BRAZILIAN PETROLEUM CORP
Form 6-K
September 06, 2007

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 6-K

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

For the month of September, 2007

Commission File Number 1-15106

PETRÓLEO BRASILEIRO S.A. - PETROBRAS

(Exact name of registrant as specified in its charter)

Brazilian Petroleum Corporation - PETROBRAS

(Translation of Registrant's name into English)

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

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

Form 20-F ___X___ Form 40-F _______

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

Yes _______ No___X____

Consolidated Financial Statements

Petróleo Brasileiro S.A. - Petrobras and Subsidiaries

June 30, 2007 and 2006
with Review Report of Independent
Registered Public Accounting Firm

PETRÓLEO BRASILEIRO S.A. - PETROBRAS
AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

Contents

Table of Contents

Review report of independent registered public accounting firm

To the Board of Directors and Shareholders
Petróleo Brasileiro S.A. - Petrobras

We have reviewed the accompanying condensed consolidated balance sheet of Petróleo Brasileiro S.A. - Petrobras (and subsidiaries) as of June 30, 2007, the related condensed consolidated statements of income, cash flows and changes in shareholders   equity for the six-month periods ended June 30, 2007 and 2006. These condensed consolidated financial statements are the responsibility of the Company   s management.

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

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

KPMG Auditores Independentes

Rio de Janeiro, Brazil
September 5, 2007

Table of Contents

PETRÓLEO BRASILEIRO S.A. - PETROBRAS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
June 30, 2007 and December 31, 2006
Expressed in Millions of United States Dollars

	June 30, 2007 (unaudited)	December 31, 2006 (Note 1)
Assets		
Current assets		
Cash and cash equivalents	**9,007**	12,688
Marketable securities	**270**	346
Accounts receivable, net	**6,328**	6,311
Inventories (Note 5)	**7,689**	6,573
Deferred income taxes	**651**	653
Recoverable taxes	**2,982**	2,593
Advances to suppliers	**1,116**	948
Other current assets	**1,137**	843
	29,180	30,955
Property, plant and equipment, net	**69,479**	58,897
Investments in non-consolidated companies and other investments	**3,614**	3,262
Other assets		
Accounts receivable, net	**1,016**	513
Advances to suppliers	**934**	852
Petroleum and Alcohol account - receivable from Federal Government (Note 6)	**412**	368
Government securities	**657**	479
Marketable securities	**165**	94
Restricted deposits for legal proceedings and guarantees (Note 13)	**879**	816
Recoverable taxes	**1,837**	1,292
Deferred income taxes	**74**	61
Goodwill	**251**	243
Prepaid expenses	**244**	244
Inventories (Note 5)	**221**	210
Other assets	**641**	394

	7,331	5,566
Total assets	**109,604**	98,680

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

Table of Contents

Liabilities and shareholders equity	June 30, 2007 (unaudited)	December 31, 2006 (Note 1)
Current liabilities		
Trade accounts payable	**6,189**	5,418
Short-term debt (Note 7)	**1,088**	1,293
Current portion of long-term debt (Note 7)	**1,857**	2,106
Current portion of project financings (Note 9)	**2,046**	2,182
Current portion of capital lease obligations (Note 10)	**213**	231
Accrued interest	**297**	247
Income taxes payable	**369**	235
Taxes payable, other than income taxes	**3,638**	3,122
Deferred income taxes	**4**	8
Payroll and related charges	**1,591**	1,192
Dividends and interest on capital payable	**1,139**	3,693
Contingencies (Note 13)	**53**	25
Advances from customers	**445**	880
Employees post-retirement benefits obligation - Pension (Note 11)	**223**	198
Other payables and accruals	**1,184**	956
	20,336	21,786
Long-term liabilities		
Long-term debt (Note 7)	**10,412**	10,510
Project financings (Note 9)	**3,731**	4,192
Capital lease obligations (Note 10)	**695**	824
Employees post-retirement benefits obligation - Pension (Note 11)	**5,436**	4,645
Employees post-retirement benefits obligation - Health care (Note 11)	**6,369**	5,433
Deferred income taxes	**3,109**	2,916
Provision for abandonment	**1,748**	1,473
Contingencies (Note 13)	**222**	208
Other liabilities	**620**	428
	32,342	30,629
Minority interest	**2,159**	1,966

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

	June 30, 2007	December 31, 2006
Shareholders equity (Note 12)	**(unaudited)**	**(Note 1)**
Shares authorized and issued		
Preferred share - 2007 and 2006 - 1,850,364,698 shares	**8,620**	7,718
Common share - 2007 and 2006 - 2,536,673,672 shares	**12,196**	10,959
Capital reserve	**668**	174
Retained earnings		
Appropriated	**24,036**	23,704
Unappropriated	**12,930**	10,541
Accumulated other comprehensive income		
Cumulative translation adjustments	**(917)**	(6,202)
Post-retirement benefit reserves adjustments, net of tax (US$1,172 and US$1,058 for June 30, 2007 and December 31, 2006, respectively) - pension cost (Note 11)	**(2,276)**	(2,052)
Post-retirement benefit reserves adjustments, net of tax (US$564 and US$508 for June 30, 2007 and December 31, 2006, respectively) - health care cost (Note 11)	**(1,095)**	(987)
Unrealized gains on available for sale securities, net of tax (US$311 and US$230 for June 30, 2007 and December 31, 2006, respectively)	**604**	446
Unrecognized loss on cash flow hedge, net of tax	**1**	(2)
	54,767	44,299
Total liabilities and shareholders equity	**109,604**	98,680

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

Table of Contents

PETRÓLEO BRASILEIRO S.A. - PETROBRAS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME
June 30, 2007 and 2006
Expressed in Millions of United States Dollars
(except number of shares and earnings per share)
(Unaudited)

	Six-month period ended June 30,	
	2007	**2006**
Sales of products and services	**50,213**	43,775
Less:		
Value-added and other taxes on sales and services	**(9,382)**	(8,540)
Contribution of intervention in the economic domain charge - CIDE	**(1,867)**	(1,714)
Net operating revenues	**38,964**	33,521
Cost of sales	**21,453**	17,244
Depreciation, depletion and amortization	**2,539**	1,633
Exploration, including exploratory dry holes	**506**	301
Selling, general and administrative expenses	**2,706**	2,292
Research and development expenses	**398**	339
Other operating expenses	**1,312**	272
Total costs and expenses	**28,914**	22,081
Equity in results of non-consolidated companies	**75**	57
Financial income (Note 8)	**673**	401
Financial expenses (Note 8)	**(460)**	(896)
Monetary and exchange variation on monetary assets and liabilities, net (Note 8)	**(313)**	159
Employee benefit expense for non-active participants	**(467)**	(508)
Other taxes	**(309)**	(287)
Other expenses, net	**28**	(32)
	(773)	(1,106)
Income before income taxes and minority interest	**9,277**	10,334

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

Table of Contents

	Six-month period ended June 30,	
	2007	**2006**
Income taxes expense (Note 4)		
Current	**(2,750)**	(3,225)
Deferred	**148**	(265)
	(2,602)	(3,490)
Minority interest in results of consolidated subsidiaries	**(182)**	(330)
Net income for the period	**6,493**	6,514
Net income applicable to each class of shares		
Common	**3,754**	3,767
Preferred	**2,739**	2,747
Net income for the period	**6,493**	6,514
Basic and diluted earnings per: (Note 12)		
Common and Preferred share	**1.48**	1.49
Common and Preferred ADS	**2.96**	2.98 (*)
Weighted average number of shares outstanding		
Common	**2,536,673,672**	2,536,673,672
Preferred	**1,850,364,698**	1,849,478,028

(*) Restated for the effect of the change in the ratio of underlying shares issued in the Company s name and the American Depositary Shares on July 2, 2007 (See Note 12).

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

Table of Contents

PETRÓLEO BRASILEIRO S.A. - PETROBRAS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
June 30, 2007 and 2006
Expressed in Millions of United States Dollars
(Unaudited)

	Six-month period ended June 30,	
	2007	**2006**
Cash flows from operating activities		
Net income for the period	**6,493**	6,514
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	**2,539**	1,633
Dry hole costs	**66**	147
Loss on sale of property, plant and equipment	**100**	76
Deferred income taxes	**(148)**	265
Equity in results of non-consolidated companies	**(75)**	(57)
Minority interest in results of consolidated subsidiaries	**182**	330
Foreign exchange and monetary (gain)/loss	**343**	(294)
Financial expense/(income) on gas hedge operations	**-**	499
Other	**49**	2
Decrease (increase) in assets		
Accounts receivable, net	**(299)**	1,485
Marketable securities	**49**	93
Inventories	**(276)**	(1,463)
Recoverable taxes	**(590)**	(365)
Advances to suppliers	**366**	(242)
Other	**(58)**	(183)
Increase (decrease) in liabilities		
Trade accounts payable	**489**	496
Payroll and related charges	**258**	(70)
Taxes payable, other than income taxes	**163**	35
Income taxes payable	**128**	268
Employee s post-retirement benefits, net of unrecognized obligation	**579**	608
Advances from customers	**(3)**	(250)
Other liabilities	**323**	(345)
Net cash provided by operating activities	**10,678**	9,182

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

Table of Contents

	Six-month period ended June 30, 2007	2006
Cash flows from investing activities		
Additions to property, plant and equipment	**(8,867)**	(5,979)
Investment in Ipiranga Companies	**(365)**	-
Other	**196**	201
Net cash used in investing activities	**(9,036)**	(5,778)
Cash flows from financing activities		
Short-term debt, net of issuances and repayments	**(256)**	91
Proceeds from issuance and draw-down on long-term debt	**1,201**	217
Principal payments of long-term debt	**(1,998)**	(651)
Proceeds from project financings	**210**	504
Payments of project financings	**(1,311)**	(452)
Payments of capital lease obligations	**(146)**	(152)
Dividends paid to shareholders	**(3,846)**	(3,078)
Dividends paid to minority interests	**(74)**	(32)
Net cash used in financing activities	**(6,220)**	(3,553)
Decrease in cash and cash equivalents	**(4,578)**	(149)
Effect of exchange rate changes on cash and cash equivalents	**897**	663
Cash and cash equivalents at beginning of period	**12,688**	9,871
Cash and cash equivalents at end of period	**9,007**	10,385
Supplemental cash flow information:		
Cash paid during the period for:		
Interest	**672**	609
Income taxes	**2,489**	2,665
Withholding income tax on financial investments	**17**	23

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

Table of Contents

PETRÓLEO BRASILEIRO S.A. - PETROBRAS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
June 30, 2007 and 2006
Expressed in Millions of United States Dollars
(Unaudited)

	Six-month period ended June 30,	
	2007	**2006**
Preferred shares		
Balance at January 1	**7,718**	4,772
Capital increase from undistributed earnings reserve	**902**	2,939
Balance at June 30	**8,620**	7,711
Common shares		
Balance at January 1	**10,959**	6,929
Capital increase from undistributed earnings reserve	**1,237**	4,030
Balance at June 30	**12,196**	10,959
Capital reserve - fiscal incentive		
Balance at January 1	**174**	159
Transfer from unappropriated retained earnings	**494**	13
Balance at June 30	**668**	172
Accumulated other comprehensive loss		
Cumulative translation adjustments		
Balance at January 1	**(6,202)**	(9,432)
Change in the period	**5,285**	2,658
Balance at June 30	**(917)**	(6,774)
Post-retirements benefit reserves adjustments, net of tax - pension cost		
Balance at January 1	**(2,052)**	(1,930)
Change in the period	**(224)**	(159)

Balance at June 30	**(2,276)**	(2,089)

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

Table of Contents

	Six-month period ended June 30,	
	2007	**2006**
Post-retirements benefit reserves adjustments, net of tax - health care cost		
Balance at January 1,	**(987)**	-
Change in the period	**(108)**	-
Balance at June 30	**(1,095)**	-
Unrecognized gains on available-for-sale securities, net of tax		
Balance at January 1	**446**	356
Unrealized gains	**239**	(76)
Tax effect on above	**(81)**	25
Balance at June 30	**604**	305
Unrecognized loss on cash flow hedge, net of tax		
Balance at January 1	**(2)**	-
Change in the period	**3**	-
Balance at June 30	**1**	-
Appropriated retained earnings		
Legal reserve		
Balance at January 1	**3,045**	2,225
Transfer from unappropriated retained earnings, net of gain or loss on translation	**335**	181
Balance at June 30	**3,380**	2,406

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

Table of Contents

	Six-month period ended June 30,	
	2007	**2006**
Undistributed earnings reserve		
Balance at January 1	**20,074**	17,439
Capital increase	**(1,647)**	(6,969)
Transfer from unappropriated retained earnings, net of gain or loss on translation	**2,103**	1,454
Balance at June 30	**20,530**	11,924
Statutory reserve		
Balance at January 1	**585**	431
Capital increase	**(492)**	-
Transfer from unappropriated retained earnings, net of gain or loss on translation	**33**	35
Balance at June 30	**126**	466
Total appropriated retained earnings	**24,036**	14,796
Unappropriated retained earnings		
Balance at January 1	**10,541**	11,968
Net income for the period	**6,493**	6,514
Interest on shareholders equity	**(1,139)**	-
Appropriation (to) fiscal incentive reserves	**(494)**	(13)
Appropriation (to) reserves	**(2,471)**	(1,670)
Balance at June 30	**12,930**	16,799
Total shareholders' equity	**54,767**	41,879
Comprehensive income is comprised as follows:		
Net income for the period	**6,493**	6,514
Cumulative translation adjustments	**5,285**	2,658
Post-retirement benefit reserves adjustments, net of tax - pension cost	**(224)**	(159)
Post-retirement benefit reserves adjustments, net of tax - health care cost	**(108)**	-
Unrealized gain on available-for-sale securities	**158**	(51)

Total comprehensive income	**11,604**	8,962

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

Table of Contents

PETRÓLEO BRASILEIRO S.A. - PETROBRAS AND SUBSIDIARIES

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Continued)
Expressed in Millions of United States Dollars
(except when specifically indicated)
(unaudited)

1. Basis of Financial Statements Preparation

The accompanying unaudited consolidated financial statements of Petróleo Brasileiro S.A. - Petrobras (the Company) have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and the rules and regulations of the Securities and Exchange Commission (SEC) for interim financial statements. Accordingly they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These unaudited consolidated financial statements and the accompanying notes should be read in conjunction with the consolidated financial statements for the year ended December 31, 2006 and the notes thereto.

The balance sheet at December 31, 2006 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

The consolidated financial statements as of June 30, 2007 and for the six-month periods ended June 30, 2007 and 2006, included in this report, are unaudited. However, in management's opinion, such consolidated financial statements reflect all normal recurring adjustments that are necessary for a fair presentation. The results for the interim periods are not necessarily indicative of trends or of results expected for the full year ending December 31, 2007.

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

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

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

Table of Contents

2. Recently Adopted Accounting Standards

a) FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement 109 (FIN 48)

In July 2006, the FASB issued FIN 48, which became effective on January 1, 2007. (see Note 4).

3. Derivative Instruments, Hedging and Risk Management Activities

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

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

a) Foreign currency risk management

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

The call option component of the Company s zero cost foreign exchange collars at June 30, 2007 had a fair value of US$25 (US$21 at December 31, 2006) and the put option components a fair value of zero at June 30, 2007 and at December 31, 2006.

3. Derivative Instruments, Hedging and Risk Management Activities (Continued)

a) Foreign currency risk management (Continued)

At June 30, 2007, the subsidiary Petrobras Energia Participaciones S.A. - PEPSA had forward sales of US dollars in exchange for Argentine pesos. During the six-month periods ended June 30, 2007 and 2006, PEPSA recognized profits for such contracts of zero and US$1, respectively. As of June 30, 2007 and December 31, 2006 the face value of effective contracts amounted to US$10 and US$18, respectively, at the average exchange rate of 3.25 and 3.26 Argentine pesos per US dollar, respectively. Other than the above-mentioned operations, as of June 30, 2007, PEPSA did not have any other positions in derivatives instruments.

b) Commodity price risk management

Petroleum and oil products

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

The Company's exposure from these contracts is limited to the difference between the contract value and market value on the volumes contracted. Crude oil future contracts are marked-to-market and related gains and losses are recognized in currently period earnings, irrespective of when the physical crude sales occur. For the six-month periods ended June 30, 2007 and 2006, the Company entered into commodity derivative transactions for 46.1% and 21.6%, respectively, of its total import and export trade volumes.

The open positions in the futures market, compared to spot market value, resulted in recognized losses of US$12 and of US$10 during the six-month periods ended June 30, 2007 and 2006, respectively.

Table of Contents

3. Derivative Instruments, Hedging and Risk Management Activities (Continued)

c) Interest rate risk management

The Company s interest rate risk is a function of the Company s long-term debt and to a lesser extent, its short-term debt. The Company s foreign currency floating rate debt is principally subject to fluctuations in LIBOR and the Company s floating rate debt denominated in Reais is principally subject to fluctuations in the Brazilian long-term interest rate (TJLP) as fixed by the National Monetary Counsel. The Company currently does not utilize derivative financial instruments to manage its exposure to fluctuations in interest rates. However, the Company will consider assessing the use of various types of derivatives to reduce its exposure to interest rate fluctuations and may use such financial instruments in the future.

d) Cash flow hedge

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

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

Table of Contents

3. Derivative Instruments, Hedging and Risk Management Activities (Continued)

d) Cash flow hedge (Continued)

The transaction gain or loss arising from the remeasurement of Yen denominated bonds is offset by the reclassification relating to the remeasurement of the hedged item at spot rates from other comprehensive income to earnings. The cross currency swap at June 30, 2007 had a fair value of (US$15) due to the devaluation of the Japanese Yen when compared to US dollar since the inception of the instrument. No amounts were recognized in earnings during the year as hedge ineffectivenesses.

e) Natural gas derivative contract

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

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

Due to the new Hydrocarbons Law of Bolivia (see Note 15), the other party to the PVRC contested the contract, alleging among others,   force majeure   and excessive onus. Consequently, the Company adjusted the fair value asset and liabilities related to the PVRC by recording a financial expense of US$328 during the first quarter of 2006 as a result of the tax increases in Bolivia.

On August 12, 2006, the parties agreed to cancel the PVRC. As a result, on August 14, 2006 the Company received US$41, wrote-off accounts receivable related to the PVRC amounting to US$77, and wrote-off the remaining fair value asset of US$94 as a consequence of the cancellation of contract.

Table of Contents

4. Income Taxes

Income taxes in Brazil comprise federal income tax and social contribution, which is an additional federal income tax. The statutory enacted tax rates for income tax and social contribution have been 25% and 9%, respectively for the six-month periods ended June 30, 2007 and 2006.

The Company s taxable income is substantially generated in Brazil and is therefore subject to the Brazilian statutory tax rate.

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109 (FIN 48). This Interpretation provides guidance on recognition, classification and disclosure concerning uncertain tax liabilities. The evaluation of a tax position requires recognition of a tax benefit if it is more likely than not it will be sustained upon examination. The Company adopted this Interpretation effective January 1, 2007. The adoption did not have a material impact on Petrobras consolidated financial statements.

The Company and its subsidiaries file tax returns in Brazilian jurisdiction and in many foreign jurisdictions. Audits in major jurisdictions are generally complete through 2001. The Company classifies interest on income tax related balances as interest expense or interest income and classifies tax related penalties as operating expenses. At January 1, 2007, the Company had no material accrued interest and penalties payable.

Table of Contents

4. Income Taxes (Continued)

The following table reconciles the tax calculated based upon statutory tax rates to the income tax expense recorded in these consolidated financial statements.

	Six-month period ended June, 30	
	2007	**2006**
Income before income taxes and minority interest		
Brazil	**8,616**	9,878
International	**661**	456
	9,277	10,334
Tax expense at statutory rates - (34%)	**(3,154)**	(3,514)
Adjustments to derive effective tax rate:		
Non-deductible post-retirement and health-benefits	**(144)**	(96)
Tax benefit on interest on shareholders equity (see Note 12)	**365**	-
Tax incentive (1)	**494**	-
Other	**(163)**	120
Income tax expense per consolidated statement of income	**(2,602)**	(3,490)

(1) It relates to tax incentives in the Northeast, within the region covered by the Northeast Development Agency (ADENE), granting a 75% reduction in income tax payable, calculated on the profits of the exploration of the incentived activities. Up to June 30, 2007 this incentive amounted to U.S.$494 and has been accounted for under the flow through method.

On May 10, 2007, the Brazilian Federal Revenue Office recognized Petrobras right to deduct this incentive from income tax payable, covering the tax years of 2006 until 2015.

Table of Contents

4. Income Taxes (Continued)

The following table shows a breakdown between domestic and international income tax expense (benefit) recorded in these consolidated financial statements:

	Six-month period ended June, 30	
	2007	**2006**
Income tax expense per consolidated statement of income:		
Brazil		
Current	**(2,647)**	(3,091)
Deferred	**179**	(262)
	(2,468)	(3,353)
International		
Current	**(103)**	(134)
Deferred	**(31)**	(3)
	(134)	(137)
	(2,602)	(3,490)

5. Inventories

	June 30, 2007	December 31, 2006
Products		
Oil products	**2,392**	2,220
Fuel alcohol	**186**	160
	2,578	2,380
Raw materials, mainly crude oil	**3,609**	2,989
Materials and supplies	**1,539**	1,274
Other	**184**	140
	7,910	6,783
Current inventories	**7,689**	6,573

Long-term inventories	**221**	210

Table of Contents

6. Petroleum and Alcohol Account - Receivable from Federal Government

The following summarizes the changes in the Petroleum and Alcohol account for the six-month period ended June 30, 2007:

	Six-month period ended June 30, 2007
Opening balance	**368**
Financial income	**4**
Translation gain	**40**
Ending balance	**412**

Petrobras after having provided all needed information required by National Treasury Secretariat - STN is in articulation with this Secretariat aiming to solve the remaining outstanding differences existing between the parts, in order to conclude the settlement process as established by Provisional Measure No. 2,181, of August 24, 2001.

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

7. Financings

a) Short-term debt

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

	June 30, 2007	December 31, 2006
Imports - oil and equipment	**52**	148
Working capital	**1,036**	1,145
	1,088	1,293

7. Financings (Continued)

The weighted average annual interest rates on outstanding short-term borrowings were 4.66% and 4.68% at June 30, 2007 and December 31, 2006, respectively.

b) Long-term debt

Composition

	June 30, 2007	December 31, 2006
Foreign currency		
Notes	**3,303**	4,217
Financial institutions	**3,836**	3,550
Sale of future receivables	**647**	680
Suppliers credits	**1,532**	1,215
Senior exchangeable notes	**330**	330
Assets related to export program be offset against sales of future receivables	**(150)**	(150)
Repurchased securities (1)	**-**	(19)
	9,498	9,823
Local currency		
National Economic and Social Development Bank - BNDES (state-owned company)	**636**	865
Debentures:		
BNDES (state-owned company)	**699**	626
Other banks	**1,231**	1,093
Other	**205**	209
	2,771	2,793
Total	**12,269**	12,616
Current portion of long-term debt	**(1,857)**	(2,106)
	10,412	10,510

(1) At June 30, 2007 and December 31, 2006, the Company had amounts invested abroad in an exclusive investment fund that held debt securities of some of the Petrobras group companies and some of the SPEs that the Company consolidates according to FIN 46(R), in the total amount of US$909 and US$982, respectively. These securities are considered to be extinguished, and thus the related amounts, together with applicable interest have been removed from the presentation of marketable securities and long-term debt, of zero (US$19 for December 31, 2006), and project

financings, of US$909 (US$963 for December 31, 2006) (see also Note 9). Gains and losses on the extinguishment are recognized as incurred. Subsequent reissuances of notes at amounts greater or lower than face amount are recorded as premium or discounts and are amortized over the life of the notes. Petrobras did not recognize losses on extinguishment of debt during the six month periods ended June 30, 2006 and 2007. In connection with the Exchange Offer PifCo paid US$56 related to the amount above the face amount of the old Notes exchanged. This amount was associated to the new Notes and has been amortized in accordance with the effective interest method. As of June 30, 2007 and December 31, 2006, the Company had an outstanding balance of net premiums on reissuance that amounted to US$33 and US$45, respectively.

7. Financings (Continued)

b) Long-term debt (Continued)

C