

# Management's Report

## **FINANCIAL INFORMATION**

Management is responsible for the information contained in this annual report. The Consolidated Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles, and include amounts based on Management's informed judgments and estimates. Where alternative accounting methods exist, Management has chosen those that it deems to be the most appropriate based on Canadian Oil Sands' operations. The financial and operating information included in this annual report is consistent with that contained in the Consolidated Financial Statements in all material respects.

To assist Management in fulfilling its responsibilities, systems of accounting, internal controls and disclosure controls are maintained to provide reasonable, but not absolute, assurance that financial information is reliable and accurate and that assets are adequately safeguarded. In addition, Canadian Oil Sands has in place a Code of Business Conduct that applies to all of its employees and directors.

PricewaterhouseCoopers LLP, Chartered Accountants, appointed annually by the Unitholders to serve as Canadian Oil Sands' external auditors, were engaged to conduct an examination of the Consolidated Financial Statements in accordance with Canadian generally accepted auditing standards and in accordance with the standards of the Public Company Accounting Oversight Board (United States), and have expressed their opinion on these statements. Canadian Oil Sands also engages independent reserve evaluators to conduct independent evaluations of its crude oil reserves and resources. The external auditors and reserve evaluators have unrestricted access to the Management of Canadian Oil Sands, the Audit Committee, the Reserves, Marketing Operations, and Environmental, Health and Safety Committee and the Board of Directors.

The Board of Directors has appointed a five-person Audit Committee, consisting of directors who are neither employees nor officers of Canadian Oil Sands and all of whom are independent. It meets regularly with Management and external auditors to discuss controls over the financial reporting process, auditing and other financial reporting matters. In addition, the Audit Committee recommends the appointment of Canadian Oil Sands' external auditors.

The Audit Committee meets at least quarterly with Management and the external auditors to review and approve interim financial statements prior to their release and recommends the audited annual financial statements to the Board of Directors for their approval. Annually, the Board of Directors reviews and approves Canadian Oil Sands' annual financial statements, Management's Discussion and Analysis, AIF, Management Information Circular, and annual reserves estimates. The Board of Directors has approved the annual audited Consolidated Financial Statements and the Management's Discussion and Analysis based on the recommendations of the Audit Committee.

#### **INTERNAL CONTROL OVER FINANCIAL REPORTING**

Management is responsible for establishing and maintaining adequate internal control over financial reporting.

Management has assessed the effectiveness of Canadian Oil Sands' internal control over financial reporting as of December 31, 2008 using criteria established in the *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, Management concluded that Canadian Oil Sands' internal control over financial reporting was effective as of December 31, 2008.

PricewaterhouseCoopers LLP, our auditors, has audited the effectiveness of Canadian Oil Sands' internal control over financial reporting as of December 31, 2008 as stated in their report which appears herein.

(signed) **“Marcel R. Coutu”**  
President & Chief Executive Officer  
February 26, 2009

(signed) **“Ryan M. Kubik”**  
Chief Financial Officer  
February 26, 2009

# Independent Auditors' Report

To the Unitholders  
of Canadian Oil Sands Trust

We have completed integrated audits of Canadian Oil Sands Trust's 2008 and 2007 consolidated financial statements and of its internal control over financial reporting at December 31, 2008. Our opinions, based on our audits, are presented below.

## **CONSOLIDATED FINANCIAL STATEMENTS**

We have audited the accompanying consolidated balance sheets of Canadian Oil Sands Trust (the "Trust") as at December 31, 2008 and December 31, 2007, and the related consolidated Statements of Income and Comprehensive Income and Unitholders' Equity and Cash Flows for the years then ended. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits of the Trust's financial statements as at December 31, 2008 and December 31, 2007 and for each of the years then ended in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit of financial statements includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. A financial statement audit also includes assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Trust as at December 31, 2008 and December 31, 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

## **INTERNAL CONTROL OVER FINANCIAL REPORTING**

We have also audited the Trust's internal control over financial reporting as of December 31, 2008, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). The Trust's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report. Our responsibility is to express an opinion on the effectiveness of the Trust's internal control over financial reporting based on our audit.

We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the

audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we consider necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

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

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

In our opinion, the Trust maintained, in all material respects, effective internal control over financial reporting as of December 31, 2008 based on criteria established in *Internal Control – Integrated Framework* issued by the COSO.

(signed) **“PricewaterhouseCoopers LLP”**

Chartered Accountants

Calgary, Alberta

February 26, 2009

# Consolidated Statements of Income and Comprehensive Income

For the years ended December 31 (\$ millions, except per Trust Unit amounts)	2008	2007
<b>Revenues</b>	<b>\$ 4,543</b>	<b>\$ 3,633</b>
<b>Expenses</b>		
Operating	1,368	1,034
Non-production	78	63
Crude oil purchases and transportation expense	374	383
Crown royalties (Note 20)	599	485
Administration	17	20
Insurance	6	8
Interest, net (Note 16)	68	85
Depreciation, depletion and accretion (Note 7)	444	351
Foreign exchange loss (gain)	159	(117)
	<b>3,113</b>	<b>2,312</b>
<b>Earnings before taxes from continuing operations</b>	<b>1,430</b>	<b>1,321</b>
Future income tax expense (recovery) (Note 13)	(93)	579
<b>Net income from continuing operations</b>	<b>1,523</b>	<b>742</b>
Income from discontinued operations	–	1
<b>Net income</b>	<b>1,523</b>	<b>743</b>
<b>Other comprehensive loss, net of income taxes</b>		
Reclassification of derivative gains to net income	(3)	(6)
<b>Comprehensive income</b>	<b>\$ 1,520</b>	<b>\$ 737</b>
<b>Weighted-average Trust Units (millions)</b>	<b>481</b>	<b>479</b>
<b>Trust Units, end of year (millions)</b>	<b>482</b>	<b>479</b>
<b>Net income per Trust Unit <sup>1</sup>:</b>		
Basic (Note 14)	<b>\$ 3.17</b>	<b>\$ 1.55</b>
Diluted (Note 14)	<b>\$ 3.16</b>	<b>\$ 1.54</b>

See Notes to Consolidated Financial Statements.

<sup>1</sup> Discontinued operations did not have a material impact on basic or diluted net income per Trust Unit.

# Consolidated Statements of Unitholders' Equity

For the years ended December 31 (\$ millions)	2008	2007
<b>Retained earnings</b>		
Balance, beginning of year, as previously reported	\$ 1,643	\$ 1,691
Net income	1,523	743
Unitholder distributions (Note 17)	(1,804)	(791)
Balance, end of year	1,362	1,643
<b>Accumulated other comprehensive income</b>		
Balance, beginning of year	24	30
Other comprehensive loss, net of income taxes	(3)	(6)
Balance, end of year	21	24
<b>Unitholders' capital</b>		
Balance, beginning of year	2,500	2,260
Issuance of Trust Units (Note 14)	24	240
Balance, end of year	2,524	2,500
<b>Contributed surplus</b>		
Balance, beginning of year	5	4
Exercise of employee stock options	(3)	–
Stock-based compensation (Note 15)	1	1
Balance, end of year	3	5
<b>Total Unitholders' equity</b>	<b>\$ 3,910</b>	<b>\$ 4,172</b>

See Notes to Consolidated Financial Statements.

# Consolidated Balance Sheets

As at December 31 (\$ millions)	2008	2007
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 279	\$ 268
Accounts receivable	184	379
Inventories (Note 6)	93	102
Prepaid expenses	5	6
	561	755
Property, plant and equipment, net (Note 7)	6,277	6,427
Other assets		
Goodwill	52	52
Reclamation trust (Note 12)	43	37
	\$ 6,933	\$ 7,271
<b>Liabilities and Unitholders' Equity</b>		
Current liabilities		
Accounts payable and accrued liabilities (Note 8)	\$ 284	\$ 289
Current portion of employee future benefits (Note 9)	17	16
	301	305
Employee future benefits and other liabilities (Note 9)	99	128
Long-term debt (Note 11)	1,258	1,218
Asset retirement obligation (Note 12)	235	226
Future income taxes (Note 13)	1,130	1,222
	3,023	3,099
Unitholders' equity (Note 14)	3,910	4,172
	\$ 6,933	\$ 7,271

Commitments, Contingencies, and Guarantees (Notes 21, 22 and 23, respectively)

See Notes to Consolidated Financial Statements.

Approved by the Board of Directors

(signed) "Wesley R. Twiss"  
Director

(signed) "C. E. (Chuck) Schultz"  
Director

# Consolidated Statements of Cash Flows

For the years ended December 31  
(\$ millions)

	2008	2007
<b>Cash from (used in) operating activities</b>		
Net income	\$ 1,523	\$ 743
Items not requiring an outlay of cash		
Depreciation, depletion and accretion	444	351
Unrealized foreign exchange loss (gain) on long-term debt	204	(153)
Future income tax expense (recovery)	(93)	578
Other	2	(3)
Net change in deferred items	(41)	26
Funds from operations	2,039	1,542
Change in non-cash working capital (Note 24)	202	(165)
Cash from operating activities	2,241	1,377
<b>Cash from (used in) financing activities</b>		
Repayment of medium term and Senior Notes (Note 11)	(150)	(272)
Net drawdown (repayment) of bank credit facilities (Note 10)	(16)	16
Unitholder distributions (Note 17)	(1,804)	(791)
Issuance of Trust Units (Note 14)	21	3
Cash used in financing activities	(1,949)	(1,044)
<b>Cash from (used in) investing activities</b>		
Capital expenditures	(281)	(183)
Acquisition of additional Syncrude working interest (Note 5)	–	(231)
Disposition of properties	–	4
Reclamation trust funding	(6)	(7)
Change in non-cash working capital (Note 24)	6	(1)
Cash used in investing activities	(281)	(418)
<b>Increase (decrease) in cash and cash equivalents</b>	<b>11</b>	<b>(85)</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>268</b>	<b>353</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 279</b>	<b>\$ 268</b>
<b>Cash and cash equivalents consist of:</b>		
Cash	\$ 18	\$ 4
Short-term investments	261	264
	<b>\$ 279</b>	<b>\$ 268</b>

**Supplementary Information** (Note 24)

See Notes to Consolidated Financial Statements.

# Notes to Consolidated Financial Statements

(Tabular amounts expressed in millions of Canadian dollars, except where otherwise noted.)

## Note 1. STRUCTURE OF CANADIAN OIL SANDS TRUST

Canadian Oil Sands Trust (the “Trust”) is an open-ended investment trust formed under the laws of the Province of Alberta in October 1995 pursuant to a trust indenture (“Trust Indenture”) that has since been amended and restated. Computershare Trust Company of Canada is appointed as Trustee under the Trust Indenture. The beneficiaries of the Trust are the holders (“Unitholders”) of the Units (“Units”) in the Trust.

Through its subsidiary, Canadian Oil Sands Limited (“COSL”), the Trust indirectly owns a 36.74 percent interest (“Working Interest”) in the Syncrude Joint Venture (“Syncrude”). Syncrude is involved in the mining and upgrading of bitumen from oil sands in Northern Alberta and is operated by Syncrude Canada Ltd. (“Syncrude Canada”).

## Note 2. SUMMARY OF ACCOUNTING POLICIES

### Consolidation

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada (“GAAP”) and include the accounts of the Trust and its subsidiaries (collectively, “Canadian Oil Sands”). The activities of Syncrude are conducted jointly with others and, accordingly, these financial statements reflect only Canadian Oil Sands’ proportionate interest in such activities, which include the production, operating costs, non-production costs, Crown royalty expenses, property, plant and equipment capital expenditures, inventories, employee future benefits and other liabilities, asset retirement obligation, and associated amounts payable and receivable. Substantially all operations of Canadian Oil Sands are carried out through the joint venture.

### Cash and Cash Equivalents

Investments with maturities of less than 90 days at purchase are considered to be cash equivalents and are recorded at cost, which approximates fair value.

### Property, Plant and Equipment

Property, plant and equipment (“PP&E”) includes oil sands assets and interests in natural gas licenses located in the Arctic Islands in Northern Canada (the “Arctic assets”). The oil sands assets are recorded at cost and include the costs of acquiring the Working Interest and costs that are directly related to the exploration, development and construction of oil sands projects. Included in the oil sands assets are asset retirement costs associated with Canadian Oil Sands’ asset retirement obligations. Overburden removal, turnaround costs and repairs and maintenance are expensed in the period incurred.

Oil sands assets are depreciated and depleted using the unit-of-production method based on estimated proved plus probable reserves. For purposes of the depreciation and depletion provision, capital costs include future capital costs expected to be necessary in the mining, extraction and upgrading process to recover the estimated proved plus probable reserves.

An impairment test is applied to the oil sands assets to ensure that capitalized costs, less the cost of unproved properties, do not exceed management’s estimate of future undiscounted revenues from proved and probable reserves, less transportation and operating expenses, Crown royalties, future development capital costs and general and administrative expenses. If it is determined that the net recoverable amount is less than the net carrying amount, a write-down to the fair value is taken and charged to earnings in the period. The Trust performs this test at least annually or more frequently if there is an indication that asset impairment has potentially occurred.

The Arctic assets are recorded at cost and include the costs of acquiring the varying interests in natural gas licenses located in the Arctic Islands in Northern Canada. The Arctic assets are not amortized as they are not yet developed. A test for impairment of the Arctic assets is performed at least annually or sooner if events or changes in circumstances indicate that their carrying amount may not be recoverable. If it is determined that the net recoverable amount is less than the net carrying amount, a write-down to the fair value is taken and charged to earnings in the period.

### Goodwill

Goodwill is recorded at cost and represents the excess of the purchase price over the accounting fair value of the identifiable assets and liabilities acquired in a business combination. Goodwill is tested annually for impairment, or when events or changes in circumstances indicate that its carrying amount may not be recoverable. If it is determined that the net recoverable amount of the underlying assets that gave rise to the goodwill is less than the net carrying amount of such assets, a write-down to the fair value of goodwill is taken and charged to earnings in the period.

**Inventories**

Inventories are valued at the lower of average cost and their net realizable value.

**Asset Retirement Obligation**

The estimated fair value of the Trust's share of Syncrude's asset retirement obligations is recognized on the Trust's Consolidated Balance Sheet. Syncrude's reclamation obligations relate to the site restoration of each mine site. The discounted full amount of the liability is recorded upon initial land disturbance or when a reasonable estimate of the fair value of the reclamation expenditures can be determined. The fair value is determined by estimating the timing and amounts of the future reclamation expenditures, and discounting the expenditures using a credit-adjusted risk-free rate applicable to the Trust. The asset retirement cost is equal to the estimated fair value of the asset retirement obligation and is capitalized as part of the Trust's PP&E. The asset retirement obligation is accreted based on the Trust's credit-adjusted risk-free rate and the accretion expense is included in the Trust's depreciation, depletion and accretion ("DD&A") expense in the Consolidated Statements of Income and Comprehensive Income.

Actual reclamation payments are charged against the accumulated asset retirement obligation when incurred.

**Revenue Recognition**

Revenues from the sale of synthetic crude oil and other products are recorded when title passes from Canadian Oil Sands to a third party. Revenues are recorded inclusive of hedging gains and losses, if any, from foreign currency exchange rate and crude oil hedge contracts.

**Employee Future Benefits**

Canadian Oil Sands accrues its proportionate share of obligations as a joint venture owner in respect of Syncrude Canada's employee benefit plans and the related costs, net of plan assets. The cost of employee pension and other retirement benefits is actuarially determined using the projected benefit method based on length of service and reflects Syncrude's best estimate of the expected performance of the plan investment, salary escalation factors, retirement ages of employees and future health care costs. The expected return on plan assets is based on the fair value of those assets. Past service costs from plan amendments are amortized on a straight-line basis over the estimated average remaining service life of active employees ("EARSLS") at the date of amendment. The excess of any net actuarial gain or loss exceeding 10 percent of the greater of the benefit obligation and fair value of the plan assets is amortized over the EARSLS.

**Future Income Taxes**

Canadian Oil Sands follows the liability method of accounting for income taxes. Under this method, future income taxes are calculated as the difference between the accounting and income tax basis of an asset or liability, referred to as temporary differences, tax effected using substantively enacted or enacted income tax rates expected to be in effect when such temporary differences reverse. Future income tax balances recorded on the Consolidated Balance Sheet are adjusted to reflect changes in temporary differences and income tax rates, with the adjustments being recognized in net income in the period that the changes occur.

**Non-Monetary Transactions**

Canadian Oil Sands exchanges crude oil batches with third parties in the normal course of operations. These transactions lack commercial substance and are therefore recorded at carrying value without the recognition of a gain or loss.

**Stock-Based Compensation**

Canadian Oil Sands recognizes stock-based compensation expense in its Consolidated Statement of Income and Comprehensive Income for all Unit options ("options") granted with a corresponding increase to contributed surplus in Unitholders' Equity. Canadian Oil Sands determines compensation expense based on the estimated fair values of the options at the time of grant, the cost of which is recognized in net income over the vesting periods of the options.

Canadian Oil Sands also recognizes stock-based compensation expense related to its performance units ("PUPs"), which are awards granted to Canadian Oil Sands officers, other select employees and consultants and its affiliates under Canadian Oil Sands' performance Unit Incentive Plan (the "Incentive Plan"). Canadian Oil Sands determines compensation expense based on the estimated fair values of the PUPs, the cost of which is recognized in net income over the vesting periods of the PUPs. At the current time, there is no issuance of Units from treasury under this Incentive Plan and instead employees in such Incentive Plan receive cash, or cash to purchase Units in the secondary market.

As an owner in Syncrude, Canadian Oil Sands also records its share of costs for Syncrude Canada's stock-based compensation programs. Syncrude Canada's programs include Incentive Phantom Share Units Plan ("Phantom Units") and Incentive Restricted Share Units Plan ("Restricted Units"), both of which require settlement by cash payments. Compensation expense for the Phantom Units and Restricted Units is recognized over the shorter of the normal vesting period and the period to eligible retirement if vesting is accelerated on retirement. Canadian Oil Sands' share of the change in the fair values of the vested Phantom Units and Restricted Units, which are based on market-related values of various Syncrude owners' shares/units at period ends, is recognized in operating expense in the year the change occurs.

### **Foreign Currency Translation**

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at exchange rates in effect at the end of the period, with the resulting gain or loss recorded in the Consolidated Statements of Income and Comprehensive Income. Revenues and expenses are translated into Canadian dollars at average exchange rates. Translation gains and losses on U.S. dollar denominated long-term debt are recorded as unrealized until repayment of the debt obligations. All other translation gains and losses are classified as realized.

### **Net Income per Trust Unit**

Canadian Oil Sands applies the treasury stock method to determine the dilutive impact, if any, of options assuming they were exercised in a reporting period. The treasury stock method assumes that all proceeds received by the Trust when options are exercised would be used to purchase Units at the average market price during the period.

### **Financial Instruments**

All financial instruments are initially measured at fair value on the balance sheet. Subsequent measurement of financial instruments is based on their classification as follows:

<i>Classification</i>	<i>Measurement</i>
Held for trading	Fair value with changes recognized in net income
Held to maturity	Amortized cost using effective interest method
Loans and receivables	Amortized cost using effective interest method
Available for sale	Fair value with changes recognized in other comprehensive income
Other liabilities	Amortized cost using effective interest method

Transaction costs are added to the amount of the associated financial instrument and amortized accordingly using the effective interest rate method.

The fair values of the Trust's financial instruments, other than long-term debt, approximate their carrying values due to the short-term nature of those instruments. The fair value of long-term debt is determined based on market price indications. In fair valuing its derivatives, the Trust utilizes a valuation technique using available market prices.

### **Measurement Uncertainty**

The preparation of the consolidated financial statements under GAAP requires management to make estimates and assumptions for many financial statement items based on its best estimates and judgments. Significant judgments and estimates relate to depreciation, depletion, impairment tests and asset retirement obligation costs as they are based on reserve engineering studies, environmental studies, new mine plans and price and cost estimates, which by their nature, are subjective and contain measurement uncertainty. The values of pension and other benefit plan accrued obligations and plan assets and the amount of pension cost charged to net income depend on certain actuarial and economic assumptions, which by their nature are subject to measurement uncertainty. The calculation of future income tax is based on assumptions, which are subject to uncertainty as to the timing and at which tax rates temporary differences are expected to reverse. Uncertainties related to various income tax positions exist because the timing of resolution and the impact on tax pool balances are not currently determinable. Accordingly, actual results may differ from estimated amounts as future events occur.

### **Reclassification**

Certain information provided for prior years has been reclassified to conform to the presentation adopted in 2008.

### Note 3. CHANGES IN ACCOUNTING POLICIES

In June 2007, the Canadian Institute of Chartered Accountants (“CICA”) issued a new accounting standard – Section 3031 *Inventories*, which replaces the existing standard for inventories, Section 3030. The main features of the new section are as follows:

- Measurement of inventories at the lower of cost and net realizable value;
- Consistent use of either first-in, first-out or a weighted average cost formula to measure cost; and
- Reversal of previous write-downs to the lower of cost and the revised net realizable value when there is a subsequent increase to the value of inventories.

The new inventory standard was effective for the Trust beginning January 1, 2008. Application of the new standard did not have a significant impact on the financial statements.

### Note 4. NEW ACCOUNTING PRONOUNCEMENTS

#### Goodwill

In February 2008, the CICA issued a new accounting standard – Section 3064 *Goodwill and Intangible Assets*, which replaces Section 3062 *Goodwill and Other Intangible Assets*, and Section 3450 *Research and Development Costs*. The new Section establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. The Section is effective for the Trust beginning January 1, 2009. Application of the new Section is not expected to have a material impact on the Trust’s financial statements.

#### International Financial Reporting Standards

On February 13, 2008, the CICA Accounting Standards Board confirmed that the adoption of International Financial Reporting Standards (“IFRS”) would be effective for interim and annual periods beginning on or after January 1, 2011 for Canadian publicly accountable enterprises. IFRS will effectively replace Canadian GAAP for these enterprises. Comparative IFRS information for the previous fiscal year will also be required.

Canadian Oil Sands has developed a plan to convert its consolidated financial statements to IFRS beginning January 1, 2011. To date, Management has identified potential differences between GAAP and IFRS related to the accounting for portions of the Syncrude joint venture and effects of transitional provision of IFRS for first time adopters. Management is reviewing the impact that these differences will have on accounting policies, information technology and data systems, internal control over financial reporting, disclosure controls and procedures, financial reporting, and business activities.

### Note 5. ACQUISITION OF ADDITIONAL SYNCRUDE WORKING INTEREST

On January 2, 2007, a subsidiary of the Trust closed an acquisition with Talisman Energy Inc. (“Talisman”) to purchase an additional 1.25 percent indirect working interest in Syncrude for \$476 million. The transaction price was comprised of \$238 million in cash and 8,189,655 Units issued from treasury with an approximate value at the time of entering the acquisition agreement of \$29 per Unit.

The acquisition has been accounted for as a purchase of assets. The Trust has allocated the purchase price based on fair values to the assets and liabilities as follows:

#### Net assets and liabilities assumed

Property, plant and equipment	\$	668
Cash		8
Working capital		1
Employee future benefits and other liabilities		(8)
Asset retirement obligation		(6)
Future income taxes		(187)
	\$	476

#### Consideration

Cash	\$	238
Issuance of Trust Units		237
Acquisition costs		1
	\$	476

The working interest was acquired through the acquisition of Talisman’s interest in a partnership between Talisman and a subsidiary of the Trust. Immediately following the acquisition of Talisman’s partnership interest, the partnership was dissolved. The dissolution resulted in an adjustment that increased Canadian Oil Sands’ future income tax liability by \$140 million as well as increased its property, plant and equipment on the Consolidated Balance Sheet.

**Note 6. INVENTORIES**

As at December 31	2008	2007
Materials and supplies	\$ 72	\$ 69
Product and linefill	21	33
	<b>\$ 93</b>	<b>\$ 102</b>

**Note 7. PROPERTY, PLANT AND EQUIPMENT, NET**

As at December 31, 2008	Cost	Accumulated Depreciation and Depletion	Net Book Value
Oil sands assets	\$ 7,942	\$ 1,830	\$ 6,112
Arctic assets	165	–	165
	<b>\$ 8,107</b>	<b>\$ 1,830</b>	<b>\$ 6,277</b>
As at December 31, 2007			
Oil sands assets	\$ 7,662	\$ 1,400	\$ 6,262
Arctic assets	165	–	165
	<b>\$ 7,827</b>	<b>\$ 1,400</b>	<b>\$ 6,427</b>

The Arctic assets are not subject to amortization as they have not yet been developed.

DD&A expense is comprised of the following:

For the years ended December 31	2008	2007
Depreciation and depletion expense	\$ 430	\$ 340
Accretion expense	14	11
	<b>\$ 444</b>	<b>\$ 351</b>

**Note 8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

As at December 31	2008	2007
Due to Syncrude Joint Venture/Syncrude Canada Ltd.	\$ 250	\$ 225
Accrued liabilities	9	42
Interest payable	25	22
	<b>\$ 284</b>	<b>\$ 289</b>

Amounts due to the Syncrude Joint Venture/Syncrude Canada Ltd. typically include commercial trade payables and Crown royalties payable.

**Note 9. EMPLOYEE FUTURE BENEFITS AND OTHER LIABILITIES**

As at December 31	2008	2007
Employee future benefits (a)	\$ 110	\$ 113
Accrued variable compensation and other (b)	61	56
	<b>171</b>	<b>169</b>
Less current portion comprised of:		
Employee future benefits	(17)	(16)
Accrued variable compensation and other (included in accounts payable and accrued liabilities)	(55)	(25)
	<b>\$ 99</b>	<b>\$ 128</b>

### a) Employee Future Benefits

Syncrude Canada has a defined benefit and two defined contribution plans providing pension benefits and other retirement and post-employment benefit (“OPEB”) plans covering most of its employees. Other post-employment benefits include certain health care and life insurance benefits for retirees, their beneficiaries and covered dependants. The OPEB plan is not funded.

#### Defined Benefit Plan

Syncrude measures its accrued benefit obligation and the fair value of plan assets for accounting purposes as at December 31 of each year. The most recent actuarial valuation of the pension plans for funding purposes was completed in 2007 and was as of December 31, 2006. The next required valuation will be as of December 31, 2009.

Canadian Oil Sands’ share of Syncrude Canada’s defined benefit plan accrued liability, based on its 36.74 percent ownership at December 31, 2008 and December 31, 2007, is comprised of its share of Syncrude Canada’s accrued benefit obligation, partially offset by its share of Syncrude Canada’s defined benefit plan assets as follows:

As at December 31	Pension Benefit Plan		Other Post-Employment Benefits		Total	
	2008	2007	2008	2007	2008	2007
Accrued benefit obligation:						
Balance, beginning of year	\$ 584	\$ 533	\$ 50	\$ 39	\$ 634	\$ 572
Acquired (Note 5)	-	18	-	1	-	19
Current service cost	23	24	1	1	24	25
Interest cost	31	28	3	2	34	30
Transferred in	3	5	-	-	3	5
Benefits paid	(24)	(21)	(2)	(1)	(26)	(22)
Actuarial loss (gain)	(114)	(3)	(11)	8	(125)	5
Balance, end of year	\$ 503	\$ 584	\$ 41	\$ 50	\$ 544	\$ 634
Fair value of plan assets:						
Actuarial fair value, beginning of year	\$ 374	\$ 339	\$ -	\$ -	\$ 374	\$ 339
Acquired (Note 5)	-	12	-	-	-	12
Actual return on plan assets	(99)	8	-	-	(99)	8
Employer contributions	33	30	-	-	33	30
Contributions – transfers	3	5	-	-	3	5
Benefits paid	(23)	(20)	-	-	(23)	(20)
Actuarial fair value, end of year	288	374	-	-	288	374
Funded status – Plan deficit	(215)	(210)	(41)	(50)	(256)	(260)
Unamortized net actuarial loss <sup>1</sup>	145	134	3	15	148	149
Unamortized past service costs <sup>1</sup>	-	-	(2)	(2)	(2)	(2)
Accrued benefit liability	\$ (70)	\$ (76)	\$ (40)	\$ (37)	\$ (110)	\$ (113)

<sup>1</sup> Amortized over the expected average remaining service lives of employees covered by the plan, which is generally 12 years.

The asset allocation for Syncrude Canada’s plan assets was as follows:

As at December 31	Percentage of plan assets	
	2008	2007
Equity securities	68	68
Debt securities	32	32
	100	100

Elements of defined benefit costs recognized in the year:

For the years ended December 31	Pension Benefit Plan		Other Post-Employment Benefits		Total	
	2008	2007	2008	2007	2008	2007
Current service cost	\$ 23	\$ 24	\$ 1	\$ 1	\$ 24	\$ 25
Interest cost	31	28	3	2	34	30
Actual return on plan assets	99	(8)	-	-	99	(8)
Actuarial loss (gain)	(114)	(3)	(11)	8	(125)	5
Elements of employee future benefits costs before adjustments to recognize the long-term nature of employee future benefit costs	\$ 39	\$ 41	\$ (7)	\$ 11	\$ 32	\$ 52
Adjustments to recognize the long-term nature of employee future benefit costs:						
Difference between expected return and actual return on plan assets	(132)	(23)	-	-	(132)	(23)
Difference between actuarial loss (gain) recognized for year and actual actuarial loss (gain) on accrued benefit obligation for year	121	9	12	(8)	133	1
	(11)	(14)	12	(8)	1	(22)
Defined benefit costs recognized in net income	\$ 28	\$ 27	\$ 5	\$ 3	\$ 33	\$ 30

### Significant Assumptions

The significant assumptions adopted in measuring Syncrude Canada's accrued benefit obligations are as follows:

	Pension Benefit Plan		Other Post-Employment Benefits	
	2008	2007	2008	2007
Accrued benefit obligation as of December 31:				
Discount rate	6.5%	5.3%	6.5%	5.3%
Rate of compensation increase	5.0%	5.0%	5.0%	5.0%
Benefit costs for years ended December 31:				
Discount rate	5.3%	5.0%	5.3%	5.0%
Expected long-term rate of return on plan assets	8.5%	8.5%	N/A	N/A
Rate of compensation increase	5.0%	5.0%	5.0%	5.0%

For measurement purposes, a 10 percent annual rate of increase in the cost of supplemental health care benefits was assumed for 2007 and 2008. The rate will remain at 10 percent for 2009 before decreasing by 0.5 percent each year thereafter to an ultimate rate of five percent in 2019. In addition, an annual rate increase of four percent in dental rates was used in 2008 and 2007.

### **Sensitivity Analysis**

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans under other post-employment benefits. A one percent increase in assumed health care cost trend rates would have increased the Trust's accrued benefit obligation by \$5 million, and a similar decrease in rates would have decreased the Trust's obligation by \$4 million. A one percent change in such rates would not have had a material impact on the Trust's current service and interest costs.

### **Defined Contribution Plans**

Canadian Oil Sands' share of Syncrude Canada's defined contribution pension plans was approximately \$2 million in each of 2008 and 2007.

### **Total Cash Payments**

Canadian Oil Sands' share of Syncrude's total cash payments for employee future benefits for 2008 was \$38 million (2007 – \$34 million), consisting of cash contributed by Syncrude Canada to its funded pension plans, cash to fund pension payments in excess of registered plan limits, cash payments directly to beneficiaries for its unfunded OPEB plans and cash contributed to its defined contribution plans.

### **b) Accrued Variable Compensation and Other**

Syncrude Canada has short-term and long-term incentive plans that are cash settled. These plans include Syncrude Canada's employee retention program (Note 21) and stock-based compensation plans (Note 15). Accrued variable compensation and other consists primarily of the long-term portion of these plans. The accrued obligations for these plans are measured at their estimated fair values.

## **Note 10. BANK CREDIT FACILITIES**

As at December 31, 2008

Extendible revolving term facility (a)	\$	40
Line of credit (b)		67
Operating credit facility (c)		800
	\$	907

The credit facilities of COSL, the operating subsidiary of the Trust, are unsecured. These credit agreements contain covenants relating to the restriction on Canadian Oil Sands' ability to sell all or substantially all of its assets or to change the nature of its business. In addition, Canadian Oil Sands has agreed to maintain its total debt-to-total book capitalization at an amount less than 60 percent, or 65 percent in certain circumstances involving acquisitions.

### **a) Extendible Revolving Term Facility**

The \$40 million extendible revolving term facility is a 364-day facility expiring April 23, 2009. This facility may be extended on an annual basis with the agreement of the bank. Amounts borrowed through this facility bear interest at a floating rate based on bankers' acceptances plus a credit spread, while any unused amounts are subject to standby fees. As at December 31, 2008, no amounts were drawn on this facility.

### **b) Line of Credit**

The \$67 million line of credit is a one-year revolving letter of credit facility. Letters of credit drawn on the facility mature April 30th each year and are automatically renewed, unless notification to cancel is provided by Canadian Oil Sands or the financial institution providing the facility at least 60 days prior to expiry. Letters of credit on this facility bear interest at a credit spread.

Letters of credit of approximately \$67 million have been written against the line of credit as at December 31, 2008.

### **c) Operating Credit Facility**

The \$800 million operating facility is a multi-year facility, expiring April 27, 2012. Amounts borrowed through this facility bear interest at a floating rate based on either prime interest rates or bankers' acceptances plus a credit spread. Unused amounts are subject to standby fees. As at December 31, 2008, no amounts were drawn on this facility.

## Note 11. LONG-TERM DEBT

As at December 31	2008	2007
5.75% Medium Term Notes due April 9, 2008 (a)	\$ –	\$ 149
5.55% Medium Term Notes due June 29, 2009 (b)	200	200
4.8% Senior Notes due August 10, 2009 (c)	304	246
5.8% Senior Notes due August 15, 2013 (d)	364	293
7.9% Senior Notes due September 1, 2021 (e)	301	243
8.2% Senior Notes due April 2, 2027 (f)	89	71
Credit facilities drawn, excluding letters of credit (Note 10)	–	16
	<b>\$ 1,258</b>	<b>\$ 1,218</b>

All of Canadian Oil Sands' medium term notes and senior notes are unsecured, rank pari passu with other senior unsecured debt of COSL, and contain certain covenants that place limitations on the sale of assets and the granting of liens or other security interests. The medium term notes are guaranteed by the Trust.

### a) 5.75% Medium Term Notes

The Trust repaid \$150 million of 5.75% Medium Term Notes on April 9, 2008.

### b) 5.55% Medium Term Notes

On June 29, 2004, COSL issued \$200 million of 5.55% unsecured Medium Term Notes, maturing June 29, 2009. Interest is payable on the notes semi-annually on June 29 and December 29.

### c) 4.8% Senior Notes

On August 9, 2004, COSL issued U.S.\$250 million of 4.8% Senior Notes, maturing August 10, 2009. Interest is payable on the notes semi-annually on February 10 and August 10.

### d) 5.8% Senior Notes

On August 6, 2003, COSL issued U.S.\$300 million of 5.8% Senior Notes, maturing August 15, 2013. Interest is payable on the notes semi-annually on February 15 and August 15.

### e) 7.9% Senior Notes

On August 24, 2001, COSL issued U.S.\$250 million of 7.9% Senior Notes, maturing September 1, 2021. Interest is payable on the notes semi-annually on March 1 and September 1. COSL has agreed to maintain its senior debt to book capitalization at an amount less than 55 percent.

### f) 8.2% Senior Notes

On April 4, 1997, COSL issued U.S.\$75 million of 8.2% Senior Notes, maturing April 1, 2027, and retired U.S.\$1.05 million during 2000. Interest is payable on the notes semi-annually on April 1 and October 1.

### h) Future Payments

Future payments payable under long-term debt, the total of which differs from the amortized cost balance recorded on the Consolidated Balance Sheet, are as follows:

2009	\$ 506
2013	367
After five years	397
	<b>\$ 1,270</b>

Canadian Oil Sands intends to refinance on a long-term basis the notes that are maturing in 2009. Of the \$840 million in total credit facilities at December 31, 2008 the Trust had \$800 million that do not expire until April 27, 2012 and may be used to refinance these obligations. In accordance with EIC-122 *Balance Sheet Classification of Callable Debt Obligations and Debt Obligations Expected to be Refinanced*, debt maturing in 2009 has not been reclassified to current liabilities.

## Note 12. ASSET RETIREMENT OBLIGATION AND RECLAMATION TRUST

For the years ended December 31	2008	2007
Asset retirement obligation, beginning of year	\$ 226	\$ 173
Acquired (Note 5)	–	6
Liabilities settled	(14)	(1)
Accretion expense	14	11
Change in estimate	9	37
Asset retirement obligation, end of year	\$ 235	\$ 226

Canadian Oil Sands and each of the other Syncrude owners are liable for their share of ongoing environmental obligations related to the ultimate reclamation of the Syncrude properties on abandonment. The Trust estimates reclamation expenditures will be made over approximately the next 60 years and has applied an average credit-adjusted risk-free discount rate of six percent (2007 – six percent) in deriving the asset retirement obligation.

Syncrude's upgrader facilities have indeterminate useful lives and therefore the fair values of the related asset retirement obligations cannot be reasonably determined. Also, the timing and amount of the reclamation expenditures, if any, related to Syncrude's sulphur blocks are not determinable at the present time. The asset retirement obligations pertaining to the upgrader facilities and the sulphur blocks will be recognized in the year in which the settlement amounts and dates can be reasonably estimated.

The total undiscounted estimated cash flows required to settle the Trust's share of Syncrude's obligation was \$774 million at December 31, 2008 (2007 – \$743 million) as a result of revised cost estimates.

The reclamation expenditures will be funded from Canadian Oil Sands' cash from operating activities and reclamation trust. In addition to this regular funding for reclamation expenditures, Canadian Oil Sands deposits \$0.1322 per barrel of production attributable to its Working Interest to a reclamation trust established for the purpose of funding the operating subsidiary's share of environmental and reclamation obligations. As at December 31, 2008, including interest earned on investments, the balance of the reclamation trust was \$43 million (2007 – \$37 million).

The Trust has posted letters of credit with the Province of Alberta in the amount of \$67 million (2007 – \$61 million) to secure its pro rata share of the reclamation obligations of the Syncrude participants.

## Note 13. FUTURE INCOME TAXES

The tax provision recorded on the consolidated financial statements differs from the amount computed by applying the combined Canadian federal and provincial income tax statutory rate to earnings before taxes as follows:

For the years ended December 31	2008	2007
Earnings before taxes	\$ 1,430	\$ 1,322
Statutory rates		
Federal	29.50%	31.00%
Federal abatement	-10.00%	-10.00%
Federal surtax	0.00%	1.12%
Alberta provincial rate	10.00%	10.00%
	29.50%	32.12%
Expected taxes at statutory rate	\$ 422	\$ 425
Add (Deduct) the tax effect of:		
Net income attributable to the Trust – tax sheltered	(532)	(254)
Substantive enactment of trust taxation	–	701
Statutory rate adjustment for future rate reductions	–	(283)
Non-taxable portion of capital losses (gains)	21	(17)
Other	(4)	7
Provision for taxes	\$ (93)	\$ 579

In 2007, *Bill C-52 Budget Implementation Act, 2007*, containing legislation to apply a new tax to publicly traded trusts in Canada, was substantively enacted by the Canadian federal government. Upon enactment of the legislation the Trust recorded an additional \$701 million future income tax expense and future income tax liability on temporary differences.

During 2007, the federal government substantively enacted tax rate reductions, which lowered tax rates expected to apply in the future to corporations and trusts.

The amount shown on the Consolidated Balance Sheet as future income taxes represents the temporary difference of the Trust and its subsidiaries at substantively enacted tax rates expected to apply when the differences reverse.

Future income taxes are comprised of the following:

As at December 31	2008	2007
Capital and other assets in excess of tax value	\$ (1,654)	\$ (1,809)
Net liabilities in excess of tax value	524	587
Balance at December 31	\$ (1,130)	\$ (1,222)

As at December 31, 2008, the following are the estimated balances available for deduction against future taxable income:

As at December 31	2008
Canadian Oil Sands Trust:	
Canadian Development Expense	\$ 89
Canadian Oil Sands Limited:	
Undepreciated Capital Costs ("UCC") <sup>1</sup>	
Federal UCC	\$ 1,709
Provincial UCC	\$ 1,568
Scientific Research and Exploration Development	\$ 14

<sup>1</sup> Approximately 58 percent are deductible at an accelerated rate up to income from a mine, and the remaining balance is deductible at the declining balance rate of 25 percent annually.

## Note 14. UNITHOLDERS' EQUITY

### a) Unitholders' Capital

The Trust is authorized to issue an unlimited number of ordinary Units pursuant to the Trust Indenture. The Units represent a beneficial interest in the Trust, share equally in all distributions from the Trust and carry equal voting rights. No conversion or pre-emptive rights, and limited retraction rights are attached to the Units. Units are redeemable at the option of the Unitholder at a price that is the lesser of 90 percent of the average closing price of the Units on the principal trading market for the 10 trading days after the date of tender for redemption and the closing market price on the date of tender for redemption, subject to restrictions on the amount to be redeemed each quarter.

In 2008, a total of 2.2 million Units were issued (2007 – 8.5 million) for proceeds of \$24 million (2007 – \$240 million).

The following table summarizes the Units that have been issued:

Date	Number of Units (Millions)	Proceeds
Balance, January 1, 2007	470.9	\$ 2,260
Issued for acquisition of additional Syncrude working interest (non-cash)	8.2	237
Issued on exercise of employee options	0.3	3
Balance, December 31, 2007	479.4	2,500
Issued on exercise of employee options	2.2	24
Balance, December 31, 2008	481.6	\$ 2,524

The Trust has a Unitholder Rights Plan (the "Rights Plan") designed to provide the Trust and its Unitholders with sufficient time to explore and develop alternatives for maximizing Unitholder value if a takeover bid is made for the Trust. One right has been issued and attached to each issued and outstanding Unit. Rights issued under the Rights Plan become exercisable when a person, and any related parties, has acquired or begins a takeover bid to acquire 20 percent or more of the Units without complying with certain provisions in the Rights Plan. Should such an acquisition or announcement occur, each right entitles the holder, other than the acquiring person, to purchase Units at a 50 percent discount to the market price.

#### b) Net Income per Unit

The following table summarizes the Units used in calculating net income per Unit:

As at December 31 ( <i>millions</i> )	2008	2007
Weighted-average Trust Units outstanding, Basic	481	479
Effect of options	1	2
Weighted-average Trust Units outstanding, Diluted	482	481

#### Note 15. STOCK-BASED COMPENSATION

Canadian Oil Sands' stock-based compensation includes stock option and performance unit plan grants for COSL employees pursuant to a long-term incentive program. In addition, Syncrude Canada has stock-based compensation plans for which Canadian Oil Sands records its Working Interest.

#### a) Canadian Oil Sands' Stock-based Compensation Plans

Canadian Oil Sands maintains two stock-based compensation plans as described below.

##### Option Plan

As of December 31, 2008 all remaining outstanding options under the Unit Option and Distribution Equivalent Plan had been exercised. As at December 31, 2008 Canadian Oil Sands had 828,261 options issued under its Unit Incentive Option Plan. The initial exercise price is based on the price of the Units on the preceding day prior to the issuance of the options. Other than exceptions relating to retirement, death or termination, each option has a term of seven years and vests in equal amounts over a three-year period. For options outstanding, the exercise price is reduced in future periods by the amount of distributions in excess of a threshold set by the Board of Directors at the time of the grant.

The following options were issued and outstanding:

Date	Number of Options (Millions)	Weighted-Average Exercise Price
Outstanding at January 1, 2007	2.7	\$ 11.01
Granted in 2007	0.2	\$ 29.93
Exercised in 2007	(0.3)	\$ (8.24)
Outstanding at December 31, 2007	2.6	\$ 12.85
Granted in 2008	0.4	\$ 39.97
Exercised in 2008	(2.2)	\$ 9.73
Outstanding at December 31, 2008	0.8	\$ 32.83
Exercisable at December 31, 2007	2.1	\$ 9.93
Exercisable at December 31, 2008	0.2	\$ 26.80

Exercise Price – As at December 31, 2008	Number of Options Outstanding (Millions)	Weighted- Average Remaining Life (Years)	Weighted- Average Exercise Price
\$19.89 – \$29.03	0.4	4.6	\$ 26.08
\$31.62 – \$43.41	0.4	6.2	\$ 39.51
	0.8	5.4	\$ 32.83

The fair value of each option is estimated on the grant date using an option-pricing model. The weighted-average fair values of the options granted and the weighted-average assumptions used in their determination are as noted below:

For the year ended December 31	2008	2007
Risk-free interest rate (%)	3.95	3.75
Expected life (years)	4.5	4.5
Expected volatility (%)	28	29
Expected distribution per Unit (\$)	3.00	1.20
Fair value per stock option (\$)	4.15	6.00

#### ***Performance Unit Incentive Plan***

Canadian Oil Sands has granted Performance Unit Rights (“PUPs”) pursuant to its Incentive Plan during 2007 and 2008. The PUPs are earned on the third anniversary of the date of grant, at which time the holder is entitled to receive an amount either in the form of Units purchased in the secondary market or in cash, equal to the aggregate current market value of the number of Units subject to the PUPs. No Units are to be issued from treasury. The number of Units granted under the PUPs is dependent on the total unitholder return generated by the Trust at the end of the three years compared to a peer group, with the actual Unit equivalents earned ranging from zero to double the target award. At December 31, 2008 a total of 117,726 PUPs were outstanding (2007 – 69,298) however no PUPs were vested at December 31, 2008 or 2007.

Canadian Oil Sands recorded approximately \$2 million of Administration expense in 2008 (2007 – \$3 million) related to its stock-based compensation plans.

#### **b) Syncrude Canada’s Stock-based Compensation Plans**

Syncrude Canada maintains two stock-based compensation plans as described below.

##### ***Incentive Restricted Share Units Plan***

Syncrude Canada implemented its Restricted Units program in 2006 which awards Restricted Units to certain employees. The Restricted Units vest three years after the date of issuance and require settlement by cash payments. Employees who retire prior to the vesting period may be eligible to receive pro-rated Restricted Units based upon the ratio of service provided during the vesting period relative to the full vesting period. At the end of the vesting period, the cash settlement is based on the weighted-average price of the shares or Units of the Syncrude owners at that time and the total shareholder return of the owners’ shares or Units as compared to a relative peer group. At December 31, 2008 a total of 424,499 Restricted Units were outstanding (2007 – 179,303), however no Restricted Units were vested at December 31, 2008 or 2007.

##### ***Incentive Phantom Share Units Plan***

Syncrude Canada implemented a stock-based compensation plan during 2002 which awarded Phantom Units to certain employees. The Phantom Units have value if the composite value of the weighted-average stock price of 70 percent of the Trust’s Units and 30 percent of various other joint venture owners’ public shares at the time of exercise by Syncrude Canada employees exceeds the issue price of the awards. The Phantom Units issued up to 2005 had a term of seven years and vest based on a graded vesting schedule: after the first year of issuance, 50 percent of the Phantom Units are exercisable, 25 percent the following year and the last 25 percent after year three. Subject to exceptions relating to early retirement, death or termination, each Phantom Unit issued under this plan after 2005 has a term of seven years and vests in equal amounts over a three-year period. When the awards are exercised they are settled in cash. At December 31, 2008 a total of 1.3 million Phantom Units were outstanding (2007 – 1.0 million) and a total of 0.3 million Phantom Units were exercisable (2007 – 0.3 million).

In 2008, Canadian Oil Sands recorded a \$9 million recovery in operating expenses related to its share of Syncrude Canada’s stock-based compensation expense as a result of declines in the plan value (2007 – \$14 million expense).

### Note 16. INTEREST, NET

For the years ended December 31	2008	2007
Interest expense on long-term debt	\$ 76	\$ 91
Interest income and other	(8)	(6)
Interest expense, net	\$ 68	\$ 85

### Note 17. UNITHOLDER DISTRIBUTIONS

The Consolidated Statements of Unitholder Distributions are provided to assist Unitholders in reconciling cash from operating activities to Unitholder distributions.

Pursuant to Section 5.1 of the Trust Indenture, the Trust distributes all the income received or receivable by the Trust in a quarter less expenses and any other amounts required by law or under the terms of the Trust Indenture to be withheld. The Trust primarily receives income by way of a royalty and interest on intercompany loans from its operating subsidiary, COSL. The royalty is designed to capture the cash generated by COSL, after the deduction of all costs and expenses including operating and administrative costs, income taxes, capital expenditures, debt interest and principal repayments, working capital and reserves for future obligations deemed appropriate. The amount of royalty income that the Trust receives in any period has a considerable amount of flexibility through the use of discretionary reserves and debt borrowings or repayments (either intercompany or third party). Quarterly distributions are determined by the Board of Directors after considering the current and expected economic and operating conditions, ensuring financing capacity for Syncrude's expansion projects and/or Canadian Oil Sands' acquisitions, and with the objective of maintaining an investment grade credit rating.

For the years ended December 31	2008	2007
Cash from operating activities	\$ 2,241	\$ 1,377
Add (Deduct):		
Capital expenditures	(281)	(183)
Acquisition of additional Syncrude working interest	–	(231)
Disposition of properties	–	4
Change in non-cash working capital <sup>1</sup>	6	(1)
Reclamation trust funding	(6)	(7)
Change in cash and cash equivalents and financing, net <sup>2</sup>	(156)	(168)
Unitholder distributions	\$ 1,804	\$ 791
Unitholder distributions per Trust Unit	\$ 3.75	\$ 1.65

<sup>1</sup> From investing activities.

<sup>2</sup> Primarily represents the change in cash and cash equivalents and net financing to fund the Trust's share of investing activities.

### Note 18. CAPITAL MANAGEMENT

The Trust's capital consists of cash and cash equivalents, debt and Unitholders' equity. The balance of each of these items at December 31 was as follows:

As at December 31	2008	2007
Long-term debt	\$ 1,258	\$ 1,218
Cash and cash equivalents	(279)	(268)
Net debt	\$ 979	\$ 950
Unitholders' equity	\$ 3,910	\$ 4,172
Total capitalization <sup>1</sup>	\$ 4,889	\$ 5,122
Net debt to total capitalization (%)	20	19

<sup>1</sup> Net debt plus Unitholders' equity.

Net debt to total capitalization increased in 2008 to 20 percent from 19 percent. This was primarily a result of cash from operating activities, distributions, debt repayments during the year and unrealized foreign exchange losses from the revaluations of the U.S. dollar denominated long-term debt and changes in Unitholders' equity.

The Trust's objective for managing capital is to maximize long-term Unitholder value by:

- Ensuring financing capacity for Syncrude's expansion projects and/or acquisitions of oil sands-related assets that are expected to add value to our Unitholders;
- Maintaining an investment grade credit rating to support financing of future expansions and acquisition opportunities, and to allow the Trust to remain un-hedged on its crude oil price exposure; and
- Distributing to Unitholders any cash that is not required for financing Syncrude's operations or capital investment growth opportunities that may offer Unitholders better value.

As disclosed in Notes 10 and 11, the Trust is bound by certain debt covenants; however, these covenants do not specifically limit the Trust's ability to pay distributions. The Trust monitors its total debt-to-total book capitalization as it must be less than 55 percent according to certain financial covenants. With a net debt-to-total capitalization of 20 percent at December 31, 2008, the Trust is well within its limits and a significant increase in debt or decrease in equity would be required to negatively impact the Trust's financial flexibility.

As a result of the Canadian trust taxation legislation passed in June 2007 and effective January 1, 2011, the Trust is subject to certain capital growth restrictions referred to as "normal growth" equity rules. These rules limit the amount of Unitholders' capital that can be issued by the Trust in each of the next two years, based on the Trust's market capitalization on October 31, 2006, as follows:

(\$ billions)	
Opening Cumulative Normal Growth Capital January 1, 2007	\$ 5.7
Issued on Talisman acquisition	(0.2)
Annual normal growth capital for 2007	2.9
Annual normal growth capital for 2008	2.9
Ending Cumulative Normal Growth Capital at December 31, 2008	\$ 11.3
<i>Normal growth capital allowed in:</i>	
2009	\$ 2.9
2010	\$ 2.9

If the maximum equity growth allowed is exceeded, the Trust may be subject to trust taxation prior to 2011. However, in 2008 the Department of Finance released draft legislation that would accelerate the safe haven guidelines to immediately allow cumulative new equity issues of up to 100 percent of an entity's October 31, 2006 market capitalization. As of December 31, 2008, this legislation was not enacted.

In addition to growth capital restrictions, the Trust also monitors its foreign ownership levels to the extent possible given the practical limitations regarding beneficial ownership information. The Trust Indenture, under which the Trust was created, provides that no more than 49 percent of the Units of the Trust can be held by non-Canadian residents. The potential impact of breaching this threshold may be the loss of mutual fund trust status, which may significantly adversely impact the valuation of the Units. At December 31, 2008, the Trust's best estimate of the foreign ownership level was 32 percent, based on account data at November 14, 2008.

## Note 19. FINANCIAL INSTRUMENTS

### Fair Values

The Trust's financial instruments include cash and cash equivalents, accounts receivable, reclamation trust short-term investments, accounts payable and accrued liabilities and debt. The fair values of the Trust's financial instruments that are included in the Consolidated Balance Sheet, with the exception of the Senior Notes and medium term notes, approximate their recorded amount due to the short-term nature of those instruments. The carrying values of the Trust's financial instruments at December 31, 2008 are as follows:

	Held for Trading	Loans and Receivables	Available for Sale	Other Liabilities	Total Carrying Value
Cash and cash equivalents	\$ 279	\$ –	\$ –	\$ –	\$ 279
Accounts receivable	–	184	–	–	184
Reclamation trust	–	–	43	–	43
Accounts payable and accrued liabilities	–	–	–	284	284
Long-term debt	–	–	–	1,258	1,258
	\$ 279	\$ 184	\$ 43	\$ 1,542	\$ 2,048

The fair values of the Senior Notes and medium term notes based on third-party market indications are as follows:

As at December 31	2008		2007	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
5.75% medium term notes due April 9, 2008	\$ –	\$ –	\$ 149	\$ 150
5.55% medium term notes due June 29, 2009	200	202	200	201
4.8% Senior Notes due August 10, 2009 (U.S.\$250 million)	304	302	246	246
5.8% Senior Notes due August 15, 2013 (U.S.\$300 million)	364	330	293	302
7.9% Senior Notes due September 1, 2021 (U.S.\$250 million)	301	279	243	269
8.2% Senior Notes due April 1, 2027 (U.S.\$73.95 million)	89	77	71	81
	\$ 1,258	\$ 1,190	\$ 1,202	\$ 1,249

### Financial Instrument Risk Management

Canadian Oil Sands provides a detailed risk management discussion, including its exposure and management of crude oil price risk, natural gas price risk, credit risk, liquidity risk and market risk (being foreign currency risk and interest rate risk) in its 2008 annual Management's Discussion and Analysis under the headings "Financial Market Risk" and "Credit Risk" included in the "Risk Management" section.

## Note 20. CROWN ROYALTIES

In 2008, Canadian Oil Sands and the other Syncrude joint venture owners exercised their pre-existing option to convert to a bitumen-based Crown royalty. Effective January 1, 2009, Syncrude will calculate Crown royalties based on deemed bitumen revenues less allowed bitumen operating, non-production and capital costs, rather than paying Crown royalties based on the production of synthetic crude oil ("SCO"). As part of the conversion to a bitumen-based royalty, only costs related to producing bitumen rather than the fully upgraded SCO can be deducted. In addition, deductible costs in calculating Crown royalties will be reduced in future years by approximately \$5 billion (\$1.8 billion net to the Trust) resulting in future Crown royalties of approximately \$1.25 billion plus interest (\$459 million plus interest net to the Trust) over a 25 year period. The cost reductions relate to capital expenditures that were deducted in computing Crown royalties on SCO in prior years and that are no longer associated with the royalty base.

Also in 2008, Canadian Oil Sands and the other Syncrude owners reached an agreement with the Alberta government on terms to transition the Syncrude Project to Alberta's New Royalty Framework. Under the agreement, the Syncrude owners will pay the greater of 25 percent of net deemed bitumen revenues, or one percent of gross deemed bitumen-based revenues, plus an additional royalty of up to \$975 million (\$358 million net to the Trust) for the period January 1, 2010 to December 31, 2015. The additional royalty of \$975 million is reduced proportionally on bitumen production of less than 345,000 barrels per day over the period and is payable in six annual installments in respect of the following periods:

	2010	2011	2012	2013	2014	2015	Total
Syncrude	\$ 75	\$ 75	\$ 100	\$ 150	\$ 225	\$ 350	\$ 975
Canadian Oil Sands Share	\$ 27	\$ 27	\$ 37	\$ 55	\$ 83	\$ 129	\$ 358

## Note 21. COMMITMENTS

Canadian Oil Sands is obligated to make future cash payments under existing contractual agreements that it has entered into either directly or as an owner in Syncrude. The following commitments that relate to Syncrude reflect Canadian Oil Sands' Working Interest in the joint venture.

### a) Management Services Agreement

Effective November 1, 2006, Syncrude Canada entered into a comprehensive Management Services Agreement with Imperial Oil Resources Ltd. ("Imperial Oil") to provide operational, technical and business management services to Syncrude Canada. The agreement has an initial term of 10 years, with five-year renewal provisions. Either Syncrude Canada or Imperial Oil has the option to cancel the agreement on 24 months notice for any reason. Canadian Oil Sands' 36.74 percent share of the annual fixed fee payable to Imperial Oil for the first 10 years under the agreement is \$17 million per year. After the first three years through to year 10, variable performance fees will also apply based on the achievement of certain performance targets. Such variable fees may be comparable to the fixed fee component if Syncrude Canada realizes a corresponding benefit through higher production and/or lower per barrel operating costs.

### b) Natural Gas Purchase Commitments

Syncrude has entered into purchase commitments for natural gas deliveries at floating market-related prices. There is one long-term natural gas supply contract that expires on October 31, 2010. Canadian Oil Sands' 36.74 percent share of this commitment is for 18 million gigajoules.

### c) Pension Plan Solvency Deficiency Payments

The latest actuarial valuation completed in 2007 for Syncrude Canada's defined benefit pension plan requires payments to fund the pension plan solvency deficiency. Canadian Oil Sands' share of these funding requirements is \$107 million over the next 14 years.

#### **d) Expenditure Commitments**

Canadian Oil Sands is committed to remaining costs of approximately \$404 million related to its share of Syncrude's Emissions Reduction project, the majority of which are expected to be incurred over the next three years.

Syncrude introduced an employee retention incentive program for permanent Fort McMurray-based employees which began on April 1, 2006 and ends on March 31, 2009. Syncrude's estimated commitment related to the program is \$128 million, or \$47 million net to Canadian Oil Sands. A similar plan has also been put in place for the three-year period starting April 1, 2009 and ending March 31, 2012.

Syncrude has various vendor commitments owing in 2009 and 2010 for non-capital items of which the more significant purchases total \$43 million, or \$16 million net to Canadian Oil Sands.

#### **e) Pipeline Commitments**

Canadian Oil Sands has a long-term agreement with Alberta Oil Sands Pipeline Limited ("AOSPL") to transport production from the Syncrude plant gate to Edmonton, Alberta. The agreement provides for reimbursement on a cost of service basis, including operating expenses, cash taxes paid, and a return on the depreciated rate base. The agreement commits Canadian Oil Sands to pay its proportionate share of the cost of service whether or not it ships any volumes on the pipeline. The projected cost of service for 2009 is \$21 million and it is expected to average \$22 million through to 2035.

### **Note 22. CONTINGENCIES**

#### **a) Tax Disputes**

For the period prior to 2000, the tax filings for COSL's predecessors, Canadian Oil Sands Investments Inc. ("COSII") and Athabasca Oil Sands Investments Inc. ("AOSII"), have been reassessed and closed. AOSII's and COSII's 2000, 2001, and 2002 tax returns have been reassessed by the Canada Revenue Agency ("CRA") and Notices of Objection have been filed pertaining to the Syncrude Remission Order and other items. A similar action had been previously instituted by Imperial Oil ("IMO") and accordingly, Canadian Oil Sands' action is being held in abeyance until the IMO action is determined. During 2008 IMO received a favourable ruling in respect of this dispute; however, CRA has appealed the decision. The resolution of this dispute regarding the Syncrude Remission Order is not expected to result in significant additional cash taxes being paid, but an unfavorable resolution would reduce the amount of tax pools available for carry forward. Timing of the resolution of this issue and the impact on tax pool balances could not be determined at December 31, 2008.

#### **b) General**

Various suits and claims arising in the ordinary course of business are pending against Syncrude Canada, the operator of the Syncrude Project for the Syncrude joint venture owners. While the ultimate effect of such actions cannot be ascertained at this time, in the opinion of the Trust's management and in consultation with its legal counsel, the liabilities that could reasonably be expected to arise from such actions would not be significant in relation to the operations of Syncrude. Syncrude Canada, as well as Canadian Oil Sands and the other Syncrude owners, also have claims pending against various parties, the outcomes of which are not yet determinable.

### **Note 23. GUARANTEES**

Canadian Oil Sands has posted performance standby letters of credit with the Province of Alberta which are renewed annually. The letters of credit guarantee to the Province of Alberta the reclamation obligations of Canadian Oil Sands' interest in future reclamation of the Syncrude mine sites. The Province of Alberta can draw on the letters of credit if Syncrude fails to perform its reclamation duties on its mine sites. The maximum potential amount of payments Canadian Oil Sands may be liable for pursuant to these letters of credit is \$67 million.

## Note 24. SUPPLEMENTARY INFORMATION

### a) Change in Non-cash Working Capital

For the years ended December 31	2008	2007
<b>Operating activities</b>		
Accounts receivable	\$ 195	\$ (135)
Inventories	9	(18)
Prepaid expenses	1	1
Accounts payable and accrued liabilities	(5)	(15)
Less: A/P change reclassified to investing and other	2	2
	<b>\$ 202</b>	<b>\$ (165)</b>
<b>Investing activities</b>		
Accounts payable and accrued liabilities	\$ 6	\$ (1)

### b) Interest and taxes paid

For the years ended December 31	2008	2007
Income tax paid	\$ –	\$ 1
Interest charges paid	\$ 74	\$ 94

### c) Major Customers

In connection with the marketing and sale of Canadian Oil Sands' own synthetic crude oil for the year ended December 31, 2008, the Trust had one customer (2007 – three) which individually accounted for more than 10 percent of consolidated revenues. This customer is a major international integrated energy company with a high quality investment grade credit rating. Sales to this customer were approximately \$837 million (2007 – \$647 million).

## Note 25. SUBSEQUENT EVENT

### Premium Distribution, Distribution Reinvestment and Optional Unit Purchase Plan

The Trust reinstated its Premium Distribution, Distribution Re-Investment and Optional Unit Purchase Plan (“DRIP”) in January 2009. The DRIP allows eligible Unitholders to direct their distributions to the purchase of additional Units at 95 percent of the weighted average market price, as defined in the DRIP. Alternatively, eligible Unitholders may elect under the premium distribution component to have their distributions invested in new Units and exchanged through the DRIP broker for a premium distribution equal to 102 percent of the amount that the Unitholder would otherwise have received on the distribution date (subject to proration and withholding tax reductions in certain circumstances). Finally, the DRIP allows those Unitholders who participate in either the regular distribution re-investment or premium distribution component of the DRIP to purchase additional Units from treasury at the average market price in minimum amounts of \$1,000 per remittance and maximum amounts of \$100,000, in a given quarter, all subject to an overall annual limit of two percent of the issued and outstanding Units being offered for purchase in this manner.