# MANAGEMENT'S REPORT

The management of Husky Energy Inc. ("the Company") is responsible for the financial information and operating data presented in this financial document.

The consolidated financial statements have been prepared by management in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise as they include certain amounts based on estimates and judgments. Management has determined such amounts on a reasonable basis in order to ensure that the financial statements are presented fairly, in all material respects. Financial information presented elsewhere in this financial document has been prepared on a basis consistent with that in the consolidated financial statements.

The Company maintains systems of internal accounting and administrative controls. These systems are designed to provide reasonable assurance that the financial information is relevant, reliable and accurate and that the Company's assets are properly accounted for and adequately safeguarded. Management's evaluation concluded that the Company's internal control over financial reporting was effective as of December 31, 2012. The system of internal controls is further supported by an internal audit function.

The Audit Committee of the Board of Directors, composed of independent non-management directors, meets regularly with management, internal auditors as well as the external auditors, to discuss audit (external, internal and joint venture), internal controls, accounting policy and financial reporting matters as well as the reserves determination process. The Committee reviews the annual consolidated financial statements with both management and the independent auditors and reports its findings to the Board of Directors before such statements are approved by the Board. The Committee is also responsible for the appointment of the external auditors for the Company.

The consolidated financial statements have been audited by KPMG LLP, the independent auditors, in accordance with Canadian Auditing Standards and the standards of the Public Company Accounting Oversight Board (United States) on behalf of the shareholders. KPMG LLP has full and free access to the Audit Committee.

Asim Ghosh
President and Chief Executive Officer

Alister Cowan
Chief Financial Officer

Calgary, Canada
February 27, 2013

# INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of Husky Energy Inc.

We have audited the accompanying consolidated financial statements of Husky Energy Inc., which comprise the consolidated balance sheets as at December 31, 2012 and December 31, 2011, the consolidated statements of income, comprehensive income, changes in shareholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

*Management's Responsibility for the Consolidated Financial Statements*

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

*Auditors' Responsibility*

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

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

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

*Opinion*

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

KPMG LLP

KPMG LLP

Chartered Accountants

Calgary, Canada

February 27, 2013

# CONSOLIDATED FINANCIAL STATEMENTS

## Consolidated Balance Sheets

| *(millions of Canadian dollars)* | **December 31, 2012** | December 31, 2011 |
|---|---|---|
| **Assets** | | |
| Current assets | | |
| Cash and cash equivalents *(note 9)* | **2,025** | 1,841 |
| Accounts receivable *(note 4)* | **1,349** | 1,235 |
| Income taxes receivable | **323** | 273 |
| Inventories *(note 5)* | **1,736** | 2,059 |
| Prepaid expenses | **64** | 36 |
| | **5,497** | 5,444 |
| Exploration and evaluation assets *(note 6)* | **810** | 746 |
| Property, plant and equipment, net *(note 7)* | **27,399** | 24,279 |
| Goodwill *(note 10)* | **663** | 674 |
| Contribution receivable *(note 8)* | **607** | 1,147 |
| Other assets | **164** | 136 |
| **Total Assets** | **35,140** | 32,426 |
| **Liabilities and Shareholders' Equity** | | |
| Current liabilities | | |
| Accounts payable and accrued liabilities *(note 12)* | **2,986** | 2,867 |
| Asset retirement obligations *(note 16)* | **107** | 116 |
| Long-term debt due within one year *(note 13)* | **–** | 407 |
| | **3,093** | 3,390 |
| Long-term debt *(note 13)* | **3,918** | 3,504 |
| Other long-term liabilities *(note 15)* | **331** | 342 |
| Contribution payable *(note 8, 22)* | **1,336** | 1,437 |
| Deferred tax liabilities *(note 17)* | **4,615** | 4,329 |
| Asset retirement obligations *(note 16)* | **2,686** | 1,651 |
| Commitments and contingencies *(note 20)* | | |
| **Total Liabilities** | **15,979** | 14,653 |
| Shareholders' equity | | |
| Common shares *(note 18)* | **6,939** | 6,327 |
| Preferred shares *(note 18)* | **291** | 291 |
| Retained earnings | **11,950** | 11,097 |
| Other reserves | **(19)** | 58 |
| **Total Shareholders' Equity** | **19,161** | 17,773 |
| **Total Liabilities and Shareholders' Equity** | **35,140** | 32,426 |

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

On behalf of the Board:

Asim Ghosh
Director

William Shurniak
Director

## Consolidated Statements of Income

| *(millions of Canadian dollars, except share data)* | Year ended December 31, 2012 | 2011 |
|---|---|---|
| Gross revenues *(note 3)* | **22,741** | 22,992 |
| Royalties | **(693)** | (1,125) |
| Marketing and other *(note 3)* | **387** | 90 |
| Revenues, net of royalties | **22,435** | 21,957 |
| Expenses | | |
| Purchases of crude oil and products *(note 3)* | **13,596** | 12,903 |
| Production and operating expenses | **2,612** | 2,476 |
| Selling, general and administrative expenses | **451** | 428 |
| Depletion, depreciation, amortization and impairment *(note 7)* | **2,580** | 2,519 |
| Exploration and evaluation expenses *(note 6)* | **350** | 470 |
| Other – net *(note 3)* | **(123)** | (193) |
| | **19,466** | 18,603 |
| Earnings from operating activities | **2,969** | 3,354 |
| Financial items *(note 14)* | | |
| Net foreign exchange gains | **14** | 10 |
| Finance income | **93** | 86 |
| Finance expenses | **(240)** | (310) |
| | **(133)** | (214) |
| Earnings before income taxes | **2,836** | 3,140 |
| Provisions for income taxes *(note 17)* | | |
| Current | **536** | 354 |
| Deferred | **278** | 562 |
| | **814** | 916 |
| **Net earnings** | **2,022** | 2,224 |
| Earnings per share *(note 18)* | | |
| Basic | **2.06** | 2.40 |
| Diluted | **2.06** | 2.34 |
| Weighted average number of common shares outstanding *(note 18)* | | |
| Basic *(millions)* | **975.8** | 923.8 |
| Diluted *(millions)* | **975.9** | 932.0 |

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

## Consolidated Statements of Comprehensive Income

| *(millions of Canadian dollars)* | Year ended December 31, 2012 | 2011 |
|---|---|---|
| Net earnings | **2,022** | 2,224 |
| Other comprehensive income (loss) | | |
| Items that will not be reclassified into earnings, net of tax: | | |
| Actuarial gains (losses) on pension plans *(note 19)* | **15** | (20) |
| Items that may be reclassified into earnings, net of tax: | | |
| Derivatives designated as cash flow hedges *(note 22)* | **3** | – |
| Exchange differences on translation of foreign operations | **(95)** | 88 |
| Hedge of net investment *(note 22)* | **15** | (18) |
| Other comprehensive income (loss) | **(62)** | 50 |
| **Comprehensive income** | **1,960** | 2,274 |

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

## Consolidated Statements of Changes in Shareholders' Equity

| | Attributable to Equity Holders | | | | | |
|---|---|---|---|---|---|---|
| | | | | Other Reserves | | |
| *(millions of Canadian dollars)* | Common Shares *(note 18)* | Preferred Shares *(note 18)* | Retained Earnings | Foreign Currency Translation | Hedging *(note 22)* | Total Shareholders' Equity |
| Balance as at December 31, 2010 | 4,574 | – | 10,012 | (10) | (2) | 14,574 |
| Net earnings | – | – | 2,224 | – | – | 2,224 |
| Other comprehensive income | | | | | | |
| Actuarial losses on pension plans (net of tax of $8 million) | – | – | (20) | – | – | (20) |
| Exchange differences on translation of foreign operations (net of tax of $14 million) | – | – | – | 88 | – | 88 |
| Hedge of net investment (net of tax of $3 million) *(note 22)* | – | – | – | (18) | – | (18) |
| Total comprehensive income | – | – | 2,204 | 70 | – | 2,274 |
| Transactions with owners recognized directly in equity: | | | | | | |
| Issue of common shares | 1,200 | – | – | – | – | 1,200 |
| Share issue costs | (27) | – | – | – | – | (27) |
| Issue of preferred shares | – | 300 | – | – | – | 300 |
| Share issue costs | – | (9) | – | – | – | (9) |
| Stock dividends paid | 580 | – | – | – | – | 580 |
| Dividends declared on common shares *(note 18)* | – | – | (1,109) | – | – | (1,109) |
| Dividends declared on preferred shares *(note 18)* | – | – | (10) | – | – | (10) |
| Balance as at December 31, 2011 | 6,327 | 291 | 11,097 | 60 | (2) | 17,773 |
| Net earnings | **–** | **–** | **2,022** | **–** | **–** | **2,022** |
| Other comprehensive income (loss) | | | | | | |
| Actuarial gains on pension plans (net of tax of $5 million) | **–** | **–** | **15** | **–** | **–** | **15** |
| Derivatives designated as cash flow hedges (net of tax of $1 million) | **–** | **–** | **–** | **–** | **3** | **3** |
| Exchange differences on translation of foreign operations (net of tax of $12 million) | **–** | **–** | **–** | **(95)** | **–** | **(95)** |
| Hedge of net investment (net of tax of $2 million) *(note 22)* | **–** | **–** | **–** | **15** | **–** | **15** |
| Total comprehensive income (loss) | **–** | **–** | **2,037** | **(80)** | **3** | **1,960** |
| Transactions with owners recognized directly in equity: | | | | | | |
| Stock dividends paid | **607** | **–** | **–** | **–** | **–** | **607** |
| Stock options exercised | **5** | **–** | **–** | **–** | **–** | **5** |
| Dividends declared on common shares *(note 18)* | **–** | **–** | **(1,171)** | **–** | **–** | **(1,171)** |
| Dividends declared on preferred shares *(note 18)* | **–** | **–** | **(13)** | **–** | **–** | **(13)** |
| **Balance as at December 31, 2012** | **6,939** | **291** | **11,950** | **(20)** | **1** | **19,161** |

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

## Consolidated Statements of Cash Flows

| *(millions of Canadian dollars)* | Year ended December 31, 2012 | 2011 |
|---|---|---|
| Operating activities | | |
| Net earnings | **2,022** | 2,224 |
| Items not affecting cash: | | |
| Accretion *(note 14)* | **97** | 79 |
| Depletion, depreciation, amortization and impairment *(note 7)* | **2,580** | 2,519 |
| Exploration and evaluation expenses | **60** | 68 |
| Deferred income taxes *(note 17)* | **278** | 562 |
| Foreign exchange | **(20)** | 14 |
| Stock-based compensation *(note 18)* | **54** | (1) |
| Loss (gain) on sale of assets | **1** | (261) |
| Other | **(62)** | (6) |
| Settlement of asset retirement obligations *(note 16)* | **(123)** | (105) |
| Income taxes paid | **(575)** | (282) |
| Interest received | **34** | 12 |
| Change in non-cash working capital *(note 9)* | **843** | 269 |
| Cash flow – operating activities | **5,189** | 5,092 |
| Financing activities | | |
| Long-term debt issuance *(note 13)* | **500** | 5,054 |
| Long-term debt repayment *(note 13)* | **(410)** | (5,434) |
| Settlement of cross currency swaps | **(89)** | – |
| Debt issue costs | **(9)** | (5) |
| Proceeds from common share issuance, net of share issue costs *(note 18)* | **–** | 1,173 |
| Proceeds from preferred share issuance, net of share issue costs *(note 18)* | **–** | 291 |
| Proceeds from exercise of stock options *(note 18)* | **5** | – |
| Dividends on common shares *(note 18)* | **(557)** | (495) |
| Dividends on preferred shares *(note 18)* | **(17)** | (7) |
| Interest paid | **(252)** | (229) |
| Contribution receivable payment *(note 8)* | **563** | 234 |
| Other | **25** | 90 |
| Change in non-cash working capital *(note 9)* | **79** | 238 |
| Cash flow – financing activities | **(162)** | 910 |
| Investing activities | | |
| Capital expenditures | **(4,701)** | (4,800) |
| Proceeds from asset sales | **24** | 179 |
| Contribution payable payment *(note 8)* | **(152)** | (103) |
| Other | **(57)** | (12) |
| Change in non-cash working capital *(note 9)* | **56** | 316 |
| Cash flow – investing activities | **(4,830)** | (4,420) |
| Increase in cash and cash equivalents | **197** | 1,582 |
| Effect of exchange rates on cash and cash equivalents | **(13)** | 7 |
| Cash and cash equivalents at beginning of year | **1,841** | 252 |
| **Cash and cash equivalents at end of year** | **2,025** | 1,841 |

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

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

## Note 1 Description of Business and Segmented Disclosures

Husky Energy Inc. ("Husky" or "the Company") is an international integrated energy company incorporated under the Business Corporations Act (Alberta). The Company's common and preferred shares are listed on the Toronto Stock Exchange ("TSX") under the symbol "HSE" and "HSE.PR.A", respectively. The registered office is located at 707, 8th Avenue S.W., PO Box 6525, Station D, Calgary, Alberta, T2P 3G7.

Management has identified segments for the Company's business based on differences in products, services and management responsibility. The Company's business is conducted predominantly through two major business segments – Upstream and Downstream.

During the first quarter of 2012, the Company completed an evaluation of activities of the Company's former Midstream segment as a service provider to the Upstream or Downstream operations. As a result, and consistent with the Company's strategic view of its integrated business, the previously reported Midstream segment activities are now aligned and reported within the Company's core exploration and production, or in its upgrading and refining businesses. The Company believes this change in segment presentation allows management and third parties to more effectively assess the Company's performance.

**Upstream** includes exploration for, and development and production of, crude oil, bitumen, natural gas and natural gas liquids (Exploration and Production) and marketing of the Company's and other producers' crude oil, natural gas, natural gas liquids, sulphur and petroleum coke, pipeline transportation and blending of crude oil and natural gas and storage of crude oil, diluent and natural gas (Infrastructure and Marketing). The Company's Upstream operations are located primarily in Western Canada, offshore East Coast of Canada, offshore Greenland, offshore China and offshore Indonesia.

**Downstream** includes upgrading of heavy crude oil feedstock into synthetic crude oil (Upgrading), refining in Canada of crude oil and marketing of refined petroleum products including gasoline, diesel, ethanol blended fuels, asphalt and ancillary products, and production of ethanol (Canadian Refined Products) and refining in the U.S. of primarily crude oil to produce and market gasoline, jet fuel and diesel fuels that meet U.S. clean fuels standards (U.S. Refining and Marketing).

Comparative periods have been reclassified to conform to the revised segment presentation.

# Segmented Financial Information

| ($ millions) | Upstream | | | | | |
|---|---|---|---|---|---|---|
| | Exploration and Production[1] | | Infrastructure and Marketing | | Total | |
| ***Year ended December 31,*** | **2012** | 2011 | **2012** | 2011 | **2012** | 2011 |
| Gross revenues | **6,547** | 7,519 | **2,420** | 1,987 | **8,967** | 9,506 |
| Royalties | **(693)** | (1,125) | **–** | – | **(693)** | (1,125) |
| Marketing and other | **–** | – | **387** | 90 | **387** | 90 |
| Revenues, net of royalties | **5,854** | 6,394 | **2,807** | 2,077 | **8,661** | 8,471 |
| Expenses | | | | | | |
| Purchases of crude oil and products | **73** | 99 | **2,258** | 1,818 | **2,331** | 1,917 |
| Production and operating expenses | **1,840** | 1,714 | **49** | 43 | **1,889** | 1,757 |
| Selling, general and administrative expenses | **178** | 153 | **21** | 17 | **199** | 170 |
| Depletion, depreciation, amortization and impairment | **2,121** | 2,018 | **22** | 24 | **2,143** | 2,042 |
| Exploration and evaluation expenses | **350** | 470 | **–** | – | **350** | 470 |
| Other – net | **(105)** | (261) | **–** | 1 | **(105)** | (260) |
| Earnings (loss) from operating activities | **1,397** | 2,201 | **457** | 174 | **1,854** | 2,375 |
| Financial items | | | | | | |
| Net foreign exchange gains | **–** | – | **–** | – | **–** | – |
| Finance income | **5** | 4 | **–** | – | **5** | 4 |
| Finance expenses | **(78)** | (68) | **–** | – | **(78)** | (68) |
| Earnings (loss) before income taxes | **1,324** | 2,137 | **457** | 174 | **1,781** | 2,311 |
| Provisions for (recovery of) income taxes | | | | | | |
| Current | **134** | 41 | **171** | 64 | **305** | 105 |
| Deferred | **211** | 515 | **(55)** | (20) | **156** | 495 |
| Total income tax provision (recovery) | **345** | 556 | **116** | 44 | **461** | 600 |
| Net earnings (loss) | **979** | 1,581 | **341** | 130 | **1,320** | 1,711 |
| Intersegment revenues | **2,003** | 2,072 | **–** | – | **2,003** | 2,072 |
| Other material non-cash items | | | | | | |
| Gain (loss) on sale of assets | **1** | 261 | **–** | – | **1** | 261 |

[1] *Includes allocated depletion, depreciation, amortization and impairment related to assets in the Infrastructure and Marketing segment as these assets provide a service to the Exploration and Production segment.*

[2] *Eliminations relate to sales and operating revenues between segments recorded at transfer prices based on current market prices.*

[3] *Certain hydrogen feedstock costs from production and operating expenses have been reclassified to purchases of crude oil and products in 2012. Prior periods have been reclassified to conform with current period presentation.*

| Downstream | | | | | | | | Corporate and Eliminations[2] | | Total | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Upgrading[3] | | Canadian Refined Products | | U.S. Refining and Marketing | | Total | | | | | |
| 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| 2,191 | 2,217 | 3,848 | 3,877 | 10,038 | 9,752 | 16,077 | 15,846 | (2,303) | (2,360) | 22,741 | 22,992 |
| – | – | – | – | – | – | – | – | – | – | (693) | (1,125) |
| – | – | – | – | – | – | – | – | – | – | 387 | 90 |
| 2,191 | 2,217 | 3,848 | 3,877 | 10,038 | 9,752 | 16,077 | 15,846 | (2,303) | (2,360) | 22,435 | 21,957 |
| 1,636 | 1,628 | 3,208 | 3,265 | 8,724 | 8,453 | 13,568 | 13,346 | (2,303) | (2,360) | 13,596 | 12,903 |
| 150 | 146 | 184 | 182 | 385 | 391 | 719 | 719 | 4 | – | 2,612 | 2,476 |
| 3 | 3 | 58 | 49 | 13 | 12 | 74 | 64 | 178 | 194 | 451 | 428 |
| 102 | 164 | 83 | 80 | 212 | 195 | 397 | 439 | 40 | 38 | 2,580 | 2,519 |
| – | – | – | – | – | – | – | – | – | – | 350 | 470 |
| (17) | 67 | (2) | – | 4 | – | (15) | 67 | (3) | – | (123) | (193) |
| 317 | 209 | 317 | 301 | 700 | 701 | 1,334 | 1,211 | (219) | (232) | 2,969 | 3,354 |
| – | – | – | – | – | – | – | – | 14 | 10 | 14 | 10 |
| – | – | – | – | – | – | – | – | 88 | 82 | 93 | 86 |
| (11) | (7) | (6) | (6) | (5) | (4) | (22) | (17) | (140) | (225) | (240) | (310) |
| 306 | 202 | 311 | 295 | 695 | 697 | 1,312 | 1,194 | (257) | (365) | 2,836 | 3,140 |
| 31 | (2) | 89 | 25 | (1) | 76 | 119 | 99 | 112 | 150 | 536 | 354 |
| 49 | 54 | (9) | 50 | 258 | 178 | 298 | 282 | (176) | (215) | 278 | 562 |
| 80 | 52 | 80 | 75 | 257 | 254 | 417 | 381 | (64) | (65) | 814 | 916 |
| 226 | 150 | 231 | 220 | 438 | 443 | 895 | 813 | (193) | (300) | 2,022 | 2,224 |
| 134 | 120 | 166 | 168 | – | – | 300 | 288 | – | – | 2,303 | 2,360 |
| – | – | (2) | – | – | – | (2) | – | – | – | (1) | 261 |

## Segmented Financial Information

| ($ millions) | Upstream | | | | | |
|---|---|---|---|---|---|---|
| | Exploration and Production(1) | | Infrastructure and Marketing | | Total | |
| ***Year ended December 31,*** | **2012** | 2011 | **2012** | 2011 | **2012** | 2011 |
| Expenditures on exploration and evaluation assets(3) | **273** | 403 | **–** | – | **273** | 403 |
| Expenditures on property, plant and equipment(3) | **3,833** | 3,728 | **54** | 43 | **3,887** | 3,771 |
| ***As at December 31,*** | | | | | | |
| Exploration and evaluation assets | **810** | 746 | **–** | – | **810** | 746 |
| Developing and producing assets at cost | **38,826** | 33,640 | **–** | – | **38,826** | 33,640 |
| Accumulated depletion, depreciation, amortization and impairment | **(17,947)** | (15,900) | **–** | – | **(17,947)** | (15,900) |
| Other property, plant and equipment at cost | **47** | 48 | **934** | 882 | **981** | 930 |
| Accumulated depletion, depreciation and amortization | **(29)** | (27) | **(414)** | (380) | **(443)** | (407) |
| Total exploration and evaluation assets and property, plant and equipment, net | **21,707** | 18,507 | **520** | 502 | **22,227** | 19,009 |
| Total assets | **22,753** | 20,141 | **1,506** | 1,509 | **24,259** | 21,650 |

(1) *Includes allocated depletion, depreciation, amortization and impairment related to assets in the Infrastructure and Marketing segment as these assets provide a service to the Exploration and Production segment.*

(2) *Eliminations relate to sales and operating revenues between segments recorded at transfer prices based on current market prices.*

(3) *Excludes capitalized costs related to asset retirement obligations and capitalized interest incurred during the period. Includes assets acquired through acquisitions.*

## Geographical Financial Information

| ($ millions) | Canada | |
|---|---|---|
| ***Year ended December 31,*** | **2012** | 2011 |
| Gross revenues | **11,365** | 11,481 |
| Royalties | **(611)** | (1,024) |
| Marketing and other | **386** | 89 |
| Revenue, net of royalties(1) | **11,140** | 10,546 |
| ***As at December 31,*** | | |
| Exploration and evaluation assets | **496** | 421 |
| Property, plant and equipment, net | **21,718** | 19,481 |
| Goodwill | **160** | 160 |
| Total non-current assets | **23,090** | 21,315 |

(1) *Based on the geographical location of legal entities.*

| Downstream | | | | | | | | Corporate and Eliminations[2] | | Total | |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Upgrading | | Canadian Refined Products | | U.S. Refining and Marketing | | Total | | | | | |
| **2012** | 2011 | **2012** | 2011 | **2012** | 2011 | **2012** | 2011 | **2012** | 2011 | **2012** | 2011 |
| **–** | – | **–** | – | **–** | – | **–** | – | **–** | – | **273** | 403 |
| **47** | 55 | **97** | 94 | **313** | 224 | **457** | 373 | **84** | 71 | **4,428** | 4,215 |
| **–** | – | **–** | – | **–** | – | **–** | – | **–** | – | **810** | 746 |
| **–** | – | **–** | – | **–** | – | **–** | – | **–** | – | **38,826** | 33,640 |
| **–** | – | **–** | – | **–** | – | **–** | – | **–** | – | **(17,947)** | (15,900) |
| **2,006** | 1,972 | **2,189** | 2,208 | **4,487** | 4,325 | **8,682** | 8,505 | **643** | 557 | **10,306** | 9,992 |
| **(950)** | (848) | **(967)** | (1,007) | **(951)** | (759) | **(2,868)** | (2,614) | **(475)** | (432) | **(3,786)** | (3,453) |
| **1,056** | 1,124 | **1,222** | 1,201 | **3,536** | 3,566 | **5,814** | 5,891 | **168** | 125 | **28,209** | 25,025 |
| **1,242** | 1,316 | **1,646** | 1,632 | **5,326** | 5,476 | **8,214** | 8,424 | **2,667** | 2,352 | **35,140** | 32,426 |

| United States | | Other International | | Total | |
| --- | --- | --- | --- | --- | --- |
| **2012** | 2011 | **2012** | 2011 | **2012** | 2011 |
| **11,004** | 11,201 | **372** | 310 | **22,741** | 22,992 |
| **–** | – | **(82)** | (101) | **(693)** | (1,125) |
| **1** | 1 | **–** | – | **387** | 90 |
| **11,005** | 11,202 | **290** | 209 | **22,435** | 21,957 |
| **–** | – | **314** | 325 | **810** | 746 |
| **3,535** | 3,572 | **2,146** | 1,226 | **27,399** | 24,279 |
| **503** | 514 | **–** | – | **663** | 674 |
| **4,055** | 4,103 | **2,498** | 1,564 | **29,643** | 26,982 |

# Note 2 Basis of Presentation

## a) Basis of Measurement and Statement of Compliance

The consolidated financial statements have been prepared by management on a historical cost basis with some exceptions, as detailed in the accounting policies set out below in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"). These accounting policies have been applied consistently for all periods presented in these consolidated financial statements.

These consolidated financial statements were approved and signed by the Chair of the Audit Committee and Chief Executive Officer on February 27, 2013, having been duly authorized to do so by the Board of Directors.

## b) Principles of Consolidation

The consolidated financial statements include the accounts of Husky Energy Inc. and its subsidiaries. Subsidiaries are defined as any entities, including unincorporated entities such as partnerships, for which the Company has the power to govern their financial and operating policies to obtain benefits from their activities. Substantially all of the Company's Upstream activities are conducted jointly with third parties and accordingly the accounts reflect the Company's proportionate share of the assets, liabilities, revenues, expenses and cash flows from these activities. Intercompany balances, net earnings and unrealized gains and losses arising from intercompany transactions are eliminated in preparing the consolidated financial statements.

## c) Use of Estimates, Judgments and Assumptions

The timely preparation of the consolidated financial statements requires management to make estimates, judgments and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingencies, if any, as at the date of the financial statements and the reported amounts of revenue and expenses during the period. Actual results may differ from these estimates, judgments and assumptions.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and on a prospective basis. By their nature, estimates are subject to measurement uncertainty and changes in such estimates in future years could require a material change in the consolidated financial statements. These underlying assumptions are based on historical experience and other factors that management believes to be reasonable under the circumstances, and are subject to change as new events occur, as more industry experience is acquired, as additional information is obtained and as the Company's operating environment changes. Specifically, amounts recorded for depletion, depreciation, amortization, impairment, asset retirement obligations, assets and liabilities measured at fair value, employee future benefits, income taxes, and contingencies are based on estimates.

Management makes judgments regarding the application of IFRS for each accounting policy. Critical judgments that have the most significant effect on the amounts recognized in the consolidated financial statements include successful efforts and impairment assessments, the determination of cash generating units ("CGUs") and the designation of the Company's functional currency.

Significant estimates, judgments and assumptions made by Management in the preparation of these consolidated financial statements are outlined in detail in Note 3.

## d) Functional and Presentation Currency

The consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency. All financial information is presented in millions of Canadian dollars, except per share amounts and unless otherwise stated.

The designation of the Company's functional currency is a management judgment based on the composition of revenue and costs in the locations in which it operates.

## Note 3 Significant Accounting Policies

### a) Cash and Cash Equivalents

Cash and cash equivalents consist of cash on hand, less outstanding cheques and deposits with an original maturity of less than three months at the time of purchase. When outstanding cheques are in excess of cash on hand and short-term deposits and the Company has the ability to net settle, the excess is reported in bank operating loans.

### b) Inventories

Crude oil, natural gas, refined petroleum products and sulphur inventories are valued at the lower of cost or net realizable value. Cost is determined using average cost or on a first-in, first-out basis, as appropriate. Materials, parts and supplies are valued at the lower of average cost or net realizable value. Cost consists of raw material, labour, direct overhead and transportation. Commodity inventories held for trading purposes are carried at fair value. Any changes in commodity inventory fair value are included as gains or losses in marketing and other in the consolidated statements of income, during the period of change. Previous inventory impairment provisions are reversed when there is a change in the condition that caused the impairment. Unrealized intersegment net earnings on inventory sales are eliminated.

### c) Precious Metals

The Company uses precious metals in conjunction with a catalyst as part of the downstream upgrading and refining processes. These precious metals remain intact; however, there is a loss during the reclamation process. The estimated loss is amortized to production and operating expenses over the period that the precious metal is in use, which is approximately two to five years. After the reclamation process, the actual loss is compared to the estimated loss and any difference is recognized in net earnings. Precious metals are included in property, plant and equipment on the balance sheet.

### d) Exploration and Evaluation Assets and Property, Plant and Equipment

#### i) Cost

Oil and gas properties and other property, plant and equipment are recorded at cost including expenditures which are directly attributable to the purchase or development of an asset. Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are included in the asset cost. Capitalization ceases when substantially all activities necessary to prepare the qualifying asset for its intended use are complete.

The appropriate accounting treatment of costs incurred for oil and natural gas exploration and evaluation and development is determined by the classification of the underlying activities as either exploratory or developmental. The results from an exploration drilling program can take considerable time to analyze, and the determination that commercial reserves have been discovered requires both judgment and industry experience. Exploration activities can fluctuate from year to year due to such factors as the level of exploratory spending, the level of risk sharing with third parties participating in exploratory drilling and, the degree of risk associated with drilling in particular areas. Properties that are assumed to be productive may, over a period of time, actually deliver oil and gas in quantities different than originally estimated because of changes in reservoir performance.

#### ii) Exploration and Evaluation Costs

Costs incurred after the legal right to explore an area has been obtained and before technical feasibility and commercial viability of the area have been established are capitalized as exploration and evaluation assets. These costs include costs to acquire acreage and exploration rights, legal and other professional fees and land brokerage fees. Pre-license costs and geological and geophysical costs associated with exploration activities are expensed in the period incurred. Costs directly associated with an exploration well are initially capitalized as an exploration and evaluation asset until the drilling of the well is complete and the results have been evaluated. If extractable hydrocarbons are found and are likely to be developed commercially, but are subject to further appraisal activity which may include the drilling of wells, the costs continue to be carried as an exploration and evaluation asset while sufficient and continued progress is made in assessing the commercial viability of the hydrocarbons. Capitalized exploration and evaluation costs or assets are not depreciated and are carried forward until technical feasibility and commercial viability of the area is determined or the assets are determined to be impaired. Technical feasibility and commercial viability are met when management determines that an exploration and evaluation asset will be developed, as evidenced by the classification of proved or probable reserves and the appropriate internal and external approvals. Upon the determination of technical feasibility and commercial viability, capitalized exploration and evaluation assets are then transferred to property, plant and equipment. All such carried costs are subject to technical, commercial and management review as well as review for impairment at least every reporting period to confirm the continued intent to develop or otherwise extract value from the discovery. These costs are also tested for impairment when transferred to property, plant and equipment. Capitalized exploration and evaluation expenditures related to wells that do not find reserves, or where no future activity is planned, are expensed as exploration and evaluation expenses.

The application of the Company's accounting policy for exploration and evaluation costs requires judgment in determining whether it is likely that future economic benefit exists when activities have not reached a stage where technical feasibility and commercial viability can be reasonably determined. Judgments may change as new information becomes available.

#### iii) Development Costs

Expenditures, including borrowing costs, on the construction, installation and completion of infrastructure facilities such as platforms, pipelines and the drilling of development wells, including unsuccessful development or delineation wells, are capitalized as oil and gas properties. Costs incurred to operate and maintain wells and equipment to lift oil and gas to the surface are expensed as production and operating expenses.

#### iv) Other Property, Plant and Equipment

Repair and maintenance costs, other than major turnaround costs, are expensed as incurred. Major turnaround costs are capitalized as part of property, plant and equipment when incurred and are amortized over the estimated period of time to the next scheduled turnaround.

#### v) Depletion, Depreciation and Amortization

Oil and gas properties are depleted on a unit-of-production basis over the proved developed reserves of the particular field, except in the case of assets whose useful life is shorter or longer than the lifetime of the proved developed reserves of that field, in which case the straight-line method or a unit-of-production method based on total recoverable reserves is applied. Rights and concessions are depleted on a unit-of-production basis over the total proved reserves of the relevant area. The unit-of-production rate for the depletion of oil and gas properties related to total proved reserves takes into account expenditures incurred to date, together with sanctioned future development expenditures required to develop the field.

Oil and gas reserves are evaluated internally and audited by independent qualified reserves engineers. The estimation of reserves is an inherently complex process and involves the exercise of professional judgment. Estimates are based on projected future rates of production, estimated commodity prices, engineering data and the timing of future expenditures, all of which are subject to uncertainty. Changes in reserve estimates can have an impact on reported net earnings through revisions to depletion, depreciation and amortization expense, in addition to determining possible impairments of property, plant and equipment.

Net reserves represent the Company's undivided gross working interest in total reserves after deducting crown, freehold and overriding royalty interests. Assumptions reflect market and regulatory conditions, as applicable, as at the balance sheet date and could differ significantly from other points in time throughout the year or future periods. Changes in market and regulatory conditions and assumptions can materially impact the estimation of net reserves.

Depreciation for substantially all other property, plant and equipment is provided using the straight-line method based on the estimated useful lives of assets, which range from five to forty-five years, less any estimated residual value. The useful lives of assets are estimated based upon the period the asset is expected to be available for use by the Company. Residual values are based upon the estimated amount that would be obtained on disposal, net of any costs associated with the disposal. Other property, plant and equipment held under finance leases are depreciated over the shorter of the lease term and the estimated useful life of the asset.

Depletion, depreciation and amortization rates for all capitalized costs associated with the Company's activities are reviewed, at least annually, or when events or conditions occur that impact capitalized costs, reserves and estimated service lives.

Any gain or loss arising on disposal of exploration and evaluation assets or property, plant and equipment is included in other - net in the consolidated statements of income in the period of disposal.

### e) Joint Arrangements

Joint arrangements represent activities where the Company has joint control established by a contractual agreement. The consolidated financial statements include the Company's proportionate share of the assets, liabilities, revenues, expenses and cash flows of the arrangement with items of a similar nature on a line-by-line basis, from the date that joint control commences until the date that joint control ceases.

## f) Business Combinations

Business combinations are accounted for using the acquisition method. Determining whether an acquisition meets the definition of a business combination or represents an asset purchase requires judgment on a case by case basis. If the acquisition meets the definition of a business combination, the assets and liabilities are recognized based on the contractual terms, economic conditions, the Company's operating and accounting policies, and other factors that exist on the acquisition date, which is the date on which control is transferred to the Company. The identifiable assets and liabilities are measured at their fair values on the acquisition date. Any additional consideration payable, contingent upon the occurrence of a future event, is recognized at fair value on the acquisition date; subsequent changes in the fair value of the liability are recognized in net earnings. Acquisition costs incurred are expensed and included in other - net in the consolidated statements of income.

## g) Goodwill

Goodwill is the excess of the purchase price paid over the recognized amount of net assets acquired, which is inherently imprecise as judgment is required in the determination of the fair value of assets and liabilities. Goodwill, which is not amortized, is assigned to appropriate CGUs or groups of CGUs. Goodwill is tested for impairment annually and when circumstances indicate that the carrying value may be impaired. Impairment losses are recognized in net earnings and are not subject to reversal. On the disposal or termination of a previously acquired business, any remaining balance of associated goodwill is included in the determination of the gain or loss on disposal.

## h) Impairment of Non-Financial Assets

The carrying amounts of the Company's non-financial assets, other than inventories and deferred tax assets, are reviewed at the end of each reporting period to determine whether there is any indication of impairment. If such indication exists, the recoverable amount is estimated.

Determining whether there are any indications of impairment requires significant judgment of external factors, such as an extended decrease in prices or margins for oil and gas commodities or products, a significant decline in an asset's market value, a significant downward revision of estimated volumes, an upward revision of future development costs, a decline in the entity's market capitalization, or significant changes in the technological, market, economic or legal environment that would have an adverse impact on the entity. If any indication of impairment exists, an estimate of the asset's recoverable amount is calculated as the higher of the fair value less costs to sell ("FVLCS") and the asset's value in use ("VIU") for an individual asset, or CGU. If the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, the asset is tested as part of a CGU, which is the smallest identifiable group of assets, liabilities and associated goodwill that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Determination of the Company's CGUs is subject to management's judgment.

FVLCS is the amount that would be obtained from the sale of a CGU in an arm's length transaction between knowledgeable and willing parties. The FVLCS is generally determined as the net present value of the estimated future cash flows expected to arise from the continued use of the CGU, including any expansion prospects, and its eventual disposal, using assumptions that an independent market participant may take into account. These cash flows are discounted using a rate which would be applied by a market participant to arrive at a net present value of the CGU.

VIU is the net present value of the estimated future cash flows expected to arise from the continued use of the asset in its present form and its eventual disposal. VIU is determined by applying assumptions specific to the Company's continued use and can only take into account sanctioned future development costs. Estimates of future cash flows used in the evaluation of impairment of assets are made using management's forecasts of commodity prices, marketing supply and demand, product margins and in the case of oil and gas properties, expected production volumes. Expected production volumes take into account assessments of field reservoir performance and include expectations about proved, probable and unproved volumes, which are risk-weighted utilizing geological, production, recovery and economic projections. Either the cash flow estimates or the discount rate is risk-adjusted to reflect local conditions as appropriate.

Given that the calculations for recoverable amounts require the use of estimates and assumptions, including forecasts of commodity prices, marketing supply and demand, product margins and in the case of oil and gas properties, expected production volumes, it is possible that the assumptions may change, which may impact the estimated life of the CGU and may require a material adjustment to the carrying value of goodwill and non-financial assets.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses recognized with respect to CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the CGU or group of CGUs on a pro rata basis. Impairment losses are recognized in depletion, depreciation, amortization and impairment in the consolidated statements of income.

Impairment losses recognized for other assets in prior years are assessed at the end of each reporting period for any indications that the impairment condition has decreased or no longer exists. An impairment loss is reversed only to the extent that the carrying amount of the asset or CGU does not exceed the carrying amount that would have been determined, net of depletion, depreciation and amortization, if no impairment loss had been recognized.

## i) Asset Retirement Obligations ("ARO")

A liability is recognized for future legal or constructive retirement obligations associated with the Company's assets. The Company has significant obligations to remove tangible assets and restore land after operations cease and the Company retires or relinquishes the asset. The retirement of Upstream and Downstream assets consists primarily of plugging and abandoning wells, removing and disposing of surface and subsea plant and equipment and facilities, and restoring land to a state required by regulation or contract. The amount recognized is the net present value of the estimated future expenditures determined in accordance with local conditions, current technology and current regulatory requirements. The obligation is calculated using the current estimated costs to retire the asset inflated to the estimated retirement date and then discounted using a credit-adjusted risk free discount rate. The liability is recorded in the period in which an obligation arises with a corresponding increase to the carrying value of the related asset. The liability is progressively accreted over time as the effect of discounting unwinds, creating an expense recognized in finance expenses. The costs capitalized to the related assets are amortized in a manner consistent with the depletion, depreciation and amortization of the underlying assets. Actual retirement expenditures are charged against the accumulated liability as incurred.

Liabilities for ARO are adjusted every reporting period for changes in estimates. These adjustments are accounted for as a change in the corresponding capitalized cost, except where a reduction in the provision is greater than the undepreciated capitalized cost of the related assets, in which case the capitalized cost is reduced to nil and the remaining adjustment is recognized in net earnings. In the case of closed sites, changes to estimated costs are recognized immediately in net earnings. Changes to the amount of capitalized costs will result in an adjustment to future depletion, depreciation and amortization, and finance expenses.

Estimating the ARO requires significant judgment as restoration technologies and costs are constantly changing, as are regulatory, political, environmental and safety considerations. Inherent in the calculation of the ARO are numerous assumptions including the ultimate settlement amounts, future third-party pricing, inflation factors, risk free discount rates, credit risk, timing of settlement and changes in the legal, regulatory, environmental and political environments. Future revisions to these assumptions may result in material changes to the ARO liability. Adjustments to the estimated amounts and timing of future ARO cash flows are a regular occurrence in light of the significant judgments and estimates involved.

## j) Legal and Other Contingent Matters

Provisions and liabilities for legal and other contingent matters are recognized in the period when the circumstance becomes probable that a future cash outflow resulting from past operations or events will occur and the amount of the cash outflow can be reasonably estimated. The timing of recognition and measurement of the provision requires the application of judgment to existing facts and circumstances, which can be subject to change, and the carrying amounts of provisions and liabilities are reviewed regularly and adjusted accordingly. The Company is required to both determine whether a loss is probable based on judgment and interpretation of laws and regulations, and determine that the loss can be reasonably estimated. When a loss is recognized, it is charged to net earnings. The Company continually monitors known and potential contingent matters and makes appropriate provisions when warranted by the circumstances present.

## k) Share Capital

Preferred shares are classified as equity since they are cancellable and redeemable only at the Company's option and dividends are discretionary and payable only if declared by the Board of Directors. Incremental costs directly attributable to the issuance of shares and stock options are recognized as a deduction from equity, net of tax. Common share dividends are paid out in common shares or in cash, and preferred share dividends are paid in cash. Both common and preferred share dividends are recognized as distributions within equity.

## l) Financial Instruments

Financial instruments are any contracts that give rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Financial instruments are initially recognized at fair value, and subsequently measured based on classification in one of the following categories: loans and receivables, held to maturity investments, other financial liabilities, fair value through profit or loss ("FVTPL") or available-for-sale ("AFS") financial assets.

Financial instruments classified as FVTPL or AFS are measured at fair value at each reporting date; any transaction costs associated with these types of instruments are expensed as incurred. Unrealized gains and losses on AFS financial assets are recognized in other comprehensive income ("OCI") and transferred to net earnings when the asset is derecognized. Unrealized gains and losses on FVTPL financial instruments related to trading activities are recognized in marketing and other in the consolidated statements of income and unrealized gains and losses on all other FVTPL financial instruments are recognized in other - net .

Financial instruments classified as loans or receivables, held to maturity investments and other financial liabilities are initially measured at fair value and subsequently carried at amortized cost using the effective interest rate method. Transaction costs that are directly attributable to the acquisition or issue of a financial instrument measured at amortized cost are added to the fair value initially recognized.

Financial instruments subsequently revalued at fair value are further categorized using a three-level hierarchy that reflects the significance of the inputs used in determining fair value. Level 1 fair value is determined by reference to quoted prices in active markets for identical assets and liabilities. Level 2 fair value is based on inputs that are independently observable for similar assets or liabilities. Level 3 fair value is not based on independently observable market data. The disclosure of the fair value hierarchy excludes financial assets and liabilities where book value approximates fair value.

## m) Derivative Instruments and Hedging Activities

Derivatives are financial instruments for which the fair value changes in response to market risks, require little or no initial investment and are settled at a future date. Derivative instruments are utilized by the Company to manage various market risks including volatility in commodity prices, foreign exchange rates and interest rate exposures. The Company's policy is not to utilize derivative instruments for speculative purposes. The Company may enter into swap and other derivative transactions to hedge or mitigate the Company's commercial risk, including derivatives that reduce risks that arise in the ordinary course of the Company's business. The Company may choose to apply hedge accounting to derivative instruments.

The fair values of derivatives are determined using valuation models which require assumptions concerning the amount and timing of future cash flows and discount rates. These estimates are also subject to change with fluctuations in commodity prices, interest rates, foreign currency exchange rates and estimates of non-performance. The actual settlement of a derivative instrument could differ materially from the fair value recorded and could impact future results.

### i) Derivative Instruments

All derivative instruments, other than those designated as effective hedging instruments, are classified as FVTPL - held for trading and are recorded on the balance sheet at fair value. Gains and losses on these instruments are recorded in the consolidated statements of income in the period they occur.

The Company may enter into commodity price contracts to offset fixed or floating price contracts entered into with customers and suppliers to retain market prices while meeting customer or supplier pricing requirements. The estimation of the fair value of commodity derivatives and the related inventory incorporates forward prices and adjustments for quality or location. Gains and losses from these contracts, which are not designated as effective hedging instruments, are recognized in revenues or purchases of crude oil and products and are initially recorded at settlement date. Derivative instruments that have been designated as effective hedging instruments are further classified as either fair value or cash flow hedges and are recorded on the balance sheet as set forth below under "Hedging Activities."

### ii) Embedded Derivatives

Derivatives embedded in a host contract are recorded separately when the economic characteristics and risks of the embedded derivative are not clearly and closely related to those of the host contract and the host contract is not measured at FVTPL. The definition of an embedded derivative is the same as other freestanding derivatives. Embedded derivatives are measured at fair value with gains and losses recognized in net earnings.

### iii) Hedging Activities

At the inception of a derivative transaction, if the Company elects to use hedge accounting, the Company formally documents the designation of the hedge, the risk management objectives, the hedging relationships between the hedged items and the hedging items, and the method for testing the effectiveness of the hedge, which must be reasonably assured over the term of the derivative transaction. This process includes linking all derivatives to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions.

The Company formally assesses, both at the inception of the hedge and at each reporting date, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of the hedged items. For fair value hedges, the gains or losses arising from adjusting the derivative to its fair value are recognized immediately in net earnings along with the offsetting gain or loss on the hedged item. For cash flow hedges, the effective portion of the gains and losses is recorded in OCI until the hedged transaction is recognized in net earnings. Any hedge ineffectiveness is immediately recognized in net earnings. When the hedged transaction is recognized in net earnings, the fair value of the associated cash flow hedging item is reclassified from other reserves into net earnings. Hedge accounting is discontinued on a prospective basis when the hedging relationship no longer qualifies for hedge accounting.

When a fair value hedging relationship is discontinued as a result of discontinuing the hedging instrument, any gain or loss on the hedging instrument is deferred and amortized to net earnings over the remaining maturity of the hedged item. Any gain or loss on the hedging instrument resulting from the discontinuation of a cash flow hedging relationship is deferred in OCI until the forecasted transaction date. If the forecasted transaction date is no longer expected to occur, the gain or loss is recognized in net earnings in the period of discontinuation.

The Company may designate certain U.S. dollar denominated debt as a hedge of its net investment in foreign operations for which the U.S. dollar is the functional currency. The unrealized foreign exchange gains and losses arising from the translation of the debt are recorded in OCI, net of tax, and are limited to the translation gain or loss on the net investment.

The Company may enter into interest rate swap agreements to hedge its fixed and floating interest rate mix on long-term debt. The estimated fair value of interest rate hedges is determined primarily through forward market prices and compared with quotes from financial institutions. Gains and losses from these contracts are recognized as an adjustment to finance expense on the hedged debt instrument.

The Company may also enter into interest rate swap agreements to fix interest rates on a highly probable forecasted issuance of long-term debt. The estimated fair value of forward starting swaps is determined primarily using forward market prices. The effective portion of gains and losses on these instruments is recorded in OCI and is adjusted for changes in the fair value of the instrument until the forecasted transaction occurs.

The Company may enter into foreign exchange contracts to hedge its foreign currency exposures on U.S. dollar denominated long-term debt. The estimated fair value of forward purchases of U.S. dollars is determined primarily using forward market prices. Gains and losses on these instruments related to foreign exchange are recorded in foreign exchange gains or losses in the period to which they relate, offsetting the respective foreign exchange gains and losses recognized on the underlying foreign currency long-term debt. The remaining portion of the gain or loss is recorded in OCI and is adjusted for changes in the fair value of the instrument over the life of the debt.

The Company may enter into foreign exchange forwards and foreign exchange collars to hedge anticipated U.S. dollar denominated crude oil and natural gas sales. The estimate of fair value for foreign currency hedges is determined primarily through forward market prices and compared with quotes from financial institutions. Gains and losses on these instruments are recognized in Upstream oil and gas revenues when the sale is recorded.

## n) Comprehensive Income

Comprehensive income consists of net earnings and OCI. OCI is comprised of the change in the fair value of the effective portion of the derivatives used as hedging items in a cash flow hedge or net investment hedge, the unrealized gains and losses on AFS financial assets, the exchange gains and losses arising from the translation of foreign operations and the actuarial gains and losses on defined benefit pension plans. Amounts included in OCI are shown net of tax. Other reserves is an equity category comprised of the cumulative amounts of OCI, relating to foreign currency translation and hedging.

## o) Impairment of Financial Assets

A financial asset is assessed at the end of each reporting period to determine whether it is impaired based on objective evidence indicating that one or more events have had a negative effect on the estimated future cash flows of that asset. Objective evidence used by the Company to assess impairment of financial assets includes quoted market prices for similar financial assets and historical collection rates for loans and receivables.

An impairment loss with respect to a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the net present value of the estimated future cash flows discounted at the original effective interest rate. An impairment loss with respect to an AFS financial asset is calculated by reference to its fair value and any amounts in OCI are transferred to net earnings.

Significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in net earnings. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized.

Given that the calculations for the net present value of estimated future cash flows related to derivative financial assets requires the use of estimates and assumptions, including forecasts of commodity prices, marketing supply and demand, product margins and expected production volumes, it is possible that the assumptions may change, which may require a material adjustment to the carrying value of financial assets.

## p) Pensions and Other Post-employment Benefits

In Canada, the Company provides a defined contribution pension plan and other post-retirement benefits to qualified employees. The Company also maintains a defined benefit pension plan for a small number of employees who did not choose to join the defined contribution pension plan in 1991. In the United States, the Company provides defined contribution pension plans (401(k)), a defined benefit pension plan and other post-retirement benefits.

The cost of the pension benefits earned by employees in the defined contribution pension plans is expensed as incurred. The cost of the benefits earned by employees in the defined benefit pension plans is determined using the projected unit credit funding method. Actuarial gains and losses are recognized in retained earnings as incurred.

Past service costs are recognized in the benefit cost on a straight-line basis over the average period until the benefits become vested. The past service costs are recognized as an expense immediately following the introduction of, or changes to, the pension plans.

The defined benefit asset or liability is comprised of the present value of the defined benefit obligation, less past service costs and the fair value of plan assets from which the obligations are to be settled. Plan assets are measured at fair value based on the closing bid price when there is a quoted price in an active market. Plan assets are assets that are held by a long-term employee benefit fund or qualifying insurance policies. Plan assets are not available to the Company's creditors. The value of any defined benefit asset is restricted to the sum of any past service costs and the present value of refunds from and reductions in future contributions to the plan. Defined benefit obligations are estimated by discounting expected future payments using the year-end market rate of interest for high-quality corporate debt instruments with cash flows that match the timing and amount of expected benefit payments.

Post-retirement medical benefits are also provided to qualifying retirees. In some cases the benefits are provided through medical care plans to which the Company, the employees, the retirees and covered family members contribute. In some plans there is no funding of the benefits before retirement. These plans are recognized on the same basis as described above for the defined benefit pension plans.

The determination of the cost of the defined benefit pension plans and the other post-retirement benefit plans reflects a number of assumptions that affect the expected future benefit payments. The valuation of these plans is prepared by an independent actuary who is engaged by the Company. These assumptions include, but are not limited to, the estimate of expected plan investment performance, salary escalation, retirement age, attrition, future health care costs and mortality. The fair value of the plan assets is used for the purposes of calculating the expected return on plan assets.

Mortality rates are based on the latest available standard mortality tables for the individual countries concerned. The assumptions for each country are reviewed each year and are adjusted where necessary to reflect changes in fund experience and actuarial recommendations. The rate of return on pension plan assets is based on a projection of real long-term bond yields and an equity risk premium, which are combined with local inflation assumptions and applied to the actual asset mix of each plan. The amount of the expected return on plan assets is calculated using the expected rate of return for the year and the fair value of assets at the beginning of the year. Future salary increases are based on expected future inflation rates for the individual countries.

## q) Income Taxes

Current income taxes are recognized in net earnings except when they relate to equity, which includes OCI, and are recognized directly in equity. Management periodically evaluates positions taken in the Company's tax returns with respect to situations in which applicable tax regulations are subject to interpretation and reassessment and establishes provisions where appropriate.

Deferred tax is measured using the liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax assets and liabilities are recognized at expected tax rates in effect in the year when the asset is expected to be realized or the liability settled, based on tax rates and tax laws that have been enacted or substantively enacted at the reporting date. Deferred income tax balances are adjusted to reflect changes in income tax rates that are substantively enacted with the adjustment being recognized in net earnings in the period that the change occurs unless it relates to items recognized directly to equity, including OCI, in which case the deferred income tax is also recorded in equity. Deferred tax assets and deferred tax liabilities are offset if a legally enforceable right exists to set off current tax assets against current income tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

The determination of the Company's income and other tax liabilities requires interpretation of complex laws and regulations often involving multiple jurisdictions. Significant estimations are also made with respect to the timing of temporary difference reversals, the realizability of tax assets and in circumstances where transaction and calculations for which the ultimate tax determination are uncertain. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

## r) Asset Exchange Transactions

Asset exchange transactions are measured at cost if the transaction lacks commercial substance or the fair value of neither the asset received nor the asset given up is reliably measurable. Otherwise, asset exchange transactions are measured at the fair value of the asset given up, unless the fair value of the asset received is more clearly evident. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up. Gains and losses are recorded in other - net in the consolidated statements of income in the period they occur.

## s) Revenue Recognition

Revenue from the sale of goods is recognized when the significant risks and rewards of ownership have passed to the buyer and it can be reliably measured. Revenues associated with the sale of crude oil, natural gas, natural gas liquids, synthetic crude oil, purchased commodities and refined petroleum products are recognized when the title passes to the customer. Revenues associated with the sale of transportation, processing and natural gas storage services are recognized when the services are provided.

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods provided in the normal course of business, net of discounts, customs duties and sales taxes. Crude oil and natural gas sold below or above the Company's working interest share of production results in production underlifts or overlifts. Underlifts are recorded as a receivable at cost with a corresponding decrease to production and operating expense while overlifts are recorded as a payable at fair value with a corresponding increase to production and operating expense.

Physical exchanges of inventory are reported on a net basis for swaps of similar items, as are sales and purchases made with a common counterparty, as part of an arrangement similar to a physical exchange.

Finance income is recognized as the interest accrues using the effective interest rate, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset.

## t) Foreign Currency

Functional currency is the currency of the primary economic environment in which the Company and its subsidiaries operate and is normally the currency in which the entity primarily generates and expends cash. The financial statements of Husky's subsidiaries are translated into Canadian dollars, which is the presentation and functional currency of the Company. The assets and liabilities of subsidiaries whose functional currencies are other than Canadian dollars are translated into Canadian dollars at the foreign exchange rate at the balance sheet date, while revenues and expenses of such subsidiaries are translated using average monthly foreign exchange rates, which approximate the foreign exchange rates on the dates of the transactions. Foreign exchange differences arising on translation are included in OCI.

The Company's transactions in foreign currencies are translated to the appropriate functional currency at the foreign exchange rate on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated to the functional currency at the foreign exchange rate at the balance sheet date and differences arising on translation are recognized in net earnings. Non-monetary assets that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transactions.

## u) Share-based Payments

In accordance with the Company's stock option plan, stock options to acquire common shares may be granted to officers and certain other employees. The Company records compensation expense over the vesting period based on the fair value of options granted. Compensation expense is recorded in net earnings as part of selling, general and administrative expenses.

The Company's stock option plan is a tandem plan that provides the stock option holder with the right to exercise the stock option or surrender the option for a cash payment. A liability for the stock options is accrued over their vesting period measured at fair value using the Black-Scholes option pricing model. The liability is revalued each reporting period until it is settled to reflect changes in the fair value of the options. The net change is recognized in net earnings. When stock options are surrendered for cash, the cash settlement paid reduces the outstanding liability. When stock options are exercised for common shares, consideration paid by the stock option holders and the previously recognized liability associated with the stock options are recorded as share capital.

The Company's Performance Share Unit Plan provides a time-vested award to certain officers and employees of the Company. Performance Share Units ("PSU") entitle participants to receive cash based on the Company's share price at the time of vesting. The amount of cash is contingent on the Company's total shareholder return relative to a peer group of companies. A liability for expected cash payments is accrued over the vesting period of the PSUs and is revalued at each reporting date based on the market price of the Company's common shares and the expected vesting percentage. Upon vesting, a cash payment is made to the participants and the outstanding liability is reduced by the payment amount.

## v) Earnings per Share

The number of basic common shares outstanding is the weighted average number of common shares outstanding for each period. Shares issued during the period are included in the weighted average number of shares from the date consideration is receivable. The calculation of basic earnings per common share is based on net earnings attributable to common shareholders divided by the weighted average number of common shares outstanding.

The number of diluted common shares outstanding is calculated using the treasury stock method, which assumes that any proceeds received from in-the-money stock options would be used to buy back common shares at the average market price for the period. The calculation of diluted earnings per share is based on net earnings attributable to common shareholders divided by the weighted average number of common shares outstanding adjusted for the effects of all dilutive potential common shares, which are comprised of share options granted to employees. Stock options granted to employees provide the holder with the ability to settle in cash or equity. For the purposes of the diluted earnings per share calculation, the Company must adjust the numerator for the more dilutive effect of cash-settlement versus equity-settlement despite how the stock options are accounted for in net earnings. As a result, net earnings reported based on accounting of cash-settled stock options may be adjusted for the results of equity-settlements for the purposes of determining the numerator for the diluted earnings per share calculation.

## w) Government Grants

Government grants are recognized when there is reasonable assurance that the grant will be received and all attached conditions will be complied with. If a grant is received but reasonable assurance and compliance with conditions is not achieved, the grant is recognized as a deferred liability until such conditions are fulfilled. When the grant relates to an expense item, it is recognized as income in the period in which the costs are incurred. Where the grant relates to an asset, it is recognized as a reduction to the net book value of the related asset and recognized in net earnings in equal amounts over the expected useful life of the related asset through lower depletion, depreciation and amortization.

## x) Recent Accounting Standards

### i) Consolidated Financial Statements

In May 2011, the IASB published IFRS 10, "Consolidated Financial Statements," which provides a single model to be applied in the assessment of control for all entities in which the Company has an investment including special purpose entities currently in the scope of Standing Interpretations Committee ("SIC") 12. Under the new control model, the Company has control over an investment if the Company has the ability to direct the activities of the investment, is exposed to the variability of returns from the investment and there is a link between the ability to direct activities and the variability of returns. IFRS 10 is effective for the Company on January 1, 2013 with required retrospective application and early adoption permitted. The Company intends to retrospectively adopt IFRS 10 on January 1, 2013. The adoption of the standard is not expected to have a material impact on the Company's financial statements.

### ii) Joint Arrangements

In May 2011, the IASB published IFRS 11, "Joint Arrangements," whereby joint arrangements are classified as either joint operations or joint ventures. Parties to a joint operation retain the rights and obligations to individual assets and liabilities of the operation, while parties to a joint venture have rights to the net assets of the venture. Joint operations shall be accounted for in a manner consistent with jointly controlled assets and operations whereby the Company's contractual share of the arrangement's assets, liabilities, revenues and expenses is included in the consolidated financial statements. Any arrangement structured through a separate vehicle that does effectively result in separation between the Company and the arrangement shall be classified as a joint venture and accounted for using the equity method of accounting. Under the existing IFRS standard, the Company has the option to account for any interests it has in joint arrangements using proportionate consolidation or equity accounting. IFRS 11 is effective for the Company on January 1, 2013 with required retrospective application and early adoption permitted. The Company intends to retrospectively adopt IFRS 11 on January 1, 2013. The adoption of the standard is not expected to have a material impact on the Company's financial statements.

### iii) Disclosure of Interests in Other Entities

In May 2011, the IASB published IFRS 12, "Disclosure of Interests in Other Entities," which contains new disclosure requirements for interests the Company has in subsidiaries, joint arrangements, associates and unconsolidated structured entities. Required disclosures aim to provide readers of the financial statements with information to evaluate the nature of and risks associated with the Company's interests in other entities and the effects of those interests on the Company's financial statements. IFRS 12 is effective for the Company on January 1, 2013 with required retrospective application and early adoption permitted. The Company intends to retrospectively adopt IFRS 12 on January 1, 2013. The adoption of the standard is not expected to have a material impact on the Company's financial statements.

### iv) Investments in Associates and Joint Ventures

In May 2011, the IASB issued amendments to IAS 28, "Investments in Associates and Joint Ventures," which provides additional guidance applicable to accounting for interests in joint ventures or associates when a portion of an interest is classified as held for sale or when the Company ceases to have joint control or significant influence over an associate or joint venture. When joint control or significant influence over an associate or joint venture ceases, the Company will no longer be required to remeasure the investment at that date. When a portion of an interest in a joint venture or associate is classified as held for sale, the portion not classified as held for sale shall be accounted for using the equity method of accounting until the sale is completed at which time the interest is reassessed for prospective accounting treatment. Amendments to IAS 28 are effective for the Company on January 1, 2013 with required retrospective application and early adoption permitted. The Company intends to retrospectively adopt these amendments on January 1, 2013. The Company does not expect the amendments to IAS 28 to have a material impact on the Company's financial statements.

### i) Fair Value Measurement

In May 2011, the IASB published IFRS 13, "Fair Value Measurement," which provides a single source of fair value measurement guidance and replaces fair value measurement guidance contained in individual IFRSs. The standard provides a framework for measuring fair value and establishes new disclosure requirements to enable readers to assess the methods and inputs used to develop fair value measurements, for recurring valuations that are subject to measurement uncertainty, and for the effect of those measurements on the financial statements. IFRS 13 is effective for the Company on January 1, 2013 with required prospective application and early adoption permitted. The Company intends to adopt IFRS 13 on January 1, 2013. The adoption of the standard is not expected to have a material impact on the Company's financial statements.

### vi) Employee Benefits

In June 2011, the IASB issued amendments to IAS 19, "Employee Benefits" to eliminate the corridor method that permits the deferral of actuarial gains and losses, to revise the presentation requirements for changes in defined benefit plan assets and liabilities and to enhance the required disclosures for defined benefit plans. Amendments to IAS 19 are effective for the Company on January 1, 2013 with required retrospective application and early adoption permitted. The Company intends to retrospectively adopt these amendments on January 1, 2013. The adoption of the amended standard is not expected to have a material impact on the Company's financial statements.

### vii) Offsetting Financial Assets and Financial Liabilities

In December 2011, the IASB issued amendments to IFRS 7, "Financial Instruments: Disclosures" and IAS 32, "Financial Instruments: Presentation" to clarify the current offsetting model and develop common disclosure requirements to enhance the understanding of the potential effects of offsetting arrangements. Amendments to IFRS 7 are effective for the Company on January 1, 2013 with required retrospective application and early adoption permitted. Amendments to IAS 32 are effective for the Company on January 1, 2014 with required retrospective application and early adoption permitted. The Company intends to retrospectively adopt the IFRS 7 amendments on January 1, 2013 and the IAS 32 amendments on January 1, 2014. The adoption of these amended standards is not expected to have a material impact on the Company's financial statements.

### viii) Financial Instruments

In November 2009, the IASB published IFRS 9, "Financial Instruments," which covers the classification and measurement of financial assets as part of its project to replace IAS 39, "Financial Instruments: Recognition and Measurement." In October 2010, the requirements for classifying and measuring financial liabilities were added to IFRS 9. Under this guidance, entities have the option to recognize financial liabilities at fair value through profit or loss. If this option is elected, entities would be required to reverse the portion of the fair value change due to their own credit risk out of net earnings and recognize the change in OCI. IFRS 9 is effective for the Company on January 1, 2015 with required retrospective application and early adoption permitted. The Company intends to retrospectively adopt the amendments on January 1, 2015. The adoption of the standard is not expected to have a material impact on the Company's financial statements.

## y) Change in Presentation of Trading Activities

During the first quarter of 2012, the Company completed a review of the trading activities within its Infrastructure and Marketing segment and determined that the realized and the unrealized gains and losses previously presented on a gross basis in gross revenues, purchases of crude oil and products and other – net, would be more appropriately presented on a net basis to reflect the nature of trading activities. As a result, these realized and unrealized gains and losses, and the underlying settlement of these contracts, have been recognized and recorded on a net basis in marketing and other in the consolidated statements of income.

Prior periods have been reclassified to reflect this change in presentation and there was no impact on net earnings:

### Earnings Impact

| *($ millions)* | 2011 |
|---|---|
| Gross revenues | (1,497) |
| Marketing and other | 90 |
| Purchases of crude oil and products | 1,399 |
| Other – net | 8 |
| **Net earnings** | – |

## z) Change in Accounting Policy

In June 2011, the International Accounting Standards Board ("IASB") issued IAS 1, "Presentation of Items of OCI: Amendments to IAS 1 Presentation of Financial Statements." The amendments stipulate the presentation of net earnings and OCI and also require the Company to group items within OCI based on whether the items may be subsequently reclassified to profit or loss. Amendments to IAS 1 were effective for the Company on January 1, 2012 with required retrospective application and early adoption permitted. The Company retrospectively adopted the amendments on January 1, 2012. The adoption of the amendments to this standard did not have a material impact on the Company's financial statements.

## Note 4 Accounts Receivable

### Accounts Receivable

| *($ millions)* | **December 31, 2012** | December 31, 2011 |
|---|---|---|
| Trade receivables | **1,291** | 1,071 |
| Allowance for doubtful accounts | **(23)** | (23) |
| Derivatives due within one year | **14** | 66 |
| Other | **67** | 121 |
| | **1,349** | 1,235 |

## Note 5 Inventories

### Inventories

| *($ millions)* | **December 31, 2012** | December 31, 2011 |
|---|---|---|
| Crude oil, natural gas and sulphur | **1,113** | 1,476 |
| Refined petroleum products | **157** | 176 |
| Trading inventories measured at fair value | **328** | 284 |
| Materials, supplies and other | **138** | 123 |
| | **1,736** | 2,059 |

Impairment of inventory to net realizable value as at December 31, 2012 was $1 million (December 31, 2011 – $3 million) primarily due to a reduction in market prices for asphalt and ethanol products.

# Note 6 Exploration and Evaluation Costs

## Exploration and Evaluation Assets

| *($ millions)* | **2012** | 2011 |
|---|---|---|
| Beginning of year | **746** | 472 |
| Additions | **291** | 331 |
| Acquisitions | **16** | 116 |
| Transfers to oil and gas properties *(note 7)* | **(198)** | (92) |
| Expensed exploration expenditures previously capitalized | **(42)** | (68) |
| Disposals | **–** | (19) |
| Exchange adjustments | **(3)** | 6 |
| End of year | **810** | 746 |

The following exploration and evaluation expenses for the years ended December 31, 2012 and 2011 relate to activities associated with the exploration for and evaluation of oil and natural gas resources and are recorded in Exploration and Production in the Upstream segment:

## Exploration and Evaluation Expense Summary

| *($ millions)* | **2012** | 2011 |
|---|---|---|
| Seismic, geological and geophysical | **146** | 170 |
| Expensed drilling | **188** | 245 |
| Expensed land | **16** | 55 |
| | **350** | 470 |

## Note 7 Property, Plant and Equipment

| Property, Plant and Equipment *($ millions)* | Oil and Gas Properties | Processing, Transportation and Storage | Upgrading | Refining | Retail and Other | Total |
|---|---|---|---|---|---|---|
| Cost | | | | | | |
| December 31, 2010 | 29,144 | 1,069 | 1,974 | 4,545 | 2,028 | 38,760 |
| Additions | 3,028 | 43 | 58 | 269 | 119 | 3,517 |
| Acquisitions | 848 | – | – | – | – | 848 |
| Transfers from exploration and evaluation *(note 6)* | 92 | – | – | – | – | 92 |
| Intersegment transfers | 84 | (84) | – | – | – | – |
| Changes in asset retirement obligations | 542 | 5 | 3 | 30 | 27 | 607 |
| Disposals and derecognition | (113) | (103) | (63) | (22) | 2 | (299) |
| Exchange adjustments | 15 | – | – | 94 | – | 109 |
| December 31, 2011 | 33,640 | 930 | 1,972 | 4,916 | 2,176 | 43,634 |
| Additions | **3,971** | **53** | **47** | **349** | **146** | **4,566** |
| Acquisitions | **16** | **–** | **–** | **–** | **–** | **16** |
| Transfers from exploration and evaluation *(note 6)* | **198** | **–** | **–** | **–** | **–** | **198** |
| Changes in asset retirement obligations | **1,097** | **(2)** | **(13)** | **(71)** | **29** | **1,040** |
| Disposals and derecognition | **(76)** | **–** | **–** | **(7)** | **(127)** | **(210)** |
| Exchange adjustments | **(20)** | **–** | **–** | **(93)** | **1** | **(112)** |
| **December 31, 2012** | **38,826** | **981** | **2,006** | **5,094** | **2,225** | **49,132** |
| Accumulated depletion, depreciation, amortization and impairment | | | | | | |
| December 31, 2010 | (13,919) | (449) | (742) | (818) | (1,062) | (16,990) |
| Depletion, depreciation, amortization and impairment[(1)] | (1,990) | (48) | (169) | (220) | (92) | (2,519) |
| Intersegment transfers | (46) | 46 | – | – | – | – |
| Disposals and derecognition | 58 | 44 | 63 | 3 | – | 168 |
| Exchange adjustments | (3) | – | – | (11) | – | (14) |
| December 31, 2011 | (15,900) | (407) | (848) | (1,046) | (1,154) | (19,355) |
| Depletion, depreciation and amortization[(1)] | **(2,101)** | **(36)** | **(102)** | **(241)** | **(103)** | **(2,583)** |
| Disposals and derecognition | **49** | **–** | **–** | **3** | **124** | **176** |
| Exchange adjustments | **5** | **–** | **–** | **24** | **–** | **29** |
| **December 31, 2012** | **(17,947)** | **(443)** | **(950)** | **(1,260)** | **(1,133)** | **(21,733)** |
| Net book value | | | | | | |
| December 31, 2011 | 17,740 | 523 | 1,124 | 3,870 | 1,022 | 24,279 |
| **December 31, 2012** | **20,879** | **538** | **1,056** | **3,834** | **1,092** | **27,399** |

*(1) Depletion, depreciation and amortization for the year ended December 31, 2012 does not include amortization of research and development assets of $5 million (2011 – $10 million), offset by exchange adjustments of $8 million (2011 – $10 million).*

Costs of property, plant and equipment, including major development projects, excluded from costs subject to depletion, depreciation and amortization as at December 31, 2012 were $6.1 billion (December 31, 2011 – $5.3 billion).

The net book values of assets under construction included within costs not subject to depletion, depreciation and amortization are as follows:

| Assets Under Construction *($ millions)* | |
|---|---|
| December 31, 2011 | 1,913 |
| **December 31, 2012** | **3,051** |

The net book values of development assets included within costs not subject to depletion, depreciation and amortization are as follows:

**Development Assets**

| ($ millions) | |
|---|---|
| December 31, 2011 | 2,200 |
| **December 31, 2012** | **1,796** |

The net book values of assets held under finance lease included in the "Refining" class within property, plant and equipment are as follows:

**Assets Under Finance Lease**

| ($ millions) | |
|---|---|
| December 31, 2011 | 32 |
| **December 31, 2012** | **30** |

In 2012, as a result of declines in future natural gas prices, an impairment test was performed on two heavily gas-weighted CGUs located in East Central Alberta. No impairment indicators were identified for Husky's remaining CGUs. The Company estimated the recoverable amount based on a VIU methodology using estimated cash flows based on both proved plus probable reserves and near-term development plans, discounted using an average pre-tax discount rate of 8% (2011 - 8%). At December 31, 2012, no impairment has been recognized in relation to these CGUs (December 31, 2011 - $70 million); however, the VIU calculation continues to be sensitive to factors such as development plans and, in particular, future natural gas prices, as a U.S. $0.10/mmbtu decrease represents an approximate effect on an annual undiscounted pre-tax earnings of $12 million.

## Note 8 Joint Ventures

### BP-Husky Refining LLC

The Company holds a 50% ownership interest in BP-Husky Refining LLC, which owns and operates the BP-Husky Toledo Refinery in Ohio. On March 31, 2008, the Company completed a transaction with BP whereby BP contributed the BP-Husky Toledo Refinery plus inventories and other related net assets and the Company contributed U.S. $250 million in cash and a contribution payable of U.S. $2.6 billion.

The Company's proportionate share of the contribution payable included in the consolidated balance sheets is as follows:

**Contribution Payable**

| ($ millions) | **2012** | 2011 |
|---|---|---|
| Beginning of year | **1,437** | 1,427 |
| Accretion | **81** | 83 |
| Paid | **(152)** | (103) |
| Foreign exchange | **(30)** | 30 |
| End of year | **1,336** | 1,437 |

The contribution payable accretes at a rate of 6% and is payable between December 31, 2012 and December 31, 2015 with the final balance due by December 31, 2015. The timing of payments during this period will be determined by the capital expenditures made at the refinery during this same period. The entity is included as part of U.S. Refining and Marketing in the Downstream segment.

Summarized below is the Company's proportionate share of operating results and financial position that have been included in the consolidated statements of income and the consolidated balance sheets in U.S. Refining and Marketing in the Downstream segment:

### Results of Operations

| *($ millions)* | **2012** | 2011 |
|---|---|---|
| Revenues | **2,574** | 2,632 |
| Expenses | **(2,319)** | (2,389) |
| Proportionate share of net earnings | **255** | 243 |

### Balance Sheets

| *($ millions)* | **December 31, 2012** | December 31, 2011 |
|---|---|---|
| Current assets | **416** | 487 |
| Non-current assets | **1,864** | 1,859 |
| Current liabilities | **(210)** | (223) |
| Non-current liabilities | **(492)** | (534) |
| Proportionate share of net assets | **1,578** | 1,589 |

## Other Joint Ventures

The Company holds a 50% interest in the Sunrise Oil Sands Partnership, which is engaged in developing an oil sands project in Northern Alberta. On March 31, 2008, the Company completed a transaction with BP whereby the Company contributed Sunrise oil sands assets with a fair value of U.S. $2.5 billion and BP contributed U.S. $250 million in cash and a contribution receivable of U.S. $2.25 billion. The contribution receivable accretes at a rate of 6% and is payable between December 31, 2012 and December 31, 2015 with the final balance due by December 31, 2015. The contribution receivable is reflected as a long-term asset as amounts to be received within twelve months of the reporting date are reflected as additions to property, plant and equipment.

The Company's proportionate share of the contribution receivable from BP included in the consolidated balance sheets is as follows:

### Contribution Receivable

| *($ millions)* | **2012** | 2011 |
|---|---|---|
| Beginning of year | **1,147** | 1,284 |
| Accretion | **53** | 71 |
| Received | **(563)** | (234) |
| Foreign exchange | **(30)** | 26 |
| End of year | **607** | 1,147 |

The Company also holds a 40% interest in Husky-CNOOC Madura Limited, which is engaged in exploring for oil and gas resources in Indonesia. Results of the Husky-CNOOC Madura Limited and Sunrise Oil Sands Partnership joint ventures are included in Exploration and Production in the Upstream segment.

Summarized below is the Company's proportionate share of operating results and financial position in the Sunrise Oil Sands Partnership and Husky-CNOOC Madura Limited that have been included in the consolidated statements of income and the consolidated balance sheets:

### Results of Operations

| *($ millions)* | **2012** | 2011 |
|---|---|---|
| Revenues | **–** | – |
| Expenses | **(13)** | (9) |
| Financial items | **30** | 97 |
| Proportionate share of net earnings | **17** | 88 |

### Balance Sheets

| *($ millions)* | **December 31, 2012** | December 31, 2011 |
|---|---|---|
| Current assets | **17** | 8 |
| Non-current assets | **1,960** | 1,778 |
| Current liabilities | **(117)** | (38) |
| Non-current liabilities | **(51)** | (21) |
| Proportionate share of net assets | **1,809** | 1,727 |

## Note 9 Cash Flows – Change in Non-cash Working Capital

### Non-cash Working Capital

| *($ millions)* | **2012** | 2011 |
|---|---|---|
| Decrease (increase) in non-cash working capital | | |
| Accounts receivable | **314** | 553 |
| Inventories | **329** | (77) |
| Prepaid expenses | **(29)** | (8) |
| Accounts payable and accrued liabilities | **364** | 355 |
| Change in non-cash working capital | **978** | 823 |
| Relating to: | | |
| Operating activities | **843** | 269 |
| Financing activities | **79** | 238 |
| Investing activities | **56** | 316 |

Cash and cash equivalents at December 31, 2012 included $127 million of cash (December 31, 2011 – $2 million) and $1,898 million of short-term investments with original maturities less than three months at the time of purchase (December 31, 2011 – $1,839 million).

## Note 10 Goodwill

### Goodwill

| ($ millions) | 2012 | 2011 |
|---|---|---|
| Beginning of year | **674** | 663 |
| Exchange adjustments | **(11)** | 11 |
| End of year | **663** | 674 |

As at December 31, 2012, goodwill related primarily to the Lima Refinery CGU included in the Downstream segment with the remaining balance allocated to various Upstream CGUs located in Western Canada. For impairment testing purposes, the recoverable amount of the Lima Refinery CGU was estimated using value-in-use methodology based on cash flows expected over a 40-year period and discounted using a pre-tax discount rate of 10% (2011 – 10%). The discount rate was determined in relation to the Company's incremental borrowing rate adjusted for risks specific to the refinery. Cash flow projections for the initial five-year period are based on budgeted future cash flows and inflated by a 2% long-term growth rate for the remaining 35-year period. The inflation rate was based upon an average expected inflation rate for the U.S. of 2% (2011 – 2%). At December 31, 2012, the recoverable amount exceeded the carrying amount of the relevant CGUs. The value-in-use calculation for the Lima Refinery CGU is particularly sensitive to changes in discount rates, forecasted crack spreads and refining margins.

## Note 11 Bank Operating Loans

At December 31, 2012, the Company had unsecured short-term borrowing lines of credit with banks totalling $515 million (December 31, 2011– $465 million) and letters of credit under these lines of credit totalling $235 million (December 31, 2011 – $250 million). As at December 31, 2012, bank operating loans were nil (December 31, 2011 – nil). Interest payable is based on Bankers' Acceptance, U.S. LIBOR or prime rates. During 2012, the Company's weighted average interest rate on short-term borrowings was approximately 1.2% (2011 – 1.2%).

Husky Energy (HK) Limited and Husky Oil China Ltd., subsidiaries of the Company, each have an uncommitted demand revolving facility of U.S. $10 million available for general purposes. As at December 31, 2012, there was no balance outstanding under these facilities (December 31, 2011 – nil). The Sunrise Oil Sands Partnership has an unsecured demand credit facility of $10 million available for general purposes. The Company's proportionate share is $5 million. As at December 31, 2012, there was no balance outstanding under this credit facility (December 31, 2011 – nil).

## Note 12 Accounts Payable and Accrued Liabilities

### Accounts Payable and Accrued Liabilities

| ($ millions) | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Trade payables | **152** | 74 |
| Accrued liabilities | **2,292** | 2,178 |
| Dividend payable *(note 18)* | **295** | 291 |
| Stock-based compensation | **47** | 9 |
| Derivatives due within one year | **5** | 138 |
| Contingent consideration | **27** | 17 |
| Other | **168** | 160 |
| | **2,986** | 2,867 |

## Note 13 Long-term Debt

| Long-term Debt ($ millions) | Maturity | Canadian $ Amount December 31, 2012 | Canadian $ Amount December 31, 2011 | U.S. $ Denominated December 31, 2012 | U.S. $ Denominated December 31, 2011 |
|---|---|---|---|---|---|
| **Long-term debt** | | | | | |
| 5.90% notes[1][2] | 2014 | **746** | 763 | **750** | 750 |
| 3.75% medium-term notes[1] | 2015 | **300** | 300 | **–** | – |
| 7.55% debentures[1] | 2016 | **199** | 203 | **200** | 200 |
| 6.20% notes[1][2] | 2017 | **298** | 305 | **300** | 300 |
| 6.15% notes[2] | 2019 | **298** | 305 | **300** | 300 |
| 7.25% notes[2] | 2019 | **746** | 763 | **750** | 750 |
| 5.00% medium-term notes | 2020 | **400** | 400 | **–** | – |
| 3.95% notes[2] | 2022 | **498** | – | **500** | – |
| 6.80% notes[2] | 2037 | **385** | 393 | **387** | 387 |
| Debt issue costs[3] | | **(24)** | (21) | **–** | – |
| Unwound interest rate swaps | | **72** | 93 | **–** | – |
| Long-term debt | | **3,918** | 3,504 | **3,187** | 2,687 |
| **Long-term debt due within one year** | | | | | |
| 6.25% notes[4] | | **–** | 407 | **–** | 400 |

(1) *A portion of the Company's debt was designated in a fair value hedging relationship for interest rate risk management and the gains or losses arising from adjusting the derivative to its fair value were recognized immediately in net earnings along with the offsetting gain or loss on the hedged item recorded at fair value until discontinuation of the hedging relationship in 2011. Refer to Note 22.*

(2) *A portion of the Company's U.S. denominated debt is designated as a hedge of the Company's net investment in its U.S. refining operations. Refer to Note 22.*

(3) *Calculated using the effective interest rate method.*

(4) *A portion of the Company's debt was designated in a cash flow hedging relationship for foreign currency risk management, with the use of cross currency swaps, until expiration of the hedging relationship in the second quarter of 2012 with the repayment of the related U.S. $400 million of 6.25% notes which matured on June 15, 2012 and the settlement of the cross currency swaps on the same day. Refer to Note 22.*

## Credit Facilities

The Company's revolving syndicated credit facility, which was entered into on November 15, 2011 and amended and restated on December 14, 2012, allows the Company to borrow up to $1.5 billion in either Canadian or U.S. currency from a group of banks on an unsecured basis. The facility is structured as a four-year committed revolving credit facility with a maturity date of December 14, 2016.

The Company also has a second revolving syndicated credit facility, which was entered into on August 31, 2010 and amended and restated on December 14, 2012. The facility allows the Company to borrow up to $1.6 billion in either Canadian or U.S. currency from a group of banks on an unsecured basis. The facility is structured as a four-year committed revolving credit with a maturity date of August 31, 2014.

These facilities, except for their maturity dates, have the same terms. Interest rates vary based on Canadian prime, Bankers' Acceptance, U.S. LIBOR or U.S. base rate, depending on the borrowing option selected and credit ratings assigned by certain credit rating agencies to the Company's rated senior unsecured debt.

As at December 31, 2012, the Company had no borrowings under either revolving syndicated credit facility (December 31, 2011 – no borrowings under the prior $1.6 billion revolving syndicated credit facility, the prior $1.7 billion revolving syndicated credit facility or the $100 million bilaterial credit facility which was cancelled effective February 3, 2012).

## Notes and Debentures

The 7.55% debentures represent unsecured securities under a trust indenture dated October 31, 1996.

The 6.15% notes represent unsecured securities under a trust indenture dated June 14, 2002.

The 5.90%, the 6.20%, the 7.25%, the 3.95% and the 6.80% notes represent unsecured securities under a trust indenture dated September 11, 2007.

The 3.75% and the 5.00% medium-term notes represent unsecured securities under a trust indenture dated December 21, 2009.

On June 15, 2012, the Company repaid the maturing 6.25% notes issued under a trust indenture dated June 14, 2002. The amount paid to note holders was U.S. $413 million, including U.S. $13 million of interest.

At December 31, 2012, the Company had entered into a cash flow hedge using forward starting interest rate swap arrangements whereby the Company fixed the underlying U.S. 10-year Treasury Bond rate on U.S. $500 million to June 16, 2014, which is the Company's forecasted debt issuance on the same date. Refer to Note 22.

On June 13, 2011, the Company filed a universal short form base shelf prospectus (the "U.S. Base Prospectus") with the Alberta Securities Commission and the U.S. Securities and Exchange Commission that enables the Company to offer up to U.S. $3.0 billion of common shares, preferred shares, debt securities, subscription receipts, warrants and units in the United States up to and including July 12, 2013. At December 31, 2012, approximately $1.5 billion remains available for issuance under the U.S. Base Prospectus.

On December 31, 2012, the Company filed a universal short form base shelf prospectus (the "Canadian Base Prospectus") with applicable securities regulators in each of the provinces of Canada, other than Quebec, that enables the Company to offer up to $3.0 billion of common shares, preferred shares, debt securities, subscription receipts, warrants and units (the "Securities") in Canada up to and including January 30, 2015. As of December 31, 2012, the Company had not issued Securities under the Canadian Base Prospectus. This Canadian Base Prospectus replaced the universal short form base shelf prospectus filed in Canada during November 2010 which had remaining unused capacity of $1.4 billion and expired in December 2012.

The ability of the Company to raise capital utilizing the U.S. Base Prospectus or the Canadian Base Prospectus is dependent on market conditions at the time of sale.

The notes and debentures disclosed above are redeemable (unless otherwise stated) at the option of the Company, at any time, at a redemption price equal to the greater of the par value of the securities and the sum of the present values of the remaining scheduled payments discounted at a rate calculated using a comparable U.S. Treasury Bond rate (for U.S. dollar denominated securities) or Government of Canada Bond rate (for Canadian dollar denominated securities) plus an applicable spread. Interest on the notes and debentures disclosed above is payable semi-annually.

The Company's notes, debentures, credit facilities and short-term lines of credit rank equally.

The unamortized portion of the gain on previously unwound interest rate swaps that were designated as a fair value hedge is included in the carrying value of long-term debt. Refer to Note 22.

## Note 14 Financial Items

### Financial Items

| ($ millions) | 2012 | 2011 |
|---|---|---|
| Foreign exchange | | |
| Gains (losses) on translation of U.S. dollar denominated long-term debt | **43** | (47) |
| Gains on cross currency swaps | **2** | 7 |
| Gains (losses) on contribution receivable | **(7)** | 34 |
| Other foreign exchange gains (losses) | **(24)** | 16 |
| Net foreign exchange gains | **14** | 10 |
| Finance income | | |
| Contribution receivable | **53** | 71 |
| Interest income | **34** | – |
| Other | **6** | 15 |
| Finance income | **93** | 86 |
| Finance expenses | | |
| Long-term debt | **(232)** | (226) |
| Contribution payable | **(81)** | (82) |
| Short-term debt | **(3)** | (9) |
| | **(316)** | (317) |
| Interest capitalized[1] | **173** | 86 |
| | **(143)** | (231) |
| Accretion of asset retirement obligations *(note 16)* | **(87)** | (73) |
| Accretion of other long-term liabilities | **(10)** | (6) |
| Finance expenses | **(240)** | (310) |
| | **(133)** | (214) |

[1] *Interest capitalized on project costs in 2012 is calculated using the Company's annualized effective interest rate of 6% (2011 – 6%).*

Other foreign exchange gains and losses primarily include realized and unrealized foreign exchange gains and losses on property, plant and equipment, and working capital.

## Note 15 Other Long-term Liabilities

### Other Long-term Liabilities

| ($ millions) | December 31, 2012 | December 31, 2011 |
|---|---|---|
| Employee future benefits *(note 19)* | **147** | 166 |
| Finance lease obligations | **31** | 33 |
| Stock-based compensation | **21** | 8 |
| Contingent consideration *(note 22)* | **78** | 112 |
| Other | **54** | 23 |
| | **331** | 342 |

## Note 16 Asset Retirement Obligations

At December 31, 2012, the estimated total undiscounted inflation adjusted amount required to settle the Company's ARO was $10.3 billion (December 31, 2011 – $8.5 billion). These obligations will be settled based on the useful lives of the underlying assets, which currently extend an average of 45 years into the future. This amount has been discounted using credit-adjusted risk-free rates of 3% to 5% (December 31, 2011 – 3% to 5%). Obligations related to environmental remediation and cleanup of oil and gas producing assets are included in the estimated ARO.

The change in estimates in 2012 primarily related to increased cost estimates for the retirement of assets in the Asia Pacific Region, the Atlantic Region and in Western Canada, and a revision of the timing of future ARO cash flows for Western Canadian and Downstream assets.

### Asset Retirement Obligations

| ($ millions) | 2012 | 2011 |
|---|---|---|
| Beginning of year | 1,767 | 1,198 |
| Additions | 154 | 188 |
| Liabilities settled | (123) | (105) |
| Liabilities disposed | (1) | (6) |
| Change in discount rate | 174 | 387 |
| Change in estimates | 737 | 32 |
| Exchange adjustment | (2) | – |
| Accretion[1] | 87 | 73 |
| End of year | 2,793 | 1,767 |
| Expected to be incurred within 1 year | 107 | 116 |
| Expected to be incurred beyond 1 year | 2,686 | 1,651 |

(1) *Accretion is included in finance expenses. Refer to Note 14.*

## Note 17 Income Taxes

The major components of income tax expense for the years ended December 31, 2012 and 2011 were as follows:

### Income Tax Expense

| ($ millions) | 2012 | 2011 |
|---|---|---|
| Current income tax | | |
| Current income tax charge | 529 | 334 |
| Adjustments in respect of current income tax of previous years | 7 | 20 |
| | 536 | 354 |
| Deferred income tax | | |
| Relating to origination and reversal of temporary differences | 221 | 511 |
| Adjustments in respect of deferred income tax of previous years | 57 | 51 |
| | 278 | 562 |

### Deferred Tax Items in OCI

| ($ millions) | 2012 | 2011 |
|---|---|---|
| Deferred tax items expensed (recovered) directly in OCI | | |
| Derivatives designated as cash flow hedges | 1 | – |
| Actuarial gains (losses) on pension plans | 5 | (8) |
| Exchange differences on translation of foreign operations | (12) | 14 |
| Hedge of net investment | 2 | (3) |
| | (4) | 3 |

### Deferred Tax Items in Equity

| *($ millions)* | **2012** | 2011 |
|---|---|---|
| Deferred tax items expensed (recovered) directly in equity | | |
| Share issue costs | **–** | (9) |

The provision for income taxes in the consolidated statements of income reflects an effective tax rate which differs from the expected statutory tax rate. Differences for the years ended December 31, 2012 and 2011 were accounted for as follows:

### Reconciliation of Effective Tax Rate

| *($ millions)* | **2012** | 2011 |
|---|---|---|
| Earnings before income taxes | | |
| Canada | **2,097** | 2,556 |
| United States | **575** | 508 |
| Other foreign jurisdictions | **164** | 76 |
| | **2,836** | 3,140 |
| Statutory income tax rate (percent) | **25.8** | 27.3 |
| Expected income tax | **732** | 857 |
| Effect on income tax resulting from: | | |
| Rate benefit on partnership earnings | **–** | (56) |
| Capital gains and losses | **(10)** | 2 |
| Foreign jurisdictions | **37** | 46 |
| Non-taxable items | **12** | (5) |
| Adjustments in respect of previous years | **64** | 71 |
| Other – net | **(21)** | 1 |
| Income tax expense | **814** | 916 |

The statutory tax rate was 25.8% in 2012 (2011 – 27.3%). The decrease from 2011 to 2012 is due to a reduction in the 2012 Canadian corporate tax rates as part of a series of corporate tax rate reductions previously enacted by the Canadian federal government.

The following reconciles the movements in the deferred income tax liabilities and assets:

| Deferred Tax Liabilities and Assets ($ millions) | January 1,2012 | Recognized in Earnings | Recognized in OCI | Other | December 31, 2012 |
|---|---|---|---|---|---|
| Deferred tax liabilities | | | | | |
| Exploration and evaluation assets and property, plant and equipment | (4,914) | **(487)** | **13** | **(12)** | **(5,400)** |
| Foreign exchange gains taxable on realization | (84) | **23** | **(3)** | **–** | **(64)** |
| Financial assets at fair value | 6 | **(13)** | **–** | **–** | **(7)** |
| Deferred tax assets | | | | | |
| Pension plans | 46 | **(2)** | **(5)** | **–** | **39** |
| Asset retirement obligations | 489 | **290** | **(1)** | **–** | **778** |
| Loss carry-forwards | 121 | **(91)** | **–** | **–** | **30** |
| Debt issue costs | 10 | **(4)** | **–** | **–** | **6** |
| Other temporary differences | (3) | **6** | **–** | **–** | **3** |
| | (4,329) | **(278)** | **4** | **(12)** | **(4,615)** |

| Deferred Tax Liabilities and Assets ($ millions) | January 1,2011 | Recognized in Earnings | Recognized in OCI | Other | December 31, 2011 |
|---|---|---|---|---|---|
| Deferred tax liabilities | | | | | |
| Exploration and evaluation assets and property, plant and equipment | (4,371) | (519) | (18) | (6) | (4,914) |
| Foreign exchange gains taxable on realization | (74) | (13) | 3 | – | (84) |
| Other temporary differences | 22 | (34) | – | 9 | (3) |
| Deferred tax assets | | | | | |
| Pension plans | 38 | – | 8 | – | 46 |
| Asset retirement obligations | 308 | 180 | 1 | – | 489 |
| Financial assets at fair value | 3 | 3 | – | – | 6 |
| Loss carry-forwards | 310 | (192) | 3 | – | 121 |
| Debt issue costs | (3) | 13 | – | – | 10 |
| | (3,767) | (562) | (3) | 3 | (4,329) |

The Company has temporary differences associated with its investments in its foreign subsidiaries, branches, and interests in joint ventures. At December 31, 2012, the Company has no deferred tax liabilities in respect of these temporary differences (December 31, 2011 - nil).

At December 31, 2012, the Company had $86 million (December 31, 2011 – $443 million) of U.S. tax losses that will expire after 2030. The Company has recorded deferred tax assets in respect of these losses, as there are sufficient taxable temporary differences in the U.S. jurisdiction to utilize these losses.

## Note 18 Share Capital

### Common Shares

The Company is authorized to issue an unlimited number of no par value common shares.

| Common Shares | Number of Shares | Amount ($ millions) |
|---|---|---|
| December 31, 2010 | 890,708,795 | 4,574 |
| Common shares issued, net of share issue costs | 44,362,214 | 1,173 |
| Stock dividends | 22,461,089 | 580 |
| Options exercised | 5,000 | – |
| December 31, 2011 | 957,537,098 | 6,327 |
| Stock dividends | **24,514,797** | **607** |
| Options exercised | **177,325** | **5** |
| **December 31, 2012** | **982,229,220** | **6,939** |

On June 29, 2011, the Company issued approximately 37 million common shares at a price of $27.05 per share for total gross proceeds of approximately $1.0 billion through a public offering, and a total of approximately 7.4 million common shares at a price of $27.05 per share for total gross proceeds of $200 million through a private placement to L.F. Investments (Barbados) Limited and Hutchison Whampoa Luxembourg Holdings S.à.r.l. The public offering was conducted under the Company's universal base shelf prospectus filed November 26, 2010 with the securities regulatory authorities in all provinces of Canada, the Company's universal base shelf prospectus filed June 13, 2011 with the Alberta Securities Commission and the U.S. Securities and Exchange Commission and the respective accompanying prospectus supplements.

Shareholders have the option to receive dividends in common shares or in cash. Quarterly dividends may be declared in an amount expressed in dollars per common share and paid by way of issuance of a fraction of a common share per outstanding common share determined by dividing the dollar amount of the dividend by the volume weighted average trading price of the common shares on the principal stock exchange on which the common shares are traded. The volume weighted average trading price of the common shares is calculated by dividing the total value by the total volume of common shares traded over the five trading day period immediately prior to the payment date of the dividend on the common shares.

During the year ended December 31, 2012, the Company declared dividends payable of $1.20 per common share (2011 – $1.20 per common share), resulting in dividends of $1.2 billion (2011 – $1.1 billion). An aggregate of $557 million was paid in cash during 2012 (2011 - $495 million). At December 31, 2012, $295 million, including $293 million in cash and $2 million in common shares, was payable to shareholders on account of dividends declared on November 1, 2012 (December 31, 2011 – $287 million, including $87 million in cash and $200 million in common shares).

### Preferred Shares

The Company is authorized to issue an unlimited number of no par value preferred shares.

| Preferred Shares | Number of Shares | Amount ($ millions) |
|---|---|---|
| December 31, 2010 | – | – |
| Cumulative Redeemable Preferred Shares, Series 1 issued, net of share issue costs | 12,000,000 | 291 |
| December 31, 2011 | 12,000,000 | 291 |
| Cumulative Redeemable Preferred Shares, Series 1 issued, net of share issue costs | **–** | **–** |
| **December 31, 2012** | **12,000,000** | **291** |

On March 18, 2011, the Company issued 12 million Cumulative Redeemable Preferred Shares, Series 1 (the "Series 1 Preferred Shares") at a price of $25.00 per share for aggregate gross proceeds of $300 million. Net proceeds after share issue costs were $291 million. The Series 1 Preferred Shares were offered by way of a prospectus supplement under the short form base shelf prospectus filed November 26, 2010 with the securities regulatory authorities in all provinces of Canada.

Holders of the Series 1 Preferred Shares are entitled to receive a cumulative quarterly fixed dividend yielding 4.45% annually for the initial period ending March 31, 2016, as and when declared by the Company's Board of Directors. Thereafter, the dividend rate will be reset every five years at a rate equal to the 5-year Government of Canada bond yield plus 1.73%. Holders of Series 1 Preferred Shares have the right, at their option, to convert their shares into Cumulative Redeemable Preferred Shares, Series 2 (the "Series 2 Preferred Shares"), subject to certain conditions, on March 31, 2016 and on March 31 every five years thereafter. Holders of the Series 2 Preferred Shares are entitled to receive a cumulative quarterly floating rate dividend at a rate equal to the three-month Government of Canada Treasury Bill yield plus 1.73%, as and when declared by the Company's Board of Directors.

In the event of liquidation, dissolution or winding-up of the Company, the holders of the Series 1 Preferred Shares will be entitled to receive $25 per share. All accrued unpaid dividends will be paid before any amounts are paid or any assets of the Company are distributed to the holders of any other shares ranking junior to the Series 1 Preferred Shares. The holders of the Series 1 Preferred Shares will not be entitled to share in any further distribution of the assets of the Company.

During the year ended December 31, 2012, the Company declared dividends payable of $13 million on the Series 1 Preferred Shares (2011 – $10 million) representing approximately $1.11 per Series 1 Preferred Share (2011 – $0.87 per Series 1 Preferred Share). At December 31, 2012, there were no amounts payable as dividends on the Series 1 Preferred Shares (December 31, 2011 – $3 million). A total of $17 million was paid during 2012 (2011 - $7 million), representing approximately $0.28 per Series 1 Preferred Share (2011 – $0.28 per Series 1 Preferred Share).

## Stock Option Plan

Pursuant to the Incentive Stock Option Plan (the "Option Plan"), the Company may grant from time to time to officers and employees of the Company options to purchase common shares of the Company. The term of each option is five years and it vests one-third on each of the first three anniversary dates from the grant date. The Option Plan provides the option holder with the right to exercise the option to acquire one common share at the exercise price or surrender the option for a cash payment. The exercise price of the option is equal to the weighted average trading price of the Company's common shares during the five trading days prior to the grant date. For options granted up to 2009, when the option is surrendered for cash, the cash payment is the difference between the weighted average trading price of the Company's common shares on the trading day prior to the surrender date and the exercise price of the option. For options granted after 2009, when the option is surrendered for cash, the cash payment is the difference between the weighted average trading price of the Company's common shares for the five trading days following the surrender date and the exercise price of the option.

Certain options granted under the Option Plan and henceforth referred to as performance options vest only if certain shareholder return targets are met. The ultimate number of performance options that vest will depend upon the Company's performance measured over three calendar years. If the Company's performance is below the specified level compared with its industry peer group, the performance options awarded will be forfeited. If the Company's performance is at or above the specified level compared with its industry peer group, the number of performance options exercisable shall be determined by the Company's relative ranking. Stock compensation expense related to the performance options is accrued based on the price of the common shares at the end of the period and the anticipated performance factor. The term of each performance option is five years and the compensation expense is recognized over the three-year vesting period of the performance options. Performance options are no longer granted and the last grant was on August 7, 2009.

Included in accounts payable and accrued liabilities and other long-term liabilities in the consolidated balance sheets at December 31, 2012 was $57 million (December 31, 2011 – $16 million) representing the estimated fair value of options outstanding. The total expense recognized in selling, general and administrative expenses in the consolidated statements of income for the Option Plan for the year ended December 31, 2012 was $42 million (2011 – recovery of $2 million). At December 31, 2012, stock options exercisable for cash had an intrinsic value of $31 million (December 31, 2011 – nil).

The following options to purchase common shares have been awarded to officers and certain other employees:

| Outstanding and Exercisable Options | 2012 | | 2011 | |
|---|---|---|---|---|
| | Number of Options *(thousands)* | Weighted Average Exercise Prices | Number of Options *(thousands)* | Weighted Average Exercise Prices |
| Outstanding, beginning of year | **33,337** | **34.62** | 29,541 | 37.04 |
| Granted[(1)] | **11,137** | **25.61** | 9,618 | 28.80 |
| Exercised for common shares | **(177)** | **27.61** | (5) | 28.19 |
| Expired or forfeited | **(15,276)** | **39.09** | (5,817) | 37.30 |
| **Outstanding, end of year** | **29,021** | **28.85** | 33,337 | 34.62 |
| **Exercisable, end of year** | **10,796** | **32.19** | 18,486 | 39.50 |

(1) *Options granted during the year ended December 31, 2012 were attributed a fair value of $3.94 per option (2011 – $4.41) at grant date.*

| Outstanding and Exercisable Options | Outstanding Options | | | Exercisable Options | |
|---|---|---|---|---|---|
| Range of Exercise Price | Number of Options *(thousands)* | Weighted Average Exercise Prices | Weighted Average Contractual Life *(years)* | Number of Options *(thousands)* | Weighted Average Exercise Prices |
| $24.96 – $29.99 | 25,765 | 27.32 | 3 | 7,540 | 28.40 |
| $30.00 – $34.99 | 661 | 31.24 | 1 | 661 | 31.24 |
| $35.00 – $39.99 | 201 | 39.97 | – | 201 | 39.97 |
| $40.00 – $42.99 | 748 | 40.91 | – | 748 | 40.91 |
| $43.00 – $45.02 | 1,646 | 45.02 | 1 | 1,646 | 45.02 |
| **December 31, 2012** | **29,021** | **28.85** | **3** | **10,796** | **32.19** |

The fair value of the share options is estimated at each reporting date using the Black-Scholes option pricing model, taking into account the terms and conditions upon which the share options are granted and for the performance options, the current likelihood of achieving the specified target. The following table lists the assumptions used in the Black-Scholes option pricing model for the two plans:

| Black-Scholes Assumptions | December 31, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | Tandem Options | Tandem Performance Options | Tandem Options | Tandem Performance Options |
| Dividend per option | **1.31** | **1.31** | 1.33 | 1.33 |
| Range of expected volatilities used *(percent)* | **13.5 - 33.2** | **13.5 - 24.8** | 21.3 – 35.9 | 21.3 – 32.0 |
| Range of risk-free interest rates used *(percent)* | **0.9 - 1.4** | **0.9 - 1.1** | 0.7 – 1.3 | 0.7 – 1.0 |
| Expected life of share options from vesting date *(years)* | **1.82** | **1.82** | 1.75 | 1.75 |
| Expected forfeiture rate *(percent)* | **11.0** | **11.0** | 11.5 | 11.5 |
| Weighted average exercise price | **29.16** | **41.36** | 34.59 | 41.51 |
| Weighted average fair value | **2.84** | **0.28** | 0.82 | 0.03 |

The expected life of the share options is based on historical data and current expectations and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility over a period similar to the expected life of the options is indicative of future trends, which may also not necessarily be the actual outcome.

## Performance Share Units

In February 2010, the Compensation Committee of the Board of Directors of the Company established the Performance Share Unit Plan for executive officers and certain employees of the Company. The term of each PSU is three years and the PSU vests on the second and third anniversary dates of the grant date in percentages determined by the Board of Directors based on the Company reaching certain shareholder return targets. Upon vesting, PSU holders receive a cash payment equal to the number of vested PSUs multiplied by the weighted average trading price of the Company's common shares for the five preceding trading days. As at December 31, 2012, the carrying amount of the liability relating to PSUs was $11 million (December 31, 2011 – $1 million). The total expense recognized in selling, general and administrative expenses in the consolidated statements of income for the PSUs for the year ended December 31, 2012 was $12 million (2011 – expense of $1 million). The weighted average contractual life of the PSUs at December 31, 2012 was 2 years.

The number of PSUs outstanding was as follows:

| Performance Share Units | 2012 | 2011 |
|---|---|---|
| Beginning of year | **500,000** | 220,000 |
| Granted | **539,500** | 295,000 |
| Exercised | **(82,000)** | – |
| Forfeited | **(93,000)** | (15,000) |
| **Outstanding, end of year** | **864,500** | 500,000 |
| **Vested, end of year** | **429,835** | 121,190 |

## Earnings per Share

| Earnings per share<br>*($ millions)* | 2012 | 2011 |
|---|---|---|
| Net earnings | **2,022** | 2,224 |
| Effect of dividends declared on preferred shares in the year | **(13)** | (10) |
| Net earnings - basic | **2,009** | 2,214 |
| Dilutive effect of accounting for share options as equity-settled[(1)] | **–** | (30) |
| Net earnings - diluted | **2,009** | 2,184 |
| *(millions)* | | |
| Weighted average common shares outstanding - basic | **975.8** | 923.8 |
| Effect of stock dividends declared in the year | **0.1** | 8.2 |
| Weighted average common shares outstanding - diluted | **975.9** | 932.0 |
| Earnings per share – basic ($/share) | **2.06** | 2.40 |
| Earnings per share – diluted ($/share) | **2.06** | 2.34 |

[(1)] *Stock-based compensation expense was $42 million based on cash-settlement for the year ended December 31, 2012 (2011 – recovery of $2 million). Stock-based compensation expense was $33 million based on equity-settlement for the year ended December 31, 2012 (2011 - expense of $28 million). For the year ended December 31, 2012, cash-settlement of share options was considered more dilutive than the equity-settlement of share options and as such, was used to calculate earnings per share - diluted.*

For the year ended December 31, 2012, 29 million tandem options and 1 million tandem performance options (2011 – 26 million tandem options and 7 million tandem performance options) were excluded from the calculation of diluted earnings per share as these options were anti-dilutive.

# Note 19 Pensions and Other Post-employment Benefits

The Company currently provides a defined contribution pension plan for all qualified employees and an other post-employment benefit plan to its retirees. The Company also maintains a defined benefit pension plan, which is closed to new entrants. The measurement date of all plan assets and the accrued benefit obligations was December 31, 2012. The most recent actuarial valuation of the plans was December 31, 2011 for the Canadian defined benefit plan and the other post-employment benefit plan. The most recent actuarial valuation of the U.S. plans was January 1, 2012.

## Defined Contribution Pension Plan

During the year ended December 31, 2012, the Company recognized a $33 million expense (2011 – $28 million) for the defined contribution plan and the U.S. 401(k) plan in net earnings.

## Defined Benefit Pension Plan ("DB Pension Plan") and Other Post-employment Benefit Plan ("OPEB Plan")

The Company has accrued the total net liability for the DB Pension Plan and the OPEB Plan in the consolidated balance sheets in other long-term liabilities as follows:

### DB Pension Plan

| *($ millions)* | **December 31, 2012** | December 31, 2011 | December 31, 2010 |
|---|---|---|---|
| Fair value of plan assets | **156** | 147 | 142 |
| Defined benefit obligation | **(189)** | (183) | (170) |
| Funded status | **(33)** | (36) | (28) |
| Unrecognized past service costs | **–** | – | – |
| **Net Liability** | **(33)** | (36) | (28) |
| Non-current liability | **(33)** | (36) | (28) |

### OPEB Plan

| *($ millions)* | **December 31, 2012** | December 31, 2011 | December 31, 2010 |
|---|---|---|---|
| Fair value of plan assets | **–** | – | – |
| Defined benefit obligation | **(105)** | (120) | (100) |
| Funded status | **(105)** | (120) | (100) |
| Unrecognized past service costs | **(9)** | (10) | (12) |
| **Net Liability** | **(114)** | (130) | (112) |
| Non-current liability | **(114)** | (130) | (112) |

The following tables summarize the experience adjustments arising on the DB Pension and the OPEB Plan liabilities:

### DB Pension Plan

| *($ millions)* | **2012** | 2011 | 2010 |
|---|---|---|---|
| Experience adjustments arising on plan liabilities | **(0.5)** | 0.2 | 1.8 |

### OPEB Plan

| *($ millions)* | **2012** | 2011 | 2010 |
|---|---|---|---|
| Experience adjustments arising on plan liabilities | **1.6** | (1.2) | (0.6) |

The following table summarizes the experience adjustments arising on the DP Pension Plan assets:

### DB Pension Plan

| *($ millions)* | **2012** | 2011 | 2010 |
|---|---|---|---|
| Experience adjustments arising on plan assets | **(2.2)** | 5.3 | (4.0) |

The following tables summarize changes to the net balance sheet position and amounts recognized in net earnings and OCI for the DB Pension Plan and the OPEB Plan for the years ended December 31, 2012 and 2011:

| DB Pension Plan and OPEB Plan Net Asset (Liability) ($ millions) | DB Pension Plan | | OPEB Plan | |
|---|---|---|---|---|
| | **2012** | 2011 | **2012** | 2011 |
| Beginning of year | **(36)** | (28) | **(130)** | (112) |
| Employer contributions | **8** | 10 | **1** | 1 |
| Benefit cost | **–** | – | **(10)** | (9) |
| Actuarial loss (gain) | **(5)** | (18) | **25** | (10) |
| End of year | **(33)** | (36) | **(114)** | (130) |

| DB Pension Plan and OPEB Plan ($ millions) | DB Pension Plan | | OPEB Plan | |
|---|---|---|---|---|
| | **2012** | 2011 | **2012** | 2011 |
| Amounts recognized in net earnings | | | | |
| Current service cost | **2** | 3 | **7** | 6 |
| Interest cost | **7** | 8 | **4** | 5 |
| Expected return on plan assets | **(9)** | (10) | **–** | – |
| Past service cost (credit) | **–** | – | **(2)** | (2) |
| Curtailment gain | **–** | (1) | **–** | – |
| Benefit cost | **–** | – | **9** | 9 |
| Amounts recognized in retained earnings | | | | |
| Actuarial loss (gain) recognized | **5** | 18 | **(25)** | 10 |
| Cumulative actuarial loss (gain), end of year | **32** | 27 | **(4)** | 21 |

The following tables summarize changes to the defined benefit obligation for the DB Pension Plan and the OPEB Plan:

| Defined Benefit Obligation ($ millions) | DB Pension Plan | | OPEB Plan | |
|---|---|---|---|---|
| | **2012** | 2011 | **2012** | 2011 |
| Beginning of year | **183** | 170 | **120** | 100 |
| Current service cost | **2** | 3 | **7** | 6 |
| Interest cost | **7** | 8 | **4** | 5 |
| Benefits paid | **(10)** | (10) | **(1)** | (1) |
| Actuarial loss (gain) | **7** | 13 | **(25)** | 10 |
| Curtailment gain | **–** | (1) | **–** | – |
| End of year | **189** | 183 | **105** | 120 |

The following table summarizes changes to the DB Pension Plan assets during the year:

| Fair Value of Plan Assets ($ millions) | **2012** | 2011 |
|---|---|---|
| Beginning of year | **147** | 142 |
| Contributions by employer | **8** | 10 |
| Benefits paid | **(10)** | (10) |
| Expected return on plan assets | **9** | 10 |
| Actuarial gain (loss) | **2** | (5) |
| End of year | **156** | 147 |

The following long term assumptions were used to estimate the value of the defined benefit obligations, the plan assets, and the OPEB Plan:

### DB Pension Plan Long-term Assumptions

| *(percent)* | Canada - DB Pension Plan 2012 | Canada - DB Pension Plan 2011 | U.S. - DB Pension Plan 2012 | U.S. - DB Pension Plan 2011 |
|---|---|---|---|---|
| Discount rate for benefit expense | **4.1** | 5.0 | **3.9** | 4.7 |
| Discount rate for benefit obligation | **3.8** | 4.1 | **3.2** | 3.9 |
| Rate of compensation expense | **3.5** | 4.0 | **4.5** | 4.5 |
| Expected rate of return on plan assets | **6.5** | 6.5 | **5.3** | 6.0 |

### OPEB Plan Long-term Assumptions

| *(percent)* | OPEB Plan 2012 | OPEB Plan 2011 |
|---|---|---|
| Discount rate for benefit expense | **4.1 - 4.3** | 4.9 – 5.2 |
| Discount rate for benefit obligation | **3.3 - 4.0** | 4.1 – 4.3 |
| Dental care escalation rate | **4.0** | 4.0 |
| Provincial health care premium | **2.5** | 2.5 |

The average health care cost trend rate used for the benefit expense for the Canadian OPEB Plan was 7.0% for 2012, 2013 and 2014, grading 0.5% per year for four years to 5.0% in 2018 and thereafter. The average health care cost trend rate used for the obligation related to the Canadian OPEB Plan was 7.0% for 2012, 2013 and 2014, grading 0.5% per year for four years to 5.0% in 2018 and thereafter.

The average health care cost trend rate used for the benefit expense for the U.S. OPEB Plan was 8.0% for 2012 and 2013, and 7.0% for 2014, grading 0.5% per year for four years to 5.0% per year in 2018 and thereafter. The average health care cost trend rate used for the obligation related to the U.S. OPEB Plan was 8.0% for 2012 and 2013, and 7.0% for 2014, grading 0.5% per year for four years to 5.0% in 2018 and thereafter.

The medical cost trend rate assumption has a significant effect on amounts reported for the OPEB plan. A one percent increase or decrease in the estimated trend rate would have the following effects:

### Medical Cost Trend Rate Sensitivity Analysis

| *($ millions)* | 1% increase | 1% decrease |
|---|---|---|
| Effect on benefit cost recognized in net earnings | 2 | (2) |
| Effect on defined benefit obligation | 18 | (15) |

The expected rate of return on the plan assets was determined based on management's best estimate and the historical rates of return, adjusted periodically by asset category. The actual rate of return on plan assets for 2012 was 8% and 6% (2011 – 3% and 1%) for the Canadian and U.S. DB Pension Plans, respectively.

During 2012, the Company contributed $8 million (2011 – $10 million) to the defined benefit pension plan assets and is expecting to contribute $8 million in 2013. Benefits of $12 million are expected to be paid in 2013.

The Company adheres to a Statement of Investment Policies and Procedures (the "Policy"). Plan assets are allocated in accordance with the long-term nature of the obligation and comprise a balanced investment based on interest rate and inflation sensitivities. The Policy explicitly prescribes diversification parameters for all classes of investment.

The composition of the DB Pension Plan assets at December 31, 2012 and 2011 was as follows:

### DB Pension Plan Assets

| *(percent)* | Target allocation range | 2012 | 2011 |
|---|---|---|---|
| Money market type funds | 0 - 7 | – | 6.8 |
| Equity securities | 50 - 80 | **59.8** | 56.1 |
| Debt securities | 30 - 50 | **39.6** | 36.7 |
| Real estate | 0 - 5 | – | – |
| Other | 0 - 15 | **0.6** | 0.4 |

## Note 20 Commitments and Contingencies

At December 31, 2012, the Company had commitments that require the following minimum future payments which are not accrued for in the consolidated balance sheet:

### Minimum Future Payments for Commitments

| *($ millions)* | Within 1 year | After 1 year but not more than 5 years | More than 5 years | Total |
|---|---|---|---|---|
| Operating leases | 130 | 806 | 556 | 1,492 |
| Firm transportation agreements | 217 | 1,037 | 2,652 | 3,906 |
| Unconditional purchase obligations | 3,089 | 4,449 | 78 | 7,616 |
| Lease rentals and exploration work agreements | 85 | 386 | 571 | 1,042 |
| | 3,521 | 6,678 | 3,857 | 14,056 |

The Company has income tax filings that are subject to audit and potential reassessment. The findings may impact the tax liability of the Company. The final results are not reasonably determinable at this time and management believes that it has adequately provided for current and deferred income taxes.

The Company is involved in various claims and litigation arising in the normal course of business. While the outcome of these matters is uncertain and there can be no assurance that such matters will be resolved in the Company's favour, the Company does not currently believe that the outcome of adverse decisions in any pending or threatened proceedings related to these and other matters would have a material adverse impact on its financial position, results of operations or liquidity.

## Note 21 Related Party Transactions

Significant subsidiaries and jointly controlled entities at December 31, 2012 and the Company's percentage equity interest (to the nearest whole number) are set out below.

| Significant Subsidiaries and Joint Operations | % | Jurisdiction |
|---|---|---|
| Subsidiary of Husky Energy Inc. | | |
| Husky Oil Operations Limited | 100 | Alberta |
| Subsidiaries and jointly controlled entities of Husky Oil Operations Limited | | |
| Husky Oil Limited Partnership | 100 | Alberta |
| Husky Terra Nova Partnership | 100 | Alberta |
| Husky Downstream General Partnership | 100 | Alberta |
| Husky Energy Marketing Partnership | 100 | Alberta |
| Sunrise Oil Sands Partnership | 50 | Alberta |
| BP-Husky Refining LLC | 50 | Delaware |
| Lima Refining Company | 100 | Delaware |
| Husky Marketing and Supply Company | 100 | Delaware |

Each of the related party transactions described below was made on terms equivalent to those that prevail in arm's length transactions unless otherwise noted.

On May 11, 2009, the Company issued 5-year and 10-year senior notes of U.S. $251 million and U.S. $107 million, respectively, to certain management, shareholders, affiliates and directors. The coupon rates offered were 5.90% and 7.25% for the 5-year and 10-year tranches, respectively. Subsequent to this offering, U.S. $122 million of the 5-year senior notes and U.S. $75 million of the 10-year senior notes issued to related parties were sold to third parties. These transactions were measured at fair market value at the date of the transaction and have been carried out on the same terms as would have applied with unrelated parties. At December 31, 2012, the senior notes are included in long-term debt in the Company's consolidated balance sheet.

In April 2011, the Company sold its 50% interest in the Meridian cogeneration facility ("Meridian") at Lloydminster to a related party. The consideration for the Company's share of Meridian was $61 million, resulting in no net gain or loss on the transaction.

The Company sells natural gas to, and purchases steam from, Meridian and other cogeneration facilities owned by a related party. These natural gas sales and steam purchases are related party transactions and have been measured at fair value. For the year ended December 31, 2012, the amount of natural gas sales to Meridian and other cogeneration facilities owned by the related party totalled $74 million (2011 - $108 million). For the year ended December 31, 2012, the amount of steam purchases by the Company from Meridian totalled $13 million (2011 - $19 million). In addition, the Company provides cogeneration and facility support services to Meridian, measured on a cost recovery basis. For the year ended December 31, 2012, the total cost recovery for these services was $19 million (2011 - $16 million).

On June 29, 2011, the Company issued 7.4 million common shares at a price of $27.05 per share for total gross proceeds of $200 million via private placement to its principal shareholders, L.F. Investments (Barbados) Limited and Hutchison Whampoa Luxembourg Holdings S.à.r.l.

The total compensation expense recognized in purchases of crude oil and products and selling, general and administrative expenses in the consolidated statements of income for the year ended December 31, 2012 was $673 million (2011 – $588 million) as follows:

## Compensation of Employees

| *($ millions)* | **2012** | 2011 |
|---|---|---|
| Short-term employee benefits | **661** | 615 |
| Post-employment benefits | **42** | 37 |
| Stock-based compensation | **54** | (1) |
| | **757** | 651 |
| Less: capitalized portion | **(84)** | (63) |
| | **673** | 588 |

The amounts disclosed in the table below are the amounts recognized as an expense during the reporting period related to key management personnel. The Company defines its key management as the officers and executives within the executive department of the Company.

## Compensation of Key Management Personnel

| *($ millions)* | **2012** | 2011 |
|---|---|---|
| Short-term employee benefits | **11** | 11 |
| Post-employment benefits | **–** | – |
| Stock-based compensation | **4** | (2) |
| | **15** | 9 |

Short-term employee benefits are comprised of salary and benefits earned during the year, plus cash bonuses awarded during the year. Annual bonus awards settled in shares are included in stock-based compensation expense in the consolidated statements of income.

Post-employment benefits represent the estimated cost to the Company to provide either a defined benefit pension plan or a defined contribution pension plan, and other post-retirement benefits for the current year of service (refer to Note 19).

Stock-based compensation expense represents the cost to the Company for participation in share-based payment plans (refer to Note 18).

# Note 22 Financial Instruments and Risk Management

## Financial Instruments

The Company's financial instruments include cash and cash equivalents, accounts receivable, contribution receivable, accounts payable and accrued liabilities, long-term debt, contribution payable, and portions of other assets and other long-term liabilities.

The following table summarizes by measurement classification, derivatives, contingent consideration and hedging instruments that are carried at fair value in the consolidated balance sheets:

### Financial Instruments at Fair Value

| *($ millions)* | **December 31, 2012** | December 31, 2011 |
|---|---|---|
| Derivatives – FVTPL (held-for-trading) | | |
| Accounts receivable | **13** | 65 |
| Accounts payable and accrued liabilities | **(5)** | (45) |
| Other assets, including derivatives | **1** | 2 |
| Other – FVTPL (held-for-trading)[1] | | |
| Accounts payable and accrued liabilities | **(27)** | (17) |
| Other long-term liabilities | **(78)** | (112) |
| Hedging instruments | | |
| Other assets, including derivatives | **1** | – |
| Accounts payable and accrued liabilities | **–** | (93) |
| Long-term debt[2] | **25** | (13) |
| | **(70)** | (213) |
| Net gains (losses) for the year related to financial instruments held at fair value | **122** | (73) |
| Included in net earnings | **104** | (55) |
| Included in OCI | **18** | (18) |

[1] *Non-derivative items related to contingent consideration recognized as part of a business acquisition.*

[2] *Represents the foreign exchange adjustment related to translation of U. S. denominated long-term debt designated as a hedge of the Company's net investment in its U.S. refining operations.*

The Company's other financial instruments that are not related to derivatives, contingent consideration or hedging activities are included in cash and cash equivalents, accounts receivable, contribution receivable, accounts payable and accrued liabilities, long-term debt, other long-term liabilities and contribution payable. These financial instruments are classified as loans and receivables or other financial liabilities and are carried at amortized cost. Excluding long-term debt, the carrying values of these financial instruments and cash and cash equivalents approximate their fair values.

The fair value of long-term debt represents the present value of future cash flows associated with the debt. Market information such as treasury rates and credit spreads are used to determine the appropriate discount rates. These fair value determinations are compared to quotes received from financial institutions to ensure reasonability. The estimated fair value of long-term debt at December 31, 2012 was $4.6 billion (December 31, 2011 – $4.4 billion).

The Company's financial assets and liabilities that are recorded at fair value on a recurring basis have been categorized into one of three categories based upon the fair value hierarchy. Level 1 fair value measurements are determined by reference to quoted prices in active markets for identical assets and liabilities. Fair value measurements of assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant outputs are observable, either directly or indirectly. Level 3 fair value measurements are based on inputs that are unobservable and significant to the overall fair value measurement. The following table summarizes the Company's assets and liabilities recorded at fair value on a recurring basis:

### Fair Value Hierarchy

| *($ millions)* | **December 31, 2012** | December 31, 2011 |
|---|---|---|
| Financial assets | | |
| Level 2 | **15** | 67 |
| Financial liabilities | | |
| Level 2 | **20** | (151) |
| Level 3 | **(105)** | (129) |
| | **(70)** | (213) |

Contingent consideration payments, based on the average differential between heavy and synthetic crude oil prices until 2014, are classified as Level 3 fair value measurements and included in accounts payable and accrued liabilities and other long-term liabilities. The fair value of the contingent consideration is determined through forecasts of synthetic crude oil volumes, crude oil prices, and forward price differentials deemed specific to the Company's Upgrader. A reconciliation of changes in fair value of financial liabilities classified in Level 3 is provided below:

### Level 3 Valuations

| *($ millions)* | **2012** | 2011 |
|---|---|---|
| Beginning of year | **129** | 53 |
| Accretion | **11** | 6 |
| Upside interest payment | **(17)** | – |
| Increase (decrease) on revaluation(1) | **(18)** | 70 |
| End of year | **105** | 129 |
| Expected to be incurred within 1 year | **27** | 17 |
| Expected to be incurred beyond 1 year | **78** | 112 |

(1) *Revaluation of the contingent consideration liability is recorded in other – net in the consolidated statements of income.*

## Risk Management Overview

The Company is exposed to market risks related to the volatility of commodity prices, foreign exchange and interest rates. It is also exposed to financial risks related to liquidity and credit and contract risks. In certain instances, the Company uses derivative instruments to manage the Company's exposure to these risks. The Company employs risk management strategies and policies to ensure that any exposures to risk are in compliance with the Company's business objectives and risk tolerance levels.

Responsibility for risk management is held by the Company's Board of Directors and is implemented and monitored by senior management within the Company.

## a) Market Risk

### i) Commodity Price Risk Management

In certain instances, the Company uses derivative commodity instruments to manage exposure to price volatility on a portion of its oil and gas production and firm commitments for the purchase or sale of crude oil and natural gas.

The Company's results will also be impacted by a decrease in the price of crude oil inventory. The Company has crude oil inventories that are feedstock, held at terminals, or part of the in-process inventories at its refineries and at offshore sites. These inventories are subject to a lower of cost or net realizable value test on a monthly basis.

### ii) Foreign Exchange Risk Management

The Company's results are affected by the exchange rates between various currencies, including the Canadian and U.S. dollar. The majority of the Company's revenues are received in U.S. dollars or from the sale of oil and gas commodities that receive prices determined by reference to U.S. benchmark prices. An increase in the value of the Canadian dollar relative to the U.S. dollar will decrease the revenues received from the sale of oil and gas commodities. Correspondingly, a decrease in the value of the Canadian dollar relative to the U.S. dollar will increase the revenues received from the sale of oil and gas commodities. The majority of the Company's expenditures are in Canadian dollars. The Company enters into short-dated foreign exchange contracts to fix the exchange rate for conversion of U.S. revenue dollars to hedge against these fluctuations and to mitigate its exposure to foreign exchange risk.

A change in the value of the Canadian dollar against the U.S. dollar will also result in an increase or decrease in the Company's U.S. dollar denominated debt, as expressed in Canadian dollars, as well as the related finance expense. In order to mitigate the Company's exposure to long-term debt affected by the U.S./Canadian dollar exchange rate, the Company may enter into cash flow hedges using cross currency debt swap arrangements. In addition, a portion of the Company's U.S. dollar denominated debt has been designated as a hedge of a net investment in a foreign operation which has a U.S. dollar functional currency. The unrealized foreign exchange gain related to this hedge is recorded in OCI.

At December 31, 2012, the Company had designated U.S. $2.8 billion of its U.S. denominated debt as a hedge of the Company's net investment in its U.S. refining operations (December 31, 2011 – U.S. $1.3 billion). Of this amount, U.S. $700 million was designated in the first quarter of 2012 and included the U.S. $500 million of the 3.95% senior unsecured notes issued on March 22, 2012. During the third quarter of 2012, U.S. $800 million was designated, including U.S. $50 million of the 7.25% notes and U.S. $750 million of the 5.90% notes issued in 2009. For the year ended December 31, 2012, the unrealized loss arising from the translation of the debt was $15 million (2011 – loss of $18 million), net of tax of $2 million (2011 – $3 million), which was recorded in OCI. At December 31, 2012, the fair value of the hedge was $97 million recorded in long-term debt in the consolidated balance sheets (December 31, 2011 - $80 million).

### iii) Interest Rate Risk Management

Interest rate risk is the impact of fluctuating interest rates on earnings, cash flows and valuations. To mitigate risk related to interest rates, the Company may enter into fair value hedges using interest rate swaps. At December 31, 2012, the balance in long-term debt related to deferred gains resulting from unwound interest rate swaps that were designated as a fair value hedge was $72 million (December 31, 2011 – $93 million). The amortization of the accrued gain upon terminating the interest rate swaps resulted in an offset to finance expenses of $21 million for the year ended December 31, 2012 (2011 – offset of $9 million).

Cash flow hedges may also be used to mitigate risk related to interest rates. At December 31, 2012, the Company had entered into a cash flow hedge using forward starting interest rate swap arrangements whereby the Company fixed the underlying U.S. 10-year Treasury Bond rate on U.S. $500 million to June 16, 2014, which is the Company's forecasted debt issuance on the same date. The effective portion of these contracts has been recorded at fair value in other assets; there was no ineffective portion at December 31, 2012. The forward starting swaps have the following terms and fair value as at December 31, 2012:

| | | December 31, 2012 | |
|---|---|---|---|
| **Forward Starting Swaps** *($ millions)* | Swap Rate[(1)] | Notional Amount *(U.S. $ millions)* | Fair Value |
| Swap Maturity | | | |
| June 15, 2024 | 2.24% | **105** | **–** |
| June 16, 2024 | 2.25% | **310** | **1** |
| June 17, 2024 | 2.24% | **85** | **–** |
| | | **500** | **1** |

(1) *Weighted average rate.*

### iv) Financial Position of Market Risk Management Contracts

The Company has the following risk management contracts and related inventory recognized at fair value in the consolidated balance sheets at December 31, 2012 and 2011:

| Financial Position ($ millions) | December 31, 2012 Asset | December 31, 2012 Liability | December 31, 2012 Net | December 31, 2011 Asset | December 31, 2011 Liability | December 31, 2011 Net |
|---|---|---|---|---|---|---|
| Commodity Price | | | | | | |
| Natural gas contracts | **3** | **(2)** | **1** | 2 | (2) | – |
| Natural gas storage contracts | **10** | **–** | **10** | 32 | (8) | 24 |
| Natural gas storage inventory[(1)] | **6** | **–** | **6** | (9) | – | (9) |
| Crude oil contracts[(2)] | **–** | **–** | **–** | – | (8) | (8) |
| Crude oil inventory[(3)] | **–** | **–** | **–** | 2 | – | 2 |
| Crude oil contracts | **–** | **(3)** | **(3)** | – | (4) | (4) |
| Crude oil inventory[(4)] | **53** | **–** | **53** | 6 | – | 6 |
| Foreign Currency | | | | | | |
| Cross currency swaps[(5)] | **–** | **–** | **–** | – | (2) | (2) |
| Foreign currency forwards | **–** | **–** | **–** | 1 | – | 1 |
| Interest Rates | | | | | | |
| Forward starting swaps | **1** | **–** | **1** | – | – | – |
| | **73** | **(5)** | **68** | 34 | (24) | 10 |

(1) *Represents the fair value adjustment to inventory recognized in the consolidated balance sheets related to third-party physical purchase and sale contracts for natural gas held in storage. Total fair value of the related natural gas storage inventory was $107 million at December 31, 2012 (December 31, 2011 – $121 million).*

(2) *Certain crude oil physical purchase contracts were designated as a fair value hedge against changes in the fair value of the related inventory held in storage. During 2012, the fair value hedging relationship was discontinued and only fair value changes related to the derivative contracts continued to be recorded in the consolidated balance sheets.*

(3) *Represents the fair value adjustment to inventory recognized in the consolidated balance sheets related to the crude oil physical purchase contracts designated as a fair value hedge. During 2012, the fair value hedging relationship was discontinued and the total fair value adjustment of the related crude oil inventory was nil at December 31, 2012 (December 31, 2011 – $16 million).*

(4) *Represents the fair value adjustment to inventory recognized in the consolidated balance sheets related to third-party crude oil physical purchase and sale contracts. Total fair value adjustment of the related crude oil inventory was $221 million at December 31, 2012 (December 31, 2011 – $147 million).*

(5) *Represents the fair value adjustment to cross currency swaps related to a portion of the Company's U.S. denominated debt designated in a cash flow hedging relationship for foreign currency risk management. The hedging relationship expired in the second quarter of 2012 with the repayment of the related U.S. $400 million of 6.25% notes which matured on June 15, 2012 and the settlement of the cross currency swaps on the same day. Refer to Note 13.*

### v) Earnings Impact of Market Risk Management Contracts

The gains (losses) recognized on risk management positions for the years ended December 31, 2012 and 2011 are set out below. All gains (losses) are unrealized, unless otherwise noted.

| Earnings Impact<br>*($ millions)* | 2012<br>Marketing and Other | <br>Purchases of Crude Oil and Products | <br>Other – Net | <br>Net Foreign Exchange Gains (Losses) | <br>OCI |
|---|---|---|---|---|---|
| Commodity Price | | | | | |
| Natural gas | **2** | **–** | **–** | **–** | **–** |
| Crude oil[1] | **48** | **(2)** | **–** | **–** | **–** |
| | **50** | **(2)** | **–** | **–** | **–** |
| Foreign Currency | | | | | |
| Cross currency swaps[2] | **–** | **–** | **(2)** | **2** | **2** |
| Foreign currency forwards[3] | **–** | **–** | **(1)** | **(5)** | **–** |
| | **–** | **–** | **(3)** | **(3)** | **2** |
| Interest Rates | | | | | |
| Forward starting swaps | **–** | **–** | **–** | **–** | **1** |
| | **50** | **(2)** | **(3)** | **(3)** | **3** |

| Earnings Impact<br>*($ millions)* | 2011<br>Marketing and Other | <br>Purchases of Crude Oil and Products | <br>Other – Net | <br>Net Foreign Exchange Gains (Losses) | <br>Finance Expenses |
|---|---|---|---|---|---|
| Commodity Price | | | | | |
| Natural gas | (11) | – | – | – | – |
| Crude oil[1] | 4 | (6) | – | – | – |
| | (7) | (6) | – | – | – |
| Foreign Currency | | | | | |
| Cross currency swaps | – | – | 2 | 7 | – |
| Foreign currency forwards[3] | – | – | 1 | (5) | – |
| | – | – | 3 | 2 | – |
| Interest Rates | | | | | |
| Interest rate swaps[4] | – | – | – | – | 13 |
| | (7) | (6) | 3 | 2 | 13 |

*(1) Certain crude oil physical purchase contracts were designated as a fair value hedge with fair value changes recognized in purchases of crude oil and products in the consolidated statements of income. During 2012, the fair value hedging relationship was discontinued and only fair value changes related to the derivative contracts continued to be recorded in purchases of crude oil and products.*

*(2) A portion of the Company's U.S. denominated debt was designated in a cash flow hedging relationship for foreign currency risk management, with the use of cross currency swaps, until expiration of the hedging relationship in the second quarter of 2012 with the repayment of the related U.S. $400 million of 6.25% notes which matured on June 15, 2012 and the settlement of the cross currency swaps on the same day. Refer to Note 13. The balance of $2 million included in other reserves was reclassified into net earnings upon the repayment of the debt and concurrent settlement of the cross currency swaps.*

*(3) Unrealized gains or losses from short-dated foreign currency forwards are included in other – net, while realized gains or losses are included in net foreign exchange gains in the consolidated statements of income.*

*(4) A portion of the Company's debt was designated in a fair value hedging relationship for interest rate risk management and recorded at fair value until discontinuation of the hedging relationship in 2011. Amortization of the accrued gain recognized upon termination of the interest rate swaps is not included in this table and is discussed in the Interest Rate Swaps section below.*

#### vi) Market Risk Sensitivity Analysis

A sensitivity analysis for commodities, foreign currency exchange, and interest rate risks has been calculated by increasing or decreasing commodity prices, foreign currency exchange rates, or interest rates as appropriate. These sensitivities represent the increase or decrease in earnings before income taxes resulting from changing the relevant rates with all other variables held constant. These sensitivities have only been applied to financial instruments and related inventories held at fair value. The Company's process for determining these sensitivities has not changed during the year.

**Commodity Price Risk**[1]

| *($ millions)* | 10% price increase | 10% price decrease |
|---|---|---|
| Crude oil price | 36 | (36) |
| Natural gas price | – | – |

**Foreign Exchange Rate**[2]

| *($ millions)* | Canadian dollar $0.01 increase | Canadian dollar $0.01 decrease |
|---|---|---|
| U.S. dollar per Canadian dollar | 1 | (1) |

**Interest Rate**[3]

| *($ millions)* | 100 basis point increase | 100 basis points decrease |
|---|---|---|
| LIBOR | 44 | (50) |

(1) *Based on average crude oil and natural gas market prices as at December 31, 2012.*
(2) *Based on the U.S./Canadian dollar exchange rate as at December 31, 2012.*
(3) *Based on U.S. LIBOR as at December 31, 2012.*

## b) Financial Risk

#### i) Liquidity Risk Management

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price. The Company's processes for managing liquidity risk include ensuring, to the extent possible, that it has access to multiple sources of capital including cash and cash equivalents, cash from operating activities, undrawn credit facilities, and availability to raise capital from various debt capital markets under its shelf prospectuses. The Company prepares annual capital expenditure budgets, which are monitored and updated as required. In addition, the Company requires authorizations for expenditures on projects, which assists with the management of capital.

Since the Company operates in the upstream oil and gas industry, it requires significant cash to fund capital programs necessary to maintain or increase production, develop reserves, acquire strategic oil and gas assets, repay maturing debt and pay dividends. The Company's upstream capital programs are funded principally by cash provided from operating activities and issuances of debt and equity. During times of low oil and gas prices, a portion of capital programs can generally be deferred. However, due to the long cycle times and the importance to future cash flow of maintaining the Company's production, it may be necessary to utilize alternative sources of capital to continue the Company's strategic investment plan during periods of low commodity prices. As a result, the Company frequently evaluates the options available with respect to sources of short and long-term capital resources. Occasionally, the Company will economically hedge a portion of its production to protect cash flow in the event of commodity price declines.

The Company had the following available credit facilities as at December 31, 2012:

**Credit Facilities**

| *($ millions)* | Available | Unused |
|---|---|---|
| Operating facilities[1] | **515** | **280** |
| Syndicated bank facilities | **3,100** | **3,100** |
| | **3,615** | **3,380** |

(1) *Consists of demand credit facilities.*

In addition to the credit facilities listed above, the Company had unused capacity under the universal short form base shelf prospectus filed in Canada of $3.0 billion and unused capacity under the universal short form base shelf prospectus filed in the

United States of U.S. $1.5 billion. The unused capacity of two Canadian shelf prospectuses expired in 2012. The unused capacity of $300 million under the debt shelf prospectus filed in Canada in December 2009 expired in January 2012 and the unused capacity of $1.4 billion under the debt shelf prospectus filed in Canada in November 2010 expired in December 2012. The ability of the Company to raise additional capital utilizing these prospectuses is dependent on market conditions.

The Company believes it has sufficient funding through the use of these facilities and access to the capital markets to meet its future capital requirements.

The following are the contractual maturities of the Company's financial liabilities as at December 31, 2012:

### Contractual Maturities of Financial Liabilities

| *($ millions)* | 2013 | 2014 | 2015 | 2016 | 2017 | Thereafter |
|---|---|---|---|---|---|---|
| Accounts payable and accrued liabilities | 2,986 | – | – | – | – | – |
| Other long-term liabilities | 3 | 52 | 38 | 3 | 3 | 29 |
| Long-term debt | 227 | 951 | 477 | 371 | 455 | 3,125 |

The Company's contribution payable pursuant to the joint arrangement with BP is payable between December 31, 2012 and December 31, 2015, with the final balance due and payable by December 31, 2015. Refer to Note 8 and Note 20 for additional contractual obligations.

### ii) Credit and Contract Risk Management

Credit and contract risk represent the financial loss that the Company would suffer if a counterparty in a transaction fails to meet its obligations in accordance with the agreed terms. The Company actively manages its exposure to credit and contract execution risk from both a customer and a supplier perspective. The Company's accounts receivables are broad based with customers in the energy industry and midstream and end user segments and are subject to normal industry risks. The Company's policy to mitigate credit risk includes granting credit limits consistent with the financial strength of the counterparties and customers, requiring financial assurances as deemed necessary, reducing the amount and duration of credit exposures and close monitoring of all accounts. The Company did not have any external customers that constituted more than 10% of gross revenues during the years ended December 31, 2012 and December 31, 2011, with the exception of the Company's joint venture partner BP, relating to revenues from the BP-Husky Toledo Refinery.

Cash and cash equivalents include cash bank balances and short-term deposits maturing in less than three months. The Company manages the credit exposure related to short-term investments by monitoring exposures daily on a per issuer basis relative to predefined investment limits.

The carrying amounts of cash and cash equivalents, accounts receivable and contribution receivable represent the Company's maximum credit exposure.

The Company's accounts receivable was aged as follows at December 31, 2012:

### Accounts Receivable Aging

| *($ millions)* | **December 31, 2012** |
|---|---|
| Current | **1,245** |
| Past due (1 – 30 days) | **95** |
| Past due (31 – 60 days) | **10** |
| Past due (61 – 90 days) | **6** |
| Past due (more than 90 days) | **16** |
| Allowance for doubtful accounts | **(23)** |
| | **1,349** |

The Company recognizes a valuation allowance when collection of accounts receivable is in doubt. Accounts receivable are impaired directly when collection of accounts receivable is no longer expected. For the year ended December 31, 2012, the Company impaired $4 million (2011 – $3 million) of uncollectible receivables.

## Note 23 Capital Disclosures

The Company's objectives when managing capital are to maintain a flexible capital structure, which optimizes the cost of capital at acceptable risk, and to maintain investor, creditor and market confidence to sustain the future development of the business. The Company manages its capital structure and makes adjustments as economic conditions and the risk characteristics of its underlying assets change. The Company considers its capital structure to include shareholders' equity and debt which at December 31, 2012 was $23.1 billion (December 31, 2011 – $21.7 billion). To maintain or adjust the capital structure, the Company may, from time to time, issue shares, raise debt and/or adjust its capital spending to manage its current and projected debt levels.

The Company monitors capital based on the current and projected ratios of debt to cash flow (defined as total debt divided by cash flow – operating activities plus non-cash charges before settlement of asset retirement obligations, income taxes paid, interest received and changes in non-cash working capital) and debt to capital employed (defined as total debt divided by total debt and shareholders' equity). The Company's objective is to maintain a debt to capital employed target of less than 25% and a debt to cash flow ratio of less than 1.5 times. At December 31, 2012, debt to capital employed was 17% (December 31, 2011 – 18%) which was below the long-term range, providing the financial flexibility to fund the Company's capital program and profitable growth opportunities. At December 31, 2012, debt to cash flow was 0.8 times (December 31, 2011 – 0.8 times). The ratio may increase at certain times as a result of capital spending. To facilitate the management of this ratio, the Company prepares annual budgets, which are updated depending on varying factors such as general market conditions and successful capital deployment. The annual budget is approved by the Board of Directors.

The Company's share capital is not subject to external restrictions; however, the syndicated credit facilities include a debt to cash flow covenant. The Company was fully compliant with these covenants at December 31, 2012.

There were no changes in the Company's approach to capital management from the previous year.

## Note 24 Government Grants

The Company has government assistance programs in place where it receives funding based on ethanol production and sales from the Lloydminster and Minnedosa ethanol plants from the Department of Natural Resources and the Government of Manitoba. The programs expire in 2015 and applications for funding are submitted quarterly. During 2012, the Company received $40 million (2011 – $38 million) under these programs. The grants accrued for operational purposes have been recorded as revenues in the consolidated statements of income.