NOTES TO THE FINANCIAL STATEMENTS

31 December, 2001

(Amounts expressed in Renminbi unless otherwise stated)

1. ORGANISATION AND PRINCIPAL ACTIVITIES

CNOOC Limited (the "Company") was incorporated in the Hong Kong Special Administrative Region ("Hong Kong"), the People's Republic of China (the "PRC") on 20 August, 1999 to hold the interests in the entities now comprising the Company and its subsidiaries (hereinafter collectively referred to as the "Group"). The Group is principally engaged in exploration, development, production and sales of crude oil, natural gas and other petroleum.

The directors of the Company consider China National Offshore Oil Corporation ("CNOOC"), a company established in the PRC, as the ultimate parent company.

2. PRINCIPAL ACCOUNTING POLICIES

(a) Basis of presentation

The financial statements are prepared under the historical cost convention as modified by the revaluation of land and buildings and short-term investments, and in accordance with Statements of Standard Accounting Practice issued by the Hong Kong Society of Accountants, accounting principles generally accepted in Hong Kong ("Hong Kong GAAP") and the requirements of the Hong Kong Companies Ordinance.

(b) Adoption of Statements of Standard Accounting Practice

In the current year, the Group has adopted, for the first time, the following Statements of Standard Accounting Practice issued by the Hong Kong Society of Accountants ("Hong Kong SSAPs"):

Hong Kong SSAP9 (revised)	Events after the balance sheet date
Hong Kong SSAP14 (revised)	Leases
Hong Kong SSAP26	Segment reporting
Hong Kong SSAP28	Provisions, contingent liabilities and contingent assets
Hong Kong SSAP29	Intangible assets
Hong Kong SSAP30	Business combinations
Hong Kong SSAP31	Impairment of assets
Hong Kong SSAP32	Consolidated financial statements and accounting for investments in subsidiaries

In addition to the adoption of the above standards, the Group has adopted the consequential changes made to Hong Kong SSAP 10 "Accounting for investments in associates", Hong Kong SSAP 17 "Property, plant and equipment", Hong Kong SSAP 18 "Revenue" and Hong Kong SSAP 21 "Accounting for interests in joint ventures".

The impact of adopting the above new Hong Kong SSAPs is not significant and, accordingly, no prior period adjustment has been made on the financial statements of the Group.

NOTES TO THE FINANCIAL STATEMENTS

2. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

(c) Basis of consolidation

The consolidated financial statements of the Group include the accounts of the Company and the enterprises that it controls. This control is normally evidenced when the Company has the power to govern the financial and operating policies of an enterprise so as to benefit from its activities. In addition, if the Company holds, either directly or indirectly, more than 50% of the issued share capital or controls more than half of the voting power or the composition of the board of directors of the subsidiaries, control is assumed.

Intragroup balances and transactions, and resulting unrealised profits are eliminated in full. Unrealised losses resulting from intragroup transactions are eliminated unless cost cannot be recovered. Consolidated financial statements are prepared using uniform accounting policies for like transactions and other events in similar circumstances.

In the Company's financial statements, investments in subsidiaries are carried at cost less any accumulated impairment losses. The results of the subsidiaries are included in the income statement to the extent of dividends received and receivable.

(d) Revenue recognition

Provided it is probable that the economic benefits associated with a transaction will flow to the Group and the revenue and costs, if applicable, can be measured reliably, revenue is recognised on the following basis:

(i) Oil and gas sales

Revenues represent the invoiced value of sales of oil and gas attributable to the interests of the Group, net of royalties and government share of allocable share oil, and are recognised when the significant risks and rewards of ownership of oil and gas have been transferred to customers.

Oil and gas lifted and sold by the Group above or below the Group's participating interests in the production sharing contracts result in overlifts and underlifts. The Group records these transactions in accordance with the entitlement method under which overlifts are recorded as liabilities and underlifts are recorded as assets. Settlement will be in kind when the liftings are equalised or in cash when production ceases.

The Group entered into a gas sales contract with a customer which contain take-or-pay clauses. The clause requires the customer to take a specified minimum volume of gas each year. If the minimum volume of gas is not taken, the customer must pay for the deficiency gas, even though the gas is not taken. The customer can offset the deficiency payment against any future purchases in excess of the specified volume. The Group recorded the deficiency payment as deferred revenue which is included in other payables until make-up gas is taken by the customer. As at 31 December, 2001, deferred revenue amounted to approximately RMB5,581,000 (2000: RMB24,208,000).

(ii) Marketing revenues

Marketing revenues represent sales of oil purchased from the foreign partners under the production sharing contracts and revenues from trading of oil through the Company's subsidiary in Singapore. The title, together with the risks and rewards of the ownership of such oil, are transferred to the Group from the foreign partners and other unrelated oil and gas companies before the Group sells such oil to its customers. The cost of the oil sold is included in crude oil and product purchases.

2. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

(d) Revenue recognition (Cont'd)

(iii) Other income

Other income mainly represents project management fees charged to the foreign partners and handling fees charged to customers and is recognised when the services are rendered.

(iv) Interest income

Interest income from deposits placed with banks and other financial institutions is recognised on a time proportion basis that takes into account the effective yield on the assets.

(v) Dividend income

Dividend income is recognised when the right to receive payment is established.

(e) Research and development costs

Research and development costs are recognised as expenses in the period in which they are incurred.

(f) Property, plant and equipment

Property, plant and equipment comprise oil and gas properties, land and buildings, and vehicles and office equipment.

(i) Oil and gas properties

For oil and gas properties, the successful efforts method of accounting is adopted. The Group capitalises initial acquisition costs of oil and gas properties, the costs of drilling and equipping successful exploratory wells, all development costs, including those renewals and betterments which extend the economic life of the assets, and the interest charges arising from borrowings used to finance the development of oil and gas properties before they are substantially ready for production. Costs of unsuccessful exploratory wells and all other exploration costs are expensed as incurred.

In the absence of a determination as to whether the reserves that have been found can be classified as proved, the costs of drilling such an exploratory well will not be carried as an asset for more than one year following completion of drilling. If, when that year has passed, a determination that proved reserves have been found cannot be made, the well shall be assumed to be impaired, and its costs shall be charged to the consolidated income statement.

Productive oil and gas properties and other tangible and intangible costs of producing properties are amortised using the unit-of-production method on a property-by-property basis under which the ratio of produced oil and gas to the estimated remaining proved reserves is used to determine the depreciation, depletion and amortisation provision. Costs associated with significant development projects are not depleted until commercial production commences and the reserves related to those costs are excluded from the calculation of depletion.

The Group estimates future dismantlement and site restoration costs for oil and gas properties with reference to the estimates provided from either internal or external engineers after taking into consideration the anticipated method of dismantlement and the extent of site restoration required in accordance with current legislation and industry practices. The Group provides for the future dismantlement and site restoration allowance using the unit-of-production method.

NOTES TO THE FINANCIAL STATEMENTS

2. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

(f) Property, plant and equipment (Cont'd)

(ii) Land and buildings

Land and buildings are stated at valuation less accumulated depreciation and accumulated impairment losses. Professional valuations are performed periodically with the last valuation performed on 31 December, 2000. In the intervening years, the directors review the carrying value of land and buildings and adjustment is made where in the directors' opinion there has been a material change in value. Any increase in land and building valuation is credited to the revaluation reserves; any decrease is first offset against an increase in earlier valuation in respect of the same property and is thereafter charged to the income statement. Depreciation is calculated on the straight-line basis at annual rate estimated to write off valuation of each asset over its expected useful life, ranging from 30 to 50 years.

(iii) Vehicles and office equipment

Vehicles and office equipment are stated at cost less accumulated depreciation and accumulated impairment losses. The straight-line method is adopted to depreciate the cost less salvage value of these assets over their expected useful life. The Group estimates the useful lives of vehicles and office equipment to be 5 years.

The useful lives of assets and method of depreciation, depletion and amortisation are reviewed periodically.

When assets are sold or retired, their costs or revalued amounts and accumulated depreciation, depletion and amortisation are eliminated from the accounts and any gain or loss resulting from their disposal is included in the income statement.

(g) Investment in an associated company

Investment in associate where significant influence is exercised by the Group are accounted for using the equity method in the consolidated financial statements, whereby the investment is initially recorded at cost and adjusted thereafter to recognise the Group's share of the post-acquisition profits or losses of the associate, distributions received from the associate and other necessary alterations in the Group's proportionate interest in the associate arising from changes in the equity of the associate that have not been included in the income statement and less any accumulated impairment losses. The Group's share of post-acquisition results of associate is included in the consolidated income statement.

In the Company's financial statements, investment in associate is carried at cost less any accumulated impairment losses. The results of the associated company are included in the income statement to the extent of dividends received and receivable.

(h) Short-term investments

Short-term investments are carried at fair value in the balance sheet. Any unrealised holding gain or loss of the investments is recognised in the income statement in the period when it arises.

Upon disposal or transfer of the investments, any profit or loss thereon is accounted for the income statement.

2. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

(i) Inventories and supplies

Inventories consist primarily of oil while supplies consist mainly of items for repair and maintenance of oil and gas properties. Inventories are stated at the lower of cost and net realisable value. Costs of inventories and supplies represent purchase or production cost of goods and are determined on a weighted average basis. Net realisable value is determined by reference to the sales proceeds of items sold in the ordinary course of business after the balance sheet date or to management's estimates based on prevailing market conditions. Supplies are capitalised to property, plant and equipment when used for renewals and betterments of oil and gas properties or recognised as expenses when used for daily operations.

(j) Trade and other receivables

Trade and other receivables are stated at their cost, after provision for doubtful accounts.

(k) Cash and cash equivalents

Cash represents cash on hand and deposits with banks and other financial institutions which are repayable on demand.

Cash equivalents represent short-term, highly liquid investments which are readily convertible into known amounts of cash with original maturities of three months or less and that are subject to an insignificant risk of change in value.

(l) Operating leases

Leases of assets under which substantially all the risks and rewards of ownership are retained by the lessor are classified as operating leases. Lease payments under an operating lease are recognised as an expense on a straight-line basis over the lease term.

(m) Provisions

A provision is recognised when an enterprise has a present obligation (legal or constructive) as a result of a past event and it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. Provisions are reviewed at each balance sheet date and adjusted to reflect the current best estimate. Where the effect of the time value of money is material, the amount of a provision is the present value of the expenditures expected to be required to settle the obligation.

(n) Taxation

The Group provides for income taxes on the basis of its net profit for financial reporting purposes, adjusted for income and expense items that are not assessable or deductible for income tax purposes.

Deferred taxation is provided under the liability method in respect of timing differences between profit as computed for taxation purposes and profit as stated in the financial statements to the extent that it is probable that a liability or asset will crystallise.

2. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

(o) Foreign currency

The books and records of the Company and its subsidiary in China are maintained in Renminbi ("RMB"). The books and records of the overseas subsidiaries are maintained either in Singapore dollars or United States dollars. Transactions in currencies other than the book currency during the year are translated into book currency at the exchange rates prevailing at the time of the transactions. Monetary assets and liabilities denominated in other currencies at the balance sheet date are translated into book currency at rates of exchange in effect at the balance sheet date. Exchange differences are dealt with in the income statement in the period in which they arise.

On consolidation, the financial statements of the overseas subsidiaries are translated into RMB using the closing rate method, whereby assets and liabilities are translated at the rates of exchange prevailing at the balance sheet date and income and expenses are translated at the average rates of exchange during the year. Share capital, share premium and retained earnings are translated at historical rates. Translation differences arising therefrom are dealt with as movements in reserves.

(p) Borrowing costs

Borrowing costs include interest charges and other costs incurred in connection with the borrowing of funds, including amortisation of discounts or premiums relating to borrowings, and amortisation of ancillary costs incurred in connection with arranging borrowings to the extent that they are regarded as an adjustment to interest costs.

Borrowing costs are expensed as incurred, except when they are directly attributable to the acquisition or construction of the property, plant and equipment that necessarily takes a substantial period of time to prepare for its intended use in which case they are capitalised as part of the costs of that asset. Capitalisation of borrowing costs commences when expenditures for the asset and borrowing costs are being incurred and the activities to prepare the asset for its intended use are in progress. To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation on that asset is determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation is determined by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate is the weighted average of the borrowing costs applicable to the borrowings of the enterprise that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalised incurred during a period should not exceed the amount of borrowing cost incurred during that period.

(q) Retirement benefits and employee subsidies

The Group provides defined contribution plans based on local laws and regulations. The plans cover full-time employees and provide for contributions ranging from 9% to 22.5% of salary. The Group's contributions to defined contribution plans are charged to expense in the year to which they relate.

The cost of employee subsidies is charged to the income statement as incurred.

2. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

(r) Impairment of assets

Property, plant and equipment and investment in an associated company and subsidiaries are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Whenever the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recognised as an expense for items of property, plant and equipment and investments in an associated company and subsidiaries carried at cost, and treated as a revaluation decrease for buildings that are carried at revalued amounts to the extent that the impairment loss does not exceed the amount held in the revaluation surplus for that same building. The recoverable amount is the higher of an asset's net selling price and value in use. The net selling price is the amount obtainable from the sale of the asset in an arm's length transaction while value in use is the present value of estimated future cash flows expected to arise from the continuing use of the asset and from its disposal at the end of its useful life. Recoverable amounts are estimated for individual assets or, if that is not possible, for the cash-generating unit.

Reversal of impairment losses recognised in prior years is recorded when the impairment losses recognised for the asset no longer exist or have decreased. The reversal is recorded in income or as a revaluation increase.

(s) Repairs and maintenance

Repairs and maintenance and overhaul costs are normally charged to the income statement as operating expense in the period in which it is incurred.

(t) Financial instruments

The Group has currency swap contracts with financial institutions which are not designated as hedging instruments and are carried at fair value, with changes in fair value included in the income statement.

(u) Segments

Business segments: for management purposes the Group is organised on a worldwide basis into three major operating segments. The divisions are the basis upon which the Group reports its primary segment information. Financial information on business and geographical segments is presented in Note 31.

Intersegment transactions: segment revenue, segment expenses and segment performance include transfers between business segments and between geographical segments. Such transfers are accounted for at cost. Those transfers are eliminated in consolidation.

(v) Contingencies

Contingent liabilities are not recognised in the financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

A contingent asset is not recognised in the financial statements but disclosed when an inflow of economic benefits is probable.

NOTES TO THE FINANCIAL STATEMENTS

2. PRINCIPAL ACCOUNTING POLICIES (CONT'D)

(w) Subsequent events

Post-year-end events that provide additional information about the Company's position at the balance sheet date or those that indicate the going concern assumption is not appropriate (adjusting events) are reflected in the financial statements. Post-year-end events that are not adjusting events are disclosed in the notes when material.

(x) Use of estimates

The preparation of financial statements in conformity with Hong Kong GAAP requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

3. PRODUCTION SHARING CONTRACTS

The Group performs a significant amount of its oil and gas activities through production sharing contracts with international oil and gas companies ("foreign partners").

For most production sharing contracts, foreign partners are required to bear all exploration costs during the exploration period and such exploration costs can be recovered according to the production sharing formula after commercial discoveries are made and production begins.

The development and operating costs are funded by the Group and the foreign partners according to their respective participating interest.

The Group has the option to take a participating interest of up to 51% in a production sharing contract and may exercise such option after the foreign partners have independently undertaken all the exploration risks and costs and made viable commercial discoveries. The foreign partners retain the remaining participating interests.

After the Group exercises the option to take a participating interest in a production sharing contract, the Group accounts for the oil and gas properties using the "proportional method" under which the Group recognises its share of development costs, revenues and expenses from such operations based on its participating interest in the production sharing contract. The Group does not account for the exploration costs incurred by its foreign partners and their share of development costs and revenues and expenses from such operations.

Part of the annual gross production of oil and gas is distributed to the PRC government for the payment of royalties pursuant to a sliding scale. The Group and the foreign partners also pay a production tax to the tax bureau at a pre-determined rate (Note 10). In addition, there is a pre-agreed portion of oil and gas designated to recover all exploration costs, development costs, operating costs incurred and related interests according to the participating interests between the Group and the foreign partners. Any remaining oil after the foregoing is first distributed to the PRC government as share oil on a pre-determined ratio pursuant to a sliding scale, and then distributed to the Group and the foreign partners based on their respective participating interests. As the government share is not included in the Group's interest in the annual production, the net sales of the Group do not include the sales revenue of the government share oil.

The foreign partners have the right to take possession of their allocable remainder oil for sale in the international market or to negotiate with the Group to sell their allocable remainder oil to the Group for resale in the PRC market.

NOTES TO THE FINANCIAL STATEMENTS

4. OIL AND GAS SALES

	2001	2000
	RMB'000	RMB'000
Gross sales	**19,663,251**	21,747,888
Royalties	**(283,014)**	(208,885)
Government share oil	**(1,819,449)**	(2,719,680)
	17,560,788	18,819,323

5. MARKETING PROFIT

	2001	2000
	RMB'000	RMB'000
Marketing revenues	**2,537,032**	5,126,015
Crude oil and product purchases	**(2,453,312)**	(5,097,765)
	83,720	28,250

6. PROFIT BEFORE TAXATION

Profit before taxation was determined at after (crediting) charging the following:

	2001	2000
	RMB'000	RMB'000
Crediting:		
Interest income on bank deposits	**(317,706)**	(236,624)
Interest	**(21,344)**	–
Dividends	**(123,213)**	–
Realised gains on investments	**(32,297)**	–
Unrealised gains on investments	**(43,796)**	–
Short-term investment income	**(220,650)**	–
Recovery of doubtful accounts	**(4,966)**	(57,658)
Charging:		
Auditors' remuneration	**7,452**	2,484
Staff costs		
– salaries, wages and other staff benefits	**675,440**	562,414
– provision for staff and workers' bonus and welfare funds	**40,000**	–
– contribution to pension scheme (Note 27)	**6,392**	12,842
Depreciation, depletion and amortisation	**2,602,799**	2,634,988
Less: amount included in inventory	**(35,879)**	(57,106)
	2,566,920	2,577,882
Operating lease rentals	**63,260**	53,732
Loss on disposals of property, plant and equipment	**51,333**	220,146
Repairs and maintenance	**457,414**	492,328
Research and development costs	**160,349**	161,733

NOTES TO THE FINANCIAL STATEMENTS

7. DIRECTORS' AND FIVE HIGHEST PAID INDIVIDUALS

(a) Details of directors' emoluments were as follows:

	2001	2000
	RMB'000	RMB'000
Fees for executive directors	**–**	–
Fees for non-executive directors	**890**	–
Other emoluments for executive directors		
– basic salaries and allowances	**6,106**	400
– bonus	**560**	440
– pension scheme contribution	**207**	160
– other	**1,500**	1,500

The emoluments of the directors analysed by the number of directors and emolument ranges were as follows:

	Number of Directors	
	2001	2000
Up to HK$1,000,000	**6**	7
HK$1,000,001 – HK$1,500,000	**–**	–
HK$1,500,001 – HK$2,000,000	**2**	–
HK$2,000,001 – HK$2,500,000	**–**	–
HK$2,500,001 – HK$3,000,000	**1**	–
	9	7

No directors had waived or agreed to waive any emoluments during the year.

NOTES TO THE FINANCIAL STATEMENTS

7. DIRECTORS' AND FIVE HIGHEST PAID INDIVIDUALS (CONT'D)

(b) Details of emoluments of the five highest paid individuals were as follows:

	2001	2000
	RMB'000	RMB'000
Basic salaries and allowances	**7,280**	400
Bonus	**1,280**	440
Pension scheme contribution	**416**	160
Other	**1,500**	1,500
Number of directors	**4**	5
Number of employees	**1**	–

Their emoluments were within the following bands:

	Number of Senior Executives	
	2001	2000
Up to HK$1,000,000	**1**	5
HK$1,000,001 – HK$1,500,000	**–**	–
HK$1,500,001 – HK$2,000,000	**2**	–
HK$2,000,001 – HK$2,500,000	**–**	–
HK$2,500,001 – HK$3,000,000	**2**	–
	5	5

No emoluments were paid to the five highest paid individuals (including directors, members and employees) as an inducement to join or upon joining the Group or as compensation for loss of office during the year.

8. SELLING AND ADMINISTRATIVE EXPENSES

	2001	2000
	RMB'000	RMB'000
Salary and staff benefits	**228,782**	172,593
Utility and office expenses	**89,462**	70,069
Recovery of doubtful accounts	**(4,966)**	(57,658)
Transportation and entertainment	**64,923**	60,682
Rentals and maintenance	**121,483**	89,184
Selling expenses	**38,069**	36,481
Other	**77,636**	84,651
	615,389	456,002

NOTES TO THE FINANCIAL STATEMENTS

9. INTEREST EXPENSE

	2001	2000
	RMB'000	RMB'000
Interest expense on bank loans which are:		
– wholly repayable within five years	219,045	241,749
– not wholly repayable within five years	81,634	191,755
Interest expense to CNOOC	8,415	41,500
Other borrowing costs	6,510	–
	315,604	475,004
Less: Amount capitalised in property, plant and equipment	(198,970)	–
	116,634	475,004

The capitalised interest rate represented the cost of capital from raising the related borrowings and varied from 2.35% to 9.15% per annum for the year ended 31 December, 2001.

10. TAXATION

(i) Income tax

The Company and its subsidiaries are subject to income taxes on an entity basis on profit arising in or derived from the tax jurisdictions in which they are domiciled and operate. The Group is not liable for profits tax in Hong Kong as it does not have any assessable income currently sourced from Hong Kong.

The Company's subsidiary, CNOOC China Limited, is a wholly foreign owned enterprise established in the PRC. It is exempt from 3% local surcharges and is subject to enterprise income tax of 30% under the prevailing tax rules and regulations. Moreover, CNOOC China Limited was entitled to a 50% reduction of enterprise income tax for three years until end of year 2000. Starting from 1 January, 2001, CNOOC China Limited is subject to enterprise income tax at the normal rate of 30%. Further, CNOOC performed assets revaluation in 1995 on its then oil properties and other plant and equipment which were transferred to CNOOC China Limited in 1999 upon the reorganisation of CNOOC. According to a notice from the tax bureau, the related revaluation surplus was deductible for tax reporting purpose by CNOOC. Based on a confirmation received from the local tax bureau in 2001, the related depreciation and amortisation can still be deductible for tax purpose by CNOOC China Limited. However, such treatment may be subject to review by higher tax authorities. Should the depreciation and amortisation not be tax deductible, an additional enterprise income tax liability of approximately RMB75,000,000 for the year ended 31 December, 2001 may arise. Management believes that the possibility of such a liability arising is unlikely.

NOTES TO THE FINANCIAL STATEMENTS

10. TAXATION (CONT'D)

(i) Income tax (Cont'd)

The Company's subsidiary in Singapore, China Offshore Oil (Singapore) International Pte. Ltd., is subject to income tax at the rate of 10% and 26% respectively for its oil trading activities and other income producing activities. The Company's subsidiaries owning interests in oil properties in Indonesia are subject to corporate and dividend tax of 56% before August 2000. Starting from August 2000 with the renewal of production sharing contracts, the tax rate was reduced to 44%. All of the Company's other subsidiaries are not subject to income taxes in their respective jurisdictions for the years presented.

An analysis of the provision for taxation in the consolidated income statement was as follows:

	2001	2000
	RMB'000	RMB'000
Overseas income taxes	**20,401**	43,873
PRC enterprise income tax		
– Current	**2,715,409**	1,600,608
– Deferred	**312,417**	281,595
	3,048,227	1,926,076

With the tax holiday exemption, current income tax liabilities of the Company's subsidiary in the PRC were reduced by approximately RMB1,920,730,000 during the year ended 31 December, 2000. The tax holiday exemption also increased the net earnings per share by RMB0.30 for the year ended 31 December, 2000.

The reconciliation of the statutory PRC enterprise income tax rate to the effective income tax rate of the Group was as follows:

	2001	2000
Statutory PRC enterprise income tax rate	**33.0%**	33.0%
Effect of tax exemption granted	**(3.0%)**	(3.0%)
Effect of tax holiday	**–**	(15.0%)
Effect of future tax rate changes on originating timing differences	**–**	1.2%
Effect of different tax rates for overseas subsidiaries	**(1.2%)**	0.3%
Tax effect of additional depreciation on revaluation and other permanent differences	**(1.1%)**	(0.7%)
Effective income tax rate	**27.7%**	15.8%

NOTES TO THE FINANCIAL STATEMENTS

10. TAXATION (CONT'D)

(i) Income tax (Cont'd)

The tax effect of significant timing differences of the Group was as follows:

	2001	2000
	RMB'000	RMB'000
Deferred tax assets		
– Dismantlement and site restoration allowance	**479,439**	452,329
– Provision for impairment of property, plant and equipment and write-off of unsuccessful exploratory drillings	**1,880,791**	1,266,523
	2,360,230	1,718,852
Deferred tax liabilities		
– Accelerated amortisation allowance for oil and gas properties	**(4,123,867)**	(3,170,072)
Net deferred tax liabilities	**(1,763,637)**	(1,451,220)

There were no significant unprovided deferred income taxes during the year.

(ii) Other taxes

The Company's PRC subsidiary pays the following taxes:

- production taxes equal to 5% of independent production and production under production sharing contracts;
- business tax of 3% to 5% on other income.

11. DIVIDENDS

The payment of future dividends will be determined by the Company's board of directors. The payment of dividends will depend upon, among other things, future earnings, capital requirements and financial condition and general business conditions of the Company. The Company's ability to pay dividends will also depend on the cash flows determined by the dividends, if any, received by the Company from its subsidiaries and associated company. As the controlling shareholder, CNOOC will be able to influence the Company's dividend policy.

Cash dividends to the shareholders in Hong Kong will be paid in Hong Kong dollars and dividends to the ADS holders will be paid to the depositary in Hong Kong dollars and will be converted by the depositary into United States dollars and paid to the holders of ADSs.

On 27 August, 2001, the board of directors declared a 2001 interim dividend of HK$0.10 per share, totaling approximately RMB871,194,000 to its shareholders, which was paid in October 2001.

On 20 December, 2000, the board of directors of the Company proposed a dividend of RMB0.98 per share, totaling approximately RMB6,426,424,000, to its shareholders for the year ended 31 December, 2000. The dividend distribution was approved by the shareholders in their annual general meeting held on 4 February, 2001.

NOTES TO THE FINANCIAL STATEMENTS

12. EARNINGS PER SHARE

The calculation of basic earnings per share for the year is based on the net profit attributable to ordinary shareholders of RMB7,957,631,000 (2000: RMB10,296,600,000), divided by the weighted average number of ordinary shares outstanding during the year of 7,941,383,305 shares (2000: 6,331,114,421 shares).

Diluted earnings per share for the year is computed by dividing net profit attributable to ordinary shareholders of RMB7,957,631,000 by the weighted average number of ordinary shares outstanding during the year adjusted for the effects of all dilutive potential ordinary shares under the share option scheme (Note 25). The weighted average number of ordinary shares used to compute diluted earnings per share during the year was 7,942,288,803 shares. There were no potential dilutive ordinary shares outstanding for the year ended 31 December, 2000.

Reconciliation of the number of ordinary shares for calculation of basic and diluted earnings per share for the year ended 31 December, 2001:

	2001
Weighted average number of ordinary shares used in calculating basic earnings per share	**7,941,383,305**
Effect of all dilutive potential ordinary shares under the share option scheme	**905,498**
Weighted average number of ordinary shares used in calculating diluted earnings per share	**7,942,288,803**

NOTES TO THE FINANCIAL STATEMENTS

13. PROPERTY, PLANT AND EQUIPMENT, NET

Movements in property, plant and equipment of the Group were:

	Group				
	2001				2000
	Oil and gas properties	**Land and buildings**	**Vehicles and office equipment**	**Total**	Total
	RMB'000	**RMB'000**	**RMB'000**	**RMB'000**	RMB'000
Cost or valuation:					
Beginning balance	**37,319,924**	**824,781**	**39,837**	**38,184,542**	34,166,507
Additions	**4,320,675**	**–**	**18,063**	**4,338,738**	4,584,343
Revaluation	**–**	**–**	**–**	**–**	104,073
Disposals and written off	**(463,140)**	**–**	**–**	**(463,140)**	(670,381)
Ending balance	**41,177,459**	**824,781**	**57,900**	**42,060,140**	38,184,542
Representing:					
At cost	**41,177,459**	**–**	**57,900**	**41,235,359**	37,359,761
At revaluation	**–**	**824,781**	**–**	**824,781**	824,781
	41,177,459	**824,781**	**57,900**	**42,060,140**	38,184,542
Accumulated depreciation, depletion and amortisation:					
Beginning balance	**(15,482,082)**	**(30,280)**	**(17,805)**	**(15,530,167)**	(13,258,982)
Charge for the year	**(2,572,896)**	**(25,373)**	**(4,530)**	**(2,602,799)**	(2,634,988)
Impairment	**(99,675)**	**–**	**–**	**(99,675)**	–
Write back on disposals	**–**	**–**	**–**	**–**	363,803
Ending balance	**(18,154,653)**	**(55,653)**	**(22,335)**	**(18,232,641)**	(15,530,167)
Net book value:					
Beginning of year	**21,837,842**	**794,501**	**22,032**	**22,654,375**	20,907,525
End of year	**23,022,806**	**769,128**	**35,565**	**23,827,499**	22,654,375
Had the property, plant and equipment been carried at cost less accumulated depreciation, depletion and amortisation, the carrying amount of each class would have been:					
Cost	**41,177,459**	**550,110**	**57,900**	**41,785,469**	37,909,871
Accumulated depreciation, depletion and amortisation	**(18,154,653)**	**(38,914)**	**(22,335)**	**(18,215,902)**	(15,522,584)
	23,022,806	**511,196**	**35,565**	**23,569,567**	22,387,287

Impairment loss for the year represented the estimated impairment resulting from downward revision of the reserves of certain oil fields.

NOTES TO THE FINANCIAL STATEMENTS

13. PROPERTY, PLANT AND EQUIPMENT, NET (CONT'D)

Property, plant and equipment of the Company mainly comprised office equipment and were all stated at cost less accumulated depreciation and accumulated impairment losses. Movements in property, plant and equipment of the Company were:

	Company	
	2001	2000
	RMB'000	RMB'000
Cost:		
Beginning balance	**5,105**	114
Additions	**646**	4,991
Ending balance	**5,751**	5,105
Accumulated depreciation:		
Beginning balance	**(935)**	–
Charge for the year	**(2,068)**	(935)
Ending balance	**(3,003)**	(935)
Net book value:		
Beginning of year	**4,170**	114
End of year	**2,748**	4,170

Land and buildings of the Group are held outside Hong Kong with lease terms of 50 years.

Certain land use rights which were previously granted by the PRC government at no cost. The land and buildings were revalued by Sallmanns (Far East) Limited, Chartered Surveyors (the "Valuer") as at 31 December, 2000 using a depreciated replacement cost approach. The depreciated replacement cost approach considers the cost to reproduce or replace in new condition the property being appraised in accordance with current construction costs for similar property in the locality with allowance for accrued depreciation as evidenced by observed condition or obsolescence present, whether arising from physical, functional or economic causes. The Valuer assumed that the assets would be used for the purposes for which they are presently used and did not consider alternative uses.

The revaluation surplus of approximately RMB104,073,000 arising from the revaluation of the land and buildings as at 31 December, 2000 has been recorded by the Group.

14. INVESTMENTS IN SUBSIDIARIES

	Company	
	2001	2000
	RMB'000	RMB'000
Investment at cost-unlisted	**7,766,955**	7,766,955
Loan to a subsidiary	**1,489,082**	–
Amounts due from subsidiaries	**1,467,642**	3,190,361
	10,723,679	10,957,316

NOTES TO THE FINANCIAL STATEMENTS

14. INVESTMENTS IN SUBSIDIARIES (CONT'D)

Loan to a subsidiary represented a loan to CNOOC China Limited to finance its capital investment. The loan to a subsidiary was unsecured, bearing interest at LIBOR plus 1% and repayable in January 2003.

Amounts due from subsidiaries were unsecured, non-interest bearing and receivable on demand.

The Company's directors are of the opinion that the underlying value of the subsidiaries was not less than the Company's carrying value of the subsidiaries as at 31 December, 2001.

As at 31 December, 2001, the Company had direct or indirect interests in the following principal subsidiaries:

Name of entity	Place and date of incorporation/ establishment	Percentage of equity interest attributable to the Group	Issued and paid up capital	Principal activities
Directly held subsidiaries:				
CNOOC China Limited	Tianjin, the PRC 15 September, 1999	100%	RMB10 billion	Offshore petroleum exploration, development, production, and sales in the PRC
CNOOC International Limited	British Virgin Islands 23 August, 1999	100%	US$2	Investment holding
China Offshore Oil (Singapore) International Pte. Ltd.	Singapore 14 May, 1993	100%	S$3 million	Sales and marketing of petroleum outside of the PRC
Indirectly held subsidiaries*:				
Malacca Petroleum Limited	Bermuda 2 November, 1995	100%	US$12,000	Investment holding
OOGC America, Inc.	State of Delaware, United States of America 2 September, 1997	100%	US$1,000	Investment holding
OOGC Malacca Limited	Bermuda 2 November, 1995	100%	US$12,000	Investment holding
CNOOC Southeast Asia Limited**	Bermuda 16 May, 1997	100%	US$12,000	Investment holding

* Indirectly held through CNOOC International Limited.

** Formerly known as OOGC Myanmar Limited.

NOTES TO THE FINANCIAL STATEMENTS

15. INVESTMENT IN AN ASSOCIATED COMPANY

Investment in an associated company represents a 30% equity interest of CNOOC China Limited in Shanghai Petroleum and Natural Gas Company Limited ("SPC"). SPC was incorporated on 7 September, 1992 in the PRC with limited liability and is principally engaged in offshore petroleum exploration, development, production and sales in the South Yellow Sea and East China Sea areas. The issued and paid up capital of SPC is RMB900,000,000.

	Group	
	2001	2000
	RMB'000	RMB'000
Investment at cost-unlisted	**270,000**	270,000
Accumulated share of profits	**290,990**	222,027
Dividends received	**(99,000)**	(21,000)
	461,990	471,027

The directors are of the opinion that the underlying value of the investment in the associated company is not less than the carrying amount of the associated company as at 31 December, 2001.

16. SHORT-TERM INVESTMENTS

As at 31 December, 2001, short-term investments mainly represented investments in liquidity funds and were stated at fair value at the balance sheet date.

Details were as follows:

	Group		Company	
	2001	2000	**2001**	2000
	RMB'000	RMB'000	**RMB'000**	RMB'000
Liquidity funds	**7,675,622**	–	**7,675,622**	–
Corporate bonds	**1,177,991**	–	**1,177,991**	–
Common stock	**42,191**	300,000	**42,191**	–
	8,895,804	300,000	**8,895,804**	–

Investment income for the year is summarised as follows:

	2001	2000
	RMB'000	RMB'000
Interest	**21,344**	–
Dividends	**123,213**	–
Realised gains on investments	**32,297**	–
Unrealised gains on investments	**43,796**	–
	220,650	–

NOTES TO THE FINANCIAL STATEMENTS

17. ACCOUNTS RECEIVABLE, NET

	Group	
	2001	2000
	RMB'000	RMB'000
Trade receivables	**1,204,907**	1,931,883
Less: Allowance for doubtful accounts	**(10,727)**	(15,693)
	1,194,180	1,916,190

The customers are required to make payment within 30 days after the delivery of oil and gas. As at 31 December, 2001, substantially all the accounts receivable were aged within six months.

18. INVENTORIES AND SUPPLIES

	Group	
	2001	2000
	RMB'000	RMB'000
Materials and supplies	**428,991**	448,536
Oil in tanks	**198,346**	178,328
	627,337	626,864

NOTES TO THE FINANCIAL STATEMENTS

19. LONG-TERM BANK LOANS

As at 31 December, 2001, long-term bank loans of the Group were used primarily to finance the development of oil and gas properties and to meet working capital requirements.

	Interest rate and final maturity	Group 2001 RMB'000	Group 2000 RMB'000
RMB denominated bank loans	Floating prevailing market rate adjusted annually with maturities through 2006	**670,000**	675,000
	Fixed interest rate at 5.94% per annum through 2005	**66,270**	75,270
US$ denominated bank loans	Floating LIBOR rate with maturities through 2003	**1,177,761**	310,429
	Floating prevailing rate for six months foreign currency loans quoted by domestic banks, with maturities through 2003	**–**	1,475,157
	Fixed interest rate of 9.15% per annum with maturities through 2006	**827,660**	827,810
Japanese Yen denominated bank loans	Fixed interest rate ranging from 2.35% to 5.15% per annum, with maturities through 2007	**1,745,848**	2,382,711
		4,487,539	5,746,377
Less: current portion		**(1,231,840)**	(997,533)
		3,255,699	4,748,844

As at 31 December, 2001, LIBOR was approximately 2.0% (2000: 6.2%).

As at 31 December, 2001, all the bank loans of the Group were unsecured and approximately RMB991,537,000 (2000: RMB1,475,157,000) of the outstanding borrowings were guaranteed by CNOOC.

The maturities of long-term bank loans are as follows:

	Group 2001 RMB'000	Group 2000 RMB'000
Balances due:		
– Within one year	**1,231,840**	997,533
– After one year but within two years	**794,593**	1,280,876
– After two years but within three years	**462,564**	837,064
– After three years but within four years	**483,364**	504,976
– After four years but within five years	**1,231,423**	525,776
	4,203,784	4,146,225
– More than five years	**283,755**	1,600,152
	4,487,539	5,746,377
Amount due within one year shown under current liabilities	**(1,231,840)**	(997,533)
	3,255,699	4,748,844

NOTES TO THE FINANCIAL STATEMENTS

19. LONG-TERM BANK LOANS (CONT'D)

Supplemental information with respect to long-term bank loans:

	Balance at year end	Weighted average interest rate at year end	Maximum amount outstanding during the year	Average amount outstanding during the year*	Weighted average interest rate during the year**
	RMB'000	%	RMB'000	RMB'000	%
For the year ended 31 December					
2001	4,487,539	5.03	5,746,377	5,116,958	5.66
2000	5,746,377	6.28	8,908,583	7,017,601	6.18

* The average amount outstanding is computed by dividing the total of outstanding principal balances as at 1 January and 31 December by 2.

** The weighted average interest rate is computed by dividing the total of weighted average interest rates as at 1 January and 31 December by 2.

20. ACCOUNTS PAYABLE

As at 31 December, 2001, substantially all the accounts payable were aged within six months.

21. OTHER PAYABLES AND ACCRUED LIABILITIES

	2001	2000
	RMB'000	RMB'000
Accrued payroll and welfare payable	**132,773**	84,136
Accrued expenses	**434,766**	288,873
Advance from customers	**86,301**	30,640
Other payables	**159,306**	254,007
	813,146	657,656

22. BALANCES WITH PARENT COMPANY AND RELATED COMPANIES

Except for RMB1,660,000,000 payable to CNOOC as at 31 December, 2000 which bore interest at 2.5% per annum, all other balances with CNOOC and related companies were unsecured, non-interest bearing and repayable on demand.

	Group		**Company**	
	2001	2000	**2001**	2000
	RMB'000	RMB'000	**RMB'000**	RMB'000
Due to parent company				
– Advances from CNOOC	**(125,493)**	(122,497)	**–**	–
– Debt payable to CNOOC for pension liabilities	**–**	(1,660,000)	**–**	–
	(125,493)	(1,782,497)	**–**	–

NOTES TO THE FINANCIAL STATEMENTS

23. DISMANTLEMENT AND SITE RESTORATION ALLOWANCE

Dismantlement and site restoration allowance represents the estimated costs of dismantling offshore oil platforms and abandoning oil and gas properties. Dismantlement and site restoration allowance has been classified under long-term liabilities. The details of the dismantlement and site restoration allowance were as follows:

	Group	
	2001	2000
	RMB'000	RMB'000
Total anticipated costs	**2,962,004**	2,757,902
Total costs accrued	**1,598,130**	1,507,763

24. SHARE CAPITAL

	Number of shares	Share capital
		HK$'000
Authorised:		
Ordinary shares of HK$0.10 each		
At 31 December, 2001 and 2000	15,000,000,000	1,500,000

	Number of shares	Share capital	Share capital
		HK$'000	Equivalent of RMB'000
Issued and fully paid:			
Ordinary shares of HK$0.10 each			
At 1 January, 2000	6,000,000,000	600,000	641,561
Issue of shares to corporate investors (i)	557,575,755	55,758	59,620
At 31 December, 2000	6,557,575,755	655,758	701,181
Ordinary shares of HK$0.10 each			
At 1 January, 2001	6,557,575,755	655,758	701,181
Issue of shares during the initial public offering (ii)	1,656,589,900	165,659	175,797
At 31 December, 2001	8,214,165,655	821,417	876,978

(i) According to the subscription agreements dated 17 March, 2000, 31 May, 2000 and 28 June, 2000, the Company issued in total 557,575,755 new shares to eight unaffiliated entities at US$0.825 per share ("Private Placements") for aggregate net proceeds of approximately RMB3,769,664,000, after deducting expenses of approximately RMB39,136,000.

NOTES TO THE FINANCIAL STATEMENTS

24. SHARE CAPITAL (CONT'D)

(ii) The Company completed its initial public offering in 2001 and the details were as follows:

- issued 1,442,426,000 shares of HK$0.10 each at HK$6.01 per share and the shares and in the form of ADSs were listed on the Stock Exchange of Hong Kong Limited ("Hong Kong Stock Exchange") and the New York Stock Exchange on 28 February, 2001 and 27 February, 2001, respectively; and
- issued 214,163,900 shares of HK$0.10 each at HK$6.01 per share on 23 March, 2001 upon the exercise of an over-allotment option by the underwriters of the global offering.

The net proceeds from the initial public offering (including the exercise of the over-allotment option) amounted to approximately RMB10,101,564,000, after deducting expenses of approximately RMB288,058,000.

25. SHARE OPTION SCHEME

The Company has a share option scheme which provides for the grant of options to the Company's senior management. Under this share option scheme, the remuneration committee of the Company's board of directors will from time to time propose for board approval the recipient of and number of shares underlying each option. The scheme provides for issuance of options exercisable for shares granted under this scheme and the pre-global offering share option scheme as described below not exceeding 10% of the total number of the Company's outstanding shares, excluding shares issued upon exercise of options granted under the scheme from time to time.

The exercise price of an option will be determined by the board of directors at its discretion upon the grant date, as long as the price will not be less than a specified minimum which is the higher of:

- the nominal value of the shares; and
- 80% of the average of the closing prices of shares on the Hong Kong Stock Exchange for the five trading days immediately preceding the date of grant of the option on which there are dealings in shares on the Hong Kong Stock Exchange.

On 27 August, 2001, the board of directors approved under the above stock option scheme to grant options of 8,820,000 shares, and the exercise price is HK$6.16 per share. Options granted under this scheme may be exercised, in whole or in part, in accordance with the following vesting schedule:

- one-third of the shares subject to the option shall vest on the first anniversary of the date of the grant;
- one-third of the shares subject to the option shall vest on the second anniversary of the date of the grant; and
- one-third of the shares subject to the option shall vest on the third anniversary of the date of the grant.

On 4 February, 2001, the Company adopted a pre-global offering share option scheme. Under this scheme, options of an aggregate of 4,620,000 shares were granted to the senior management on 12 March, 2001. The exercise price is HK$5.95 per share. Options granted under this scheme will be exercisable, in whole or in part, in accordance with the following vesting schedule:

- 50% of the shares underlying the option shall vest 18 months after the date of the grant, and
- 50% of the shares underlying the option shall vest 30 months after the date of the grant.

Outstanding options under the two options plans described above will remain in force for a maximum of ten years from the grant date.

NOTES TO THE FINANCIAL STATEMENTS

25. SHARE OPTION SCHEME (CONT'D)

No options have been exercised since the date of grant and up to the date when the board of directors approved the financial statements.

26. RESERVES

Movements in reserves were as follows:

	Group					
	Share premium	**Revaluation reserves**	**Cumulative translation reserve**	**Statutory reserve**	**Retained earnings**	**Total**
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Balances at 1 January, 2000	7,124,955	170,598	–	100,874	345,813	7,742,240
Surplus on revaluation of properties (Note 13)	–	104,073	–	–	–	104,073
Foreign currency translation difference	–	–	(6,350)	–	–	(6,350)
Net profit for the year	–	–	–	–	10,296,600	10,296,600
Appropriation to statutory reserve	–	–	–	847,464	(847,464)	–
Dividends (Note 11)	–	–	–	–	(6,426,424)	(6,426,424)
Net proceeds from Private Placements (Note 24 (i))	3,710,483	–	–	–	–	3,710,483
Balances at 1 January, 2001	10,835,438	274,671	(6,350)	948,338	3,368,525	15,420,622
Foreign currency translation difference	–	–	702	–	–	702
Net profit for the year	–	–	–	–	7,957,631	7,957,631
Appropriation to statutory reserve	–	–	–	587,022	(587,022)	–
Dividends (Note 11)	–	–	–	–	(871,194)	(871,194)
Net proceeds from issue of ordinary shares (Note 24(ii))	9,925,767	–	–	–	–	9,925,767
Balances at 31 December, 2001	20,761,205	274,671	(5,648)	1,535,360	9,867,940	32,433,528

Included in retained earnings is an amount of RMB311,990,000 (2000: 222,027,000), being the retained earnings attributable to an associated company.

The application of the share premium account is governed by Section 48B of the Hong Kong Companies Ordinance.

The translation reserves and revaluation reserves have been established and will be dealt with in accordance with the accounting policies adopted for foreign currency translation and the revaluation of land and buildings.

NOTES TO THE FINANCIAL STATEMENTS

26. RESERVES (CONT'D)

According to the laws and regulations of the PRC and articles of association of CNOOC China Limited, CNOOC China Limited is required to provide for certain statutory funds, namely, general reserve fund and staff and workers' bonus and welfare fund, which are appropriated from net profit and after making good losses from previous years, but before dividend distribution. CNOOC China Limited is required to allocate at least 10% of its net profit as reported in accordance with the generally accepted accounting principles in the PRC ("PRC GAAP") to the general reserve fund until the balance of such fund has reached 50% of its registered capital. Appropriation to staff and workers' bonus and welfare fund which is determined at the discretion of CNOOC China Limited's directors, is charged to expense as incurred under Hong Kong GAAP. The reserve fund can only be used, upon approval by the relevant authority, to offset against accumulated losses or increase capital. Staff and workers' bonus and welfare fund can only be used for special bonuses or collective welfare of employees, and assets acquired through this fund shall not be taken as assets of CNOOC China Limited.

As at 31 December, 2001, the general reserve fund appropriated amounted to RMB1,535,360,000 (2000: RMB948,338,000), representing approximately 15.4% (2000: 9.5%) of the total registered capital of CNOOC China Limited.

	Company		
	Share premium	**Retained earnings**	**Total**
	RMB'000	RMB'000	RMB'000
Balances at 1 January, 2000	7,124,955	–	7,124,955
Net profit for the year	–	6,443,844	6,443,844
Dividends (Note 11)	–	(6,426,424)	(6,426,424)
Net proceeds from Private Placements (Note 24(i))	3,710,483	–	3,710,483
Balances at 1 January, 2001	10,835,438	17,420	10,852,858
Net profit for the year	–	1,073,901	1,073,901
Dividends (Note 11)	–	(871,194)	(871,194)
Net proceeds from issue of ordinary shares (Note 24(ii))	9,925,767	–	9,925,767
Balances at 31 December, 2001	20,761,205	220,127	20,981,332

As at 31 December, 2001, the distributable profits of the Company amounted to approximately RMB220,127,000 (2000: RMB17,420,000).

27. RETIREMENT BENEFITS

All the Group's full-time employees in the PRC are covered by a government regulated pension, and are entitled to an annual pension equal to their basic salaries at their retirement dates. The PRC government is responsible for the pension liabilities to these retired employees. The Group is required to make annual contributions to the government-regulated pension at rates ranging from 9% to 22.5% of the employees' basic salaries.

The contribution to the PRC government pension plan for the year ended 31 December, 2001 amounted to approximately RMB6,392,000 (2000: RMB12,842,000).

The Company is required to provide mandatory provident fund at a rate of 5% of the basic salaries for all full time employees in Hong Kong. The related pension costs are expensed as incurred.

NOTES TO THE FINANCIAL STATEMENTS

28. RELATED PARTY TRANSACTIONS

Companies are considered to be related if one company has the ability, directly or indirectly, to control the other company or exercise significant influence over the other company in making financial and operating decisions. Companies are also considered to be related if they are subject to common control or common significant influence.

The Group has entered into several agreements with CNOOC and its affiliates, which govern the provision of materials, utilities and ancillary services, the provision of technical services, the provision of research and development services, the provision of bank guarantees and various other commercial arrangements.

(i) Provision of materials, utilities and ancillary services

CNOOC China Limited has entered into materials, utilities and ancillary services supply agreements with the affiliates of CNOOC. Under these agreements, the affiliates of CNOOC provide to CNOOC China Limited various materials, utilities and ancillary services for the term of three years from 9 September, 1999.

The materials, utilities and ancillary services are provided at:

– state-prescribed prices,
– where there is no state-prescribed price, market prices, including the local or national market prices or the prices at which CNOOC's affiliates previously provided the relevant materials, utilities and ancillary services to independent third parties, or
– where neither of the prices mentioned above is applicable, the cost to CNOOC's affiliates of providing the relevant materials, utilities and services, including the cost of sourcing or purchasing from third parties, plus a margin of not more than 5% before any applicable taxes.

(ii) Technical services

CNOOC China Limited has entered into technical service agreements with specialised companies formed by CNOOC. According to the agreements, the Group uses the technical services provided by these specialised companies, including:

– offshore drilling;
– ship tugging, oil tanker transportation and security services;
– well survey, well logging, well cementation and other related technical services;
– collection of geophysical data, ocean geological prospecting, and data processing; and
– design, construction, installation and test of offshore and onshore production facilities.

(iii) Research and development services

Under the terms of a general research and development services agreement with CNOOC's subsidiaries, China Offshore Oil Research Centre (the "Centre"), the Group pays the Centre for a term of three years from 9 September, 1999, an annual amount of RMB110,000,000, for the provision of the services, including:

– geophysical exploration services;
– seismic data processing;
– comprehensive exploration research services; and
– information technology services.

NOTES TO THE FINANCIAL STATEMENTS

28. RELATED PARTY TRANSACTIONS (CONT'D)

(iv) Lease agreements

The Group has entered into lease agreements with affiliates of CNOOC for the leasing of various office, warehouse and residential premises for a three-year term commencing 9 September, 1999. Lease charges are based on market rates.

(v) Sales of crude oil, condensate oil and liquefied petroleum gas

The Group sells crude oil, condensate oil and liquefied petroleum gas to CNOOC's affiliates which engage in the downstream petroleum business at the international market price. For the year ended 31 December, 2001, the total sales amounted to approximately RMB1,814,197,000 (2000: RMB507,677,000).

The following is a summary of significant recurring transactions carried out in the ordinary course of business between the Group and CNOOC and its affiliates.

	2001	2000
	RMB'000	RMB'000
Included in exploration costs:		
Provision for geological and geophysical services	**139,659**	55,295
Provision for research and development services	**89,999**	109,880
Provision for drilling services	**389,847**	106,150
Included in operating expenses:		
Provision for technological services	**44,044**	254,276
Provision for research and development services	**29,587**	51,853
Provision for oil transportation services	**68,399**	171,490
Provision for production related services	**579,207**	597,579
Provision for materials, utilities and ancillary services	**148,149**	163,828
Included in selling and administrative expenses:		
Rental for office lease	**45,524**	49,089
Provision for research and development services	**40,763**	–
Provision for other ancillary services	**87,557**	31,748
Included in interest income and expense		
Interest income from a related company	**–**	25
Interest expense to CNOOC	**8,415**	41,500
Capitalised under property, plant and equipment:		
Provision for oil and gas property construction services	**1,341,545**	865,549
Provision for drilling services	**285,834**	445,414
Provision for well measurement services	**97,633**	140,065

In addition to the recurring transactions described above, pursuant to a conditional agreement dated 27 August, 2001, the Group will acquire interests in certain oil and natural gas fields in the Xihu Trough in the East China Sea of the PRC from CNOOC for a total consideration of US$45,000,000. As at 31 December, 2001, the transaction has not been completed and the legal title of the reserves has not been passed to the Group. The amount paid was recorded as prepayments which is included in other current assets in the balance sheet.

NOTES TO THE FINANCIAL STATEMENTS

29. COMMITMENTS AND CONTINGENCIES

(i) Capital commitments

As at 31 December, 2001, the Group and the Company had the following capital commitments, principally for the construction and purchases of property, plant and equipment:

	2001	2000
	RMB'000	RMB'000
Contracted for	**1,606,700**	3,325,216
Authorised but not contracted for	**5,183,690**	7,729,113

As at 31 December, 2001, the Group had unutilised banking facilities amounted to approximately RMB7,599,371,000 (2000: RMB15,146,544,000) to finance development of oil and gas properties.

The Group had no significant contingent liabilities as at 31 December, 2001.

(ii) Research and development commitments

According to the research and development services agreement with the Centre, the Group agreed to pay the Centre for a term of three years from 9 September, 1999, an annual amount of RMB110,000,000 for provision of general geophysical exploration services, comprehensive exploration research services, information technology services and seismic data processing. As at 31 December, 2001, commitments for research and development services to be provided by the Centre amounted to approximately RMB83,382,500 (2000: RMB192,472,500).

(iii) Operating lease commitments

Operating lease commitments as at 31 December, 2001 amounted to approximately RMB94,079,000 (2000: RMB143,922,000) and were as follows:

	2001	2000
	RMB'000	RMB'000
Commitment due:		
– Within one year	**48,789**	49,843
– After one year but within two years	**45,290**	48,789
– After two years but within three years	**–**	45,290
	94,079	143,922

NOTES TO THE FINANCIAL STATEMENTS

29. COMMITMENTS AND CONTINGENCIES (CONT'D)

(iv) Commitment to invest in development of Australia's gas project

In August 2001, the Company signed a Memorandum of Understanding to explore the feasibility of acquiring an equity interest in oil and gas assets in a large natural gas field in Australia, and to develop the natural gas market in coastal China. In November 2001, the Company entered into a Heads of Agreement on a joint venture to develop Northwest Shelf gas in Australia. The Company agreed to co-invest in the development of Australia's Northwest Shelf gas project and to produce and process liquefied natural gas to sell to the China markets, subject to the joint venture successfully bidding for the contract to supply liquefied natural gas to an import facility in Guangdong Province, in which CNOOC, the parent company, has an equity interest.

(v) Financial instruments

As at 31 December, 2001, the Group had currency swap contracts with a financial institution to sell United States dollars in exchange for Japanese Yen in order to hedge against future repayments of certain Japanese Yen denominated loans. The hedged Japanese Yen loans bore interest at fixed rate of 4.5% per annum. The interest stipulated in the swap contract for the United States dollars was floating LIBOR rate.

The details are as follows:

	2001		2000	
	Notional contract amount	**Weighted average contractual exchange rate**	Notional contract amount	Weighted average contractual exchange rate
	(JPY'000)	**(JPY/US$)**	(JPY'000)	(JPY/US$)
Year				
2001	**–**	**–**	271,470	95.00
2002	**271,470**	**95.00**	271,470	95.00
2003	**271,470**	**95.00**	271,470	95.00
2004	**271,470**	**95.00**	271,470	95.00
2005	**271,470**	**95.00**	271,470	95.00
2006	**271,470**	**95.00**	271,470	95.00
2007	**271,470**	**95.00**	271,470	95.00

NOTES TO THE FINANCIAL STATEMENTS

30. NOTES TO CASH FLOW STATEMENT

(a) The reconciliation of profit before taxation to net cash inflow from operating activities is as follows:

	2001	2000
	RMB'000	RMB'000
Profit before taxation	**11,005,858**	12,222,676
Adjustments for:		
Depreciation, depletion and amortisation	**2,566,920**	2,577,882
Impairment losses related to property, plant and equipment	**99,675**	–
Recovery of doubtful accounts	**(4,966)**	(57,658)
Profit of an associated company	**(89,963)**	(218,326)
Loss on disposals and written off of property, plant and equipment	**456,827**	220,146
Dismantlement and site restoration allowance	**90,367**	103,569
Short-term investment income	**(220,650)**	–
Interest income	**(317,706)**	(236,624)
Interest expense	**116,634**	475,004
Exchange gain, net	**(261,305)**	(324,178)
Operating profit before working capital changes	**13,441,691**	14,762,491
Decrease in accounts receivable	**726,976**	1,146,613
Decrease (Increase) in inventories and supplies	**35,422**	(2,438)
Increase in other current assets	**(447,473)**	(39,386)
Increase (Decrease) in accounts payable and accrued liabilities	**379,233**	(1,440,278)
(Decrease) Increase in other taxes payable	**(110,867)**	2,701
Net cash inflow from operating activities	**14,024,982**	14,429,703

NOTES TO THE FINANCIAL STATEMENTS

30. NOTES TO CASH FLOW STATEMENT (CONT'D)

(b) Analysis of changes in financing during the year:

	Paid-in capital and share premium	Bank loans	Due to parent company	Due to related companies
	RMB'000	RMB'000	RMB'000	RMB'000
Balances at 1 January, 2000	7,766,955	9,102,789	1,614,130	296,829
Proceeds from short-term bank loans	–	339,423	–	–
Repayments of bank loans	–	(3,371,657)	–	–
Net proceeds from Private Placements	3,769,664	–	–	–
Net proceeds from loans	–	–	47,256	–
Net repayments of loans	–	–	–	(164,570)
Effect of changes in foreign exchange rates	–	(324,178)	–	–
Properties transferred from CNOOC	–	–	121,111	–
Balances at 1 January, 2001	11,536,619	5,746,377	1,782,497	132,259
Proceeds from short-term bank loans	–	2,500,000	–	–
Repayments of bank loans	–	(3,497,533)	–	–
Net proceeds from issue of ordinary shares	10,101,564	–	–	–
Net repayments of loans	–	–	(1,657,004)	–
Net proceeds from loans	–	–	–	25,564
Effect of changes in foreign exchange rates	–	(261,305)	–	–
Balances at 31 December, 2001	21,638,183	4,487,539	125,493	157,823

31. SEGMENT INFORMATION

(a) Business segments

The Group is involved in the upstream operating activities of the petroleum industry that comprise production sharing contracts with foreign partners, independent operations and trading business. These segments are determined primarily because the senior management makes key operating decisions and assesses performance of the segments separately. The accounting policies of the Group's segments are the same as those described in the principal accounting policies in Note 2. The Group evaluates performance based on profit or loss from operations before income taxes.

NOTES TO THE FINANCIAL STATEMENTS

31. SEGMENT INFORMATION (CONT'D)

An analysis by business segment is as follows:

	Independent operations		Production sharing contracts		Trading business		Unallocated		Eliminations		Total	
	2001	2000	**2001**	2000	**2001**	2000	**2001**	2000	**2001**	2000	**2001**	2000
	RMB'000	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000
TURNOVER												
Sales to external customers:												
Oil and Gas sales	**9,845,019**	9,283,228	**7,023,926**	8,859,606	**-**	-	**-**	-	**-**	-	**16,868,945**	18,142,834
Marketing revenues	**-**	-	**-**	-	**3,228,875**	5,802,504	**-**	-	**-**	-	**3,228,875**	5,802,504
Intersegment revenues	**-**	-	**691,843**	676,489	**-**	-	**-**	-	**(691,843)**	(676,489)	**-**	-
Other income	**558,368**	161,790	**123,312**	107,390	**-**	-	**40,057**	9,400	**-**	-	**721,737**	278,580
	10,403,387	9,445,018	**7,839,081**	9,643,485	**3,228,875**	5,802,504	**40,057**	9,400	**(691,843)**	(676,489)	**20,819,557**	24,223,918
RESULTS												
Operating expenses	**(1,183,252)**	(894,813)	**(1,145,878)**	(1,229,265)	**-**	-	**-**	-	**-**	-	**(2,329,130)**	(2,124,078)
Production taxes	**(525,454)**	(526,491)	**(355,544)**	(510,238)	**-**	-	**(2,770)**	-	**-**	-	**(883,768)**	(1,036,729)
Exploration costs	**(955,475)**	(523,633)	**(83,822)**	(29,236)	**-**	-	**-**	-	**-**	-	**(1,039,297)**	(552,869)
Depreciation, depletion and amortisation	**(1,531,184)**	(1,443,045)	**(1,035,736)**	(1,130,820)	**-**	-	**-**	(4,017)	**-**	-	**(2,566,920)**	(2,577,882)
Dismantlement and site restoration allowances	**(41,530)**	(49,145)	**(48,837)**	(54,424)	**-**	-	**-**	-	**-**	-	**(90,367)**	(103,569)
Impairment losses related to property, plant and equipment	**(60,907)**	-	**(38,768)**	-	**-**	-	**-**	-	**-**	-	**(99,675)**	-
Crude oil and product purchases	**-**	-	**-**	-	**(3,145,155)**	(5,774,254)	**-**	-	**691,843**	676,489	**(2,453,312)**	(5,097,765)
Selling and administrative expenses	**(35,686)**	(33,146)	**(100)**	(99)	**-**	-	**(579,603)**	(422,757)	**-**	-	**(615,389)**	(456,002)
Other	**(514,655)**	(133,976)	**-**	-	**-**	-	**(3,221)**	(83,623)	**-**	-	**(517,876)**	(217,599)
Interest income	**-**	-	**-**	-	**-**	-	**317,706**	236,624	**-**	-	**317,706**	236,624
Interest expense	**(69,437)**	(262,274)	**(13,871)**	(171,230)	**-**	-	**(33,326)**	(41,500)	**-**	-	**(116,634)**	(475,004)
Exchange gain, net	**-**	-	**-**	-	**-**	-	**235,409**	381,336	**-**	-	**235,409**	381,336
Investment income	**-**	-	**-**	-	**-**	-	**220,650**	-	**-**	-	**220,650**	-
Share of profit of an associated company	**-**	-	**-**	-	**-**	-	**89,963**	218,326	**-**	-	**89,963**	218,326
Non-operating income (loss), net	**18,267**	(221,442)	**-**	-	**-**	-	**16,674**	25,411	**-**	-	**34,941**	(196,031)
Provision for taxation	**-**	-	**-**	-	**-**	-	**(3,048,227)**	(1,926,076)	**-**	-	**(3,048,227)**	(1,926,076)
Net profit	**5,504,074**	5,357,053	**5,116,525**	6,518,173	**83,720**	28,250	**(2,746,688)**	(1,606,876)	**-**	-	**7,957,631**	10,296,600
OTHER INFORMATION												
Segment assets	**15,422,016**	15,592,100	**10,295,857**	9,829,861	**368,670**	-	**17,771,115**	6,704,417	**-**	-	**43,857,658**	32,126,378
Investment in equity method associate	**-**	-	**-**	-	**-**	-	**461,990**	471,027	**-**	-	**461,990**	471,027
Total assets	**15,422,016**	15,592,100	**10,295,857**	9,829,861	**368,670**	-	**18,233,105**	7,175,444	**-**	-	**44,319,648**	32,597,405
Segment liabilities	**4,254,418**	4,795,521	**3,372,175**	3,878,273	**106,862**	-	**3,275,687**	7,801,808	**-**	-	**11,009,142**	16,475,602
Capital expenditures	**1,922,074**	3,326,893	**2,398,601**	1,244,159	**-**	-	**18,063**	13,291	**-**	-	**4,338,738**	4,584,343

NOTES TO THE FINANCIAL STATEMENTS

31. SEGMENT INFORMATION (CONT'D)

(b) Geographical segments:

The Company is an oil and gas company engaged in the exploration, development and production of crude oil and natural gas offshore China. Approximately 87% of the total revenue of the Group is contributed by PRC customers, therefore, the Group's activities are conducted predominantly in the PRC. An analysis by geographical segment is as follows:

	PRC		Outside PRC		Total	
	2001	2000	**2001**	2000	**2001**	2000
	RMB'000	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000
External sales	**18,104,658**	17,559,042	**2,714,899**	6,664,876	**20,819,557**	24,223,918
Segment assets	**43,783,409**	32,432,338	**536,239**	165,067	**44,319,648**	32,597,405
Capital expenditures	**4,311,241**	4,566,554	**27,497**	17,789	**4,338,738**	4,584,343

(c) An analysis of sales to the major customers by segment is as follows:

	2001	2000
	RMB'000	RMB'000
Production sharing contracts		
China Petroleum & Chemical Corporation	**2,861,847**	1,850,239
PetroChina Company Limited	**1,126,127**	690,853
Castle Peak Power Company Limited	**1,205,649**	1,199,090
	5,193,623	3,740,182
Independent operations		
China Petroleum & Chemical Corporation	**3,420,685**	4,474,822
PetroChina Company Limited	**194,460**	767,576
	3,615,145	5,242,398
	8,808,768	8,982,580

32. CONCENTRATION OF CUSTOMERS

A substantial portion of the oil and gas sales of the Group is made to a small number of customers on an open account basis.

	2001	2000
	RMB'000	RMB'000
China Petroleum & Chemical Corporation	**6,282,532**	6,325,061
PetroChina Company Limited	**1,320,587**	1,458,429
Castle Peak Power Company Limited	**1,205,649**	1,199,090

33. SUBSEQUENT EVENTS

(i) On 18 January, 2002, CNOOC Southeast Asia Limited entered into a share purchase agreement to acquire shares and intercompany loans of nine subsidiaries of Repsol-YPF, S.A. The nine subsidiaries together hold a portfolio of operating and non-operating interests in oil and gas production sharing and technical assistance contracts in contract areas located offshore and onshore Indonesia. The aggregate consideration for the shares and intercompany loans is US$585,000,000. The assets to be acquired include a 65.3% interest in the Offshore Southeast Sumatra Contract Area production sharing contract, a 36.7% interest in the Offshore Northwest Java Contract Area production sharing contract, a 25.0% interest in the West Madura Offshore Block production sharing contract, a 50.0% interest in the Poleng Field technical assistance contract and a 16.7% interest in the Blora Block production sharing contract. The acquisition is expected to be completed on or before 30 September, 2002. The Company would act as guarantor of CNOOC Southeast Asia Limited's obligations under the acquisition.

(ii) Bond issue and establishment of CNOOC Finance (2002) Company

On 1 March, 2002, CNOOC Finance (2002) Limited, a company incorporated in the British Virgin Islands on 24 January, 2002 and a wholly owned subsidiary of the Company, issued US$500,000,000 principal amount of 6.375% guaranteed notes due 2012. The obligations of CNOOC Finance (2002) Limited in respect of the notes are unconditionally and irrevocably guaranteed by the Company.

(iii) Dividends

On 27 March, 2002, the board of directors proposed a final dividend of HK$0.15 per share, totaling HK$1,232,124,848 (Equivalent to RMB1,306,791,614) to its shareholders for the year ended 31 December, 2001. The proposed dividend distribution is subject to shareholders approval in their next meeting.

34. ADDITIONAL FINANCIAL INFORMATION

(i) Net current assets and total assets less current liabilities

As at 31 December, 2001, net current assets and total assets less current liabilities of the Group amounted to approximately RMB15,638,483,000 (2000: RMB704,228,000) and RMB39,927,972,000 (2000: RMB23,829,630,000), respectively.

(ii) Fair value of financial instruments

The carrying amounts of cash and cash equivalents, time deposits and short-term investments approximated fair value due to the short maturity of these instruments.

The estimated fair value of long-term bank loans based on current market interest rates for comparable instruments approximated their book value.

NOTES TO THE FINANCIAL STATEMENTS

35. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND U.S. GAAP

The accounting policies adopted by the Group conform to Hong Kong GAAP, which differ in certain respects from generally accepted accounting principles in the United States of America ("U.S. GAAP").

(a) Net profit and net equity

(i) Revaluation of land and buildings

The Group revalued certain land and buildings on 31 August, 1999 as part of the reorganisation. The Group has recorded the revaluation surplus on that date. On 31 December, 2000, the Group revalued such properties again and the related revaluation surplus of approximately RMB104,073,000 had been recorded on that date. Under Hong Kong GAAP, revaluation of property, plant and equipment is permitted and depreciation, depletion and amortisation are based on the revalued amount. Additional depreciation arising from the revaluation was approximately RMB9,156,000 for the year ended 31 December, 2001 (2000: RMB5,687,000). Under U.S. GAAP, property, plant and equipment is required to be stated at cost. Hence, no additional depreciation, depletion and amortisation from the revaluation is recognised under U.S. GAAP.

(ii) Short-term investments

According to Hong Kong GAAP, available-for-sale investments in marketable securities are measured at fair value and related unrealised holding gains and losses are included in current period earnings. According to U.S. GAAP, such investments are also measured at fair value and classified in accordance with Statement of Financial Accounting Standards ("SFAS") No. 115. Under U.S. GAAP, related unrealised gains and losses are excluded from current period earnings reported.

(iii) Impairment of long-lived assets

Under Hong Kong GAAP, impairment charges are recognised when a long-lived asset's carrying amount exceeds the higher of an asset's net selling price and value in use, which incorporates discounting the asset's estimated future cash flows.

Under U.S. GAAP, long-lived assets are assessed for possible impairment in accordance with SFAS No.121, "Accounting for the Impairment of Long-lived assets and for Long-lived Assets to Be Disposed Of". SFAS No.121 requires the Group to assess the need for an impairment of capitalised costs of proved oil and gas properties and the costs of wells and related equipment and facilities on a property-by-property basis. If an impairment is indicated based on undiscounted expected future cash flows, then an impairment is recognised to the extent that net capitalised costs exceed the estimated fair value of the property. Fair value of the property is estimated by the Group using the present value of future cash flows discounted at 10%. The impairments were determined based on the difference between the carrying value of the assets and the present value of future cash flows discounted at 10%. It is reasonably possible that a change in reserve or price estimates could occur in the near term and adversely impact management's estimate of future cash flows and consequently the carrying value of properties.

In addition, under Hong Kong GAAP, a subsequent increase in the recoverable amount of an asset is reversed to the income statement to the extent that an impairment loss on the same asset was previously recognised as an expense when the circumstances and events that led to the write-down or write-off cease to exist. The reversal is reduced by the amount that would have been recognised as depreciation had the write-off not occurred. Under U.S. GAAP, an impairment loss establishes a new cost basis for the impaired asset and the new cost basis should not be adjusted subsequently other than for further impairment losses.

NOTES TO THE FINANCIAL STATEMENTS

35. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND U.S. GAAP (CONT'D)

(a) Net profit and net equity (Cont'd)

For the year ended 31 December, 2001, there were no difference on the amounts of impairment losses recognised under Hong Kong GAAP and U.S. GAAP and no reversal of the recovery of previous impairment charges recorded under Hong Kong GAAP.

(iv) Stock compensation plans

As described in Note 25 to the financial statements, as of 31 December, 2001, the Group had two stock option plans. The Group applies Accounting Principles Board Opinion 25 and related Interpretations in accounting for these stock option plans. Accordingly, compensation costs that have been recognised for the stock option plans were RMB2,755,000 for the year ended 31 December, 2001. Had compensation costs for the Group's stock option plans been determined based on the fair value at the grant dates for awards under the plans consistent with the method of SFAS No. 123, the Group's net income and earnings per share for the year ended 31 December, 2001 would have been reduced to the pro forma amounts indicated below:

	As reported	Pro forma
Net income (RMB'000)	**7,920,236**	7,912,150
Earnings per share		
– Basic	**RMB1.00**	RMB1.00
– Diluted	**RMB1.00**	RMB1.00

Weighted average fair value of the options at the grant dates for awards under the plans was RMB3.10 per share which was estimated using the Black-Scholes model with the following assumptions: dividend yield of 2.0%, an expected life of 5 years; expected volatility of 44%; and risk-free interest rates of 5.25%.

Weighted average exercise price of the stock options was HK$6.09 per share.

Effects on net profit and net equity of differences between Hong Kong GAAP and U.S. GAAP are summarised below:

	Net profit	
	2001	2000
	RMB'000	RMB'000
As reported under Hong Kong GAAP	**7,957,631**	10,296,600
Impact of U.S. GAAP adjustments:		
– Reversal of additional depreciation, depletion and amortisation arising from the revaluation surplus on land and buildings	**9,156**	5,687
– Unrealised holding gains from available-for-sale investments in marketable securities	**(43,796)**	–
– Recognition of stock compensation cost	**(2,755)**	–
As restated under U.S. GAAP	**7,920,236**	10,302,287
Net income per share under U.S. GAAP		
– Basic	**RMB 1.00**	RMB 1.63
– Diluted	**RMB 1.00**	RMB 1.63

NOTES TO THE FINANCIAL STATEMENTS

35. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND U.S. GAAP (CONT'D)

(a) Net profit and net equity (Cont'd)

	Net Equity	
	2001	2000
	RMB'000	RMB'000
As reported under Hong Kong GAAP	**33,310,506**	16,121,803
Impact of U.S. GAAP adjustments:		
– Reversal of revaluation surplus on land and buildings	**(274,671)**	(274,671)
– Reversal of additional accumulated depreciation, depletion and amortisation charges arising from the revaluation surplus on land and buildings	**16,739**	7,583
As restated under U.S. GAAP	**33,052,574**	15,854,715

There are no significant GAAP differences that affect classifications within the balance sheet or income statement but do not affect net income or shareholders' equity.

(b) Statement of cash flows

The Group applies Hong Kong SSAP 15 "Cash Flow Statements". Its objectives and principles are similar to those set out in SFAS No. 95, "Statement of Cash Flows". The principal differences between the standards relate to classification. Under Hong Kong SSAP15, the Group presents its cash flows for (a) operating activities; (b) returns on investments and servicing of finance; (c) taxation; (d) investing activities; and (e) financing. Cash flows from taxation and returns on investments and servicing of finance would be included as operating activities under SFAS No. 95, with the exception of distributions, which under SFAS No. 95 would be classified as financing activities. Summarised cash flow data by operating, investing and financing activities in accordance with SFAS No. 95 are as follows:

	2001	2000
	RMB'000	RMB'000
Net cash inflow (outflow) from:		
– Operating activities	**11,759,457**	13,232,701
– Investing activities	**(11,366,434)**	(7,860,606)
– Financing activities	**3,204,074**	(3,454,350)
Changes in cash and cash equivalents	**3,597,097**	1,917,745
Cash and cash equivalents at beginning of year	**2,796,627**	878,882
Cash and cash equivalents at end of year	**6,393,724**	2,796,627

NOTES TO THE FINANCIAL STATEMENTS

35. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND U.S. GAAP (CONT'D)

(c) Comprehensive income

According to SFAS No. 130, it is required to include a statement of other comprehensive income for revenues and expenses, gains and losses that under U.S. GAAP are included in comprehensive income and excluded from net income.

	2001	2000
	RMB'000	RMB'000
Net income under U.S. GAAP	**7,920,236**	10,302,287
Other comprehensive income:		
Foreign currency translation adjustments	**702**	(6,350)
Unrealised gains on short-term investments	**43,796**	–
Comprehensive income under U.S. GAAP	**7,964,734**	10,295,937

Roll forward of accumulated other comprehensive income components are as follows:

	Foreign currency translation adjustments	**Unrealised gains on short-term investment**	**Accumulated other comprehensive income**
	RMB'000	RMB'000	RMB'000
Balance at 1 January, 2000	–	–	–
Current year change	(6,350)	–	(6,350)
Balance at 1 January, 2001	(6,350)	–	(6,350)
Current year change	702	43,796	44,498
Balance at 31 December, 2001	(5,648)	43,796	38,148

(d) Derivative instruments

The Group had a currency swap contract with a financial institution to sell United States dollars in exchange for Japanese Yen in order to hedge certain Japanese Yen denominated loan repayments in the future. In accordance with SFAS No. 133, the derivative contract was recorded as "other current liabilities" in the consolidated balance sheet at fair value. For the year ended 31 December, 2001, the Group recognised related changes in fair value, a loss of RMB29,134,000, and included the amount in "exchange gain, net" in the consolidated income statement. The adoption of SFAS No. 133 as at 1 January, 2001 had no impact on the Group's financial statements.

NOTES TO THE FINANCIAL STATEMENTS

35. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND U.S. GAAP (CONT'D)

(e) Use of estimates in the preparation of financial statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The most significant estimates pertain to proved oil and gas reserve volumes and the future development, dismantlement and abandonment costs as well as estimates relating to certain oil and gas revenues and expenses. Actual amounts could differ from those estimates and assumptions.

(f) Deferred income taxes

Under Hong Kong GAAP, the Group provides deferred taxes for timing differences only to the extent that it is probable that a liability or asset will crystallise in the foreseeable future. U.S. GAAP requires full provision for deferred taxes under the asset and liability method on all temporary differences.

For Hong Kong GAAP purposes, deferred taxes are provided using the liability method whereby it is calculated using tax rates estimated to be applicable when timing differences reverse.

For U.S. GAAP purposes, deferred tax assets and liabilities are recognised for the expected future tax consequences of existing differences between financial reporting and tax reporting bases of assets and liabilities, and loss or tax credit carryforwards using enacted tax rates expected to be in effect when these differences are realised. Valuation allowances are recorded for deferred tax assets for which it is more likely than not that such assets will be realised.

For the year ended 31 December, 2001, there was no difference on the amounts of deferred income taxes recognised under Hong Kong GAAP and U.S. GAAP.

(g) Segment reporting

The Group's segment information is based on the segmental operating results regularly reviewed by the Group's chief operating decision maker. The accounting policies used are the same as those used in the preparation of the Group's consolidated Hong Kong GAAP financial statements.

(h) Newly issued accounting standards

SFAS No. 141 "Business Combinations"

In June 2001, SFAS No. 141 "Business Combinations" was released. This statement addresses financial accounting and reporting for business combinations and requires that the purchase method of accounting to be used for all business combinations initiated or with the acquisition date after 30 June, 2001. The adoption of the statement is not expected to have a significant effect on the Group's financial statements.

NOTES TO THE FINANCIAL STATEMENTS

35. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND U.S. GAAP (CONT'D)

(h) Newly issued accounting standards (Cont'd)

SFAS No. 143 "Accounting for Asset Retirement Obligations"

On 15 August, 2001, SFAS No. 143 "Accounting for Asset Retirement Obligations" was released and will be effective for the fiscal years beginning after 15 June, 2002. This statement requires that the fair value of a liability for an asset retirement obligation be recognised in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalised as part of the carrying amount of the long-lived assets. Further under this statement, the liability is discounted and accretion expense is recognised using the credit-adjusted risk-free interest rate in effect when the liability was initially recognised.

According to the existing accounting policies adopted to prepare the financial statements, the Group estimates future dismantlement and site restoration costs for oil and gas properties with reference to the estimates provided from either internal or external engineers after taking into consideration the anticipated method of dismantlement and the extent of site restoration required in accordance with current legislation and industry practice. The Group provides for the future dismantlement and site restoration allowance using the unit of production method over the useful life of the related asset.

Adoption of the statement will likely result in increase in both costs of assets and total liabilities. The Group is currently assessing these matters and has not yet determined whether or the extent to which they will affect the financial statements.

SFAS No. 144 "Accounting for the Impairment or Disposal of Long-lived Assets"

In August 2001, SFAS No. 144 "Accounting for the Impairment or Disposal of Long-lived Assets" was released and will be effective for the fiscal years beginning after 15 December, 2001. This statement retains the requirements of SFAS No.121 to (a) recognise an impairment loss only if the carrying amount of a long-lived asset is not recoverable from its undiscounted cash flows and (b) measure an impairment loss as the difference between the carrying amount and fair value of the asset. This statement requires that a long-lived asset to be abandoned, exchanged for a similar productive asset, or distributed to owners in a spinoff be considered held and used until it is disposed of. The accounting model for long-lived assets to be disposed of by sale is used for all long-lived assets, whether previously held and used or newly acquired. That accounting model retains the requirement of SFAS No.121 to measure a long-lived asset classified as held for sale at the lower of its carrying amount or fair value less cost to sell and to cease depreciation. Therefore, discontinued operations are no longer measured on a net realisable value basis, and future operating losses are no longer recognised before they occur. The changes in this statement improve financial reporting by requiring that one accounting model be used for long-lived assets to be disposed of by sale, whether previously held and used or newly acquired, and by broadening the presentation of discontinued operations to include more disposal transactions.

The adoption of the statement is not expected to have a significant effect on the Group's financial statements.