BRAZILIAN PETROLEUM CORP
Form 6-K
November 28, 2006

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

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

For the month of November, 2006

Commission File Number 1-15106

PETRÓLEO BRASILEIRO S.A. - PETROBRAS

(Exact name of registrant as specified in its charter)

Brazilian Petroleum Corporation - PETROBRAS

(Translation of Registrant's name into English)

Avenida República do Chile, 65
20031-912 - Rio de Janeiro, RJ
Federative Republic of Brazil
(Address of principal executive office)

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

Form 20-F ___X___ Form 40-F _______

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

Yes _______ No___X____

Consolidated Financial Statements

Petróleo Brasileiro S.A. -
PETROBRAS and Subsidiaries

September 30, 2006 and 2005
with Review Report of Independent
Registered Public Accounting Firm

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PETRÓLEO BRASILEIRO S.A. - PETROBRAS AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

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Review Report of Independent Registered Public
Accounting Firm

The Board of Directors and Shareholders of
Petróleo Brasileiro S.A. - PETROBRAS
Rio de Janeiro - RJ

We have reviewed the accompanying condensed consolidated balance sheet of Petróleo Brasileiro S.A. - PETROBRAS (and subsidiaries) as of September 30, 2006, the related condensed consolidated statements of income, cash flows and changes in shareholders equity for the nine-month period ended September 30, 2006. These condensed consolidated financial statements are the responsibility of the Company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States.

The consolidated financial statements of Petróleo Brasileiro S.A. PETROBRAS as of and for the year ended December 31, 2005, were audited by other independent registered public accounting firm whose report dated February 17, 2006, expressed an unqualified opinion on those consolidated financial statements. Such consolidated financial statements were not audited by us and, accordingly, we do not express an opinion or any form of assurance as to the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2005. Additionally, the condensed consolidated statements of income, cash flows and changes in shareholders equity for the nine-month period ended September 30, 2005 were reviewed by another independent registered public accounting firm, who issued an unqualified review report dated November 11, 2005. These condensed consolidated financial statements were not reviewed or audited by us, and accordingly, we do not express an opinion or any form of assurance as to those statements.

November 17, 2006

KPMG Auditores Independentes

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PETRÓLEO BRASILEIRO S.A. - PETROBRAS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
September 30, 2006 and December 31, 2005
Expressed in Millions of United States Dollars

	September 30, 2006	December 31, 2005
	(unaudited)	(Note 1)
Assets		
Current assets		
Cash and cash equivalents	**11,097**	9,871
Marketable securities	**219**	456
Accounts receivable, net	**6,430**	6,184
Inventories (Note 5)	**6,796**	5,305
Deferred income taxes	**449**	473
Recoverable taxes	**2,531**	2,087
Advances to suppliers	**905**	652
Other current assets	**901**	750
	29,328	25,778
Property, plant and equipment, net	**53,516**	45,920
Investments in non-consolidated companies and other investments	**3,115**	1,810
Other assets		
Accounts receivable, net	**1,049**	642
Advances to suppliers	**422**	462
Petroleum and alcohol account - receivable from Federal Government (Note 6)	**360**	329
Government securities	**445**	364
Marketable securities	**183**	129
Restricted deposits for legal proceedings and guarantees (Note 13)	**828**	775
Recoverable taxes	**543**	639
Goodwill	**242**	237
Prepaid expenses	**245**	246
Inventories (Note 5)	**210**	236
Fair value asset of gas hedge (Note 3 (d))	**-**	547
Other assets	**503**	511

	5,030	5,117
Total assets	**90,989**	78,625

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

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Liabilities and shareholders equity	September 30, 2006 (unaudited)	December 31, 2005 (Note 1)
Current liabilities		
Trade accounts payable	**4,704**	3,838
Short-term debt (Note 7)	**926**	950
Current portion of long-term debt (Note 7)	**1,881**	1,428
Current portion of project financings (Note 9)	**2,496**	2,413
Current portion of capital lease obligations (Note 10)	**223**	239
Accrued interest	**198**	221
Income taxes payable	**391**	409
Taxes payable, other than income taxes	**3,613**	3,014
Payroll and related charges	**1,114**	918
Dividends and interest on capital payable	**2,076**	3,068
Contingencies (Note 13)	**39**	72
Advances from customers	**594**	609
Employees post-retirement benefits obligation - Pension (Note 11)	**186**	206
Other payables and accruals	**949**	770
	19,390	18,155
Long-term liabilities		
Long-term debt (Note 7)	**9,824**	11,503
Project financings (Note 9)	**3,800**	3,629
Capital lease obligations (Note 10)	**884**	1,015
Employees post-retirement benefits obligation - Pension (Note 11)	**4,511**	3,627
Employees post-retirement benefits obligation - Health care (Note 11)	**3,710**	3,004
Deferred income taxes	**2,307**	2,159
Provision for abandonment	**913**	842
Contingencies (Note 13)	**246**	238
Deferred purchase incentive (Note 3 (d))	**-**	144
Other liabilities	**451**	318
	26,646	26,479
Minority interest	**1,694**	1,074

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

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	September 30, 2006	December 31, 2005
Shareholders equity (Note 12)	**(unaudited)**	(Note 1)
Shares authorized and issued		
Preferred share - 2006 - 1,850,364,698 shares and 2005 - 1,849,478,028 shares	**7,718**	4,772
Common share - 2006 and 2005 - 2,536,673,672 shares	**10,959**	6,929
Capital reserve	**171**	159
Retained earnings		
Appropriated	**14,729**	20,095
Unappropriated	**18,375**	11,968
Accumulated other comprehensive income		
Cumulative translation adjustments	**(6,950)**	(9,432)
Amounts not recognized as net periodic pension cost, net of tax	**(2,078)**	(1,930)
Unrealized gains on available for sale securities, net of tax	**338**	356
Unrecognized loss on cash flow hedge	**(3)**	-
	43,259	32,917
Total liabilities and shareholders equity	**90,989**	78,625

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

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PETRÓLEO BRASILEIRO S.A. - PETROBRAS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
September 30, 2006 and 2005
Expressed in Millions of United States Dollars
(except number of shares and earnings per share)
(Unaudited)

	Nine-month period ended September 30,	
	2006	2005
Sales of products and services	**69,267**	52,555
Less:		
Value-added and other taxes on sales and services	**(13,239)**	(10,149)
Contribution of intervention in the economic domain charge - CIDE	**(2,701)**	(2,345)
Net operating revenues	**53,327**	40,061
Cost of sales	**28,744**	21,337
Depreciation, depletion and amortization	**2,616**	2,139
Exploration, including exploratory dry holes	**545**	438
Selling, general and administrative expenses	**3,636**	2,957
Research and development expenses	**511**	275
Other operating expenses	**582**	825
Total costs and expenses	**36,634**	27,971
Equity in results of non-consolidated companies	**36**	113
Financial income (Note 8)	**930**	141
Financial expenses (Note 8)	**(1,414)**	(909)
Monetary and exchange variation on monetary assets and liabilities, net (Note 8)	**107**	229
Employee benefit expense for non-active participants	**(764)**	(708)
Other taxes	**(417)**	(257)
Other expenses, net	**(58)**	(81)
	(1,580)	(1,472)
Income before income taxes and minority interest	**15,113**	10,618

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

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	Nine-month period ended September 30,	
	2006	2005
Income taxes expense (Note 4)		
Current	**(4,763)**	(2,913)
Deferred	**114**	(680)
	(4,649)	(3,593)
Minority interest in results of consolidated subsidiaries	**(424)**	(204)
Net income for the period	**10,040**	6,821
Net income applicable to each class of shares		
Common	**5,806**	3,945
Preferred	**4,234**	2,876
Net income for the period	**10,040**	6,821
Basic and diluted earnings per: (Note 12)		
Common and Preferred share	**2.29**	1.56
Common and Preferred ADS	**9.16**	6.24
Weighted average number of shares outstanding		
Common	**2,536,673,672**	2,536,673,672
Preferred	**1,849,747,602**	1,849,478,028

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

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PETRÓLEO BRASILEIRO S.A. - PETROBRAS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
September 30, 2006 and 2005
Expressed in Millions of United States Dollars
(Unaudited)

	Nine-month period ended September 30,	
	2006	2005
Cash flows from operating activities		
Net income for the period	**10,040**	6,821
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	**2,616**	2,139
Dry hole costs	**231**	252
Loss on sales of property, plant and equipment	**224**	299
Deferred income taxes	**(114)**	680
Equity in results of non-consolidated companies	**(36)**	(113)
Minority interest in results of consolidated subsidiaries	**424**	204
Foreign exchange and monetary (gain)/loss	**723**	(155)
Financial expense on hedge operations	**488**	138
Decrease (increase) in assets:		
Accounts receivable, net	**(260)**	(870)
Marketable securities	**235**	444
Inventories	**(877)**	(618)
Recoverable taxes	**(219)**	(392)
Advances to suppliers	**(103)**	(137)
Others	**170**	(154)
Increase (decrease) in liabilities:		
Trade accounts payable	**673**	931
Payroll and related charges	**130**	105
Taxes payable	**495**	439
Employees post-retirement benefits, net of unrecognized pension obligation	**969**	810
Other liabilities	**(136)**	(14)
Net cash provided by operating activities	**15,673**	10,809

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

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	Nine-month period ended September 30,	
	2006	2005
Cash flows from investing activities		
Additions to property, plant and equipment	**(9,598)**	(6,811)
Acquisition of USA trading and refine companies	**(416)**	-
Others	**140**	(100)
Net cash used in investing activities	**(9,874)**	(6,911)
Cash flows from financing activities		
Short-term debt, net of issuances and repayments	**(379)**	(1,061)
Proceeds from issuance and draw-down on long-term debt	**1,220**	776
Principal payments on long-term debt	**(2,617)**	(908)
Proceeds from project financings	**633**	1,306
Payments of project financings	**(680)**	(324)
Payments of capital lease obligations	**(238)**	(330)
Dividends paid to shareholder and minority interests	**(3,144)**	(1,909)
Net cash used in financing activities	**(5,205)**	(2,450)
Increase in cash and cash equivalents	**594**	1,448
Effect of exchange rate changes on cash and cash equivalents	**632**	1,108
Cash and cash equivalents at beginning of period	**9,871**	6,856
Cash and cash equivalents at end of period	**11,097**	9,412

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

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PETRÓLEO BRASILEIRO S.A. - PETROBRAS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
September 30, 2006 and 2005
Expressed in Millions of United States Dollars (except per-share amounts)
(Unaudited)

	Nine-month period ended September 30,	
	2006	2005
Preferred shares		
Balance at January 1	**4,772**	4,772
Capital increase from undistributed earnings reserve	**2,939**	-
Capital increase with issue of preferred shares (Note 12)	**7**	-
Balance at September 30	**7,718**	4,772
Common shares		
Balance at January 1	**6,929**	6,929
Capital increase from undistributed earnings reserve	**4,030**	-
Balance at September 30	**10,959**	6,929
Capital reserve - fiscal incentive		
Balance at January 1	**159**	134
Transfer from unappropriated retained earnings	**12**	30
Balance at September 30	**171**	164
Accumulated other comprehensive income		
Cumulative translation adjustments		
Balance at January 1	**(9,432)**	(12,539)
Foreign currency translation gain	**2,482**	5,257
Balance at September 30	**(6,950)**	(7,282)
Unrecognized loss on cash flow hedge		

Balance at January 1	**-**	-
Unrealized losses	**(5)**	-
Tax effect on above	**2**	-
Balance at September 30	**(3)**	-
Amounts not recognized as net periodic pension cost, net of tax		
Balance at January 1	**(1,930)**	(1,975)
Decrease in additional minimum liability	**(223)**	(582)
Tax effect on above	**75**	197
Balance at September 30	**(2,078)**	(2,360)

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

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	Nine-month period ended September 30,	
	2006	2005
Unrecognized gain on available for sale securities		
Balance at January 1	**356**	460
Unrealized losses	**(26)**	(67)
Tax effect on above	**8**	23
Balance at September 30	**338**	416
Appropriated retained earnings		
Legal reserve		
Balance at January 1	**2,225**	1,520
Transfer from unappropriated retained earnings, net of gain or loss on translation	**170**	296
Balance at September 30	**2,395**	1,816
Undistributed earnings reserve		
Balance at January 1	**17,439**	9,688
Capital increase	**(6,969)**	-
Transfer from unappropriated retained earnings, net of gain or loss on translation	**1,400**	1,884
Balance at September 30	**11,870**	11,572

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

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	Nine-month period ended September 30,	
	2006	2005
Statutory reserve		
Balance at January 1	**431**	318
Transfer from unappropriated retained earnings, net of gain or loss on translation	**33**	62
Balance at September 30	**464**	380
Total appropriated retained earnings	**14,729**	13,768
Unappropriated retained earnings		
Balance at January 1	**11,968**	13,199
Net income for the period	**10,040**	6,821
Dividends (2006 - US$0.46 to common and preferred shares; 2005 - US$0.21 to common and preferred shares)	**(2,018)**	(933)
Appropriation (to) fiscal incentive reserves	**(12)**	(30)
Appropriation (to) reserves	**(1,603)**	(2,242)
Balance at September 30	**18,375**	16,815
Total shareholders' equity	**43,259**	33,222
Comprehensive income is comprised as follows:		
Net income for the period	**10,040**	6,821
Cumulative translation adjustments	**2,482**	5,257
Amounts not recognized as net periodic pension cost	**(148)**	(385)
Unrealized loss on available for sale securities, net	**(18)**	(44)
Unrecognized loss on cash flow hedge	**(3)**	-
Total comprehensive income	**12,353**	11,649

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

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PETRÓLEO BRASILEIRO S.A. - PETROBRAS AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
Expressed in Millions of United States Dollars
(except as otherwise specifically indicated)
(Unaudited)

1. Basis of Financial Statements Preparation

The accompanying unaudited consolidated financial statements of Petróleo Brasileiro S.A. - PETROBRAS (the Company) have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and the rules and regulations of the Securities and Exchange Commission (SEC) for interim financial statements. Accordingly they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These unaudited consolidated financial statements and the accompanying notes should be read in conjunction with the consolidated financial statements for the year ended December 31, 2005 and the notes thereto.

The balance sheet at December 31, 2005 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

The consolidated financial statements as of September 30, 2006 and for the nine-month periods ended September 30, 2006 and 2005, included in this report, are unaudited. However, in management's opinion, such consolidated financial statements reflect all normal recurring adjustments that are necessary for a fair presentation. The results for the interim periods are not necessarily indicative of trends or of results expected for the full year ending December 31, 2006.

The preparation of these financial statements requires the use of estimates and assumptions that reflect the assets, liabilities, revenues and expenses reported in the financial statements, as well as amounts included in the notes thereto.

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

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

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2. Recently Adopted Accounting Standards

a) Emerging Issues Task Force (EITF) 04-3

At its September 2005 meeting, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 04-13, Accounting for Purchases and Sales of Inventory with the Same Counterparty. Issue 04-13 requires that two or more legally separate exchange transactions with the same counterparty, including buy/sell transactions, be combined and considered as a single arrangement for purposes of applying the provisions of Accounting Principles Board Opinion No. 29, Accounting for Nonmonetary Transactions, when the transactions are entered into in contemplation of one another. The Company adopted the EITF 04-13 on a prospective basis as from April 1, 2006. There are no new arrangements entered into, nor modifications or renewals of existing arrangements in connection with EITF 04-13 from April 1 to September 30, 2006. Net operating revenues and cost of sales were not affected by EITF 04-13.

b) SFAS No. 158 - Employers Accounting for Defined Benefit Pension and Other Postretirement Plans

In September 2006, the FASB issued SFAS No. 158 - Employers Accounting for Defined Benefit Pension and Other Postretirement Plans an Amendment of FASB Statements No. 87, 88, 106 and 132(R) (SFAS 158) , which will become effective for the Company on December 31, 2006. This standard requires the Company to recognize the overfunded or underfunded status of each of its defined benefit pension and other postretirement benefit plans as an asset or liability and to reflect changes in the funded status through Accumulated other comprehensive income, as a separate component of stockholders equity, in the year in which they occur.

Based on estimates as of September 30, 2006, the Company anticipates that upon adoption of SFAS 158 the liabilities will be increased and stockholders equity will be reduced by US$2 billion. This estimate may differ from the actual impacts at December 31, 2006, which will be based on year-end pension plan valuations and calculations of the Company s obligations as of year-end for pensions and other postretirement benefit plans.

3. Derivative Instruments, Hedging and Risk Management Activities

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

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

a) Foreign currency risk management

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

The call and put portion of the Company s zero cost foreign exchange collars at September 30, 2006 have a fair value of US$16 and US$0.04, respectively (US$12 and US$1 at December 31, 2005).

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b) Cash flow hedge

In September, 2006 PIFCo entered into cross currency swap under which it swaps principal and interest payments on Yen denominated bonds for U.S. dollar amounts. Under U.S. GAAP, foreign currency cash flow hedges can only be designated as such when hedging the risk to the entity s functional currency, and therefore, this cross currency swaps is qualified for hedge accounting designation take into account that PIFCo s functional currency is the US dollar, and the assessment of hedge effectiveness indicates that the change in fair value of the designated hedging instrument is highly effective.

The hedged item is ¥ 35 billion bond, ten-year maturity, carrying a semi-annual coupon of 2.15% p.a. The hedge instrument is a cross currency swap, ten year maturity, under which US dollars is paid and Japanese Yen is received mirroring the Yen bond conditions. The effectiveness test was made at the inception at the hedge based on the hypothetical derivative method. The effectiveness test will be made on an ongoing basis on a quartely basis.

The transaction gain or loss arising from the remeasurement of Yen denominated bonds is offset by the reclassification relating to the remeasurement of the hedged item at spot rates from other comprehensive income to earnings. The cross currency swap at September 30, 2006 had a fair value of (US$ 5) due to the devaluation of the Japanese Yen when compared to US dollar since the inception of the instrument.

c) Commodity price risk management

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

c) Commodity price risk management (Continued)

The Company's exposure on these contracts is limited to the difference between contract value and market value on the volumes hedged. Crude oil future contracts are marked to market and related gains and losses are recognized currently under earnings, irrespective of when physical crude sales occur. During the nine-month periods ended September 30, 2006 and 2005, the Company carried out economic hedging activities on 23.5% and 20.5%, respectively, of its total traded volume (imports and exports). The open positions on the futures market, compared to spot market value, resulted in a gain of US$41 and a loss of US$5 during the nine-month periods ended September 30, 2006 and 2005, respectively.

d) Natural gas derivative contract

In connection with the long-term contract to buy gas (The Gas Supply Agreement or "GSA") to supply thermoelectric plants and for other uses in Brazil, the Company entered into a contract, with Empresa Petrolera ANDINA, a gas producer in Bolivia, that constituted a derivative financial instrument under SFAS 133. This contract, the Natural Gas Price Volatility Reduction Contract (the "PVRC"), was executed with the purpose of reducing the effects of price volatility under the GSA.

The terms of the PVRC include a collar for the period from 2005 to 2019, with the Company receiving cash payments when the calculated price is above the established ceiling, and the Company making cash payments when the price is below the established floor, with no cash payments being made when the price is between the ceiling and the floor.

As of December 31, 2005, the Company recorded a derivative asset based on the fair value calculation amounting to US$547 and a liability of US$144, which is deemed a deferred purchase incentive.

Due to the new Hydrocarbons Law of Bolivia (See Note 15), the other party involved in the PVRC contested the contract, alleging among other, force majeure and excessive onus. On August 12, 2006, the parties agreed to cancel the PVRC. As a result, on August 14, 2006 the Company received US$41 and wrote-off accounts receivable related to the PVRC amounting to US$77.

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d) Natural gas derivative contract (Continued)

The Company adjusted the fair value asset and liabilities related to the PVRC by recording a financial expense of US$328 during the first quarter of 2006 as a result of the tax increases in Bolivia. In the second quarter of 2006, the Company wrote-off the remaining fair value asset of US$94 as a consequence of the contract cancellation.

e) Interest rate risk management

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

f) Risk Management activity at PEPSA

From time to time, PEPSA also uses derivative instruments such as options, swaps and others, mainly to mitigate the impact of changes in crude oil prices, interest rates and future exchange rates. Such derivative instruments are designed to mitigate specific exposures, and are assessed periodically to assure high correlation of the derivative instrument to the risk exposure identified and to assure that the derivative is highly effective in offsetting changes in cash flows inherent in the covered risk. As of September 30, 2006, PEPSA did not have any position in derivative instruments covering such risks.

The Company makes forward sales of US dollars in exchange for Argentine pesos. As of September 30, 2006, the face value of effective contracts amounting to US$8 at the average exchange rate of 3.28 Argentine pesos per US dollar. For the nine-month period ended September 30, 2006, the Company recognized a gain of US$1.

4. Income Taxes

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

	Nine-month period ended September30,	
	2006	2005
Income before income taxes and minority interest	**15,113**	10,618
Tax expense at statutory rates - (34 %)	**(5,138)**	(3,610)
Adjustments to derive effective tax rate:		
Non-deductible post-retirement and health-benefits	**(162)**	(193)
Tax benefit on interest on shareholders equity	**683**	317
Others	**(32)**	(107)
Income tax expense per consolidated statement of income	**(4,649)**	(3,593)

5. Inventories

	September 30, 2006	December 31, 2005
Products		
Oil products	**2,591**	2,020
Fuel alcohol	**154**	66
	2,745	2,086
Raw materials, mainly crude oil	**2,812**	2,266
Materials and supplies	**1,208**	1,047
Others	**241**	142
Total	**7,006**	5,541
Current inventories	**6,796**	5,305

Long-term inventories	**210**	236

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6. Petroleum and Alcohol Account - Receivable from Federal Government

a) Changes in the Petroleum and alcohol account

The following summarizes the changes in the Petroleum and alcohol account for the nine-month period ended September 30, 2006:

	Nine-month period ended September 30, 2006
Opening balance	**329**
Financial income	**6**
Translation gain	**25**
Ending balance	**360**

The Petroleum and alcohol account arose in periods previous to December 31, 2002 as a result of regulation in the fuels market. The Federal Government has certified the balance and placed a portion of the amount (US$53) in a restricted use account.

b) Settlement of the Petroleum and alcohol account with the Federal Government

As defined in Law no. 10,742 dated October 06, 2003, the settlement of the Petroleum and alcohol account with the Federal Government should have been completed by June 30, 2004. The Company has been working with the Ministry of Mines and Energy - MME and Secretary of the National Treasury - STN in order to resolve remaining issues necessary to conclude the settlement process.

The remaining balance of the Petroleum and alcohol account may be paid as follows: (1) National Treasury Bonds issued at the same amount as the final balance of the Petroleum and alcohol account; (2) offset of the balance of the Petroleum and alcohol account, with any other amount owed by the Company to the Federal Government, including taxes; or (3) by a combination of the above options.

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7. Financings

a) Short-term debt

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

	September 30, 2006	December 31, 2005
Imports - oil and equipment	**97**	340
Working capital	**829**	610
	926	950

The weighted average annual interest rates on outstanding short-term borrowings were 4.64% and 4.09% at September 30, 2006 and December 31, 2005, respectively.

b) Long-term debt

Composition

	September 30, 2006	December 31, 2005
Foreign currency		
Notes	**4,620**	5,871
Financial institutions	**2,802**	3,215
Sale of future receivables	**696**	1,241
Suppliers credits	**1,264**	1,349
Senior exchangeable notes	**330**	330
Assets related to export program to be offset against sales of future receivables	**(150)**	(300)
Repurchased securities (1)	**(239)**	(356)
	9,323	11,350

b) Long-term debt (Continued)

	September 30, 2006	December 31, 2005
Local currency		
National Economic and Social Development Bank - BNDES	**328**	298
Debentures:		
BNDES	**539**	291
Other banks	**1,029**	935
Others	**486**	57
	2,382	1,581
Total	**11,705**	12,931
Current portion of long-term debt	**(1,881)**	(1,428)
	9,824	11,503

(1) At September 30, 2006 and December 31, 2005, the Company had amounts invested abroad in an exclusive investment fund that held debt securities of some of the PETROBRAS group companies and some of the SPEs that the Company consolidates according to FIN 46 (R), in the total amount of US$597 and US$2,078, respectively. These securities are considered to be extinguished, and thus the related amounts, together with applicable interest have been removed from the presentation of marketable securities and long-term debt, of US$239 and US$356 for September 30, 2006 and December 31, 2005, respectively and project financings, of US$358 and US$1,722, respectively (See also Note 9). Gains and losses on extinguishment are recognized as incurred. Subsequent reissuances of notes at amounts greater or lower than par are recorded as premium or discounts and are amortized over the life of the notes. Petrobras recognized a loss of US$17 on extinguishment of debt during the period ended September 30, 2005. As of September 30, 2006 , the Company had an outstanding balance of net premiums on reissuance of US$51.

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b) Long-term debt (Continued)

Composition of foreign currency denominated debt by currency

	September 30,