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All amounts in \$ millions, unless otherwise indicated.
For the year ended December 31, 2010

1. DESCRIPTION OF BUSINESS AND SEGMENTED DISCLOSURES

Cenovus Energy Inc. ("Cenovus" or the "Company") is in the business of the development, production and marketing of crude oil, natural gas and natural gas liquids ("NGLs") in Canada with refining operations in the United States ("U.S.").

The Company is headquartered in Calgary, Alberta and its Common Shares are listed on the Toronto and New York stock exchanges. Information on the Company's background and the basis of presentation for these financial statements are found in Note 2.

The Company's operating and reportable segments are as follows:

- **Upstream**, which includes Cenovus's development and production of crude oil, natural gas and NGLs in Canada, is organized into two reportable operations:
 - **Oil Sands**, which consists of Cenovus's producing bitumen assets at Foster Creek and Christina Lake, heavy oil assets at Pelican Lake, new resource play assets such as Narrows Lake, Grand Rapids and Telephone Lake, and the Athabasca natural gas assets. Certain of the Company's oil sands properties, notably Foster Creek, Christina Lake and Narrows Lake, are jointly owned with ConocoPhillips, an unrelated U.S. public company and operated by Cenovus.
 - **Conventional**, which includes the development and production of conventional crude oil, natural gas and NGLs in western Canada.

- **Refining and Marketing**, which is focused on the refining of crude oil products into petroleum and chemical products at two refineries located in the U.S. The refineries are jointly owned with and operated by ConocoPhillips. This segment also markets Cenovus's crude oil and natural gas, as well as third-party purchases and sales of product that provide operational flexibility for transportation commitments, product type, delivery points and customer diversification.
- **Corporate and Eliminations**, which primarily includes unrealized gains or losses recorded on derivative financial instruments as well as other Cenovus-wide costs for general and administrative and financing activities. As financial instruments are settled, the realized gains and losses are recorded in the operating segment to which the derivative instrument relates. Eliminations relate to sales and operating revenues and purchased product between segments recorded at transfer prices based on current market prices and to unrealized intersegment profits in inventory.

The operating and reportable segments shown above have been changed from those presented in prior periods to match Cenovus's new operating structure. All prior periods have been restated to reflect this presentation.

The tabular financial information which follows presents the segmented information first by segment, then by product and geographic location. Capital expenditures, goodwill, sales information and information relating to Cenovus's major customers are summarized at the end of the note.

RESULTS OF OPERATIONS – SEGMENT AND OPERATIONAL INFORMATION

For the years ended December 31,	Oil Sands			Conventional			Total Upstream		
	2010	2009	2008	2010	2009	2008	2010	2009	2008
Gross Revenues	2,719	2,277	2,558	2,539	3,369	4,130	5,258	5,646	6,688
Less: Royalties	279	135	246	170	138	287	449	273	533
Net Revenues	2,440	2,142	2,312	2,369	3,231	3,843	4,809	5,373	6,155
Expenses									
Production and mineral taxes	–	1	2	34	43	78	34	44	80
Transportation and blending	935	628	791	130	132	230	1,065	760	1,021
Operating	369	332	335	441	416	427	810	748	762
Purchased product	–	–	–	–	–	–	–	–	–
	1,136	1,181	1,184	1,764	2,640	3,108	2,900	3,821	4,292
Depreciation, depletion and amortization							1,039	1,250	1,179
Segment Income (Loss)							1,861	2,571	3,113
Balances as at December 31,									
Property, Plant & Equipment							10,196	10,095	9,949
Goodwill							1,146	1,146	1,146
Total Assets							14,543	14,921	15,466

For the years ended December 31,	Refining and Marketing			Corporate and Eliminations			Consolidated		
	2010	2009	2008	2010	2009	2008	2010	2009	2008
Gross Revenues	8,228	6,922	10,684	(64)	(778)	731	13,422	11,790	18,103
Less: Royalties	–	–	–	–	–	–	449	273	533
Net Revenues	8,228	6,922	10,684	(64)	(778)	731	12,973	11,517	17,570
Expenses									
Production and mineral taxes	–	–	–	–	–	–	34	44	80
Transportation and blending	–	–	–	–	–	–	1,065	760	1,021
Operating	489	534	543	3	30	(13)	1,302	1,312	1,292
Purchased product	7,664	6,020	10,500	(115)	(110)	(159)	7,549	5,910	10,341
	75	368	(359)	48	(698)	903	3,023	3,491	4,836
Depreciation, depletion and amortization	239	232	205	32	45	13	1,310	1,527	1,397
Segment Income (Loss)	(164)	136	(564)	16	(743)	890	1,713	1,964	3,439
General and Administrative				251	211	171	251	211	171
Interest, net				279	244	233	279	244	233
Accretion of asset retirement obligation				75	45	40	75	45	40
Foreign exchange (gain) loss, net				(51)	304	(308)	(51)	304	(308)
(Gain) loss on divestiture of assets				9	–	–	9	–	–
Other (income) loss, net				(13)	(2)	3	(13)	(2)	3
				550	802	139	550	802	139
Earnings Before Income Tax							1,163	1,162	3,300
Income tax expense							170	344	774
Net Earnings							993	818	2,526
Balances as at December 31,									
Property, Plant & Equipment	5,188	5,003	4,967	146	116	98	15,530	15,214	15,014
Goodwill	–	–	–	–	–	–	1,146	1,146	1,146
Total Assets	6,714	6,404	5,964	838	430	1,184	22,095	21,755	22,614

UPSTREAM PRODUCT AND OPERATIONAL INFORMATION

For the years ended December 31,	Crude Oil & NGLs								
	Oil Sands			Conventional			Total		
	2010	2009	2008	2010	2009	2008	2010	2009	2008
Gross Revenues	2,603	2,056	2,262	1,220	1,161	1,606	3,823	3,217	3,868
Less: Royalties	276	129	178	153	119	208	429	248	386
Net Revenues	2,327	1,927	2,084	1,067	1,042	1,398	3,394	2,969	3,482
Expenses									
Production and mineral taxes	—	1	2	28	28	40	28	29	42
Transportation and blending	934	626	784	86	87	154	1,020	713	938
Operating	341	298	279	202	174	171	543	472	450
Operating Cash Flow	1,052	1,002	1,019	751	753	1,033	1,803	1,755	2,052

For the years ended December 31,	Natural Gas								
	Oil Sands			Conventional			Total		
	2010	2009	2008	2010	2009	2008	2010	2009	2008
Gross Revenues	102	214	278	1,306	2,196	2,512	1,408	2,410	2,790
Less: Royalties	1	6	68	17	19	79	18	25	147
Net Revenues	101	208	210	1,289	2,177	2,433	1,390	2,385	2,643
Expenses									
Production and mineral taxes	—	—	—	6	15	38	6	15	38
Transportation and blending	1	2	7	44	45	76	45	47	83
Operating	23	25	43	235	237	252	258	262	295
Operating Cash Flow	77	181	160	1,004	1,880	2,067	1,081	2,061	2,227

For the years ended December 31,	Other								
	Oil Sands			Conventional			Total		
	2010	2009	2008	2010	2009	2008	2010	2009	2008
Gross Revenues	14	7	18	13	12	12	27	19	30
Less: Royalties	2	—	—	—	—	—	2	—	—
Net Revenues	12	7	18	13	12	12	25	19	30
Expenses									
Production and mineral taxes	—	—	—	—	—	—	—	—	—
Transportation and blending	—	—	—	—	—	—	—	—	—
Operating	5	9	13	4	5	4	9	14	17
Operating Cash Flow	7	(2)	5	9	7	8	16	5	13

For the years ended December 31,	Total								
	Oil Sands			Conventional			Total		
	2010	2009	2008	2010	2009	2008	2010	2009	2008
Gross Revenues	2,719	2,277	2,558	2,539	3,369	4,130	5,258	5,646	6,688
Less: Royalties	279	135	246	170	138	287	449	273	533
Net Revenues	2,440	2,142	2,312	2,369	3,231	3,843	4,809	5,373	6,155
Expenses									
Production and mineral taxes	—	1	2	34	43	78	34	44	80
Transportation and blending	935	628	791	130	132	230	1,065	760	1,021
Operating	369	332	335	441	416	427	810	748	762
Operating Cash Flow	1,136	1,181	1,184	1,764	2,640	3,108	2,900	3,821	4,292

GEOGRAPHIC INFORMATION

The Refining and Marketing segment operates in both Canada and the United States. Both of Cenovus's refining facilities are located and carry on business in the United States. The marketing of Cenovus's crude oil and natural gas

produced in Canada, as well as the third party purchases and sales of product is undertaken in Canada. Physical product sales that settle in the United States are considered to be export sales undertaken by a Canadian business.

For the years ended December 31,	Refining and Marketing								
	Canada (Marketing)			United States (Refining)			Total		
	2010	2009	2008	2010	2009	2008	2010	2009	2008
Gross Revenues	1,604	965	1,211	6,624	5,957	9,473	8,228	6,922	10,684
Less: Royalties	–	–	–	–	–	–	–	–	–
Net Revenues	1,604	965	1,211	6,624	5,957	9,473	8,228	6,922	10,684
Expenses									
Operating	17	17	20	472	517	523	489	534	543
Purchased product	1,579	938	1,184	6,085	5,082	9,316	7,664	6,020	10,500
Operating Cash Flow	8	10	7	67	358	(366)	75	368	(359)
Depreciation, depletion and amortization	10	12	4	229	220	201	239	232	205
Segment Income (Loss)	(2)	(2)	3	(162)	138	(567)	(164)	136	(564)

CAPITAL EXPENDITURES

For the years ended December 31,	2010	2009	2008
Capital			
Oil Sands	867	629	758
Conventional	523	466	848
Upstream	1,390	1,095	1,606
Refining and Marketing	656	1,033	539
Corporate	76	34	59
	2,122	2,162	2,204
Acquisition Capital			
Oil Sands	25	–	–
Conventional	23	3	–
Refining and Marketing	38	–	–
Total	2,208	2,165	2,204

In addition to the above, in 2009 Cenovus acquired strategic bitumen lands in exchange for certain non-core holdings.

GOODWILL ADDITIONS

There were no additions to goodwill during 2010, 2009 or 2008.

EXPORT SALES

Sales of crude oil, natural gas and NGLs produced or purchased in Canada delivered to customers outside of Canada were \$646 million (2009–\$618 million; 2008–\$1,388 million).

MAJOR CUSTOMERS

In connection with the marketing and sale of Cenovus's own and purchased crude oil, natural gas and refined products for the year ended December 31, 2010, Cenovus had two customers (2009–two; 2008–two) which individually accounted for more than 10 percent of its consolidated gross revenues. Sales to these customers, major international integrated energy companies with an investment grade credit rating, were approximately \$7,671 million (2009–\$6,389 million; 2008–\$9,619 million).

2. BACKGROUND & BASIS OF PRESENTATION

In these Consolidated Financial Statements, unless otherwise indicated, all dollars are expressed in Canadian dollars. The Company's functional currency is Canadian dollars. All references to C\$ or \$ are to Canadian dollars and references to US\$ are to U.S. dollars.

Cenovus began independent operations on December 1, 2009, as a result of the plan of arrangement ("Arrangement") involving Encana Corporation ("Encana") whereby Encana was split into two independent energy companies, one a natural gas company, Encana and the other an oil company, Cenovus. In connection with the Arrangement, Encana common shareholders received one share in each of the new Encana and Cenovus in exchange for each Encana share held. Common shares of Cenovus began trading on a "when issued" basis on the Toronto ("TSX") and New York ("NYSE") stock exchanges on November 2, 2009. Regular trading of the Cenovus shares began on the TSX on December 3, 2009 and on the NYSE on December 9, 2009.

Up until the completion of the Arrangement, Encana was considered a related party due to its parent-subsidiary relationship with the Cenovus entities. However, subsequent to the Arrangement, Encana is no longer a related party as defined by the CICA Handbook Section 3840 – Related Party Transactions.

BASIS OF PRESENTATION/CARVE-OUT FINANCIAL INFORMATION

The results for the year ended December 31, 2010 and the one month period from December 1 to December 31, 2009 represent the Company's operations, cash flow and financial position as a stand-alone entity. The results for the periods prior to the Arrangement, being from January 1 to November 30, 2009 and January 1 to December 31, 2008 have been prepared on a "carve-out" accounting basis whereby the results have been derived from the accounting records of Encana using the historical results of operations and historical basis of assets and liabilities of the businesses transferred to Cenovus.

As the Company operated as part of Encana and was not a stand-alone entity prior to November 30, 2009, the historical Consolidated Financial Statements include allocations of certain Encana revenues, expenses, assets and liabilities, including the items described below.

The operating results of Cenovus were specifically identified based on Encana's divisional organization. Certain other expenses presented in the Consolidated Statements of Earnings and Comprehensive Income represent allocations and estimates of the cost of services incurred by Encana. These allocations and estimates include unrealized mark-to-market gains and losses, general and administrative costs, net interest, foreign exchange gains and losses and income tax expenses. The majority of the assets and liabilities of Cenovus were identified based on the divisional structure, with the most significant exceptions being property, plant and equipment ("PP&E"), income taxes payable and long-term debt.

Refining, crude oil and natural gas marketing and corporate depreciation, depletion and amortization were specifically identified based on Encana's divisional structure where possible. Depletion related to upstream properties

was allocated to Cenovus based on the related production volumes utilizing the depletion rate calculated for Encana's consolidated Canadian cost centre.

Mark-to-market gains and losses resulting from derivative financial instruments entered into by Encana were allocated to Cenovus based on the related product volumes.

Salaries, benefits, pension, long-term incentives and other post-employment benefits costs, assets and liabilities were allocated to Cenovus based on Management's best estimate of how services were historically provided by existing employees. Costs, assets and liabilities associated with retired employees remained with Encana.

Net interest expense was calculated primarily using the debt balance allocated to Cenovus.

Income taxes were recorded as if Cenovus and its subsidiaries had been separate tax paying legal entities, each filing a separate tax return in its local jurisdiction.

The calculation of income taxes is based on a number of assumptions, allocations and estimates, including those used to prepare the Cenovus Carve-out Consolidated Financial Statements. Prior to the Arrangement, Cenovus's tax pools were allocated for the Canadian cost centre based on the same allocation method used to determine PP&E for carve-out purposes.

PP&E related to upstream oil and gas activities are accounted for by Cenovus using the full cost method of accounting. PP&E related to upstream oil and gas activities was determined based on an allocation process which used the ratio of future net revenue, discounted at 10 percent, of the respective divisions of Encana to the future net revenue, discounted at 10 percent, of all proved properties in Canada at December 31, 2008. Future net revenue was the estimated net amount to be received with respect to development and production of crude oil and natural gas reserves.

Goodwill was allocated to Cenovus based on the properties associated with the former business combinations on which it arose.

For the purpose of preparing the Carve-out Consolidated Financial Statements, it was determined that Cenovus should maintain approximately the same Debt to Capitalization ratio as consolidated Encana based on U.S. dollar amounts. As a result, prior to the Arrangement, debt was allocated to Cenovus based on this ratio, which was calculated using U.S. dollars. Debt is defined as the current and long-term portions of Long-term Debt. Capitalization is not a term that has a prescribed meaning under generally accepted accounting principles ("non-GAAP") and is a measure defined as Debt plus Shareholders' Equity.

Management believes the assumptions underlying the Cenovus Carve-out Consolidated Financial Statements are reasonable. However, the Cenovus Consolidated Financial Statements herein may not reflect Cenovus's financial position, results of operations, and cash flows had Cenovus been a stand-alone company during the periods presented or what Cenovus's operations, financial position, and cash flows will be in the future. Encana's direct investment in

Cenovus is shown as Net Investment in place of Shareholders' Equity because a direct ownership by shareholders in Cenovus did not exist prior to November 30, 2009. Encana's investment includes the accumulated net earnings, other comprehensive income and net cash distributions to Encana.

In the opinion of Management, the Consolidated and the historical Carve-out Consolidated Financial Statements reflect all adjustments (including normal recurring adjustments) necessary for a fair statement of the financial position and the results of operations and cash flows in accordance with Canadian generally accepted accounting principles ("Canadian GAAP").

3. CHANGE IN REPORTING CURRENCY

As a result of the Arrangement, Cenovus reported its results in U.S. dollars for the preparation of its December 31, 2009 consolidated financial statements as this was the reporting currency used by Encana. Effective January 1, 2010, the Company changed its reporting currency to Canadian dollars. The change in reporting currency is to better reflect the business of Cenovus, and it allows for increased comparability to the Company's peers. In implementing this change, the Company has followed the requirements of the Canadian Institute of Chartered Accountants ("CICA") Emerging Issues Committee

("EIC") Abstract 130 ("EIC-130"), "Translation Method When the Reporting Currency Differs from the Measurement Currency or there is a Change in the Reporting Currency."

With the change in reporting currency, all comparative financial information has been restated from U.S. dollars to Canadian dollars to reflect the Company's consolidated financial statements as if they had been historically reported in Canadian dollars.

4. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) Principles of Consolidation

The Consolidated Financial Statements include the accounts of Cenovus and its subsidiaries and are presented in accordance with Canadian GAAP. Information prepared in accordance with GAAP in the United States is included in Note 24.

Investments in jointly controlled partnerships and unincorporated joint ventures carry on certain of Cenovus's development, production and crude oil refining businesses and are accounted for using the proportionate consolidation method, whereby Cenovus's proportionate share of revenues, expenses, assets and liabilities are included in the accounts.

B) Foreign Currency Translation

The accounts of self-sustaining operations are translated using the current rate method, whereby assets and liabilities are translated at period end exchange rates, while revenues and expenses are translated using average rates over the period. Translation gains and losses relating to the self-sustaining operations are included in Accumulated Other Comprehensive Income ("AOCI") as a separate component of Shareholders' Equity.

Monetary assets and liabilities of Cenovus that are denominated in foreign currencies are translated into its functional currency at the rates of exchange in effect at the period end date. Any gains or losses are recorded in the Consolidated Statement of Earnings.

C) Measurement Uncertainty

The timely preparation of the Consolidated Financial Statements in conformity with Canadian GAAP requires that Management make estimates and assumptions and use judgment regarding the reported amounts of assets

and liabilities and disclosures of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenues and expenses during the period. Such estimates primarily relate to unsettled transactions and events as of the date of the Consolidated Financial Statements. Accordingly, actual results may differ from estimated amounts as future confirming events occur.

Amounts recorded for depreciation, depletion and amortization, asset retirement costs and obligations and amounts used for ceiling test and impairment calculations are based on estimates of crude oil and natural gas reserves, future costs required to develop those reserves and future cash flows. By their nature, these estimates of reserves, including the estimates of future prices and costs, and the related future cash flows are subject to measurement uncertainty, and the impact in the Consolidated Financial Statements of future periods could be material.

The values of pension assets and obligations and the amount of pension costs charged to net earnings depend on certain actuarial and economic assumptions which, by their nature, are subject to measurement uncertainty.

The amount of compensation expense accrued for long-term performance-based compensation arrangements is subject to Management's best estimate of whether or not the performance criteria will be met and what the ultimate payout will be.

The estimated fair value of financial assets and liabilities, by their very nature, are subject to measurement uncertainty.

Tax regulations and legislation and the interpretations thereof in the various jurisdictions in which Cenovus operates are subject to change. As such, income taxes are subject to measurement uncertainty.

D) Revenue Recognition

Revenues associated with the sales of Cenovus's crude oil, natural gas, NGLs and petroleum and refined products are recognized when title passes from the Company to its customer. Realized gains and losses from crude oil and natural gas commodity price risk management activities are recorded in revenue when the product is sold.

Revenues and purchased product are recorded on a gross basis when the title to product passes and the risks and rewards of ownership have been transferred. Purchases and sales of products that are entered into in contemplation of each other with the same counterparty are recorded on a net basis. Revenues associated with the services provided as agent are recorded as the services are provided.

Unrealized gains and losses from natural gas and crude oil commodity price risk management activities are recorded as revenue based on the related mark-to-market calculations at the end of the respective period.

E) Production and Mineral Taxes

Costs paid to non-mineral interest owners based on production of crude oil, natural gas and NGLs are recognized when the product is produced.

F) Transportation and Blending Costs

The costs associated with the transportation of crude oil, natural gas and NGLs, including the cost of diluent used in blending, are recognized when the product is delivered and the services provided.

G) Employee Benefit Plans

Accruals for obligations under the employee benefit plans and the related costs are recorded net of plan assets.

The cost of pensions and other post-employment benefits is actuarially determined using the projected benefit method based on length of service, and reflects Management's best estimate of expected plan investment performance, salary escalation, retirement ages of employees and expected future health care costs. The expected return on plan assets is based on the fair value of those assets. The accrued benefit obligation is discounted using the market interest rate on high quality corporate debt instruments as at the measurement date.

Pension expense for the defined benefit pension plan includes the cost of pension benefits earned during the current year, the interest cost on pension obligations, the expected return on pension plan assets, the amortization of the net transitional obligation, the amortization of adjustments arising from pension plan amendments and the amortization of the excess of the net actuarial gain or loss over 10 percent of the greater of the benefit obligation and the fair value of plan assets. Amortization is calculated on a straight-line basis over a period covering the expected average remaining service lives of employees covered by the plans.

Pension expense for the defined contribution pension plans is recorded as the benefits are earned by the employees covered by the plans.

H) Income Taxes

Cenovus follows the liability method of accounting for income taxes, where future income taxes are recorded for the effect of any difference between the accounting and income tax basis of an asset or liability, using the substantively enacted income tax rates. Accumulated future income tax balances are adjusted to reflect changes in income tax rates that are substantively enacted with the adjustment being recognized in net earnings in the period that the change occurs.

I) Earnings Per Share Amounts

Basic net earnings per common share is computed by dividing the net earnings by the weighted average number of common shares outstanding during the period. Diluted net earnings per share amounts are calculated giving effect to the potential dilution that would occur if stock options, without tandem stock appreciation rights attached, were exercised or other contracts expected to result in the issuance of common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options without tandem share appreciation rights attached and other dilutive instruments. The treasury stock method assumes that proceeds received from the exercise of in-the-money stock options without tandem stock appreciation rights attached are used to repurchase common shares at the average market price.

J) Cash and Cash Equivalents

Cash and cash equivalents include short-term investments, such as money market deposits or similar type instruments, with a maturity of three months or less when purchased.

K) Inventories

Product inventories, including petroleum and refined products, are valued at the lower of cost and net realizable value on a first-in, first-out or weighted average cost basis.

L) Property, Plant and Equipment

Upstream

Crude oil and natural gas properties are accounted for in accordance with the CICA guideline on full cost accounting in the oil and gas industry. Under this method, all costs, including internal costs and asset retirement costs, directly associated with the acquisition of, the exploration for, and the development of bitumen, crude oil and natural gas reserves, are capitalized on a country-by-country cost centre basis.

Costs accumulated within each cost centre are depreciated, depleted and amortized using the unit-of-production method based on estimated proved reserves determined using estimated future prices and costs. For purposes of this calculation, natural gas is converted to oil on an energy equivalent basis. Capitalized costs subject to depletion include estimated future costs to be incurred in developing proved reserves. Proceeds from the divestiture of

properties are normally deducted from the full cost pool without recognition of gain or loss unless that deduction would result in a change to the rate of depreciation, depletion and amortization of 20 percent or greater, in which case a gain or loss is recorded. Costs of major development projects and costs of acquiring and evaluating significant unproved properties are excluded, on a cost centre basis, from the costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties, or impairment has occurred. Costs that have been impaired are included in the costs subject to depreciation, depletion and amortization.

An impairment loss is recognized in net earnings when the carrying amount of a cost centre is not recoverable and the carrying amount of the cost centre exceeds its fair value. The carrying amount of the cost centre is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows from proved reserves. If the sum of the cash flows is less than the carrying amount, the impairment loss is limited to the amount by which the carrying amount exceeds the sum of:

- i. the fair value of proved and probable reserves; and
- ii. the costs of unproved properties that have been subject to a separate impairment test.

Refining

The initial acquisition costs of refining property, plant and equipment are capitalized when incurred. Costs include the cost of constructing or otherwise acquiring the equipment or facilities, the cost of installing the asset and making it ready for its intended use and the associated asset retirement costs. Capitalized costs are not subject to depreciation until the asset is put into use, after which they are depreciated on a straight-line basis over the estimated service lives of each component of the refining facilities.

An impairment loss is recognized on refining property, plant and equipment when the carrying amount is not recoverable and exceeds its fair value. The carrying amount is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows from expected use and eventual disposition. If the carrying amount is not recoverable, an impairment loss is measured as the amount by which the carrying amount exceeds the fair value.

Other

Costs associated with office furniture, fixtures, leasehold improvements, information technology and aircraft are carried at cost and depreciated on a straight-line basis over the estimated service lives of the assets, which range from three to 25 years. Assets under construction are not subject to depreciation until put into use.

M) Capitalization of Costs

Expenditures related to renewals or betterments that improve the productive capacity or extend the life of an asset are capitalized. Maintenance and repairs are expensed as incurred.

N) Amortization of Other Assets

Items included in Other Assets are amortized, where applicable, on a straight-line basis over the estimated useful lives of the assets.

O) Goodwill

Goodwill, which represents the excess of purchase price over fair value of net assets acquired, is assessed for impairment at least annually. Goodwill and all other assets and liabilities have been allocated to the country cost centre level, referred to as a reporting unit. To assess impairment, the fair value of the reporting unit is determined and compared to the book value of the reporting unit. If the fair value of the reporting unit is less than the book value, then a second test is performed to determine the amount of the impairment. The amount of the impairment is determined by deducting the fair value of the reporting unit's assets and liabilities from the fair value of the reporting unit to determine the implied fair value of goodwill and comparing that amount to the book value of the reporting unit's goodwill. Any excess of the book value of goodwill over the implied fair value of goodwill is the impairment amount.

P) Asset Retirement Obligation

The fair value of estimated asset retirement obligations is recognized in the Consolidated Balance Sheets when incurred and a reasonable estimate of fair value can be made.

Asset retirement obligations include those legal obligations where Cenovus will be required to retire tangible long-lived assets such as producing well sites, crude oil and natural gas processing plants, and refining facilities. The asset retirement cost, equal to the initially estimated fair value of the asset retirement obligation, is capitalized as part of the cost of the related long-lived asset. Changes in the estimated obligation resulting from revisions to estimated timing or amount of undiscounted cash flows are recognized as a change in the asset retirement obligation and the related asset retirement cost.

Amortization of asset retirement costs are included in depreciation, depletion and amortization in the Consolidated Statements of Earnings. Increases in the asset retirement obligation resulting from the passage of time are recorded as accretion of asset retirement obligation in the Consolidated Statements of Earnings.

Actual expenditures incurred are charged against the accumulated obligation.

Q) Stock-Based Compensation

Obligations for payments, cash or common shares, under Cenovus's stock option, performance share unit and deferred share unit plans are accrued using the intrinsic method as compensation cost over the vesting period. Fluctuations in the price of Cenovus's common shares change the accrued compensation cost and are recognized when they occur.

Encana replacement stock options with tandem stock appreciation rights attached held by Cenovus employees are accrued using the fair value method. The fair value is recognized as compensation cost over the vesting period. Fluctuations in the fair value of the rights change the accrued compensation cost and are recognized when they occur.

R) Financial Instruments

Financial instruments are measured at fair value on initial recognition of the instrument. Measurement in subsequent periods depends on whether the financial instrument has been classified as "held-for-trading", "available-for-sale", "held-to-maturity", "loans and receivables", or "other financial liabilities".

Financial assets and financial liabilities “held-for-trading” are measured at fair value with changes in those fair values recognized in net earnings. Financial assets “available-for-sale” are measured at fair value, with changes in those fair values recognized in Other Comprehensive Income (“OCI”). Financial assets “held-to-maturity”, “loans and receivables” and “other financial liabilities” are measured at amortized cost using the effective interest method of amortization.

Cash and cash equivalents are designated as “held-for-trading” and are measured at fair value. Accounts receivable and accrued revenues and the Partnership Contribution Receivable and partner loans receivable are designated as “loans and receivables”. Accounts payable and accrued liabilities, the Partnership Contribution Payable and partner loans payable and long-term debt are designated as “other financial liabilities”. Long-term debt transaction costs, premiums and discounts are capitalized within long-term debt and amortized using the effective interest method.

Derivative Financial Instruments

Risk management assets and liabilities are derivative financial instruments classified as “held-for-trading” unless designated for hedge accounting. Derivative instruments that do not qualify as hedges, or are not designated as hedges, are recorded using mark-to-market accounting whereby instruments are recorded in the Consolidated Balance Sheets as either an asset or liability with changes in fair value recognized in net earnings. Realized gains or losses from financial derivatives related to crude oil and natural gas commodity prices are recognized in crude oil and natural gas revenues as the related sales occur. Realized gains or losses from financial derivatives related to power commodity prices are recognized in operating costs as the related power costs are incurred. Unrealized gains and losses are recognized at the end of each respective reporting period. The estimated fair value of all derivative instruments is based on quoted market prices or, in their absence, third-party market indications and forecasts.

Derivative financial instruments are used to manage economic exposure to market risks relating to commodity prices, foreign currency exchange

rates and interest rates. Derivative financial instruments are not used for speculative purposes.

Policies and procedures are in place with respect to the required documentation and approvals for the use of derivative financial instruments and specifically ties their use, in the case of commodities, to the mitigation of market price risk associated with cash flows expected to be generated from budgeted capital programs, and in other cases to the mitigation of market price risks for specific assets and obligations. When applicable, the Company identifies relationships between financial instruments and anticipated transactions, as well as its risk management objective and the strategy for undertaking the economic hedge transaction. Where specific financial instruments are executed, the Company assesses, both at the time of purchase and on an ongoing basis, whether the financial instrument used in the particular transaction is effective in offsetting changes in fair values or cash flows of the transaction.

S) Reclassification

In addition to the restatement required due to the changes in operating segments (see Note 1), certain information provided for prior years has been reclassified to conform to the presentation adopted in 2010.

T) Recent Accounting Pronouncements

Beginning with the three month period ending March 31, 2011, Cenovus is required to report its results in accordance with International Financial Reporting Standards (“IFRS”). Cenovus has developed a detailed changeover plan to complete the transition to IFRS. The plan includes the preparation of required comparative information for 2010, given that the IFRS date of transition was January 1, 2010. The Company is on schedule with its plan and is continuing to assess the potential impact of the adoption of IFRS on its Consolidated Financial Statements.

5. CHANGES IN ACCOUNTING POLICIES AND PRACTICES

BUSINESS COMBINATIONS

On January 1, 2010, Cenovus early adopted CICA Handbook Section 1582, “Business Combinations,” which replaces CICA Handbook Section 1581 of the same name. The new standard requires assets and liabilities acquired in a business combination, contingent consideration and certain acquired contingencies to be measured at their fair values as of the date of acquisition. In addition, acquisition-related and restructuring costs are to be recognized separately from the business combination and included in the Statement of Earnings. This accounting policy was applied to the November 1, 2010 purchase of the marine terminal facilities disclosed in Note 6.

CONSOLIDATED FINANCIAL STATEMENTS AND NON-CONTROLLING INTERESTS

In conjunction with the early adoption of CICA Handbook Section 1582, the Company was also required to early adopt CICA Handbook Sections 1601,

“Consolidated Financial Statements” and 1602, “Non-controlling Interests” effective January 1, 2010. These sections replace the former consolidated financial statement standard, CICA Handbook Section 1600, “Consolidated Financial Statements.” Section 1601 establishes the requirements for the preparation of the consolidated financial statements and Section 1602 establishes the accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. Section 1602 requires a non-controlling interest to be classified as a separate component of equity. In addition, net earnings, and components of other comprehensive income are attributed to both the parent and non-controlling interest. The early adoption of these standards did not have a material impact on the Company’s Consolidated Financial Statements for the year ended December 31, 2010. These standards along with CICA Handbook Section 1582 above are converged with IFRS (see Note 4).

6. ASSETS AND LIABILITIES HELD FOR SALE

On November 1, 2010, under the terms of an agreement with a non-related Canadian company, Cenovus acquired certain marine terminal facilities in Kitimat, British Columbia for cash consideration of \$38 million.

Cenovus intends to sell the facilities as soon as practicable. As a result, the net assets acquired have been recorded at estimated fair value less costs to sell, and have been classified as held for sale. These assets are reported in the

Refining and Marketing segment. Cenovus recognized a bargain purchase gain of \$12 million, resulting from the excess fair value of the net assets acquired over the cash consideration paid. The table below represents the purchase cost and the preliminary allocation to the assets and liabilities. The gain has been recorded in other income.

Cash consideration	38
Fair value of Liabilities assumed	
Asset retirement obligation	5
Future income taxes	4
Total Purchase Price and Liabilities Assumed	47
Estimated Fair Value of Assets acquired	
Property, Plant and Equipment	59
Bargain Purchase Gain	12

As at December 31, 2010 the assets and liabilities classified as held for sale consists of the following:

	December 31, 2010
Assets Held for Sale	
Property, plant and equipment	65
Liabilities Related to Assets Held for Sale	
Asset retirement obligation	5
Future income taxes	2
	7

7. DIVESTITURES

For the years ended December 31,	2010	2009	2008
Oil Sands	81	89	8
Conventional	221	130	40
Corporate	7	3	–
Cash Proceeds	309	222	48

8. INTEREST, NET

For the years ended December 31,	2010	2009	2008
Interest Expense—Long-Term Debt	227	211	205
Interest Expense—Other	196	220	228
Interest Income	(144)	(187)	(200)
	279	244	233

Interest Expense—Other and Interest Income are primarily due to the Partnership Contribution Payable and Receivable, respectively (See Note 11).

9. FOREIGN EXCHANGE (GAIN) LOSS, NET

For the years ended December 31,	2010	2009	2008
Unrealized Foreign Exchange (Gain) Loss on translation of:			
U.S. dollar debt issued from Canada	(182)	(381)	430
U.S. dollar Partnership Contribution Receivable issued from Canada	91	504	(744)
Other	22	204	(3)
Unrealized Foreign Exchange (Gain) Loss	(69)	327	(317)
Realized Foreign Exchange (Gain) Loss	18	(23)	9
	(51)	304	(308)

10. INCOME TAXES

The provision for income taxes is as follows:

For the years ended December 31,	2010	2009	2008
Current			
Canada	82	979	393
United States	—	(45)	(24)
Total Current Tax	82	934	369
Future Tax	88	(590)	405
	170	344	774

Future income tax expense in 2010 includes a tax benefit of \$107 million from the recognition of net capital losses expected to be realized against future capital gains. These net capital losses are attributable to an internal restructuring undertaken in 2010. Net capital losses of \$415 million, attributable

to the restructuring and to realized foreign exchange losses, are unrecognized at December 31, 2010. Recognition is dependent on the level of future capital gains.

Current income tax expense in 2009 includes the incremental tax incurred as a result of certain corporate restructuring transactions which were required to effect the Arrangement.

The following table reconciles income taxes calculated at the Canadian statutory rate with the recorded income taxes:

For the years ended December 31,	2010	2009	2008
Earnings Before Income Tax	1,163	1,162	3,300
Canadian Statutory Rate	28.2%	29.2%	29.7%
Expected Income Tax	328	339	980
Effect on Taxes Resulting from:			
Statutory and other rate differences	(33)	(1)	(92)
Non-deductible stock-based compensation	29	–	–
Multi-jurisdictional financing	(93)	(134)	(135)
Foreign exchange gains not included in net earnings	28	58	71
Non-taxable capital (gains) losses	(9)	30	(53)
Recognition of capital losses	(107)	–	–
Other	27	52	3
	170	344	774
Effective Tax Rate	14.6%	29.6%	23.5%

The net future income tax liability consists of:

As at December 31,	2010	2009
Future Tax Liabilities		
Property, plant and equipment in excess of tax values	2,534	2,654
Timing of partnership items	125	9
Net foreign exchange gains	127	61
Risk management	55	17
Other	55	1
Future Tax Assets		
Unused tax losses	(281)	(242)
Risk management	(45)	(33)
Other	(166)	–
Net Future Income Tax Liability	2,404	2,467

The approximate amounts of tax pools available are as follows:

As at December 31,	2010	2009
Canada	4,239	3,754
United States	3,082	2,637
	7,321	6,391

Included in the above tax pools are \$236 million (2009–\$491 million) of Canadian non-capital losses which expire no earlier than 2026 and \$607 million (2009–\$232 million) of U.S. net operating losses which expire no earlier than 2029.

Also included in the above tax pools are \$983 million (2009–\$51 million) of Canadian net capital losses, available for carry forward to reduce future capital gains.

11. PARTNERSHIP CONTRIBUTION RECEIVABLE AND PAYABLE

In connection with the Arrangement with Encana, Cenovus acquired Encana's assets which are jointly controlled with ConocoPhillips. On January 2, 2007, Encana became a 50 percent partner in an integrated, North American oil business with ConocoPhillips which consists of an upstream entity and a refining entity. The upstream entity contribution included assets from Encana, primarily the Foster Creek and Christina Lake properties, with a fair value of US\$7.5 billion and a note receivable (Partnership Contribution Receivable) contributed from ConocoPhillips of an equal amount. For the refining entity, ConocoPhillips contributed its Wood River and Borger refineries, located in Illinois and Texas, respectively, for a fair value of US\$7.5 billion and Encana contributed a note payable (Partnership Contribution Payable) of US\$7.5 billion.

In accordance with Canadian GAAP, these entities have been accounted for using the proportionate consolidation method with the results of operations included in the Upstream and Refining and Marketing segments (See Note 1).

PARTNERSHIP CONTRIBUTION RECEIVABLE

This note receivable is denominated in US\$ and bears interest at a rate of 5.3 percent per annum. Equal payments of principal and interest are payable quarterly, with final payment due January 2, 2017. The current and long-term Partnership Contribution Receivable shown in the Consolidated Balance Sheets represent Cenovus's 50 percent share of this promissory note, net of payments to date.

MANDATORY RECEIPTS

	2011	2012	2013	2014	2015	Thereafter	Total
Partnership Contribution Receivable—US\$	348	366	386	407	429	569	2,505
Partnership Contribution Receivable—C\$ equivalent	346	364	384	405	427	565	2,491

PARTNERSHIP CONTRIBUTION PAYABLE

This note payable is denominated in US\$ and bears interest at a rate of 6.0 percent per annum. Equal payments of principal and interest are payable quarterly, with final payment due January 2, 2017. The current and long-term

Partnership Contribution Payable amounts shown in the Consolidated Balance Sheets represent Cenovus's 50 percent share of this promissory note, net of payments to date.

MANDATORY PAYMENTS

	2011	2012	2013	2014	2015	Thereafter	Total
Partnership Contribution Payable—US\$	345	366	388	412	437	584	2,532
Partnership Contribution Payable—C\$ equivalent	343	364	386	410	435	581	2,519

In addition to the Partnership Contribution Receivable and Payable, Other Assets and Other Liabilities include equal amounts for interest bearing partner loans, with no fixed repayment terms, related to the funding of

refining operating and capital requirements. At December 31, 2010 these amounts were \$274 million (December 31, 2009—\$183 million).

12. INVENTORIES

As at December 31,	2010	2009
Product		
Upstream – Oil Sands	80	84
Refining and Marketing	779	772
Parts and Supplies	21	19
	880	875

As a result of a significant decline in commodity prices in the latter half of 2008, Cenovus recorded a write-down of its product inventory by \$186 million from cost to net realizable value at December 31, 2008. Product turnover and the improvement in commodity prices has resulted in all of the 2008 write-down being reversed, \$178 million in 2009 and \$8 million in 2010.

The total amount of inventories recognized as an expense during the year was \$5,997 million (2009–\$4,999 million; 2008–\$9,322 million).

13. PROPERTY, PLANT AND EQUIPMENT, NET

As at December 31,	2010			2009		
	Cost	Accumulated DD&A*	Net	Cost	Accumulated DD&A*	Net
Upstream	22,691	(12,495)	10,196	21,550	(11,455)	10,095
Refining and Marketing	5,883	(695)	5,188	5,537	(534)	5,003
Corporate and Eliminations	446	(300)	146	390	(274)	116
	29,020	(13,490)	15,530	27,477	(12,263)	15,214

* Depreciation, depletion and amortization

Upstream property, plant and equipment includes internal costs directly related to exploration, development and construction activities of \$102 million (2009–\$117 million). Costs classified as general and administrative expenses have not been capitalized as part of the capital expenditures.

Costs in respect of significant unproved properties and major development projects are excluded from the country cost centre's depletable base. Refining assets not put into use are excluded from depreciable costs. At the end of the year these costs were:

As at December 31,	2010	2009	2008
Upstream	758	644	278
Refining and Marketing	1,673	1,366	598
	2,431	2,010	876

The Canadian prices used in the ceiling test evaluation of Cenovus's crude oil and natural gas reserves at December 31, 2010 were:

	2011	2012	2013	2014	2015	Average Annual % Change to 2022
WTI (US\$/barrel)	85.00	87.70	90.50	93.40	96.30	2%
AECO (\$/Mcf)	4.25	4.90	5.40	5.90	6.35	4%
Crude Oil (\$/barrel)	64.75	66.32	65.08	66.59	68.71	2%
Natural Gas Liquids (\$/barrel)	62.19	66.27	68.94	71.25	73.58	2%
Natural Gas (\$/Mcf)	4.05	4.70	5.20	5.70	6.14	4%

During the year ended December 31, 2010, it was determined that a processing unit at the Borger refinery was a redundant asset and would not be used in future operations at the refinery. The fair value of the unit was determined to be negligible based on market prices for refining assets of similar age and

condition. Accordingly, the carrying amount of the unit was reduced to zero and an impairment loss of \$37 million net to Cenovus, was recorded as additional depreciation, depletion and amortization in the Consolidated Statements of Earnings and Comprehensive Income within the Refining and Marketing segment.

14. OTHER ASSETS

As at December 31,	2010	2009
Partner Loans	274	183
Deferred Asset—Refining and Marketing	99	121
Deferred Pension Plan and Savings Plan	11	9
Other	7	7
	391	320

15. LONG-TERM DEBT

As at December 31,	Note	2010	2009
Canadian Dollar Denominated Debt			
Revolving term debt*	A	—	32
U.S. Dollar Denominated Debt			
Revolving term debt*	A	—	26
Unsecured notes	B	3,481	3,663
		3,481	3,689
Total Debt Principal		3,481	3,721
Debt Discounts and Transaction Costs	C	(49)	(65)
Current Portion of Long-Term Debt	D	—	—
		3,432	3,656

* Revolving term debt includes commercial paper, bankers' acceptances, LIBOR loans, prime rate loans and U.S. base rate loans.

The weighted average interest rate on outstanding debt for the year ended December 31, 2010 was 5.8 percent (2009—5.5 percent).

A) Revolving Term Debt

At December 31, 2010, Cenovus had in place a committed credit facility in the amount of C\$2,500 million or its equivalent amount in U.S. dollars. The committed credit facility matures on November 30, 2014 and is extendable from time to time for a period of up to four years at the option of Cenovus and upon agreement from the lenders. Borrowings are available by way of Bankers Acceptances, LIBOR based loans, prime rate loans or U.S. base rate loans. At December 31, 2010, no amounts were drawn on Cenovus's committed bank credit facility (2009–\$58 million).

B) Unsecured Notes

In conjunction with the Arrangement, on September 18, 2009 Cenovus completed a private offering of senior unsecured notes of an aggregate

principal amount of US\$3,500 million. The notes were disclosed on Cenovus's Consolidated Balance Sheets as a long term liability, net of financing costs as at September 30, 2009. The net proceeds of \$3,718 million were placed into an escrow account held by the escrow agent, The Bank of New York Mellon, pending the completion of the Arrangement. Cenovus placed an additional \$162 million into the escrow account so that the total escrowed funds of \$3,880 million would be sufficient to pay the special mandatory redemption price for the notes if the Arrangement did not proceed. Upon completion of the Arrangement, funds were released from escrow and the proceeds of the notes were used to pay the note payable to Encana of US\$3,500 million as part of the Arrangement. On November 30, 2009 these notes became the direct, unsecured obligations of Cenovus. In 2010, substantially all of these notes were exchanged for notes registered under the Securities Act of 1933 with the same terms and conditions as the original issued notes.

	US\$ Principal Amount	2010	2009
4.50% due September 15, 2014	800	796	837
5.70% due October 15, 2019	1,300	1,293	1,361
6.75% due November 15, 2039	1,400	1,392	1,465
	3,500	3,481	3,663

Cenovus has in place a Canadian base shelf prospectus for unsecured medium term notes in the amount of \$1,500 million. The Canadian shelf prospectus allows for the issuance of medium term notes in Canadian dollars or other foreign currencies from time to time in one or more offerings. The terms of the notes, including, but not limited to, interest at either fixed or floating rates and expiry dates, will be determined at the date of issue. At December 31, 2010, no medium term notes have been issued under this Canadian prospectus. The shelf prospectus expires in July 2012.

Cenovus has in place a U.S. base shelf prospectus for unsecured notes in the amount of US\$1,500 million. The U.S. shelf prospectus allows for the issuance of debt securities in U.S. dollars or other foreign currencies from time to

time in one or more offerings. The terms of the notes, including, but not limited to, interest at either fixed or floating rates and expiry dates, will be determined at the date of issue. At December 31, 2010, no notes have been issued under this U.S. prospectus. The shelf prospectus expires in August 2012.

At December 31, 2010, the Company is in compliance with all of the terms of its debt agreements.

C) Debt Discounts and Transaction Costs

Long-term debt transaction costs and discounts are recorded within long-term debt and are being amortized using the effective interest method. During 2010, no transaction costs were recorded within long term debt (2009–\$70 million).

D) Mandatory Debt Payments

	US\$ Principal Amount	C\$ Principal Amount	Total C\$ Equivalent
2011	–	–	–
2012	–	–	–
2013	–	–	–
2014	800	–	796
2015	–	–	–
Thereafter	2,700	–	2,685
	3,500	–	3,481

16. ASSET RETIREMENT OBLIGATION

The aggregate carrying amount of the obligation associated with the retirement of upstream oil and gas assets and refining facilities is as follows:

As at December 31,	2010	2009
Asset Retirement Obligation, Beginning of Year	1,147	793
Liabilities Incurred	44	6
Liabilities Settled	(33)	(38)
Liabilities Divested	(88)	(10)
Change in Estimated Future Cash Flows	69	357
Accretion Expense	75	45
Foreign Currency Translation	(1)	(6)
Asset Retirement Obligation, End of Year	1,213	1,147

The total undiscounted amount of estimated cash flows required to settle the obligation is \$6,093 million (2009–\$5,683 million), which has been discounted using a weighted average credit-adjusted risk free rate of

6.09 percent (2009–6.23 percent). Most of these obligations are not expected to be paid for several years, or decades, in the future and will be funded from general resources at that time.

17. OTHER LIABILITIES

As at December 31,	2010	2009
Partner Loans	274	183
Deferred Revenue	37	40
Other	35	16
	346	239

18. SHARE CAPITAL

AUTHORIZED

Cenovus is authorized to issue an unlimited number of Common Shares, an unlimited number of First Preferred Shares and an unlimited number of Second Preferred Shares.

ISSUED AND OUTSTANDING

As at December 31,	2010		2009	
	Number of Common Shares (thousands)	Amount	Number of Common Shares (thousands)	Amount
Outstanding, Beginning of Year	751,309	3,681	–	–
Common Shares Issued Pursuant to the Arrangement	–	–	751,273	3,680
Common Shares Issued under Stock Option Plans	1,366	35	36	1
Outstanding, End of Year	752,675	3,716	751,309	3,681

To determine Cenovus's share capital amount at the time of the Arrangement, Encana's stated capital immediately prior to the Arrangement was split based on the relative fair market values of the Encana and Cenovus Common Shares at the time of the initial exchange. Cenovus's share capital amount was deducted from Encana's net investment with the remaining \$6,055 million reclassified as Paid in Surplus.

At December 31, 2010, there were 26 million (2009–24 million) Common Shares available for future issuance under stock option plans. There were no Preferred Shares outstanding as at December 31, 2010.

The Company has a dividend reinvestment plan ("DRIP"). Under the DRIP, holders of Common Shares may reinvest all or a portion of the cash dividends payable on their Common Shares in additional Common Shares. At the discretion of the Company, the additional Common Shares may be issued from treasury or purchased on the market.

NET INVESTMENT

For periods prior to the Arrangement, Encana's net investment in the operations of Cenovus is presented as total Net Investment in the Consolidated Financial Statements. Total Net Investment consists of Owner's Net Investment and AOCI.

STOCK-BASED COMPENSATION

A) Employee Stock Option Plan

Cenovus has an Employee Stock Option Plan that provides employees with the opportunity to exercise an option to purchase Common Shares of the Company. Option exercise prices approximate the market price for the Common Shares on the date the options were issued. Options granted are exercisable at 30 percent of the number granted after one year, an additional 30 percent of the number granted after two years, and are fully exercisable after three years. Options granted prior to February 17, 2010 expire after five years while options granted on February 17, 2010 or later expire after seven years.

All options issued by the Company under the Employee Stock Option Plan have associated tandem stock appreciation rights. In lieu of exercising the options, the tandem stock appreciation rights give the option holder the right to receive a cash payment equal to the excess of the market price of Cenovus's Common Shares at the time of exercise over the exercise price of the right. The tandem stock appreciation rights vest and expire under the same terms and conditions as the underlying options. For the purpose of this note, options with associated tandem stock appreciation rights are referred to as "TSARs".

In addition, certain of the TSARs are performance based ("Performance TSARs"). The Performance TSARs vest and expire under the same terms and service conditions as the underlying option, and have an additional vesting requirement whereby vesting is subject to achievement of prescribed performance relative to pre-determined key measures. Performance TSARs that do not vest when eligible are forfeited.

In accordance with the Arrangement described in Note 2, each Cenovus and Encana employee exchanged their original Encana TSAR for one Cenovus Replacement TSAR and one Encana Replacement TSAR. The terms and conditions of the Cenovus and Encana Replacement TSARs are similar to the terms and conditions of the original Encana TSAR. The original exercise price

of the Encana TSAR was apportioned to the Cenovus and Encana Replacement TSARs based on the one day volume weighted average trading price of Cenovus's Common Share price relative to that of Encana's Common Share price on the TSX on December 2, 2009. Cenovus TSARs and Cenovus Replacement TSARs are measured against the Cenovus Common Share price while Encana Replacement TSARs are measured against the Encana Common Share price. The Cenovus Replacement TSARs have similar vesting provisions as outlined above for the Employee Stock Option Plan. The original Encana Performance TSARs were also exchanged under the same terms as the original Encana TSARs.

Unless otherwise indicated, all references to TSARs collectively refer to both the Cenovus issued TSARs and Cenovus Replacement TSARs.

TSARs Held by Cenovus Employees

The following tables summarize the information related to the TSARs held by Cenovus employees as at December 31, 2010:

As at December 31, 2010, (thousands of units)	Performance			Weighted Average Exercise Price (\$)
	TSARs	TSARs	Total	
Outstanding, Beginning of Year	8,402	8,053	16,455	27.52
Granted	6,087	–	6,087	26.54
Exercised for cash payment	(1,099)	(77)	(1,176)	21.32
Exercised as options for shares	(948)	(109)	(1,057)	23.52
Forfeited	(398)	(794)	(1,192)	28.55
Outstanding, End of Year	12,044	7,073	19,117	27.75
Exercisable, End of Year	4,154	3,580	7,734	28.07

(thousands of units)	Outstanding TSARs					Exercisable TSARs			
	Performance TSARs	Performance TSARs	Total	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price (\$)	Performance TSARs	Performance TSARs	Total	Weighted Average Exercise Price (\$)
Range of Exercise Price (\$)									
20.00 to 24.99	1,198	–	1,198	0.25	22.96	1,172	–	1,172	22.94
25.00 to 29.99	8,925	4,694	13,619	3.99	26.47	1,818	2,351	4,169	26.59
30.00 to 34.99	1,733	2,379	4,112	2.19	32.87	1,051	1,229	2,280	32.86
35.00 to 39.99	119	–	119	2.44	37.22	72	–	72	37.22
40.00 to 44.99	67	–	67	2.45	43.23	40	–	40	43.23
45.00 to 49.99	2	–	2	2.39	45.56	1	–	1	45.56
	12,044	7,073	19,117	3.35	27.75	4,154	3,580	7,734	28.07

Cenovus Replacement TSARs Held by Encana Employees

Encana is required to reimburse Cenovus in respect of cash payments made by Cenovus to Encana's employees when these employees exercise a Cenovus Replacement TSAR for cash. No compensation expense is recognized and no further Cenovus Replacement TSARs will be granted to Encana employees.

Cenovus has recorded a liability of \$123 million (2009-\$84 million) in the Consolidated Balance Sheets for Cenovus Replacement TSARs held by Encana employees using the fair value method, with an offsetting accounts receivable from Encana. The fair value of each Cenovus Replacement TSAR held by Encana employees was estimated using the Black-Scholes-Merton model with weighted average assumptions as follows:

	2010
Risk Free Rate	1.70%
Dividend Yield	2.40%
Volatility	23.99%
Cenovus's Common Share Price	\$33.28

The following tables summarize information related to the Cenovus Replacement TSARs held by Encana employees as at December 31, 2010:

As at December 31, 2010, (thousands of units)	Performance			Weighted Average Exercise Price (\$)
	TSARs	TSARs	Total	
Outstanding, Beginning of Year	12,482	10,463	22,945	27.14
Exercised for cash payment	(3,847)	(411)	(4,258)	22.67
Exercised as options for shares	(105)	(1)	(106)	19.44
Forfeited	(316)	(1,111)	(1,427)	28.80
Outstanding, End of Year	8,214	8,940	17,154	28.16
Exercisable, End of Year	5,977	4,828	10,805	27.88

(thousands of units)

Range of Exercise Price (\$)	Outstanding TSARs					Exercisable TSARs			
	Performance TSARs	Performance TSARs	Total	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price (\$)	Performance TSARs	Performance TSARs	Total	Weighted Average Exercise Price (\$)
20.00 to 24.99	1,658	-	1,658	0.17	22.95	1,650	-	1,650	22.95
25.00 to 29.99	4,116	6,107	10,223	2.19	26.49	2,711	3,368	6,079	26.63
30.00 to 34.99	2,271	2,833	5,104	2.09	32.83	1,515	1,460	2,975	32.74
35.00 to 39.99	90	-	90	2.44	37.24	54	-	54	37.24
40.00 to 44.99	77	-	77	2.44	42.81	46	-	46	42.81
45.00 to 49.99	2	-	2	2.39	45.56	1	-	1	45.56
	8,214	8,940	17,154	1.97	28.16	5,977	4,828	10,805	27.88

Encana Replacement TSARs Held by Cenovus Employees

Cenovus is required to reimburse Encana in respect of cash payments made by Encana to Cenovus employees when a Cenovus employee exercises an Encana Replacement TSAR for cash. No further Encana Replacement TSARs will be granted to Cenovus employees.

The Company has recorded a liability of \$24 million (2009–\$70 million) in the Consolidated Balance Sheets for Encana Replacement TSARs held by Cenovus's employees using the fair value method.

The fair value of each Encana Replacement TSAR was estimated using the Black-Scholes-Merton model with weighted average assumptions as follows:

	2010
Risk Free Rate	1.70%
Dividend Yield	2.74%
Volatility	23.57%
Encana's Common Share Price	\$29.09

The following tables summarize information related to the Encana Replacement TSARs held by Cenovus employees as at December 31, 2010:

As at December 31, 2010, (thousands of units)	Performance			Weighted Average Exercise Price (\$)
	TSARs	TSARs	Total	
Outstanding, Beginning of Year	8,305	8,052	16,357	30.46
Exercised for cash payment	(1,568)	(148)	(1,716)	24.43
Exercised as options for Encana shares	(94)	–	(94)	21.47
Forfeited	(214)	(806)	(1,020)	31.98
Outstanding, End of Year	6,429	7,098	13,527	31.17
Exercisable, End of Year	4,461	3,605	8,066	30.85

(thousands of units)	Outstanding TSARs					Exercisable TSARs			
	Performance		Total	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price (\$)	Performance		Total	Weighted Average Exercise Price (\$)
Range of Exercise Price (\$)	TSARs	TSARs				TSARs	TSARs		
20.00 to 24.99	7	–	7	2.75	23.04	4	–	4	23.06
25.00 to 29.99	4,371	4,718	9,089	2.04	28.59	3,127	2,376	5,503	28.30
30.00 to 34.99	312	–	312	1.75	32.61	274	–	274	32.71
35.00 to 39.99	1,597	2,380	3,977	2.13	36.47	971	1,229	2,200	36.47
40.00 to 44.99	74	–	74	2.49	42.28	45	–	45	42.28
45.00 to 49.99	66	–	66	2.46	47.86	39	–	39	47.86
50.00 to 54.99	2	–	2	2.39	50.39	1	–	1	50.39
	6,429	7,098	13,527	2.06	31.17	4,461	3,605	8,066	30.85

B) Performance Share Units

The Company has granted Performance Share Units ("PSUs") to certain employees under its Performance Share Unit Plan for Employees. PSUs are whole share units and entitle employees to receive, upon vesting, either a Common Share of Cenovus or a cash payment equal to the value of a Cenovus Common Share. The number of PSUs eligible for payment is

determined over three years based on the units granted multiplied by 30 percent after year one, 30 percent after year two and 40 percent after year three, multiplied by a performance multiplier for each year. The multiplier is based on the Company achieving key pre-determined performance measures. PSUs vest after three years.

The following table summarizes information related to the PSUs held by Cenovus employees as at December 31, 2010:

(thousands)	Outstanding PSUs
Outstanding, Beginning of Year	–
Granted	1,252
Cancelled	(35)
Units in Lieu of Dividends	35
Outstanding, End of Year	1,252

C) Deferred Share Units

Under two Deferred Share Unit Plans, Cenovus directors, officers and employees may receive Deferred Share Units ("DSUs"), which are equivalent in value to a Common Share of the Company. Employees have the option to convert either 25 or 50 percent of their annual bonus award into DSUs. DSUs vest immediately, are redeemed in accordance with terms of the agreement and expire on December 15 of the calendar year following the year of cessation of directorship or employment.

Pursuant to the terms of the Arrangement, Encana DSUs credited to directors, officers and employees of Cenovus were exchanged for Cenovus DSUs. The fair value of the Cenovus DSUs credited to each holder was based on the fair market value of Cenovus Common Shares relative to Encana Common Shares prior to the effective date of the Arrangement.

The following table summarizes information related to the DSUs held by Cenovus directors, officers and employees as at December 31, 2010:

(thousands)	Outstanding DSUs
Outstanding, Beginning of Year	768
Granted	65
Granted from Annual Bonus Awards	81
Units in Lieu of Dividends	26
Outstanding, End of Year	940

D) Stock-Based Compensation Expense (Recovery)

The following table summarizes the stock-based compensation expense (recovery) recorded for all plans within operating and general and administrative expenses on the Consolidated Statements of Earnings and Comprehensive Income:

	2010	2009*	2008
TSARs held by Cenovus employees	52	(2)	–
Encana Replacement TSARs held by Cenovus employees	(23)	32	–
Performance Share Units	13	–	–
Deferred Share Units	9	–	–
Total stock-based compensation expense (recovery)	51	30	–

* 2009 represents one month of compensation expense incurred under the Cenovus plan post Arrangement.

Included in the financial information prior to the Arrangement, the Company recorded compensation expense (recovery) for the following Encana plans:

	2010	2009	2008
Encana TSARs	–	4	(5)
Encana DSUs	–	3	1
Total stock-based compensation expense (recovery)	–	7	(4)

19. CAPITAL STRUCTURE

Cenovus's capital structure is comprised of Shareholders' Equity plus Debt. Cenovus's objectives when managing its capital structure are to maintain financial flexibility, preserve access to capital markets, ensure its ability to finance internally generated growth and to fund potential acquisitions while maintaining the ability to meet the Company's financial obligations as they come due.

Cenovus monitors its capital structure and short-term financing requirements using, among other things, non-GAAP financial metrics consisting of Debt to

Capitalization and Debt to Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA"). These metrics are used to steward Cenovus's overall debt position as measures of Cenovus's overall financial strength. Debt is defined as the current and long-term portions of long-term debt excluding any amounts with respect to the Partnership Contribution Payable or Receivable.

Cenovus targets a Debt to Capitalization ratio of between 30 and 40 percent.

As at December 31,	2010	2009
Debt	3,432	3,656
Shareholders' Equity	10,022	9,608
Total Capitalization	13,454	13,264
Debt to Capitalization ratio	26%	28%

Cenovus targets a Debt to Adjusted EBITDA of between 1.0 and 2.0 times.

As at December 31,	2010	2009	2008
Debt	3,432	3,656	3,719
Net Earnings	993	818	2,526
Add (deduct):			
Interest, net	279	244	233
Income tax expense	170	344	774
Depreciation, depletion and amortization	1,310	1,527	1,397
Accretion of asset retirement obligation	75	45	40
Foreign exchange (gain) loss, net	(51)	304	(308)
(Gain) loss on divestiture of assets	9	–	–
Other (income) loss, net	(13)	(2)	3
Adjusted EBITDA	2,772	3,280	4,665
Debt to Adjusted EBITDA	1.2x	1.1x	0.8x

It is Cenovus's intention to maintain an investment grade rating to ensure it has continuous access to capital and the financial flexibility to fund its capital programs, meet its financial obligations and finance potential acquisitions. Cenovus will maintain a high level of capital discipline and manage its capital structure to ensure sufficient liquidity through all stages of the economic cycle. To manage the capital structure, Cenovus may adjust capital and

operating spending, adjust dividends paid to shareholders, purchase shares for cancellation pursuant to normal course issuer bids, issue new shares, issue new debt, draw down on its credit facilities or repay existing debt.

Cenovus's capital structure, objectives and targets have remained unchanged since Cenovus's inception. At December 31, 2010, Cenovus is in compliance with all of the terms of its debt agreements.

20. PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS

The Company provides employees with a pension plan that includes defined contribution and defined benefit components, and other post-employment benefit plans ("OPEB"). Most of the employees participate in the defined contribution pension; the defined benefit pension component is closed to new entrants.

The Company files an actuarial valuation of its pension plans with the provincial regulator at least every three years. The most recently filed valuation was dated November 30, 2009 and the next required actuarial valuation will be as at December 31, 2012.

Information related to defined benefit pension and OPEB plans, based on actuarial estimations is as follows:

As at December 31,	Pension Benefits		OPEB	
	2010	2009	2010	2009
Accrued Benefit Obligation, End of Year	68	56	14	11
Fair Value of Plan Assets, End of Year	59	54	–	–
Funded Status—Plan Assets (less) than Benefit Obligation	(9)	(2)	(14)	(11)
Amounts Not Recognized:				
Unamortized net actuarial (gain) loss	20	15	1	(1)
Unamortized past service cost	–	–	–	1
Accrued Benefit Asset (Liability)	11	13	(13)	(11)

The weighted average assumptions used to determine benefit obligations are as follows:

As at December 31,	Pension Benefits		OPEB	
	2010	2009	2010	2009
Discount Rate	5.25%	6.00%	5.25%	6.00%
Rate of Compensation Increase	4.05%	4.05%	5.65%	5.77%

Estimated future payment of pension and other benefits are as follows:

	Pension Benefits	OPEB
2011	1	–
2012	2	–
2013	2	1
2014	3	1
2015	4	1
2016 – 2020	23	9
Total	35	12

21. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

Cenovus's consolidated financial assets and liabilities consist of cash and cash equivalents, accounts receivable and accrued revenues, accounts payable and accrued liabilities, Partnership Contribution Receivable and Payable and partner loans, risk management assets and liabilities, and long-term debt.

Risk management assets and liabilities arise from the use of derivative financial instruments. Fair values of financial assets and liabilities, summarized information related to risk management positions, and discussion of risks associated with financial assets and liabilities are presented as follows.

A) Fair Value of Financial Assets and Liabilities

The fair values of cash and cash equivalents, accounts receivable and accrued revenues, and accounts payable and accrued liabilities approximate their carrying amount due to the short-term maturity of those instruments.

The fair values of the Partnership Contribution Receivable and Partnership Contribution Payable and partner loans approximate their carrying amount due to the specific non-tradeable nature of these instruments.

Risk management assets and liabilities are recorded at their estimated fair value based on mark-to-market accounting, using quoted market prices or, in their absence, third-party market indications and forecasts.

Long-term debt is carried at amortized cost. The estimated fair values of long-term borrowings have been determined based on market information. At December 31, 2010, the carrying value of Cenovus's long-term debt accounted for using amortized cost was \$3,432 million and the fair value was \$3,940 million (December 31, 2009—carrying value—\$3,656 million, fair value—\$3,964 million).

B) Risk Management Assets and Liabilities

Under the terms of the Arrangement with Encana, the risk management positions at November 30, 2009 were allocated to Cenovus based upon Cenovus's proportion of the related volumes covered by the contracts. To effect the allocation, Cenovus entered into a contract with Encana with the same terms and conditions as between Encana and the third parties to the existing contracts. All positions entered into after the Arrangement have been negotiated between Cenovus and third parties.

Net Risk Management Position

As at December 31,	2010	2009
Risk Management		
Current asset	163	60
Long-term asset	43	1
	206	61
Risk Management		
Current liability	163	70
Long-term liability	10	4
	173	74
Net Risk Management Asset (Liability)	33	(13)

Of the \$33 million net risk management asset balance at December 31, 2010, an asset of \$41 million relates to the contract with Encana (2009—net liability of \$15 million).

Summary of Unrealized Risk Management Positions

As at December 31,	2010 Risk Management			2009 Risk Management		
	Asset	Liability	Net	Asset	Liability	Net
Commodity Prices						
Crude Oil	4	159	(155)	8	66	(58)
Natural Gas	202	—	202	53	—	53
Power	—	14	(14)	—	8	(8)
Total Fair Value	206	173	33	61	74	(13)

Net Fair Value Methodologies Used to Calculate Unrealized Risk Management Positions

As at December 31,	2010	2009
Prices actively quoted	40	6
Prices sourced from observable data or market corroboration	(7)	(19)
Total Fair Value	33	(13)

Prices actively quoted refers to the fair value of contracts valued using quoted prices in an active market. Prices sourced from observable data or market corroboration refers to the fair value of contracts valued in part using active quotes and in part using observable, market-corroborated data.

Net Fair Value of Commodity Price Positions at December 31, 2010

As at December 31, 2010,	Notional Volumes	Term	Average Price	Fair Value
Crude Oil Contracts				
Fixed Price Contracts				
WTI NYMEX Fixed Price	28,600 bbls/d	2011	US\$85.54/bbl	(85)
WTI NYMEX Fixed Price	29,200 bbls/d	2011	C\$88.32/bbl	(58)
WTI NYMEX Fixed Price	5,000 bbls/d	2012	US\$92.44/bbl	(3)
WTI NYMEX Fixed Price	3,000 bbls/d	2012	C\$93.82/bbl	(1)
Other Fixed Price Contracts *		2011		4
Other Financial Positions **				(12)
Crude Oil Fair Value Position				(155)
Natural Gas Contracts				
Fixed Price Contracts				
NYMEX Fixed Price	379 MMcf/d	2011	US\$5.70/Mcf	158
NYMEX Fixed Price	130 MMcf/d	2012	US\$5.96/Mcf	41
AECO Fixed Price	80 MMcf/d	2012	C\$4.49/Mcf	–
Other Fixed Price Contracts *		2011-2013		3
Natural Gas Fair Value Position				202
Power Purchase Contracts				
Power Fair Value Position				(14)

* Cenovus has entered into fixed priced swaps to protect against widening price differentials between production areas in Canada and various sales points.

** Other financial positions are part of ongoing operations to market the Company's production.

Earnings Impact of Realized and Unrealized Gains (Losses) on Risk Management Positions

For the years ended December 31,	Realized Gain (Loss)		
	2010	2009	2008
Gross Revenues	272	1,154	(305)
Less: Royalties	–	–	–
Net Revenues	272	1,154	(305)
Operating Expenses and Other	6	(38)	31
Gain (Loss) on Risk Management	278	1,116	(274)

For the years ended December 31,	Unrealized Gain (Loss)		
	2010	2009	2008
Gross Revenues	60	(668)	890
Less: Royalties	–	–	–
Net Revenues	60	(668)	890
Operating Expenses and Other	(14)	(30)	9
Gain (Loss) on Risk Management	46	(698)	899

Reconciliation of Unrealized Risk Management Positions

For the years ended December 31,	2010		2009	2008
	Fair Value	Total Unrealized Gain (Loss)	Total Unrealized Gain (Loss)	Total Unrealized Gain (Loss)
Fair Value of Contracts, Beginning of Year	(13)			
Change in Fair Value of Contracts in Place at Beginning of Year and Contracts Entered into During the Year	324	324	418	625
Fair Value of Contracts Realized During the Year	(278)	(278)	(1,116)	274
Fair Value of Contracts, End of Year	33	46	(698)	899

Commodity Price Sensitivities – Risk Management Positions

The following table summarizes the sensitivity of the fair value of Cenovus's risk management positions to fluctuations in commodity prices, with all other variables held constant. When assessing the potential impact of these commodity price changes, Management believes 10 percent volatility is a reasonable measure. Fluctuations in commodity prices could have resulted in unrealized gains (losses) impacting earnings before income tax at December 31, 2010 as follows:

	10% Price Increase	10% Price Decrease
Crude oil price	(227)	227
Natural gas price	(104)	104
Power price	6	(6)

C) Risks Associated with Financial Assets and Liabilities

Commodity Price Risk

Commodity price risk arises from the effect that fluctuations of future commodity prices may have on the fair value or future cash flows of financial assets and liabilities. To partially mitigate exposure to commodity price risk, the Company has entered into various financial derivative instruments. The use of these derivative instruments is governed under formal policies and is subject to limits established by the Board of Directors. The Company's policy is not to use derivative financial instruments for speculative purposes.

Crude Oil – The Company has partially mitigated its exposure to the commodity price risk on its crude oil sales and condensate supply used for blending with fixed price swaps. To help protect against widening crude oil price differentials in various production areas, Cenovus has entered into a limited number of swaps to manage the price differentials between these production areas and various sales points.

Natural Gas – To partially mitigate the natural gas commodity price risk, the Company has entered into swaps, which fix the NYMEX and AECO prices. To help protect against widening natural gas price differentials in various production areas, Cenovus has entered into a limited number of swaps to manage the price differentials between these production areas and various sales points.

Power – The Company has in place two Canadian dollar denominated derivative contracts, which commenced January 1, 2007 for a period of 11 years, to manage its electricity consumption costs.

Credit Risk

Credit risk arises from the potential that the Company may incur a loss if a counterparty to a financial instrument fails to meet its obligation in accordance with agreed terms. This credit risk exposure is mitigated through the use of Board-approved credit policies governing the Company's credit portfolio and with credit practices that limit transactions according to counterparties' credit quality. Agreements are entered into with major financial institutions with investment grade credit ratings or with counterparties having investment grade credit ratings. A substantial portion of

Cenovus's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks. As at December 31, 2010, over 92 percent (2009–98 percent) of Cenovus's accounts receivable and financial derivative credit exposures are with investment grade counterparties.

At December 31, 2010, Cenovus had two counterparties whose net settlement position individually account for more than 10 percent (2009–three counterparties, including Encana) of the fair value of the outstanding in-the-money net financial and physical contracts by counterparty. The maximum credit risk exposure associated with accounts receivable and accrued revenues, risk management assets and the Partnership Contribution Receivable and the partner loans receivable is the total carrying value. The current concentration of this credit risk resides with A rated or higher counterparties. Cenovus's exposure to its counterparties is acceptable and within Credit Policy tolerances.

Liquidity Risk

Liquidity risk is the risk that Cenovus will not be able to meet all of its financial obligations as they become due. Liquidity risk also includes the risk of not being able to liquidate assets in a timely manner at a reasonable price. Cenovus manages its liquidity risk through the active management of cash and debt. As disclosed in Note 19, Cenovus targets a Debt to Capitalization ratio between 30 and 40 percent and a Debt to Adjusted EBITDA of between 1.0 to 2.0 times to manage the Company's overall debt position. It is Cenovus's intention to maintain investment grade credit ratings on its senior unsecured debt.

Cenovus manages its liquidity risk by ensuring that it has access to multiple sources of capital including: cash and cash equivalents, cash from operating activities, undrawn credit facilities, commercial paper and availability under its shelf prospectuses. At December 31, 2010, Cenovus's committed credit facility was fully available. In addition Cenovus had \$1,500 million in unused capacity under its Canadian shelf prospectus and US\$1,500 million in unused capacity under its U.S. shelf prospectus, the availability of which are dependent on market conditions.

Cash outflows relating to financial liabilities are outlined in the table below:

	Less than 1 Year	1 - 3 Years	4 - 5 Years	Thereafter	Total
Accounts Payable and Accrued Liabilities	1,825	–	–	–	1,825
Risk Management Liabilities	163	10	–	–	173
Long-Term Debt ^{(1) (2)}	203	407	1,167	5,236	7,013
Partnership Contribution Payable ⁽¹⁾	486	972	972	609	3,039
Partner Loans Payable	–	274	–	–	274

⁽¹⁾ Principal and interest, including current portion

⁽²⁾ No principal repayment until 2014 and thereafter (see Note 15D)

Foreign Exchange Risk

Foreign exchange risk arises from changes in foreign exchange rates that may affect the fair value or future cash flows of Cenovus's financial assets or liabilities. As Cenovus operates in North America, fluctuations in the exchange rate between the U.S./Canadian dollars can have a significant effect on reported results. Cenovus's functional currency and reporting currency is Canadian dollars. All amounts are reported in Canadian dollars, unless otherwise indicated.

As disclosed in Note 9, Cenovus's foreign exchange (gain) loss primarily includes unrealized foreign exchange gains and losses on the translation of the U.S. dollar debt issued from Canada and the translation of the U.S. dollar Partnership Contribution Receivable issued from Canada. At December 31, 2010, Cenovus had US\$3,500 million in U.S. dollar debt issued from Canada (US\$3,525 million at December 31, 2009) and US\$2,505 million related to

the U.S. dollar Partnership Contribution Receivable (US\$2,834 million at December 31, 2009). A \$0.01 change in the U.S. to Canadian dollar exchange rate would have resulted in a \$10 million change in foreign exchange (gain) loss at December 31, 2010 (2009—\$7 million).

Interest Rate Risk

Interest rate risk arises from changes in market interest rates that may affect the earnings, cash flows and valuations. Cenovus has the flexibility to partially mitigate its exposure to interest rate changes by maintaining a mix of both fixed and floating rate debt.

At December 31, 2010, one hundred percent of the Company's debt was fixed-rate debt and as a result, had interest rates on floating rate debt changed by one percent there would be no impact on net earnings (December 31, 2009—\$nil; 2008—\$5 million). This assumes the amount of fixed and floating debt remains unchanged from December 31, 2010.

22. SUPPLEMENTARY INFORMATION

A) Per Share Amounts

For the years ended December 31, (millions)	2010	2009	2008
Weighted Average Common Shares Outstanding – Basic	751.9	751.0	750.1
Effect of Stock Options and Other Dilutive Securities	0.8	0.4	1.7
Weighted Average Common Shares Outstanding – Diluted	752.7	751.4	751.8

Since Cenovus's shares were issued pursuant to the Arrangement, the per share amounts disclosed for 2009 and 2008 are based on the number of Encana's Common Shares outstanding.

B) Supplementary Cash Flow Information

For the years ended December 31,	2010	2009	2008
Interest Paid	423	426	422
Income Taxes Paid	62	1,284	542

Income taxes paid in 2009 includes amounts paid to Encana as a result of the dissolution of a partnership in connection with the Arrangement.

23. COMMITMENTS AND CONTINGENCIES

A) Commitments

As part of normal operations, the Company has committed to certain amounts over the next five years and thereafter as follows:

	2011	2012	2013	2014	2015	Thereafter	Total
Operating Leases (Building Leases)	33	87	88	85	78	1,553	1,924
Pipeline Transportation ⁽¹⁾	107	93	167	167	166	953	1,653
Purchases of Goods and Services	157	23	12	10	7	23	232
Capital Commitments	91	71	4	4	4	14	188
Product Purchases	23	18	18	18	18	7	102
Other Long-Term Commitments	4	2	1	1	–	1	9
Total Payments	415	294	290	285	273	2,551	4,108
Product Sales	50	52	54	56	57	63	332

⁽¹⁾ Certain transportation commitments included are subject to regulatory approval

At December 31, 2010, there were outstanding letters of credit aggregating \$23 million issued as security for performance under certain contracts (2009–\$13 million).

In addition to the above, Cenovus's commitments related to its risk management program are disclosed in Note 21.

B) Contingencies

Legal Proceedings

Cenovus is involved in various legal claims associated with the normal course of operations. Cenovus believes it has made adequate provisions for such legal claims.

Asset Retirement

Cenovus is responsible for the retirement of long-lived assets related to its oil and gas properties, refining facilities and midstream facilities at the end of their useful lives. Cenovus has recognized a liability of \$1,218 million, including \$5 million that has been classified as Liabilities Related to Assets Held for Sale, based on current legislation and estimated costs. Actual costs may differ from those estimated due to changes in legislation and changes in costs.

Income Tax Matters

The tax regulations and legislation and interpretations thereof in the various jurisdictions in which Cenovus operates are continually changing. As a result, there are usually a number of tax matters under review. Management believes that the provision for taxes is adequate.

24. UNITED STATES ACCOUNTING PRINCIPLES AND REPORTING

The Cenovus Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP") which, in most respects, conform to accounting principles generally accepted in the United States ("U.S. GAAP"). The significant differences between Canadian GAAP and U.S. GAAP applicable to Cenovus are described in this note. The most notable differences are:

- full cost accounting;
- pensions and other post-employment benefits;
- liability-based stock compensation plans;
- income taxes;
- other comprehensive income; and
- joint venture accounting.

RECONCILIATION OF NET EARNINGS UNDER CANADIAN GAAP TO U.S. GAAP

For the years ended December 31,	Note 24	2010	2009	2008
Net Earnings—Canadian GAAP		993	818	2,526
Increase (Decrease) in Net Earnings Under U.S. GAAP:				
Operating expense	C ii)	9	4	(13)
Depreciation, depletion and amortization expense	A, C ii)	107	239	21
General and administrative expense	C ii)	11	9	(17)
Stock-based compensation expense		—	—	1
Income tax expense	D	(87)	(199)	(138)
Net Earnings—U.S. GAAP		1,033	871	2,380

CONSOLIDATED STATEMENTS OF EARNINGS AND COMPREHENSIVE INCOME – U.S. GAAP

For the years ended December 31,	Note 24	2010	2009	2008
Gross Revenues		13,422	11,790	18,103
Less: Royalties		449	273	533
Net Revenues		12,973	11,517	17,570
Expenses				
Production and mineral taxes		34	44	80
Transportation and blending		1,065	760	1,021
Operating	C ii)	1,293	1,308	1,305
Purchased product		7,549	5,910	10,341
Depreciation, depletion and amortization	A, C ii)	1,203	1,288	1,376
General and Administrative	C ii)	240	202	188
Interest, net		279	244	233
Accretion of asset retirement obligation		75	45	40
Foreign exchange (gain) loss, net		(51)	304	(308)
Stock-based compensation—options		—	—	(1)
(Gain) loss on divestiture of assets		9	—	—
Other (income) loss, net		(13)	(2)	3
		11,683	10,103	14,278
Earnings Before Income Tax		1,290	1,414	3,292
Income tax expense	D	257	543	912
Net Earnings – U.S. GAAP		1,033	871	2,380
Other Comprehensive Income (Loss), Net of Tax				
Foreign Currency Translation Adjustment		(13)	(238)	347
Compensation Plans		(7)	32	(9)
Comprehensive Income		1,013	665	2,718

CONDENSED CONSOLIDATED BALANCE SHEETS – U.S. GAAP

As at December 31,	Note 24	2010		2009	
		As Reported	U.S. GAAP	As Reported	U.S. GAAP
Assets					
Current Assets		2,775	2,775	2,453	2,453
Assets Held for Sale		65	65	–	–
Property, Plant and Equipment	A, B, C ii)				
(includes unproved properties and major development projects of \$2,428 and \$2,010 as of December 31, 2010 and 2009, respectively)		29,020	28,997	27,477	27,455
Accumulated Depreciation, Depletion and Amortization		(13,490)	(14,045)	(12,263)	(12,925)
Property, Plant and Equipment, net (Full Cost Method for Oil and Gas Activities)		15,530	14,952	15,214	14,530
Partnership Contribution Receivable		2,145	2,145	2,621	2,621
Risk Management		43	43	1	1
Other Assets	C i)	391	390	320	319
Goodwill		1,146	1,146	1,146	1,146
		22,095	21,516	21,755	21,070
Liabilities and Shareholders' Equity					
Current Liabilities	C i), C ii), D	2,485	2,644	1,984	2,098
Liabilities Related to Assets Held for Sale		7	7	–	–
Long-Term Debt		3,432	3,432	3,656	3,656
Partnership Contribution Payable		2,176	2,176	2,650	2,650
Risk Management		10	10	4	4
Asset Retirement Obligation		1,213	1,213	1,147	1,147
Other Liabilities	C i), C ii)	346	348	239	239
Deferred Income Taxes	D	2,404	2,331	2,467	2,368
		12,073	12,161	12,147	12,162
Shareholders' Equity	E	10,022	9,355	9,608	8,908
		22,095	21,516	21,755	21,070

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS – U.S. GAAP

For the years ended December 31,	2010	2009	2008
Operating Activities			
Net earnings	1,033	871	2,380
Depreciation, depletion and amortization	1,203	1,288	1,376
Deferred income taxes	116	(396)	554
Unrealized (gain) loss on risk management	(46)	698	(899)
Unrealized foreign exchange (gain) loss	(69)	327	(317)
Accretion of asset retirement obligation	75	45	40
(Gain) loss on divestiture of assets	9	–	–
Other (income) loss, net	35	7	(20)
Net change in other assets and liabilities	(55)	(26)	(92)
Net change in non-cash working capital	293	225	202
Cash From Operating Activities	2,594	3,039	3,224
Cash (Used in) Investing Activities	(1,796)	(2,063)	(2,109)
Net Cash Provided before Financing Activities	798	976	1,115
Cash From (Used in) Financing Activities	(631)	(977)	(1,226)

NOTES

A) Full Cost Accounting

Under U.S. GAAP, a ceiling test is applied to ensure the unamortized capitalized costs in a cost centre do not exceed the sum, net of applicable income taxes, of the present value, discounted at 10 percent, of the estimated future net revenues calculated on the basis of estimated value of future production from proved reserves using oil and gas prices at the balance sheet date, less related unescalated estimated future development and production costs, plus unimpaired unproved property costs. For 2010 and 2009, depletion charges under U.S. GAAP were also calculated by reference to proved reserves estimated using an average price for the prior 12-month period. For 2008, depletion charges under U.S. GAAP were calculated by reference to proved reserves estimated using oil and gas prices at the balance sheet date.

Under Canadian GAAP, a similar ceiling test calculation is performed with the exception that cash flows from proved reserves are undiscounted and utilize forecast pricing and future development and production costs to determine whether impairment exists. The impairment amount is measured using the fair value of proved and probable reserves. Depletion charges under Canadian GAAP are also calculated by reference to proved reserves estimated using estimated future prices and costs.

At December 31, 2008, Cenovus's capitalized costs of oil and gas properties in Canada exceeded the full cost ceiling resulting in a non-cash U.S. GAAP write-down of \$73 million charged to DD&A. Additional depletion was also recorded in certain prior years, as a result of ceiling test differences between Canadian GAAP and U.S. GAAP. As a result, the depletion base of unamortized capitalized costs is less for U.S. GAAP purposes.

The U.S. GAAP adjustment for the difference in depletion calculations resulted in a decrease to DD&A of \$107 million (2009–\$237 million; 2008–\$98 million).

B) Property, Plant and Equipment Allocation

For periods prior to the Arrangement, net property, plant and equipment related to Canadian upstream oil and gas activities have been allocated for U.S. GAAP carve-out purposes using the same methodology as the carve-out allocation for Canadian GAAP purposes.

The balances related to Canadian upstream operations have been allocated between Cenovus and Encana in accordance with the CICA Handbook Accounting Guideline AcG-16, based on the ratio of future net revenue, discounted at 10 percent, of the properties carved out to the discounted future net revenue of all proved properties in Canada using the reserve reports dated December 31, 2008. Future net revenue is the estimated net amount to be received with respect to development and production of crude oil and natural gas reserves, the value of which has been determined by independent qualified reserve evaluators.

C) Compensation Plans

i) Pensions and Other Post-Employment Benefits

Under U.S. GAAP, ASC 715-30, "Compensation – Retirement Benefits," requires Cenovus to recognize the over-funded or under-funded status of defined benefit and post-employment plans on the balance sheet as an asset or liability and to recognize changes in the funded status through Other Comprehensive Income. Canadian GAAP does not require the recognition of the funded status of these plans on its balance sheet.

ii) Liability-Based Stock Compensation Plans

Under Canadian GAAP, obligations for liability-based stock compensation plans are recorded using the intrinsic-value method of accounting. For U.S. GAAP purposes, Cenovus adopted ASC 718, "Compensation – Stock Compensation" for the year ended December 31, 2006 using the modified-prospective approach. Under ASC 718, liability-based stock compensation plans, including tandem share appreciation rights, performance tandem share appreciation rights, share appreciation rights and performance share appreciation rights, are required to be re-measured at fair value at each reporting period up until the settlement date.

To the extent compensation cost relates to employees directly involved in crude oil and natural gas development activities, certain amounts are capitalized to property, plant and equipment. Amounts not capitalized are recognized as administrative expenses or operating expenses. The current period adjustments have the following impact:

- Net property, plant and equipment decreased by \$1 million (2009–\$25 million decrease)
- Current liabilities decreased by \$14 million (2009–\$41 million decrease)
- Other liabilities decreased by \$7 million (2009–\$1 million increase)
- Operating expenses decreased by \$9 million (2009–\$4 million decrease)
- Administrative expenses decreased by \$11 million (2009–\$9 million decrease)
- No adjustment was made to depreciation, depletion and amortization expenses (2009–\$2 million decrease)

The following table provides a reconciliation of the statutory rate to the actual tax rate:

For the years ended December 31,	2010	2009	2008
Earnings Before Income Tax–U.S. GAAP	1,290	1,414	3,292
Canadian Statutory Rate	28.2%	29.2%	29.7%
Expected Income Tax	364	413	977
Effect on Taxes Resulting from:			
Statutory and other rate differences	(36)	(7)	(88)
Non-deductible stock-based compensation	32	–	–
Multi-jurisdictional financing	(93)	(134)	(135)
Foreign exchange gains not included in net earnings	28	58	71
Non-taxable capital (gains) losses	(9)	30	(53)
Recognition of capital losses	(107)	–	–
Unrecognized non-capital losses	–	131	–
Other	78	52	140
Income Tax–U.S. GAAP	257	543	912
Effective Tax Rate	19.9%	38.4%	27.7%

D) Income Taxes

U.S. GAAP uses enacted tax rates and legislative changes to calculate current and deferred income taxes, whereas Canadian GAAP uses substantively enacted tax rates and legislative changes. In 2009, Cenovus incurred losses in one of its subsidiary companies which were recognized and included in calculating future income taxes for Canadian GAAP purposes on the basis that the tax legislative changes were substantially enacted. For U.S. GAAP, these losses were not recognized as the tax legislative changes were not enacted by December 31, 2009 nor December 31, 2010. There was no additional impact to income tax expense in 2010 (2009–\$131 million, 2008–nil). In 2010 some of these losses were claimed to reduce the current taxes payable under Canadian GAAP. For U.S. GAAP the losses were not available and the current tax payable increased by \$59 million offset by a decrease to the deferred income tax payable with no impact on total tax expense.

The remaining differences resulted from the deferred income tax adjustments included in the Reconciliation of Net Earnings under Canadian GAAP to U.S. GAAP and the Condensed Consolidated Balance Sheet include the effect of such rate differences, if any, as well as the tax effect of the other reconciling items noted.

The net deferred income tax liability consists of:

As at December 31,	2010	2009
Deferred Tax Liabilities		
Property, plant and equipment in excess of tax values	2,390	2,407
Timing of partnership items	125	9
Net foreign exchange gains	127	–
Risk management	55	17
Other	55	79
Deferred Tax Assets		
Unused tax losses	(209)	(111)
Risk management	(45)	(33)
Other	(167)	–
Net Deferred Income Tax Liability	2,331	2,368

E) Other Comprehensive Income

ASC 715-30 requires a change in the funded status of defined benefit and post-employment plans to be recognized on the balance sheet and changes in the funded status through other comprehensive income. In 2010, a loss of \$7 million, net of tax was recognized in other comprehensive income (2009–gain of \$32 million) as noted in D i). On adoption of ASC 715-30, as required, the transitional amount of \$24 million, net of tax was booked directly to Accumulated Other Comprehensive Income.

F) Joint Venture with ConocoPhillips

Under Canadian GAAP, the Refining operations that are jointly controlled are

proportionately consolidated. U.S. GAAP requires the Refining operations be accounted for using the equity method. However, under an accommodation of the U.S. Securities and Exchange Commission, accounting for jointly controlled investments does not require reconciliation from Canadian to U.S. GAAP if the joint venture is jointly controlled by all parties having an equity interest in the entity, which is the case for the Refining operations. Equity accounting for the Refining operations would have no impact on Cenovus's net earnings or retained earnings. As required, the following disclosures are provided for the Refining operations of the joint venture.

CONSOLIDATED STATEMENTS OF EARNINGS

For the years ended December 31,	2010	2009
Operating Cash Flow (See Note 1)	67	358
Depreciation, depletion and amortization	(229)	(220)
Other	(12)	(12)
Net Earnings (Loss)	(174)	126

CONSOLIDATED BALANCE SHEETS

As at December 31,	2010	2009
Current Assets	951	808
Long-term Assets	5,275	5,104
Current Liabilities	559	511
Long-term Liabilities	327	410

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended December 31,	2010	2009
Cash From (Used in) Operating Activities	117	(62)
Cash From (Used in) Investing Activities	(657)	(1,034)