements	1	-	79	-	80
Divestitures	-	-	-	(4)	(4)
As at December 31, 2011	23,858	194	3,425	576	28,053
Additions	2,442	44	118	191	2,795
Transfers from E&E Assets (Note 15)	218	-	-	-	218
Transfers and Reclassifications	-	-	(55)	-	(55)
Change in Decommissioning Liabilities	484	-	(16)	-	468
Exchange Rate Movements	1	-	(73)	-	(72)
Divestitures	-	-	-	-	-
<b>As at December 31, 2012</b>	<b>27,003</b>	<b>238</b>	<b>3,399</b>	<b>767</b>	<b>31,407</b>
<b>ACCUMULATED DEPRECIATION, DEPLETION AND AMORTIZATION</b>					
As at December 31, 2010	12,121	124	97	304	12,646
Depreciation and Depletion Expense	1,108	15	85	40	1,248
Transfers and Reclassifications	(211)	-	(5)	-	(216)
Impairment Losses	2	-	45	-	47
Exchange Rate Movements	1	-	3	-	4
As at December 31, 2011	13,021	139	225	344	13,729
Depreciation and Depletion Expense	1,368	19	146	52	1,585
Transfers and Reclassifications	-	-	(55)	-	(55)
Impairment Losses	-	-	-	-	-
Exchange Rate Movements	1	-	(5)	-	(4)
<b>As at December 31, 2012</b>	<b>14,390</b>	<b>158</b>	<b>311</b>	<b>396</b>	<b>15,255</b>
<b>CARRYING VALUE</b>					
As at December 31, 2010	9,599	29	2,853	146	12,627
As at December 31, 2011	10,837	55	3,200	232	14,324
<b>As at December 31, 2012</b>	<b>12,613</b>	<b>80</b>	<b>3,088</b>	<b>371</b>	<b>16,152</b>

(1) Includes office furniture, fixtures, leasehold improvements, information technology and aircraft.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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Additions to development and production assets include internal costs directly related to the development, construction and production of crude oil and natural gas properties of \$161 million (2011 – \$125 million). All of the Company's development and production assets are located within Canada. Costs classified as general and administrative expenses have not been capitalized as part of capital expenditures. No borrowing costs have been capitalized in 2012 (2011 – \$nil).

Property, plant and equipment include the following amounts in respect of assets not available for use which are not subject to depreciation until put into use:

As at December 31,	2012	2011
Development and Production	38	52
Refining Equipment	13	125
Other	11	112
	<b>62</b>	<b>289</b>

### Impairment

The impairment of property, plant and equipment and any subsequent reversal of such impairment losses are recognized in depreciation, depletion and amortization in the Consolidated Statements of Earnings and Comprehensive Income.

Depreciation, depletion and amortization expense includes impairment losses as follows:

For the years ended December 31,	2012	2011	2010
Development and Production	-	2	-
Refining Equipment	-	45	14
	<b>-</b>	<b>47</b>	<b>14</b>

There were no impairments or impairment reversals of property, plant and equipment in 2012. The impairment losses for the year ended December 31, 2011 were related to a catalytic cracking unit at the Wood River Refinery, which will not be used in future operations, and an impairment on non-core natural gas assets that were reclassified as held for sale (Note 14). The natural gas assets reside in the Conventional segment. The 2010 impairment loss related to a processing unit at the Borger Refinery which was determined to be a redundant asset.

## 17. DIVESTITURES

In January 2012, the Company completed the sale of non-core natural gas assets located in Northern Alberta. A loss of \$2 million was recorded on the sale. These assets and the related liabilities were reported in the Conventional segment.

In 2011, the Company disposed of non-core crude oil and natural gas properties and marine terminal facilities recognizing an after-tax gain of \$91 million in the Statement of Earnings and Comprehensive Income. In 2010, an after-tax gain of \$116 million was recognized on the disposition of non-core crude oil and natural gas properties and corporate assets.

## 18. OTHER ASSETS

As at December 31,	2012	2011
Long-Term Receivables	22	18
Prepays	8	8
Other	28	18
	<b>58</b>	<b>44</b>



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### 19. GOODWILL

As at December 31,	2012	2011
Carrying Value, Beginning of Year	1,132	1,132
Impairment	(393)	-
Carrying Value, End of Year	739	1,132

There were no additions to goodwill during 2012 or 2011.

#### Impairment Test for Cash-Generating Units Containing Goodwill

For the purpose of impairment testing, goodwill is allocated to the CGU to which it relates. All of the Company's goodwill arose on the acquisition of exploration and production assets. The carrying amount of goodwill allocated to the Company's exploration and production CGUs was as follows:

As at December 31,	2012	2011
Suffield	-	393
Foster Creek	242	242
Northern Alberta	497	497
	739	1,132

At December 31, 2012, the Company determined that the carrying amount of the Suffield CGU exceeded its fair value less costs to sell and the full amount of the impairment was attributed to goodwill. This goodwill arose in 2002 upon the formation of the predecessor corporation. An impairment loss of \$393 million was recorded as goodwill impairment on the Consolidated Statement of Earnings and Comprehensive Income. The Suffield property resides on the Canadian Forces Base in southeast Alberta and the operating results are included in the Conventional segment. Future cash flows for the area have declined due to lower natural gas and crude oil prices and increased operating costs. In addition, minimal levels of capital spending for natural gas resulted in production exceeding reserve replacement in the area. With lower future cash flows and decreasing volumes, the carrying amount of the goodwill exceeded its fair value.

The recoverable amount was determined using fair value less costs to sell. A calculation based on discounted after-tax cash flows of proved and probable reserves using forecast prices and costs as estimated by Cenovus's independent qualified reserves evaluators was completed (Note 4). To assess reasonableness, an evaluation of fair value based on comparable asset transactions was also completed.

There was no impairment of goodwill in 2011 or 2010.

#### Sensitivities

Changes to the assumed discount rate or forward price estimates independently would have the following impact on the impairment of the Suffield CGU:

	One Percent Increase in the Discount Rate	Five Percent Decrease in the Forward Price Estimates
Impairment of Goodwill	-	-
Impairment of PP&E	50	100

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### 20. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

As at December 31,	2012	2011
Accruals	1,510	1,193
Trade	676	789
Employee Long-Term Incentives	196	209
Interest	82	72
Other	186	316
	<b>2,650</b>	<b>2,579</b>

### 21. LONG-TERM DEBT

As at December 31,		2012	2011
Revolving Term Debt <sup>(1)</sup>	A	-	-
U.S. Dollar Denominated Unsecured Notes	B	4,726	3,559
Total Debt Principal	C	4,726	3,559
Debt Discounts and Transaction Costs	D	(47)	(32)
		<b>4,679</b>	<b>3,527</b>

(1) Revolving term debt may include bankers' acceptances, LIBOR loans, prime rate loans and U.S. base rate loans.

The weighted average interest rate on outstanding debt for the year ended December 31, 2012 was 5.3 percent (2011 – 5.5 percent, 2010 – 5.8 percent).

#### A) Revolving Term Debt

At December 31, 2012, Cenovus had in place a committed credit facility in the amount of \$3.0 billion or the equivalent amount in U.S. dollars. The committed credit facility was renegotiated in September 2012 to slightly reduce both the standby fees required to maintain the facility as well as the cost of future borrowings. The maturity date was extended to November 30, 2016 and is extendable from time to time, for a period of up to four years at the option of Cenovus and upon agreement from the lenders. Borrowings are available by way of Bankers' Acceptances, LIBOR based loans, prime rate loans or U.S. base rate loans. At December 31, 2012, there were no amounts drawn on Cenovus's committed bank credit facility (2011 – \$nil).

#### B) Unsecured Notes

Unsecured notes are comprised of the following:

As at December 31,	US\$ Principal Amount	2012	2011
4.50% due September 15, 2014	800	796	814
5.70% due October 15, 2019	1,300	1,293	1,322
3.00% due August 15, 2022	500	498	-
6.75% due November 15, 2039	1,400	1,393	1,423
4.45% due September 15, 2042	750	746	-
	<b>4,750</b>	<b>4,726</b>	<b>3,559</b>

Cenovus has in place a Canadian base shelf prospectus for unsecured medium-term notes in the amount of \$1.5 billion. The Canadian shelf prospectus allows for the issuance of medium-term notes in Canadian dollars or other foreign currencies, from time to time, in one or more offerings. The terms of the notes, including, but not limited to, the principal amount, interest at either fixed or floating rates and maturity dates, will be determined at the date of issue. As at December 31, 2012, no medium-term notes have been issued under this Canadian shelf prospectus. The Canadian shelf prospectus expires in June 2014.

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Cenovus has in place a U.S. base shelf prospectus for unsecured notes in the amount of US\$2.0 billion. The U.S. shelf prospectus allows for the issuance of debt securities in U.S. dollars or other foreign currencies, from time to time, in one or more offerings. The terms of the notes, including, but not limited to, the principal amount, interest at either fixed or floating rates and maturity dates, will be determined at the date of issue. As at December 31, 2012, US\$750 million remains under this U.S. base shelf prospectus. The U.S. shelf prospectus expires in July 2014.

On August 17, 2012, Cenovus completed a public offering in the U.S. of senior unsecured notes of US\$500 million, with a coupon rate of 3.00 percent, due August 15, 2022 and US\$750 million of senior unsecured notes with a coupon rate of 4.45 percent due September 15, 2042, for an aggregate principal amount of US\$1.25 billion. The net proceeds will be used for general corporate purposes, including repayment of commercial paper indebtedness.

As at December 31, 2012, the Company is in compliance with all of the terms of its debt agreements.

### C) Mandatory Debt Payments

	US\$ Principal Amount	C\$ Principal Amount	Total C\$ Equivalent
2013	-	-	-
2014	800	-	796
2015	-	-	-
2016	-	-	-
2017	-	-	-
Thereafter	3,950	-	3,930
	<u>4,750</u>	<u>-</u>	<u>4,726</u>

### D) Debt Discounts and Transaction Costs

Long-term debt transaction costs and discounts associated with the unsecured notes are recorded within long-term debt and are amortized using the effective interest rate method. Transaction costs associated with the revolving term debt are recorded as a prepayment and are being amortized over the remaining term of the committed credit facility. During 2012, additional transaction costs of \$19 million were recorded (2011 – \$3 million).

## 22. DECOMMISSIONING LIABILITIES

The decommissioning provision represents the present value of the expected future costs associated with the retirement of upstream crude oil and natural gas assets and refining facilities. The aggregate carrying amount of the obligation is as follows:

As at December 31,	2012	2011
Decommissioning Liabilities, Beginning of Year	1,777	1,399
Liabilities Incurred	99	49
Liabilities Settled	(66)	(56)
Transfers and Reclassifications	3	(55)
Change in Estimated Future Cash Flows	144	146
Change in Discount Rate	273	218
Unwinding of Discount on Decommissioning Liabilities	86	75
Foreign Currency Translation	(1)	1
Decommissioning Liabilities, End of Year	<u>2,315</u>	<u>1,777</u>

The undiscounted amount of estimated cash flows required to settle the obligation is \$6,865 million (2011 – \$6,541 million), which has been discounted using a credit-adjusted risk-free rate of 4.2 percent (2011 – 4.8 percent). Most of these obligations are not expected to be paid for several years, or decades, and will be funded from general resources at that time. Revisions in estimated cash flows resulted from accelerated timing of forecast abandonment and reclamation spending and higher cost estimates.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### Sensitivities

Changes to the credit-adjusted risk-free rate or the inflation rate would have the following impact on the decommissioning liabilities:

As at December 31,	2012		2011	
	Credit-Adjusted Risk-Free Rate	Inflation Rate	Credit-Adjusted Risk-Free Rate	Inflation Rate
One Percent Increase	(408)	572	(367)	504
One Percent Decrease	565	(418)	494	(379)

## 23. OTHER LIABILITIES

As at December 31,	2012	2011
Deferred Revenue	31	35
Employee Long-Term Incentives	64	55
Pension and Other Post-Employment Benefits (Note 24)	28	16
Other	28	22
	<b>151</b>	<b>128</b>

## 24. PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS

The Company provides employees with a pension that includes either a defined contribution or defined benefit component and other post-employment benefit plans ("OPEB"). Most of the employees participate in the defined contribution pension. Starting in 2012, employees who meet certain criteria are eligible to elect to convert from the current defined contribution pension to a defined benefit pension.

The Company is required to file an actuarial valuation of its registered defined benefit pension plan with the provincial regulator at least every three years. The most recently filed valuation was dated June 30, 2012 and the next required actuarial valuation will be as at December 31, 2014.

The defined benefit pension provides pension benefits at retirement based on years of service and final average earnings. Future enrollment is limited to eligible employees who meet certain criteria. The defined benefit pension is funded according to the federal and provincial government pension legislation, where applicable. Contributions are made to trust funds administered by an independent trustee. The Company's contributions to the defined benefit pension plans are based on the results of the actuarial valuation and direction by the Human Resources and Compensation Committee of the Board.

The Company's OPEB provides retired employees with life insurance benefits, health care and dental benefits until age 65. These benefits are funded on an as required basis.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### A) Defined Benefit and OPEB Plan Obligation and Funded Status

Information related to defined benefit pension and OPEB plans, based on actuarial estimations, is as follows:

As at December 31,	Pension Benefits		OPEB	
	2012	2011	2012	2011
<b>Defined Benefit Obligation</b>				
Defined Benefit Obligation, Beginning of Year	84	68	19	14
Current Service Costs	10	3	2	2
Interest Costs	4	3	1	1
Benefits Paid	(2)	(1)	-	-
Plan Participant Contributions	1	-	-	-
Actuarial (Gains) Losses	7	11	(2)	2
Plan Conversion	30	-	-	-
Defined Benefit Obligation, End of Year	134	84	20	19
<b>Plan Assets</b>				
Fair Value of Plan Assets, Beginning of Year	61	59	-	-
Expected Return on Plan Assets	4	3	-	-
Employer Contributions	22	4	-	-
Plan Participant Contributions	1	-	-	-
Actuarial Gains (Losses)	-	(4)	-	-
Benefits Paid	(2)	(1)	-	-
Asset Transfer from Plan Conversion	12	-	-	-
Fair Value of Plan Assets, End of Year	98	61	-	-
Funded Status – Plan Assets (Less) than Benefit Obligation	(36)	(23)	(20)	(19)
Unamortized Net Actuarial (Gain) Loss not Recognized	26	22	2	4
<b>Pension and Other Post-Employment Benefit (Liability)</b>	<b>(10)</b>	<b>(1)</b>	<b>(18)</b>	<b>(15)</b>

The pension and other post-employment benefit liability is included in other liabilities on the Consolidated Balance Sheets.

### B) Pension and Other Post-Employment Benefit Costs

Pension and other post-employment benefit costs are as follows:

For the years ended December 31,	Pension Benefits			OPEB		
	2012	2011	2010	2012	2011	2010
Current Service Cost	10	3	3	3	2	1
Interest Cost	4	4	3	1	1	1
Expected Return on Plan Assets	(4)	(4)	(3)	-	-	-
Actuarial Gains (Losses)	3	1	-	-	-	-
Past Service Cost <sup>(1)</sup>	18	-	-	-	-	-
Defined Benefit Plan Cost	31	4	3	4	3	2
Defined Contribution Plan Cost	25	22	18	-	-	-
Total Plan Cost	56	26	21	4	3	2

<sup>(1)</sup> Past service costs for eligible employees who were given a one-time option to convert from the defined contribution pension to defined benefit pension retrospectively to the later of the date they would have been eligible to enroll in the defined benefit pension or November 30, 2009. Past service costs were fully vested and recorded immediately.

Pension costs are recorded in operating and general and administrative expenses, and PP&E and E&E assets, corresponding to where the associated salaries and wages of the employees rendering the service are recorded.

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### C) Actuarial Assumptions

The principal weighted average actuarial assumptions used to determine benefit obligations and expenses are as follows:

	Pension Benefits			OPEB		
	2012	2011	2010	2012	2011	2010
<b>Benefit Obligation at December 31</b>						
Discount Rate	4.00%	4.25%	5.25%	4.00%	4.25%	5.25%
Rate of Compensation Increase	4.39%	3.99%	4.05%	5.77%	5.77%	5.65%
<b>Benefit Expense for the Year</b>						
Discount Rate	4.25%	5.25%	6.00%	4.25%	5.25%	6.00%
Expected Return on Plan Assets	5.54%	5.59%	5.59%	N/A	N/A	N/A
Rate of Compensation Increase	3.99%	4.05%	4.05%	5.77%	5.65%	5.77%

The discount rates are determined with reference to market yields on high quality corporate debt instruments of similar duration to the benefit obligations at the end of the reporting period.

The expected rate of return on plan assets is based on historical and projected rates of return for each asset class in the plan investment portfolio.

The expected average remaining service period of the active employees covered by the defined benefit pension and OPEB plans are seven and 11 years, respectively.

Assumed health care cost trend rates are as follows:

	2012	2011	2010
Health Care Cost Trend for Next Year	8%	10%	10%
Rate that the Trend Rate Gradually Trends to	5%	5%	5%
Year that the Trend Rate Reaches the Rate Which it is Expected to Remain At	2021	2022	2021

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

	One Percentage Point Increase	One Percentage Point Decrease
Effect on Service and Interest Cost	-	-
Effect on Pension and Other Post-Employment Benefit Liability	1	(1)

### D) Plan Assets and Investment Objectives

The objective of the asset allocation is to manage the funded status of the plan at an appropriate level of risk, giving consideration to the security of the assets and the potential volatility of market returns and the resulting effect on both contribution requirements and pension expense. The long-term return is expected to achieve or exceed the return from a composite benchmark comprised of passive investments in appropriate market indices. The asset allocation structure is subject to diversification requirements and constraints which reduce risk by limiting exposure to individual equity investment and credit rating categories.

The actual return on the plan assets for the year ended December 31, 2012 was \$3 million (2011 – \$nil).

The Company's weighted average pension plan asset allocation, based on market values as at December 31, 2012 and 2011, are as follows:

	Target Allocation	Percentage of Plan Assets	
		2012	2011
Equity Securities	65-70%	63%	60%
Debt Securities	30%	30%	33%
Real Estate and Other	0-5%	7%	7%
Total	100%	100%	100%

Equity securities do not include any direct investments in Cenovus shares.

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The expected contributions for the year ended December 31, 2013 is \$15 million for the defined benefit pension plan and \$nil for the OPEB.

### E) Defined Benefit Plan and OPEB Experience Adjustments

Experience adjustments as a percentage of total plan assets and liabilities are as follows:

As at December 31,	2012	2011	2010
<b>Defined Benefit</b>			
Experience Adjustments Arising on Plan Liabilities	2%	(1)%	3%
Experience Adjustments Arising on Plan Assets	0%	7%	(2)%
<b>OPEB</b>			
Experience Adjustments Arising on Plan Liabilities	3%	2%	2%

## 25. SHARE CAPITAL

### A) Authorized

Cenovus is authorized to issue an unlimited number of common shares, an unlimited number of first preferred shares and an unlimited number of second preferred shares. The first and second preferred shares may be issued in one or more series with rights and conditions to be determined by the Company's Board of Directors prior to issuance and subject to the Company's articles.

### B) Issued and Outstanding

As at December 31,	2012		2011	
	Number of Common Shares (thousands)	Amount	Number of Common Shares (thousands)	Amount
Outstanding, Beginning of Year	754,499	3,780	752,675	3,716
Common Shares Issued under Stock Option Plans	1,344	49	1,824	64
Outstanding, End of Year	755,843	3,829	754,499	3,780

There were no preferred shares outstanding as at December 31, 2012 (2011 – nil).

At December 31, 2012, there were 28 million (2011 – 30 million) common shares available for future issuance under stock option plans.

The Company has a dividend reinvestment plan ("DRIP"). Under the DRIP, holders of common shares may reinvest all or a portion of the cash dividends payable on their common shares in additional common shares. At the discretion of the Company, the additional common shares may be issued from treasury or purchased on the market.

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### C) Paid in Surplus

Cenovus's paid in surplus reflects the Company's retained earnings prior to the split of Encana under the Arrangement into two independent energy companies, Encana and Cenovus. In addition, paid in surplus includes compensation expense related to the Company's NSRs discussed in Note 26 A.

	Pre-Arrangement Earnings	Stock-Based Compensation	Total
As at December 31, 2010	4,083	-	4,083
Stock-Based Compensation Expense	-	24	24
As at December 31, 2011	4,083	24	4,107
Stock-Based Compensation Expense	-	47	47
As at December 31, 2012	4,083	71	4,154

## 26. STOCK-BASED COMPENSATION PLANS

### A) Employee Stock Option Plan

Cenovus has an Employee Stock Option Plan that provides employees with the opportunity to exercise an option to purchase common shares of the Company. Option exercise prices approximate the market price for the common shares on the date the options were issued. Options granted are exercisable at 30 percent of the number granted after one year, an additional 30 percent of the number granted after two years and are fully exercisable after three years. Options granted prior to February 17, 2010 expire after five years while options granted on or after February 17, 2010 expire after seven years.

Options issued by the Company under the Employee Stock Option Plan prior to February 24, 2011 have associated tandem stock appreciation rights. In lieu of exercising the options, the tandem stock appreciation rights give the option holder the right to receive a cash payment equal to the excess of the market price of Cenovus's common shares at the time of exercise over the exercise price of the option.

Options issued by the Company on or after February 24, 2011 have associated net settlement rights. The net settlement rights, in lieu of exercising the option, give the option holder the right to receive the number of common shares that could be acquired with the excess value of the market price of Cenovus's common shares at the time of exercise over the exercise price of the option.

The tandem stock appreciation rights and net settlement rights vest and expire under the same terms and conditions as the underlying options. For the purpose of this financial statement note, options with associated tandem stock appreciation rights are referred to as "TSARs" and options with associated net settlement rights are referred to as "NSRs".

In addition, certain of the TSARs are performance based ("Performance TSARs"). The Performance TSARs vest and expire under the same terms and service conditions as the underlying option, and have an additional vesting requirement whereby vesting is subject to achievement of prescribed performance relative to pre-determined key measures. Performance TSARs that do not vest when eligible are forfeited.

In accordance with the Arrangement described in Note 1, each Cenovus and Encana employee exchanged their original Encana TSAR for one Cenovus Replacement TSAR and one Encana Replacement TSAR. The terms and conditions of the Cenovus and Encana Replacement TSARs are similar to the terms and conditions of the original Encana TSAR. The original exercise price of the Encana TSAR was apportioned to the Cenovus and Encana Replacement TSARs based on the one day volume weighted average trading price of Cenovus's common share price relative to that of Encana's common share price on the TSX on December 2, 2009. Cenovus TSARs and Cenovus Replacement TSARs are measured against the Cenovus common share price while Encana Replacement TSARs are measured against the Encana common share price. The Cenovus Replacement TSARs have similar vesting provisions as outlined above for the Employee Stock Option Plan. The original Encana Performance TSARs were also exchanged under the same terms as the original Encana TSARs.



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As at December 31, 2012	Issued	Term (Years)	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price (\$)	Closing Share Price (\$)	Units Outstanding
Encana Replacement TSARs held by Cenovus Employees	Prior to Arrangement	5	0.66	32.66	19.66	7,722
Cenovus Replacement TSARs held by Encana Employees	Prior to Arrangement	5	0.70	29.29	33.29	5,229
TSARs	Prior to February 17, 2010	5	0.72	29.28	33.29	6,225
TSARs	On or After February 17, 2010	7	4.20	26.71	33.29	5,026
NSRs	On or After February 24, 2011	7	5.85	37.52	33.29	15,074

Unless otherwise indicated, all references to TSARs collectively refer to both the Cenovus issued TSARs and Cenovus Replacement TSARs.

### NSRs

The weighted average unit fair value of NSRs granted during the year ended December 31, 2012 was \$7.62 before considering forfeitures, which are considered in determining total cost for the period. The fair value of each NSR was estimated on its grant date using the Black-Scholes-Merton valuation model with weighted average assumptions as follows:

Risk-Free Interest Rate	1.37%
Expected Dividend Yield	2.31%
Expected Volatility <sup>(1)</sup>	28.62%
Expected Life (Years)	4.55

(1) Expected volatility has been based on historical share volatility of the Company and comparable industry peers.

The following tables summarize information related to the NSRs as at December 31, 2012:

As at December 31, 2012 (thousands of units)	NSRs	Weighted Average Exercise Price (\$)
Outstanding, Beginning of Year	5,809	36.95
Granted	9,665	37.87
Exercised for Common Shares	(5)	33.99
Forfeited	(395)	37.56
Outstanding, End of Year	15,074	37.52
Exercisable, End of Year	1,700	36.98

For options exercised during the year, the weighted average market price of Cenovus's common shares at the date of exercise was \$35.28.

As at December 31, 2012 Range of Exercise Price (\$)	Outstanding NSRs (thousands of units)	
	NSRs	Weighted Average Remaining Contractual Life (Years)
30.00 to 39.99	15,074	5.85
		Weighted Average Exercise Price (\$)
		37.52

As at December 31, 2012 Range of Exercise Price (\$)	Exercisable NSRs (thousands of units)	
	NSRs	Weighted Average Exercise Price (\$)
30.00 to 39.99	1,700	36.98

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### TSARs Held by Cenovus Employees

The Company has recorded a liability of \$64 million at December 31, 2012 (December 31, 2011 – \$90 million) in the Consolidated Balance Sheets based on the fair value of each TSAR held by Cenovus employees. Fair value was estimated at the period end date using the Black-Scholes-Merton valuation model with weighted average assumptions as follows:

Risk-Free Interest Rate	1.28%
Expected Dividend Yield	2.58%
Expected Volatility <sup>(1)</sup>	27.80%
Cenovus's Common Share Price	\$33.29

(1) Expected volatility has been based on historical share volatility of the Company and comparable industry peers.

The intrinsic value of vested TSARs held by Cenovus employees at December 31, 2012 was \$45 million (2011 – \$43 million).

The following tables summarize information related to the TSARs held by Cenovus employees as at December 31, 2012:

As at December 31, 2012 (thousands of units)	TSARs	Performance TSARs	Total	Weighted Average Exercise Price (\$)
Outstanding, Beginning of Year	9,391	5,530	14,921	28.12
Granted	-	-	-	-
Exercised for Cash Payment	(937)	(1,057)	(1,994)	28.52
Exercised as Options for Common Shares	(683)	(641)	(1,324)	27.77
Forfeited	(134)	(207)	(341)	26.77
Expired	(11)	-	(11)	30.85
Outstanding, End of Year	<b>7,626</b>	<b>3,625</b>	<b>11,251</b>	<b>28.13</b>
Exercisable, End of Year	<b>5,369</b>	<b>3,625</b>	<b>8,994</b>	<b>28.46</b>

For options exercised during the year, the weighted average market price of Cenovus's common shares at the date of exercise was \$36.73.

### Outstanding TSARs (thousands of units)

As at December 31, 2012 Range of Exercise Price (\$)	TSARs	Performance TSARs	Total	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price (\$)
20.00 to 29.99	6,269	2,143	8,412	2.88	26.38
30.00 to 39.99	1,294	1,482	2,776	0.48	33.10
40.00 to 49.99	63	-	63	0.45	43.29
	<b>7,626</b>	<b>3,625</b>	<b>11,251</b>	<b>2.27</b>	<b>28.13</b>

### Exercisable TSARs (thousands of units)

As at December 31, 2012 Range of Exercise Price (\$)	TSARs	Performance TSARs	Total	Weighted Average Exercise Price (\$)
20.00 to 29.99	4,132	2,143	6,275	26.35
30.00 to 39.99	1,174	1,482	2,656	33.11
40.00 to 49.99	63	-	63	43.29
	<b>5,369</b>	<b>3,625</b>	<b>8,994</b>	<b>28.46</b>

The closing price of Cenovus common shares on the TSX as at December 31, 2012 was \$33.29.

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### Encana Replacement TSARs Held by Cenovus Employees

Cenovus is required to reimburse Encana in respect of cash payments made by Encana to Cenovus employees when a Cenovus employee exercises an Encana Replacement TSAR for cash. No further Encana Replacement TSARs will be granted to Cenovus employees.

The Company has recorded a liability of \$1 million at December 31, 2012 (2011 – \$1 million) in the Consolidated Balance Sheets based on the fair value of each Encana Replacement TSAR held by Cenovus employees. Fair value was estimated at the period end date using the Black-Scholes-Merton valuation model with weighted average assumptions as follows:

Risk-Free Interest Rate	1.21%
Expected Dividend Yield	3.86%
Expected Volatility <sup>(1)</sup>	30.40%
Encana's Common Share Price	\$19.66

(1) Expected volatility has been based on the historical volatility of Encana's publicly traded shares.

The intrinsic value of vested Encana Replacement TSARs held by Cenovus employees at December 31, 2012 was \$nil (2011 – \$nil).

The following tables summarize information related to the Encana Replacement TSARs held by Cenovus employees as at December 31, 2012:

As at December 31, 2012 (thousands of units)	TSARs	Performance TSARs	Total	Weighted Average Exercise Price (\$)
Outstanding, Beginning of Year	4,281	6,130	10,411	31.97
Exercised for Cash Payment	-	-	-	-
Exercised as Options for Encana Common Shares	-	-	-	-
Forfeited	(112)	(333)	(445)	31.04
Expired	(1,008)	(1,236)	(2,244)	29.79
Outstanding, End of Year	3,161	4,561	7,722	32.66
Exercisable, End of Year	3,161	4,561	7,722	32.66

### Outstanding & Exercisable TSARs (thousands of units)

As at December 31, 2012 Range of Exercise Price (\$)	TSARs	Performance TSARs	Total	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price (\$)
20.00 to 29.99	1,564	2,510	4,074	1.12	29.02
30.00 to 39.99	1,465	2,051	3,516	0.15	36.41
40.00 to 49.99	130	-	130	0.48	44.85
50.00 to 59.99	2	-	2	0.39	50.39
	3,161	4,561	7,722	0.66	32.66

The closing price of Encana common shares on the TSX as at December 31, 2012 was \$19.66.

### Cenovus Replacement TSARs Held by Encana Employees

Encana is required to reimburse Cenovus in respect of cash payments made by Cenovus to Encana employees when these employees exercise a Cenovus Replacement TSAR for cash. No compensation expense is recognized and no further Cenovus Replacement TSARs will be granted to Encana employees.

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The Company has recorded a liability of \$35 million at December 31, 2012 (2011 – \$83 million) in the Consolidated Balance Sheets based on the fair value of each Cenovus Replacement TSAR held by Encana employees, with an offsetting account receivable from Encana. Fair value was estimated at the period end date using the Black-Scholes-Merton valuation model with weighted average assumptions as follows:

Risk-Free Interest Rate	1.21%
Expected Dividend Yield	2.58%
Expected Volatility <sup>(1)</sup>	27.80%
Cenovus's Common Share Price	\$33.29

(1) Expected volatility has been based on historical share volatility of the Company and comparable industry peers.

The intrinsic value of vested Cenovus Replacement TSARs held by Encana employees at December 31, 2012 was \$22 million (2011 – \$32 million).

The following tables summarize the information related to the Cenovus Replacement TSARs held by Encana employees as at December 31, 2012:

As at December 31, 2012 (thousands of units)	TSARs	Performance TSARs	Total	Weighted Average Exercise Price (\$)
Outstanding, Beginning of Year	3,935	5,751	9,686	28.96
Exercised for Cash Payment	(1,788)	(2,189)	(3,977)	28.69
Exercised as Options for Common Shares	(8)	(12)	(20)	26.64
Forfeited	(84)	(314)	(398)	27.67
Expired	(30)	(32)	(62)	27.67
Outstanding, End of Year	2,025	3,204	5,229	29.29
Exercisable, End of Year	2,025	3,204	5,229	29.29

For options exercised during the year, the weighted average market price of Cenovus's common shares at the date of exercise was \$36.72.

### Outstanding & Exercisable TSARs (thousands of units)

As at December 31, 2012 Range of Exercise Price (\$)	TSARs	Performance TSARs	Total	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price (\$)
20.00 to 29.99	1,087	1,899	2,986	1.12	26.27
30.00 to 39.99	886	1,305	2,191	0.14	33.08
40.00 to 49.99	52	-	52	0.44	42.70
	2,025	3,204	5,229	0.70	29.29

The closing price of Cenovus common shares on the TSX as at December 31, 2012 was \$33.29.

### B) Performance Share Units

Cenovus has granted Performance Share Units ("PSUs") to certain employees under its Performance Share Unit Plan for Employees. PSUs are whole share units and entitle employees to receive, upon vesting, either a common share of Cenovus or a cash payment equal to the value of a Cenovus common share. For a portion of PSUs, the number of PSUs eligible for payment is determined over three years based on the units granted multiplied by 30 percent after year one, 30 percent after year two and 40 percent after year three. All PSUs are eligible to vest based on the Company achieving key pre-determined performance measures. PSUs vest after three years.

The Company has recorded a liability of \$124 million at December 31, 2012 (2011 – \$55 million) in the Consolidated Balance Sheets for PSUs based on the market value of the Cenovus common shares at December 31, 2012. The intrinsic value of vested PSUs was \$nil at December 31, 2012 and 2011 as PSUs are paid out upon vesting.

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The following table summarizes the information related to the PSUs held by Cenovus employees as at December 31, 2012:

(thousands of units)	PSUs
Outstanding, Beginning of Year	2,623
Granted	2,704
Cancelled	(183)
Units in Lieu of Dividends	114
Outstanding, End of Year	<b>5,258</b>

### C) Deferred Share Units

Under two Deferred Share Unit Plans, Cenovus directors, officers and employees may receive Deferred Share Units ("DSUs"), which are equivalent in value to a common share of the Company. Employees have the option to convert either zero, 25 or 50 percent of their annual bonus award into DSUs. DSUs vest immediately, are redeemed in accordance with the terms of the agreement and expire on December 15 of the calendar year following the year of cessation of directorship or employment.

The Company has recorded a liability of \$36 million at December 31, 2012 (2011 – \$35 million) in the Consolidated Balance Sheets for DSUs based on the market value of the Cenovus common shares at December 31, 2012. The intrinsic value of vested DSUs equals the carrying value as DSUs vest at the time of grant.

The following table summarizes the information related to the DSUs held by Cenovus directors, officers and employees as at December 31, 2012:

(thousands of units)	DSUs
Outstanding, Beginning of Year	1,042
Granted to Directors	64
Granted from Annual Bonus Awards	22
Units in Lieu of Dividends	30
Exercised	(74)
Outstanding, End of Year	<b>1,084</b>

### D) Total Stock-Based Compensation Expense (Recovery)

The following table summarizes the stock-based compensation expense (recovery) recorded for all plans within operating and general and administrative expenses on the Consolidated Statements of Earnings and Comprehensive Income:

For the years ended December 31,	2012	2011	2010
NSRs	27	16	-
TSARs Held by Cenovus Employees	(1)	24	45
Encana Replacement TSARs Held by Cenovus Employees	-	(8)	(20)
PSUs	46	27	13
DSUs	3	4	9
<b>Total Stock-Based Compensation Expense (Recovery)</b>	<b>75</b>	<b>63</b>	<b>47</b>

## 27. EMPLOYEE SALARIES AND BENEFIT EXPENSES

For the years ended December 31,	2012	2011	2010
Salaries, Bonuses and Other Short-Term Employee Benefits	441	399	348
Defined Contribution Pension Plan	14	13	11
Defined Benefit Pension Plan and OPEB	20	4	(1)
Stock-Based Compensation (Note 26)	75	63	47
	<b>550</b>	<b>479</b>	<b>405</b>

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### 28. RELATED PARTY TRANSACTIONS

#### Key Management Compensation

Key management includes Directors (executive and non-executive), Executive Officers, Senior Vice-Presidents and Vice-Presidents. The compensation paid or payable to key management is as follows:

For the years ended December 31,	2012	2011	2010
Salaries, Director Fees and Short-Term Benefits	27	25	22
Post-Employment Benefits	7	3	2
Other Long-Term Benefits	-	-	-
Stock-Based Compensation	35	35	37
<b>Total</b>	<b>69</b>	<b>63</b>	<b>61</b>

Post-employment benefits represent the present value of future pension benefits earned during the year. Stock-based compensation includes the costs recognized during the year associated with stock options, NSRs, TSARs, PSUs and DSUs.

### 29. INTEREST IN JOINT OPERATIONS

On January 2, 2007, Cenovus became a 50 percent partner in an integrated North American heavy oil business. The integrated business is structured through two joint arrangements. The upstream entity, FCCL Partnership, is involved in the development and production of crude oil and is jointly controlled with ConocoPhillips. The refining entity, WRB Refining LP, includes two refineries in the U.S. and focuses on the refining of crude oil into petroleum and chemical products. WRB is jointly controlled with Phillips 66.

Cenovus recognizes its share of the assets, liabilities, revenues and expenses (proportionately consolidates) of these joint operations with the results of operations included in the Oil Sands and Refining and Marketing segments, respectively. Cenovus's Consolidated Financial Statements include the following amounts related to these joint arrangements:

Statements of Earnings For the years ended December 31,	FCCL Partnership <sup>(1)</sup>			WRB Refining LP <sup>(1)</sup>		
	2012	2011	2010	2012	2011	2010
<b>Revenues</b>	<b>3,132</b>	2,364	1,829	<b>9,160</b>	8,672	6,624
<b>Expenses</b>						
Purchased Product	-	-	-	<b>7,339</b>	7,223	6,095
Operating, Transportation and Blending and Realized Gain/Loss on Risk Management	<b>1,944</b>	1,397	1,074	<b>552</b>	473	462
<b>Operating Cash Flow</b>	<b>1,188</b>	967	755	<b>1,269</b>	976	67
Depreciation, Depletion and Amortization	<b>303</b>	205	210	<b>135</b>	130	86
Other Expenses (Income)	<b>1</b>	(136)	20	<b>4</b>	(4)	13
<b>Net Earnings (Loss)</b>	<b>884</b>	898	525	<b>1,130</b>	850	(32)

(1) FCCL Partnership and WRB Refining LP are not separate tax paying entities. Income taxes related to the Partnerships' income are the responsibility of their respective Partners.

As at December 31,	FCCL Partnership		WRB Refining LP	
	2012	2011	2012	2011
Cash and Cash Equivalents	388	145	172	166
Other Current Assets	761	792	1,111	1,236
Long-Term Assets	7,599	6,864	3,087	3,188
Current Liabilities	350	317	566	759
Long-Term Liabilities	137	83	58	73

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Capital commitments through jointly controlled entities are as follows:

As at December 31, 2012	1 Year	2 Years	3 Years	4 Years	5 Years	Thereafter	Total
Capital Commitments <sup>(1)</sup>	268	34	44	40	2	1	389

(1) Contracts undertaken on behalf of the FCCL Partnership and WRB Refining LP are reflected at Cenovus's 50 percent interest.

As at December 31, 2011	1 Year	2 Years	3 Years	4 Years	5 Years	Thereafter	Total
Capital Commitments <sup>(1)</sup>	179	58	11	2	3	-	253

(1) Contracts undertaken on behalf of the FCCL Partnership and WRB Refining LP are reflected at Cenovus's 50 percent interest.

There are no contingent liabilities related to the Company's interest in jointly controlled entities, nor contingent liabilities of the jointly controlled entities themselves.

### 30. CAPITAL STRUCTURE

Cenovus's capital structure objectives and targets have remained unchanged from previous periods. Cenovus's capital structure consists of Shareholders' Equity plus Debt. Debt is defined as short-term borrowings and the current and long-term portions of long-term debt excluding any amounts with respect to the Partnership Contribution Payable or Receivable. Cenovus's objectives when managing its capital structure are to maintain financial flexibility, preserve access to capital markets, ensure its ability to finance internally generated growth and to fund potential acquisitions while maintaining the ability to meet the Company's financial obligations as they come due.

Cenovus monitors its capital structure and financing requirements using, among other things, non-GAAP financial metrics consisting of Debt to Capitalization and Debt to Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization ("Adjusted EBITDA"). These metrics are used to steward Cenovus's overall debt position as measures of Cenovus's overall financial strength.

Cenovus continues to target a Debt to Capitalization ratio of between 30 and 40 percent over the long-term.

As at December 31,	2012	2011
Long-Term Debt	4,679	3,527
Shareholders' Equity	9,806	9,406
Capitalization	14,485	12,933
<b>Debt to Capitalization</b>	<b>32%</b>	27%

Cenovus continues to target a Debt to Adjusted EBITDA of between 1.0 and 2.0 times over the long-term.

As at December 31,	2012	2011	2010
Debt	4,679	3,527	3,432
Net Earnings	993	1,478	1,081
Add (Deduct):			
Finance Costs	455	447	498
Interest Income	(109)	(124)	(144)
Income Tax Expense	783	729	223
Depreciation, Depletion and Amortization	1,585	1,295	1,302
Goodwill Impairment	393	-	-
Exploration Expense	68	-	-
Unrealized (Gain) Loss on Risk Management	(57)	(180)	(46)
Foreign Exchange (Gain) Loss, net	(20)	26	(51)
(Gain) Loss on Divestiture of Assets	-	(107)	(116)
Other (Income) Loss, net	(5)	4	(13)
Adjusted EBITDA	4,086	3,568	2,734
<b>Debt to Adjusted EBITDA</b>	<b>1.1x</b>	1.0x	1.3x

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It is Cenovus's intention to maintain investment grade credit ratings to help ensure it has continuous access to capital and the financial flexibility to fund its capital programs, meet its financial obligations and finance potential acquisitions. Cenovus will maintain a high level of capital discipline and manage its capital structure to ensure sufficient liquidity through all stages of the economic cycle. To manage its capital structure, Cenovus may adjust capital and operating spending, adjust dividends paid to shareholders, purchase shares for cancellation pursuant to normal course issuer bids, issue new shares, issue new debt, draw down on its credit facilities or repay existing debt.

At December 31, 2012, Cenovus is in compliance with all of the terms of its debt agreements.

### 31. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Cenovus's consolidated financial assets and financial liabilities consist of cash and cash equivalents, accounts receivable and accrued revenues, accounts payable and accrued liabilities, Partnership Contribution Receivable and Payable, partner loans, risk management assets and liabilities, long-term receivables, short-term borrowings and long-term debt. Risk management assets and liabilities arise from the use of derivative financial instruments.

#### A) Fair Value of Financial Assets and Liabilities

The fair values of cash and cash equivalents, accounts receivable and accrued revenues, accounts payable and accrued liabilities, and short-term borrowings approximate their carrying amount due to the short-term maturity of those instruments.

The fair values of the Partnership Contribution Receivable and Partnership Contribution Payable, partner loans and long-term receivables approximate their carrying amount due to the specific non-tradeable nature of these instruments.

Risk management assets and liabilities are recorded at their estimated fair value based on mark-to-market accounting, using quoted market prices or, in their absence, third-party market indications and forecasts.

Long-term debt is carried at amortized cost. The estimated fair values of long-term borrowings have been determined based on prices sourced from market data. As at December 31, 2012, the carrying value of Cenovus's long-term debt accounted for using amortized cost was \$4,679 million and the fair value was \$5,582 million (December 31, 2011 carrying value - \$3,527 million, fair value - \$4,316 million).

#### B) Risk Management Assets and Liabilities

Under the terms of the Arrangement, risk management positions at November 30, 2009 were allocated to Cenovus based upon Cenovus's proportion of the related volumes covered by the contracts. To effect the allocation, Cenovus entered into a contract with Encana with the same terms and conditions as between Encana and the third parties to the existing contracts. All positions entered into after the Arrangement have been negotiated between Cenovus and third parties.

#### Net Risk Management Position

As at December 31,	2012	2011
<b>Risk Management Assets</b>		
Current Asset	283	232
Long-Term Asset	5	52
	<b>288</b>	<b>284</b>
<b>Risk Management Liabilities</b>		
Current Liability	17	54
Long-Term Liability	1	14
	<b>18</b>	<b>68</b>
<b>Net Risk Management Asset (Liability)</b>	<b>270</b>	<b>216</b>



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### Summary of Unrealized Risk Management Positions

As at December 31,	2012			2011		
	Asset	Liability	Net	Asset	Liability	Net
<b>Commodity Prices</b>						
Crude Oil	221	16	205	22	65	(43)
Natural Gas	66	1	65	247	3	244
Power	1	1	-	15	-	15
<b>Total Fair Value</b>	<b>288</b>	<b>18</b>	<b>270</b>	<b>284</b>	<b>68</b>	<b>216</b>

### Net Fair Value Methodologies Used to Calculate Unrealized Risk Management Positions

As at December 31,	2012	2011
Prices Actively Quoted (Level 1)	120	226
Prices Sourced from Observable Data or Market Corroboration (Level 2)	150	(10)
<b>Total Fair Value</b>	<b>270</b>	<b>216</b>

Prices actively quoted refers to the fair value of contracts valued using quoted prices in an active market. Prices sourced from observable data or market corroboration refers to the fair value of contracts valued in part using active quotes and in part using observable, market-corroborated data.

### Net Fair Value of Commodity Price Positions at December 31, 2012

As at December 31, 2012	Notional Volumes	Term	Average Price	Fair Value
<b>Crude Oil Contracts</b>				
Fixed Price Contracts				
Brent Fixed Price <sup>(1)</sup>	18,500 bbls/d	2013	US\$110.36/bbl	23
Brent Fixed Price <sup>(1)</sup>	18,500 bbls/d	2013	\$111.72/bbl	33
WCS Differential <sup>(2)</sup>	49,200 bbls/d	2013	US\$(20.74)/bbl	145
WCS Differential <sup>(2)</sup>	9,400 bbls/d	2014	US\$(20.13)/bbl	5
Other Financial Positions <sup>(3)</sup>				(1)
<b>Crude Oil Fair Value Position</b>				<b>205</b>
<b>Natural Gas Contracts</b>				
Fixed Price Contracts				
NYMEX Fixed Price	166 MMcf/d	2013	US\$4.64/Mcf	66
Other Fixed Price Contracts <sup>(4)</sup>				(1)
<b>Natural Gas Fair Value Position</b>				<b>65</b>
<b>Power Purchase Contracts</b>				
Power Fair Value Position				-

(1) Brent fixed price positions consist of both Brent fixed price swaps and WTI swaps converted to Brent.

(2) Cenovus has entered into fixed price swaps to protect against widening light/heavy price differentials for heavy crudes.

(3) Other financial positions are part of ongoing operations to market the Company's production.

(4) Cenovus has entered into other fixed price contracts to protect against widening price differentials between production areas and various sales points.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### Earnings Impact of Realized and Unrealized Gains (Losses) on Risk Management Positions

For the years ended December 31,	2012	2011	2010
<b>Realized Gain (Loss) <sup>(1)</sup></b>			
Crude Oil	81	(135)	(17)
Natural Gas	247	210	289
Refining	7	(14)	10
Power	1	7	(4)
	<b>336</b>	<b>68</b>	<b>278</b>
<b>Unrealized Gain (Loss) <sup>(2)</sup></b>			
Crude Oil	247	106	(92)
Natural Gas	(176)	38	152
Refining	1	7	(8)
Power	(15)	29	(6)
	<b>57</b>	<b>180</b>	<b>46</b>
<b>Gain (Loss) on Risk Management</b>	<b>393</b>	<b>248</b>	<b>324</b>

(1) Realized gains and losses on risk management are recorded in the operating segment to which the derivative instrument relates.

(2) Unrealized gains and losses on risk management are recorded in the Corporate and Eliminations segment.

### Reconciliation of Unrealized Risk Management Positions from January 1 to December 31, 2012

	2012		2011		2010	
	Fair Value	Total Unrealized Gain (Loss)	Total Unrealized Gain (Loss)	Total Unrealized Gain (Loss)	Total Unrealized Gain (Loss)	Total Unrealized Gain (Loss)
Fair Value of Contracts, Beginning of Year	216					
Change in Fair Value of Contracts in Place at Beginning of Year and Contracts Entered into During the Year	393	393	248		324	
Unrealized Foreign Exchange Gain (Loss) on U.S. Dollar Contracts	(3)	-	-		-	
Fair Value of Contracts Realized During the Year	(336)	(336)	(68)		(278)	
Fair Value of Contracts, End of Year	<b>270</b>	<b>57</b>	<b>180</b>		<b>46</b>	

### Commodity Price Sensitivities – Risk Management Positions

The following table summarizes the sensitivity of the fair value of Cenovus's risk management positions to fluctuations in commodity prices, with all other variables held constant. Management believes the price fluctuations identified in the table below are a reasonable measure of volatility. The impact of fluctuating commodity prices on the Company's open risk management positions as at December 31 could have resulted in unrealized gains (losses) impacting earnings before income tax for the year ended December 31 as follows:

#### Risk Management Positions in Place as at December 31, 2012

Commodity	Sensitivity Range	Increase	Decrease
Crude Oil Commodity Price	± US\$10 per bbl Applied to Brent and WTI Hedges	(156)	156
Crude Oil Differential Price	± US\$5 per bbl Applied to Differential Hedges tied to Production	111	(111)
Natural Gas Commodity Price	± \$1 per mcf Applied to NYMEX Natural Gas Hedges	(55)	55
Natural Gas Basis Price	± \$0.10 per mcf Applied to Natural Gas Basis Hedges	1	(1)
Power Commodity Price	± \$25 per MWhr Applied to Power Hedge	19	(19)

#### Risk Management Positions in Place as at December 31, 2011

Commodity	Sensitivity Range	Increase	Decrease
Crude Oil Commodity Price	± US\$10 per bbl Applied to WTI Hedges	(214)	214
Crude Oil Differential Price	± US\$5 per bbl Applied to Differential Hedges tied to Production	67	(67)
Natural Gas Commodity Price	± \$1 per mcf Applied to NYMEX and AECO Hedges	(160)	160
Natural Gas Basis Price	± \$0.10 per mcf Applied to Natural Gas Basis Hedges	2	(2)
Power Commodity Price	± \$25 per MWhr Applied to Power Hedge	19	(19)

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

*All amounts in \$ millions, unless otherwise indicated  
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### **C) Risks Associated with Financial Assets and Liabilities**

#### **Commodity Price Risk**

Commodity price risk arises from the effect that fluctuations of future commodity prices may have on the fair value or future cash flows of financial assets and liabilities. To partially mitigate exposure to commodity price risk, the Company has entered into various financial derivative instruments. The use of these derivative instruments is governed under formal policies and is subject to limits established by the Board of Directors. The Company's policy is not to use derivative instruments for speculative purposes.

Crude Oil – The Company has used fixed price swaps to partially mitigate its exposure to the commodity price risk on its crude oil sales and condensate supply used for blending. Cenovus has entered into a limited number of swaps and futures to help protect against widening light/heavy crude oil price differentials.

Natural Gas – To partially mitigate the natural gas commodity price risk, the Company has entered into swaps, which fix the NYMEX price. To help protect against widening natural gas price differentials in various production areas, Cenovus has entered into a limited number of swaps to manage the price differentials between these production areas and various sales points.

Power – The Company has in place a Canadian dollar denominated derivative contract, which commenced January 1, 2007 for a period of 11 years, to manage a portion of its electricity consumption costs.

#### **Credit Risk**

Credit risk arises from the potential that the Company may incur a loss if a counterparty to a financial instrument fails to meet its obligation in accordance with agreed terms. This credit risk exposure is mitigated through the use of Board-approved credit policies governing the Company's credit portfolio and with credit practices that limit transactions according to counterparties' credit quality. Agreements are entered into with major financial institutions with investment grade credit ratings and with large commercial counterparties, most of which have investment grade credit ratings. A substantial portion of Cenovus's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks. At December 31, 2012 and 2011, substantially all of the Company's accounts receivable were current. As at December 31, 2012, 87 percent (2011 – 92 percent) of Cenovus's accounts receivable and financial derivative credit exposures are with investment grade counterparties.

At December 31, 2012, Cenovus had two counterparties (2011 – two counterparties) whose net settlement position individually account for more than 10 percent of the fair value of the outstanding in-the-money net financial and physical contracts by counterparty. The maximum credit risk exposure associated with accounts receivable and accrued revenues, risk management assets, Partnership Contribution Receivable, partner loans receivable, and long-term receivables is the total carrying value. The majority of this credit risk resides with A rated or higher counterparties. Cenovus's exposure to its counterparties is acceptable and within Credit Policy tolerances.

#### **Liquidity Risk**

Liquidity risk is the risk that Cenovus will not be able to meet all of its financial obligations as they become due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price. Cenovus manages its liquidity risk through the active management of cash and debt and by maintaining appropriate access to credit. As disclosed in Note 30, over the long term, Cenovus targets a Debt to Capitalization ratio between 30 and 40 percent and a Debt to Adjusted EBITDA of between 1.0 to 2.0 times to manage the Company's overall debt position. It is Cenovus's intention to maintain investment grade credit ratings on its senior unsecured debt.

Cenovus manages its liquidity risk by ensuring that it has access to multiple sources of capital including: cash and cash equivalents, cash from operating activities, undrawn credit facilities, commercial paper and availability under its shelf prospectuses. At December 31, 2012, Cenovus had \$3.0 billion available on its committed credit facility. In addition, Cenovus had in place a Canadian debt shelf prospectus for \$1.5 billion and unused capacity of US\$750 million under a U.S. debt shelf prospectus, the availability of which are dependent on market conditions.

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Undiscounted cash outflows relating to financial liabilities are:

<b>2012</b>	Less than 1 Year	1-3 Years	4-5 Years	Thereafter	<b>Total</b>
Accounts Payable and Accrued Liabilities	2,650	-	-	-	<b>2,650</b>
Risk Management Liabilities	17	1	-	-	<b>18</b>
Long-Term Debt <sup>(1)</sup>	254	1,263	432	7,051	<b>9,000</b>
Partnership Contribution Payable <sup>(1)</sup>	486	972	609	-	<b>2,067</b>
Other <sup>(1)</sup>	-	9	4	4	<b>17</b>

(1) Principal and interest, including current portion.

<b>2011</b>	Less than 1 Year	1-3 Years	4-5 Years	Thereafter	<b>Total</b>
Accounts Payable and Accrued Liabilities	2,579	-	-	-	<b>2,579</b>
Risk Management Liabilities	54	14	-	-	<b>68</b>
Long-Term Debt <sup>(1)</sup>	208	1,230	343	5,182	<b>6,963</b>
Partnership Contribution Payable <sup>(1)</sup>	497	994	994	125	<b>2,610</b>
Other <sup>(1)</sup>	3	10	3	4	<b>20</b>

(1) Principal and interest, including current portion.

### Foreign Exchange Risk

Foreign exchange risk arises from changes in foreign exchange rates that may affect the fair value or future cash flows of Cenovus's financial assets or liabilities. As Cenovus operates in North America, fluctuations in the exchange rate between the U.S./Canadian dollars can have a significant effect on reported results.

As disclosed in Note 7, Cenovus's foreign exchange (gain) loss primarily includes unrealized foreign exchange gains and losses on the translation of the U.S. dollar debt issued from Canada and the translation of the U.S. dollar Partnership Contribution Receivable issued from Canada. At December 31, 2012, Cenovus had US\$4,750 million in U.S. dollar debt issued from Canada (2011 – US\$3,500 million; 2010 – US\$3,500 million) and US\$1,791 million related to the U.S. dollar Partnership Contribution Receivable (2011 – US\$2,157 million; 2010 – US\$2,505 million). A \$0.01 change in the U.S. to Canadian dollar exchange rate would have resulted in a \$30 million change in foreign exchange (gain) loss at December 31, 2012 (2011 – \$13 million; 2010 – \$10 million).

### Interest Rate Risk

Interest rate risk arises from changes in market interest rates that may affect earnings, cash flows and valuations. Cenovus has the flexibility to partially mitigate its exposure to interest rate changes by maintaining a mix of both fixed and floating rate debt.

At December 31, 2012, the increase or decrease in net earnings for a one percentage point change in interest rates on floating rate debt amounts to \$nil (2011 – \$nil; 2010 – \$nil). This assumes the amount of fixed and floating debt remains unchanged from the respective balance sheet dates.

## 32. SUPPLEMENTARY CASH FLOW INFORMATION

For the years ended December 31,	<b>2012</b>	2011	2010
Interest Paid	<b>342</b>	357	423
Interest Received	<b>113</b>	128	148
Income Taxes Paid	<b>304</b>	-	62

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### 33. COMMITMENTS AND CONTINGENCIES

#### A) Commitments

As part of normal operations, the Company has committed to certain amounts over the next five years and thereafter as follows:

2012	1 Year	2 Years	3 Years	4 Years	5 Years	Thereafter	Total
Pipeline Transportation <sup>(1)</sup>	145	209	378	403	675	8,130	9,940
Operating Leases (Building Leases)	109	106	112	110	104	1,602	2,143
Product Purchases	81	18	18	6	-	-	123
Capital Commitments <sup>(2)</sup>	320	54	61	53	6	2	496
Other Long-Term Commitments	33	25	18	7	6	10	99
Total Payments <sup>(3)</sup>	688	412	587	579	791	9,744	12,801
Fixed Price Product Sales	50	52	54	55	3	-	214

(1) Certain transportation commitments included are subject to regulatory approval.

(2) Includes those commitments related to jointly controlled entities.

(3) Contracts undertaken on behalf of the FCCL Partnership and WRB Refining LP are reflected at Cenovus's 50 percent interest.

2011	1 Year	2 Years	3 Years	4 Years	5 Years	Thereafter	Total
Pipeline Transportation <sup>(1)</sup>	143	137	187	311	347	2,754	3,879
Operating Leases (Building Leases)	71	93	85	80	80	1,491	1,900
Product Purchases	19	18	19	19	6	-	81
Capital Commitments <sup>(2)</sup>	366	98	40	23	22	20	569
Other Long-Term Commitments	5	4	1	1	-	1	12
Total Payments <sup>(3)</sup>	604	350	332	434	455	4,266	6,441
Fixed Price Product Sales	52	54	56	57	60	3	282

(1) Certain transportation commitments included are subject to regulatory approval.

(2) Includes those commitments related to jointly controlled entities.

(3) Contracts undertaken on behalf of the FCCL Partnership and WRB Refining LP are reflected at Cenovus's 50 percent interest.

At December 31, 2012, there were outstanding letters of credit aggregating \$36 million issued as security for performance under certain contracts (2011 – \$17 million).

In addition to the above, Cenovus's commitments related to its risk management program are disclosed in Note 31.

#### B) Contingencies

##### Legal Proceedings

Cenovus is involved in a limited number of legal claims associated with the normal course of operations. Cenovus believes it has made adequate provisions for such legal claims. There are no individually or collectively significant claims.

##### Decommissioning Liabilities

Cenovus is responsible for the retirement of long-lived assets at the end of their useful lives. Cenovus has recognized a liability of \$2,315 million, based on current legislation and estimated costs, related to its crude oil and natural gas properties, refining facilities and midstream facilities. Actual costs may differ from those estimated due to changes in legislation and changes in costs.

##### Income Tax Matters

The tax regulations and legislation and interpretations thereof in the various jurisdictions in which Cenovus operates are continually changing. As a result, there are usually a number of tax matters under review. Management believes that the provision for taxes is adequate.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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### **34. SUBSEQUENT EVENT**

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Subsequent to December 31, 2012, Management decided to divest its Lower Shaunavon and certain of its Bakken properties in Saskatchewan. The public sales process is expected to be launched in late February 2013. The land base associated with these properties is relatively small and does not offer sufficient scalability to be material to Cenovus's overall asset portfolio. Operating results from these properties are included in the Conventional segment.