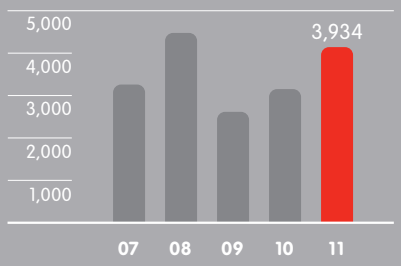
Canadian Oil Sands

2011 Annual Report

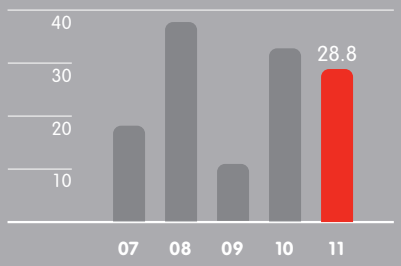
# We are driving performance

# Delivering results

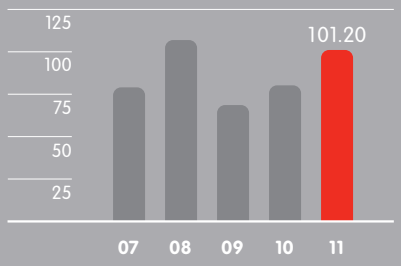
**SALES, AFTER CRUDE OIL PURCHASES AND TRANSPORTATION EXPENSE**
(in millions)




**RETURN ON AVERAGE SHAREHOLDERS EQUITY[4]**
(%)




**NET REALIZED SCO SELLING PRICE**
($/bbl)




| All references to "dollars" or "C$" are in Canadian dollars and all references to "US$" are in United States dollars | 2011 | 2010[1] | % change |
|---|---|---|---|
| **FINANCIAL** ($ millions, except per share amounts) | | | |
| Sales, after crude oil purchases and transportation expense | **3,934** | 3,180 | 24% |
| Net income | **1,144** | 1,189 | 4% |
| Per share, basic and diluted | **2.36** | 2.46 | 4% |
| Cash flow from operations[2,4] | **1,897** | 1,232 | 54% |
| Per share[4] | **3.91** | 2.55 | 53% |
| Dividends | **533** | 896 | 41% |
| Per share | **1.10** | 1.85 | 41% |
| **FINANCIAL RATIOS[4]** | | | |
| Net debt to cash flow from operations (times)[2] | **0.2** | 1.0 | |
| Net debt to total capitalization (%) | **9** | 24 | |
| Return on average shareholders' equity (%) | **28.8** | 33.0 | |
| Return on average productive capital employed (%) | **33.2** | 19.1 | |
| **OPERATIONS** | | | |
| Sales volumes, net of crude oil purchases[3] | | | |
| Total (mmbbls) | **38.7** | 39.2 | –1% |
| Daily average (bbls) | **106,015** | 107,280 | –1% |
| Operating expenses ($/bbl)[4] | **38.80** | 35.42 | 10% |
| Capital expenditures ($ millions) | **643** | 582 | 10% |
| Net realized selling price ($/bbl)[4] | **101.20** | 80.53 | 26% |
| Average West Texas Intermediate (US$/bbl) | **95.11** | 79.61 | 19% |
| Average foreign exchange rate (US$/C$) | **1.01** | 0.97 | 4% |
| **SHARE INFORMATION** | | | |
| Closing price on December 31 ($/share) | **23.25** | 26.45 | –12% |
| Number of shares outstanding (in millions) | **484.5** | 484.4 | 0% |

Certain calculations displayed above are non-GAAP financial measures. Please see the Management's Discussion and Analysis section of this report for a discussion of non-GAAP items.

A five-year statistical summary is provided on page 94.

1 Adjusted for International Financial Reporting Standards ("IFRS"). Note 26 to the 2011 annual audited consolidated financial statements discloses the impact of the transition to IFRS on the Corporation's reported financial position, income and cash flows.
2 Cash flow from operations is calculated as cash from operating activities, as reported on the Consolidated Statement of Cash Flows, before changes in non-cash working capital.
3 The Corporation's sales volumes differ from its production volumes due to changes in inventory, which are primarily in-transit pipeline volumes, and are after purchased crude oil volumes.
4 Non-GAAP measure(s).

Canadian Oil Sands Limited (COS) is a pure investment opportunity in the oil sands through our 36.74 per cent interest in the Syncrude joint venture. Syncrude has a productive capacity of 350,000 barrels per day, and has enough reserves and resources to operate at that level for decades. Unique among our peers, we are the only oil sands company whose assets are undiluted with lower-value heavy oil or natural gas, higher-risk foreign assets, or declining conventional resources; our significant cash flow stream is 100 per cent derived from high-quality, light, sweet synthetic crude.

**INSIDE THIS REPORT**



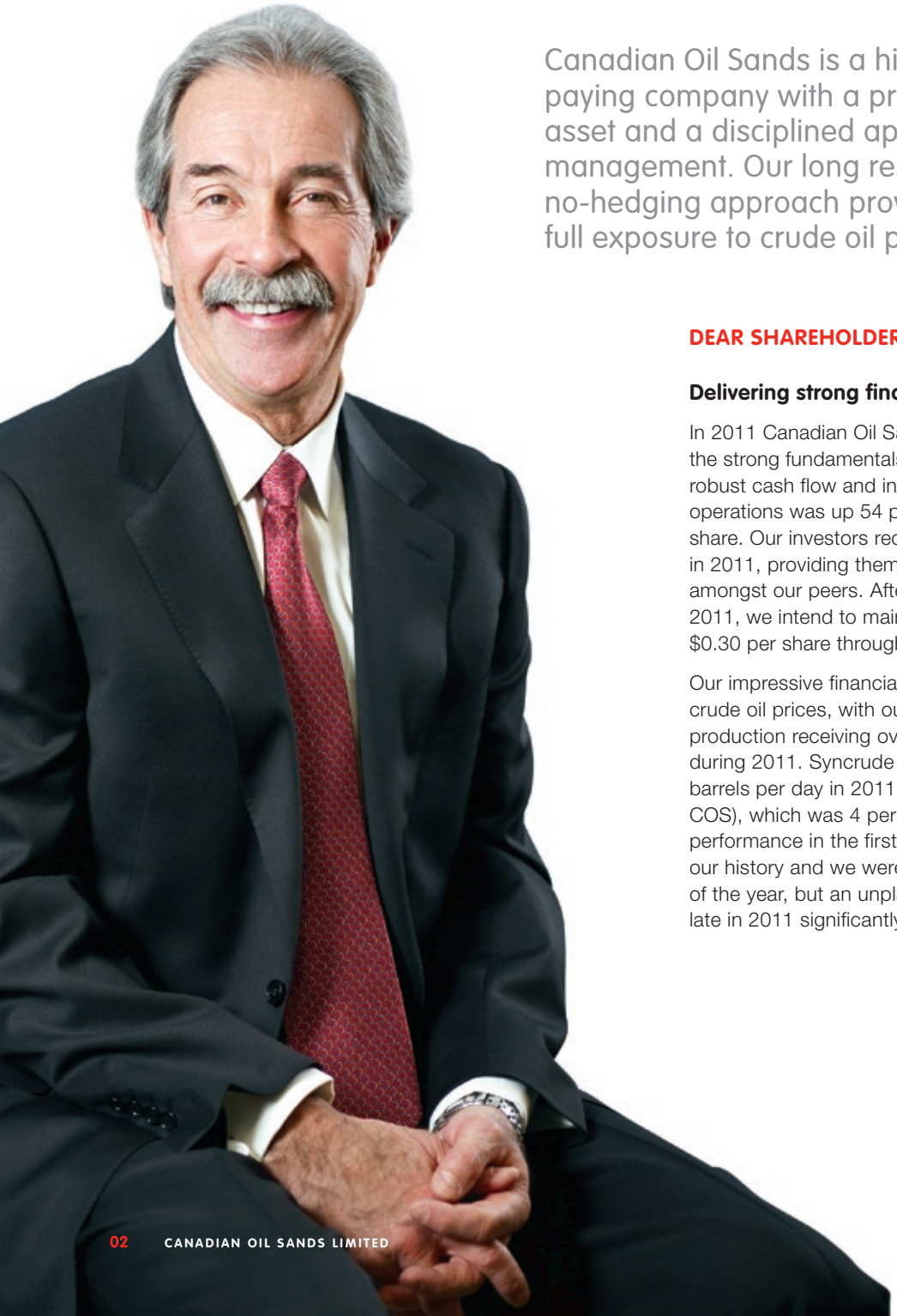





**IMPORTANT:**
Please read the Advisories regarding forward-looking information on page 91 and non-GAAP financial measures on page 92.

COVER: Syncrude's more than 5,500 employees, including Jinny (pictured), work towards the vision of securing Canada's energy future.

# Building long-term value



Canadian Oil Sands is a high-quality, dividend-paying company with a proven, producing asset and a disciplined approach to financial management. Our long resource life and no-hedging approach provides investors with full exposure to crude oil prices.

## DEAR SHAREHOLDER,

### Delivering strong financial performance

In 2011 Canadian Oil Sands (COS) once again demonstrated the strong fundamentals of its Syncrude business, generating robust cash flow and income for its investors. Cash flow from operations was up 54 per cent to $1.9 billion, or $3.91 per share. Our investors received $1.10 per share in dividends in 2011, providing them with one of the most attractive yields amongst our peers. After increasing the dividend early in 2011, we intend to maintain a quarterly dividend of at least $0.30 per share through 2012.

Our impressive financial results reflect our leverage to crude oil prices, with our high-quality, light, sweet crude oil production receiving over $100 per barrel on average during 2011. Syncrude produced an average 290,000 barrels per day in 2011 (106,000 barrels per day net to COS), which was 4 per cent below our target. Operational performance in the first half of the year was the best in our history and we were poised to meet our targets for most of the year, but an unplanned outage in a hydrogen unit late in 2011 significantly reduced volumes.

LEFT:
Marcel R. Coutu
President and Chief Executive Officer

**"COS is supporting Syncrude to achieve two priorities – improving capacity utilization, which is our highest return project, and successfully executing a multi-year major capital projects program."**

**2011 HIGHLIGHTS**

- Cash flow from operations increased 54 per cent to $1.9 billion based on strong commodity prices.
- Paid $530 million in dividends to investors ($1.10 per share).
- Achieved a record 36-month coker run length.
- Produced and sold more SCO in the first half of the year than in any comparable period in Syncrude's history.
- Announced major project capital expenditure program.

### Focused on increasing capacity rates

We achieved some important milestones that highlight progress toward our goal of increasing production rates. The turnaround of Coker 8-2 was completed as planned following a record 36-month run for bitumen throughput. The reliability of non-slurry pumps, a leading indicator of overall plant reliability, exceeded our target for the year.

Our challenge is to reduce unplanned downtime. With a cost base that is largely fixed, Syncrude is similar to a manufacturing operation; reducing the frequency and severity of outages contributes to higher production rates and lower per barrel costs.

Syncrude has a formal approach to achieving this goal through the Management Services Agreement. Under this agreement, ExxonMobil and Imperial Oil, a 25 per cent owner in the Syncrude project, are implementing their proprietary global management and reliability systems at Syncrude. We believe this will enable Syncrude to achieve industry-leading capacity utilization rates and higher production over time.

### Investing in our Syncrude asset

Syncrude is an extensive operation comprised of two separate mines and an upgrading complex that includes three cokers, the primary units for converting bitumen into synthetic oil. An outage in one area of the plant may reduce production volumes but is unlikely to affect the entire operation. This solid operating base provides COS with a strong foundation of cash flow to fund our business and pay dividends to our investors.

COS and the other Syncrude owners are investing in several major projects over the next few years to maintain and enhance this operating base as well as to improve environmental performance. These projects are detailed on page 15.

The most significant investment will be in our mining operations. By the end of 2014, Syncrude will have replaced or relocated most of its bitumen crushing and slurrying facilities. Investment in these facilities, as well as implementation of a recent technology called wet crushing, is expected to result in higher recovery rates and lower maintenance requirements.

Syncrude also is installing new equipment to process tailings material, a by-product of the bitumen extraction process. A composite tails plant and a centrifuge plant are being built to accelerate reclamation of disturbed land and reduce the size of tailings ponds.

### A strong balance sheet to control risk

During 2011, we intentionally increased liquidity to prepare for the capital expenditures that will be required over the next few years. We built up about $700 million of cash, which reduced net debt to $400 million. In 2012, we will use primarily our cash flow and some of our cash balance to fund our $0.30 per share quarterly dividend, while funding our $1.5 billion capital program; as a result, net debt levels may rise.

After 2014 our per barrel capital expenditures are expected to drop significantly, supporting free cash flow expansion and the potential for dividend increases.

Our approach to financial management at COS is designed to deliver the full value of the Syncrude asset to investors over the long term. We maintain a strong balance sheet to support our business during low points in the crude oil price cycle, to protect our investment grade credit ratings and access to capital markets, and to avoid hedging. We do not pay a dividend that the business cannot support.

**"We deliver the long-term value of our Syncrude asset through efficient capital allocation. Our priority is reinvesting in our business to maintain strong, stable and safe operations. Remaining cash is distributed to investors. This approach provides our investors with the best potential for share price appreciation while receiving an attractive dividend."**

In 2011, Syncrude achieved its goal of extending a coker run length to 36 months. Optimizing coker run lengths is an important factor in increasing capacity utilization.

This financial discipline protects the long-term value for investors by avoiding over-leveraging and equity dilution. It also provides our investors with an attractive dividend, plus the opportunity for share price appreciation.

## Looking to the future

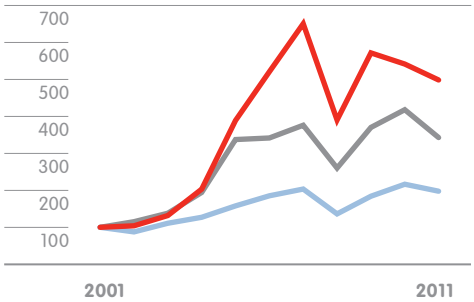
Equity markets continue to be mired in fear and pessimism over the debt crisis in Europe and America. Along with the rest of the market, COS' share price has suffered greatly from this lack of investor confidence. I have never seen our share price so disconnected from our business fundamentals and I don't believe this can continue. In time, I believe investor confidence should return and revalue COS for what it is: a high-quality, dividend-paying company with a healthy balance sheet and ability to generate strong earnings through long-life crude oil reserves.

The world will continue to need crude oil. The International Energy Agency predicts that oil will remain the dominant energy fuel through 2035. By that time demand will have grown by 14 per cent to 99 million barrels per day. Global decline rates of producing fields average 5 per cent, making it extremely challenging to replace and grow production to meet future demand.

Canada is in a strong position in the world energy market. We are not only energy self-sufficient, but we can grow our crude oil supply, in part because of assets like Syncrude. Over the next few years, Syncrude is focused on optimizing the existing operation, our most economic

**TOTAL SHAREHOLDER RETURNS[1]**

($ value based on $100 invested on December 31, 2001)

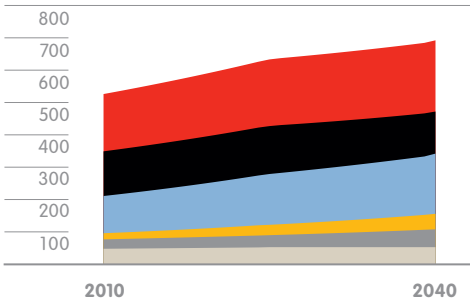



1. Capital appreciation plus reinvestment of all distributions/dividends

COS is focused on delivering solid total shareholder return over time. A $100 investment in COS on December 31, 2001 would have grown to approximately $500 at year-end 2011.

**WORLD ENERGY CONSUMPTION**

(quadrillion Btu)




SOURCE: Exxon/Mobil "2012 The Outlook for Energy: A View to 2040"

While renewables are expected to be an important and growing source of energy, world demand for crude oil is anticipated to remain strong.

Syncrude introduced a herd of wood bison into a reclaimed area in 1993 to assess the capability of the landscape to support large mammals. Today, approximately 300 wood bison graze on more than 300 hectares of land. The herd is managed cooperatively with the Fort McKay First Nation and has been recognized with several livestock awards at national competitions.

### LAND RECLAMATION FACTS

- Only 3 per cent of the surface area of Alberta's oil sands will ever be mined.
- Over 40 years, only 662 square kilometres have been mined, an area about the size of the city of Edmonton, Alberta.
- 100 per cent of disturbed land must be returned to nature and certified reclaimed by the Alberta government.
- Syncrude is a leader in land reclamation and is the only oil sands operator to receive certification for a reclaimed area.
- Syncrude has reclaimed over 3,500 hectares to date.

SOURCES: Canadian Association of Petroleum Producers and Syncrude

### 2012 FOCUS

- Increase capacity utilization towards our long-term goal of industry-leading operating performance.
- Deliver at least a $0.30 quarterly dividend per share to investors.
- Maintain a strong balance sheet.
- Invest in our business to maintain our strong operating base and advance environmental initiatives.

growth opportunity. As we approach the end of this decade, we expect to begin investment in the next stage of Syncrude's growth with a view to bringing on new volumes early in the 2020s.

I am confident that we will achieve our goals in a manner that protects the safety of our people and respects the environment. Syncrude's commitment to sustainable development was recognized in 2011 with the Mining Association of Canada Towards Sustainable Mining Award.

COS aims to deliver the full value of the Syncrude asset to investors by providing strategic oversight to Syncrude and marketing our share of production volumes. Our team of 28 employees drives value creation for shareholders, and I am very proud of and confident in their efforts.

COS benefits from the counsel of a strong board of directors. In 2011, Board member Ian Bourne was the recipient of a Fellowship Award from the Institute of Corporate Directors in recognition for his contributions to corporate governance.

I'd also like to take this opportunity to welcome two new directors who joined the COS Board since our last annual general meeting: Gerald Grandey, former President and CEO of Cameco, one of the world's largest uranium producers, and Sarah Raiss, former Executive Vice-President of Corporate Services for TransCanada, the largest natural gas transmission company in North America. Both are seasoned executives with unique points of view that enhance your already strong Board.

COS' business is extremely solid. We have a strong balance sheet to reduce risk in this volatile market. Our Syncrude asset is a significant source of cash flow generation and our long-life reserves offer future growth. Although we base our financial plan on a more conservative oil price outlook, we continue to believe strongly in a rising oil price environment, which is the main driver of our business. I look forward to delivering that value to our investors well into the future.

(signed)

**Marcel R. Coutu**
President and Chief Executive Officer
February 23, 2012

# Tracking progress

| | CORE STRATEGY | 2011 GOALS |
|---|---|---|
|  | **Maximizing the value of your COS investment** | • Improve Syncrude reliability in a safe and environmentally responsible manner.<br>• Maintain strong production and operating cost targets.<br>• Maintain discipline of paying a dividend. |
|  | **Optimizing operations** | • Achieve approximately 3 per cent production growth.<br>• Begin relocating/rebuilding mine trains.<br>• Complete detailed engineering and announce total expected cost of mine train relocations and replacements.<br>• Continue with implementation of Management Services Agreement (MSA) with ExxonMobil. |
|  | **Developing the capacity for long-term growth** | • Continue planning for upgrader and bitumen growth.<br>• Advance conceptual design to optimize scope. |
|  | **Being a responsible producer** | • Invest $290 million ($789 million gross to Syncrude) in environmental projects.<br>• Complete the Syncrude Emissions Reduction (SER) project.<br>• Complete filling the East Mine pit with composite tailings. |

We track the progress of our business across four core strategies. Here's how we measured up in 2011, and our plans for 2012.

| 2011 PROGRESS | 2012 GOALS |
| --- | --- |
| • Syncrude achieved the best first six months of production in its history, reflecting increased stability of key components such as pumps. During the last three months of the year, however, an unplanned outage in a hydrogen unit impacted year-end results. Syncrude has an excellent safety record and continues to be a responsible producer.<br>• Total operating expenses were in line with guidance, although production was lower than target. As a result, our costs per barrel were 6 per cent higher than expected.<br>• In 2011, COS paid out $1.10/share to investors. | • Pay a minimum of $0.30 in quarterly dividends per share to investors.<br>• Deliver top quartile total shareholder returns (capital appreciation plus dividends) relative to our peers.<br>• Maintain a strong balance sheet while remaining unhedged in our production, allowing investors full exposure to crude oil prices. |
| • While we did not achieve the targeted production growth, Syncrude's focus remains on improving capacity utilization. This offers the best opportunity to add significant value in the near-term.<br>• Construction has begun on the mine train relocations and rebuilds. These projects are expected to be completed by the end of 2014.<br>• Total engineered costs for the mine train projects were announced.<br>• While we are disappointed with the pace of utilization improvement at Syncrude, we believe that the leadership of ExxonMobil and Imperial Oil is establishing a strong foundation to support more predictable and robust production rates over the long term. | • Safety and health remain a priority, with COS supporting Syncrude in integrating these factors into all business decisions.<br>• Increase production by about 7 per cent. Achieve higher plant utilization, including a 36-month run-time for Coker 8-3.<br>• Maintain stable total operating costs while improving per barrel costs through increased production.<br>• Advance mine train relocations and rebuilds on-schedule and on-budget. |
| • The joint venture owners remain focused on profitably growing production over the long term, and delaying the Aurora South development should enable Syncrude to develop execution plans to better control risk and improve economics. | • Assess growth projects to optimize economics.<br>• Continue to meet the conditions of our previous approval for Aurora South.<br>• Evaluate opportunities to add value through consolidation of Syncrude interests or acquisition of other oil sands assets. |
| • Syncrude invested $442 million in 2011 ($162 million net to COS) in environmental projects to advance tailings management and other objectives. Timing adjustments resulted in a decrease in capital expenditures in 2011 on major environmental projects compared to our initial estimates, although the expected completion dates for these projects have not been affected.<br>• Construction of the $1.6 billion SER project was completed. Start-up is anticipated in 2012. Once fully operational, this project is expected to reduce Syncrude's total sulphur dioxide emissions by 60 per cent below current approved levels.<br>• East Mine pit filled in preparation for full-scale planting to begin within three years. | • Invest $1.1 billion in environmental projects ($0.4 billion net to COS).<br>• Establish a strong role for COS in Syncrude's new Safety, Health, Environment and Corporate Sustainability Committee.<br>• Continue building the industry's first end-pit lake and fen wetland.<br>• Begin construction of our commercial-scale centrifuge tailings project. |

# People
## driving performance

A small and experienced team of 28 employees, including many oil sands industry veterans, shoulders the responsibility for stewarding our Syncrude asset. While we possess complementary backgrounds and diverse points of view, we are a cohesive team that shares the same values and goals. Our strength lies in our prudent financial approach; a breadth of on-the-ground expertise that supports our commitment to driving operational reliability at Syncrude; a marketing nimbleness that allows us to act quickly to leverage market forces to our advantage; and high standards for environmental and social sustainability.

## 36.74%

**Ownership of Syncrude**

Canadian Oil Sands Limited is the largest joint venture owner of Syncrude.

## +54%

**Cash flow from operations**

COS posted strong financial results year-over-year on robust commodity markets and premium pricing for our product.

## 29%

**Return on average shareholder's equity**

Our goal is to deliver solid returns to our investors over the long term.

## 105 million

**Barrels produced**

Syncrude is the largest producer of light, sweet, synthetic crude oil in the industry.

## 6 million

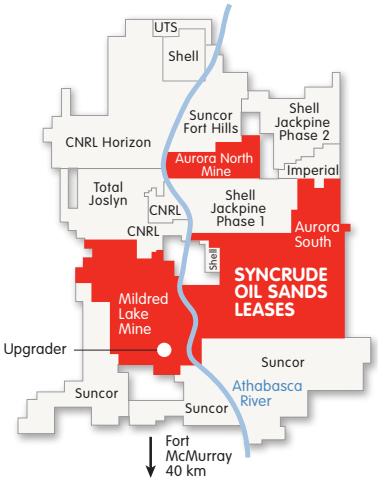
**Trees and shrubs planted to date at Syncrude**

Part of Syncrude's industry leading reclamation program.

* All figures for 2011 except as noted.

# We are a leader

COS is the largest owner in the Syncrude joint venture, a leading producer of high-quality, light, sweet synthetic crude oil in Canada's oil sands industry. We have a demonstrated commitment to developing this valuable resource responsibly.




Syncrude owns a high-quality position in the "sweet spot" of the Athabasca oil sands deposit with 4.8 billion barrels of proved and probable reserves and several billion barrels more of resources.

## High-quality investment

Syncrude was incorporated in 1964 and has produced over 2 billion barrels of crude oil since bringing on its first barrel of production in 1978. Today, Syncrude is one of the largest producers of high-quality synthetic crude oil from Canada's oil sands. A key difference between COS and conventional oil and gas producers is that we have sufficient reserves and resources today to sustain current rates of production without decline for decades.

We take pride in our investment in Syncrude. This asset combines the best aspects of an oil sands investment:

- A track record of successful operations and process improvements;
- High-quality leases that will support future production for decades;
- A responsible approach to the development of this long-life resource; and
- A product – light, sweet, synthetic crude oil – that provides the energy the world needs.

Over 5,500 employees work at Syncrude in mining, reclamation, extraction, upgrading (pictured) utilities and administration. In 2011, Syncrude was named as one of Alberta's top 50 employers.

## Stewarding a high quality asset

As success at Syncrude translates directly to value creation for COS and its shareholders, we actively steward Syncrude to reach its highest potential across the organization. COS chairs committees and is heavily involved in providing leadership and governance in almost every area of Syncrude's activities: mining and upgrader operations, finance and audit, growth and development, major projects, human resources, communications and sustainability. COS President and CEO Marcel Coutu chairs Syncrude's Management Committee that oversees the entire project on behalf of the owners.

Operations at Syncrude are supported by Imperial Oil/ExxonMobil via a long-term Management Services Agreement (MSA). The overarching goal of the MSA is to achieve industry-leading, reliable and safe operations at Syncrude through the application of ExxonMobil's global best operations practices, proprietary systems and staff expertise, combined with the depth and breadth of Syncrude's experienced workforce. Imperial Oil has a vested interest in Syncrude as the second largest owner with a 25 per cent stake.

## Oil sands innovations

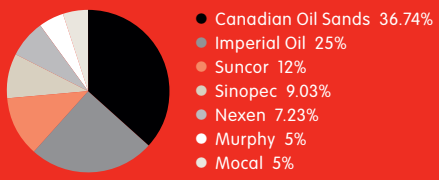
An oil sands pioneer, Syncrude has been active for over 40 years in the research and development of new technologies and innovations to reduce our impact on the environment and improve operating efficiencies. This commitment to finding new and better ways to develop this valuable resource has led to the development of many of the technologies that have become industry standards, including hydrotransport technology to substantially reduce energy requirements and advancements in reclamation.

The spirit of innovation that created the oil sands industry builds a strong foundation for future success in meeting the challenges of oil sands development. Today, Syncrude invests over $60 million every year in the industry's only dedicated research and development program. Approximately 100 scientists and technologists, including a growing number of experts dedicated to improving environmental performance, work toward tomorrow's oil sands advancements in a state-of-the-art laboratory.

**"Syncrude has a long and proud history of innovation in the oil sands. We're carrying on that tradition through our focus on continuous improvement to help meet the expectations of Canadians for responsible oil sands development."**

**SCOTT SULLIVAN**
Syncrude CEO

**SYNCRUDE JOINT VENTURE**
As of December 31, 2011




COS is the largest owner in the Syncrude joint venture, with a 36.74 per cent interest.

# We are disciplined

COS' finance team exercises financial discipline while maintaining the flexibility to respond to changing market conditions. Our goal is to create sustainable long-term value for shareholders.

COS' finance and accounting teams work collaboratively to secure ongoing access to capital markets, analyze and interpret market trends as well as produce clear and concise reporting.

ABOVE FROM LEFT: Rob Dawson, VP Finance, Philip Birkby, Controller, and Alison Trollope, Manager, Investor Relations.

### Managing a high-quality asset

COS is the only pure play in the oil sands with a production stream of 100 per cent light, sweet synthetic crude oil production. We know that many investors choose COS to gain exposure to oil prices, so we do not typically hedge our production. As a result, we must ensure that we are well-positioned to fund our business plan through periods of volatile commodity and financial markets by placing a high priority on a strong balance sheet.

Investing in our business for sustained long-term success is a priority. In 2010, Syncrude embarked on a multi-year capital program to support strong, stable, long-life production while achieving operational efficiencies and implementing technologies to manage tailings, a by-product of the bitumen extraction process.

The costs related to this program are expected to ramp up in 2012. This spending profile demanded particular prudence during 2011 to ensure that we can fund our share of Syncrude's capital expenditures. The need for prudence was amplified by global economic uncertainty creating volatility in oil prices.

### Well-positioned in a volatile market

With about $700 million of cash and $1.5 billion of available operating credit facilities at year-end 2011, we are well-positioned to fund our business plan and to weather any further softening in the global economy. Our cash balance provides COS with the capacity to maintain at least a $0.30 quarterly dividend per share in 2012, even though our free cash flow estimate is less than our anticipated 2012 dividend level under our current $90/bbl crude oil estimate. Sustaining the dividend while funding the capital program is expected to increase net debt levels from the very low current levels, as we draw down on our cash reserves.

Although we may retain cash on our balance sheet to control risk during periods of higher capital commitments, our goal is to return cash that is not invested in our business to investors in the form of dividends. COS continues to pay an attractive yield compared to alternative investments. In 2011, COS paid $530 million in dividends to investors, or $1.10 per share. At December 31, 2011, our prevailing $0.30 quarterly dividend represented a yield of 5.2 per cent, compared to an average yield of 2.8 per cent for the companies in the S&P/TSX Composite Index. The payment of a significant dividend reflects our confidence in the long-term free cash flow generation capacity of our asset and our discipline in paying that cash out to investors.

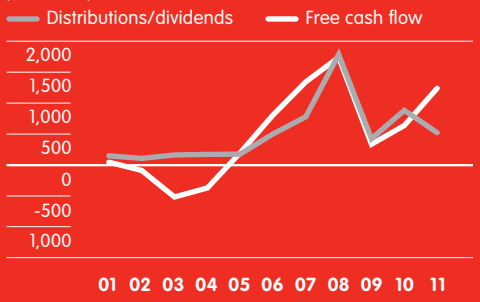
### Adding future value

COS also continues to evaluate new opportunities to add value, such as consolidation of Syncrude interests or acquisition of other oil sand-related assets.

**"Our long-term strategy is to return cash that we do not require in our business to shareholders as a dividend. We maintain a strong balance sheet so we can remain unhedged, allowing our investors to capture the full value of rising oil prices."**

**RYAN KUBIK**
Chief Financial Officer

**EFFICIENT CAPITAL MANAGEMENT**
($ millions)




Since 2001, COS has paid a total of $5.7 billion in dividends, reflecting the substantial cash flow we have generated over our capital expenditures.

The state-of-the-art centralized control room at Syncrude monitors equipment performance and adjusts process conditions for reliable operations.

# We are committed

Today, Syncrude's operational reliability is competitive to that of our peers. Our goal is to become an industry-leading producer with production rates approaching full capacity. Through this commitment to operational excellence we expect to unlock latent value in Syncrude – and ultimately COS.

COS' operations team stewards Syncrude in its efforts to achieve predictable and growing production rates, which is the best opportunity for us to capture incremental value in the near-term.

ABOVE FROM LEFT:
Adrienne Nickerson, Director, Operations and Darren Hardy, Senior Vice President, Operations.

COS' highly experienced technical leadership team consists of industry and Syncrude veterans with decades of experience in the field. This team provides stewardship of Syncrude's operations and growth. As the largest investor in Syncrude, COS works closely with Syncrude's senior technical and operations management teams and our joint venture owners to determine the operation's annual tactical plans, including measurable performance goals, and to influence the long-term strategic direction of the project.

Through our relationships with other leaders in the industry and independent knowledge, COS is able to provide Syncrude's joint venture participants with insight into Syncrude and industry challenges. This enhances our combined effectiveness in stewarding the business.

Since introducing truck and shovel mining in the 1990s, Syncrude has worked with manufacturers to improve operating costs and reduce emissions intensity by increasing the hauling capacity of each unit. Today s haulage trucks carry up to 400 tonnes per load.

## Focused on best-in-class utilization

There is significant value to be realized from our Syncrude asset in the near to medium term through organic production growth from our existing facilities. Syncrude's highest priority is to safely increase production to consistently reach productive capacity of 350,000 bbl/d. This would translate to more than 20 per cent growth over 2011 production. As most of our operating costs are fixed, spreading those costs over more barrels is expected to have a significant impact on our bottom line.

Under the Management Services Agreement with Imperial Oil/ExxonMobil, a disciplined root-cause analysis of all outages is undertaken in order to identify and resolve systemic issues and to document operational best practices. COS is working closely with Syncrude and Imperial Oil/ ExxonMobil to establish a foundation for operational excellence that should support more predictable and robust production rates over the long term.

## Oversight of major projects

Syncrude is investing in a number of major projects between 2012 and 2014 to support strong stable production while achieving operational efficiencies and improving environmental performance. These projects include the replacement and relocation of mine trains, the crushing and slurrying facilities that process bitumen, and the construction of plants to process tailings.

As with all of Syncrude's major projects, COS actively participates in the evaluation of strategy, scope and cost of initiatives prior to project sanctioning. COS remains abreast of industry best practices and advancements in technology to ensure we are able to provide effective and detailed feedback and to achieve progressive and cost-effective solutions.

We will continue our stewardship of these projects to ensure excellence in project execution, including schedule management and cost control.

**"COS leverages our significant in-house, oil sands-focused mining and upgrading expertise. We actively participate in setting Syncrude's strategic direction for current operations and future growth, lend technical expertise in the development of solutions to improve reliability, and offer industry insight in the development of environmental initiatives."**

**ADRIENNE NICKERSON**
Director, Operations

# We are nimble

COS' in-house marketing team is responsible for maximizing the long-term realized price of our high-quality synthetic crude oil; monitoring and responding to supply and demand forces in the crude oil market; assessing our risk exposure and maintaining strong relationships with our customers.

COS has a highly experienced and capable team that markets our high-value product.

ABOVE FROM LEFT: Sheldon Ho, Senior Marketing Representative, and Terry Frehlich, Senior Trader.

Crude oil marketing is a highly dynamic business. Our product is primarily sold to a broad range of refineries in Canada and the U.S., with customer allocations and specific terms changing month to month. Armed with extensive experience in pipeline logistics, knowledge of the types of refineries best suited to our product, and established customer relationships, our marketing department is able to act in a timely and decisive manner to consistently add value.

Having an experienced and nimble marketing team was particularly important in 2011, when market forces made for a volatile, but ultimately rewarding, year.

### Record synthetic premiums in 2011

Historically, our product has traded at a slight premium or discount to West Texas Intermediate (WTI), the primary benchmark for North American light, sweet crudes, including synthetic crude oil (SCO). In 2011, however, the premium widened significantly.

This market shift happened for two reasons. In part, it was due to operational upsets and maintenance at several oil sands plants leading to lower supplies of synthetic crude in the market. This was a short-term factor and has largely been corrected.

The second reason was more complex. In 2011, there was a dislocation of the long-established pricing relationships between the WTI crude oil benchmark and other light crude oil benchmarks such as European Brent Crude ("Brent") and Louisiana Light Sweet Crude ("LLS"). This was created by an oversupply of crude oil to North American inland markets, caused by constrained pipeline access to coastal refinery markets, and resulted in WTI trading as much as $28/bbl lower than Brent/LLS. Historically, typical spreads have averaged in the $1.50 to $2.00/bbl range.

When this oversupply occurred, we targeted sales to markets that have limited access to WTI/inland priced crudes. This allowed COS' supply to compete with higher priced crude available from the U.S. Gulf Coast. As a result of this and other initiatives, COS realized an average premium to WTI of about $7/bbl in 2011. This premium shifted to a discount as we entered 2012.

A number of dynamic forces are at play in crude oil markets, resulting in significant volatility in crude oil prices as well as the price spreads between different quality blends. Using logistical proficiency, experience and strong business relationships to help mitigate the effects of this volatility, we are able to quickly formulate a portfolio of options and optimize market placement of COS' production.

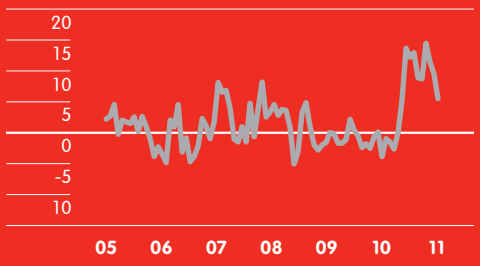
### Market outlook

Pipeline capacity to accommodate additional shipments of Western Canadian oil to refineries within North America is limited and is expected to become increasingly tight as production in the region continues to grow. COS is working closely with pipeline companies to identify and support new opportunities to ship our product. This includes enhancing logistical flexibility in existing markets as well as potentially diversifying our customer base by accessing new markets, such as the United States Gulf Coast and Asia.

**"Success in our business is achieved by building strong, long-term relationships with our customers based on integrity and trust. Our goal is to become the "go-to" supplier for synthetic crude, which we believe will drive sustained superior performance."**

**DAVID SIRRS**
Vice President, Marketing

**SCO PRICE DIFFERENTIAL TO WTI**
($US/bbl)




SOURCE: NGX

While the price differential between our product and WTI widened significantly in 2011, it has historically tracked closer to plus or minus $1/bbl.

Since 1978, Syncrude has produced over 2 billion barrels of SCO, a highly desirable refinery feedstock that has historically received a price close to West Texas Intermediate.

# We are responsible

As a responsible supplier of the energy the world needs, Syncrude has made significant advances in mitigating the impact of oil sands development on air, water and land. We will continue to make investments in projects that enhance future environmental performance.

COS plans to further expand our oil sands outreach in 2012. As COS' Executive Advisor, Sustainability and Oil Sands Outreach, industry veteran Don Thompson (pictured) supports our efforts to educate a variety of audiences about the benefits and challenges of the oil sands industry.

Since the early 1980s, Syncrude has reduced energy use per barrel by 39 per cent and the water intensity of its process by about 60 per cent. Syncrude has returned over 3,500 hectares to nature, planted 6 million trees and shrubs and is responsible for over 70 per cent of the reclaimed land in the oil sands mining industry.

### Advancing current projects

While we are proud of these achievements, we know that continuous improvements must be made to sustain our social licence to operate.

The Syncrude Emissions Reduction (SER) project is designed to reduce our sulphur dioxide emissions by 60 per cent below the current licensed level. This $1.6 billion investment ($0.6 billion net to COS) does not increase our production or enhance profitability, but it does demonstrate that we are serious about reducing emissions. The project is expected to start up in 2012.

After a successful pilot project, Syncrude is working on the first commercial-scale demonstration of water capping as a reclamation technology.

Tailings management will remain a key focus of investment in environmental projects over the next several years as the industry strives to accelerate the recovery of tailings ponds to reclaimed landscapes. In 2012, COS plans to invest $0.4 billion in tailings management infrastructure.

All of Syncrude's land will be returned to a productive capability comparable to that of the pre-disturbed landscape. Syncrude is a leader in land reclamation, with over 3,500 hectares returned to nature and the industry's first government certification for reclaimed land. Work continues to reclaim our former East and West mines. At the East mine, a 52-hectare watershed is being created, including the first reclaimed fen in the industry. At our West Mine, this area is currently being filled with mature fine tailings and is planned to be capped with water around 2012 to form a lake in the first commercial-scale demonstration of water capping as a reclamation technology.

## Broadening our reach

In 2012, COS will continue our efforts to increase awareness of the benefits and challenges of oil sands development among stakeholders. COS has engaged Don Thompson a 30-year Syncrude veteran and oil sands pioneer to spearhead our efforts to explain the benefits and challenges of responsible and ethical oil sands development to a range of audiences, from students to policy makers and technical audiences. We will leverage these opportunities to gather information from stakeholders to increase our own awareness and understanding of stakeholder opinions and expectations on oil sands performance.

## Assessing and managing risk and opportunities

Identifying and proactively managing risk is an increasingly important aspect in effective corporate governance. In 2011, on a recommendation from COS, Syncrude expanded the mandate of its Safety, Health and Environment subcommittee to include Corporate Sustainability. The goal is to enhance the understanding among the joint venture owners of current and future risks related to environmental, social and economic sustainability.

## Recognition as a sustainable leader

In 2011, Canadian Oil Sands Limited was named to the Dow Jones Sustainability Index (DJSI) North America for the second consecutive year on the strength of Syncrude's leadership in responsible oil sands development.

Syncrude's sustainability reporting has been recognized for its excellence in transparency. We encourage you to read more about Syncrude's sustainability efforts at www.syncrude.ca.

**"COS' mission is to steward continuous improvements across all key measures of sustainability. We also aim to establish a deeper understanding among stakeholders of Syncrude's achievements and challenges, and in doing so, we hope to foster an informed and productive dialogue about the oil sands."**

**SCOTT ARNOLD**
Director, Sustainability and External Relations

**TOTAL INDUSTRY LAND RECLAMATION**
(permanent and certified hectares returned to nature)


With over 3,500 hectares of land returned to nature, Syncrude has completed more than 70 per cent of the reclamation in the oil sands mining industry.

# Measuring performance

Centrifuging to remove the water in fine tails is a key part of Syncrude's multi-pronged approach to tailings management. Centrifuged tails can be used under soil for land reclamation.

CONTENTS

# Management's Discussion and Analysis

The following Management's Discussion and Analysis ("MD&A") was prepared as of February 23, 2012 and should be read in conjunction with the audited consolidated financial statements and notes thereto of Canadian Oil Sands Limited (the "Corporation") for the years ended December 31, 2011 and December 31, 2010 and the Corporation's Annual Information Form ("AIF") dated February 23, 2012. Additional information on the Corporation, including its AIF, is available on SEDAR at **www.sedar.com** or on the Corporation's website at **www.cdnoilsands.com.** References to "Canadian Oil Sands" or "we" include the Corporation, its subsidiaries and partnerships and, as applicable, Canadian Oil Sands Trust (the "Trust") prior to its dissolution. The financial results of Canadian Oil Sands have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP") and are reported in Canadian dollars, unless stated otherwise.

**As a result of our conversion from an income trust to a corporate structure on December 31, 2010 pursuant to which all outstanding trust units of the Trust were exchanged on a one-for-one basis for common shares of the Corporation, the financial information of Canadian Oil Sands refers to common shares or shares ("Shares"), shareholders and dividends which were referred to as Units, Unitholders and distributions under the trust structure.**

## Forward Looking Information Advisory

*In the interest of providing the Corporation's shareholders and potential investors with information regarding the Corporation, including management's assessment of the Corporation's future production and cost estimates, plans and operations, certain statements throughout this MD&A contain "forward-looking information" under applicable securities law. Forward-looking statements are typically identified by words such as "anticipate", "expect", "believe", "plan", "intend" or similar words suggesting future outcomes. Forward-looking statements in this MD&A include, but are not limited to, statements with respect to: the expectations regarding the 2012 annual Syncrude forecasted production range of 106 million barrels to 117 million barrels and the single-point Syncrude production estimate of 113 million barrels (41.5 million barrels net to the Corporation); the timing and impact on production of the turnaround of Coker 8-3 and maintenance on Coker 8-1; the expectation that capacity rates at Syncrude will gradually increase and that 2012 volumes at Syncrude will increase by seven per cent over 2011 volumes; future dividends and any increase or decrease from current payment amounts, and our intention to pay a quarterly dividend of at least $0.30 per Share for 2012; the establishment of future dividend levels with the intent of absorbing short-term market volatility over several quarters; the expectation that the new accounting standards relating to joint arrangements, employee benefits, consolidated financial statements, disclosures of interests in other entities, fair value measurements and stripping costs will not result in any significant accounting or disclosure changes; plans regarding crude oil hedges, natural gas hedges and currency hedges in the future; the level of natural gas consumption in 2012 and beyond; the expected sales, operating expenses, Crown royalties, capital expenditures, current and deferred taxes and cash flow from operations for 2012; the expectation that 2012 deferred taxes will flow through current taxes and cash flow from operations in 2013; the expected price for crude oil and natural gas in 2012; the expected foreign exchange rates in 2012; the expected realized selling price, which includes the anticipated differential to West Texas Intermediate ("WTI") to be received in 2012 for the Corporation's product; the expectations regarding net debt in 2012; the anticipated impact of increases or decreases in oil prices, production, operating expenses, foreign exchange rates and natural gas prices on the Corporation's cash flow from operations; the expectation that regular maintenance capital costs will average approximately $10 per barrel over the next few years; the expected amount of total major project costs and anticipated target in-service dates for the Syncrude Emissions Reduction ("SER") project, the Mildred Lake mine train replacements, the Aurora North mine train relocations and the composite tails plant at the Aurora North mine; the expectation that the SER project will significantly reduce total sulphur dioxide and other emissions; the expectation that the Corporation will finance the major projects primarily with cash flow from operations; the cost estimates for 2012 major project spending and post-2012 major project spending; the expectation that over the long-term, as increased capacity to deliver crude oil from inland to coastal markets is established, WTI prices will increase relative to the European Brent crude and other world-based benchmarks, and the SCO price differential will revert to historical levels; the expectation that supply/demand dynamics and pipeline capacity constraints could create significant volatility in the SCO price differential in the short term; the timing of the Aurora South development; the expectation regarding refineries' demand for our SCO; the expectation that reduction in energy in Syncrude operations will reduce both $CO_2$ emissions and operating expenses; future plans regarding the Corporation's Premium Dividend, Dividend Reinvestment and Optional Share Purchase Plan; the belief that the mine train relocations/replacements will not impact production; the expectation that Syncrude's 2012 production outlook will not be impacted by a shortage of supplies or labour; the expectations regarding future pipeline apportionment and sufficient pipeline capacity and the timing of the construction of the commercial scale pilot centrifuge plants.*

*You are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur. Although the Corporation believes that the expectations represented by such forward-looking statements are reasonable and reflect the current views of the Corporation with respect to future events, there can be no assurance that such assumptions and expectations will prove to be correct.*

*The factors or assumptions on which the forward-looking information is based include, but are not limited to: the assumptions outlined in the Corporation's guidance document as posted on the Corporation's website at **www.cdnoilsands.com** as of February 1, 2012 and as subsequently amended or replaced from time to time, including without limitation, the assumptions as to production, operating expenses and oil prices; the successful and timely implementation of capital projects; the ability to obtain regulatory and Syncrude joint venture owner approval; our ability to either generate sufficient cash flow from operations to meet our current and future obligations or obtain external sources of debt and equity capital; the continuation of assumed tax, royalty and regulatory regimes and the accuracy of the estimates of our reserves and resources volumes.*

*Some of the risks and other factors which could cause actual results or events to differ materially from current expectations expressed in the forward-looking statements contained in this MD&A include, but are not limited to: the impacts of legislative or regulatory changes especially as such relate to royalties, taxation, the environment and tailings; the impact of technology on operations and processes and how new complex technology may not perform as expected; skilled labour shortages and the productivity achieved from labour in the Fort McMurray area; the supply and demand metrics for oil and natural gas; the impact that pipeline capacity and refinery demand have on prices for our products; the unanimous joint venture owner approval for major expansions and changes in product types; the variances of stock market activities generally; global economic conditions/volatility; normal risks associated with litigation, general economic, business and market conditions; the impact of Syncrude being unable to meet the conditions of its approval for its tailings management plan under Directive 074; volatility of crude oil prices; volatility of the SCO to WTI differential; unsuccessful or untimely implementation of capital or maintenance projects and such other risks and uncertainties described in the Corporation's AIF dated February 23, 2012 and in the reports and filings made with securities regulatory authorities from time to time by the Corporation which are available on the Corporation's profile on SEDAR at **www.sedar.com** and on the Corporation's website at **www.cdnoilsands.com**.*

*You are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this MD&A are made as of the date of this MD&A, and unless required by law, the Corporation does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this MD&A are expressly qualified by this cautionary statement.*

## Non-GAAP Financial Measures

*In this MD&A we refer to financial measures that do not have any standardized meaning as prescribed by Canadian generally accepted accounting principles ("GAAP"). These non-GAAP financial measures include cash flow from operations, cash flow from operations on a per Share basis, net debt, total capitalization and net debt to total capitalization. In addition, the Corporation refers to various per barrel figures, such as net realized selling prices, operating expenses and Crown royalties, which also are considered non-GAAP measures. We derive per barrel figures by dividing the relevant sales or cost figure by our sales volumes, which are net of purchased crude oil volumes in a period. Non-GAAP financial measures provide additional information that we believe is meaningful regarding the Corporation's operational performance, its liquidity and its capacity to fund dividends, capital expenditures and other investing activities. Users are cautioned that non-GAAP financial measures presented by the Corporation may not be comparable with measures provided by other entities.*

*Since January, 2011, we report cash flow from operations in total and on a per Share basis. Previously, we reported cash from operating activities. Cash flow from operations is calculated as cash from operating activities, as reported on the Consolidated Statement of Cash Flows, before changes in non-cash working capital. Cash flow from operations per Share is calculated as cash flow from operations divided by the weighted-average number of Shares outstanding in the period. We believe cash flow from operations, which is not impacted by fluctuations in non-cash working capital balances, is more indicative of operational performance. The majority of our non-cash working capital is liquid and typically settles within 30 days.*

*Cash flow from operations is reconciled to cash from operating activities as follows:*

| | Year Ended December 31 | |
|---|---|---|
| *($ millions)* | **2011** | 2010 |
| Cash flow from operations | **$ 1,897** | $ 1,232 |
| Change in non-cash working capital[1] | **61** | 63 |
| Cash from operating activities[1] | **$ 1,958** | $ 1,295 |

[1] *As reported in the Consolidated Statements of Cash Flows.*

## Transition to International Financial Reporting Standards

Canadian GAAP has been revised to incorporate International Financial Reporting Standards ("IFRS") and publicly traded companies like the Corporation are required to apply such standards for years beginning on or after January 1, 2011. Note 26 to the attached audited consolidated financial statements discloses the impact of the transition to IFRS on the Corporation's reported financial position, income and cash flows, including the nature and effect of changes in accounting policies from those used in the Corporation's audited consolidated financial statements for the year ended December 31, 2010 which were prepared in accordance with Canadian GAAP prior to the transition to IFRS.

Financial measures for the year ended December 31, 2010 reported in this MD&A as comparative figures have been adjusted to reflect the transition to IFRS, as have the financial measures for all 2010 quarters reported in the summary of quarterly results on page 34. The accounting policies applied in these audited consolidated financial statements are based on IFRS as issued, outstanding and effective on February 23, 2012.

Under IFRS, the Corporation's consolidated balance sheets are adjusted to reflect the following:

- The deferred tax liability was re-measured on transition to IFRS at January 1, 2010 using the 39 per cent individual tax rate applicable to earnings not distributed to trust unitholders. On conversion from an income trust to a corporate structure on December 31, 2010, the deferred tax liability was re-measured using the 25 per cent corporate tax rate, resulting in a deferred tax recovery in the fourth quarter of 2010. Prior to the transition to IFRS, deferred taxes were measured using the 25 per cent corporate tax rate.
- The asset retirement obligation liability and related property, plant and equipment were re-measured on transition at January 1, 2010, and, as applicable, at the end of each reporting period thereafter, to reflect the current risk free interest rate. Prior to the transition to IFRS, these were measured using a credit-adjusted interest rate and were not re-measured each reporting period for changes in this rate.
- Employee future benefits and other liabilities were adjusted on transition at January 1, 2010, and at the end of each reporting period thereafter, to record previously unrecognized actuarial gains or losses on Syncrude Canada Ltd.'s ("Syncrude Canada's") defined benefit pension plan.

Under IFRS, beginning in 2010 net income is adjusted to reflect the following:

- Operating expenses have decreased, reflecting the capitalization of major turnaround costs as property, plant and equipment; previously these costs were expensed. Operating expenses per barrel have likewise decreased.
- Interest costs relating to certain qualifying assets being constructed are now capitalized; previously all interest costs were expensed.
- Depreciation and depletion has increased, reflecting the depreciation of capitalized turnaround costs partially offset by the reclassification of accretion of the asset retirement obligation; accretion is now presented with interest as part of net finance expense.
- Other less significant IFRS adjustments have impacted operating expenses, administration expenses, depreciation and depletion, and net finance expense.

While the IFRS adjustments do not impact the Corporation's total cash flow, beginning in 2010 cash flow from operations and cash used in investing activities have each been adjusted, by equal and offsetting amounts, to reflect the capitalization of both major turnaround costs and interest costs on certain qualifying assets during construction.

Revenues are now reported net of Crown royalties; previously Crown royalties were reported as an expense. Lastly, future income taxes are now referred to as deferred taxes.

## Business Description

Canadian Oil Sands is the largest joint venture owner of the Syncrude Joint Venture ("Syncrude"), a major producer of high quality, low sulphur, light, synthetic crude oil ("SCO"). Canadian Oil Sands' only producing asset is a 36.74 per cent working interest in Syncrude, generating revenue from its share of production, and represents the only public opportunity for undiversified investment directly in Syncrude.

The Syncrude Project is located near Fort McMurray, Alberta and is comprised of oil sands mines, utilities plants, bitumen extraction plants and an upgrading complex that processes bitumen into SCO. The bitumen is open-pit mined from oil sands leases located in the Athabasca oil sands deposit. Syncrude Canada Ltd. ("Syncrude Canada") operates Syncrude on behalf of the Syncrude owners. Each joint venture owner has an undivided interest in the assets of Syncrude, takes its production in kind, and funds its proportionate share of Syncrude's operating and capital expenditures on a daily basis. Oversight of Syncrude Canada is provided by a Syncrude Management Committee and various management sub-committees as well as Syncrude Canada's Board of Directors and Board committees, all of which are staffed by representatives of the Syncrude owners. In particular, the Syncrude Management Committee oversees and approves significant Syncrude expenditures and long-term strategies.

The productive capacity of Syncrude's facilities is approximately 350,000 barrels per day of SCO, on average, including an allowance for a certain amount of downtime, and is referred to as "barrels per calendar day". All references to Syncrude's productive capacity in this report refer to barrels per calendar day, unless stated otherwise. Canadian Oil Sands' production volumes differ from its sales volumes due to changes in inventory, which are primarily in-transit pipeline volumes.

Based on evaluations performed in accordance with the COGE Handbook by our qualified independent petroleum reserve evaluators effective December 31, 2011, Canadian Oil Sands estimates Syncrude's proved plus probable reserves at 4.8 billion barrels (1.8 billion barrels net to the Corporation), best estimate contingent resources at 5.2 billion barrels (1.9 billion barrels net to the Corporation) and best estimate prospective resources at 1.6 billion barrels (0.6 billion barrels net to the Corporation). Based on the current annual production outlook for 2012 of 113 million barrels, or 41.5 million barrels net to Canadian Oil Sands, Syncrude's estimated proved plus probable reserve life is approximately 42 years. More information regarding Canadian Oil Sands' reserves and resources can be found in the "Reserves Data and Other Information" section in our 2011 Annual Information Form ("AIF") dated February 23, 2012 at **www.sedar.com** or on our website at **www.cdnoilsands.com**.

Canadian Oil Sands funds its share of Syncrude's operations and capital expenditures, along with our own administrative and financing costs, dividends and acquisitions through cash generated from the sale of Syncrude production as well as debt and equity financing.

Canadian Oil Sands' cash flow from operations and net income are highly dependent on the selling price received for SCO, production and sales volumes, operating and other expenses, including Crown royalties. The dividends paid to Shareholders are likewise dependent on these factors as well as the amount and timing of capital expenditures. The price we receive for our product, net of crude oil purchases and transportation expense, reflects the realized selling price at the Syncrude plant gate. Historically, our selling price has correlated closely with the Canadian dollar denominated West Texas Intermediate ("WTI") benchmark oil price and has been impacted by movements in United States/Canadian ("U.S./Cdn") currency exchange rates. However, supply and demand fundamentals create volatility in crude oil prices and impact the weighted-average price differential of our SCO product relative to Canadian dollar WTI as well as WTI prices relative to other crude benchmarks. These price differentials can change quickly, reflecting changes in the short-term supply and demand in the market and pipeline availability for transporting crude oil.

Production volumes reflect the capacity of the Syncrude facility and the reliability of its operations. The process of mining, extracting and upgrading bitumen is a technical and complex operation that resembles a manufacturing process rather than a conventional oil development. Regular maintenance of operating units is required. Unplanned outages of units do occur, and these outages usually affect costs and production volumes, and consequently, revenues and operating expenses. For the Syncrude Project, reliability is a critical success factor because the operating costs are largely fixed. If the facilities can process additional barrels, the per barrel costs are reduced and the economics of Syncrude are enhanced.

Further, reduced reliability may increase repair or maintenance costs, and along with lower production volumes, results in higher per barrel operating expenses. Syncrude's operations are subject to a number of risks that are discussed in further detail in the "Risk Management" section of this MD&A.

More information regarding Canadian Oil Sands, including our AIF, is available at **www.sedar.com** or on our website at **www.cdnoilsands.com**.

## Executive Overview

Canadian Oil Sands recorded strong financial results in 2011 with cash flow from operations rising to $1.9 billion, a 54 per cent increase over 2010. This was despite a challenging business climate characterized by concerns with the global economy and, in particular, the Eurozone debt crisis, which created significant uncertainty and volatility in world oil prices. We expect global economic concerns to continue into 2012, and we will continue to manage our business conservatively in order to maintain liquidity and financial flexibility as we execute a large capital program at Syncrude over the next several years.

In 2011, WTI crude oil traded at a significant discount to the world-based "Brent" crude oil benchmark due to an over-supply of crude oil to North American inland markets. In addition, in certain markets our SCO competed with crude oils priced closely with world-based benchmarks, resulting in an average $7 per barrel SCO premium relative to WTI for the year. As increased pipeline capacity to deliver inland North American crudes to coastal markets is established, we anticipate that the differential between WTI and Brent will narrow. We also expect, with increasing supplies of light crude oils in North America, that the SCO price differential will revert to historic levels closer to WTI. Supply/demand dynamics and pipeline capacity constraints can create significant volatility over short time periods. In the past twelve months, the monthly SCO price differential has ranged from an approximate $15 per barrel premium in mid-2011 to an approximate $15 per barrel discount in early 2012.

Our strategy of providing unhedged exposure to crude oil prices yielded a 25 per cent year-over-year increase in Canadian Oil Sands' realized selling price, which averaged $101 per barrel in 2011 compared with $81 per barrel in 2010, as we were able to capture the benefit of both higher WTI crude oil prices and a substantial SCO to WTI premium.

Syncrude production totalled 105.3 million barrels, or about 288,000 barrels per day, in 2011, 1.6 per cent lower than 2010 volumes of 107.0 million barrels, or about 293,000 barrels per day. Strong operational performance at Syncrude through the first two quarters of the year led to record production volumes over that period; however, an unplanned shutdown of a hydrogen unit during the fourth quarter was the key factor driving the year-over-year decrease.

Syncrude's focus into 2012 remains on improving capacity utilization, as this offers the best opportunity to add significant near-term production growth and value. Because of the relatively fixed-cost nature of the Syncrude operation, each incremental barrel of production contributes to lower per-barrel costs and higher netbacks. A Management Services Agreement ("MSA") between Syncrude and Imperial Oil/ExxonMobil is directed at establishing a strong foundation for operational excellence. While we have been disappointed by lower-than-expected reliability gains to date under the MSA, we believe it will support more predictable and robust production rates over the long term. Syncrude achieved an important objective in 2011 by reaching a 36-month run on Coker 8-2, which underwent a turnaround in the fall. Extending the time between turnarounds for each of Syncrude's operating units is a key factor in improving capacity utilization.

In 2011, Syncrude's owners resolved to defer production growth from the undeveloped Aurora South leases by several years into the early 2020s. The owners remain focused on profitably growing production over the long term, and delaying the Aurora South development should enable Syncrude to focus on increasing capacity utilization of its existing operations and develop execution plans to better control the risk and improve the economics of the Aurora South development.

In 2011, Syncrude embarked on a large multi-year capital program to replace or relocate four of Syncrude's five mining trains and to support Syncrude's tailings management plans. These projects should create a stable, more efficient foundation for future bitumen production and enhance environmental performance. Engineered cost estimates are now complete for the mine train replacements and relocations, setting a target against which project execution will be measured. The profile for major projects' spending through 2014 is as follows:

| *($ billions)* | Spent to Dec 31, 2011 | 2012 | 2013 | 2014 | Total |
|---|---|---|---|---|---|
| Syncrude | $ 2.3 | $ 2.7 | $ 2.0 | $ 1.2 | $ 8.2 |
| Canadian Oil Sands share | $ 0.9 | $ 1.0 | $ 0.8 | $ 0.4 | $ 3.1 |

- *Major projects spending includes costs for the Syncrude Emissions Reduction (SER), Mildred Lake Mine Train Replacement, Aurora North Mine Train Relocation, and Aurora North Tailings Management projects. Costs for the Centrifuge Tailings Management project are included in 2012 spending but are excluded from 2013 and 2014 spending, as this project has not reached sufficient design definition.*
- *Major projects costs include both capital expenditures, excluding capitalized interest, and certain non-production expenses.*

The Syncrude Emissions Reduction ("SER") project reached mechanical completion in late 2011, as per the revised schedule and budget estimates established in 2008; it is expected to start up in the first half of 2012. This $1.6 billion (gross to Syncrude) environmental project is designed to reduce total sulphur dioxide and other emissions.

Spending has commenced on two other environmental projects in support of Syncrude's reclamation efforts. Our Aurora North Tailings Management project involves the construction of a composite tails plant at the Aurora North mine and the Centrifuge Tailings Management project involves the construction of a centrifuge plant at the Mildred Lake mine. These investments are in response to Directive 074, regulation announced by the Alberta Energy Resources Conservation Board ("ERCB") in 2009.

In 2011, we intentionally retained cash on our balance sheet to fund Syncrude's multi-year capital projects and support dividend stability, ending the year with over $700 million. We are well-positioned to manage risks associated with this capital program at Syncrude, even under an uncertain outlook for the global economy. We intend to fund our share of Syncrude's upcoming capital expenditures primarily with cash flow from operations, which remains strong at prevailing oil prices, and we are targeting a quarterly dividend of at least $0.30 per Share in 2012. We continue to focus on increasing capacity utilization and are estimating 2012 production of 113 million barrels at Syncrude, a seven per cent increase over 2011 levels. Finally, we remain focused on stewarding Syncrude's major capital projects, as their successful execution is critical to maintaining a strong operating base and improving environmental performance.

## Review of Financial Results

| *($ millions, except per Share and volume amounts)* | Year Ended December 31 **2011** | 2010 | 2009[1] |
|---|---|---|---|
| Cash flow from operations[2] | **$ 1,897** | $ 1,232 | $ 754 |
| Per Share[2] | **$ 3.91** | $ 2.55 | $ 1.56 |
| Net income | **$ 1,144** | $ 1,189 | $ 432 |
| Per Share, Basic and Diluted | **$ 2.36** | $ 2.46 | $ 0.89 |
| Sales, after crude oil purchases and transportation expense | **$ 3,934** | $ 3,180 | $ 2,615 |
| Sales volumes[3] | | | |
| Total (mmbbs) | **38.7** | 39.2 | 37.6 |
| Daily average (bbls) | **106,015** | 107,280 | 103,129 |
| Realized SCO selling price ($/bbl) | **$ 101.20** | $ 80.53 | $ 69.47 |
| West Texas Intermediate (average $US/bbl) | **$ 95.11** | $ 79.61 | $ 62.09 |
| Operating expenses ($/bbl) | **$ 38.80** | $ 35.42 | $ 35.29 |
| Capital expenditures | **$ 643** | $ 582 | $ 409 |
| Dividends | **$ 533** | $ 896 | $ 435 |
| Per Share | **$ 1.10** | $ 1.85 | $ 0.90 |
| Total assets | **$ 8,620** | $ 7,132 | $ 6,953 |
| Net debt[4] | **$ 414** | $ 1,171 | $ 1,041 |
| Total other long-term liabilities[5] | **$ 1,488** | $ 780 | $ 493 |

[1] *Not adjusted for IFRS.*
[2] *Cash flow from operations and cash flow from operations per Share are non-GAAP measures and are defined on page 22 within this MD&A.*
[3] *The Corporation's sales volumes differ from its production volumes due to changes in inventory, which are primarily in-transit pipeline volumes. Sales volumes are net of purchases.*
[4] *Long-term debt less cash and cash equivalents. Net debt is a non-GAAP measure.*
[5] *This balance includes employee future benefits and other liabilities as well as the Corporation's asset retirement obligation.*

### Net Income per Barrel

| *($ per barrel)*[1] | | Year Ended December 31 | | | | |
|---|---|---|---|---|---|---|
| | | **2011** | | 2010 | | 2009[2] |
| Sales after crude oil purchases and transportation expense | **$** | **101.66** | $ | 81.21 | $ | 69.47 |
| Operating expenses | | **(38.80)** | | (35.42) | | (35.29) |
| Crown royalties | | **(7.93)** | | (7.80) | | (6.06) |
| | **$** | **54.93** | $ | 37.99 | $ | 28.12 |
| Non-production expenses | | **(2.93)** | | (2.68) | | (3.75) |
| Administration and insurance | | **(0.85)** | | (0.80) | | (0.87) |
| Depreciation and depletion | | **(9.84)** | | (10.96) | | (15.16) |
| Net finance expense | | **(1.19)** | | (2.09) | | (2.45) |
| Foreign exchange gain (loss) | | **(0.57)** | | 1.54 | | 4.28 |
| Goodwill impairment | | **–** | | – | | (1.38) |
| Deferred tax (expense) recovery | | **(10.00)** | | 7.36 | | 2.67 |
| | | **(25.38)** | | (7.63) | | (16.66) |
| Net income per barrel | **$** | **29.55** | $ | 30.36 | $ | 11.46 |
| Sales volumes (mmbbls)[3] | | **38.7** | | **39.2** | | **37.6** |

[1] *Unless otherwise specified, the per barrel measures in this MD&A have been derived by dividing the relevant item by sales volumes in the period.*
[2] *Not adjusted for IFRS.*
[3] *Sales volumes, net of purchased crude oil volumes.*

Cash flow from operations increased 54 per cent to $1,897 million, or $3.91 per Share, in 2011 from $1,232 million, or $2.55 per Share, in 2010. The increase was due mainly to higher sales partially offset by higher operating expenses. Cash flow from operations in 2010 increased 63 per cent from $754 million, or $1.56 per Share, in 2009. The increase was due mainly to higher sales partially offset by higher operating expenses and Crown royalties.

Sales net of crude oil purchases and transportation expense increased $754 million to $3,934 million in 2011 from $3,180 million in 2010, reflecting a higher average realized selling price partially offset by lower sales volumes. Sales net of crude oil purchases and transportation expense in 2010 increased $565 million from $2,615 million in 2009, reflecting a higher average realized selling price and higher sales volumes. Additional information is provided in the “Sales Net of Crude Oil Purchases and Transportation Expense” section of this MD&A.

Crown royalties totalled $307 million, or $7.93 per barrel, in 2011, similar to 2010 when Crown royalties totalled $306 million, or $7.80 per barrel. Despite increases in realized SCO prices, bitumen prices were largely unchanged year over year. The impact of slightly lower bitumen production volumes and higher allowed costs in 2011 relative to 2010 was largely offset by additional royalties recognized in the fourth quarter of 2011 to reflect revisions to the estimated quality, transportation and handling deductions used to calculate bitumen values. Crown royalties increased to $306 million, or $7.80 per barrel, in 2010 from $228 million, or $6.06 per barrel, in 2009 due to higher bitumen volumes and prices partially offset by higher allowed costs in 2010. Additional information is provided in the “Crown Royalties” section of this MD&A.

Operating expenses in 2011 increased about eight per cent to $1,501 million, or $38.80 per barrel, from $1,387 million, or $35.42 per barrel, in 2010, primarily due to increased maintenance and higher diesel costs in 2011. Operating expenses increased about four per cent to $1,387 million, or $35.42 per barrel, in 2010 from $1,328 million, or $35.29 per barrel, in 2009 primarily due to higher production volumes and increased maintenance in 2010. Additional information is provided in the “Operating Expenses” section of this MD&A.

Net income decreased by $45 million to $1,144 million, or $2.36 per Share, in 2011 from $1,189 million, or $2.46 per Share, in 2010. Net income increased by $757 million in 2010 from $432 million, or $0.89 per Share, in 2009. In addition to the variances in sales, Crown royalties and operating expenses described earlier, net income was impacted by variances in deferred taxes, depreciation and depletion and foreign exchange gains and losses.

The Corporation recorded a $387 million deferred tax expense in 2011 as opposed to a $289 million recovery in 2010. Prior to December 31, 2010, income was sheltered from current taxes by the payment of distributions to trust unitholders. As such, there were no significant drawdowns of tax pools or a resulting deferred tax expense in 2010. Upon conversion from an income trust to a corporate structure effective December 31, 2010, Canadian Oil Sands' earnings are sheltered from current taxes through the drawdown of tax pools. A deferred tax expense has been recognized in 2011 to reflect the cost of reducing these pools. The 2010 deferred tax recovery reflects the $269 million re-measurement of the Corporation's deferred tax liability at a lower tax rate upon conversion to a corporation. While Canadian Oil Sands was structured as an income trust, deferred taxes were measured using the 39 per cent individual tax rate applicable to earnings not distributed to trust unitholders. Beginning December 31, 2010, deferred taxes are measured using the 25 per cent corporate tax rate. The Corporation recorded a $101 million deferred tax recovery in 2009, mostly due to the substantive enactment of tax rate reductions.

Depreciation and depletion expense in 2011 totalled $381 million compared with $429 million in 2010 and $570 million in 2009. The year-over-year decreases reflect changes made to the estimation methodology used to allocate asset costs over their estimated useful lives as well as impairment charges recorded in 2009 on the Arctic natural gas assets.

Canadian Oil Sands recorded a $25 million foreign exchange loss on the revaluation of its U.S. dollar-denominated long-term debt in 2011, reflecting a weakening in the value of the Canadian dollar relative to the U.S. dollar during the year. By comparison, Canadian Oil Sands recorded foreign exchange gains of $58 million and $200 million in 2010 and 2009, respectively, reflecting a strengthening in the value of the Canadian dollar relative to the U.S. dollar in both years.

Capital expenditures in 2011 rose to $643 million from $582 million in 2010 and $409 million in 2009 as spending increased on large multi-year capital projects to replace or relocate four of Syncrude's five mining trains and to support Syncrude's tailings management plans. Additional information is provided in the "Capital Expenditures" section of this MD&A.

Canadian Oil Sands paid dividends totalling $533 million, or $1.10 per Share, in 2011, a decrease from 2010 and 2009 distribution levels, reflecting the need to reinvest a greater share of cash flow from operations at the outset of Syncrude's large multi-year capital program. In addition, 2009 and 2010 distributions reflected the Corporation's strategy of building tax pools in advance of the December 31, 2010 corporate conversion.

Net debt, comprised of long-term debt less cash and cash equivalents, decreased to approximately $0.4 billion at December 31, 2011 from approximately $1.2 billion at December 31, 2010 as Canadian Oil Sands generated approximately $1.9 billion in cash flow from operations in 2011, exceeding capital expenditures and dividend payments of approximately $0.6 billion and $0.5 billion, respectively. Net debt increased during 2010 and 2009 as capital expenditures and distributions exceeded cash flow from operations in both years.

Canadian Oil Sands increased its estimated asset retirement obligation to $1,037 million at December 31, 2011 from $501 million at December 31, 2010. The increase was capitalized as property, plant and equipment. Additional information is provided in the "Asset Retirement Obligation" section of this MD&A. In 2010, Canadian Oil Sands decreased its estimated asset retirement obligation due to changes in the estimated timing of reclamation expenditures.

**Sales Net of Crude Oil Purchases and Transportation Expense**

| *($ millions)* | **2011** | 2010 | $ Change | % Change |
|---|---|---|---|---|
| Sales[1] | **$ 4,182** | $ 3,460 | $ 722 | 21 |
| Crude oil purchases | **(221)** | (254) | 33 | (13) |
| Transportation expense | **(27)** | (26) | (1) | 4 |
| | **$ 3,934** | $ 3,180 | $ 754 | 24 |
| Sales volumes (mmbbls)[2] | **38.7** | 39.2 | (0.5) | (1) |
| Realized SCO selling price[3] (average $Cdn/bbl) | **$ 101.20** | $ 80.53 | $ 20.67 | 26 |
| WTI (average $US/bbl) | **95.11** | 79.61 | 15.50 | 20 |
| SCO premium (discount) to WTI (weighted average $Cdn/bbl) | **7.32** | (1.61) | 8.93 | (555) |
| Average foreign exchange rate ($US/$Cdn) | **1.01** | 0.97 | 0.04 | 4 |

[1] *Sales include sales of purchased crude oil, sales of sulphur and proceeds from insurance claims.*
[2] *Sales volumes, net of purchased crude oil volumes.*
[3] *SCO sales net of crude oil purchases and transportation expense divided by sales volumes, net of purchased crude oil volumes.*

The $754 million, or 24 per cent, increase in sales net of crude oil purchases and transportation expense in 2011 relative to 2010 reflects a higher average realized SCO selling price in 2011 partially offset by lower sales volumes. Higher WTI crude oil prices, which averaged U.S. $95 per barrel in 2011 compared with U.S. $80 per barrel in 2010, were offset somewhat by a stronger Canadian dollar, which averaged $1.01 U.S./Cdn in 2011, up from $0.97 U.S./Cdn in 2010. In addition, the Corporation realized a weighted-average SCO premium of $7.32 per barrel in 2011 versus a $1.61 per barrel discount in 2010. Sales volumes averaged 106,000 barrels per day in 2011 compared with 107,000 barrels per day in 2010, reflecting the operational issues with the hydrogen unit and Coker 8-1 in the fourth quarter of 2011.

The increase in the 2011 differential was primarily the result of two factors. The first was the lower supply of SCO in the market because of operational upsets and maintenance at several oil sands plants during the year. The second was the dislocation of the WTI crude oil benchmark to other light oil benchmarks such as Brent and Louisiana Light Sweet (“LLS”) crude due to an over-supply of crude oil to North American inland markets. In certain U.S. markets, SCO sometimes competes with crude oil priced higher than WTI, such as LLS, which can contribute to a positive differential to WTI.

The Corporation purchases crude oil from third parties to fulfill sales commitments with customers when there are shortfalls in Syncrude’s production and to facilitate certain transportation and tankage arrangements and operations. Sales include the sale of purchased crude oil while the cost of these purchases is included in crude oil purchases and transportation expense. Crude oil purchases were lower in 2011 relative to 2010, reflecting additional purchased volumes in 2010 to support transportation arrangements and unanticipated production shortfalls, partially offset by higher crude oil prices in 2011.

**Crown Royalties**

Crown royalties totalled $307 million, or $7.93 per barrel, in 2011, similar to 2010 when Crown royalties totalled $306 million, or $7.80 per barrel. Despite increases in realized SCO prices, bitumen prices were largely unchanged year over year. The impact of slightly lower bitumen production volumes and higher allowed costs in 2011 relative to 2010 was largely offset by additional royalties recognized in the fourth quarter of 2011 to reflect revisions to the estimated quality, transportation and handling deductions used to calculate bitumen values over the 2009 to 2011 period.

Beginning in 2009, Syncrude transitioned to paying Crown royalties based on bitumen production rather than on the production of SCO. From 2009 through 2015, Syncrude’s Crown royalties are determined pursuant to the Syncrude Royalty Amending Agreement and the Syncrude Bitumen Royalty Option Agreement.

Under the Syncrude Royalty Amending Agreement, the Syncrude owners pay the greater of 25 per cent of net deemed bitumen revenues, or one per cent of gross deemed bitumen revenues, plus a transition royalty of up to $975 million ($358 million net to the Corporation) for the period January 1, 2010 to December 31, 2015. The transition royalty of $975 million is reduced proportionally if bitumen production is less than 345,000 barrels per day over the period. The $975 million ($358 million net to the Corporation) is scheduled over six annual installments as follows:

| *($ millions)* | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | Total |
|---|---|---|---|---|---|---|---|
| Syncrude | $ 75 | $ 75 | $ 100 | $ 150 | $ 225 | $ 350 | $ 975 |
| Canadian Oil Sands' share | $ 27 | $ 27 | $ 37 | $ 55 | $ 83 | $ 129 | $ 358 |

The Syncrude Royalty Amending Agreement requires that bitumen be valued by a formula that references the value of bitumen based on a Canadian heavy oil price adjusted for reasonable quality, transportation and handling deductions (including diluent costs) to reflect the quality and location differences between Syncrude's bitumen and the reference price of bitumen. The Alberta government and the Syncrude owners are in discussions to determine the appropriate adjustments for quality, transportation and handling. For estimating and paying royalties, Syncrude used a bitumen value based on Syncrude and its owners' interpretation of the Syncrude Royalty Amending Agreement. In the fourth quarter of 2011, Syncrude revised its estimate of this bitumen value for the period from January 1, 2009 to December 31, 2011 and, as a result, approximately $20 million of additional Crown royalties were recognized.

In December 2010 the Alberta government provided a modified notice of a bitumen value for Syncrude (the "Syncrude BVM") which is different than the bitumen value used by Syncrude for estimating and paying royalties. Canadian Oil Sands' share of the royalties recognized for the period from January 1, 2009 to December 31, 2011 are estimated to be approximately $40 million lower than the amount calculated using the Syncrude BVM. The Syncrude owners and the Alberta government continue to discuss the basis for reasonable quality, transportation, and handling adjustments but if such discussions do not result in an agreed upon solution, either party may seek judicial determination of the matter. Should these discussions or a judicial determination result in a deemed bitumen value different than that used by Syncrude for estimating and paying royalties, the cumulative impact on Canadian Oil Sands' share of royalties since January 1, 2009 will be recognized immediately and will impact both net income and cash flow from operations accordingly.

**Operating Expenses**

The following table breaks down operating expenses into their major components and shows operating expenses per barrel of bitumen and SCO. The information allocates costs to bitumen production and upgrading on the basis used to determine Crown royalties.

| | **2011** | | 2010 | |
|---|---|---|---|---|
| *($ per barrel)* | **Bitumen** | **SCO** | Bitumen | SCO |
| Bitumen production | **$ 25.53** | **$ 30.37** | $ 20.63 | $ 24.34 |
| Internal fuel allocation[2] | **2.40** | **2.85** | 2.36 | 2.79 |
| Total produced bitumen costs | **27.93** | **33.22** | 22.99 | 27.13 |
| Upgrading costs[1] | | **10.62** | | 13.34 |
| Less: internal fuel allocation to bitumen[2] | | **(2.85)** | | (2.79) |
| Bitumen purchases | | **–** | | – |
| Total Syncrude operating expenses | | **40.99** | | 37.68 |
| Canadian Oil Sands adjustments[3] | | **(2.19)** | | (2.26) |
| Total operating expenses | | **38.80** | | 35.42 |
| *(thousands of barrels per day)* | **Bitumen** | **SCO** | Bitumen | SCO |
| Syncrude production volumes | **343** | **288** | 346 | 293 |

[1] *Upgrading costs include the production and ongoing maintenance costs associated with processing and upgrading of bitumen to SCO.*
[2] *Reflects energy generated by the upgrader that is used in the bitumen production process and is valued by reference to natural gas prices. Natural gas prices averaged $3.48 per GJ in 2011 and $3.87 per GJ in 2010.*
[3] *Canadian Oil Sands' adjustments mainly pertain to actual reclamation costs and major turnaround costs, which Syncrude includes in operating expenses. Canadian Oil Sands capitalizes major turnaround costs and recognizes actual reclamation costs through its asset retirement obligation. Major turnaround costs are expensed through depreciation and reclamation costs are expensed through both depletion and accretion (within net finance expense).*

| *($ per barrel of SCO)* | **2011** | 2010 | $ Change | % Change |
|---|---|---|---|---|
| Production costs | **$ 33.79** | $ 31.15 | $ 2.64 | 9 |
| Purchased energy | **5.01** | 4.27 | 0.74 | 17 |
| Total operating expenses | **$ 38.80** | $ 35.42 | $ 3.38 | 10 |
| *(GJs per barrel of SCO)* | | | | |
| Purchased energy consumption | **1.44** | 1.10 | 0.34 | 31 |

Operating expenses increased about eight per cent to $1,501 million, or $38.80 per barrel, in 2011 from $1,387 million, or $35.42 per barrel, in 2010 primarily due to:

- increased costs for maintenance, primarily in tailings management and extraction; and
- increased diesel costs. New low-sulphur regulations that went into effect in mid-2010 have reduced the amount of diesel that Syncrude can produce internally for use in its operations, resulting in increased diesel purchases; however, bitumen redirected from diesel production to SCO largely offsets the operating expense increase, resulting in an immaterial impact on net income. In addition, diesel prices were 30 per cent higher in 2011 relative to 2010.

The increased diesel purchases are also reflected in the increased purchased energy consumption rate in 2011 relative to 2010.

Operating expenses on a per barrel basis are affected by the Corporation's sales volumes, which were lower in 2011 than in 2010.

**Non-Production Expenses**

Non-production expenses totalled $113 million in 2011 compared with $105 million in 2010. Non-production expenses consist primarily of development expenditures relating to capital programs, which are expensed, such as pre-feasibility engineering, technical and support services, research and development, evaluation drilling and regulatory and stakeholder consultation expenditures. Non-production expenses can vary on a periodic basis depending on the number of projects underway and the development stage of the projects.

### Net Finance Expense

| *($ millions)* | **2011** | 2010 |
|---|---|---|
| Interest costs | **$ 87** | $ 91 |
| Less capitalized interest | **(57)** | (30) |
| Interest expense | **30** | 61 |
| Accretion of asset retirement obligation | **16** | 21 |
| Net finance expense | **$ 46** | $ 82 |

Interest costs in 2011 were largely unchanged from 2010; however, interest expense was lower in 2011 because a higher portion of interest costs were capitalized in 2011 as cumulative capital expenditures on qualifying assets rose. As such, net finance expense decreased to $46 million in 2011 from $82 million in 2010.

### Depreciation and Depletion Expense

Depreciation and depletion expense totalled $381 million in 2011 compared with $429 million in 2010, reflecting changes made during 2011 to the estimated useful lives of certain assets.

### Foreign Exchange (Gain) Loss

| *($ millions)* | **2011** | 2010 |
|---|---|---|
| Foreign exchange (gain) loss – long-term debt | **$ 25** | $ (58) |
| Foreign exchange (gain) loss – other | **(3)** | (2) |
| Total foreign exchange (gain) loss | **$ 22** | $ (60) |

Foreign exchange gains/losses are primarily the result of revaluations of our U.S. dollar denominated long-term debt caused by fluctuations in U.S. and Canadian dollar exchange rates.

The foreign exchange losses on long-term debt for 2011 were the result of a weakening in the value of the Canadian dollar relative to the U.S. dollar from $1.01 U.S./Cdn at December 31, 2010 to $0.98 U.S./Cdn at December 31, 2011. The foreign exchange gains in 2010 were the result of a strengthening in the value of the Canadian dollar relative to the U.S. dollar from $0.96 U.S./Cdn at December 31, 2009 to $1.01 U.S./Cdn at December 31, 2010.

### Deferred Taxes

The Corporation recorded a deferred tax expense of $387 million in 2011 as opposed to a deferred tax recovery of $289 million in 2010. Prior to December 31, 2010, income was sheltered from current taxes by the payment of distributions to trust unitholders. As such, there were no significant drawdowns of tax pools or a resulting deferred tax expense in 2010. Upon conversion from an income trust to a corporate structure effective December 31, 2010, Canadian Oil Sands' earnings are sheltered from current taxes through the drawdown of tax pools. A deferred tax expense has been recognized in 2011 to reflect the cost of reducing these pools.

The 2010 deferred tax recovery incorporates the $269 million re-measurement of the Corporation's deferred tax liability at a lower tax rate upon conversion to a corporation. While Canadian Oil Sands was structured as an income trust, deferred taxes were measured using the 39 per cent individual tax rate applicable to earnings not distributed to trust unitholders. Beginning December 31, 2010, deferred taxes are measured using the 25 per cent corporate tax rate.

### Asset Retirement Obligation

Canadian Oil Sands increased its estimated asset retirement obligation during 2011 to $1,037 million at December 31, 2011 from $501 million at December 31, 2010. The increase was capitalized as property, plant and equipment and reflects the completion of a comprehensive mine development and closure plan which includes:

- the reclamation of new storage areas and additional mature fine tailings treatment costs, both required to meet the Alberta Energy Resources Conservation Board's Directive 074 regulations;
- geotechnical design development for regional land drainage features required for final closure;
- updated material handling cost assumptions, which reflect current contract rates and parameters; and
- a decrease in the risk-free interest rate used to discount future reclamation payments.

The obligation also reflects $49 million of reclamation spending during 2011. A $29 million current portion of the asset retirement obligation is included in accounts payable and accrued liabilities, while the $1,008 million non-current portion is separately presented as an asset retirement obligation on the December 31, 2011 Consolidated Balance Sheets.

**Pension and Other Post-Employment Benefit Plans**

The Corporation's share of the estimated unfunded portion of Syncrude Canada's pension and other post-employment benefit plans increased to $465 million at December 31, 2011 from $327 million at December 31, 2010. The change reflects a decrease in the interest rate used to discount estimated future pension costs combined with lower than estimated returns on the pension plan assets. A $128 million actuarial loss, net of $42 million in deferred taxes, has been recognized in 2011 other comprehensive income to reflect these estimate changes. A liability for the $465 million unfunded balance is recognized on the December 31, 2011 Consolidated Balance Sheets.

## Summary of Quarterly Results

| | **2011** | | | | 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | **Q4** | **Q3** | **Q2** | **Q1** | Q4 | Q3 | Q2 | Q1 |
| Sales[1] ($ millions) | **$ 884** | **$ 989** | **$ 1,045** | **$ 1,016** | $ 912 | $ 692 | $ 842 | $ 734 |
| Net income ($ millions) | **$ 232** | **$ 242** | **$ 346** | **$ 324** | $ 575 | $ 193 | $ 245 | $ 176 |
| Per Share, Basic & Diluted | **$ 0.48** | **$ 0.50** | **$ 0.71** | **$ 0.67** | $ 1.19 | $ 0.40 | $ 0.51 | $ 0.36 |
| Cash flow from operations[2] ($ millions) | **$ 363** | **$ 512** | **$ 544** | **$ 478** | $ 398 | $ 230 | $ 379 | $ 225 |
| Per Share[2] | **$ 0.75** | **$ 1.06** | **$ 1.12** | **$ 0.99** | $ 0.82 | $ 0.48 | $ 0.78 | $ 0.46 |
| Dividends ($ millions) | **$ 146** | **$ 145** | **$ 145** | **$ 97** | $ 242 | $ 242 | $ 242 | $ 170 |
| Per Share | **$ 0.30** | **$ 0.30** | **$ 0.30** | **$ 0.20** | $ 0.50 | $ 0.50 | $ 0.50 | $ 0.35 |
| Daily averages sales volumes[3] (bbls) | **91,259** | **109,260** | **102,938** | **120,894** | 114,739 | 96,477 | 118,569 | 99,286 |
| Realized SCO selling price ($/bbl) | **$ 104.78** | **$ 97.89** | **$ 111.00** | **$ 93.04** | $ 83.97 | $ 77.94 | $ 78.07 | $ 82.06 |
| Operating expenses[4] ($/bbl) | **$ 46.88** | **$ 37.19** | **$ 37.07** | **$ 35.53** | $ 35.81 | $ 37.97 | $ 30.86 | $ 37.94 |
| Purchased natural gas price ($/GJ) | **$ 3.19** | **$ 3.51** | **$ 3.62** | **$ 3.59** | $ 3.45 | $ 3.44 | $ 3.68 | $ 4.95 |
| WTI[5] (average $US/bbl) | **$ 94.06** | **$ 89.54** | **$ 102.34** | **$ 94.60** | $ 85.24 | $ 76.21 | $ 78.05 | $ 78.88 |
| Foreign exchange rates ($US/$Cdn) | | | | | | | | |
| Average | **$ 0.98** | **$ 1.02** | **$ 1.03** | **$ 1.02** | $ 0.99 | $ 0.96 | $ 0.97 | $ 0.96 |
| Quarter-end | **$ 0.98** | **$ 0.96** | **$ 1.04** | **$ 1.03** | $ 1.01 | $ 0.97 | $ 0.94 | $ 0.98 |

1 *Sales after crude oil purchases and transportation expense.*
2 *Cash flow from operations and cash flow from operations per Share are non-GAAP measures and are defined on page 22 within this MD&A.*
3 *Daily average sales volumes net of crude oil purchases.*
4 *Derived from operating expenses, as reported on the Consolidated Statements of Income and Comprehensive Income, divided by sales volumes during the period.*
5 *Pricing obtained from Bloomberg.*

During the last eight quarters, the following items have had a significant impact on the Corporation's financial results:

- fluctuations in U.S. dollar WTI oil prices have impacted the Corporation's sales, Crown royalties, net income and cash flow from operations;
- U.S. to Canadian dollar exchange rate fluctuations have resulted in foreign exchange gains and losses on the revaluation of U.S. dollar-denominated debt and have impacted commodity pricing;
- fluctuations in the differential between SCO and Canadian dollar WTI oil prices have impacted the Corporation's sales, net income and cash flow from operations;
- planned and unplanned maintenance activities have impacted quarterly production volumes, revenues and operating expenses;
- net income in 2011 reflects an increase in deferred taxes after conversion to a corporation on December 31, 2010. Tax pools are being drawn down to shelter taxable income under the corporate structure, whereas distributions were available to shelter taxable income prior to 2011.
- net income increased in the fourth quarter of 2010 due to a $269 million deferred tax recovery resulting from re-measuring the deferred tax liability at a lower tax rate upon conversion from an income trust to a corporate structure on December 31, 2010. This deferred tax recovery was not recognized under Canadian GAAP before the adoption of IFRS (see the "Deferred Taxes" section of this MD&A for further discussion).

Quarterly variances in net income and cash flow from operations are caused mainly by fluctuations in crude oil prices, production and sales volumes, operating expenses and natural gas prices. Net income is also impacted by unrealized foreign exchange gains and losses, depreciation and depletion, impairment charges and deferred tax amounts.

While the supply/demand balance for crude oil affects selling prices, the impact of this relationship is difficult to predict and quantify and has not displayed significant seasonality. Natural gas prices are typically higher in winter months as heating demand rises, but this seasonality is influenced by weather conditions and North American natural gas inventory levels. In addition, recent technological developments in North American natural gas production have significantly increased production levels and reduced natural gas prices. These conditions may persist for the next several years.

Syncrude production levels may not display seasonal patterns or trends. While maintenance and turnaround activities are typically scheduled to avoid the winter months, the exact timing of unit outages cannot be precisely scheduled, and unplanned outages may occur. The costs of major turnarounds are capitalized as property, plant and equipment and depreciated over the period until the next scheduled turnaround. The costs of all other turnarounds and maintenance activities are expensed in the period incurred, which can result in volatility in quarterly operating expenses. All turnarounds and maintenance activities impact per barrel operating expenses because sales volumes are lower in the periods when this work is occurring.

Canadian Oil Sands' unaudited fourth quarter 2011 results were discussed and analyzed in our MD&A released on February 1, 2012 and filed with the Corporation's February 1, 2012 press release, which is available on our website at **www.cdnoilsands.com** or at **www.sedar.com**.

## Capital Expenditures

Capital expenditures totalled $643 million in 2011 compared with $582 million in 2010. Syncrude is investing in a number of major projects in 2011 through 2014 to support strong, stable production while achieving operational efficiencies and improving environmental performance. These include the following:

- the SER project, which accounted for $110 million and $113 million of the capital spent in 2011 and 2010, respectively. The SER project commenced in 2006 and involves retrofitting technology into the operation of Syncrude's original two cokers in order to reduce total sulphur dioxide and other emissions.
- mine train replacement and relocation projects, which accounted for $166 million and $73 million of the capital spent in 2011 and 2010, respectively. These projects involve reconstructing or relocating crushers, surge facilities and slurry preparation equipment to support mine development and tailings storage.

- the Aurora North Tailings Management project, which accounted for $40 million and $19 million of the capital spent in 2011 and 2010, respectively. This project involves the construction of a composite tails plant at the Aurora North mine to process tailings in support of Syncrude's reclamation efforts.

Capital expenditures also included:

- capitalized interest costs, which were $57 million in 2011 compared with $30 million in 2010, reflecting higher cumulative capital expenditures on qualifying assets in 2011.
- capitalized turnaround costs, which were $44 million in 2011 compared with $46 million in 2010.

The remaining capital expenditures related to regular maintenance of business and other investment activities, including relocation of tailings facilities and other infrastructure projects.

More information on Canadian Oil Sands' major capital projects is provided in the "Outlook" section of this MD&A.

## Contractual Obligations and Commitments

The following table outlines the significant contractual obligations and commitments that were assumed in the normal course of operations and were known as of February 23, 2012. These obligations and commitments represent future cash payments that the Corporation is required to make under existing contractual agreements that it has entered into either directly, or as a 36.74 per cent owner in Syncrude:

| *($ millions)* | Total | <1 year | 1-3 years | 3-5 years | After 5 years |
|---|---|---|---|---|---|
| Asset retirement obligation[1] | $ 2,210 | $ 30 | $ 49 | $ 79 | $ 2,052 |
| Long-term debt[2] | 1,756 | 83 | 454 | 131 | 1,088 |
| Pipeline commitments[3] | 1,227 | 28 | 49 | 109 | 1,041 |
| Other obligations[4] | 338 | 124 | 116 | 24 | 74 |
| Capital expenditure commitments[5] | 305 | 228 | 77 | – | – |
| Pension plan solvency deficiency payments[6] | 296 | 44 | 88 | 41 | 123 |
| Management services agreement[7] | 85 | 17 | 34 | 34 | – |
| | $ 6,217 | $ 554 | $ 867 | $ 418 | $ 4,378 |

[1] *Reflects Canadian Oil Sands' 36.74 per cent share of the undiscounted estimated future cash flows required to settle Syncrude's obligation to reclaim each of its mine sites and decommission its utilities plants, bitumen extraction plants, and upgrading complex.*
[2] *Actual payments differ from the carrying value of the long-term debt as the amounts in this table include both principal and interest payments.*
[3] *Reflects Canadian Oil Sands' commitment for take-or-pay transportation services on several pipelines.*
[4] *These obligations include, but are not limited to, Canadian Oil Sands' commitments for storage and terminal services, as well as Canadian Oil Sands' 36.74 per cent share of Syncrude's commitments for natural gas purchases at floating prices as well as annual disposal fees for the flue gas desulphurization unit.*
[5] *Capital expenditure commitments are primarily comprised of Canadian Oil Sands' 36.74 per cent share of committed costs under the Mildred Lake Mine Train Replacement and Aurora North Tailings Management projects.*
[6] *Canadian Oil Sands is responsible for funding its 36.74 per cent share of Syncrude Canada's registered pension plan solvency deficiency, which was confirmed in the December 31, 2010 actuarial valuation completed in 2011.*
[7] *Reflects Canadian Oil Sands' 36.74 per cent share of Syncrude Canada's annual fixed service fees under the agreement.*

During 2011, Canadian Oil Sands entered into a new contractual obligation for approximately $700 million for the transportation of crude oil, and has assumed its share of new Syncrude capital commitments totalling approximately $300 million primarily related to the Mildred Lake Mine Train Replacement and Aurora North Tailings Management projects.

## Dividends

On February 1, 2012, the Corporation declared a quarterly dividend of $0.30 per Share for a total dividend of approximately $145 million. The dividend will be paid on February 29, 2012 to Shareholders of record on February 24, 2012.

Dividend payments continue to be set on a quarterly basis by the Board of Directors in the context of current and expected crude oil prices, economic conditions, Syncrude's operating performance, and the Corporation's capacity to finance

operating and investing obligations. Dividend levels are established with the intent of absorbing short-term market volatility over several quarters. Dividend levels also recognize our intention to fund the current major projects primarily through cash flow from operations, and to maintain a strong balance sheet to reduce exposure to potential oil price declines, capital cost increases, or major operational upsets.

For 2012, Canadian Oil Sands is targeting a quarterly dividend of at least $0.30 per Share, based on current assumptions, with support from our cash balances, as necessary.

## Liquidity and Capital Resources

| *($ millions, except % amounts)* | **December 31 2011** | December 31 2010 |
|---|---|---|
| Long-term debt | **$ 1,132** | $ 1,251 |
| Cash and cash equivalents | **(718)** | (80) |
| Net debt[1,2] | **$ 414** | $ 1,171 |
| Shareholders' equity | **$ 4,210** | $ 3,726 |
| Total capitalization[1,3] | **$ 4,624** | $ 4,897 |
| Net debt to total capitalization[1,4] (%) | **9** | 24 |

[1] *Net debt, total capitalization, and net debt to total capitalization are non-GAAP measures.*
[2] *Long-term debt less cash and cash equivalents.*
[3] *Net debt plus Shareholders' equity.*
[4] *Net debt divided by total capitalization.*

Net debt, comprised of long-term debt less cash and cash equivalents, decreased to approximately $0.4 billion at December 31, 2011 from approximately $1.2 billion at December 31, 2010, as Canadian Oil Sands generated approximately $1.9 billion in cash flow from operations in 2011, exceeding capital expenditures and dividend payments of approximately $0.6 billion and $0.5 billion, respectively.

Shareholders' equity increased to approximately $4.2 billion at December 31, 2011 from approximately $3.7 billion at December 31, 2010, as net income exceeded dividends in 2011.

On June 1, 2011, Canadian Oil Sands entered into a four-year $1,500 million credit facility agreement expiring on June 1, 2015, which replaced the $800 million operating facility.

Debt covenants restrict Canadian Oil Sands' ability to sell all or substantially all of its assets or change the nature of its business, and limit total debt to total capitalization to 55 per cent. A significant increase in debt or decrease in Shareholders' equity would be required before covenants restrict the Corporation's financial flexibility.

## Shareholders' Capital and Trading Activity

Canadian Oil Sands issues options, performance units ("PSUs"), and restricted share units ("RSUs") under its long-term incentive plans for employees, and deferred share units ("DSUs") as a component of non-executive directors' compensation.

Options represent the right of the option holder to purchase a Share at the exercise price determined at the date of grant. For options granted prior to 2011, exercise prices are reduced by dividends over a threshold amount. Subject to certain exemptions relating to retirement, death or termination, the options vest by one-third following the date of grant in each of the first three years and expire seven years from the date of grant. At December 31, 2011, there were approximately 1.8 million options outstanding with an average exercise price of $27.41 per option. On February 6, 2012, another 403,656 options were granted with a fair value of approximately $2 million. The approximate 2.2 million options outstanding at February 23, 2012 represent less than one per cent of total Shares outstanding.

PSUs are awarded and settled in cash, in Shares purchased in the secondary market, or in Shares issued from treasury, at the end of a three-year period. The settlement value is based on the Corporation's Share price at the three-year vesting date if the total Shareholder return generated by the Corporation relative to a comparator group, comprised of other industry peers and the S&P/TSX oil and gas E&P index, meets certain thresholds over the three-year period. At December 31, 2011, there were approximately 0.3 million PSUs outstanding with an accrued value of approximately $5 million. On February 6, 2012 another 89,476 PSUs were granted with a fair value of approximately $2 million. The approximate 0.3 million PSUs outstanding at February 23, 2012 represent less than one per cent of the total Shares outstanding on a Share-equivalent-basis.

RSUs are awarded and settled in cash, in Shares purchased in the secondary market or in Shares issued from treasury at the end of a three-year period. The settlement value is based on the Corporation's Share price at the three-year vesting date. At December 31, 2011, there were 7,891 RSUs outstanding. On February 6, 2012, another 9,069 RSUs were granted. RSUs outstanding at February 23, 2012 represent less than one per cent of the total Shares outstanding on a Share-equivalent-basis.

DSUs are awarded and settled in cash, in Shares purchased in the secondary market or in Shares issued from treasury. DSUs vest immediately upon grant and settle when a director's service ceases. The settlement value is based on the Corporation's Share price on that date. At December 31, 2011 and February 23, 2012, there were 22,498 DSUs outstanding, representing less than one per cent of the total Shares outstanding on a Share-equivalent-basis.

More detail on the Corporation's options, PSUs, RSUs and DSUs can be found in Note 14 to the audited Consolidated Financial Statements, and in the Corporation's Management Proxy Circular dated March 15, 2011, which is available on our website at **www.cdnoilsands.com** or at **www.sedar.com**.

The Corporation's shares trade on the Toronto Stock Exchange under the symbol COS. The Corporation had a market capitalization of approximately $11 billion with 484.5 million shares outstanding and a closing price of $23.25 per Share on December 31, 2011. A table summarizing the Shares issued in 2011 is included in Note 13(a) to the audited Consolidated Financial Statements. The following table summarizes the trading activity for 2011.

**Canadian Oil Sands Limited – Trading Activity**

| | Total 2011 | Fourth Quarter 2011 | Third Quarter 2011 | Second Quarter 2011 | First Quarter 2011 |
|---|---|---|---|---|---|
| Share price | | | | | |
| High | $ 33.94 | $ 24.50 | $ 28.74 | $ 33.78 | $ 33.94 |
| Low | $ 18.17 | $ 18.17 | $ 19.60 | $ 25.90 | $ 24.98 |
| Close | $ 23.25 | $ 23.25 | $ 20.39 | $ 27.83 | $ 32.67 |
| Volume of Shares traded (millions) | 567.1 | 146.2 | 127.2 | 126.6 | 167.1 |
| Weighted average Shares outstanding (millions) | 484.5 | 484.5 | 484.5 | 484.5 | 484.5 |

**Premium Dividend, Dividend Reinvestment and Optional Share Purchase Plan**

On December 31, 2010, upon conversion from an income trust structure to a corporate structure, the Trust's Premium Distribution, Distribution Reinvestment and Optional Unit Purchase Plan ("Trust DRIP") was replaced by the Corporation's Premium Dividend, Dividend Reinvestment and Optional Share Purchase Plan ("Corporate DRIP") with substantially the same terms and conditions as the Trust DRIP. The Corporate DRIP allows eligible Shareholders to direct their dividends to the purchase of additional Shares or receive a premium dividend amount. The Corporate DRIP has been suspended but could be reinstated in the future to help preserve balance sheet equity.

## Critical Accounting Estimates

A critical accounting estimate is considered to be one that requires assumptions be made about matters that are uncertain at the time the accounting estimate is made and would have a material impact on the financial results if different assumptions were used. Canadian Oil Sands makes numerous estimates in its financial results in order to provide timely information to users. The following estimates are considered critical:

a) Canadian Oil Sands records an asset retirement obligation (liability) and capitalizes the costs of the obligation as PP&E based on the estimated discounted fair value of its share of Syncrude's future expenditures required for the restoration of each of Syncrude's mine sites that have been disturbed and for the decommissioning of Syncrude's utilities plants, bitumen extraction plants, and upgrading complex. Syncrude is required to reclaim disturbed areas to a sustainable landscape with productivity that is equal to or greater than existed prior to development. In determining the fair value, Canadian Oil Sands must estimate the amount of the future expenditures, the timing of when they will be required, and then apply an appropriate risk-free interest rate. Given the long reserve life of Syncrude's leases, the expenditures will be made over approximately the next 70 years; as such, it is difficult to estimate their precise timing and amount.

   Any changes in the anticipated timing or amount of the expenditures, or to the risk-free interest rate subsequent to the initial obligation being recorded, results in a change to the asset retirement obligation and corresponding PP&E. Such changes will impact the accretion of the obligation and the depreciation or depletion of the PP&E and will correspondingly impact net income.

   Canadian Oil Sands' asset retirement obligation was $1,037 million at December 31, 2011 (December 31, 2010 – $501 million; January 1, 2010 – $550 million). Additional information about the increase in the obligation is provided in the "Asset Retirement Obligation" section of this MD&A

b) Canadian Oil Sands accrues its obligations for Syncrude Canada's post-employment benefits using actuarial and other assumptions to estimate the accrued benefit obligation, the return on plan assets and the expense related to the current period. The basic assumptions utilized are outlined in Note 8 to the December 31, 2011 audited Consolidated Financial Statements. The changes in these assumptions give rise to actuarial gains and losses which are recognized immediately in other comprehensive income as incurred. The accrued benefit obligation is measured using the estimated discounted fair value of the Canadian Oil Sands' share of future payments under Syncrude Canada's post-employment benefits plans. A one per cent decrease in the interest rate used to discount the accrued benefit obligation would result in a $177 million increase in Canadian Oil Sands' share of the employee future benefits liability, while a one per cent increase in the interest rate would result in a $136 million decrease.

   In addition, actual payments related to Syncrude Canada's post-employment benefits plans could vary greatly from estimates assumed in the accrued benefit obligation, resulting in actuarial gains and losses.

   Canadian Oil Sands does not have a post-employment benefits plan for its own employees. Therefore, all of the employee future benefits liabilities and expenditures relate to its Working Interest in Syncrude Canada's post-employment benefits plans. Canadian Oil Sands' liability for employee future benefits was $465 million at December 31, 2011 (December 31, 2010 – $327 million; January 1, 2010 – $281 million).

c) Canadian Oil Sands calculates depreciation expense for certain tangible assets on a straight-line basis. As such, Canadian Oil Sands must estimate the useful lives of these assets. While these useful life estimates are reviewed on a regular basis and depreciation calculations are revised accordingly, actual lives may differ from the estimates.

d) Canadian Oil Sands must estimate the reserves it expects to recover in the future and the related net revenues expected to be generated from producing those reserves. Reserves and future net revenues are evaluated and reported in a reserve report prepared by independent petroleum reserve evaluators who determine these evaluations using various factors and assumptions, such as: forecasts of mining and extraction recovery and upgrading yield based on geological and engineering data, projected future rates of production, projected operating costs, Crown royalties

and taxes, projected crude oil prices and oil price differentials and timing and amounts of future capital expenditures and other development costs, all of which are estimates. The factors and assumptions used in the estimates are assessed for reasonableness based on the information available at the time that the estimates are prepared. Estimates of reserves and future net revenues are critical to asset impairment tests. In addition, for certain intangible assets, which are depleted on a unit-of-production basis, reserves are used as a component of the depletion calculations to allocate capital costs over their estimated useful lives. The reserve report is reviewed by Canadian Oil Sands' management, the Reserves, Marketing Operations, and Environmental, Health and Safety Committee and the Board of Directors.

As circumstances change and new information becomes available, the reserve report data could change. Future actual results could vary greatly from our estimates, and could cause changes in our asset impairment tests or depletion estimates, both of which use the reserves and/or future net revenues in their respective calculations.

e) Accounting for income taxes is a complex process that requires the Corporation to interpret frequently changing laws and regulations, including changing income tax rates, and make certain judgments with respect to the application of tax law, estimating the timing of temporary difference reversals, and estimating the realizability of tax assets. Therefore, income taxes are subject to measurement uncertainty. Canadian Oil Sands' liability for deferred taxes was $1,264 million at December 31, 2011 (December 31, 2010 – $919 million; January 1, 2010 – $1,229 million).

## Changes in Accounting Policies

Apart from the changes described in the "Transition to International Financial Reporting Standards" section of this MD&A, there were no new accounting policies adopted, nor any changes to accounting policies, in 2011.

## New Accounting Standards

In May 2011, the International Accounting Standards Board ("IASB") issued IFRS 11, *Joint Arrangements*, to replace International Accounting Standard ("IAS") 31, *Interests in Joint Ventures*, IFRS 10, *Consolidated Financial Statements*, and IFRS 12, *Disclosure of Interests in Other Entities*, and IFRS 13, *Fair Value Measurements,* effective for years beginning on or after January 1, 2013 with earlier application permitted. IFRS 11 eliminates the accounting policy choice between proportionate consolidation and equity method accounting for joint ventures available under IAS 31 and, instead, mandates one of these two methodologies based on the economic substance of the joint arrangement. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements. IFRS 12 requires entities to disclose information about the nature of their interests in joint ventures and IFRS 13 defines, and establishes a framework for measuring, fair value.

In June 2011, the IASB issued an amendment to IAS 19, *Employee Benefits*, to address the accounting and disclosure of defined benefit pension plans effective for years beginning on or after January 1, 2013 with earlier application permitted.

In October 2011, the IASB issued International Financial Reporting Interpretations Committee ("IFRIC") Interpretation 20, *Stripping Costs in the Production Phase of a Surface Mine*, which clarifies the accounting for costs associated with waste removal in surface mining effective for years beginning on or after January 1, 2013 with earlier application permitted.

Canadian Oil Sands has not applied any of these new standards as of December 31, 2011. We continue to assess their impact and, at this time, do not anticipate any of them to result in significant accounting or disclosure changes.

## Risk Management

Canadian Oil Sands approaches the management of risk systematically through a process designed to identify, categorize and assess risks. Syncrude Canada, as operator of the joint venture, identifies and assesses the operational, environmental, health, and safety ("EH&S") risks that may impact its operations. The Corporation then augments Syncrude Canada's analysis with further consideration of risks specific to Canadian Oil Sands. Risks are categorized based on their probability of occurrence and their potential impact on Canadian Oil Sands' future cash flow from operations, net income, corporate reputation and EH&S performance. Syncrude and Canadian Oil Sands take a number of actions once the risks have been identified and categorized, including avoidance, mitigation, risk transfer and acceptance. In addition to ongoing monitoring and review, the Board of Directors of Canadian Oil Sands Limited is presented at least annually, and with quarterly updates where relevant, with a summary of management's assessment of the risks and strategies for managing such risks. The Board of Directors reviews the assessment and recommendations, and provides oversight of this risk management process.

There are a number of risks that could impact Canadian Oil Sands' cash flow from operations and net income and, therefore, the dividends ultimately paid to Shareholders. Cash flow from operations is highly sensitive to a number of factors including: Syncrude production; sales volumes; oil and natural gas prices; price differentials; foreign currency exchange rates; operating, non-production, administration and financing expenses; Crown royalties and regulatory and environmental risks. Dividends may also be impacted by Canadian Oil Sands' financing requirements for capital expenditures. Sensitivities to the most significant items affecting cash flow from operations are provided in the "2012 Outlook" section of this MD&A.

The following discusses the significant risks that impact Canadian Oil Sands' cash flow from operations, net income, corporate reputation and EH&S performance. More information regarding Canadian Oil Sands' risks is available in its AIF dated February 23, 2012, which is available on our website at **www.cdnoilsands.com** or at **www.sedar.com**.

### Commodity Price Risk

***Crude Oil Price Risk***

Canadian Oil Sands' sales are impacted by changes in both the U.S. dollar denominated crude oil prices and U.S./Cdn currency exchange rates.

Historically, our selling price has correlated closely to the Canadian dollar denominated WTI benchmark oil price and has been impacted by movements in U.S./Cdn currency exchange rates. However, supply and demand fundamentals create volatility in crude oil prices and impact the weighted-average price differential of our SCO product relative to Canadian dollar WTI prices as well as WTI prices relative to other crude benchmarks. These price differentials can change quickly, reflecting changes in the short-term supply and demand in the market and pipeline availability for transporting crude oil. Over the last three years, daily WTI prices have experienced significant volatility, ranging from U.S. $114 per barrel to U.S. $34 per barrel. Over the past twelve months, the SCO to Canadian dollar WTI monthly price differential has ranged from an approximate $15 per barrel premium to an approximate $15 per barrel discount.

Substantially all of our production is currently consumed by refineries in Canada and the United States for further processing into refined products. We compete for these markets against worldwide sources of crude oil and these refineries compete against other refineries and imported refined products. In recent years, various oil sands and other conventional crude oil projects in North America have come on-stream and additional projects are under development, or are being contemplated. This increases the supply of crude oil in the market. In addition, a number of refineries in the United States have, or are in the process of, modifying their plants to process heavy crude oil which is typically priced lower than light crude oil. This is expected to decrease these refineries' demand for our SCO.

If North American demand for crude oil or refined products decreases, if the regional or global supply of crude oil or refined products increases, if planned or unplanned shutdowns of, or modifications to, refineries occur, or if there is insufficient pipeline capacity or access to markets to absorb the increased supply (as discussed in the "Marketing and Transportation of Synthetic Crude Oil Risk" section of this MD&A), then the price we receive for our SCO may be negatively impacted.

A prolonged period of low crude oil prices or large SCO to Canadian dollar WTI discounts could have a material adverse effect on the Corporation's financial condition. Canadian Oil Sands' operating margin is very sensitive to oil prices. Low prices adversely impact cash flow from operations and profitability, and any substantial and extended decline in price could impact Canadian Oil Sands' ability to pay dividends and repay debt obligations.

Canadian Oil Sands prefers to remain unhedged on crude oil prices; however, during periods of significant capital spending and financing requirements, management may hedge prices to reduce cash flow volatility. Canadian Oil Sands did not have any crude oil price hedges in place during 2011 or 2010; instead, a strong balance sheet was used to mitigate the risk around crude oil price movements. As at February 23, 2012, the Corporation remains unhedged on its crude oil price exposure.

***Natural Gas Price Risk***

Purchased natural gas is a significant component of the bitumen production and upgrading processes. Increases in natural gas prices, therefore, introduce the risk of higher operating expenses. Similar to crude oil prices, monthly average AECO natural gas prices have experienced significant movements over the last three years, ranging from a high of $6.29 per GJ to a low of $1.92 per GJ. To the extent crude oil and natural gas prices move together, the risk of natural gas price increases is mitigated, as the Corporation is significantly more levered to oil price increases. The main risk involves a de-linking of crude oil and natural gas price movements. The Corporation has previously used hedge positions to mitigate natural gas price risk and will continue to assess this strategy as a means to manage short-term operating expenses. No natural gas price hedges were utilized in 2011 or 2010 and as at February 23, 2012, there were no natural gas price hedges in place.

**Operational Risk**

Our investment in Syncrude is our only producing asset and therefore the results of the Corporation depend on Syncrude's operations. The Syncrude Project is a 24-hour per day, 365-day per year operation which includes complex, inter-dependent facilities. The shutdown of any part of Syncrude's operation could significantly impact the production of SCO. Causes of production shortfalls and/or interruptions may include, but are not limited to: design errors; equipment failures; operator errors; weather-related shutdowns; or catastrophic events such as fire, earthquake, storms, explosions or dam failures. There is also the risk that the Syncrude plant will not achieve its design capacity on a sustained basis and/or will not be able to produce SCO with the expected quality specifications, either of which would impact Canadian Oil Sands' financial returns.

Productivity of the mining or extraction operations may be such that internally produced bitumen may not be sufficient to supply enough feed for the upgrading facility to meet its production capacity. While Syncrude has the ability to import purchased bitumen, there are physical restrictions on the amount of bitumen that can be transported into Syncrude's facilities and there is a risk that sufficient quantities of bitumen may not be available or economical. Further, the cost of purchased bitumen may be higher than Syncrude's own production costs. Partially offsetting this risk is the opportunity at periods in time, such as during coker turnarounds, for the mining and extraction operations to produce more bitumen than is required by the upgrading facility, which results in Syncrude building bitumen inventory for later use; however, Syncrude's capacity to store bitumen is limited to about 2.5 million barrels.

Extreme cold weather can affect both ongoing operations and capital projects by reducing worker productivity, producing mechanical failure, and potentially increasing natural gas consumption. Major incidents or unscheduled outages during winter months may curtail production and result in significant increases to operating expenses.

The Syncrude Project incorporates operational risk management programs as well as support from Imperial Oil/ExxonMobil through a Management Services Agreement. These organizations apply robust engineering and design standards and utilize maintenance and inspection procedures to mitigate operational risk. Sustained, safe and reliable operations are critical to achieving targets for production and operating expenses.

In addition, we are exposed to risks associated with major construction projects, including the possibility that projects will not be completed on time and/or will not achieve their design objectives.

If the mine train relocation and replacement projects, currently in progress, are not executed timely and effectively, production could be adversely impacted. At the Aurora North mine, Syncrude has three mine trains but only operates two at any given time. To mitigate production risk at that location, the plan is to relocate mine trains one at a time, while the other two trains continue to operate. In addition, the mine train relocations will be scheduled during planned upgrader outages when demand for bitumen is lower. To mitigate the risk at the Mildred Lake mine, the plan is to have the replacement mine trains operating before the old mine trains are decommissioned. The mine train relocations and replacements are necessary to vacate depleted pits to allow tailings placement. If the mine trains are not removed on time, there is a risk that Syncrude will not be able to place tailings, and therefore produce planned levels of bitumen, for some period. Additional information on Syncrude's tailings management program is provided in the "Environmental Risk" discussion within the "Risk Management" section of this MD&A.

Complications could arise when major construction projects are commissioned and become operational, as new systems are integrated with existing systems and facilities. The SER project is scheduled for commissioning and start-up in 2012. SER will allow Syncrude to significantly reduce sulphur emissions and comply with regulated emissions targets which are reduced, in stages, over a three-year period following SER's start-up. While there are risks with the start-up and commissioning of any new asset, the staged emissions targets are considered reasonable and achievable.

Canadian Oil Sands reduces exposure to some operational risks by maintaining appropriate levels of insurance, primarily business interruption ("BI") and property insurance. The Corporation has purchased total coverage of approximately U.S. $1.0 billion of BI and property insurance, net to Canadian Oil Sands, in case Syncrude experiences an event causing a loss or interruption of production, such as a fire or explosion at the operating facilities. The BI insurance is subject to an average 75-day self-retention period. While such insurance mitigates the impact of certain operational upsets, insurance is unlikely to fully protect against catastrophic events or prolonged shutdowns.

Canadian Oil Sands also faces risks associated with competition amongst other oil sands producers for limited resources, in particular skilled labour, in the Fort McMurray area where Syncrude and other oil sands producers operate. The demand for these resources creates costs pressure on products and services to operate Syncrude's facilities.

In addition, any limitations on the availability of an experienced workforce increase the risk of design or operator error. To mitigate this risk, Syncrude Canada is focused on attracting and retaining experienced and skilled labour. Syncrude Canada offers competitive industry compensation to employees and contract staff, has a very strong record for safety performance and is an innovative and socially responsible company committed to the environment and dedicated to its employees, the Aboriginal Peoples, and the communities of northern Alberta. Additionally, Syncrude Canada has an employee retention program and, to deal with the increased demands on local infrastructure, such as housing, Syncrude Canada cooperates with other industry participants to share resources, such as camps.

There may also be increased activity in global industries, such as the mining sector, which are competing for constrained supplies and labour. While we do not expect any specific shortage to impact our current 2012 production outlook, the ability to achieve higher levels of production in the future may be limited by unexpected supply or labour constraints.

**Capital Expenditure Risk**

Inherent in the mining of oil sands and production of SCO is a need to make substantial capital expenditures. The demand for skilled labour and other limited resources impacting operating expenses is having a similar effect on capital expenditures. There is also a risk that capital maintenance at Syncrude will be required more often than currently planned, or that significant capital projects could arise that were not previously anticipated.

In addition to potential capital cost increases, we are exposed to financing risks associated with funding our share of Syncrude's capital program. We have historically minimized this risk by diversifying our funding sources, which include credit facilities and cash flow from operations. In addition, we believe that the Corporation has the ability to access public debt and equity markets, given our asset base and current credit ratings; however, maintenance of such market access may be impacted by sustained low production and low commodity prices. For further discussion, see the "Liquidity Risk" disclosure within the "Financial Market Risk" section of this MD&A.

There is also risk associated with estimating costs for major projects. Canadian Oil Sands often discloses estimates for Syncrude's major projects, which encompass the conceptual stage through to final scope design, including detailed engineering cost estimates. These projects, however, typically evolve over time and updates for timing and cost estimates are often provided during project construction. At each stage of these major projects, cost estimates involve uncertainties. Accordingly, actual costs can vary from the estimates Canadian Oil Sands provides and these differences can be significant.

**Financial Market Risk**

Canadian Oil Sands is subject to financial market risk as a result of fluctuations in foreign currency exchange rates, interest rates, liquidity, and credit.

***Foreign Currency Risk***

Canadian Oil Sands' results are affected by fluctuations in the U.S./Cdn currency exchange rates, as sales generated are based on a WTI benchmark price in U.S. dollars while operating expenses and capital expenditures are denominated primarily in Canadian dollars. Our sales exposure is partially offset by U.S. dollar obligations, such as interest costs on U.S. dollar-denominated long-term debt (Senior Notes) and our share of Syncrude's U.S. dollar vendor payments. In addition, when our U.S. dollar Senior Notes mature, we have exposure to U.S. dollar exchange rates on the principal repayment of the notes. This repayment of U.S. dollar debt acts as a partial economic hedge against the U.S. dollar-denominated sales receipts we collect from our customers.

In the past, the Corporation has hedged foreign currency exchange rates by entering into fixed rate currency contracts. The Corporation did not have any foreign currency hedges in place during 2011 or 2010, and does not currently intend to enter into any new currency hedge positions. The Corporation may, however, hedge foreign currency exchange rates in the future, depending on the business environment and growth opportunities.

As at December 31, 2011, portions of Canadian Oil Sands' cash and cash equivalents, accounts receivable, accounts payable and long-term debt were denominated in U.S. dollars. Based on these U.S. dollar financial instrument closing balances, 2011 net income and other comprehensive income would have increased/decreased by approximately $10 million for every $0.01 decrease/increase in the value of the U.S./Cdn currency exchange rate.

***Interest Rate Risk***

Canadian Oil Sands' net income and cash flow from operations are impacted by U.S. and Canadian interest rate changes because our credit facilities and investments are exposed to floating interest rates. In addition, we are exposed to the refinancing of maturing long-term debt at prevailing interest rates. As at December 31, 2011, there were no amounts drawn on the credit facilities ($145 million at December 31, 2010; $nil at January 1, 2010) and the next long-term debt maturity is in August 2013. The Corporation did not have a significant exposure to interest rate risk based on either the amount of floating rate debt or the short-term nature of investments outstanding during the year.

***Liquidity Risk***

Liquidity risk is the risk that Canadian Oil Sands will not be able to meet its financial obligations as they come due. Canadian Oil Sands actively manages its liquidity through cash, debt and equity management strategies. Such strategies encompass, among other factors: having adequate sources of financing available through bank credit facilities, estimating future cash flow from operations based on reasonable production and pricing assumptions, understanding operating commitments and future capital expenditure requirements, analysing economic hedging opportunities, and complying with debt covenants. In addition, over the long-term, Canadian Oil Sands spreads out the maturities of its various debt tranches and maintains a prudent capital structure.

The next long-term debt maturity is in August 2013, the $1.5 billion credit facility does not expire until June 2015, Canadian Oil Sands held cash balances totalling $718 million at December 31, 2011, and Canadian Oil Sands was in compliance with its debt covenants throughout 2011, collectively resulting in relatively low liquidity risk.

More information regarding the available credit facilities and contractual maturities of Canadian Oil Sands' long-term debt can be found in Notes 9 and 10, respectively, to the consolidated financial statements.

***Credit Risk***
Canadian Oil Sands is exposed to credit risk primarily through customer accounts receivable balances, financial counterparties with whom the Corporation has invested its cash and cash equivalents, and with its insurance providers in the event of an outstanding claim. The maximum exposure to any one customer or financial counterparty is managed through a credit policy.

Canadian Oil Sands carries credit insurance on some counterparties to help mitigate a portion of the impact should a loss occur and continues to transact primarily with investment grade customers. The vast majority of accounts receivable at December 31, 2011 was due from investment grade energy producers, financial institutions, and refinery-based customers.

At December 31, 2011, our cash and cash equivalents were invested in deposits and Bankers' Acceptances with high-quality senior banks as well as investment grade commercial paper. As of February 23, 2012, there are no financial assets that are past their maturity or impaired due to credit risk-related defaults.

**Syncrude Joint Venture Ownership Risk**
Syncrude is a joint venture that is currently owned by seven participants with varying interests. Major capital decisions for new expansion projects require unanimous support of the Syncrude owners, while other matters require only the approval of a majority of the working interests and three Syncrude owners. Historically, Canadian Oil Sands and the Syncrude owners have sought consensus on all significant matters. There can be no assurance, however, that unanimous agreement will be reached on major capital programs or that future expansions will be executed as currently planned. Additionally, while the obligations of the Syncrude owners are stated to be joint and not several under the terms of the joint venture agreement, a number of the environmental regulatory requirements impose joint and several liability on all land owners and, as such, the Syncrude owners. Mitigating this is the credit strength of the other joint venture owners, as well as the ability of the joint venture owners to take the production of any defaulting joint venture owner to satisfy any such obligations.

**Marketing and Transportation of Synthetic Crude Oil Risk**
All of our Syncrude production is currently transported through the Alberta Oil Sands Pipeline Limited ("AOSPL") system, which delivers crude oil to Edmonton, Alberta. Disruptions in service on this system could adversely affect our crude oil sales and, potentially, production volumes. The AOSPL system feeds into various other crude oil pipelines that deliver our SCO to refinery customers throughout Canada and the United States.

Interruptions in the availability of these pipeline systems may limit the ability to deliver production volumes and could adversely impact sales volumes or the prices received for our product. These interruptions may be caused by capacity constraints if the supply of feedstock into the system exceeds the infrastructure capacity or by the inability of the pipelines to operate.

As discussed in the "Crude Oil Price Risk" section of this MD&A, various oil sands and conventional crude oil projects in North America are increasing the supply of crude oil in the market. While we believe long-term pipeline capacity will be sufficient to match crude oil supply, there can be no certainty that investments will be made to provide this capacity. There is also no certainty that short-term operational constraints on the pipeline system, arising from pipeline interruptions and/or increased supply of crude oil, will not occur. We manage exposure to these risks by allocating deliveries to multiple customers via multiple pipelines; however, pipeline choices are limited.

In response to growing crude oil supply, two large pipeline projects which increased the take-away capacity from western Canada were completed in 2010, and a number of projects to build new, or expand and extend existing, pipelines are currently planned; however, these projects require final commercial and/or regulatory approvals. The projects are expected to result in excess pipeline capacity. Unfortunately, leaks on pipelines that ships western Canadian crude to downstream markets occurred in 2010 and 2011, resulting in shutdowns and pressure restrictions. The resulting reduced pipeline capacity combined with increasing crude oil supply resulted in pipeline apportionment through 2011 and into 2012. Apportionment occurs when the demand for pipeline space exceeds the capacity of the pipeline and, as a result, the pipeline space is allocated to the various shipping companies like Canadian Oil Sands. If this capacity is returned to service, and as long as there are no additional restrictions, it should help reduce the levels of apportionment.

**Environmental Risk**

Canadian Oil Sands is committed to ensuring that Syncrude develops its oil sands resources in a responsible way. We are subject to laws and regulations governing the impact Syncrude and other oil sands operations have on the environment. Additionally, we are subject to reputational risk regarding such environmental impacts. The following highlights two key environmental risks at this time.

***Tailings Management***

Fine tailings, a byproduct of the oil sands mining extraction process, are comprised of silts, clays and hydrocarbon residues (collectively "fines") suspended in water. Like all oil sands mining operations, Syncrude produces a significant volume of fine tailings and stores them in tailings ponds. The fines can remain in suspension for many years, if not indefinitely. Before tailings ponds can be reclaimed, water must be separated from the suspended fines such that solidified silts, clays and hydrocarbon residues can be incorporated into reclamation landscapes. The water is recycled back into operations. To achieve this, Syncrude uses a method called composite tails, which combines fine tailings with gypsum and sand to help fines settle faster; however, additional tailings management technologies are required in order to meet government directives for closure and reclamation.

On February 5, 2009, the Alberta ERCB released Directive 074: Tailings Performance Criteria and Requirements for Oil Sands Mining Schemes. This directive provides industry-wide criteria to supplement existing regulations by requiring operators to:

- reduce fine tailings by capturing a minimum amount of fines in Dedicated Disposal Areas ("DDAs");
- form and manage DDAs to ensure the formation of trafficable deposits that are ready for reclamation five years after active deposition has ceased; and
- submit to the ERCB annual compliance reports for DDAs, annual tailing plans and tailings pond status reports. DDA plans must also be submitted two years prior to construction.

Syncrude's tailings plan outlines a multi-pronged approach for meeting the long-term intent of Directive 074 through the implementation of three main tailings technologies:

- composite tails;
- water capping, which involves layering water over a deposit of fine tailings to form a lake; and
- centrifuging, which involves putting tailings through vessels where a spinning action separates out the water.

Syncrude's tailings plans incorporate the use of both water capping and centrifuging, which are developmental technologies. Syncrude has been researching water capping technology for more than 20 years with bench-scale laboratory experiments and test ponds. A commercial-scale pond will be commissioned in 2012 to serve as a demonstration of the water-capping concept. Likewise, extensive field tests have been done on centrifuging technology with the support of the Canada Centre for Mineral and Energy Technology. Notwithstanding this, there is an inherent risk that these technologies may not be as effective as desired, or perform as required in order to meet the tailings plan.

The monitoring and reporting requirements under Directive 074 will also mean greater regulatory scrutiny over tailings management now and into the future. Directive 074 will allow the ERCB to take enforcement action against companies that fail to meet tailings management criteria. Enforcement actions range from non-compliance fees to increased inspections and suspension or cancellation of approvals. It is noteworthy that Directive 074 is performance-based, and gives companies the flexibility to choose the technology they prefer to achieve the performance criteria. While Syncrude continues to develop tailings management technologies, there is a risk of increased costs to develop and implement various measures and the potential for tailings specific regulatory approval conditions to be attached to future regulatory applications and/or renewals.

Syncrude Canada is collaborating with other oil sands mining companies in a unified effort to advance tailings management. This will involve sharing technical information, collaborating on tailings-related research and development, eliminating monetary and intellectual property barriers and working to develop an appropriate framework so that tailings information is organized, verified through peer review and kept current.

***Greenhouse Gas Emissions***

The Syncrude operations emit greenhouse gases so legislation or regulations that significantly restrict or penalize current emission levels could have a material impact on our operations. The costs of meeting such thresholds would increase operating expenses and/or capital costs, and as such, may impact the profitability of the operations.

In 2007, through the Specified Gas Emitters Regulation, Alberta became the first province in Canada to regulate greenhouse gases ("GHG") by establishing intensity targets for Large Final Emitters of carbon dioxide ("$CO_2$"). Effectively, the regulation requires Syncrude, beginning in the second half of 2007, to reduce per barrel emissions of GHG by 12 per cent from the average of its annual per barrel emissions between 2003 and 2005. If Syncrude is unable to meet this target directly, it must purchase offset credits or pay into a government fund dedicated to the development of emissions reduction technologies.

For 2011, Syncrude accrued approximately $0.21 per barrel, or approximately $8 million net to Canadian Oil Sands, for compliance with the Specified Gas Emitters Regulation, which is reflected in operating expenses. The cost estimate remains preliminary, pending Syncrude's actual $CO_2$ emission intensity level and clarification from the Alberta government regarding details of implementation.

Canada's federal government has indicated its intention to implement a regulatory framework to reduce GHG emissions, and in December 2011, committed under the Durban Platform to negotiating an international climate change agreement by 2015 that would create binding commitments for all major emitters, with such agreement to come into force before 2020.

Syncrude continues to explore and implement measures to reduce energy intensity in its operations, which is expected to reduce both $CO_2$ emissions and operating expenses. Syncrude expects these efforts will lower $CO_2$ emissions per barrel of SCO production. Total $CO_2$ emissions may, however, increase as production rises and the risk exists that these mitigation efforts will not meet societal expectations or new environmental regulations.

## Consolidated Results Compared to Prior Year's Outlook

In its 2010 annual MD&A, Canadian Oil Sands provided guidance with regard to its estimate of 2011 Syncrude production volumes, its expected cash flow from operations and its capital expenditures (the "original estimate" or "original Outlook"). During 2011 the Corporation revised this guidance in quarterly reports and information releases to reflect actual results for each quarter and new significant information as it became available (the "revised estimate" or "revised Outlook").

| | | 2011 Outlook | |
|---|---|---|---|
| *(millions of Canadian dollars, except volume and per barrel amounts)* | 2011 Actual | Original[1] | Revised[2] |
| **Operating assumptions** | | | |
| Syncrude production (mmbbls) | 105.3 | 110.0 | 110.0 |
| Canadian Oil Sands sales (mmbbls) | 38.7 | 40.4 | 40.4 |
| Sales, net of crude oil purchases and transportation | $ 3,934 | $ 3,188 | $ 4,005 |
| Operating expenses | $ 1,501 | $ 1,487 | $ 1,542 |
| Operating expenses per barrel | $ 38.80 | $ 36.79 | $ 38.15 |
| Crown royalties | $ 307 | $ 181 | $ 310 |
| Cash flow from operations[3] | $ 1,897 | $ 1,214 | $ 1,952 |
| **Capital expenditure assumptions** | | | |
| Major projects | $ 316 | $ 622 | $ 362 |
| Regular maintenance | $ 270 | $ 305 | $ 272 |
| Capitalized interest | $ 57 | $ – | $ 57 |
| Total capital expenditures | $ 643 | $ 927 | $ 691 |
| **Business environment assumptions** | | | |
| West Texas Intermediate (U.S.$/bbl) | $ 95.11 | $ 80.00 | $ 92.00 |
| Premium (discount) to average Cdn$ WTI prices (Cdn$/bbl) | $ 7.32 | $ (2.75) | $ 8.00 |
| Foreign exchange rate (U.S.$/Cdn$) | $ 1.01 | $ 0.98 | $ 1.01 |
| AECO natural gas (Cdn$/GJ) | $ 3.48 | $ 4.00 | $ 3.75 |

[1] *Original 2011 Outlook as provided in the 2010 annual report dated February 23, 2011.*
[2] *Revised 2011 Outlook as provided in the third quarter 2011 quarterly report dated October 27, 2011.*
[3] *Canadian Oil Sands forecasted cash from operating activities of $1,316 million, rather than cash flow from operations of $1,214 million, in the Original 2011 Outlook. $1,316 million included cash flows of $102 million from changes in non-cash working capital.*

Syncrude actual 2011 production of 105.3 million barrels was lower than Canadian Oil Sands' 110 million barrel estimate due primarily to the unplanned shutdown of a hydrogen unit to perform required maintenance as well as a process upset in Coker 8-1 during the fourth quarter of the year.

Cash flow from operations was $1,897 million, 56 per cent higher than the $1,214 million original estimate, and sales net of crude oil purchase and transportation were $3,934 million, 23 per cent higher than the $3,188 million original estimate. The favourable variances relative to the original estimates primarily reflect a higher-than-expected realized selling price net of lower-than-expected sales volumes. WTI oil prices averaged U.S. $95.11 per barrel, above the U.S. $80.00 per barrel original estimate, and Canadian Oil Sands realized a $7.32 per barrel premium relative to Canadian dollar WTI (the "SCO differential") as opposed to a $2.75 per barrel discount as originally estimated. In October 2011, we revised our estimate of WTI prices to U.S. $92.00 per barrel, to reflect strengthening in oil prices, and the differential to an $8.00 per barrel premium, to reflect the short-term supply and demand dynamics discussed in the "Sales Net of Crude Purchases and Transportation Expense" section of this MD&A.

Total operating expenses of $1,501 million were one per cent above the $1,487 original estimate, reflecting higher-than-expected maintenance and diesel costs, largely offset by lower-than-expected natural gas costs; these factors, combined with the lower-than-expected sales volumes, resulted in actual per barrel operating expenses of $38.80, five per cent higher than the $36.79 original estimate.

Capital expenditures were $643 million, $284 million below the $927 million original estimate and $48 million below the $691 million revised estimate, due primarily to adjustments to the expected timing of spending on major projects. The expected completion dates and cost estimates for these major projects are not affected by these adjustments.

## 2012 Outlook

| *(millions of Canadian dollars, except volume and per barrel amounts)* | | As of February 23 2012 |
|---|---|---|
| **Operating assumptions** | | |
| Syncrude production (mmbbls) | | 113 |
| Canadian Oil Sands sales (mmbbls) | | 41.5 |
| Sales, net of crude oil purchases and transportation | $ | 3,813 |
| Operating expenses | $ | 1,516 |
| Operating expenses per barrel | $ | 36.52 |
| Crown royalties | $ | 253 |
| Cash flow from operations | $ | 1,825 |
| **Capital expenditure assumptions** | | |
| Major projects | $ | 974 |
| Regular maintenance | $ | 405 |
| Capitalized interest | $ | 81 |
| Total capital expenditures | $ | 1,460 |
| **Business environment assumptions** | | |
| West Texas Intermediate (U.S.$/bbl) | $ | 90.00 |
| Premium (Discount) to average Cdn$ WTI prices (Cdn$/bbl) | $ | – |
| Foreign exchange rate (U.S.$/Cdn$) | $ | 0.98 |
| AECO natural gas (Cdn$/GJ) | $ | 3.50 |

All amounts in this 2012 Outlook dated February 23, 2012 are unchanged from the 2012 Outlook dated February 1, 2012, which was provided in the fourth quarter 2011 report.

Canadian Oil Sands continues to estimate annual Syncrude production of 113 million barrels (309,000 barrels per day) with a range of 106 to 117 million barrels for 2012. Net to Canadian Oil Sands, this is equivalent to 41.5 million barrels (113,000 barrels per day). The production outlook incorporates a turnaround of Coker 8-3 in the second quarter of the year, as originally planned, and maintenance on Coker 8-1 in the first quarter.

Sales, net of crude oil purchases and transportation expense, are estimated to be approximately $3.8 billion, reflecting our 41.5 million barrel production estimate and a $92 per barrel sales price. The sales price assumes an average U.S. $90 per barrel WTI crude oil price, a $0.98 U.S./Cdn foreign exchange rate, and no SCO premium/discount to Canadian dollar WTI.

We are estimating operating expenses of approximately $1.5 billion in 2012, comprised of approximately $1.3 billion in production costs and $0.2 billion in purchased energy costs. The purchased energy costs reflect a $3.50 per gigajoule ("GJ") natural gas price assumption and a consumption rate of about one GJ per barrel of SCO produced; based on our production assumption, this translates to operating expenses of $36.52 per barrel.

Capital expenditures are estimated to total $1,460 million, comprised of $974 million of spending on major projects, $405 million in regular maintenance of the business and other projects, and $81 million in capitalized interest.

Current taxes are estimated to total $30 million in 2012. Based on the assumptions in our Outlook, Canadian Oil Sands expects to record deferred taxes of approximately 15 per cent to 20 per cent of (pre-tax) cash flow from operations in 2012, which will flow through current taxes and cash flow from operations in 2013.

Based on these inputs, Canadian Oil Sands is estimating cash flow from operations of $1,825 million, or $3.77 per Share, in 2012. After deducting forecast 2012 capital expenditures, we estimate $365 million in remaining cash flow from operations for the year, or $0.75 per Share.

Net debt is expected to rise during 2012 as cash balances are used to fund a portion of capital expenditures and dividends. Our 2011 results have positioned Canadian Oil Sands to manage risk associated with a rising capital program and an uncertain outlook for the global economy, thereby providing some stability to our dividend level. For 2012, we are targeting a quarterly dividend of at least $0.30 per Share, based on current assumptions and with support from our cash balances, as necessary.

Changes in certain factors and market conditions could potentially impact Canadian Oil Sands' Outlook. The following table provides a sensitivity analysis of the key factors affecting the Corporation's performance.

**Outlook Sensitivity Analysis (February 23, 2012)**

| | | Cash Flow from Operations Increase | |
|---|---|---|---|
| Variable[1] | Annual Sensitivity | $ millions | $ / Share |
| Syncrude operating expenses decrease | Cdn$1.00/bbl | $ 34 | $ 0.07 |
| Syncrude operating expenses decrease | Cdn$50 million | $ 15 | $ 0.03 |
| WTI crude oil price increase | U.S.$1.00/bbl | $ 35 | $ 0.07 |
| Syncrude production increase | 2 million bbls | $ 56 | $ 0.12 |
| Canadian dollar weakening | U.S.$0.01/Cdn$ | $ 32 | $ 0.07 |
| AECO natural gas price decrease | Cdn$0.50/GJ | $ 19 | $ 0.04 |

[1] *2012 cash flow from operations sensitivities are not expected to be significantly impacted by income taxes; however, in 2012, Canadian Oil Sands will record deferred taxes of approximately 15 per cent to 20 per cent of cash flow from operations before taxes that are expected to flow through current tax expense and cash flow from operations in 2013.*

*The 2012 Outlook contains forward-looking information and users are cautioned that the actual amounts may vary from the estimates disclosed. Please refer to the "Forward-Looking Information Advisory" section of this MD&A for the risks and assumptions underlying this forward-looking information.*

**Major Projects**

The following tables provide cost and schedule estimates for Syncrude's major projects. Costs for the Centrifuge Tailings Management project at the Mildred Lake mine are included in 2012 spending but are excluded from 2013 and 2014 spending, as this project has not reached sufficient design definition. Regular maintenance capital costs post 2012 will be provided on an annual basis with the budget for the following year, and are currently estimated to average approximately $10 per barrel over the next few years.

### Major Projects[1] – Total Project Cost and Schedule Estimates[2]

| | | Spent to Dec 31, 2011 ($ billions) | Total Cost Estimate ($ billions) | Estimated % Accuracy | Target In-Service Date |
|---|---|---|---|---|---|
| **Syncrude Emissions Reduction (SER)** | Syncrude | $ 1.4 | $ 1.6 | +5%/-5% | Q2 2012 |
| Retrofit technology into Syncrude's original two cokers to reduce total sulphur dioxide and other emissions | COS share | 0.5 | 0.6 | | |
| **Mildred Lake Mine Train Replacement** | Syncrude | $ 0.5 | $ 4.2 | +15%/-15% | Q4 2014 |
| Reconstruct crushers, surge facilities, and slurry prep facilities to support tailings storage requirements | COS share | 0.2 | 1.6 | | |
| **Aurora North Mine Train Relocation** | Syncrude | $ 0.2 | $ 1.0 | +15%/-15% | Q1 2014 |
| Relocate crushers, surge facilities, and slurry prep facilities to support tailings storage requirements | COS share | 0.1 | 0.4 | | |
| **Aurora North Tailings Management** | Syncrude | $ 0.2 | $ 0.8 | +15%/-15% | Q4 2013 |
| Construct composite tails (CT) plant at the Aurora North mine | COS share | 0.1 | 0.3 | | |

### Major Projects[1] – Annual Spending Profile[2]

| *($ billions)* | Spent to Dec 31, 2011 | 2012 | 2013 | 2014 | Total |
|---|---|---|---|---|---|
| **Syncrude** | $ 2.3 | $ 2.7 | $ 2.0 | $ 1.2 | $ 8.2 |
| **Canadian Oil Sands share** | $ 0.9 | $ 1.0 | $ 0.8 | $ 0.4 | $ 3.1 |

[1] *Major projects spending includes costs for the Syncrude Emissions Reduction (SER), Mildred Lake Mine Train Replacement, Aurora North Mine Train Relocation, and Aurora North Tailings Management projects. Costs for the Centrifuge Tailings Management project are included in 2012 spending but are excluded from 2013 and 2014 spending, as this project has not reached sufficient design definition.*

[2] *Major projects costs include both capital expenditures, excluding capitalized interest, and certain non-production expenses.*

Canadian Oil Sands plans to finance these major projects primarily with cash flow from operations.

The front-end engineering design work is now completed for the Aurora North Mine Train Relocation and Aurora North Tailings Management projects, resulting in fully engineered project cost estimates of $1.0 and $0.8 billion (gross to Syncrude), respectively ($0.4 billion and $0.3 billion, respectively, net to Canadian Oil Sands).

*The major projects tables contain forward-looking information and users of this information are cautioned that the actual yearly and total major project costs and the actual in-service dates for the major projects may vary from the plans disclosed. The major project cost estimates and major project target in-service dates are based on current spending plans. Please refer to the "Forward-Looking Information Advisory" section of this MD&A for the risks and assumptions underlying this forward-looking information. For a list of additional risk factors that could cause the actual amount of the major project costs and the major project target in-service dates to differ materially, please refer to the Corporation's Annual Information Form dated February 23, 2012 which is available on the Corporation's profile on SEDAR at* ***www.sedar.com*** *and on the Corporation's website at* ***www.cdnoilsands.com****.*

**Controls Environment**

Management is responsible for establishing and maintaining adequate internal control over financial reporting. We have established disclosure controls and procedures, internal control over financial reporting, and organization-wide policies to provide reasonable assurance that Canadian Oil Sands' consolidated financial position, financial performance and cash flows are presented fairly. Our disclosure controls and procedures are designed to provide reasonable assurance of the timely disclosure and communication of all material information.

We periodically review and update our internal control systems to reflect changes in our business environment. We did not materially change any of our internal controls during 2011.

All internal control systems, no matter how well designed, have inherent limitations. These systems, therefore, provide reasonable but not absolute assurance that financial information is accurate and complete.

Canadian Oil Sands, under the supervision and participation of management, including the President and Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures and the design of our internal control over financial reporting pursuant to National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* as of December 31, 2011. In addition, management has evaluated the effectiveness of our internal control over financial reporting as of December 31, 2011 using criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on these evaluations, Canadian Oil Sands' management concluded that:

- Our disclosure controls and procedures were effective as of December 31, 2011 to provide reasonable assurance that material information is recorded, processed, summarized and reported within the time periods specified by the applicable Canadian securities regulators. Furthermore, our disclosure controls and procedures are designed to provide reasonable assurance that material information required to be disclosed under applicable Canadian securities regulation is communicated to our management, including our President and Chief Executive Officer and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure; and
- Our internal control over financial reporting as of December 31, 2011 was designed and operated effectively to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Corporation's financial statements for external purposes in accordance with GAAP.

PricewaterhouseCoopers LLP, our auditors, have expressed an unqualified opinion on the effectiveness of Canadian Oil Sands' internal control over financial reporting as of December 31, 2011, as stated in their report which appears herein.

# Management's Report

**Financial Information**

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

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

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

The Board of Directors has appointed a four-person Audit Committee, consisting of directors who are neither employees nor officers of Canadian Oil Sands and all of whom are independent. It meets regularly with management and external auditors to discuss controls over the financial reporting process, auditing and other financial reporting matters. In addition, the Audit Committee recommends the appointment of Canadian Oil Sands' external auditors. The Audit Committee meets at least quarterly with management and the external auditors to review and approve interim financial statements prior to their release and recommends the audited annual financial statements to the Board of Directors for their approval. Annually, the Board of Directors reviews and approves Canadian Oil Sands' annual financial statements, Management's Discussion and Analysis, AIF, Management Proxy Circular, and annual reserves estimates. The Board of Directors has approved the annual audited Consolidated Financial Statements and the Management's Discussion and Analysis based on the recommendations of the Audit Committee.

**Internal Control Over Financial Reporting**

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

Management has assessed the effectiveness of Canadian Oil Sands' internal control over financial reporting as of December 31, 2011 using criteria established in the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that Canadian Oil Sands' internal control over financial reporting was effective as of December 31, 2011.

PricewaterhouseCoopers LLP, our auditors, has audited the effectiveness of Canadian Oil Sands' internal control over financial reporting as of December 31, 2011 as stated in their report which appears herein.

(signed) **Marcel R. Coutu**
President and Chief Executive Officer
February 23, 2012

(signed) **Ryan M. Kubik**
Chief Financial Officer
February 23, 2012

# Independent Auditor's Report

**To the Shareholders of Canadian Oil Sands Limited**

We have completed an integrated audit of Canadian Oil Sands Limited's 2011 consolidated financial statements and its internal control over financial reporting as at December 31, 2011 and an audit of its 2010 consolidated financial statements. Our opinions, based on our audits, are presented below.

**Report on the Consolidated Financial Statements**
We have audited the accompanying consolidated financial statements of Canadian Oil Sands Limited, which comprise the consolidated balance sheets as at December 31, 2011, December 31, 2010 and January 1, 2010 and the consolidated statements of income and comprehensive income, shareholders' equity and cash flows for the years ended December 31, 2011 and 2010, and the related notes, which comprise a summary of significant accounting policies and other explanatory information.

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

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

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

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

**Opinion**
In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Canadian Oil Sands Limited as at December 31, 2011, December 31, 2010 and January 1, 2010 and its financial performance and cash flows for the years ended December 31, 2011 and 2010 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

**Report on Internal Control Over Financial Reporting**
We have also audited Canadian Oil Sands Limited's internal control over financial reporting as at December 31, 2011, based on criteria established in *Internal Control – Integrated Framework*, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

**Management's Responsibility for Internal Control Over Financial Reporting**
Management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report.

**Auditor's Responsibility**
Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

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

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

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

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

**Opinion**
In our opinion, Canadian Oil Sands Limited maintained, in all material respects, effective internal control over financial reporting as at December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by COSO.

(signed) **PricewaterhouseCoopers LLP**
**Chartered Accountants**
Calgary, Alberta, Canada
February 23, 2012

# Consolidated Statements of Income and Comprehensive Income

| For the years ended December 31 *(millions of Canadian dollars, except per Share and Share volume amounts)* | | **2011** | | 2010 |
|---|---|---|---|---|
| Sales | **$** | **4,182** | $ | 3,460 |
| Crown royalties (Note 15) | | **(307)** | | (306) |
| **Revenues** | | **3,875** | | 3,154 |
| | | | | |
| **Expenses** | | | | |
| Operating | | **1,501** | | 1,387 |
| Non-production | | **113** | | 105 |
| Crude oil purchases and transportation | | **248** | | 280 |
| Administration | | **25** | | 20 |
| Insurance | | **8** | | 11 |
| Depreciation and depletion | | **381** | | 429 |
| | | **2,276** | | 2,232 |
| **Earnings from operating activities** | | **1,599** | | 922 |
| Foreign exchange (gain) loss (Note 16) | | **22** | | (60) |
| Net finance expense (Note 17) | | **46** | | 82 |
| **Earnings before taxes** | | **1,531** | | 900 |
| Deferred tax expense (recovery) (Note 12) | | **387** | | (289) |
| **Net income** | | **1,144** | | 1,189 |
| **Other comprehensive loss, net of income taxes** | | | | |
| Actuarial loss on employee future benefit plans (Note 8) | | **(128)** | | (61) |
| Reclassification of derivative gains to net income | | **(3)** | | (3) |
| **Comprehensive income** | **$** | **1,013** | $ | 1,125 |
| | | | | |
| **Weighted average Shares** (millions) | | **485** | | 484 |
| **Shares, end of year** (millions) | | **485** | | 484 |
| | | | | |
| **Net income per Share** (Note 13(b)) | | | | |
| Basic and diluted | **$** | **2.36** | $ | 2.46 |

*See Notes to Consolidated Financial Statements*

# Consolidated Statements of Shareholders' Equity

| For the years ended December 31 *(millions of Canadian dollars)* | **2011** | 2010 |
|---|---|---|
| **Retained earnings** | | |
| Balance, beginning of year | **$ 1,034** | $ 802 |
| Net income | **1,144** | 1,189 |
| Actuarial loss on employee future benefit plans | **(128)** | (61) |
| Dividends | **(533)** | (896) |
| Balance, end of year | **1,517** | 1,034 |
| **Accumulated other comprehensive income** | | |
| Balance, beginning of year | **15** | 18 |
| Reclassification of derivative gains to net income | **(3)** | (3) |
| Balance, end of year | **12** | 15 |
| **Shareholders' capital** | | |
| Balance, beginning of year | **2,671** | 2,671 |
| Issuance of shares | **2** | – |
| Balance, end of year | **2,673** | 2,671 |
| **Contributed surplus** | | |
| Balance, beginning of year | **6** | – |
| Share-based compensation | **2** | 6 |
| Balance, end of year | **8** | 6 |
| **Total Shareholders' equity** | **$ 4,210** | $ 3,726 |

*See Notes to Consolidated Financial Statements*

# Consolidated Balance Sheets

| As at *(millions of Canadian dollars)* | **December 31 2011** | December 31 2010 | January 1 2010 |
|---|---|---|---|
| **ASSETS** | | | |
| Current assets | | | |
| Cash and cash equivalents | **$ 718** | $ 80 | $ 122 |
| Accounts receivable | **376** | 379 | 354 |
| Inventories (Note 5) | **142** | 129 | 133 |
| Prepaid expenses | **10** | 6 | 7 |
| | **1,246** | 594 | 616 |
| Property, plant and equipment, net (Note 6) | **7,227** | 6,396 | 6,265 |
| Exploration and evaluation | **89** | 89 | 89 |
| Reclamation trust (Note 11) | **58** | 53 | 48 |
| | **$ 8,620** | $ 7,132 | $ 7,018 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | | |
| Current liabilities | | | |
| Accounts payable and accrued liabilities (Note 7) | **$ 479** | $ 405 | $ 284 |
| Current portion of employee future benefits (Note 8) | **47** | 51 | 17 |
| | **526** | 456 | 301 |
| Employee future benefits and other liabilities (Note 8) | **480** | 316 | 284 |
| Long-term debt (Note 10) | **1,132** | 1,251 | 1,163 |
| Asset retirement obligation (Note 11) | **1,008** | 464 | 550 |
| Deferred taxes (Note 12) | **1,264** | 919 | 1,229 |
| | **4,410** | 3,406 | 3,527 |
| Shareholders' equity (Note 13) | **4,210** | 3,726 | 3,491 |
| | **$ 8,620** | $ 7,132 | $ 7,018 |

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

*See Notes to Consolidated Financial Statements*

Approved by the Board of Directors

*(signed)* **Wesley R. Twiss**
Director

*(signed)* **Donald J. Lowry**
Director

# Consolidated Statements of Cash Flows

| For the years ended December 31 *(millions of Canadian dollars)* | | **2011** | | 2010 |
|---|---|---|---|---|
| **Cash from (used in) operating activities** | | | | |
| Net income | **$** | **1,144** | $ | 1,189 |
| Items not requiring an outlay of cash | | | | |
| Depreciation and depletion | | **381** | | 429 |
| Accretion of asset retirement obligation (Note 11) | | **16** | | 21 |
| Foreign exchange (gain) loss on long-term debt (Note 16) | | **25** | | (58) |
| Deferred tax expense (recovery) (Note 12) | | **387** | | (289) |
| Other | | **2** | | (3) |
| Actual reclamation expenditures (Note 11) | | **(49)** | | (48) |
| Change in employee future benefits and other liabilities | | **(9)** | | (9) |
| | | **1,897** | | 1,232 |
| Change in non-cash working capital (Note 24(a)) | | **61** | | 63 |
| Cash from operating activities | | **1,958** | | 1,295 |
| **Cash from (used in) financing activities** | | | | |
| Net drawdown (repayment) of bank credit facilities (Note 9) | | **(145)** | | 145 |
| Issuance of shares (Note 13) | | **2** | | – |
| Dividends | | **(533)** | | (896) |
| Cash used in financing activities | | **(676)** | | (751) |
| **Cash from (used in) investing activities** | | | | |
| Capital expenditures | | **(643)** | | (582) |
| Reclamation trust funding | | **(5)** | | (5) |
| Change in non-cash working capital (Note 24(a)) | | **4** | | 1 |
| Cash used in investing activities | | **(644)** | | (586) |
| **Increase (decrease) in cash and cash equivalents** | | **638** | | (42) |
| **Cash and cash equivalents, beginning of year** | | **80** | | 122 |
| **Cash and cash equivalents, end of year** | **$** | **718** | $ | 80 |
| **Cash and cash equivalents consist of:** | | | | |
| Cash | **$** | **326** | $ | 52 |
| Short-term investments | | **392** | | 28 |
| | **$** | **718** | $ | 80 |

**Supplementary Information** (Note 24)

*See Notes to Consolidated Financial Statements*

# Notes to Consolidated Financial Statements

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

## 1) Nature of Operations

Canadian Oil Sands Limited (the "Corporation") was incorporated under the laws of the Province of Alberta, Canada in 2010 pursuant to a plan of arrangement effecting the reorganization from an income trust into a corporate structure effective December 31, 2010.

The Corporation indirectly owns a 36.74 per cent interest ("Working Interest") in the Syncrude Joint Venture ("Syncrude"). Syncrude is involved in the mining and upgrading of bitumen from oil sands in Northern Alberta. The Syncrude Project is comprised of open-pit oil sands mines, utilities plants, bitumen extraction plants, and an upgrading complex that processes bitumen into Synthetic Crude Oil. Each joint-venture owner, including the Corporation, takes its proportionate share of production in kind, and funds its proportionate share of Syncrude's operating and capital costs on a daily basis. Syncrude Canada operates Syncrude on behalf of the joint-venture owners and is responsible for selecting, compensating, directing and controlling Syncrude's employees, and for administering all related employment benefits and obligations. The Corporation's investment in Syncrude and Syncrude Canada represents its only producing asset.

The Corporation's office is located at the following address: 2500 First Canadian Centre, 350 – 7th Avenue S.W., Calgary, Alberta, Canada T2P 3N9.

## 2) Basis of Presentation

The audited consolidated financial statements reflect the December 31, 2010 reorganization from an income trust into a corporate structure pursuant to which all outstanding trust units of Canadian Oil Sands Trust (the "Trust") were exchanged on a one-for-one basis for common shares ("Shares") of the Corporation (the "Corporate Conversion"). The financial information of the Corporation refers to Common Shares or Shares, Shareholders and dividends, which were formerly referred to as Units, Unitholders and distributions under the trust structure.

These audited consolidated financial statements are prepared and reported in Canadian dollars in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). The CICA Handbook has been revised to incorporate International Financial Reporting Standards ("IFRS") and publicly accountable enterprises are required to apply such standards for years beginning on or after January 1, 2011. These audited consolidated financial statements have been prepared in full compliance with IFRS as issued by the International Accounting Standards Board ("IASB"). In these financial statements and notes, the term "Canadian GAAP" refers to Canadian generally accepted accounting principles before the conversion to IFRS.

Subject to certain transition exemptions and exceptions disclosed in Note 26, the Corporation has applied IFRS-compliant accounting policies to its transition date balance sheet at January 1, 2010 and throughout 2010 and 2011 as if these policies had always been in effect. Note 26 discloses the impact of the transition to IFRS on the Corporation's reported equity, income and cash flows, including the nature and effect of changes in accounting policies from those used in the Corporation's Canadian GAAP consolidated financial statements for the year ended December 31, 2010.

These audited consolidated financial statements were approved by the Corporation's Board of Directors for issue on February 23, 2012.

## 3) Summary Of Accounting Policies

**Consolidation**
The consolidated financial statements include the accounts of the Corporation and its subsidiaries and partnerships (collectively "Canadian Oil Sands"). The activities of Syncrude are conducted jointly with others and, accordingly, these financial statements reflect only Canadian Oil Sands' proportionate interest in such activities, which include the production, Crown royalties, operating and non-production expenses, as well as a proportionate interest in Syncrude's property, plant and equipment, inventories, employee future benefits and other liabilities, asset retirement obligation, and associated accounts payable and receivable.

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

**Property, Plant and Equipment**
Property, plant and equipment ("PP&E") are recorded at cost and include the costs of acquiring the Working Interest in, and costs that are directly related to the acquisition, development and construction of, oil sands projects, including the cost of initial overburden removal, major turnaround costs, certain interest costs, and reclamation costs associated with the asset retirement obligation. Repairs and maintenance, non-major turnaround costs and ongoing overburden removal on producing oil sands mines are expensed as operating expenses in the period incurred.

PP&E is depreciated on a straight-line basis over the estimated useful lives of the assets, with the exception of mine development and asset retirement costs, which are depleted on a unit-of-production basis over the estimated proved and probable reserves of the producing mines. The following estimated useful lives of the tangible assets are reviewed annually for any changes to those estimates:

| Category | Estimated Useful Life |
|---|---|
| Major turnarounds | 2 to 3 years |
| Vehicles and equipment | 5 to 20 years |
| Mining equipment | Lesser of 25 years and the remaining life of the mine |
| Upgrading and extraction | 25 years |
| Buildings | 20 to 40 years |

Capitalized major turnaround costs are depreciated over the estimated period to the next turnaround.

Costs of assets under construction are capitalized as construction in progress. Assets under construction are not available for use and therefore construction in progress is not depreciated. On completion, the cost of construction in progress, including capitalized interest, is transferred to the appropriate category of PP&E and depreciated accordingly.

**Exploration and Evaluation**
Exploration and evaluation ("E&E") assets include the costs of acquiring undeveloped oil sands leases ("oil sands lease acquisition costs") and interests in natural gas licenses located in the Arctic Islands in northern Canada (the "Arctic natural gas assets"). E&E assets are not available for use and are not amortized.

**Impairment**
The carrying amounts of PP&E and E&E assets are reviewed for possible impairment whenever changes in circumstances indicate that the carrying amounts may not be recoverable. For the purpose of measuring recoverable amounts, assets are grouped at the lowest levels for which there are separately identifiable cash inflows ("cash generating units" or "CGUs"). The recoverable amount is the higher of a CGU's fair value less cost to sell (being the amount obtainable from the sale of a CGU in an arm's length transaction, net of disposal costs) and its value in use (being the net present value of the CGU's expected future cash flows). An impairment loss is recognized for the amount by which the carrying amount exceeds the recoverable amount.

E&E assets are also subject to impairment testing at the time they are transferred to PP&E.

PP&E consists entirely of Canadian Oil Sands' proportionate interest in Syncrude's PP&E. PP&E is combined with the oil sands lease acquisition costs, within the E&E assets, to form one CGU for impairment testing purposes. The balance of the E&E assets, being the Arctic natural gas assets, form a second CGU which is tested for impairment separately from the oil sands assets.

Impairments are reversed, net of imputed depreciation and depletion, if the reversal can be related objectively to an event occurring after the impairment charge was recognized. Impairment charges and reversals are recorded as depreciation and depletion.

**Interest Costs**
Interest costs attributable to the acquisition or construction of qualifying assets which require a substantial period of time to prepare for their intended use are capitalized as PP&E. All other interest costs are recognized as net finance expense in the period in which they are incurred.

**Inventories**
Inventories, which include crude oil and materials and supplies, are valued at the lower of average cost and their net realizable value.

**Asset Retirement Obligation**
The estimated fair value of Canadian Oil Sands' share of Syncrude's asset retirement obligation is recognized on the Consolidated Balance Sheets. Syncrude's asset retirement obligation provides for the site restoration of each mine site and the decommissioning of utilities plants, bitumen extraction plants, and the upgrading complex. The discounted amount of these future restoration and decommissioning (collectively "reclamation") expenditures is recorded upon initial land disturbance or when a reasonable estimate of the fair value of the reclamation expenditures can be determined. The fair value is determined by estimating the timing and amounts of the expenditures, and discounting them using a risk-free interest rate. The cost of the asset retirement obligation is capitalized as PP&E and depreciated over the remaining life of the associated mine or plant.

The fair value of the asset retirement obligation is re-measured at each reporting date using the risk-free interest rate in effect at that time and changes in the fair value are capitalized as PP&E.

The asset retirement obligation is accreted using the risk-free interest rate and the accretion expense is included in net finance expense on the Consolidated Statements of Income and Comprehensive Income. Actual reclamation payments, when incurred, reduce the asset retirement obligation.

**Revenue Recognition**
Sales include sales of synthetic crude oil, including both produced and purchased volumes, sales of other products, and proceeds from insurance. Sales from the sale of synthetic crude oil and other products are recorded when title passes from Canadian Oil Sands to a third party. Sales also include gains and losses, if any, from crude oil hedge contracts designated as hedges for accounting purposes. Sales are presented before Crown royalties whereas revenues are presented net of Crown royalties.

**Employee Future Benefits**
Canadian Oil Sands accrues its proportionate share of obligations as a joint interest owner in respect of Syncrude Canada's post-employment benefit obligations, which include defined benefit and defined contribution pension plans and a defined benefit other post-employment benefits ("OPEB") plan.

The cost of the defined benefit pension plan and OPEB plan is actuarially determined using the projected unit credit method based on length of service, and reflects Canadian Oil Sands' best estimate of the expected performance of the plan investment, salary escalation factors, retirement ages of employees and future health care costs. The discount rate used to determine the accrued benefit obligation is based on a market rate of interest for high-quality corporate debt instruments with cash flows that match the timing and amount of expected benefit payments. The expected return on plan assets is

based on the fair value of those assets. Actuarial gains and losses, net of income taxes, are recognized immediately in other comprehensive income. The current service cost of the defined benefit plans is recognized in operating expenses as the service is rendered. Any past service costs arising from plan amendments are recognized immediately in operating expenses.

The cost of the defined contribution plans is recognized in operating expenses as the service is rendered and contributions become payable.

**Taxes**

Taxes are recognized in net income, except where they relate to items recognized directly in other comprehensive income or shareholders' equity, in which case the related taxes are also recognized in other comprehensive income or shareholders' equity.

Current taxes receivable or payable are estimated on taxable income for the current year at the statutory tax rates enacted or substantively enacted.

Deferred tax assets and liabilities are recognized based on the differences between the tax and accounting values of assets and liabilities, referred to as temporary differences, and are calculated using enacted or substantively enacted tax rates for the periods in which the temporary differences are expected to reverse. The effect of tax rate changes is recognized in net income, other comprehensive income or shareholders' equity, as the case may be, in the period of enactment or substantive enactment. Deferred tax assets are recognized only to the extent that it is probable that future taxable profits will be available against which the assets can be utilized.

**Share-Based Compensation**

Canadian Oil Sands recognizes share-based compensation expense in its Consolidated Statements of Income and Comprehensive Income for all options granted with a corresponding increase to contributed surplus in Shareholders' Equity. Canadian Oil Sands determines the compensation cost based on the estimated fair values of the options at the time of grant, which is then recognized in administration expenses over the vesting periods of the options.

Canadian Oil Sands also recognizes share-based compensation expense related to its performance units ("PSUs"), which are awards granted to Canadian Oil Sands' officers, restricted share units ("RSUs"), which are awarded to select employees, and deferred share units ("DSUs"), which form part of Canadian Oil Sands' non-executive directors' compensation. Canadian Oil Sands determines compensation expense based on the estimated fair values of the PSUs, RSUs, and DSUs, and recognizes this in administration expenses over the vesting periods of the units. Changes in the fair values of the PSUs, RSUs, and DSUs over the vesting period are recorded in net income in the period the change occurs.

As an owner in Syncrude, Canadian Oil Sands accrues its 36.74 per cent share of Syncrude Canada's share-based compensation awards with a corresponding increase or decrease in operating expenses. Syncrude Canada's share-based compensation awards include restricted share units ("Syncrude RSUs") and phantom share units ("Syncrude PSUs"), both of which require settlement by cash payments. The Syncrude RSUs' and Syncrude PSUs' fair values are based on a weighted-average of the price of certain Syncrude owners' shares and, for certain of the Syncrude RSUs, the total shareholder return of these shares over the units' vesting period. Compensation expense for the Syncrude RSUs and Syncrude PSUs is recognized in operating expenses over the shorter of the normal vesting period and the period to eligible retirement if vesting is accelerated on retirement. The changes in the fair values of the Syncrude RSUs and Syncrude PSUs over the vesting periods are recognized in operating expenses in the period the change occurs.

**Foreign Currency Translation**

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

**Net Income Per Share**
The Corporation calculates basic earnings per share by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share are calculated by adjusting the weighted average number of common shares outstanding for dilutive common shares related to the Corporation's share-based compensation plans. The number of shares included is computed using the treasury stock method, which assumes that proceeds received from the exercise of in-the-money options are used to repurchase common shares at the average market price.

**Dividends**
Dividends on common shares are recognized in the period in which the dividends are approved by the Corporation's Board of Directors.

**Financial Instruments**
All financial instruments are initially measured at fair value on the Consolidated Balance Sheets. Subsequent measurement of financial instruments is based on their classification as follows:

| Classification | Measurement |
|---|---|
| Fair value through profit or loss | Fair value with changes recognized in net income |
| Held to maturity | Amortized cost using effective interest method |
| Loans and receivables | Amortized cost using effective interest method |
| Available for sale | Fair value with changes recognized in other comprehensive income |
| Other liabilities | Amortized cost using effective interest method |

Transaction costs in respect of financial instruments measured at fair value are recognized immediately in net income. Transaction costs in respect of other financial instruments are included in the initial cost and amortized accordingly using the effective interest method.

The inputs to fair value measurements of financial instruments, including their classification within a hierarchy that prioritizes the inputs to fair value measurement, are as follows:

Level 1: Quoted prices in active markets for identical assets or liabilities;
Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
Level 3: Inputs for the asset or liability that are not based on observable market data.

## 4) Critical Accounting Estimates

A critical accounting estimate is considered to be one that requires assumptions be made about matters that are uncertain at the time the accounting estimate is made and would have a material impact on the financial results if different assumptions were used. Canadian Oil Sands makes numerous estimates in its financial results in order to provide timely information to users. The following estimates are considered critical:

**a) Asset Retirement Obligation**
In determining the estimated fair value of the asset retirement obligation, Canadian Oil Sands must estimate the amount of the future expenditures, the timing of when they will be required, and then apply an appropriate risk-free interest rate. Given the long reserve life of Syncrude's leases, the expenditures will be made over approximately the next 70 years; as such, it is difficult to estimate the precise timing and amount of these expenditures.

Any changes in the anticipated timing or amount of the expenditures, or to the risk-free interest rate subsequent to the initial obligation being recorded, results in a change to the asset retirement obligation and corresponding PP&E. Such changes will impact the accretion of the obligation and the depreciation or depletion of the PP&E and will correspondingly impact net income.

**b) Employee Future Benefits**

Canadian Oil Sands accrues its obligations for Syncrude Canada's post-employment benefits using actuarial and other assumptions to estimate the accrued benefit obligation, the return on plan assets and the expense related to the current period. Changes in these assumptions give rise to actuarial gains and losses. The accrued benefit obligation is measured using the estimated discounted fair value of the Canadian Oil Sands' share of future payments under Syncrude Canada's post-employment benefits plans. A sensitivity analysis of the impacts of changes in the interest rate used to discount the accrued benefit obligation is provided in Note 8. Actual payments related to Syncrude Canada's post-employment benefits plans could vary greatly from estimates assumed in the accrued benefit obligation, resulting in actuarial gains and losses.

**c) Depreciation and Depletion**

Canadian Oil Sands calculates depreciation expense for certain tangible assets on a straight-line basis. As such, Canadian Oil Sands must estimate the useful lives of these assets. While these useful life estimates are reviewed on a regular basis and depreciation calculations are revised accordingly, actual lives may differ from the estimates.

**d) Reserves**

Canadian Oil Sands must estimate the reserves it expects to recover in the future and the related net revenues expected to be generated from producing those reserves. Reserves and future net revenues are evaluated and reported in a reserve report prepared by independent petroleum reserve evaluators who determine these evaluations using various factors and assumptions, such as: forecasts of mining and extraction recovery and upgrading yield based on geological and engineering data, projected future rates of production, projected operating costs, Crown royalties and taxes, projected crude oil prices and oil price differentials and timing and amounts of future capital expenditures and other development costs, all of which are estimates. The factors and assumptions used in the estimates are assessed for reasonableness based on the information available at the time that the estimates are prepared. Estimates of reserves and future net revenues are critical to asset impairment tests. In addition, for asset retirement and mine development costs, which are depleted on a unit-of-production basis, reserves are used as a component of the depletion calculations to allocate capital costs over their estimated useful lives. The reserve report is reviewed by Canadian Oil Sands' management, the Reserves, Marketing Operations and Environmental, Health and Safety Committee and the Board of Directors.

As circumstances change and new information becomes available, the reserve report data could change. Future actual results could vary greatly from our estimates, and could cause changes in our asset impairment tests or depletion estimates, both of which use the reserves and/or future net revenues in their respective calculations.

**e) Income Taxes**

Accounting for income taxes is a complex process that requires the Corporation to interpret frequently changing laws and regulations, including changing income tax rates, and make certain judgments with respect to the application of tax law, estimating the timing of temporary difference reversals, and estimating the realizability of tax assets. Therefore, income taxes are subject to measurement uncertainty.

## 5) Inventories

| As at *($ millions)* | **December 31 2011** | December 31 2010 | January 1 2010 |
|---|---|---|---|
| Materials and supplies | **$ 108** | $ 106 | $ 113 |
| Product and linefill | **34** | 23 | 20 |
| | **$ 142** | $ 129 | $ 133 |

The $1,501 million of operating expenses and $221 million of crude oil purchases, included within crude oil purchases and transportation expense on the Consolidated Statements of Income and Comprehensive Income, approximate the amounts of produced and purchased inventories, respectively, which were recognized as an expense in 2011 (2010 – $1,387 million and $254 million, respectively).

## 6) Property, Plant and Equipment, Net

| | Year Ended December 31, 2011 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| *($ millions)* | Upgrading and extracting | Mining equipment | Vehicles and equipment | Buildings | Asset Retirement costs | Major Turnaround costs | Construction in progress | Mine development | Total |
| **Cost** | | | | | | | | | |
| Balance at January 1, 2011 | $ 4,669 | $ 1,381 | $ 688 | $ 304 | $ 362 | $ 103 | $ 694 | $ 345 | $ 8,546 |
| Additions | – | – | – | – | – | 43 | 600 | – | 643 |
| Change in asset retirement costs | – | – | – | – | 569 | – | – | – | 569 |
| Retirements | (6) | (9) | (22) | (1) | – | (32) | – | (1) | (71) |
| Reclassifications[1] | 25 | 45 | 24 | 7 | – | – | (150) | 49 | – |
| Balance at December 31, 2011 | $ 4,688 | $ 1,417 | $ 690 | $ 310 | $ 931 | $ 114 | $ 1,144 | $ 393 | $ 9,687 |
| **Accumulated depreciation** | | | | | | | | | |
| Balance at January 1, 2011 | $ 1,092 | $ 449 | $ 264 | $ 100 | $ 103 | $ 50 | $ – | $ 92 | $ 2,150 |
| Depreciation | 169 | 92 | 54 | 7 | 14 | 35 | – | 10 | 381 |
| Retirements | (6) | (9) | (22) | (1) | – | (32) | – | (1) | (71) |
| Reclassifications[1] | 29 | (52) | (2) | (6) | 21 | – | – | 10 | – |
| Balance at December 31, 2011 | $ 1,284 | $ 480 | $ 294 | $ 100 | $ 138 | $ 53 | $ – | $ 111 | $ 2,460 |
| **Net book value at December 31, 2011** | **$ 3,404** | **$ 937** | **$ 396** | **$ 210** | **$ 793** | **$ 61** | **$ 1,144** | **$ 282** | **$ 7,227** |

| | Year Ended December 31, 2010 | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| *($ millions)* | Upgrading and extracting | Mining equipment | Vehicles and equipment | Buildings | Asset Retirement costs | Major Turnaround costs | Construction in progress | Mine development | Total |
| **Cost** | | | | | | | | | |
| Balance at January 1, 2010 | $ 4,594 | $ 1,288 | $ 667 | $ 298 | $ 384 | $ 95 | $ 439 | $ 323 | $ 8,088 |
| Additions | – | – | – | – | – | 46 | 536 | – | 582 |
| Change in asset retirement costs | – | – | – | – | (22) | – | – | – | (22) |
| Retirements | (3) | (33) | (21) | (1) | – | (38) | – | (6) | (102) |
| Reclassifications[1] | 78 | 126 | 42 | 7 | – | – | (281) | 28 | – |
| Balance at December 31, 2010 | $ 4,669 | $ 1,381 | $ 688 | $ 304 | $ 362 | $ 103 | $ 694 | $ 345 | $ 8,546 |
| **Accumulated depreciation** | | | | | | | | | |
| Balance at January 1, 2010 | $ 931 | $ 356 | $ 231 | $ 92 | $ 78 | $ 48 | $ – | $ 87 | $ 1,823 |
| Depreciation | 164 | 126 | 54 | 9 | 25 | 40 | – | 11 | 429 |
| Retirements | (3) | (33) | (21) | (1) | – | (38) | – | (6) | (102) |
| Balance at December 31, 2010 | $ 1,092 | $ 449 | $ 264 | $ 100 | $ 103 | $ 50 | $ – | $ 92 | $ 2,150 |
| **Net book value at December 31, 2010** | **$ 3,577** | **$ 932** | **$ 424** | **$ 204** | **$ 259** | **$ 53** | **$ 694** | **$ 253** | **$ 6,396** |

[1] *Reclassifications are primarily transfers from Construction in progress to other categories of property, plant and equipment when construction is completed and assets are available for use.*

In 2011, interest costs of $57 million were capitalized and included in property, plant and equipment (2010 – $30 million) based on a 7.3 per cent interest capitalization rate (2010 – 7.3 per cent).

## 7) Accounts Payable and Accrued Liabilities

| As at *($ millions)* | **December 31 2011** | December 31 2010 | January 1 2010 |
|---|---|---|---|
| Accounts payable and accrued liabilities | **$ 429** | $ 348 | $ 263 |
| Current portion of asset retirement obligation (Note 11) | **29** | 37 | – |
| Interest payable | **21** | 20 | 21 |
| | **$ 479** | $ 405 | $ 284 |

## 8) Employee Future Benefits and Other Liabilities

| As at *($ millions)* | **December 31 2011** | December 31 2010 | January 1 2010 |
|---|---|---|---|
| Employee future benefits | **$ 465** | $ 327 | $ 281 |
| Accrued variable compensation and other | **37** | 46 | 59 |
| Transition Crown royalty (Note 15) | **61** | 31 | – |
| | **$ 563** | $ 404 | $ 340 |
| Less current portion comprised of: | | | |
| Employee future benefits | **(47)** | (51) | (17) |
| Accrued variable compensation and other (included in accounts payable and accrued liabilities) | **(36)** | (37) | (39) |
| | **$ 480** | $ 316 | $ 284 |

**Employee Future Benefits**

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

***Defined Benefit Plans***

The most recent actuarial valuation of the pension and OPEB plans for funding purposes was completed in 2011 and was as of December 31, 2010. The next valuation will be completed during 2012 as of December 31, 2011.

Canadian Oil Sands' share of Syncrude Canada's accrued benefit liability relating to the defined benefit plans, based on its 36.74 per cent ownership, at December 31, 2011 and December 31, 2010 is comprised of its share of Syncrude Canada's accrued benefit obligation, partially offset by its share of Syncrude Canada's plan assets as follows:

| | Pension | | Other Post-Employment Benefits | | Total | |
|---|---|---|---|---|---|---|
| *($ millions)* | **2011** | 2010 | **2011** | 2010 | **2011** | 2010 |
| Accrued benefit obligation: | | | | | | |
| Balance, beginning of year | **$ 717** | $ 584 | **$ 52** | $ 48 | **$ 769** | $ 632 |
| Current service cost | **32** | 25 | **1** | 1 | **33** | 26 |
| Interest cost | **38** | 36 | **3** | 3 | **41** | 39 |
| Employee contributions | **4** | 6 | **–** | – | **4** | 6 |
| Benefits paid | **(29)** | (27) | **(2)** | (2) | **(31)** | (29) |
| Actuarial loss | **140** | 93 | **6** | 2 | **146** | 95 |
| Balance, end of year | **$ 902** | $ 717 | **$ 60** | $ 52 | **$ 962** | $ 769 |
| Fair value of plan assets: | | | | | | |
| Balance, beginning of year | **$ 442** | $ 351 | **$ –** | $ – | **$ 442** | $ 351 |
| Actual return on plan assets | **10** | 39 | **–** | – | **10** | 39 |
| Employer contributions | **69** | 71 | **–** | – | **69** | 71 |
| Employee contributions | **4** | 6 | **–** | – | **4** | 6 |
| Benefits paid | **(28)** | (25) | **–** | – | **(28)** | (25) |
| Balance, end of year | **$ 497** | $ 442 | **$ –** | $ – | **$ 497** | $ 442 |
| Accrued benefit liability | **$ (405)** | $ (275) | **$ (60)** | $ (52) | **$ (465)** | $ (327) |

The accrued benefit obligation relates to both unfunded and partly funded plans as follows:

| | Pension | | Other Post-Employment Benefits | | Total | |
|---|---|---|---|---|---|---|
| As at December 31 *($ millions)* | **2011** | 2010 | **2011** | 2010 | **2011** | 2010 |
| Accrued benefit obligation arising from: | | | | | | |
| Unfunded plans | **$ 40** | $ 31 | **$ 60** | $ 52 | **$ 100** | $ 83 |
| Partly funded plans | **862** | 686 | **–** | – | **862** | 686 |
| | **$ 902** | $ 717 | **$ 60** | $ 52 | **$ 962** | $ 769 |

The asset allocation for Syncrude Canada's defined benefit plan assets was as follows:

| | Percentage of Plan assets | |
|---|---|---|
| As at December 31 | **2011** | 2010 |
| Equity securities | **60** | 60 |
| Debt securities | **40** | 40 |
| | **100** | 100 |

Syncrude Canada's plan assets are invested using a passive strategy with investments in indexed securities. Investments that are not traded in active markets are not significant.

Elements of defined benefit costs recognized in the year:

| For the years ended December 31 *($ millions)* | Pension 2011 | Pension 2010 | Other Post-Employment Benefits 2011 | Other Post-Employment Benefits 2010 | Total 2011 | Total 2010 |
|---|---|---|---|---|---|---|
| Current service cost | **$ 32** | $ 25 | **$ 1** | $ 1 | **$ 33** | $ 26 |
| Interest cost | **38** | 36 | **3** | 3 | **41** | 39 |
| Expected return on plan assets | **(34)** | (28) | **–** | – | **(34)** | (28) |
| Recognized in operating expenses | **$ 36** | $ 33 | **$ 4** | $ 4 | **$ 40** | $ 37 |
| Actuarial loss (gain) | | | | | | |
| Actuarial loss on accrued benefit obligation | **$ 140** | $ 93 | **$ 6** | $ 2 | **$ 146** | $ 95 |
| Difference between actual return and expected return on plan assets | **24** | (11) | **–** | – | **24** | (11) |
| Recognized in other comprehensive income[1] | **$ 164** | $ 82 | **$ 6** | $ 2 | **$ 170** | $ 84 |
| Total defined benefit cost | **$ 200** | $ 115 | **$ 10** | $ 6 | **$ 210** | $ 121 |

[1] *Actuarial losses are recognized in other comprehensive income and presented net of income taxes. The $170 million actuarial loss in 2011 was presented net of $42 million of income taxes ($128 million after tax). The $84 million actuarial loss in 2010 was presented net of $23 million of income taxes ($61 million after tax).*

**Significant Assumptions**

The significant assumptions adopted in measuring Syncrude Canada's defined benefit plans are as follows:

| As at December 31 | Pension 2011 | Pension 2010 | Other Post-Employment Benefits 2011 | Other Post-Employment Benefits 2010 |
|---|---|---|---|---|
| Accrued benefit obligation | | | | |
| Discount rate | **4.25%** | 5.25% | **4.25%** | 5.00% |
| Rate of compensation increase | **4.50%** | 4.45% | **4.50%** | 4.45% |
| Plan assets | | | | |
| Expected rate of return on plan assets | **7.30%** | 7.50% | **n/a** | n/a |

An eight per cent annual rate of increase in the cost of supplemental health care benefits was assumed for 2011 and 2012 (2010 – 8 per cent) decreasing by 0.5 per cent each year thereafter to a five per cent ultimate rate in 2018. In addition, an annual rate increase of four per cent in dental rates was used in 2011 and 2010.

***Sensitivity Analysis***

A one per cent decrease in the interest rate used to discount future benefit payments would result in a $177 million increase in Canadian Oil Sands' share of Syncrude Canada's accrued benefit obligation and a $9 million decrease in annual interest costs, while a one per cent increase in the interest rate would result in a $136 million decrease in Canadian Oil Sands' share of the accrued benefit obligation and a $12 million increase in annual interest costs.

A one per cent increase or decrease in assumed health care cost trend rates would increase or decrease Canadian Oil Sands' share of the accrued benefit obligation by $5 million, respectively, and would have an insignificant impact on Canadian Oil Sands' current service and interest costs.

***Defined Contribution Plans***

Canadian Oil Sands' share of Syncrude Canada's defined contribution pension plan expense was approximately $3 million in 2011 (2010 – $3 million).

***Total Cash Payments***

Canadian Oil Sands' share of Syncrude's total cash payments for employee future benefits for 2011 was $75 million (2010 – $77 million), consisting of cash contributed by Syncrude Canada to its funded pension plans, cash to fund pension

payments in excess of registered plan limits, cash payments for unfunded OPEB plans and cash contributed to its defined contribution plans. Canadian Oil Sands' share of Syncrude Canada's estimated 2012 cash payments to fund the defined benefit plans is $73 million.

## 9) Bank Credit Facilities

| As at December 31, 2011 *($ millions)* | |
|---|---|
| Operating credit facility (a) | $ 1,500 |
| Extendible revolving term facility (b) | 40 |
| Line of credit (c) | 100 |
| | $ 1,640 |

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

### a) Operating Credit Facility

On June 1, 2011, Canadian Oil Sands entered into a $1,500 million credit facility agreement, replacing its existing $800 million operating facility. The new agreement expires on June 1, 2015. Amounts borrowed through this facility bear interest at a floating rate based on either prime interest rates or bankers' acceptances plus a credit spread, while any unused amounts are subject to standby fees. As at December 31, 2011, no amounts were drawn against this facility ($145 million was drawn against the $800 million facility at December 31, 2010; no amounts were drawn against the $800 million facility at January 1, 2010).

### b) Extendible Revolving Term Facility

The $40 million extendible revolving term facility is a two year facility expiring June 30, 2013. This facility may be extended on an annual basis with the agreement of the bank. Amounts borrowed through this facility bear interest at a floating rate based on bankers' acceptances plus a credit spread, while any unused amounts are subject to standby fees. At December 31, 2011, no amounts were drawn against this facility (December 31, 2010 – $nil; January 1, 2010 – $nil).

### c) Line of Credit

The $100 million line of credit is a one-year revolving letter of credit facility. Letters of credit drawn on the facility mature April 30th each year and are automatically renewed, unless notification to cancel is provided at least 60 days prior to expiry by either Canadian Oil Sands or the financial institution providing the facility. Letters of credit on this facility bear interest at a credit spread. Letters of credit of approximately $75 million have been written against the line of credit as at December 31, 2011 (December 31, 2010 – $75 million; January 1, 2010 – $70 million).

## 10) Long-Term Debt

| As at *($ millions)* | **December 31 2011** | December 31 2010 | January 1 2010 |
|---|---|---|---|
| 5.8% Senior Notes due August 15, 2013 (a) | **$ 303** | $ 296 | $ 311 |
| 7.75% Senior Notes due May 15, 2019 (b) | **505** | 493 | 520 |
| 7.9% Senior Notes due September 1, 2021 (c) | **250** | 245 | 257 |
| 8.2% Senior Notes due April 1, 2027 (d) | **74** | 72 | 75 |
| Credit facilities drawn, excluding letters of credit (Note 9) | **–** | 145 | – |
| | **$ 1,132** | $ 1,251 | $ 1,163 |

Canadian Oil Sands' Senior Notes are unsecured, rank pari passu with other senior unsecured debt of the Corporation, and contain certain covenants that place limitations on the sale of assets and the granting of liens or other security interests.

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

**b) 7.75% Senior Notes**
On May 11, 2009, the Corporation issued U.S. $500 million of 7.75% Senior Notes, maturing May 15, 2019. Interest is payable on the notes semi-annually on May 15 and November 15.

**c) 7.9% Senior Notes**
On August 24, 2001, the Corporation issued U.S. $250 million of 7.9% Senior Notes, maturing September 1, 2021. Interest is payable on the notes semi-annually on March 1 and September 1. The Corporation has agreed to maintain its debt-to-capitalization at an amount less than 55 per cent.

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

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

| As at December 31 *($ millions)* | | 2011 |
|---|---|---|
| 2013 | $ | 305 |
| After five years | | 838 |
| | $ | 1,143 |

## 11) Asset Retirement Obligation and Reclamation Trust

Canadian Oil Sands and each of the other Syncrude owners are liable for their share of ongoing environmental obligations related to the ultimate reclamation of the Syncrude properties on abandonment. The Corporation estimates reclamation expenditures will be made over approximately the next 70 years and has applied a risk-free interest rate of 2.50 per cent at December 31, 2011 (December 31, 2010 – 3.35 per cent; January 1, 2010 – 3.90 per cent) in deriving the asset retirement obligation.

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the Corporation's share of the obligation associated with the retirement of the Syncrude properties:

| *($ millions)* | | **2011** | | 2010 |
|---|---|---|---|---|
| Asset retirement obligation, beginning of year | **$** | **501** | $ | 550 |
| Change in estimated liability | | **471** | | (43) |
| Liabilities settled | | **(49)** | | (48) |
| Accretion expense | | **16** | | 21 |
| Change in risk-free interest rate | | **98** | | 21 |
| Asset retirement obligation, end of year | **$** | **1,037** | $ | 501 |
| Less current portion | | **(29)** | | (37) |
| Non-current portion | **$** | **1,008** | $ | 464 |

The increase in the asset retirement obligation from $501 million at December 31, 2010 to $1,037 million at December 31, 2011 reflects additional costs identified through the completion of a revised comprehensive mine development and closure plan which includes:

- the reclamation of new storage areas and additional mature fine tailings treatment costs, both required to meet the Alberta Energy Resources Conservation Board's Directive 074 regulations;
- geotechnical design development for regional land drainage features required for final closure;
- revised material handling cost assumptions, which reflect current contract rates and parameters; and
- a decrease in the risk-free interest rate used to discount future reclamation payments.

These increases were partially offset by reclamation spending.

The total undiscounted estimated cash flows required to settle Canadian Oil Sands' share of the asset retirement obligation was $2,210 million at December 31, 2011 (December 31, 2010 – $1,194 million; January 1, 2010 – $1,273 million).

The reclamation expenditures will be funded from Canadian Oil Sands' cash from operating activities and reclamation trust. In addition to annual funding for reclamation expenditures, through December 31, 2011 Canadian Oil Sands deposited $0.1322 per barrel of production attributable to its working interest in Syncrude to a reclamation trust established for the purpose of funding its share of environmental and reclamation obligations.

Additionally, Canadian Oil Sands has posted letters of credit with the Province of Alberta in the amount of $75 million (December 31, 2010 – $75 million; January 1, 2010 – $70 million) to secure its pro rata share of the reclamation obligations of the Syncrude owners.

## 12) Income Taxes

The income tax expense recorded on the Consolidated Statements of Income and Comprehensive Income differs from the amount computed by applying the combined Canadian federal and provincial statutory income tax rate to earnings before taxes as follows:

| For the years ended December 31 *($ millions, except income tax rates)* | **2011** | 2010 |
|---|---|---|
| Earnings before taxes | **$ 1,531** | $ 900 |
| Statutory income tax rates | | |
| Canadian basic federal income tax rate | **26.50%** | 28.00% |
| Canadian federal abatement | **-10.00%** | -10.00% |
| Alberta provincial income tax rate | **10.00%** | 10.00% |
| | **26.50%** | 28.00% |
| Expected taxes at statutory rate | **406** | 252 |
| Add (deduct) the tax effect of: | | |
| Difference between current year and future years tax rates | **(23)** | – |
| Non-taxable portion of capital (gains) losses | **3** | (8) |
| Other | **1** | (13) |
| Recovery on December 31, 2010 re-measurement of deferred tax liability[1] (Note 26(e)(vii)) | **–** | (269) |
| Earnings attributable to the Trust – tax sheltered[2] | **–** | (251) |
| Income tax expense (recovery) | **$ 387** | $ (289) |

[1] *Upon conversion from an income trust to a corporation on December 31, 2010, the deferred tax liability was re-measured using a 25 per cent corporate tax rate, resulting in a $269 million deferred tax recovery.*

[2] *Prior to the December 31, 2010 conversion from an income trust to a corporation, payments of distributions to Trust unitholders were deductible in computing taxable income.*

The amounts shown on the Consolidated Balance Sheets as deferred taxes represent the differences between the accounting and tax values of assets and liabilities and/or the timing differences arising when revenues or expenses are included in accounting income in one period and taxable income in a different period. These temporary differences are tax-effected using enacted or substantively enacted tax rates expected to apply when the temporary differences reverse.

The deferred tax liability recorded on the Consolidated Balance Sheets is comprised of the following:

| As at *($millions)* | **December 31 2011** | December 31 2010 | January 1 2010 |
|---|---|---|---|
| Deferred tax assets (liabilities): | | | |
| Property, plant and equipment in excess of tax value | **$ (1,608)** | $ (1,149) | $ (1,181) |
| Additional liability on January 1, 2010 re-measurement[1] (Note 26(e)(vii)) | **–** | – | (269) |
| Partnership earnings[2] | **(200)** | – | – |
| Non-capital losses carried forward | **193** | 60 | 48 |
| Tax credits | **23** | 17 | 13 |
| Liabilities in excess of tax value | **328** | 153 | 160 |
| Net deferred tax liability | **$ (1,264)** | $ (919) | $ (1,229) |

[1] *The January 1, 2010 deferred tax liability was re-measured on transition to IFRS using the 39 per cent individual tax rate applicable to earnings not distributed to trust unitholders.*
[2] *In 2011, the Corporation's taxable income was primarily generated through a partnership and the related taxes are payable in future periods.*

The temporary differences underlying the $200 million deferred tax liability for partnership earnings and the $193 million deferred tax asset for non-capital losses are expected to reverse in 2012. The temporary differences underlying the other deferred tax assets and liabilities are not expected to reverse before 2013.

The deferred tax expense recorded on the Consolidated Statements of Income and Comprehensive Income is comprised of the following:

| For the years ended December 31 *($ millions)* | **2011** | 2010 |
|---|---|---|
| Origination and reversal of temporary differences | **$ 386** | $ (10) |
| Recovery on December 31, 2010 re-measurement of deferred tax liability | **–** | (269) |
| Adjustments for prior years | **1** | (10) |
| Deferred tax expense (recovery) | **$ 387** | $ (289) |

The following estimated balances are available for deduction against future taxable income:

| As at *($ millions)* | **December 31 2011** |
|---|---|
| Undepreciated Capital Costs[1] | **$ 814** |
| Non-capital losses carried forward[2] | **772** |
| Canadian Development Expenses | **44** |
| Canadian Exploration Expenses | **26** |
| Tax credits and other | **98** |
| | **$ 1,754** |
| Taxable income generated in partnership during 2011 on which taxes are payable in future periods[3] | **(801)** |
| Estimated balances available for deduction against future taxable income | **$ 953** |

[1] *Approximately 73 per cent of Undepreciated Capital Costs are currently available for deduction at the declining balance rate of 25 per cent annually while the balance (approximately 27 per cent of the costs) relate to multi-year capital projects and are not yet available for deduction.*
[2] *Non-capital losses are immediately available for deduction and will be applied against the $801 million of taxable income generated in 2011 on which income taxes are payable in future periods.*
[3] *Effective December 31, 2010, the Corporation's taxable income or losses are primarily generated through a partnership, with the related taxes payable in subsequent periods.*

## 13) Shareholders' Equity

### a) Shareholders' Capital

***Authorized***

The Corporation is authorized to issue an unlimited number of Common Shares without nominal or par value, and a maximum of 10,000,000 preferred shares, issuable in series.

***Issued***

The following tables summarize the Shares issued in 2010 and 2011:

| | Number of Shares *(millions)* | Proceeds *($ millions)* |
|---|---|---|
| Shareholders' capital, January 1, 2010 | – | $ – |
| Common Shares issued in exchange for Trust Units on December 31, 2010 | 484.45 | 2,671 |
| Shareholders' capital, December 31, 2010 | 484.45 | 2,671 |
| Issued on exercise of employee options | 0.08 | 2 |
| Shareholders' capital, December 31, 2011 | 484.53 | $ 2,673 |

| | Number of Shares *(millions)* | Proceeds *($ millions)* |
|---|---|---|
| Unitholders' capital, January 1, 2010 | 484.45 | $ 2,671 |
| Common Shares issued in exchange for Trust Units on December 31, 2010 | (484.45) | (2,671) |
| Unitholders' capital, December 31, 2010 | – | $ – |

On December 31, 2010, as described in Note 2, Canadian Oil Sands reorganized from an income trust structure to a corporate structure whereby all outstanding Trust Units were exchanged on a one-for-one basis for Shares of the Corporation.

On February 1, 2012, the Corporation declared a quarterly dividend of $0.30 per Share for a total dividend of approximately $145 million. The dividend will be paid on February 29, 2012 to Shareholders of record on February 24, 2012.

**b) Net Income Per Share**

The following table summarizes the Shares used in calculating net income per Share:

| For the year ended December 31 *(millions)* | **2011** | 2010 |
|---|---|---|
| Weighted-average Shares outstanding, Basic | **485** | 484 |
| Effect of options | **–** | – |
| Weighted-average Shares outstanding, Diluted | **485** | 484 |

## 14) Share-Based Compensation

Canadian Oil Sands issues options, PSUs, and RSUs under its long-term incentive plans for employees, and DSUs as a component of non-executive directors' compensation. In addition, Syncrude Canada issues Syncrude RSUs and Syncrude PSUs for which Canadian Oil Sands records its 36.74 per cent ownership share.

Canadian Oil Sands recorded the following amounts related to share-based compensation awards in its consolidated financial statements in 2011 and 2010:

| *($ millions)* | Options (a) | PSUs (b) | Syncrude RSUs (c) | Syncrude PSUs (d) |
|---|---|---|---|---|
| **2011** | | | | |
| **Expense (recovery) recognized during the year** | **$ 2** | **$ 4** | **$ 5** | **$ (5)** |
| **Liability recognized at December 31** | **n/a** | **5** | **3** | **7** |
| 2010 | | | | |
| Expense (recovery) recognized during the year | $ – | $ (2) | $ (4) | $ 4 |
| Liability recognized at December 31 | n/a | 1 | – | 19 |
| Liability recognized at January 1 | 7 | 5 | 4 | 19 |

Details of the share-based compensation awards are as follows:

| | 2011 | | | |
|---|---|---|---|---|
| | **Options (a)** | **PSUs (b)** | **Syncrude RSUs (c)** | **Syncrude PSUs (d)** |
| Outstanding at January 1, 2011 | **1,649,756** | **238,424** | **321,228** | **1,072,524** |
| Granted during 2011 | **317,512** | **76,644** | **195,139** | **332,019** |
| Redeemed during 2011 | **(85,928)** | **(48,428)** | **(92,379)** | **(95,771)** |
| Forfeited during 2011 | **(84,769)** | **(10,412)** | **(14,852)** | **(661)** |
| Outstanding at December 31, 2011 | **1,796,571** | **256,228** | **409,136** | **1,308,111** |
| Less unvested at December 31, 2011 | **(695,383)** | **(256,228)** | **(409,136)** | **(630,275)** |
| Vested at December 31, 2011 | **1,101,188** | **–** | **–** | **677,836** |
| Weighted-average exercise price of awards outstanding at December 31, 2011 *($)* | **27.41** | **n/a** | **–** | **31.23** |
| Vesting schedule for awards unvested at December 31, 2011 | | | | |
| Scheduled to vest during: 2012 | **365,879** | **105,602** | **113,800** | **308,624** |
| 2013 | **226,737** | **76,297** | **112,942** | **210,977** |
| 2014 | **102,767** | **74,329** | **182,394** | **110,674** |
| | **695,383** | **256,228** | **409,136** | **630,275** |

| | 2010 | | | |
|---|---|---|---|---|
| | Options (a) | PSUs (b) | Syncrude RSUs (c) | Syncrude PSUs (c) |
| Outstanding at January 1, 2010 | 1,310,549 | 197,635 | 247,459 | 785,900 |
| Granted during 2010 | 339,207 | 78,869 | 129,381 | 311,996 |
| Redeemed during 2010 | – | (34,953) | (44,037) | (20,044) |
| Forfeited during 2010 | – | (3,127) | (11,575) | (5,328) |
| Outstanding at December 31, 2010 | 1,649,756 | 238,424 | 321,228 | 1,072,524 |
| Less unvested at December 31, 2010 | (821,213) | (238,424) | (321,228) | (604,634) |
| Vested at December 31, 2010 | 828,543 | – | – | 467,890 |
| Weighted-average exercise price of awards outstanding at December 31, 2010 *($)* | 27.37 | n/a | – | 35.84 |
| Vesting schedule for awards unvested at December 31, 2010 | | | | |
| Scheduled to vest during: 2011 | 414,647 | 48,428 | 92,173 | 293,608 |
| 2012 | 277,205 | 111,127 | 113,606 | 208,422 |
| 2013 | 129,361 | 78,869 | 115,449 | 102,604 |
| | 821,213 | 238,424 | 321,228 | 604,634 |

**a) Options**

Canadian Oil Sands' options provide the holder with a right to purchase a Share at the exercise price determined at the grant date. For options granted prior to 2011, exercise prices are reduced by dividends over a threshold amount. For options granted during 2011, exercise prices are not reduced by dividends. Subject to certain exceptions relating to retirement, death or termination, the options vest by one-third following the date of grant in each of the first three years and expire seven years from the date of grant.

The weighted-average exercise prices and significant assumptions for options granted during 2011 and 2010 were as follows:

| | **2011** | 2010 |
|---|---|---|
| Weighted-average exercise price *($)*[1] | **26.78** | 28.20 |
| Assumed interest rate *(%)*[2] | **3.50** | 3.00 |
| Assumed life *(years)*[2] | **4.5** | 4.5 |
| Assumed volatility *(%)*[2] | **36** | 36 |
| Assumed dividend yield *(%)*[2] | **2.99** | 4.96 |
| Weighted-average grant-date fair value *($/option)* | **6.72** | 5.64 |

[1] *The exercise price is based on the Share price immediately prior to the grant.*
[2] *The assumed interest rate, life, volatility and dividend yield are estimated using historical data.*

**b) PSUs**

Canadian Oil Sands' PSUs are awarded and settled in cash, in Shares purchased in the secondary market, or in Shares issued from treasury, at the end of a three-year period. The settlement value is based on the Corporation's Share price at the vesting date and the total Shareholder return generated by the Corporation relative to a comparator group, comprised of other industry peers and the S&P/TSX oil and gas E&P index.

**c) Syncrude RSUs**

Syncrude Canada awards Syncrude RSUs to certain employees. Subject to certain exceptions relating to retirement, death or termination, Syncrude RSUs vest over three years after the award date and require settlement by cash payments. There are two types of Syncrude RSUs. The cash settlement for the first type is based on the weighted-average price of certain Syncrude owners' shares and the total shareholder return of such owners' shares over the vesting period relative to a peer group. The cash settlement for the second type is based purely on the weighted-average price of certain Syncrude owners' shares; it is not contingent on shareholder return.

**d) Syncrude PSUs**

Syncrude Canada awards Syncrude PSUs to certain employees. Subject to certain exceptions relating to retirement, death or termination, Syncrude PSUs awarded before 2005 have a term of seven years and are subject to a vesting schedule under which up to 50 per cent of the units are exercisable after one year of issuance, an additional 25 per cent may be exercised after two years, and the remaining 25 per cent may be exercised after three years. Syncrude PSUs awarded after 2005 have a term of seven years and vest in equal amounts over a three-year period. Syncrude PSUs are settled in cash and have value if the weighted-average price of the shares of certain of Syncrude's shareholders at the exercise date exceeds the exercise price.

**e) RSUs**

Canadian Oil Sands' RSUs are awarded and settled in cash, in Shares purchased in the secondary market, or in Shares issued from treasury, at the end of a three-year vesting period. The settlement value is based on the Corporation's Share price at the vesting date. Canadian Oil Sands issued 8,151 RSUs and 260 RSUs were forfeited during 2011. At December 31, 2011, a total of 7,891 RSUs were outstanding (December 31, 2010 and January 1, 2010 – nil).

Canadian Oil Sands' 2011 share-based compensation expense and December 31, 2011 liability relating to RSUs were each less than $1 million.

**f) DSUs**

Canadian Oil Sands' DSUs are awarded and settled in cash, in Shares purchased in the secondary market or in Shares issued from treasury. DSUs vest immediately upon grant and settle when a director's service ceases. The settlement value is based on the Corporation's Share price on that date. Canadian Oil Sands issued 22,498 DSUs during 2011 and, at December 31, 2011, a total of 22,498 DSUs were outstanding (December 31, 2010 and January 1, 2010 – nil).

Canadian Oil Sands' 2011 share-based compensation expense and December 31, 2011 liability relating to DSUs were each less than $1 million.

## 15) Crown Royalties

Until December 31, 2015, Syncrude's Crown royalties are determined pursuant to the Syncrude Royalty Amending Agreement and the Syncrude Bitumen Royalty Option Agreement.

Under the Syncrude Royalty Amending Agreement, the Syncrude owners pay the greater of 25 per cent of net deemed bitumen revenues, or one per cent of gross deemed bitumen revenues, plus a transition royalty of up to $975 million ($358 million net to the Corporation) for the period January 1, 2010 to December 31, 2015. The transition royalty is reduced proportionally if bitumen production is less than 345,000 barrels per day over the period. The $975 million ($358 million net to the Corporation) is scheduled over six annual installments as follows:

| *($ millions)* | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | Total |
|---|---|---|---|---|---|---|---|
| Syncrude | $ 75 | $ 75 | $ 100 | $ 150 | $ 225 | $ 350 | $ 975 |
| Canadian Oil Sands' share | $ 27 | $ 27 | $ 37 | $ 55 | $ 83 | $ 129 | $ 358 |

The Syncrude Royalty Amending Agreement requires that bitumen be valued by a formula that references the value of bitumen based on a Canadian heavy oil price adjusted for reasonable quality, transportation and handling deductions (including diluent costs) to reflect the quality and location differences between Syncrude's bitumen and the reference price of bitumen. In December 2010, the Alberta government provided a modified notice of a bitumen value for Syncrude (the "Syncrude BVM"). For estimating and paying royalties, Syncrude used a bitumen value based on Syncrude and its owners' interpretation of the Syncrude Royalty Amending Agreement, which is different than the Syncrude BVM. Canadian Oil Sands' share of the royalties recognized for the period from January 1, 2009 to December 31, 2011 are now estimated to be approximately $40 million lower than the amount calculated using the Syncrude BVM. The Syncrude owners and the Alberta government continue to discuss the basis for reasonable quality, transportation, and handling adjustments but if such discussions do not result in an agreed upon solution, either party may seek judicial determination of the matter. Should these discussions or a judicial determination result in a deemed bitumen value different than that used by Syncrude for estimating and paying royalties, the cumulative impact on Canadian Oil Sands' share of royalties since January 1, 2009 will be recognized immediately and impact both net income and cash from operating activities accordingly.

Under the Syncrude Bitumen Royalty Option Agreement, costs related to capital expenditures that were deducted in computing Crown royalties on SCO in prior years, and are no longer associated with the royalty base, are recaptured by the Crown. These recapture amounts result in approximately $30 million of additional Crown royalties per year, net to the Corporation, over a 25-year period.

## 16) Foreign Exchange

| For the years ended December 31 *($ millions)* | **2011** | 2010 |
|---|---|---|
| Foreign exchange (gain) loss – long-term debt | **$ 25** | $ (58) |
| Foreign exchange (gain) loss – other | **(3)** | (2) |
| Total foreign exchange (gain) loss | **$ 22** | $ (60) |

## 17) Net Finance Expense

| For the years ended December 31 *($ millions)* | | **2011** | | 2010 |
|---|---|---|---|---|
| Interest costs | **$** | **87** | $ | 91 |
| Less capitalized interest | | **(57)** | | (30) |
| Interest expense | | **30** | | 61 |
| Accretion of asset retirement obligation | | **16** | | 21 |
| Net finance expense | **$** | **46** | $ | 82 |

## 18) Capital Management

The Corporation's capital consists of cash and cash equivalents, debt and Shareholders' equity. The balance of each of these items at December 31, 2011 and 2010 and January 1, 2010 was as follows:

| As at *($ millions)* | | **December 31 2011** | | December 31 2010 | | January 1 2010 |
|---|---|---|---|---|---|---|
| Long-term debt | **$** | **1,132** | $ | 1,251 | $ | 1,163 |
| Cash and cash equivalents | | **(718)** | | (80) | | (122) |
| Net debt[1,2] | **$** | **414** | $ | 1,171 | $ | 1,041 |
| Shareholders' equity | **$** | **4,210** | $ | 3,726 | $ | 3,491 |
| Total capitalization[1,3] | **$** | **4,624** | $ | 4,897 | $ | 4,532 |
| Net debt to total capitalization[1,4] (%) | | **9** | | 24 | | 23 |

[1] *Net debt, total capitalization, and net debt to total capitalization are non-GAAP measures.*
[2] *Long-term debt less cash and cash equivalents.*
[3] *Net debt plus Shareholders' equity.*
[4] *Net debt divided by total capitalization.*

Net debt, comprised of long-term debt less cash and cash equivalents, decreased to $414 million at December 31, 2011 from $1,171 million at December 31, 2010, as Canadian Oil Sands generated $1,958 million in cash from operating activities in 2011 while capital expenditures were $643 million and dividend payments were $533 million.

Shareholders' equity increased to $4,210 million at December 31, 2011 from $3,726 million at December 31, 2010, as net income exceeded dividends in 2011.

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

- ensuring financing capacity for Syncrude's oil sands-related investing activities;
- targeting an investment grade credit rating and financial flexibility to control risk and allow the Corporation to maintain its crude oil price exposure; and
- distributing to Shareholders any cash that is not required for financing Syncrude's operations or capital investment.

As disclosed in Notes 9 and 10, the Corporation is bound by certain debt covenants; however, these covenants do not specifically limit the Corporation's ability to pay dividends. The Corporation monitors its total debt-to-total capitalization, as it must be less than 55 per cent according to certain financial covenants. With a net debt-to-total capitalization of 9 per cent at December 31, 2011, the Corporation is well within its limits and a significant increase in debt or decrease in equity would be required to negatively impact the Corporation's financial flexibility.

## 19) Financial Instruments

The Corporation's financial instruments include cash and cash equivalents, accounts receivable, reclamation trust investments, accounts payable, accrued liabilities and long-term debt. The carrying values of the Corporation's financial instruments and their related categories at December 31, 2011 and 2010 and January 1, 2010 were as follows:

| | December 31 | | January 1 |
|---|---|---|---|
| As at *($ millions)* | **2011** | 2010 | 2010 |
| **Financial Assets** | | | |
| Loans and receivables | | | |
| Cash and cash equivalents | **$ 718** | $ 80 | $ 122 |
| Accounts receivable | **376** | 379 | 354 |
| Reclamation trust | **58** | 53 | 48 |
| | **$ 1,152** | $ 512 | $ 524 |
| **Financial Liabilities** | | | |
| Other liabilities | | | |
| Accounts payable and accrued liabilities[1] | **$ 450** | $ 368 | $ 284 |
| Long-term debt | **1,132** | 1,251 | 1,163 |
| | **$ 1,582** | $ 1,619 | $ 1,447 |

[1] *Excludes current portion of asset retirement obligation.*

### Fair Values

The fair values of cash and cash equivalents, accounts receivable, reclamation trust investments and accounts payable and accrued liabilities approximate their carrying values due to the short-term nature of those instruments. The fair value of long-term debt, based on third-party market indications, is as follows:

| | December 31 | | January 1 |
|---|---|---|---|
| As at *($ millions)* | **2011** | 2010 | 2010 |
| 5.8% Senior Notes due August 15, 2013 (U.S. $300 million) | **$ 324** | $ 325 | $ 339 |
| 7.75% Senior Notes due May 15, 2019 (U.S. $500 million) | **624** | 590 | 611 |
| 7.9% Senior Notes due September 1, 2021 (U.S. $250 million) | **318** | 300 | 307 |
| 8.2% Senior Notes due April 1, 2027 (U.S. $73.95 million) | **92** | 83 | 83 |
| | **$ 1,358** | $ 1,298 | $ 1,340 |

### Financial Risks

#### *Foreign Currency Risk*

Canadian Oil Sands' results are affected by fluctuations in the U.S./Cdn currency exchange rates, as sales generated are based on a WTI benchmark price in U.S. dollars while operating expenses and capital expenditures are denominated primarily in Canadian dollars. Our sales exposure is partially offset by U.S. dollar obligations, such as interest costs on U.S. dollar-denominated long-term debt (Senior Notes) and our share of Syncrude's U.S. dollar vendor payments. In addition, when our U.S. dollar Senior Notes mature, we have exposure to U.S. dollar exchange rates on the principal repayment of the notes. This repayment of U.S. dollar debt acts as a partial economic hedge against the U.S. dollar-denominated sales receipts we collect from our customers.

As at December 31, 2011, portions of Canadian Oil Sands' cash and cash equivalents, accounts receivable, accounts payable and long-term debt were denominated in U.S. dollars. Based on these U.S. dollar financial instrument closing balances, 2011 net income and other comprehensive income would have increased/decreased by approximately $10 million for every $0.01 decrease/increase in the value of the U.S./Cdn currency exchange rate.

***Interest Rate Risk***

Canadian Oil Sands' financial results are impacted by U.S. and Canadian interest rate changes because our credit facilities and investments are exposed to floating interest rates. In addition, we are exposed to the refinancing of maturing long-term debt at prevailing interest rates. As at December 31, 2011, there were no amounts drawn on the credit facilities ($145 million at December 31, 2010, $nil at January 1, 2010) and the next long-term debt maturity is in August, 2013. Canadian Oil Sands did not have a significant exposure to interest rate risk based on the amount of floating rate debt or the short-term nature of investments outstanding during the year.

***Liquidity Risk***

Liquidity risk is the risk that Canadian Oil Sands will not be able to meet its financial obligations as they come due. Canadian Oil Sands actively manages its liquidity through cash, debt and equity management strategies. Such strategies encompass, among other factors: having adequate sources of financing available through bank credit facilities, estimating future cash from operating activities based on reasonable production and pricing assumptions, understanding operating commitments and future capital expenditure requirements, analysing economic hedging opportunities, and complying with debt covenants. In addition, over the long-term, Canadian Oil Sands spreads out the maturities of its various debt tranches and maintains a prudent capital structure.

The next long-term debt maturity is in August 2013, the $1.5 billion credit facility does not expire until June, 2015, Canadian Oil Sands held cash balances totalling $718 million at December 31, 2011, and Canadian Oil Sands was in compliance with its debt covenants throughout 2011, resulting in relatively low liquidity risk.

More information regarding the available credit facilities and contractual maturities of Canadian Oil Sands' long-term debt can be found in Notes 9 and 10, respectively.

The expected timing of cash flows related to financial liabilities is outlined below:

| | Cash outflow by period | | | | |
|---|---|---|---|---|---|
| *($ millions)* | Total | <1 year | 1-3 years | 4-5 years | After 5 years |
| Accounts payable and accrued liabilities[1] | $ 450 | $ 450 | $ – | $ – | $ – |
| Long-term debt[2] | $ 1,756 | $ 83 | $ 454 | $ 131 | $ 1,088 |

[1] *Excludes current portion of asset retirement obligation.*
[2] *Actual payments differ from the carrying value of long-term debt as the amounts in this table include both principal and interest payments.*

***Credit Risk***

Canadian Oil Sands is exposed to credit risk primarily through customer receivable balances, financial counterparties with whom the Corporation has invested its cash and cash equivalents, and with its insurance providers in the event of an outstanding claim. The maximum exposure to any one customer or financial counterparty is controlled through a credit policy that limits exposure based on credit ratings. The policy also specifically limits the exposure to customers with a credit rating below investment grade to a maximum of 25 per cent of Canadian Oil Sands' consolidated accounts receivable. This credit risk concentration is monitored on a regular basis. Risk is further mitigated as accounts receivable with customers typically are settled in the month following the sale, and investments with financial counterparties are typically short-term in nature and are placed with institutions that have a credit rating of "R-1 (low)" or better, as defined by the Dominion Bond Rating Service ("DBRS").

Canadian Oil Sands carries credit insurance on some counterparties to help mitigate a portion of the impact should a loss occur and continues to transact primarily with investment grade customers.

The Corporation's maximum credit exposure related to customer receivables was $376 million at December 31, 2011 (December 31, 2010 at $354 million; January 1, 2010 at $329 million). The vast majority of accounts receivable at December 31, 2011 was due from investment grade energy producers, financial institutions, and refinery-based customers, and our cash and cash equivalents were invested in deposits and Bankers' Acceptances with high-quality senior banks as well as investment grade commercial paper. At present, there are no financial assets that are past their maturity or impaired due to credit risk-related defaults.

## 20) Key Management Personnel Compensation

Key management personnel include certain of the Corporation's senior management and all of the Corporation's directors. Canadian Oil Sands recorded the following amounts in its financial statements relating to key management personnel compensation in 2011 and 2010:

| *($ millions)* | **2011** | 2010 |
|---|---|---|
| Expense (recovery) for the year | | |
| Short-term benefits expense[1] | **$ 4** | $ 5 |
| Share-based compensation expense (recovery) | **7** | (1) |
| | **$ 11** | $ 4 |
| Liability recorded at December 31[2] | **$ 7** | $ 3 |
| Liability recorded at January 1[2] | | $ 6 |

[1] *Short-term benefits include salaries, annual incentive plan payments, the Corporation's contributions to savings accounts on behalf of key management personnel, and fees paid to directors.*
[2] *Liability to key management personnel for short-term benefits and share-based compensation.*

## 21) Commitments

Canadian Oil Sands is obligated to make future cash payments under contractual agreements that it has entered into either directly or as an owner in Syncrude. The following table outlines the significant commitments that the Corporation is required to fund:

| *($ millions)* | Total | <1 year | 1-3 years | 4-5 years | After 5 years |
|---|---|---|---|---|---|
| Pipeline commitments (a) | 1,227 | 28 | 49 | 109 | 1,041 |
| Pension plan solvency deficiency payments (b) | 296 | 44 | 88 | 41 | 123 |
| Capital expenditure commitments (c) | 305 | 228 | 77 | – | – |
| Management services agreement (d) | 85 | 17 | 34 | 34 | – |
| Other commitments (e) | 338 | 124 | 116 | 24 | 74 |
| | 2,251 | 441 | 364 | 208 | 1,238 |

### a) Pipeline Commitments

Canadian Oil Sands has commitments for transportation services on several pipelines. These commitments require Canadian Oil Sands to pay for services whether or not any volumes are shipped. Amounts are due under these pipeline commitments over the next 24 years.

### b) Pension Plan Solvency Deficiency Payments

An actuarial valuation of Syncrude Canada's defined benefit pension plans was completed in 2011, and Syncrude Canada is required to fund a pension plan solvency deficiency. Canadian Oil Sands' share of these funding requirements is $296 million. Amounts are due over the next 14 years.

### c) Capital Expenditure Commitments

Capital expenditure commitments are primarily comprised of Canadian Oil Sands' 36.74 per cent share of Syncrude's committed costs under the Mildred Lake Mine Train Replacement and Aurora North Tailings Management projects. Amounts are due in 2012 and 2013.

### d) Management Services Agreement

Effective November 1, 2006, Syncrude Canada entered into a comprehensive Management Services Agreement with Imperial Oil Resources Ltd. ("Imperial Oil") to provide operational, technical and business management services to Syncrude Canada. The agreement has an initial term of 10 years, with five-year renewal provisions. Either Syncrude Canada or Imperial Oil has the option to cancel the agreement on 24 months' notice for any reason. Canadian Oil Sands' 36.74 per cent share of the annual fixed fee payable to Imperial Oil for the first 10 years under the agreement is

$17 million per year. In years 4 through 10, variable performance fees also apply based on the achievement of certain performance targets. Such variable fees may be comparable to the fixed fee component if Syncrude Canada realizes a corresponding benefit through higher production and/or lower per barrel operating expenses. In 2010 and 2011, the first two years of application of the variable fees, no such fees were earned.

**e) Other Commitments**

Other commitments include:

- Syncrude's purchase commitments for natural gas deliveries in 2012 through 2014 at floating market prices. Canadian Oil Sands' 36.74 per cent share of these commitments is estimated to be $132 million.
- Canadian Oil Sands' commitments for storage and terminal services which total $55 million. Amounts are due over the next 12 years.

## 22) Contingencies

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

See Note 15 for a discussion of the contingent liability relating to the bitumen value used to measure Crown royalties.

## 23) Guarantees

Canadian Oil Sands has posted performance standby letters of credit with the Province of Alberta which are renewed annually. The letters of credit guarantee to the Province of Alberta the reclamation obligations of Canadian Oil Sands' interest in future reclamation of the Syncrude mines and plants (Note 11). The Province of Alberta can draw on the letters of credit if Syncrude fails to perform its reclamation duties. The maximum potential amount of payments Canadian Oil Sands may be liable for pursuant to these letters of credit is $75 million.

## 24) Supplementary Information

**a) Change in Non-Cash Working Capital**

| Year ended December 31 *($ millions)* | **2011** | 2010 |
|---|---|---|
| Operating activities: | | |
| Accounts receivable | **$ 4** | $ (25) |
| Inventories | **(13)** | 4 |
| Prepaid expenses | **(4)** | 1 |
| Accounts payable and accrued liabilities | **75** | 121 |
| Less: A/P and A/R changes reclassified to investing and other | **(1)** | (38) |
| Change in operating non-cash working capital | **$ 61** | $ 63 |
| Investing activities: | | |
| Accounts receivable | **$ –** | $ (5) |
| Accounts payable and accrued liabilities | **4** | 6 |
| Change in investing non-cash working capital | **$ 4** | $ 1 |

### b) Income Taxes and Interest Paid

| Year ended December 31 *($ millions)* | **2011** | 2010 |
|---|---|---|
| Income taxes paid | **$ –** | $ – |
| Interest paid | **$ 95** | $ 91 |

Income taxes and interest payments are included within cash from operating activities on the Consolidated Statements of Cash Flows.

### c) Major Customers

In connection with the marketing and sale of Canadian Oil Sands' own synthetic crude oil for the year ended December 31, 2011, the Corporation had two customers (2010 – two) which individually accounted for more than 10 per cent of consolidated sales. Sales to these customers in 2011 were approximately $1,173 million (2010 – $1,292 million).

## 25) New Accounting Standards

In May 2011, the International Accounting Standards Board ("IASB") issued IFRS 11, *Joint Arrangements*, to replace International Accounting Standard ("IAS") 31, *Interests in Joint Ventures*, IFRS 10, *Consolidated Financial Statements*, IFRS 12, *Disclosure of Interests in Other Entities*, and IFRS 13, *Fair Value Measurements,* effective for years beginning on or after January 1, 2013 with earlier application permitted. IFRS 11 eliminates the accounting policy choice between proportionate consolidation and equity method accounting for joint ventures available under IAS 31 and, instead, mandates one of these two methodologies based on the economic substance of the joint arrangement. IFRS 10 establishes principles for the presentation and preparation of consolidated financial statements. IFRS 12 requires entities to disclose information about the nature of their interests in joint ventures and IFRS 13 defines, and establishes a framework for measuring, fair value.

In June 2011, the IASB issued an amendment to IAS 19, *Employee Benefits*, to address the accounting and disclosure of defined benefit pension plans effective for years beginning on or after January 1, 2013 with earlier application permitted.

In October 2011, the IASB issued International Financial Reporting Interpretations Committee ("IFRIC") Interpretation 20, Stripping Costs in the Production Phase of a Surface Mine, which clarifies the accounting for costs associated with waste removal in surface mining effective for years beginning on or after January 1, 2013 with earlier application permitted.

Canadian Oil Sands has not applied any of these new standards as of December 31, 2011. Canadian Oil Sands continues to assess their impact and, at this time, does not anticipate any of them to result in significant accounting or disclosure changes.

## 26) Transition to International Financial Reporting Standards

The impact of the transition to IFRS is summarized in this note as follows:

a) Transition Exceptions and Exemptions
b) Reconciliation of Assets, Liabilities and Shareholders' Equity as previously reported under Canadian GAAP to IFRS
c) Reconciliation of Net Income and Comprehensive Income as previously reported under Canadian GAAP to IFRS
d) Reconciliation of Cash Flows as previously reported under Canadian GAAP to IFRS
e) Notes to the Reconciliations

### a) Transition Exceptions and Exemptions

Canadian Oil Sands has applied the following transition exceptions and exemptions to full retrospective application of IFRS:

| Exception / exemption | Description | As described in Note 26 (e) |
|---|---|---|
| Capitalization of interest costs | Exempt all interest costs incurred prior to January 1, 2010 from capitalization | (ii) |
| Asset retirement obligation | Apply prescribed method to estimate January 1, 2010 net book value of asset retirement obligation's cost capitalized in PP&E | (iii) |
| Employee future benefits | Record previously unrecognized actuarial losses on defined benefit pension plan through January 1, 2010 retained earnings | (iv) |
| Business combinations | Exempt pre-January 1, 2010 business combinations from re-measurement | |
| Leases | Exempt all leases assessed under Canadian GAAP from re-assessment | |

**b) Reconciliations of Assets, Liabilities and Shareholders' Equity as Previously Reported Under Canadian GAAP to IFRS**

| *($ millions)* | Note 26 | December 31 2010 | January 1 2010 |
|---|---|---|---|
| **Assets – Canadian GAAP** | | **$ 7,016** | **$ 6,953** |
| Property, plant and equipment – Canadian GAAP | | $ 6,369 | $ 6,289 |
| Capitalization of turnaround costs | (i) | 52 | 46 |
| Capitalization of interest costs | (ii) | 30 | – |
| Asset retirement obligation | (iii) | 34 | 19 |
| Reclass to exploration and evaluation | (viii) | (89) | (89) |
| Property, plant and equipment – IFRS | | $ 6,396 | $ 6,265 |
| Exploration and evaluation – Canadian GAAP | | $ – | $ – |
| Reclass from property, plant and equipment | (viii) | 89 | 89 |
| Exploration and evaluation – IFRS | | $ 89 | $ 89 |
| **Assets – IFRS** | | **$ 7,132** | **$ 7,018** |
| **Liabilities – Canadian GAAP** | | **$ (3,058)** | **$ (2,984)** |
| Employee future benefits and other liabilities – Canadian GAAP | | $ (67) | $ (104) |
| Defined benefit pension plan | (iv) | (240) | (166) |
| Cash settled share-based awards | (v) | (9) | (7) |
| Equity settled share-based awards | (vi) | – | (7) |
| Employee future benefits and other liabilities – IFRS | | $ (316) | $ (284) |
| Asset retirement obligation – Canadian GAAP | | $ (286) | $ (389) |
| Asset retirement obligation | (iii) | (178) | (161) |
| Asset retirement obligation – IFRS | | $ (464) | $ (550) |
| Deferred taxes – Canadian GAAP | | $ (998) | $ (1,027) |
| Deferred taxes | (vii) | 79 | (202) |
| Deferred taxes – IFRS | | $ (919) | $ (1,229) |
| **Liabilities – IFRS** | | **$ (3,406)** | **$ (3,527)** |
| **Shareholders' Equity – Canadian GAAP** | | **$ (3,958)** | **$ (3,969)** |
| Retained earnings – Canadian GAAP | | $ (1,349) | $ (1,359) |
| Capitalization of turnaround costs | (i) | (52) | (46) |
| Capitalization of interest costs | (ii) | (30) | – |
| Asset retirement obligation | (iii) | 144 | 142 |
| Defined benefit pension plan | (iv) | 240 | 166 |
| Cash settled share-based awards | (v) | 9 | 7 |
| Reclass equity settled share-based awards | (vi) | 84 | 84 |
| Equity settled share-based awards | (vi) | (1) | 2 |
| Deferred taxes | (vii) | (79) | 202 |
| Retained earnings – IFRS | | $ (1,034) | $ (802) |
| Shareholders' capital – Canadian GAAP | | $ (2,587) | $ (2,587) |
| Reclass equity settled share-based awards | (vi) | (84) | (84) |
| Shareholders' capital – IFRS | | $ (2,671) | $ (2,671) |
| Contributed surplus – Canadian GAAP | | $ (7) | $ (5) |
| Equity settled share-based awards | (vi) | 1 | 5 |
| Contributed surplus – IFRS | | $ (6) | $ – |
| **Shareholders' Equity – IFRS** | | **$ (3,726)** | **$ (3,491)** |

### c) Reconciliations of Net Income and Comprehensive Income as Previously Reported Under Canadian GAAP to IFRS

| *($ millions)* | Note 26 | | Year ended December 31 2010 |
|---|---|---|---|
| **Net income – Canadian GAAP** | | **$** | **886** |
| Operating expenses – Canadian GAAP | | $ | (1,439) |
| Capitalization of turnaround costs | (i) | | 46 |
| Actuarial losses on defined benefit pension plan | (iv) | | 8 |
| Cash settled share-based awards | (v) | | (2) |
| Operating expenses – IFRS | | $ | (1,387) |
| Depreciation and depletion expense – Canadian GAAP | | $ | (408) |
| Capitalization of turnaround costs | (i) | | (40) |
| Increase in depletion of asset retirement obligation's cost | | | (6) |
| Reclass accretion of asset retirement obligation to net finance expense | (x) | | 25 |
| Depreciation and depletion expense – IFRS | | $ | (429) |
| Interest expense – Canadian GAAP | | $ | (91) |
| Capitalization of interest costs | (ii) | | 30 |
| Decrease in accretion of asset retirement obligation accretion | | | 4 |
| Reclass accretion of asset retirement obligation from depreciation and depletion expense | (x) | | (25) |
| Net finance expense – IFRS | | $ | (82) |
| Administration expense – Canadian GAAP | | $ | (23) |
| Equity settled share-based awards | (vi) | | 3 |
| Administration expense – IFRS | | $ | (20) |
| Deferred tax recovery (expense) – Canadian GAAP | | $ | 29 |
| Deferred taxes | (vii) | | 260 |
| Deferred tax recovery – IFRS | | $ | 289 |
| **Net income – IFRS** | | **$** | **1,189** |
| **Comprehensive income – Canadian GAAP** | | **$** | **883** |
| Other comprehensive loss – Canadian GAAP | | $ | (3) |
| Actuarial losses on defined benefit pension plan | (iv) | | (61) |
| Other comprehensive loss – IFRS | | $ | (64) |
| Sum of net income adjustments above | | $ | 303 |
| **Comprehensive income – IFRS** | | **$** | **1,125** |

### d) Reconciliation of Cash Flows as Previously Reported Under Canadian GAAP to IFRS

| *($ millions)* | Note 26 | | Year ended December 31 2010 |
|---|---|---|---|
| **Cash from operating activities – Canadian GAAP** | | **$** | **1,219** |
| Capitalization of turnaround costs | (i) | | 46 |
| Capitalization of interest costs | (ii) | | 30 |
| **Cash from operating activities – IFRS** | | **$** | **1,295** |
| | | | |
| **Cash used in investing activities – Canadian GAAP** | | **$** | **(510)** |
| Capitalization of turnaround costs | (i) | | (46) |
| Capitalization of interest costs | (ii) | | (30) |
| **Cash used in investing activities – IFRS** | | **$** | **(586)** |

### e) Notes to the Reconciliations

#### *i) Capitalization of Turnaround Costs*

Under Canadian GAAP, turnaround costs were expensed as operating expenses when incurred. Under IFRS, costs of major turnarounds are capitalized as property, plant, and equipment and depreciated over the period until the next turnaround, which typically ranges from 24 to 30 months.

*January 1, 2010 Transition Adjustments*

An adjustment was recorded at January 1, 2010 to capitalize turnaround costs expensed under Canadian GAAP. This adjustment resulted in a $46 million increase in property, plant and equipment, net of $48 million accumulated depreciation, with a corresponding $46 million increase in retained earnings.

*2010 Adjustments*

For the year ended December 31, 2010, the capitalization of turnaround costs under IFRS resulted in a $46 million decrease in operating expenses and a $40 million increase in depreciation and depletion. Expenditures of $46 million were reclassified from operating activities to investing activities in the statement of cash flows. December 31, 2010 property, plant and equipment and retained earnings were each $52 million higher under IFRS as a result of capitalizing turnaround costs.

#### *ii) Capitalization of Interest Costs*

Under Canadian GAAP, all interest costs were expensed. Under IFRS, interest costs relating to qualifying assets that take a substantial period of time to construct are capitalized and subsequently expensed as depreciation over the assets' expected useful lives.

*January 1, 2010 Transition Adjustments*

Canadian Oil Sands has applied the transition election available under IFRS 1 to exempt all interest costs incurred prior to January 1, 2010 from capitalization.

*2010 Adjustments*

For the year ended December 31, 2010, the capitalization of interest costs under IFRS resulted in a $30 million decrease in interest expense with a corresponding increase in property, plant and equipment. Expenditures of $30 million were reclassified from operating activities to investing activities in the statement of cash flows. December 31, 2010 property, plant and equipment and retained earnings were each $30 million higher under IFRS as a result of capitalizing interest costs.

***iii) Asset Retirement Obligation***

Under Canadian GAAP, the asset retirement obligation was measured, when initially recognized, using a credit-adjusted discount rate and was not re-measured for changes to this rate. Under IFRS, the asset retirement obligation is measured, when initially recognized, using a risk-free discount rate and is re-measured at each reporting date for changes to this rate.

*January 1, 2010 Transition Adjustments*

Canadian Oil Sands has applied the transition election available under IFRS 1 to estimate the January 1, 2010 net book value of the asset retirement obligation's cost capitalized in property, plant and equipment.

An adjustment was recorded at January 1, 2010 to re-measure the asset retirement obligation using a risk-free discount rate and to recognize the impact of applying the IFRS 1 election. The combined effect was a $161 million increase in the asset retirement obligation and a $19 million increase in property, plant, and equipment, with a corresponding $142 million decrease in retained earnings.

*2010 Adjustments*

The risk-free discount rate was lower at December 31, 2010 than at January 1, 2010 and the asset retirement obligation and related property, plant and equipment were re-measured. At December 31, 2010, the asset retirement obligation was $178 million higher and the related property, plant and equipment asset was $34 million higher under IFRS as a result of the January 1, 2010 transition adjustments and the December 31, 2010 re-measurement.

***iv) Actuarial Losses on Defined Benefit Pension Plan***

Under Canadian GAAP, Canadian Oil Sands recognized its proportionate share of actuarial gains and losses on Syncrude Canada's defined benefit pension plan using the corridor method, whereby the excess of any net actuarial gain or loss exceeding 10 per cent of the greater of the benefit obligation or fair value of plan assets was amortized over the estimated average remaining service life of employees. Under IFRS, these actuarial gains and losses are immediately recognized as incurred in other comprehensive income.

*January 1, 2010 Transition Adjustments*

Canadian Oil Sands has applied the transition election available under IFRS 1 to recognize previously unrecognized actuarial losses through January 1, 2010 retained earnings. This resulted in a $166 million increase in employee future benefits and accrued liabilities with a corresponding $166 million decrease in retained earnings.

*2010 Adjustments*

For the year ended December 31, 2010, actuarial losses of $61 million, net of $21 million in deferred taxes, were immediately recognized in other comprehensive income while $8 million of operating expenses relating to the amortization of these costs under Canadian GAAP were removed.

At December 31, 2010, employee future benefits and accrued liabilities were $240 million higher while retained earnings were $240 million lower under IFRS as a result of these adjustments.

***v) Cash-Settled Share-Based Awards***

Under Canadian GAAP, cash-settled share-based awards were measured at each reporting date at their intrinsic value. Under IFRS, cash-settled share-based awards are measured at fair value. The cash-settled share-based awards include Canadian Oil Sands' proportionate share of the Syncrude RSUs and Syncrude PSUs, and Canadian Oil Sands' PSUs.

***vi) Equity-Settled Share-Based Awards***

Under Canadian GAAP, options were classified as equity-settled share-based awards while Canadian Oil Sands operated as a trust. The share-based compensation expense relating to these options was measured using their grant date fair value and amortized over their vesting period with a corresponding charge to contributed surplus. When options were exercised, amounts in contributed surplus were reclassified to share capital.

Under IFRS, these options were not recognized as equity-settled share-based awards until the December 31, 2010 conversion to a corporation. Prior to this, options were re-measured at fair value at each reporting date. While share-based compensation expense was still amortized over the vesting period of the options, this charge was recorded as a liability, rather than to contributed surplus, under IFRS. However, when options were exercised, liabilities were still reclassified to shareholders' capital.

Beginning December 31, 2010, upon conversion to a corporation, the issued and outstanding options are classified under IFRS as equity-settled share-based awards and share-based compensation expense is measured using the grant-date fair value amortized over the vesting periods of the options.

*January 1, 2010 Transition Adjustments*
An adjustment was recorded at January 1, 2010 to recognize the additional share-based compensation expense relating to all previously settled options resulting in an $84 million increase in shareholders' capital with a corresponding $84 million decrease in retained earnings.

***vii) Deferred Taxes***
Under Canadian GAAP, deferred taxes were referred to as future income taxes and were measured by applying the 25 per cent corporate tax rate, applicable to earnings distributed to trust unitholders, to temporary differences. While Canadian Oil Sands was structured as an income trust, IFRS required that deferred taxes be measured using the 39 per cent individual tax rate applicable to earnings not distributed to trust unitholders. At December 31, 2010, after the conversion to a corporation, IFRS requires that deferred taxes be measured using the 25 per cent corporate tax rate, resulting in the recognition of a deferred tax recovery.

*January 1, 2010 Transition Adjustments*
An adjustment to re-measure deferred taxes using the 39 per cent rate was recorded at January 1, 2010 resulting in a $269 million increase in the deferred taxes liability with a corresponding $269 million decrease in retained earnings. The adjustment was reversed on December 31, 2010, resulting in a $269 million deferred tax recovery during the year ended December 31, 2010.

The impact of this re-measurement combined with the tax effect of the January 1, 2010 transition adjustments resulted in a $202 million increase in the deferred tax liability and a corresponding $202 million decrease in retained earnings under IFRS.

*2010 Adjustments*
For the year ended December 31, 2010, deferred tax recovery adjustments of $260 million were recorded mainly as a result of the tax rate reduction from 39 per cent to 25 per cent, reflecting the conversion from an income trust to a corporation.

The $202 million increase in the deferred tax liability at January 1, 2010, the $260 million deferred tax recovery adjustments for the year ended December 31, 2010, and the $21 million deferred tax recovery adjustment recorded with the actuarial losses in other comprehensive income, collectively result in a $79 million decrease in the December 31, 2010 deferred tax liability and a $79 million increase in December 31, 2010 retained earnings under IFRS.

***viii) Exploration and Evaluation Costs***
Under Canadian GAAP, capitalized exploration and evaluation costs were included in property, plant, and equipment on the balance sheet. Under IFRS, capitalized exploration and evaluation costs are presented as a separate line item on the balance sheet.

*January 1, 2010 Transition Adjustments*
An adjustment was recorded at January 1, 2010 to reclassify $89 million from property, plant, and equipment to exploration and evaluation assets.

*2010 Adjustments*
There were no incremental exploration and evaluation costs capitalized during the three months and year ended December 31, 2010.

***ix) Crown Royalties***
Under Canadian GAAP, Crown royalties were presented as expenses in the statements of income and comprehensive income. Under IFRS, Crown royalties are netted against revenues.

***x) Net Finance Expense***
Under Canadian GAAP, accretion of the asset retirement obligation was presented with depreciation and depletion in the statements of income and comprehensive income. Under IFRS, accretion is combined with interest expense and presented as finance expense. Finance expense is presented net of interest income earned on cash and cash equivalents.

## FORWARD-LOOKING INFORMATION

In the interest of providing shareholders and potential investors of Canadian Oil Sands Limited (the "Corporation" or "Canadian Oil Sands" or "we") with information regarding the Corporation, including management's assessment of the Corporation's future production and cost estimates, plans and Syncrude operations, certain statements throughout this annual report contain "forward-looking information" under applicable securities law. Forward-looking statements are typically identified by words such as "anticipate", "expect", "believe", "plan", "intend" or similar words suggesting future outcomes. Forward-looking statements in this annual report include, but are not limited to, statements with respect to: the estimated value and amount of reserves recoverable and the time frame to recover such reserves; the estimated resources; the ability of Syncrude's reserve base to support production for decades; the quality of Syncrude's leases; future dividends and any increase or decrease from current payment amounts and our intention to pay a quarterly dividend of at least $0.30 per common share for 2012; the belief that the management services agreement will enable Syncrude to achieve industry-leading capacity utilization rates and higher production over time; the expected benefits of wet crushing technology; the intention to use primarily our cash flow and some of our cash balance to fund our $0.30 per share quarterly dividend, while funding our $1.5 billion capital program; the expectations regarding net debt; the view that our per barrel capital expenditures will significantly drop after 2014, supporting free cash flow expansion and the potential for dividend increases; the expectation that Syncrude will invest $1.1 billion in environmental projects ($0.4 billion net to COS) in 2012; the expectations regarding future global oil demand and supply; the timing of the Aurora South development; the belief in a rising oil price environment; the timing of the construction of the commercial scale pilot and commercial scale centrifuge plants; the goal of increasing production by seven per cent in 2012; plans regarding crude oil hedges in the future; the goal of returning cash that is not invested in the business to shareholders in the form of dividends; the expectation that the costs related to the mine train relocations/replacements and tailings management projects will ramp up in 2012; the ability and timing in achieving Syncrude design capacity; the potential impacts on production and cash flow from operations of achieving Syncrude design capacity; the expectations regarding pipeline capacity for shipments of western Canadian oil to refineries within North America; the views on potentially diversifying Canadian Oil Sands' customer base by accessing new markets such as the United States Gulf Coast and Asia; the expectation that the Syncrude Emissions Reduction ("SER") project will reduce sulphur dioxide emissions by 60 per cent below current approved levels; the expected amount of investment in tailings management infrastructure in 2012; the expectations regarding the East Mine and the West Mine reclamations; the expectation that Syncrude will continue to develop better and more sustainable practices; the expectation that Syncrude will achieve higher plant utilization; the anticipated target in-service dates for the SER project, the Mildred Lake mine train replacements and the Aurora North mine train relocations and the expected total cost of the SER project.

You are cautioned not to place undue reliance on forward-looking statements, as there can be no assurance that the plans, intentions or expectations upon which they are based will occur. By their nature, forward-looking statements involve numerous assumptions, known and unknown risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and other forward-looking statements will not occur. Although the Corporation believes that the expectations represented by such forward-looking statements are reasonable and reflect the current views of the Corporation, there can be no assurance that such expectations will prove to be correct.

The factors or assumptions on which the forward-looking information is based include, but are not limited to: the assumptions outlined in the Corporation's guidance document as posted on the Corporation's website at **www.cdnoilsands.com** as of the date hereof and as subsequently amended or replaced from time to time, including without limitation, the assumptions as to production, operating expenses and oil prices; the successful and timely implementation of capital projects; the ability to obtain regulatory and Syncrude joint venture owner approval; our ability to either generate sufficient cash flow from operations to meet our current and future obligations or obtain external sources of debt and equity capital; the continuation of assumed tax, royalty and regulatory regimes and the accuracy of the estimates of our reserves and resources volumes.

Some of the risks and other factors that could cause results to differ materially from those expressed in the forward-looking statements contained in this annual report include, but are not limited to: the supply and demand metrics for oil and natural gas; general economic, business and market conditions and in particular, the impact of any downturn in the economy and the length of such economic recession; risks inherent to the operation of any large, complex refinery units, especially the integration between mining operations and an upgrader facility; regulatory changes which may impact the penalties on greenhouse gas emitters and operators with tailings ponds; labour shortages and the productivity achieved from labour in the Fort McMurray area; the impact of technology on operations and processes and how new complex technology may not perform as expected; currency and interest rate fluctuations; the availability of pipeline and global refining capacity; changes in business strategy; the availability and price of energy commodities; regulatory decisions; the effects of competition and pricing pressures; shifts in market demands; changes in laws and regulations including environmental and regulatory laws; potential increases in costs; the unanimous joint venture owner approval for major expansions and changes in product types; the impact of Syncrude not being able to meet the conditions of its approval for its tailings management plan under Directive 074; unsuccessful or untimely implementation of capital or maintenance projects; volatility of crude oil prices; volatility of the synthetic crude oil to West Texas Intermediate differential; the availability of adequate levels of insurance; various events which could disrupt operations including fires, equipment failures and severe weather conditions; technological changes; management retention and development and such other risks and uncertainties described in the Corporation's Annual Information Form dated February 23, 2012 and in the reports and filings made with the securities regulatory authorities from time to time by the Corporation, which are available on the Corporation's profile on SEDAR at **www.sedar.com** and on the Corporation's website at **www.cdnoilsands.com**.

You are cautioned that the foregoing list of important factors is not exhaustive. Furthermore, the forward-looking statements contained in this annual report are made as of the date of this annual report and unless required by law, the Corporation does not undertake any obligation to update publicly or to revise any of the included forward-looking statements, whether as a result of new information, future events or otherwise. The forward-looking statements contained in this annual report are expressly qualified by this cautionary statement.

In any reference to contingent resources in this annual report, there is no certainty that it will be commercially viable to produce any portion of the resources.

In any reference to prospective resources in this annual report, there is no certainty that any portion of the resources will be discovered. If discovered, there is no certainty that it will be commercially viable to produce any portion of the resources.

The financial results of the Corporation have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") and are reported in Canadian dollars, unless otherwise stated.

## NON-GAAP FINANCIAL MEASURES

In this MD&A we refer to financial measures that do not have any standardized meaning as prescribed by Canadian GAAP. These non-GAAP financial measures include cash flow from operations, cash flow from operations on a per share basis, net debt, net debt to total capitalization, net debt to cash flow from operations, return on average productive capital employed, return on average shareholders' equity and free cash flow. In addition, the Corporation refers to various per barrel figures, such as net realized selling prices, operating expenses, Crown royalties and netback price, which also are considered non-GAAP measures. We derive per barrel figures by dividing the relevant sales or cost figure by our sales volumes, which are net of purchased crude oil volumes in a period. Non-GAAP financial measures provide additional information that we believe is meaningful regarding the Corporation's operational performance, its liquidity and its capacity to fund dividends, capital expenditures and other investing activities. Users are cautioned that non-GAAP financial measures presented by the Corporation may not be comparable with measures provided by other entities.

Since January, 2011, we report cash flow from operations in total and on a per share basis. Previously, we reported cash from operating activities. Cash flow from operations is calculated as cash from operating activities, as reported on the Consolidated Statement of Cash Flows, before changes in non-cash working capital. Cash flow from operations per share is calculated as cash flow from operations divided by the weighted-average number of shares outstanding in the period. We believe cash flow from operations, which is not impacted by fluctuations in non-cash working capital balances, is more indicative of operational performance. The majority of our non-cash working capital is liquid and typically settles within 30 days.

**Alberta oil sand(s) deposits** The four deposits, Athabasca, Peace River, Cold Lake and Wabasca, have total resources in place estimated at 1.7 trillion to 2.5 trillion barrels. The Athabasca Oil Sands deposit, Alberta's largest and most accessible source of bitumen, contains more than one trillion barrels of bitumen over an area encompassing more than 30,000 square kilometres.

**Bitumen** The molasses-like substance that comprises up to 18 per cent of oil sands. Bitumen, in its raw state, is black, asphalt-like oil. It requires upgrading or blending to make it transportable by pipeline and usable by conventional refineries.

**Carbon dioxide ($CO_2$)** A non-toxic gas produced from decaying materials, respiration of plant and animal life, and combustion of organic matter, including fossil fuels; carbon dioxide is the most common greenhouse gas produced by human activities.

**Cokers** Vessels in which bitumen is cracked into its fractions and from which coke is withdrawn in the process of converting bitumen to upgraded crude oil.

**Conventional oil** Petroleum found in liquid form, flowing naturally, or capable of being pumped without further processing or dilution.

**Feedstock(s)** Raw material supplied to refinery, oil sands upgrader, or petrochemical plant.

**Flue gas scrubber/desulphurizer** Equipment that removes sulphur dioxide and other emissions.

**Fluid coking** A major part of the upgrading process whereby high temperatures in a coker break down the complex bitumen molecules, reject carbon and cause bitumen molecules to reformulate into lighter fractions that become the main ingredients in upgraded crude oil.

**Greenhouse gases** Any of the various gases that contribute to the greenhouse effect.

**Oil sand(s)** A composition of sand, bitumen, mineral-rich clays and water.

**Oil sand(s) lease** A long-term agreement with the provincial government that permits the leaseholder to extract bitumen, other metals and minerals contained in the oil sands in the specified lease area.

**Ore grade** The percentage of bitumen by weight in the oil sands.

**Overburden** Layer of rocky, clay-like material that lies under muskeg and above oil sands deposits.

**Sulphur dioxide ($SO_2$)** A compound of sulphur and oxygen produced by burning sulphur.

**Synthetic crude oil** A high-quality product resulting from the mining, extraction and upgrading of bitumen.

**Tailings** A combination of water, sand, silt, fine clay particles and residual hydrocarbon that is a by-product of removing bitumen from oil sand.

**Tailings systems** Separation of water from sand and clay to enable incorporation of solids into reclamation landscapes and recycling of water back into the operations.

**Total volume to bitumen in place (TV/BIP)** The ratio of total ore plus overburden volume to total bitumen in place.

**Turnaround** A unit shutdown essential for good maintenance of the mining, producing and upgrading facilities. A turnaround reduces production but does not usually halt it entirely as the various operating units are often duplicated.

**Upgrader** A facility that upgrades bitumen (extra heavy oil) into synthetic crude oil.

**Upgrading** The conversion of heavy bitumen into a lighter crude oil by increasing the ratio of hydrogen to carbon, either by removing carbon (coking) or adding hydrogen (hydroprocessing).

## RESERVES AND RESOURCES DEFINITIONS

**Proved reserves** Reserves that can be estimated with a high degree of certainty to be recoverable. NI 51-101 further identifies the certainty level for proved reserves as "at least a 90 per cent probability that the quantities actually recovered will equal or exceed the estimated proved reserves".

**Proved plus probable reserves** Additional reserves that are less certain to be recovered than proved reserves. NI 51-101 defines the certainty level as "at least a 50 per cent probability that the quantities actually recovered will equal or exceed the sum of the estimated proved plus probable reserves." Therefore, under NI 51-101, the proved plus probable reserves represent a "best estimate" or "expected reserves".

**Contingent resources** Quantities of petroleum estimated, as of a given date, to be potentially recoverable from known accumulations using established technology or technology under development, but which are not currently considered to be commercially recoverable due to one or more contingencies.

**Prospective resources** Quantities of petroleum estimated, as of a given date, to be potentially recoverable from undiscovered accumulations by application of future development projects. Prospective resources have both an associated chance of discovery and a chance of development.

**Best estimate** Term used to describe an uncertainty category for resources estimates referring to the best estimate of the quantity that will actually be recovered. It is equally likely that the actual remaining quantities recovered will be greater or less than the "best estimate". The best estimate of Contingent and Prospective Resources is prepared independent of the risks associated with achieving commercial production.

## FINANCIAL METRICS

**Netback** Net realized selling price, after hedging, less operating expenses and Crown royalties.

**Net debt to cash flow from operations** Net debt divided by cash flow from operations.

**Net debt to total capitalization** Net debt divided by net debt plus shareholders' equity.

**Return on average shareholders' equity** Net income divided by average shareholders' equity.

**Return on average productive capital employed** Net income before net interest expense, deferred taxes and unrealized foreign exchange gains and losses, divided by average net debt plus shareholders' equity, less capitalized costs related to major expansion projects not yet in use.

## ABBREVIATIONS

American Petroleum Institute specific gravity: **API**

barrel(s): **bbl, bbls**

barrel(s)/day: **bbl/d, bbls/d, bpd**

carbon dioxide: **$CO_2$**

gigajoule: **GJ**

greenhouse gases: **GHG(s)**

millions of barrels: **mmbbls**

sulphur dioxide: **$SO_2$**

Syncrude crude oil: **SCO**

thousands of barrels: **mbbls**

West Texas Intermediate: **WTI**

| ($ millions, except as indicated) | **2011** | 2010[1] | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| **FINANCIAL** | | | Not adjusted for IFRS | | |
| Sales, after crude oil purchases and transportation expense | **3,934** | 3,180 | 2,615 | 4,169 | 3,250 |
| Operating expenses | **1,501** | 1,387 | 1,328 | 1,368 | 1,034 |
| Non-production expenses | **113** | 105 | 141 | 78 | 63 |
| Crown royalties | **307** | 306 | 228 | 599 | 485 |
| Administration | **25** | 20 | 24 | 17 | 20 |
| Insurance | **8** | 11 | 9 | 6 | 8 |
| Interest expense, net | **30** | 61 | 93 | 68 | 85 |
| Depreciation and depletion | **381** | 429 | 570 | 444 | 351 |
| Goodwill impairment | **–** | – | 52 | – | – |
| Foreign exchange (gain) loss | **22** | (60) | (161) | 159 | (117) |
| Deferred tax (expense) recovery | **387** | (289) | (101) | (93) | 579 |
| Net income | **1,144** | 1,189 | 432 | 1,523 | 743 |
| Per share ($) | **2.36** | 2.46 | 0.89 | 3.17 | 1.55 |
| Cash flow from operations[2,4] | **1,897** | 1,232 | 754 | 2,039 | 1,542 |
| Per share ($)[4] | **3.91** | 2.55 | 1.56 | 4.24 | 3.22 |
| Dividends | **533** | 896 | 435 | 1,804 | 791 |
| Per share ($) | **1.10** | 1.85 | 0.90 | 3.75 | 1.65 |
| Capital expenditures | **643** | 582 | 409 | 281 | 183 |
| **RESERVES** (billions of SCO bbls, net to COS) | | | | | |
| Proved reserves | **0.8** | 0.9 | 1.0 | 1.0 | 1.0 |
| Proved plus probable reserves | **1.8** | 1.8 | 1.9 | 1.8 | 1.8 |
| Contingent resources | **1.9** | 2.0 | 1.8 | 2.0 | 2.1 |
| Prospective resources | **0.6** | 0.6 | 0.7 | 0.8 | 0.8 |
| **OPERATING NETBACK** ($/bbl)[4] | | | | | |
| Net realized SCO selling price | **101.20** | 80.53 | 69.47 | 107.47 | 79.29 |
| Operating expenses | **38.80** | 35.42 | 35.29 | 35.26 | 25.23 |
| Crown royalties | **7.93** | 7.80 | 6.06 | 15.44 | 11.83 |
| Netback price | **54.47** | 37.31 | 28.12 | 56.77 | 42.23 |
| **FINANCIAL RATIOS**[4] | | | | | |
| Net debt to cash flow from operations (times)[2] | **0.2** | 1.0 | 1.4 | 0.5 | 0.6 |
| Net debt to total capitalization (%) | **9.0** | 24.0 | 21.0 | 20.0 | 18.6 |
| Return on average productive capital employed (%) | **33.2** | 19.1 | 6.7 | 33.9 | 24.7 |
| Return on average shareholders' equity (%) | **28.8** | 33.0 | 11.0 | 37.7 | 18.3 |
| **$/SHARE PRICES** | | | | | |
| High | **33.94** | 33.05 | 39.89 | 55.25 | 38.88 |
| Low | **18.17** | 24.24 | 16.65 | 18.15 | 25.09 |
| Close | **23.25** | 26.45 | 29.91 | 21.10 | 38.71 |
| Trading volume (millions of shares) | **567.1** | 412.7 | 416.0 | 463.6 | 373.8 |
| Number of shares outstanding (in millions) | **484.5** | 484.4 | 484.4 | 481.6 | 479.4 |
| **PRODUCTION** | | | | | |
| COS average daily sales (bbl/d)[3] | **106,015** | 107,280 | 103,129 | 105,986 | 112,298 |
| COS total (in millions) | **38.7** | 39.2 | 37.6 | 38.8 | 41.0 |
| Syncrude average daily sales (bbl/d) | **288,372** | 293,288 | 279,926 | 289,129 | 305,049 |
| Syncrude total (in millions) | **105.3** | 107.0 | 102.2 | 105.8 | 111.3 |

1 Adjusted for International Financial Reporting Standards ("IFRS"). Note 26 to the 2011 annual audited consolidated financial statements discloses the impact of the transition to IFRS on the Corporation's reported financial position, income and cash flows.
2 Cash flow from operations is calculated as cash from operating activities, as reported on the Consolidated Statement of Cash Flows, before changes in non-cash working capital.
3 The Corporation's sales volumes differ from its production volumes due to changes in inventory, which are primarily in-transit pipeline volumes, and are after purchased crude oil volumes.
4 Non-GAAP measure(s).

## Board of Directors

**DONALD J. LOWRY**[2]
Chairman of the Board
President and Chief Executive Officer
EPCOR Utilities Inc.
Edmonton, Alberta

**IAN A. BOURNE**[1,2]
Calgary, Alberta

**MARCEL R. COUTU**
President and Chief Executive Officer
Canadian Oil Sands Limited
Calgary, Alberta

**GERALD W. GRANDEY**[1,2]
Saskatoon, Saskatchewan

**SARAH E. RAISS**[1]
Calgary, Alberta

**JOHN K. READ**[1,3]
Calgary, Alberta

**BRANT G. SANGSTER**[3]
Calgary, Alberta

**C.E. (CHUCK) SHULTZ**[3]
Chairman Emeritus of the Board
Chairman and Chief Executive Officer
Dauntless Energy Inc.
Calgary, Alberta

**WESLEY R. TWISS**[2,3]
Calgary, Alberta

**JOHN B. ZAOZIRNY, Q.C.**[1]
Canaccord Financial Corporation
Calgary, Alberta

1 Member of the Corporate Governance and Compensation Committee
2 Member of the Audit Committee
3 Member of the Reserves, Marketing Operations and Environmental, Health and Safety Committee

## Officers

**MARCEL R. COUTU**
President and Chief Executive Officer

**RYAN M. KUBIK**
Chief Financial Officer

**TRUDY M. CURRAN**
Senior Vice President, General Counsel and Corporate Secretary

**ALLEN R. HAGERMAN, FCA**
Executive Vice President

**DARREN K. HARDY**
Senior Vice President, Operations

**ROBERT P. DAWSON**
Vice President, Finance

**PHILIP D. BIRKBY**
Controller

**SIREN FISEKCI**
Vice President, Investor and Corporate Relations

**DAVID J. SIRRS**
Vice President, Marketing

**SCOTT W. ARNOLD**
Director, Sustainability and External Relations

## Ticker Symbols

Toronto Stock Exchange: COS
OTCQX: COSWF

## Registrar and Transfer Agent

Computershare Trust Company of Canada, with offices in Vancouver, Calgary, Toronto, and Montreal, is the registrar and Transfer Agent for Canadian Oil Sands Limited.

**COMPUTERSHARE TRUST COMPANY OF CANADA**
600, 530 – 8th Avenue SW
Calgary, Alberta T2P 3S8
Telephone: 1 (800) 564-6253
Fax: (403) 267-6598
E-mail: service@computershare.com

## Auditors

**PRICEWATERHOUSECOOPERS LLP CHARTERED ACCOUNTANTS**
Calgary, Alberta

## Independent Qualified Reserves Evaluators

**GLJ PETROLEUM CONSULTANTS LTD**
Calgary, Alberta

## Internal Auditors

**DELOITTE & TOUCHE LLP**
Calgary, Alberta

## Canadian Oil Sands Limited

2500 First Canadian Centre
350 – 7th Avenue S.W.
Calgary, Alberta T2P 3N9
Telephone: (403) 218-6200
Fax: (403) 218-6201

## Investor and Media Contacts

**SIREN FISEKCI**
Vice President, Investor and Corporate Relations

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Manager, Investor Relations

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## Notice of Meeting

Canadian Oil Sands' 2012 Annual General Meeting will be held in the Metropolitan Conference Centre, The Ballroom, 333 4th Avenue SW, Calgary, Alberta on Monday, April 30, 2012 at 2:30 pm (MST). All shareholders are invited to attend, and those unable to do so are requested to sign and return the form of proxy mailed with this report to ensure representation at the meeting. The meeting will be webcast on our website at www.cdnoilsands.com.

DESIGN: CRAIB DESIGN AND COMMUNICATIONS WWW.CRAIB.COM

Canadian Oil Sands

INVESTED IN OUR ENERGY FUTURE

# Why invest in COS?

- **SUPERIOR QUALITY** With large, bitumen-rich leases located in the sweet spot of the Athabasca oil sands deposit and a fully integrated upgrading facility that produces 100% light, sweet crude oil, the quality of our Syncrude asset is exceptional.

- **TRACK RECORD** Syncrude is an experienced oil sands operator, producing a high-quality crude oil for over 30 years. Its track record is bolstered by the expertise of Imperial Oil and ExxonMobil to support improving operational performance and future project expansion.

- **DEPENDABLE** Syncrude's high-quality crude oil resource provides a strong, long life cash generating asset base. Canadian Oil Sands strives to protect the long-term value of our asset through efficient capital management and a strong balance sheet.

- **SUSTAINABLE** Syncrude is a responsible producer of the energy the world needs and invests significant resources in the sustainable development of its resource. Syncrude applies innovative thinking to reduce its impact on the environment and is committed to building strong relationships with the communities in which it operates.

- **ESSENTIAL** Crude oil is a major source of energy for the world and Canada's oil sands are a significant, growing, responsible and secure source of supply. Canadian Oil Sands is an owner of significant oil sands production, offering upside exposure to rising crude oil prices.