

FINANCIAL

STATEMENTS AND ANALYSIS

Net Margin up 10%

The Company's net margin was up 10% in relation to that in 2002. The higher net margin was mainly a result of the alignment of domestic oil product prices with those of the international market. Other contributing factors were an 18.2% appreciation of the Real against the US dollar in 2003, generating a gain from net exchange variations, mainly on financing, of US\$ 509 million during the year, a gain of US\$ 697 million resulting from the adoption of SFAS N° 143 – Accounting for Asset Retirement Obligations, and a 27% increase in sales in the international market. Moreover, a 3% increase in the domestic production of crude oil and NGL led to a rise in the proportion of domestic feedstock in the total processed at the Company's refineries and resulted in products of greater added-value. This proportion rose from 79% in 2002 to 80% in 2003. (Page 2)

Net profit in Supply is up 144%

Net profit in the area of Supply reached US\$ 1.7 billion, an increase of 144% in relation to 2002. This result is due to a higher gross margin in the segment, increased margins in international refining and domestic oil's greater share in refinery feedstock. Another contributing factor was the optimization of logistics costs, particularly those involving charters. (Page 5)

Operating revenue sets a new record

The Company's operating revenue established a record that is unsurpassed in the history of Brazilian industry. At US\$ 42.7 billion, it is the largest volume achieved in a single year by a Brazilian company, and is 29% up on the figure for 2002. Consolidated net operating revenue came to US\$ 30.8 billion, against US\$ 22.6 billion in the previous year. The result reflected increased foreign sales, mainly resulting from Petrobras' acquisition of the Argentinean companies Petrolera Santa Fé and Petrolera Entre Lomas (ex Perez Companc) and the renamed

Petrobras Energía Participaciones (ex PeCom). Another contributing factor was the price stability of the main oil products in the domestic market, which were aligned with international market prices. Furthermore, the Company increased its revenues from international sales and exports, mainly of oil from the Campos Basin, and the sale of gas in the consolidating state distribution market. This turnover could have been higher still, were it not for the impact of the Brazilian economic downturn on domestic sales. (Page 3)

Investment in 2003 reaches US\$ 6.5 billion



Petrobras invested US\$ 6.5 billion in 2003, in projects that included joint ventures, mainly for the expansion of its oil and natural gas production capacity. Of the Petrobras system's investment in Brazil, 56% was directed into exploration and production, primarily in the Campos Basin fields of Marlim Sul, Roncador, Albacora Leste and Marlim Leste. (Page 8)

Market confidence allowed Petrobras to raise U.S.\$ 5.4 billion in the international capital markets



Market confidence allowed Petrobras to raise US\$ 5.4 billion in the international capital markets during 2003. Notably, investor demand for issuances of Petrobras's global notes exceeded the actual amount issued on several occasions, and the notes were sold in record time. Demand

was strong notwithstanding the fact that these notes do not have any additional guarantee or political risk insurance. They are important milestones for the Company, not only for the reduction in costs and lengthening of Petrobras' debt maturity profile (the 15-year bonds issued on December 10, 2003 are of the longest maturity ever issued by the Company), but also because Petrobras' was able to diversify its investor base. A significant portion of these notes were acquired by investors from the high grade and high yield markets, comprising U.S. investors who are typically more interested in financing companies within the United States. (Page 9)

International area profit recovery in 2003

The International area showed a profit of US\$ 101 million in 2003, compared to a net loss of US\$ 114 million in 2002. This result was mainly due to the increase in sales of the Argentinean operations acquired by the Company. In addition, gross profits were swelled by US\$ 756 million as a result of higher international prices for oil and oil products. In 2003, the International area increased its spending on prospecting and drilling by US\$ 69 million. There was also an increase in the Company's operating expen-

ses abroad, mainly due to a provision of US\$ 56 million, in December, for contractual losses relating to oil pipeline transportation fees in Ecuador. January to December average daily production abroad of oil and liquefied natural gas (LNG) reached 160.9 thousand barrels (bpd), while natural gas production reached 85 thousand barrels of oil equivalent (boed), making a total of 245.9 boed. In 2003, the Company's proven oil reserves abroad attained a total of 1.2 billion barrels of oil equivalent, using SEC criteria. (Page 6)

Financial Analysis

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You should read the financial analysis together with the audited consolidated financial statements of Petrobras and its subsidiaries as of December 31, 2003 and 2002 and the accompanying notes thereto prepared in accordance with generally accepted accounting principles in the United States of America.

Financial Highlights

	US\$ MILLION	
	(EXCEPT EARNINGS PER SHARE OR UNLESS OTHERWISE NOTED)	
	YEAR ENDED	
	DEC. 31, 2003	DEC. 31, 2002
Income statement data		
Sales of products and services	42,690	32,987
Net operating revenues	30,797	22,612
Financial expenses, net	(136)	(1,700)
Net income	6,559	2,311
Basic and diluted earnings per share:		
Common and Preferred	5.98	2.13
Balance sheet data		
Total assets	53,612	32,154
Total debt ⁽¹⁾	21,890	14,680
Current ⁽¹⁾	3,694	1,986
Long-term ⁽¹⁾	18,196	12,694
Net debt ⁽²⁾	11,980	11,229
Shareholders' equity ⁽³⁾	17,152	9,301
Total capitalization ⁽⁴⁾	39,042	23,981
Other data		
Gross margin (%) ⁽⁵⁾	49.9	49.1
Net margin (%) ⁽⁶⁾	21.3	10.2
Debt to equity ratio ⁽⁷⁾	68%	71%

(1) Total debt includes short-term debt, total long-term debt, total capital lease obligations and total project financings.

(2) Net debt is calculated as total debt less cash and cash equivalents. At December 31, 2002 and at December 31, 2003 this item excludes Junior Notes in the amount of US\$ 150 million and US\$ 300 million, respectively.

(3) Shareholders' equity includes unrecognized losses in the amount of US\$ 1,588 million for the year ended December 2003 and US\$ 1,361 million for the year ended December 31, 2002, in each case related to an "Amount not recognized as net periodic pension cost".

(4) Total capitalization means shareholders' equity plus total debt.

(5) Gross margin is calculated as net operating revenues less cost of sales divided by net operating revenues.

(6) Net margin is calculated as net income divided by net operating revenues.

(7) Debt to equity ratio is calculated as total liabilities divided by the sum of total liabilities and total shareholders' equity.

REVENUES

Consolidated sales of products and services increased 29.4% to US\$ 42,690 million for 2003, as compared to US\$ 32,987 million for 2002, primarily as a result of the increase in the price of certain oil products in the international markets and the increase in sales volume outside Brazil (international sales).

Net operating revenues increased 36.2% to US\$ 30,797 million for 2003, as compared to US\$ 22,612 million for 2002. This increase was primarily attributable to the alignment in 2003 of prices of certain oil products in the Brazilian market with international prices of such products prevailing at the end of 2002. The increase in net operating revenues was also attributable, to a lesser extent, to an increase in sales volume outside Brazil (international sales), which includes sales conducted by PEPSA and PELSA. This increase was partially offset by a 4.3% reduction in sales volume in the domestic market, primarily due to a decrease in Brazilian consumer demand.

The following chart summarizes sales volumes during 2003 and 2002:

Sales Volume (thousand bpd)	2003	2002
Oil Products	1,510	1,600
Alcohol and Others	33	44
Natural Gas	177	156
Total	1,720	1,800
Distribution	435	467
Inter-company sales	(393)	(425)
Total domestic market	1,762	1,842
Exports	452	449
International sales	242	79
Other operations (1)	141	129
Total international market	835	657
Total	2,597	2,499

(1) Includes third-party sales by the international subsidiary, Petrobras International Finance Company (PIFCO).

NET INCOME

Petrobras recorded net income of US\$ 6,559 million in 2003, as compared to net income of US\$ 2,311 million in 2002. The main factors contributing to a 183.8% higher net income were:

- An increase in sales of products and services, primarily attributable to the alignment in 2003 of prices of certain oil products in the Brazilian market with international prices of such products prevailing at the end of 2002 and an increase in sales volume outside Brazil (international sales), which includes sales conducted by PEPSA and PELSA. This increase was partially offset by a 4.3% reduction in sales volume in the domestic market, primarily due to a decrease in Brazilian consumer demand;
- A 2.7% increase in national production of crude oil, NGL and natural gas, generating an increase in the share of Brazilian oil processed by Petrobras' refineries (80% during 2003, as compared to 79% in 2002);
- A gain of US\$ 697 million (net of US\$ 359 million in taxes) resulting from the adoption of SFAS No. 143 – Accounting for Asset Retirement Obligations ("SFAS 143");
- An 18.2% appreciation of the Real against the US dollar in 2003, generating a gain from net exchange variations, mainly on financing, of US\$ 509 million during the year;

The increase in net income was partially offset by:

- An increase in the production costs of domestic oil, resulting from an increase of US\$ 1,067 million in taxes and charges imposed by the Brazilian government;
- A US\$ 275 million charge related to dry holes;
- A US\$ 183 million charge for contractually obligated payments made in connection with Petrobras' investments in thermoelectric power plants;
- A US\$ 114 million expense for a lower cost or market adjustment with respect to turbines that Petrobras originally expected to use in connection with thermoelectric projects, but which Petrobras no longer intends to use for such projects;
- A US\$ 56 million increase in contractual losses from compliance with ship or pay commitments with respect to investments in the OCP pipeline in Ecuador;
- A provision of US\$ 55 million for notifications of tax assessments received from the National Social Security Institute (Instituto Nacional do Seguro Social, or INSS).

Business Segments

SEGMENT INFORMATION

The following segment information has been prepared in accordance with SFAS N° 131 – Disclosure about Segments of an Enterprise and Related Information (“SFAS 131”). Petrobras operates in the following business segments, which are described as follows:

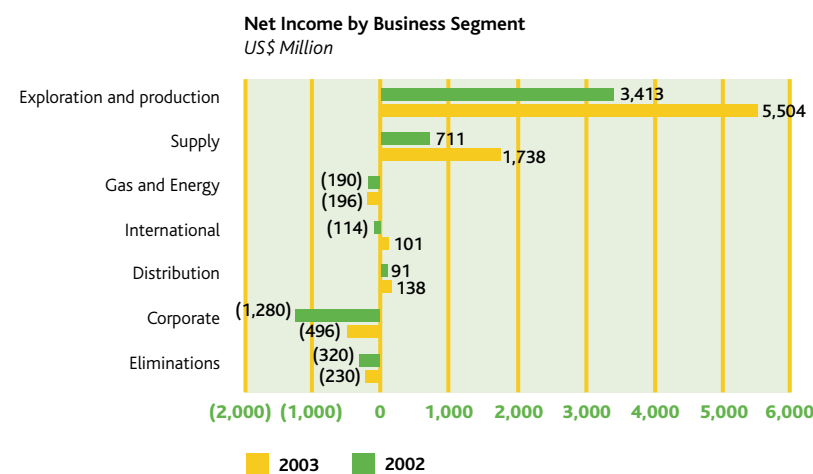
- **Exploration and Production** – This segment includes Petrobras' exploration, development and production activities in Brazil, and its sales of crude oil and natural gas in the domestic and foreign markets.
- **Supply** – This segment includes Petrobras' refining, logistic, transportation and commercialization activities for crude oil, oil products and fuel alcohol. Additionally, this segment includes the petrochemical and fertilizers division, which includes investments in domestic petrochemical companies and Petrobras' two domestic fertilizer plants.
- **Distribution** – This segment represents the oil product and fuel alcohol distribution activities conducted by Petrobras majority owned subsidiary, Petrobras Distribuidora S.A. – BR in Brazil.
- **Gas and Energy** – This segment currently encompasses the commercialization and transportation of natural gas produced in or imported into Brazil. Additionally, this segment includes Petrobras' domestic electric energy commercialization activities, as well as investments in domestic natural gas transportation companies, state-owned natural gas distributors and thermoelectric companies.
- **International** – This segment represents Petrobras' international activities conducted in 13 countries, which include exploration and production, supply, distribution and gas and energy.

The items that cannot be attributed to these business segments are allocated to Petrobras' corporate segment, especially those linked with corporate financial management, overhead related to central administration and other expenses, including actuarial expenses related to the pension and health-care plans.

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

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

- Net operating revenues: these were considered to be the revenues from sales to third parties, plus revenues between the business segments, based on the internal transfer prices established by the areas;
- The operating income includes net operating revenue, the costs of products and services sold, calculated per business segment, based on the internal transfer price and the other operating costs of each segment, as well as operating expenses, based on the expenses actually incurred in each segment; and
- Assets covers the assets allocated to each business segment.



The comparison between results of operations for 2003 and 2002 has been affected by the 5.2% rise in the average Real/ US dollar exchange rate for 2003 as compared to the average Real/ US dollar exchange rate for 2002. For simplicity, Petrobras refers to this change in the average exchange rate as the “5.2% decrease in the value of the Real against the US dollar in 2003, as compared to 2002.”

EXPLORATION AND PRODUCTION

Consolidated net income for our exploration and production segment increased 61.3% to US\$ 5,504 million for 2003, as compared to US\$ 3,413 million for 2002. This increase was primarily attributable to:

- a US\$ 2,652 million increase in net operating revenues as a result of the increase in the price of crude oil in the international markets and a 2.7% increase in production of crude oil, LNG (Liquefied Natural Gas) and natural gas;
- the cumulative effect of a change in accounting principle related to future liabilities for asset retirement obligations, which led to an increase in net income of US\$ 697 million, net of taxes;
- a US\$ 626 million reduction in net financial expenses, primarily related to the effects of the 18.2% appreciation of the Real against the US dollar during 2003, as compared to a 52.3% depreciation of the Real against the US dollar during 2002; and
- a US\$ 423 million reduction in depreciation, depletion and amortization primarily attributable to the 5.2% decrease in the value of the Real against the US dollar in 2003, as compared to 2002, as well as the beneficial effect of adopting SFAS 143, as described in Note 3 to Petrobras' consolidated financial statements.

These effects were partially offset by a US\$ 1,325 million increase in cost of sales, primarily composed of:

- an increase of approximately US\$ 152 million in costs related to crude oil, natural gas and LNG volumes sold or transferred to other business segments; and
- an increase of approximately US\$ 1,067 million in taxes and charges levied by the Brazilian government.

SUPPLY

Consolidated net income for the supply segment increased to US\$ 1,738 million for 2003, as compared to US\$ 711 million for 2002.

This increase was primarily attributable to an increase of US\$ 6,377 million in net operating revenues. This increase in net operating revenues was primarily due to the alignment in 2003 of prices of certain oil products in the Brazilian market with international market prices of such products at the end of 2002 and to refineries' increased processing of higher value added products.

This increase was partially offset by the increase of US\$ 4,702 million in cost of sales, mainly due to the increase in import prices of crude oil and oil products and increases in prices of products transferred from other segments, notwithstanding the following facts:

- the 6.2% decrease in volume of sales within the supply segment as a result of a decrease in Brazilian consumer demand;
- the higher participation of domestic crude oil in the total feedstock processed (80% in 2003 and 79% in 2002); and
- the streamlining of logistical expenses, mainly freight costs.

GAS AND ENERGY

Petrobras' gas and Energy segment registered a net loss of US\$ 196 million for 2003, as compared to a net loss of US\$ 190 million for 2002. This result was affected primarily by the following factors:

- a US\$ 467 million increase in losses involving minority interest, primarily related to the effects of the net loss by Transportadora Brasileira Gasoduto Bolivia-Brasil S.A. – TBG related to the 18.2% appreciation of the Real against the US dollar during 2003, as compared to a 52.3% depreciation of the Real against the US dollar during 2002;
- a US\$ 451 million increase in cost of sales, primarily due to a 13.5% increase in the volume of natural gas sold and to the start of operations by some thermoelectric power plants at the end of 2003;
- a US\$ 114 million expense for a lower of cost or market adjustment in gas turbines;
- a US\$ 562 million increase in net operating revenues, primarily due to the increase of natural gas prices and to the 13.5% increase in the volume of natural gas sold;
- a US\$ 183 million decrease in losses related to Petrobras' investments in thermoelectric power plants; and
- a US\$ 150 million increase in the results of non-consolidated companies, primarily due to gains from investments in natural gas distribution companies and the adoption of FIN 46, resulting in the consolidation of three thermoelectric power plants for which Petrobras recorded losses in equity in 2002.

INTERNATIONAL

Consolidated net income for the international segment increased to a net gain of US\$ 101 million for 2003, as compared to a net loss of US\$ 114 million for 2002. This increase was primarily attributable to:

- a US\$ 1,342 million increase in net operating revenues resulting from the increase of oil product prices in the international market and an increase in the volume of sales conducted by PEPSA and PELSAs; and
- a US\$ 157 million increase in the results of non-consolidated companies, primarily due to a gain of US\$ 59 million in equity investments in Compañía Mega during 2003, as compared to a loss of US\$ 95 million during 2002.

This increase was partially offset by the following factors, primarily attributable to PEPSA and PELSAs' operations:

- a US\$ 586 million increase in cost of sales;
- a US\$ 182 million increase in depreciation, depletion and amortization;
- a US\$ 160 million increase in debt expense, net;
- a US\$ 118 million increase in selling, general and administrative expenses;
- a US\$ 69 million increase in exploration, including exploratory dry holes and impairment; and
- a US\$ 56 million increase in contractual losses from compliance with ship or pay commitments with respect to Petrobras' investments in the OCP pipeline in Ecuador.

DISTRIBUTION

Consolidated net income for the distribution segment increased 51.6% to US\$ 138 million for 2003, as compared to US\$ 91 million for 2002. This increase was primarily attributable to a US\$ 1,453 million increase in net operating revenues as a result of the increase of oil product sales prices to refineries (Petrobras increased these sales prices in order to maintain the gross margin).

This effect was partially offset by a 6.0% decrease in the volume of oil products sold within the distribution segment in 2003 as compared to the volume sold in 2002; the decrease in market share in the Brazilian oil products market to 31.5% for 2003, as compared to 32.9% for 2002; and the increase of US\$ 1,396 million in cost of sales in 2003, reflecting the increase in prices of oil products purchased from refineries.

CORPORATE

Consolidated loss for the units that make up the corporate segment decreased 61.3% to a net loss of US\$ 496 million during 2003, as compared to a net loss of US\$ 1,280 million during 2002. This decrease was primarily attributable to the reduction of US\$ 1,268 million in financial expenses, net, mainly due to the effect of the 18.2% appreciation of the Real against the US dollar during 2003, as compared to a 52.3% depreciation of the Real against the US dollar during 2002.

This decrease was partially offset by:

- a US\$ 160 million increase in general and administrative expenses, primarily due to higher expenses related to technical consulting services in non-core general and administrative activities and employee training expenses;
- a US\$ 160 million increase in expenses related to employee benefits; and
- a US\$ 73 million increase in institutional relations and cultural projects.

NET INCOME BY SEGMENT EXCLUDING NON-RECURRING ITEMS

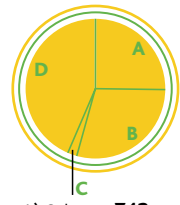
	YEAR ENDED DECEMBER 31, 2003							
	US\$ MILLION							
	E&P	SUPPLY	GAS & ENERGY	INTERN.	DISTRIB.	CORPOR.	ELIMIN.	TOTAL
Net income (loss) by segment	5,504	1,738	(196)	101	138	(496)	(230)	6,559
Effect of a change in accounting principle related to future liabilities for asset retirement obligations	(1,056)							(1,056)
Losses related to contractual obligations with thermoelectric power plants			183					183
Adjustment to market value of turbines for the thermoelectric plants			114					114
Contractual losses on transport services (Ship-or-Pay)				56				56
INSS Contingencies	52	2				1		55
	4,500	1,740	101	157	138	(495)	(230)	5,911
Tax effect	341	(1)	(101)	(19)				220
Net income (loss) by segment excluding non-recurring items	4,841	1,739	0	138	138	(495)	(230)	6,131

	YEAR ENDED DECEMBER 31, 2002							
	US\$ MILLION							
	E&P	SUPPLY	GAS & ENERGY	INTERN.	DISTRIB.	CORPOR.	ELIMIN.	TOTAL
Net income (loss) by segment	3,413	711	(190)	(114)	91	(1,280)	(320)	2,311
Losses related to contractual obligations with thermoelectric power plants			459					459
INSS Contingencies	37	29				39		105
Regularization of Petroleum and Alcohol accounts						29		29
	3,450	740	269	(114)	91	(1,212)	(320)	2,904
Tax effect	(13)	(10)	(156)			(23)		(202)
Net income (loss) by segment excluding non-recurring items	3,437	730	113	(114)	91	(1,235)	(320)	2,702

Inventories

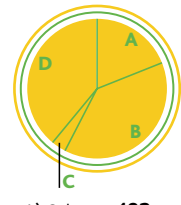
Consolidated fuel alcohol, raw material, oil product and other inventories totaled US\$ 2,947 million for 2003, 16.2% higher than the prior year balance, due to the increase in the international prices and the appreciation of the Real against the US dollar.

Inventories Dec. 31, 2003
US\$ Million



A) Others – **742**
B) Oil products – **858**
C) Fuel alcohol – **67**
D) Raw materials, mainly crude oil – **1,280**

Inventories Dec. 31, 2002
US\$ Million



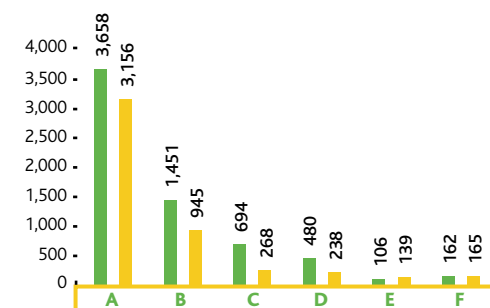
A) Others – **482**
B) Oil products – **982**
C) Fuel alcohol – **86**
D) Raw materials, mainly crude oil – **990**

Capital Expenditures

In 2003, Petrobras continued to prioritize capital expenditures for the development of crude oil and natural gas production projects through internal investments and through structured undertakings with partners. Petrobras invested a total of US\$ 6,551 million in 2003, a 33.4% increase over investments made in 2002.

The capital expenditures in 2003 were primarily directed towards increasing production capabilities in the Campos Basin, modernizing of refineries, expanding pipeline transportation and distribution systems and, to a lesser extent, investing in energy and gas related activities, including investments in thermoelectric power plants. Petrobras spent US\$ 3,658 million (55.8% of total capital expenditures) in 2003 on domestic exploration and production activities.

Capital Expenditures by Segment
US\$ Million



A) Exploration and Production
B) Supply
C) Gas and Energy
D) International
E) Distribution
F) Corporate

■ 2003 ■ 2002

Indebtedness

Petrobras' net debt at December 31, 2003 totaled US\$ 11,980 million, a 6.7% increase from net debt of US\$ 11,229 million at December 31, 2002, primarily due to the inclusion of PEPESA and PELSA's net debt of US\$ 1,788 million in its net debt totals and the issuance of US\$ 5,400 million in long-term debt in the international capital markets during 2003. Petrobras' net debt decreased, however, as a result of the significant increase in cash and cash equivalents provided by operating activities.

	US\$ MILLION	
	DEC. 31, 2003	DEC. 31, 2002
Net debt		
Short-term debt	1,329	671
Current portion of long term debt	1,145	727
Current portion of project financings	842	239
Current portion of capital lease obligations	378	349
	3,694	1,986
Long term debt	11,888	6,987
Project financings	5,066	3,800
Capital lease obligations	1,242	1,907
	18,196	12,694
(-) Cash and cash equivalents	(9,610)	(3,301)
(-) Junior Notes	(300)	(150)
Net debt (1)	11,980	11,229
Reconciliation of Net debt		
Total long-term debt	13,033	7,714
Plus short-term debt	1,329	671
Plus total project financings	5,908	4,039
Plus total capital lease obligations	1,620	2,256
Less cash and cash equivalents	(9,610)	(3,301)
Less Junior Notes	(300)	(150)
Net debt	11,980	11,229

(1) Calculation of net debt may not be comparable to the calculation of net debt by other companies. Management believes that net debt is an appropriate supplemental measure that helps investors assess Petrobras' liquidity and assists management in targeting leverage improvements. Please see the table above for a reconciliation of net debt to total long-term debt.

Shareholders' Equity

CAPITAL

Petrobras' paid in capital stock at December 31, 2003 was US\$ 7,262 million, represented by 634,168,418 common shares and 462,369,507 preferred shares.

The Extraordinary General Meeting, held together with the Ordinary General Meeting on March 29, 2004, approved an increase in Petrobras' capital to R\$ 32.9 billion (US\$ 11.7 billion), through the capitalization of revenue reserves accrued during previous financial years, in the amount of R\$ 13 billion (US\$ 4.5 billion), and without the issuance of new shares. This increase in capitalization will help Petrobras meet its significant investment requirements. Additionally, the Extraordinary General Meeting held on March 29, 2004, approved an increase in authorized capital from R\$ 30 billion (US\$ 10.4 billion) to R\$ 60 billion (US\$ 20.8 billion).

Financial Statements

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Consolidated Balance Sheets

December 31, 2003 and 2002

Expressed in Millions of United States Dollars

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

The accompanying notes are an integral part of these consolidated financial statements.

	AS OF DECEMBER 31,	
	2003	2002
Liabilities and shareholders' equity		
Current liabilities		
Trade accounts payable	2,261	1,702
Income tax	148	119
Taxes payable, other than income taxes	2,157	1,682
Short-term debt (Note 12)	1,329	671
Current portion of long-term debt (Note 12)	1,145	727
Current portion of project financings (Note 14)	842	239
Current portion of capital lease obligations (Note 15)	378	349
Accrued interest	181	120
Dividends and interest on capital payable (Note 18)	1,139	307
Contingencies (Note 22)	84	318
Payroll and related charges	581	283
Advances from customers	258	119
Ventures under consortium agreements	166	106
Employee benefits obligation – Pension (Note 17)	160	89
Other payables and accruals	392	432
	11,221	7,263
Long-term liabilities		
Long-term debt (Note 12)	11,888	6,987
Project financings (Note 14)	5,066	3,800
Employee benefits obligation – Pension (Note 17)	1,895	1,363
Employee benefits obligation – Health care (Note 17)	1,580	1,060
Capital lease obligations (Note 15)	1,242	1,907
Deferred income tax (Note 4)	1,122	259
Provision for abandonment of wells (Note 3 (a))	396	-
Thermoelectric liabilities (Note 3 (b))	1,142	-
Contingencies (Note 22)	271	50
Other liabilities	270	300
	24,872	15,726
	367	(136)
Minority interest		
Shareholders' equity		
Shares authorized and issued (Note 18)		
Preferred share – 2003 – 462,369,507 shares (2002 – 451,935,669 shares)	2,973	2,459
Common share – 2003 and 2002 – 634,168,418 shares	4,289	3,761
Capital reserve (Note 18)	118	89
Retained earnings		
Appropriated (Note 18)	10,696	5,585
Unappropriated	14,957	16,085
Accumulated other comprehensive income		
Cumulative translation adjustments	(14,450)	(17,306)
Amounts not recognized as net periodic pension cost, net of tax (Note 17)	(1,588)	(1,361)
Unrealized gains (losses) on securities, net of tax	157	(11)
	17,152	9,301
Total liabilities and shareholders' equity	53,612	32,154

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Income

December 31, 2003, 2002 and 2001

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

	YEAR ENDED DECEMBER, 31		
	2003	2002	2001
Sales of products and services	42,690	32,987	34,145
Less:			
Value-added and other taxes on sales and services	(6,348)	(5,241)	(8,627)
Contribution of intervention in the economic domain charge – CIDE	(5,545)	(5,134)	-
Specific parcel price – PPE	-	-	(969)
Net operating revenues	30,797	22,612	24,549
Cost of sales	15,416	11,506	12,807
Depreciation, depletion and amortization	1,785	1,930	1,729
Exploration, including exploratory dry holes	512	435	404
Selling, general and administrative expenses	2,091	1,741	1,751
Impairment (Note 9 (b))	70	75	145
Research and development expenses	201	147	132
Total costs and expenses	20,075	15,834	16,968
Equity in results of non-consolidated companies (Note 10)	141	(178)	(8)
Financial income (Note 13)	602	1,142	1,375
Financial expenses (Note 13)	(1,247)	(774)	(808)
Monetary and exchange variation on monetary assets and liabilities, net (Note 13)	509	(2,068)	(915)
Employee benefit expense	(595)	(451)	(594)
Other taxes	(333)	(360)	(295)
Loss on government securities (Note 6)	-	-	(1,099)
Other expenses, net	(1,026)	(857)	(445)
	(1,949)	(3,546)	(2,789)
Income before income taxes and minority interest and accounting change	8,773	3,232	4,792
Income tax expense (Note 4)			
Current	(2,599)	(1,269)	(1,196)
Deferred	(64)	116	(193)
	(2,663)	(1,153)	(1,389)
Minority interest in results of consolidated subsidiaries	(248)	232	88
Income before effect of change in accounting principle	5,862	2,311	3,491
Cumulative effect of change in accounting principle, net of taxes	697	-	-
Net income for the year	6,559	2,311	3,491
Net income applicable to each class of shares			
Common/ADS	3,793	1,349	2,038
Preferred/ADS	2,766	962	1,453
Net income for the year	6,559	2,311	3,491
Basic and diluted earnings per share (Note 18 (b))			
Common/ADS and Preferred/ADS			
Before effect of change in accounting principle	5.35	2.13	3.21
After effect of change in accounting principle	5.98	2.13	3.21
Weighted average number of shares outstanding			
Common/ADS	634,168,418	634,168,418	634,168,418
Preferred/ADS	462,369,507	451,935,669	451,935,669

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Cash Flows

December 31, 2003, 2002 and 2001

Expressed in Millions of United States Dollars

	YEAR ENDED DECEMBER, 31		
	2003	2002	2001
Cash flows from operating activities			
Net income for the year	6,559	2,311	3,491
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation, depletion and amortization	1,805	1,951	1,731
Dry hole costs	207	198	194
Loss on property, plant and equipment	119	99	811
Loss on government securities	-	-	1,099
Minority interest in loss (income) of subsidiaries	248	(232)	(88)
Deferred income taxes	64	(116)	193
Foreign exchange and monetary loss (gain)	(138)	2,714	807
Accretion expense – asset retirement obligation	43	-	-
Impairment of oil and gas properties	70	75	145
Provision for uncollectible accounts	25	56	421
Gain on exchange of businesses with Repsol-YPF	-	-	(500)
Cumulative effect of change in accounting principle, net of taxes	(697)	-	-
Equity in the results of non-consolidated companies	(141)	178	8
Others	1	2	(93)
Decrease (increase) in assets			
Accounts receivable, net	(477)	(541)	(102)
Petroleum and Alcohol account	(15)	(157)	1,173
Interest receivable on government securities	(157)	(10)	(243)
Inventories	244	(1,139)	232
Advances to suppliers	562	(797)	(240)
Prepaid expenses	96	(31)	(206)
Recoverable taxes	(365)	(190)	(422)
Others	90	(266)	(47)
Increase (decrease) in liabilities			
Trade accounts payable	(156)	669	(64)
Payroll and related charges	222	95	84
Taxes payable, other than income taxes	60	441	212
Employee post-retirement benefits, net of unrecognized pension obligation	535	177	(61)
Risk management activities	41	68	123
Accrued interest	62	158	58
Contingencies	(78)	365	37
Abandonment	(29)	-	-
Other liabilities	(231)	209	(10)
Net cash provided by operating activities	8,569	6,287	8,743
Cash flows from investing activities			
Additions to property, plant and equipment	(6,551)	(4,911)	(4,254)
Investment in Perez Compan S.A – PEPSA	-	(1,073)	-
Investments in thermoelectric plants	-	(447)	(15)
Investment in non-consolidated companies	(73)	(153)	(207)
Dividends received from non-consolidated companies	13	11	24
Restricted deposits for legal proceedings	(188)	(84)	(140)
Effect on cash from merger with subsidiaries and affiliates	231	-	-
Effect on cash of FIN 46 adoption	1,049	-	-
Others	-	1	-
Net cash used in investing activities	(5,519)	(6,656)	(4,592)
Cash flows from financing activities			
Short-term debt, net issuances and repayments	321	(367)	(1,648)
Proceeds from issuance of long-term debt	4,629	1,937	2,347
Principal payments on long-term debt	(1,315)	(1,173)	(1,023)
Project financing funding (payments)	(208)	(746)	760
Payment of finance lease obligations	(108)	(247)	(465)
Dividends paid to shareholders	(941)	(999)	(1,702)
Dividends paid to minority interests	(2)	(19)	(23)
Net cash provided by (used) in financing activities	2,376	(1,614)	(1,754)
Increase (decrease) in cash and cash equivalents	5,426	(1,983)	2,397
Effect of exchange rate changes on cash and cash equivalents	883	(2,076)	(863)
Cash and cash equivalents at beginning of year	3,301	7,360	5,826
Cash and cash equivalents at end of year	9,610	3,301	7,360
Supplemental cash flow information:			
Cash paid during the year in			
Interest	622	200	393
Income taxes	2,384	812	951
Withholding income tax on financial investments	47	120	178
Non-cash investing and financing transactions during the year			
Capital lease obligations	-	144	406
Project finance expenditures funded by special purpose companies	-	946	1,121
Net assets acquired in purchase business combination with Repsol-YPF	-	-	424
Transfer of Government securities to PETROS	-	313	2,140
Consolidation of merchant type thermoelectrics	1,142	-	-
Exchange of BR shares for Petrobras preferred shares	130	-	-
Recognition of asset retirement obligation – FAS 143	114	-	-

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

December 31, 2003, 2002 and 2001

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

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

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statements of Changes in Shareholders' Equity

December 31, 2003, 2002 and 2001

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

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

	YEAR ENDED DECEMBER, 31		
	2003	2002	2001
Statutory reserve			
Balance at January 1	164	215	221
Transfer from (to) unappropriated retained earnings, net of gain or loss on translation	71	(51)	(6)
Balance at December 31	235	164	215
Total appropriated retained earnings	10,696	5,585	6,869
Unappropriated retained earnings			
Balance at January 1	16,085	15,124	14,456
Net income for the year	6,559	2,311	3,491
Dividends (per share: 2003 – US\$ 1.49 to common and preferred shares; 2002 – US\$ 1.19 to common and preferred shares; 2001 – US\$ 1.62 to common and preferred shares)	(1,635)	(1,287)	(1,851)
Appropriation (to) from fiscal incentive reserve	(29)	(39)	91
Appropriation to reserves	(6,023)	(24)	(1,063)
Balance at December 31	14,957	16,085	15,124
Total shareholders' equity	17,152	9,301	13,247
Comprehensive income (loss) is comprised as follows:			
Net income for the year	6,559	2,311	3,491
Cumulative translation adjustments	2,856	(5,452)	(2,695)
Amounts not recognized as net periodic pension cost	(227)	506	(351)
Unrealized gain on available-for-sale securities	168	(24)	(52)
Total comprehensive income (loss)	9,356	(2,659)	393

The accompanying notes are an integral part of these consolidated financial statements.

Notes to the Consolidated Financial Statements

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

1. The Company and its operations

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

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

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

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

2. Summary of significant accounting policies

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

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

(A) BASIS OF FINANCIAL STATEMENTS PREPARATION

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

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

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

(B) BASIS OF CONSOLIDATION

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

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

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

(1) Parent Company of Petrobras Energia S.A.-PEPSA. (former Perez Companc S.A.-PECOM) and Petrolera Entre Lomas S.A. – PELSA (former Petrolera Perez Companc S.A.)

(2) Consolidated according to FIN 46, commencing December 31, 2003. Formerly were special purpose entities formed in connection with project finance transactions.

(3) Consolidated according to FIN 46, commencing December 31, 2003. Formerly were accounted for as capital leases pursuant to SFAS 13. See Notes 15 and 16.

(4) Consolidated according to FIN 46, commencing December 31, 2003. Formerly were not consolidated to Petrobras financial statements, see Note 16.

(C) CASH EQUIVALENTS

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

(D) ACCOUNTS RECEIVABLE

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

(E) INVENTORIES

Inventories are stated as follows:

- Raw materials comprise principally crude oil inventories, which are stated at the lower of average cost or market value.
- Oil products and fuel alcohol are stated, respectively, at average refining and purchase cost, adjusted when applicable to their realizable value.
- Materials and supplies are stated at average purchase cost, not exceeding replacement value and imports in transit are stated at identified cost.

(F) INVESTMENTS IN NON-CONSOLIDATED COMPANIES

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

(G) GOVERNMENT AND MARKETABLE SECURITIES

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

(H) PROPERTY, PLANT AND EQUIPMENT**• Costs incurred in oil and gas producing activities**

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

• Property acquisition costs

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

• Exploratory costs

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

• Development costs

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

• Production costs

Costs incurred with producing wells are expensed as incurred.

• Abandonment costs

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

• Depreciation, depletion and amortization

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

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

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

• Impairment

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

• Maintenance and repairs

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

• Capitalized interest

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

(I) REVENUES, COSTS AND EXPENSES

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

(J) INCOME TAXES

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

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

(K) EMPLOYEE POST-RETIREMENT BENEFITS

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

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

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

(L) ENVIRONMENTAL AND REMEDIATION COSTS

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

(M) ACCOUNTING FOR THE EFFECT OF FEDERAL GOVERNMENT REGULATION

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

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

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

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

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

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

(N) COMPENSATED ABSENCES

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

(O) EARNINGS PER SHARE

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

(P) RESEARCH AND DEVELOPMENT COSTS

Research and development costs are charged to expenses when incurred.

(Q) ACCOUNTING FOR DERIVATIVES AND HEDGING ACTIVITIES

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

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

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

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

(R) RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

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

(S) RECLASSIFICATIONS

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

3. Accounting change**(A) SFAS NO. 143 – ACCOUNTING FOR ASSET RETIREMENT OBLIGATIONS**

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

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

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

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

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

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

	ASSETS	LIABILITIES
Balance as of December 31, 2002	-	1,166
Reversion of provision	-	(1,056)
Assets related to proved developed property	16	-
Accumulated depreciation	(9)	-
Assets related to proved undeveloped property	44	44
Balance as of January 1, 2003	51	154
PEPSA acquisition	11	28
Depreciation and impairment	(29)	-
Accretion expenses	-	43
Liabilities incurred	114	114
Liabilities settled	-	(14)
Cumulative translation adjustment	15	71
Balance as of December 31, 2003	162	396

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

	ASSETS	LIABILITIES
Balance as of January 1, 2001	-	1,588
Reversal of provision	97	(1,333)
Asset retirement obligation balances at January 1, 2001	97	255
Depreciation	(2)	-
Liabilities settled	-	(14)
Actualization of provision, at net present value	-	33
Cumulative translation adjustment	(15)	(39)
Balance as of December 31, 2001	80	235
Depreciation	(2)	-
Liabilities settled	-	(30)
Actualization of provision, at net present value	-	29
Cumulative translation adjustment	(27)	(80)
Balance as of December 31, 2002	51	154

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

	2002		2001	
	PRO FORMA		PRO FORMA	
	AS REPORTED	(UNAUDITED)	AS REPORTED	(UNAUDITED)
Net operating revenues	22,612	22,612	24,549	24,549
Cost of sales	11,506	11,506	12,807	12,807
Depreciation, depletion and amortization	1,930	1,651	1,729	1,649
Exploration, including exploratory dry holes	435	464	404	437
Impairment	75	75	145	145
Others	(5,434)	(5,434)	(4,672)	(4,672)
Income tax expense	(1,153)	(1,238)	(1,389)	(1,405)
Minority interest	232	232	88	88
Cumulative effect of change in accounting principle, net of tax	-	-	-	816
Net income for the year	2,311	2,476	3,491	4,338
Basic and diluted earnings per share	2.13	2.28	3.21	3.99

(B) INTERPRETATION NO. 46 (FIN 46) – CONSOLIDATION OF VARIABLE INTEREST ENTITIES

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

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

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

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

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

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

(C) EITF 01-08 – DETERMINING WHETHER AN ARRANGEMENT CONTAINS A LEASE

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

(D) EITF 02-6 – CLASSIFICATION IN THE STATEMENT OF CASH FLOWS OF PAYMENTS MADE TO SETTLE AN ASSET RETIREMENT OBLIGATION

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

4. Income taxes

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

	YEAR ENDED DECEMBER 31, (%)		
	2003	2002	2001
Federal income tax rate	25	25	25
Social contribution	9	9	9 to 12
Composite tax rate	34	34	34 to 37

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

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

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

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

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

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

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

	AS OF DECEMBER 31,	
	2003	2002
Current Assets		
Inventories	13	39
Lease obligations	82	96
Provision for profit sharing	97	41
Provision for loss on Energy	-	70
Provision for INSS	23	12
Other temporary differences	41	13
Net current deferred tax assets	256	271
Non-current assets		
Employees' post-retirement benefits, net of unrecognized pension obligation	764	531
Deferred assets	130	51
Tax loss carryforwards	69	243
Investments	65	2
Lease obligations	330	618
Project financing	109	706
Provision for notification from INSS	47	26
Other temporary differences	289	140
Valuation allowance	(54)	(239)
	1,749	2,078
Liabilities		
Capitalized exploration and development costs	1,635	670
Property, plant and equipment	1,131	1,638
Other temporary differences	105	29
	2,871	2,337
Net long-term deferred tax liabilities	(1,122)	(259)

As a result of the NTN-P swap transaction in 2001, described in Note 66, the income tax on interest on government securities held-to-maturity, which payment had been deferred, became payable and the corresponding provision for income tax and social contribution was transferred to current liabilities on December 28, 2001.

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

	YEAR ENDED DECEMBER 31,		
	2003	2002	2001
Balance at January 1,	(239)	(170)	(147)
Reductions (additions)	80	(69)	(23)
Balance at December 31,	(159)	(239)	(170)

5. Cash and cash equivalents

	AS OF DECEMBER 31,	
	2003	2002
Cash	765	661
Investments – local currency	4,926	2,216
Investments – U.S. dollars	3,919	424
	9,610	3,301

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

6. Government securities

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

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

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

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

7. Accounts receivable, net

Accounts receivable consisted of the following:

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

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

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

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

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

8. Inventories

	AS OF DECEMBER 31,	
	2003	2002
Products		
Oil products	858	982
Fuel alcohol	67	86
	925	1,068
Raw materials, mainly crude oil	1,280	990
Materials and supplies	708	482
Others	34	-
	2,947	2,540

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

9. Property, plant and equipment, net

(A) COMPOSITION OF BALANCE

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

	AS OF DECEMBER 31,					
	2003			2002		
	COST	ACCUMULATED DEPRECIATION	NET	COST	ACCUMULATED DEPRECIATION	NET
Buildings and improvements	587	(298)	289	383	(215)	168
Oil and gas assets	25,741	(12,305)	13,436	17,465	(10,374)	7,091
Equipment and other assets	11,597	(5,574)	6,023	6,635	(3,491)	3,144
Capital lease – platforms, vessels and thermoelectric plants	2,743	(994)	1,749	3,351	(852)	2,499
Rights and concessions	531	(83)	448	121	(4)	117
Land	136	-	136	105	-	105
Materials	294	-	294	184	-	184
Expansion projects –						
Construction and installations in progress:						
Exploration and production	4,817	-	4,817	3,477	-	3,477
Supply	2,442	-	2,442	1,105	-	1,105
Gas and Energy	1,020	-	1,020	243	-	243
Distribution	106	-	106	64	-	64
Corporate	31	-	31	-	-	-
Other	14	-	14	27	-	27
	50,059	(19,254)	30,805	33,160	(14,936)	18,224

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

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

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

(B) IMPAIRMENT

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

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

(C) RETURN OF EXPLORATION AREAS TO THE ANP

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

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

(D) 5TH ANP AUCTION OF EXPLORATORY BLOCKS

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

10. Investments in non-consolidated companies and other investments

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

	TOTAL OWNERSHIP	INVESTMENTS	
		2003	2002
Equity method	20% – 50% (a)	664	131
Investments available-for-sale	8% – 16%	331	85
Other investments, at cost		178	118
Total		1,173	334

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

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

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

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

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

11. Receivable from Federal Government

(A) DEREGULATION OF THE BRAZILIAN FUEL MARKET

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

(B) CHANGES IN THE PETROLEUM AND ALCOHOL ACCOUNT

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

	YEAR ENDED DECEMBER 31,	
	2003	2002
Opening balance	182	81
Advances (collections) – PPE	-	(6)
Reimbursements to third parties: principally subsidies paid to fuel alcohol producers	5	253
Financial income	10	2
Result of audit conducted by the Federal Government	-	(29)
Translation gain (loss)	42	(119)
Closing balance	239	182

(C) CERTIFICATION BY THE FEDERAL GOVERNMENT

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

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

The settlement of the account with the Federal Government should have been completed by December 31, 2002, according to the provisions of Law No. 10,453 of May 13, 2002, amended by Decree No. 4,491 of November 29, 2002. On June 26, 2003 Provisional Measure 123, article 11, which was converted to Law No. 10,742 dated October 6, 2003, extended the term of settlement of accounts involving reciprocal debits and credits between Petrobras and the Federal Government to June 30, 2004, and in so doing, automatically extending the term for certification of the outstanding balance in the Petroleum and Alcohol account.

(D) NATIONAL TREASURY BONDS SERIES H (NTN-H)

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

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

12. Financings

(A) SHORT-TERM DEBT

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

	AS OF DECEMBER 31,	
	2003	2002
Imports – oil and equipment	872	286
Working capital	447	385
Others	10	-
	1,329	671

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

(B) LONG-TERM DEBT• **Composition**

	AS OF DECEMBER 31,	
	2003	2002
Foreign currency		
Notes	5,462	2,234
Financial institutions	3,591	2,240
Sale of future receivables	1,767	900
Suppliers' credits	728	876
Senior exchangeable notes	338	338
Repurchased securities (1)	(207)	-
	11,679	6,588
Local currency		
Debentures	666	500
Brazilian Development Bank – BNDES (state-owned company, see Note 26)	358	403
Debentures (state-owned company, see Note 26)	262	188
Others	68	35
	1,354	1,126
Total (2)	13,033	7,714
Current portion of long-term debt	(1,145)	(727)
	11,888	6,987

(1) At December 31, 2003, the Company had amounts invested abroad in an exclusive investment fund that held debt securities of some of the Petrobras group companies in the total amount of US\$ 920. These securities are considered to be extinguished, and thus the related amounts, together with applicable interest, have been removed from the presentation of marketable securities and long-term debt, US\$ 207, and project finance, US\$ 713. See also Note 14.

(2) Includes US\$ 375 related to thermoelectric plants consolidated under FIN 46. See additional discussion in Note 16.

• **Composition of foreign currency denominated debt by currency**

	AS OF DECEMBER 31,	
	2003	2002
Currency		
United States dollars	10,621	5,522
Japanese Yen	628	764
Euros	429	297
Others	1	5
	11,679	6,588

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

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

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

As of December 31, 2003, US\$ 1,923 was related to PEPSA's long-term debt.

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

Interest rates on long-term debt were as follows:

	AS OF DECEMBER 31,	
	2003	2002
Foreign currency		
6% or less	4,365	3,080
Over 6% to 8%	2,154	1,220
Over 8% to 10%	4,990	2,287
Over 10% to 15%	170	1
	11,679	6,588
Local currency		
6% or less	668	235
Over 6% to 8%	-	390
Over 10% to 15%	686	501
	1,354	1,126
	13,033	7,714

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

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

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

On October 24, 2003, Petrobras Energia S.A. issued US\$ 100 in notes – Series R – due 2013, with a 9.375% annual coupon, payable semi-annually, and a 9.5% annual yield to maturity.

• **Structured financing of exports**

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

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

- US\$ 1,500 in Senior Trust Certificates, which were negotiated by PFL on the international market at face value. The amount was transferred to Petrobras as prepayment for exports to be made to PFL, according to the prepayment agreement.
- US\$ 300 in Junior Trust Certificates, which are held in the portfolio of PFL. If PF Export incurs any losses on the receipt of the value of the exports transferred by PFL, these losses will be compensated by the Junior Trust Certificates.

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

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

(C) ISSUE OF NON-CONVERTIBLE DEBENTURES

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

Issue date	QUANTITY	PERIOD	INDEX	INTEREST
August 29	750,000	10 years	IGPM	11% p.a.
October 4 and 23	775,000	8 years	IGPM	10.3% p.a.

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

(D) GUARANTEES AND COVENANTS

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

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

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

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

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

(E) LINES OF CREDIT

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

13. Financial income (expenses), net

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

	YEAR ENDED DECEMBER 31,		
	2003	2002	2001
Financial expenses			
Loans and financing	(808)	(527)	(610)
Capitalized interest	184	139	123
Leasing	(117)	(51)	(88)
Project financing	(410)	(226)	(153)
Other	(96)	(109)	(80)
	(1,247)	(774)	(808)
Financial income			
Investments	243	801	893
Advances to suppliers	36	35	34
Government securities	24	70	243
Other	299	236	205
	602	1,142	1,375
Monetary and exchange variation			
Monetary and exchange variation on monetary assets	(269)	958	179
Monetary and exchange variation on monetary liabilities	778	(3,026)	(1,094)
	509	(2,068)	(915)
	(136)	(1,700)	(348)

14. Project financing

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

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

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

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

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

	AS OF DECEMBER 31,	
	2003	2002
Barracuda/Caratinga	2,555	1,481
Cabiúnas	857	673
Espadarte/Voador/Marimbá (EVM)	826	575
Marlim	680	635
Nova Marlim	475	508
Albacora	126	123
Pargo, Carapeba, Garoupa and Cherne (PCGC)	76	44
Malhas project	286	-
Langstrand Holdings S.A.	700	-
PDET ON-SHORE	40	-
Repurchased securities	(713)	-
	5,908	4,039
Current portion of project financing	(842)	(239)
	5,066	3,800

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

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

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

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

Cabiúnas	185
Nova Transportadora do Sudeste – NTS	370
Nova Transportadora do Nordeste – NTN	470
	1,025

BARRACUDA/CARATINGA

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

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

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

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

CABIÚNAS

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

ESPADARTE/VOADOR/MARIMBÁ (EVM)

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

MARLIM

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

NOVA MARLIM

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

ALBACORA

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

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

PARGO, CARAPEBA, GAROUPA, CHERNE AND CONGRO (PCGC)

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

MALHAS PROJECT

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

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

LANGSTRAND PROJECT

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

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

15. Capital leases

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

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

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

16. Thermoelectric plant obligations

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

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

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

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

17. Employees' post-retirement benefits and other benefits

(A) EMPLOYEES' POST-RETIREMENT BENEFIT BALANCES

The balances related to Employees' Post-retirement Benefits are represented as follows:

	AS OF DECEMBER 31,			
	2003		2002	
	PENSION BENEFITS	HEALTH CARE BENEFITS	PENSION BENEFITS	HEALTH CARE BENEFITS
Current liabilities	160	-	89	-
Long-term liabilities	1,895	1,580	1,363	1,060
Employees' post-retirement benefit obligations	2,055	1,580	1,452	1,060
Accumulated other comprehensive income	2,407	-	2,061	-
Tax effect	(819)	-	(700)	-
Net balance recorded in shareholders' equity	1,588	-	1,361	-
Other assets: Unrecognized pension obligations	-	-	61	-

(B) PENSION PLAN – FUNDAÇÃO PETROBRAS DE SEGURIDADE SOCIAL – PETROS

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

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

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

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

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

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

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

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

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

PLAN ASSETS

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

The table below describes the types of plan assets:

	AS OF DECEMBER 31,	
	2003	2002
Government securities	50%	50%
Investment funds	23%	26%
Equity instruments	13%	9%
Other	14%	15%
	100%	100%

Plan assets include the following securities of related parties:

	AS OF DECEMBER 31,	
	2003	2002
Petrobras common shares	30	4
Petrobras preferred shares	75	35
Government controlled companies	43	22
Government securities	2,662	1,633
Securities of other related parties	184	56
	2,994	1,750

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

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

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

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

PETROBRAS VIDA PLAN

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

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

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

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

TRANSPETRO

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

PETROBRAS ENERGIA – PEPSA**Defined contribution plan**

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

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

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

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

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

(C) HEALTH CARE BENEFITS – "ASSISTÊNCIA MULTIDISCIPLINAR DE SAÚDE" (AMS)

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

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

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

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

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

	ONE PERCENTAGE-POINT INCREASE	ONE PERCENTAGE-POINT DECREASE
Effect on total of services and interest cost component	80	(62)
Effect on post-retirement benefit obligation	567	(448)

(D) THE FUNDED STATUS OF THE PLANS

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

	AS OF DECEMBER 31,			
	2003		2002	
	PENSION BENEFITS	HEALTH CARE BENEFITS	PENSION BENEFITS	HEALTH CARE BENEFITS
Change in benefit obligation:				
Benefit obligation at beginning of year	5,215	1,868	6,460	1,948
Service cost	97	36	54	21
Interest cost	678	243	255	144
Actuarial loss	909	533	975	479
Benefits paid	(402)	(77)	(311)	(52)
Acquisitions/Mergers – GASPETRO	25	6	-	-
Gain (loss) on translation	1,246	464	(2,218)	(667)
Benefit obligation at end of year (1)	7,768	3,073	5,215	1,873
Change in plan assets:				
Fair value of plan assets at beginning of year	3,715	-	4,299	-
Actual return on plan assets	1,162	-	754	-
Company contributions	98	77	377	52
Employee contributions	95	-	72	-
Benefits paid	(402)	(77)	(311)	(52)
Acquisitions/Mergers – GASPETRO	32	-	-	-
Gain (loss) on translation	891	-	(1,476)	-
Fair value of plan assets at end of year	5,591	-	3,715	-
Reconciliation:				
Funded status	(2,177)	(3,073)	(1,500)	(1,873)
Unrecognized actuarial loss	2,529	1,493	2,109	813
Unrecognized transition obligation	-	-	61	-
Net amount recognized	352	(1,580)	670	(1,060)
Amounts recognized in the balance sheet consist of:				
Employees' post-retirement benefits	(2,055)	(1,580)	(1,452)	(1,060)
Unrecognized pension obligations	-	-	61	-
Accumulated other comprehensive income	2,407	-	2,061	-
Net amount recognized	352	(1,580)	670	(1,060)

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

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

Net periodic benefit cost includes the following components:

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

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

	2003		2002	
	PENSION	HEALTH CARE	PENSION	HEALTH CARE
	BENEFITS	BENEFITS	BENEFITS	BENEFITS
Discount rates	Inflation: 5% + 6%	Inflation: 5% + 6%	Inflation: 5% + 6%	Inflation: 5% + 6%
Rates of increase in compensation levels	Inflation: 5% + 2%	Inflation: 5% + 2%	Inflation: 5% + 2%	Inflation: 5% + 2%
Expected long-term rate of return on assets	Inflation: 5% + 6%	Not applicable	Inflation: 5% + 6%	Not applicable

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

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

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

18. Shareholders' equity

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

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

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

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

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

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

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

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

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

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

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

(A) DIVIDENDS AND INTEREST ON SHAREHOLDERS’ EQUITY

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

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

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

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

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

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

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

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

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

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

(B) BASIC AND DILUTED EARNINGS PER SHARE

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

	YEAR ENDED DECEMBER 31,		
	2003	2002	2001
Income before effect of change in accounting principle	5,862	2,311	3,491
Cumulative effect of change in accounting principle, net of taxes	697	-	-
Net income for the period	6,559	2,311	3,491
Less priority preferred share dividends	(226)	(77)	(117)
Less common share dividends, up to the priority preferred share dividends on a per-share basis	(309)	(107)	(164)
Remaining net income to be equally allocated to common and preferred shares	6,024	2,127	3,210
Weighted average number of shares outstanding:			
Common/ADS	634,168,418	634,168,418	634,168,418
Preferred/ADS	462,369,507	451,935,669	451,935,669
Basic and diluted earnings per share			
Common and Preferred:			
Before effect of change in accounting principle	5.35	2.13	3.21
After effect of change in accounting principle	5.98	2.13	3.21

(C) CAPITAL RESERVES

• AFRMM

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

• Fiscal incentive reserve

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

(D) APPROPRIATED RETAINED EARNINGS

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

- **Legal reserve**

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

- **Undistributed earnings reserve**

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

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

- **Statutory reserve**

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

19. International acquisitions

(A) ACQUISITION OF AN INTEREST IN PETROBRAS ENERGIA PARTICIPACIONES S.A. – PEPSA – (FORMERLY KNOWN AS PEREZ COMPANC S.A.) AND PETROLERA ENTRE LOMAS S.A. – PELSA (FORMERLY KNOWN AS PETROLERA PEREZ COMPANC S.A.).

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

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

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

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

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

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

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

Consolidated income statement data for the year ended December 31.

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

(B) ACQUISITION OF PETROLERA SANTA FE

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

20. Petrobras Distribuidora – BR

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

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

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

21. Accounts – temporary agreement on price stabilization in Argentina

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

22. Commitments and contingencies

Petrobras is subject to a number of commitments and contingencies arising in the normal course of its business. Additionally, the operations and earnings of the Company have been, and may be in the future, affected from time to time in varying degrees by political developments and laws and regulations, such as the Federal Government's continuing role as the controlling shareholder of the Company, the state of the Brazilian economy, forced divestiture of assets, tax increases and retroactive tax claims, and environmental regulations. The likelihood of such occurrences and their overall effect upon the Company are unpredictable.

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

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

Petrobras has guaranteed that it will purchase specified volumes of natural gas carried through the TBG pipeline.

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

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

(A) LITIGATION

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

	AS OF DECEMBER 31,	
	2003	2002
Labor claims	22	13
Tax claims	39	13
Civil claims	90	24
Commercial claims and other contingencies	109	-
	260	50
Contractual contingencies – thermoelectric plants (see Note 16)	-	205
Contingencies for joint liability	95	113
Total	355	368
Current Contingencies	(84)	(318)
Long-term Contingencies	271	50

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

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

On May 28, 1981, Kallium Mineração S.A. brought an action against Petromisa, a former subsidiary of Petrobras, in the Federal Court of the State of Rio de Janeiro, alleging damages of approximately US\$ 450 relating to the rescission of a contract to develop a potassium salt mine. On August 10, 1999, a decision was handed down that considered most of the plaintiff's claims to be unfounded (losses, damages and loss of profit), requiring the Company only to reimburse "all expenses incurred as a result of the prospecting research" carried out, in accordance with amounts to be calculated in the final award. No award for loss of profit was established in the decision. In September of 1999 both parties filed appeals with the appeals court in the state of Rio de Janeiro. Based on the opinion of its legal advisers, management does not expect an unfavorable outcome in this case and considers the risk of loss with respect to this lawsuit to be remote.

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

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

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

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

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

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

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

Petrobras is a defendant in four labor claims filed by the Unions of Petroleum Workers of three federal states (Rio de Janeiro, São Paulo and Sergipe), alleging that official inflation rates for 1987, 1989 and 1990 (understatement of the official inflation rate – Bresser, Summer and Collor Plans) were not fully included in the workers’ salaries.

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

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

Of the total amount involved in these claims, approximately US\$ 394 up to December 31, 2003, US\$ 32 were effectively withdrawn from the Company’s accounts as a result of provisional judicial orders.

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

(B) NOTIFICATION FROM THE INSS – JOINT LIABILITY

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

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

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

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

(C) TAX ASSESSMENTS – INTERNAL REVENUE SERVICE OF RIO DE JANEIRO

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

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

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

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

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

(D) ENVIRONMENTAL MATTERS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(E) MINIMUM OPERATING LEASE PAYMENTS

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

2004	1,008
2005	1,127
2006	784
2007	237
2008	200
2009 and thereafter	3,065
Minimum operating lease payment commitments	6,421

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

23. Derivative instruments, hedging and risk management activities

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

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

(A) FOREIGN CURRENCY RISK MANAGEMENT

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

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

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

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

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

B) COMMODITY PRICE RISK MANAGEMENT

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

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

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

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

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

(C) INTEREST RATE RISK MANAGEMENT

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

D) RISK MANAGEMENT ACTIVITY AT PEPSA

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

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

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

24. Financial instruments

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

(A) CONCENTRATIONS OF CREDIT RISK

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

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

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

(B) FAIR VALUE

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

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

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

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

25. Segment information

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

- **Exploration and Production** – This segment includes the Company's exploration, development and production activities in Brazil, as well as sales of crude oil and natural gas in the domestic and foreign markets.
- **Supply** – This segment includes the Company's refining, logistic, transportation and commercialization activities for oil, oil products and fuel alcohol. Additionally, this segment includes the petrochemical and fertilizers division, which includes investments in domestic petrochemical companies and the Company's two domestic fertilizer plants.
- **Distribution** – This segment represents the oil product and fuel alcohol distribution activities conducted by the Company's majority owned subsidiary, Petrobras Distribuidora S.A. – BR in Brazil.
- **Gas and Energy** – This segment currently encompasses the commercialization and transportation of natural gas produced in or imported into Brazil. Additionally, this segment includes the Company's domestic electric energy commercialization activities as well as investments in domestic natural gas transportation companies, state-owned natural gas distributors and thermoelectric companies.
- **International** – This segment represents the Company's international activities conducted in 13 countries, which include Exploration and Production, Supply, Distribution and Gas & Energy.

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

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

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

- **Net operating revenues:** these were considered to be the revenues from sales to third parties, plus revenues between the business segments, based on the internal transfer prices established by the areas;
- **The operating income includes net operating revenue,** the costs of products and services sold, calculated per business segment, based on the internal transfer price and the other operating costs of each segment, as well as operating expenses, based on the expenses actually incurred in each segment;
- **Assets:** covers the assets relating to each segment.

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

The following present the Company's assets by segment:

AS OF DECEMBER 31, 2003								
	EXPLORATION AND PRODUCTION	SUPPLY	GAS AND ENERGY	INTERNATIONAL (SEE SEPARATE DISCLOSURE)	DISTRIBUTION	CORPORATE	ELIMINATIONS	TOTAL
Current assets	2,057	4,871	528	1,738	1,208	9,466	(1,968)	17,900
Cash and cash equivalents	1,042	575	109	445	33	7,406	-	9,610
Other current assets	1,015	4,296	419	1,293	1,175	2,060	(1,968)	8,290
Investments in non-consolidated companies and other investments	6	463	151	449	22	82	-	1,173
Property, plant and equipment, net	16,742	4,980	4,174	4,181	442	336	(50)	30,805
Non-current assets	970	285	751	306	208	4,479	(3,265)	3,734
Petroleum and Alcohol account	-	-	-	-	-	239	-	239
Government securities	-	-	-	-	-	283	-	283
Other assets	970	285	751	306	208	3,957	(3,265)	3,212
Total assets	19,775	10,599	5,604	6,674	1,880	14,363	(5,283)	53,612

AS OF DECEMBER 31, 2003							
	EXPLORATION AND PRODUCTION	SUPPLY	GAS AND ENERGY	DISTRIBUTION	CORPORATE	ELIMINATIONS	TOTAL
Current assets	806	463	167	71	670	(439)	1,738
Cash and cash equivalents	178	42	4	5	216	-	445
Other current assets	628	421	163	66	454	(439)	1,293
Investments in non-consolidated companies and other investments	128	121	199	-	1	-	449
Property, plant and equipment, net	3,301	565	202	64	49	-	4,181
Non-current assets	166	12	-	15	1,664	(1,551)	306
Other assets	166	12	-	15	1,664	(1,551)	306
Total assets	4,401	1,161	568	150	2,384	(1,990)	6,674

AS OF DECEMBER 31, 2002

	EXPLORATION AND PRODUCTION	SUPPLY	GAS AND ENERGY	INTERNATIONAL (SEE SEPARATE DISCLOSURE)	DISTRIBUTION	CORPORATE	ELIMINATIONS	TOTAL
Current assets	1,181	4,323	819	736	973	3,249	(959)	10,322
Cash and cash equivalents	1	509	16	211	59	2,505	-	3,301
Other current assets	1,180	3,814	803	525	914	744	(959)	7,021
Investments in non-consolidated companies and other investments	7	168	70	11	16	62	-	334
Property, plant and equipment, net	11,611	3,186	1,881	1,024	296	226	-	18,224
Non-current assets	385	211	556	1,092	141	1,943	(1,054)	3,274
Petroleum and Alcohol account	-	-	-	-	-	182	-	182
Government securities	-	-	-	-	-	176	-	176
Other assets	385	211	556	1,092	141	1,585	(1,054)	2,916
Total assets	13,184	7,888	3,326	2,863	1,426	5,480	(2,013)	32,154

AS OF DECEMBER 31, 2002

INTERNATIONAL

	EXPLORATION AND PRODUCTION	SUPPLY	GAS AND ENERGY	DISTRIBUTION	CORPORATE	ELIMINATIONS	TOTAL
Current assets	374	215	37	109	201	(200)	736
Cash and cash equivalents	90	16	-	35	70	-	211
Other current assets	284	199	37	74	131	(200)	525
Investments in non-consolidated companies and other investments	9	-	-	2	-	-	11
Property, plant and equipment, net	835	126	11	49	3	-	1,024
Non-current assets	420	8	(9)	-	1,275	(602)	1,092
Other assets	420	8	(9)	-	1,275	(602)	1,092
Total assets	1,638	349	39	160	1,479	(802)	2,863

Revenues and net income by segment are as follows:

YEAR ENDED DECEMBER 31, 2003

	EXPLORATION AND PRODUCTION	SUPPLY	GAS AND ENERGY	INTERNATIONAL (SEE SEPARATE DISCLOSURE)	DISTRIBUTION	CORPORATE	ELIMINATIONS	TOTAL
Net operating revenues from third parties	2,369	17,024	1,229	2,298	7,877	-	-	30,797
Inter-segment net operating revenues	13,329	6,695	250	129	138	-	(20,541)	-
Net operating revenues	15,698	23,719	1,479	2,427	8,015	-	(20,541)	30,797
Cost of sales	(6,154)	(19,944)	(1,045)	(1,398)	(7,257)	-	20,382	(15,416)
Depreciation, depletion and amortization	(955)	(397)	(87)	(288)	(29)	(29)	-	(1,785)
Exploration, including exploratory dry holes and impairment	(452)	-	-	(130)	-	-	-	(582)
Selling, general and administrative expenses	(123)	(732)	(149)	(208)	(416)	(554)	91	(2,091)
Research and development expenses	(92)	(50)	(6)	-	-	(53)	-	(201)
Costs and expenses	(7,776)	(21,123)	(1,287)	(2,024)	(7,702)	(636)	20,473	(20,075)
Equity in results of non-consolidated companies	-	25	56	62	-	(2)	-	141
Financial income (expenses), net	(317)	146	(78)	(129)	(62)	506	(202)	(136)
Employee benefit expenses	-	-	-	-	-	(595)	-	(595)
Other taxes	(9)	(24)	(19)	(25)	(48)	(208)	-	(333)
Other expenses, net	(224)	(100)	(387)	(55)	(1)	(259)	-	(1,026)
Income (loss) before income taxes and minority interest and accounting change	7,372	2,643	(236)	256	202	(1,194)	(270)	8,773
Income tax benefits (expenses)	(2,506)	(874)	196	(154)	(63)	698	40	(2,663)
Minority interest	(59)	(31)	(156)	(1)	(1)	-	-	(248)
Income before effect of change in accounting principle	4,807	1,738	(196)	101	138	(496)	(230)	5,862
Cumulative effect of change in accounting principle, net of taxes	697	-	-	-	-	-	-	697
Net income (loss)	5,504	1,738	(196)	101	138	(496)	(230)	6,559

YEAR ENDED DECEMBER 31, 2003

	INTERNATIONAL						
	EXPLORATION AND PRODUCTION	SUPPLY	GAS AND ENERGY	DISTRIBUTION	CORPORATE	ELIMINATIONS	TOTAL
Net operating revenues from third parties	535	998	159	592	14	-	2,298
Inter-segment net operating revenues	534	633	3	29	-	(1,070)	129
Net operating revenues	1,069	1,631	162	621	14	(1,070)	2,427
Cost of sales	(300)	(1,478)	(103)	(585)	(14)	1,082	(1,398)
Depreciation, depletion and amortization	(223)	(46)	(11)	(4)	(4)	-	(288)
Exploration, including exploratory dry holes and impairment	(130)	-	-	-	-	-	(130)
Selling, general and administrative expenses	(59)	(34)	(2)	(32)	(81)	-	(208)
Costs and expenses	(712)	(1,558)	(116)	(621)	(99)	1,082	(2,024)
Equity in results of non-consolidated companies	2	6	(2)	-	56	-	62
Financial income (expenses), net	(100)	(11)	-	-	(18)	-	(129)
Other taxes	(3)	(5)	-	(5)	(12)	-	(25)
Other expenses, net	(73)	(9)	7	-	20	-	(55)
Income (loss) before income taxes and minority interest	183	54	51	(5)	(39)	12	256
Income tax benefits (expenses)	(132)	(2)	-	-	(20)	-	(154)
Minority interest	3	(2)	(1)	(1)	-	-	(1)
Net income (loss)	54	50	50	(6)	(59)	12	101

YEAR ENDED DECEMBER 31, 2002

	EXPLORATION AND PRODUCTION	SUPPLY	GAS AND ENERGY	INTERNATIONAL (SEE SEPARATE DISCLOSURE)	DISTRIBUTION	CORPORATE	ELIMINATIONS	TOTAL
Net operating revenues from third parties	2,346	12,073	747	986	6,460	-	-	22,612
Inter-segment net operating revenues	10,700	5,269	170	99	102	-	(16,340)	-
Net operating revenues	13,046	17,342	917	1,085	6,562	-	(16,340)	22,612
Cost of sales	(4,829)	(15,242)	(594)	(812)	(5,861)	-	15,832	(11,506)
Depreciation, depletion and amortization	(1,378)	(358)	(45)	(106)	(24)	(19)	-	(1,930)
Exploration, including exploratory dry holes and impairment	(449)	-	-	(61)	-	-	-	(510)
Selling, general and administrative expenses	(177)	(584)	(54)	(90)	(442)	(394)	-	(1,741)
Research and development expenses	(74)	(37)	(5)	-	-	(31)	-	(147)
Costs and expenses	(6,907)	(16,221)	(698)	(1,069)	(6,327)	(444)	15,832	(15,834)
Equity in results of non-consolidated companies	-	11	(94)	(95)	-	-	-	(178)
Financial income (expenses), net	(943)	(13)	(18)	31	5	(762)	-	(1,700)
Employee benefit expenses	-	(2)	-	-	(14)	(435)	-	(451)
Other taxes	-	(18)	(9)	(12)	(36)	(285)	-	(360)
Other expenses, net	(160)	5	(495)	14	(10)	(231)	20	(857)
Income (loss) before income taxes and minority interest	5,036	1,104	(397)	(46)	180	(2,157)	(488)	3,232
Income tax benefits (expenses)	(1,623)	(386)	(104)	(64)	(58)	914	168	(1,153)
Minority interest	-	(7)	311	(4)	(31)	(37)	-	232
Net income (loss)	3,413	711	(190)	(114)	91	(1,280)	(320)	2,311

YEAR ENDED DECEMBER 31, 2002

	INTERNATIONAL						
	EXPLORATION AND PRODUCTION	SUPPLY	GAS AND ENERGY	DISTRIBUTION	CORPORATE	ELIMINATIONS	TOTAL
Net operating revenues from third parties	96	473	36	377	4	-	986
Inter-segment net operating revenues	188	445	-	-	-	(534)	99
Net operating revenues	284	918	36	377	4	(534)	1,085
Cost of sales	(75)	(848)	(30)	(391)	(2)	534	(812)
Depreciation, depletion and amortization	(87)	(13)	-	(5)	(1)	-	(106)
Exploration, including exploratory dry holes and impairment	(61)	-	-	-	-	-	(61)
Selling, general and administrative expenses	(29)	(9)	-	(19)	(33)	-	(90)
Costs and expenses	(252)	(870)	(30)	(415)	(36)	534	(1,069)
Equity in results of non-consolidated companies	-	-	-	-	(95)	-	(95)
Financial income (expenses), net	6	(7)	(6)	-	38	-	31
Other taxes	(1)	(3)	-	(4)	(4)	-	(12)
Other expenses, net	9	(2)	-	1	6	-	14
Income (loss) before income taxes and minority interest	46	36	-	(41)	(87)	-	(46)
Income tax benefits (expenses)	(50)	-	-	-	(14)	-	(64)
Minority interest	(1)	(4)	-	-	1	-	(4)
Net income (loss)	(5)	32	-	(41)	(100)	-	(114)

YEAR ENDED DECEMBER 31, 2001

	EXPLORATION AND PRODUCTION	SUPPLY	GAS AND ENERGY	INTERNATIONAL (SEE SEPARATE DISCLOSURE)	DISTRIBUTION	CORPORATE	ELIMINATIONS	TOTAL
Net operating revenues from third parties	308	15,969	659	777	6,836	-	-	24,549
Inter-segment net operating revenues	9,796	5,757	177	71	100	-	(15,901)	-
Net operating revenues	10,104	21,726	836	848	6,936	-	(15,901)	24,549
Cost of sales	(3,766)	(17,279)	(600)	(541)	(6,310)	-	15,689	(12,807)
Depreciation, depletion and amortization	(1,228)	(301)	(62)	(101)	(28)	(9)	-	(1,729)
Exploration, including exploratory dry holes and impairment	(463)	-	-	(86)	-	-	-	(549)
Selling, general and administrative expenses	(128)	(745)	(46)	(57)	(414)	(361)	-	(1,751)
Research and development expenses	(63)	(40)	(3)	-	-	(26)	-	(132)
Costs and expenses	(5,648)	(18,365)	(711)	(785)	(6,752)	(396)	15,689	(16,968)
Equity in results of non-consolidated companies	-	28	8	(44)	-	-	-	(8)
Financial income (expenses), net	(372)	(112)	(242)	12	(1)	364	3	(348)
Employee benefit expenses	-	-	-	-	-	(594)	-	(594)
Other taxes	-	(14)	(3)	(2)	(36)	(240)	-	(295)
Other expenses, net	(458)	333	(26)	90	60	(1,543)	-	(1,544)
Income (loss) before income taxes and minority interest	3,626	3,596	(138)	119	207	(2,409)	(209)	4,792
Income tax benefits (expenses)	(1,187)	(1,058)	(38)	(91)	(101)	1,001	85	(1,389)
Minority interest	-	-	122	(4)	(28)	(2)	-	88
Net income (loss)	2,439	2,538	(54)	24	78	(1,410)	(124)	3,491

	YEAR ENDED DECEMBER 31, 2001						
	INTERNATIONAL						TOTAL
	EXPLORATION AND PRODUCTION	SUPPLY	GAS AND ENERGY	DISTRIBUTION	CORPORATE	ELIMINATIONS	
Net operating revenues from third parties	217	469	-	90	1	-	777
Inter-segment net operating revenues	178	160	-	-	-	(267)	71
Net operating revenues	395	629	-	90	1	(267)	848
Cost of sales	(129)	(597)	-	(76)	(1)	262	(541)
Depreciation, depletion and amortization	(94)	(6)	-	(1)	-	-	(101)
Exploration, including exploratory dry holes and impairment	(86)	-	-	-	-	-	(86)
Selling, general and administrative expenses	(36)	(9)	-	(7)	(5)	-	(57)
Costs and expenses	(345)	(612)	-	(84)	(6)	262	(785)
Equity in results of non-consolidated companies	-	-	-	-	(44)	-	(44)
Financial income (expenses), net	13	(1)	-	-	-	-	12
Other taxes	-	(1)	-	(1)	-	-	(2)
Other expenses, net	100	-	-	-	(10)	-	90
Income (loss) before income taxes and minority interest	163	15	-	5	(59)	(5)	119
Income tax benefits (expenses)	(58)	(8)	-	(29)	4	-	(91)
Minority interest	-	(4)	-	-	-	-	(4)
Net income (loss)	105	3	-	(24)	(55)	(5)	24

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

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

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

	YEAR ENDED DECEMBER 31,		
	2003	2002	2001
Brazil	34,025	27,410	30,122
International	8,665	5,577	4,023
	42,690	32,987	34,145

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

26. Related party transactions

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

Transactions with major related parties resulted in the following balances:

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

These balances are included in the following balance sheet classifications:

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

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

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

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

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

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

The “International” geographical area includes activities in Angola, Argentina, Bolivia, Colombia, Ecuador, Mexico, Nigeria, Peru, the United States of America and Venezuela. The Company has immaterial non-consolidated companies involved in exploration and production activities; the amounts related to such are presented under “Company’s share in unconsolidated affiliates”.

(I) CAPITALIZED COSTS RELATING TO OIL AND GAS PRODUCING ACTIVITIES

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

	AS OF DECEMBER 31, 2003		
	BRAZIL	INTERNATIONAL	WORLDWIDE
Unproved oil and gas properties	1,253	650	1,903
Proved oil and gas properties	11,924	3,835	15,759
Support equipment	10,336	516	10,852
Gross capitalized costs	23,513	5,001	28,514
Depreciation and depletion	(11,458)	(1,830)	(13,288)
	12,055	3,171	15,226
Construction and installations in progress	4,687	130	4,817
	16,742	3,301	20,043
Company’s share in unconsolidated affiliates	-	78	78
Net capitalized costs	16,742	3,379	20,121

	AS OF DECEMBER 31, 2002		
	BRAZIL	INTERNATIONAL	WORLDWIDE
Unproved oil and gas properties	538	337	875
Proved oil and gas properties	10,049	1,192	11,241
Support equipment	8,062	15	8,077
Gross capitalized costs	18,649	1,544	20,193
Depreciation and depletion	(10,514)	(709)	(11,223)
	8,135	835	8,970
Construction and installations in progress	3,476	-	3,476
Net capitalized costs	11,611	835	12,446

(II) COSTS INCURRED IN OIL AND GAS PROPERTY ACQUISITION, EXPLORATION AND DEVELOPMENT ACTIVITIES

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

	AS OF DECEMBER 31, 2003		
	BRAZIL	INTERN. (1)	WORLDWIDE
Property acquisitions			
Proved	-	2,255	2,255
Unproved	7	6	13
Exploration costs	827	96	923
Development costs	3,025	285	3,310
	3,859	2,642	6,501

	AS OF DECEMBER 31, 2002		
	BRAZIL	INTERNATIONAL	WORLDWIDE
Property acquisitions			
Proved	-	15	15
Unproved	12	4	16
Exploration costs	725	104	829
Development costs	2,691	82	2,773
	3,428	205	3,633

	AS OF DECEMBER 31, 2001		
	BRAZIL	INTERNATIONAL	WORLDWIDE
Property acquisitions			
Unproved	62	121	183
Exploration costs	528	110	638
Development costs	2,411	119	2,530
	3,001	350	3,351

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

(III) RESULTS OF OPERATIONS OF OIL AND GAS PRODUCING ACTIVITIES

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

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

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

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

	YEAR ENDED DECEMBER 31, 2002		
	BRAZIL	INTERNATIONAL	WORLDWIDE
Net operating revenues:			
Sales to third parties	2,346	96	2,442
Intersegment	10,700	188	10,888
	13,046	284	13,330
Production costs	(4,829)	(75)	(4,904)
Exploration expenses	(392)	(43)	(435)
Depreciation, depletion, amortization	(1,378)	(87)	(1,465)
Impairment of oil and gas properties	(57)	(18)	(75)
Results before income taxes	6,390	61	6,451
Income tax expense	(2,173)	(58)	(2,231)
Results of operations	4,217	3	4,220

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

(1) Includes PEPSA from June 1, 2003.

(IV) RESERVE QUANTITY INFORMATION

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

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

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

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

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

	OIL (MILLIONS OF BARRELS)			GAS (BILLIONS OF CUBIC FEET)		
	BRAZIL	INTERNATIONAL	WORLDWIDE	BRAZIL	INTERNATIONAL	WORLDWIDE
Worldwide Net Proved Developed and Undeveloped Reserves						
Reserves at January 1, 2001	8,227.4	128.9	8,356.3	6,266.8	2,173.2	8,440.0
Revisions of previous estimates	(949.6)	(0.3)	(949.9)	401.1	13.0	414.1
Extensions, discoveries and improved recovery	877.6	2.2	879.8	835.3	65.5	900.8
Sales of reserves in place	(31.6)	(20.2)	(51.8)	(194.0)	(38.8)	(232.8)
Production for the year	(471.0)	(14.6)	(485.6)	(423.9)	(50.7)	(474.6)
Reserves at December 31, 2001	7,652.8	96.0	7,748.8	6,885.3	2,162.2	9,047.5
Revisions of previous estimates	822.0	3.1	825.1	787.0	(49.8)	737.2
Extensions, discoveries and improved recovery	888.2	10.8	899.0	102.2	9.2	111.4
Sales of reserves in place	-	23.6	23.6	-	71.5	71.5
Production for the year	(529.8)	(11.8)	(541.6)	(446.7)	(48.1)	(494.8)
Reserves at December 31, 2002	8,833.2	121.7	8,954.9	7,327.8	2,145.0	9,472.8
Revisions of previous estimates	(682.1)	(10.8)	(692.9)	459.3	(294.8)	164.5
Extensions, discoveries and improved recovery	1,439.8	55.5	1,495.3	778.3	80.1	858.4
Purchase of reserves in place – PEPSA	-	602.8	602.8	-	1,346.9	1,346.9
Sales of reserves in place	-	(7.7)	(7.7)	-	(49.5)	(49.5)
Production for the year	(539.5)	(40.8)	(580.3)	(454.0)	(136.8)	(590.8)
Reserves at December 31, 2003	9,051.4	720.7*	9,772.1	8,111.4	3,090.9*	11,202.3
Net Proved Developed Reserves						
At January 1, 2001	3,780.8	80.1	3,860.9	3,614.3	1,368.4	4,982.7
At December 31, 2001	3,899.4	66.6	3,966.0	3,946.0	1,336.8	5,282.8
At December 31, 2002	3,912.9	94.7	4,007.6	3,892.5	2,043.9	5,936.4
At December 31, 2003	3,629.5	404.1	4,033.6	4,398.1	2,548.4	6,946.5

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

(V) STANDARDIZED MEASURE OF DISCOUNTED FUTURE NET CASH FLOWS RELATING TO PROVED OIL AND GAS QUANTITIES AND CHANGES THEREIN

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

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

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

	BRAZIL	INTERNATIONAL	WORLDWIDE
At December 31, 2003			
Future cash inflows	216,112	20,881	236,993
Future production costs	(86,666)	(5,212)	(91,878)
Future development costs	(18,727)	(1,799)	(20,526)
Future income tax expenses	(38,982)	(4,651)	(43,633)
Undiscounted future net cash flows	71,737	9,219	80,956
10 percent midyear annual discount for timing of estimated cash flows	(36,215)	(4,013)	(40,228)
Company's share in unconsolidated affiliates	-	91	91
Standardized measure of discounted future net cash flows	35,522	5,297*	40,819
At December 31, 2002			
Future cash inflows	210,063	6,759	216,822
Future production costs	(84,191)	(1,625)	(85,816)
Future development costs	(13,798)	(358)	(14,156)
Future income tax expenses	(37,934)	(1,906)	(39,840)
Undiscounted future net cash flows	74,140	2,870	77,010
10 percent midyear annual discount for timing of estimated cash flows	(36,932)	(1,364)	(38,296)
Standardized measure of discounted future net cash flows	37,208	1,506	38,714
At December 31, 2001			
Future cash inflows	129,989	5,217	135,206
Future production costs	(56,087)	(1,356)	(57,443)
Future development costs	(9,650)	(277)	(9,927)
Future income tax expenses	(21,810)	(1,526)	(23,336)
Undiscounted future net cash flows	42,442	2,058	44,500
10 percent midyear annual discount for timing of estimated cash flows	(21,531)	(1,023)	(22,554)
Standardized measure of discounted future net cash flows	20,911	1,035	21,946

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

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

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

Board of Directors

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ADVISOR

Fábio Colletti Barbosa

ADVISOR

Gerald Dinu Reiss

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ADVISOR

José Eduardo de Barros Dutra

ADVISOR

Executive Board

José Eduardo de Barros Dutra

PRESIDENT

Guilherme de Oliveira Estrella

MANAGER OF EXPLORATION AND PRODUCTION

Ildo Luís Sauer

MANAGER OF GAS AND ENERGY

José Sérgio Gabrielli de Azevedo

CHIEF FINANCIAL OFFICER AND INVESTOR RELATIONS OFFICER

Nestor Cuñat Cerveró

MANAGER OF INTERNATIONAL ACTIVITIES

Renato de Souza Duque

MANAGER OF CORPORATE SERVICES

Rogério Manso da Costa Reis

MANAGER OF REFINING, TRANSPORTATION AND MARKETING

Marcos Menezes

ACCOUNTANT – CRC-RJ 35.286/O-1

Report of the Independent Auditors

To the Board of Directors and Shareholders of

Petróleo Brasileiro S.A. – Petrobras:

We have audited the accompanying consolidated balance sheet of Petróleo Brasileiro S.A. – Petrobras and its subsidiaries as of December 31, 2003, and the related consolidated statements of income, shareholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Petróleo Brasileiro S.A. – Petrobras, as of December 31, 2002 and for the years ended December 31, 2002 and 2001, were audited by other auditors, whose report, dated February 13, 2003, expressed an unqualified opinion on those statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Petróleo Brasileiro S.A. – Petrobras and its subsidiaries at December 31, 2003, and the consolidated results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

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

Rio de Janeiro, Brazil

February 13, 2004

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AUDITORES INDEPENDENTES S/S
CRC – 2SP 015.199/O-6 – F – RJ

Paulo José Machado

ACCOUNTANT CRC – 1RJ 061.469/O – 4