Notes to Financial Statements

31 December 2003
(All amounts expressed in Renminbi unless otherwise stated)

1. CORPORATE INFORMATION

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 certain entities thereby creating a group comprising the Company and its subsidiaries. During the year, the Company and its subsidiaries (hereinafter collectively referred to as the "Group") were principally engaged in the exploration, development, production and sale of crude oil, natural gas and other petroleum.

In the opinion of the directors, the ultimate holding company is China National Offshore Oil Corporation ("CNOOC"), a company established in the PRC.

2. IMPACT OF NEW AND REVISED STATEMENTS OF STANDARD ACCOUNTING PRACTICE ("SSAPS")

The following new and revised SSAPs are effective for the first time for the current year's financial statements:

- SSAP 12 (Revised): "Income taxes"
- SSAP 35: "Accounting for government grants and disclosure of government assistance"

SSAP 12 (Revised) prescribes the basis for accounting for income taxes payable or recoverable, arising from the taxable profit or loss for the current period (current tax); and income taxes payable or recoverable in future periods, principally arising from taxable and deductible temporary differences and the carryforward of the unused tax losses (deferred tax).

The SSAP 12 (Revised) has had no significant impact for these financial statements on the amounts recorded for income taxes. However, the related note disclosures are now more extensive than previously required. These are detailed in note 14 to the financial statements and include a reconciliation between the accounting profit and the tax expense for the year.

SSAP 35 prescribes the accounting for government grants and other forms of government assistance.

The adoption of the SSAP 35 has had no significant impact for these financial statements.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

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

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2003. The results of subsidiaries acquired or disposed of during the year are consolidated from or to their effective dates of acquisition or disposal, respectively. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Subsidiaries

A subsidiary is a company in which the Company, directly or indirectly, controls more than half of its voting power or issued share capital or controls the composition of its board of directors.

The results of subsidiaries are included in the Company's income statement to the extent of dividends received and receivable. The Company's interests in subsidiaries are stated at cost less any impairment losses.

Associates

An associate is a company, not being a subsidiary or a jointly-controlled entity, in which the Group has a long term interest of generally not less than 20% of the equity voting rights and over which it is in a position to exercise significant influence.

The Group's share of the post-acquisition results and reserves of the associate is included in the consolidated income statement and consolidated reserves, respectively. The Group's proportionate interests in the associates are stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses. The results of the associate are included in the Company's income statement to the extent of dividend received and receivable.

Related parties

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Parties are also considered to be related if they are subject to common control or common significant influence. Related parties may be individuals or corporate entities.

Impairment of assets

An assessment is made whenever events or changes in circumstances indicate that there is any indication of impairment of any assets, or when there is any indication that an impairment loss previously recognised for an asset in prior years may no longer exist or may have decreased. If any such indication exists, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's value in use or its net selling price.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. An impairment loss is charged to the income statement in the period in which it arises, unless the asset is carried at a revalued amount, when the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however not to an amount higher than the carrying amount that would have been determined (net of any depreciation/amortisation), had no impairment loss been recognised for the asset in prior years.

A reversal of an impairment loss is credited to the income statement in the period in which it arises, unless the asset is carried at a revalued amount, when the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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. Impairment of initial acquisition costs is recognised based on exploratory experience and management judgement. Upon discovery of commercial reserves, acquisition costs are transferred to proved properties. The costs of drilling and equipping successful exploratory wells, all development costs, including those renewals and betterments which extend the economic lives of the assets, and the borrowing costs arising from borrowings used to finance the development of oil and gas properties before they are substantially ready for production are capitalised. The costs of unsuccessful exploratory wells and all other exploration costs are expensed as incurred.

Exploratory wells are evaluated for economic viability within one year of completion. Exploratory wells that discover potentially economic reserves in areas where major capital expenditure will be required before production would begin and when the major capital expenditure depends upon successful completion of further exploratory work remain capitalised and are reviewed periodically for impairment.

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 developed 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.

Capitalised acquisition costs of proved properties are amortised by the unit-of-production method on a property-by-property basis computed based on the total estimated units of proved reserves.

The Group estimates future dismantlement 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 required in accordance with current legislation and industry practices. The associated cost is capitalised and the liability is discounted and an accretion expense is recognised using the credit-adjusted risk-free interest rate in effect when the liability is initially recognised.

(ii) Land and buildings

Land and buildings represent the onshore buildings and the land use rights and 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 the valuation of each asset over its expected useful life, ranging from 30 to 50 years.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(iii) Vehicles and office equipment

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

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

The gain or loss on disposal or retirement of property, plant and equipment recognised in the income statement is the difference between the net sales proceeds and the carrying amount of the relevant asset. Any revaluation reserve relating to the fixed asset is transferred to retained earnings as a reserve movement.

Research and development costs

All research costs are charged to the income statement as incurred.

Development expenditure (other than relating to oil and gas properties discussed above) incurred on projects is capitalised and deferred only when the projects are clearly defined; the expenditure is separately identifiable and can be measured reliably; there is reasonable certainty that the projects are technically feasible and have commercial value. Development expenditure which does not meet these criteria is expensed when incurred. No development costs were capitalised during the year.

Trade and other receivables

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

Short term investments

Short term investments are investments in debt and equity securities not intended to be held on a continuing basis and are stated at their fair values at the balance sheet date, on an individual investment basis. The gains or losses arising from changes in the fair value of a security are credited or charged to the income statement in the period in which they arise.

Inventories and supplies

Inventories consist primarily of oil and supplies consist mainly of items for repairs 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 based on estimated selling prices less any estimated costs to be incurred to completion and disposal. Supplies are capitalised to property, plant and equipment when used for renewals and betterments of oil and gas properties and have resulted in an increase in the future economic values of oil and gas properties or are recognised as expenses when used.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are payable on demand and form an integral part of the Group's cash management. For the purpose of the balance sheet, cash and cash equivalents comprise cash on hand and at banks, and term deposits with maturities of three months or less which are not restricted to use.

Provisions

A provision is recognised when a present obligation (legal or constructive) has arisen as a result of a past event and it is probable that a future outflow of resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation.

When the effect of discounting is material, the amount recognised for a provision is the present value at the balance sheet date of the future expenditures expected to be required to settle the obligation. The increase in the discounted present value amount arising from the passage of time is included in finance costs in the income statement.

Provisions for dismantlement are made based on the present value of the future costs expected to be incurred, on a property-by-property basis, in respect of the Group's expected dismantlement and abandonment costs at the end of the related oil exploration and recovery activities.

Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the income statement or in equity if it relates to items that are recognised in same or a different period directly in equity.

Deferred tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred tax liabilities are recognised for all taxable temporary differences:

- except where the deferred tax liability arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

- in respect of taxable temporary differences associated with investments in subsidiaries and associates, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, and the carryforward of unused tax assets and unused tax losses can be utilised:

- except where the deferred tax asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income tax (continued)

- in respect of deductible temporary differences associated with investments in subsidiaries and associates, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised. Conversely, previously unrecognised deferred tax assets are recognised to the extent that it is probable that sufficient taxable profit will be available to allow all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantially enacted at the balance sheet date.

Revenue recognition

Revenue is recognised when it is probable that the economic benefits will flow to the Group and when the revenue can be measured reliably, on the following bases:

(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 that are lifted and sold on behalf of the PRC government. Sales 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 results 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 at year end oil prices. Settlement will be in kind when the liftings are equalised or in cash when production ceases.

The Group has entered into a gas sales contract with a customer which contains take-or-pay clauses. The clauses require 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 records any deficiency payments as deferred revenue which is included in other payables until any make-up gas is taken by the customer or the expiry of the contract.

(ii) Marketing revenues

Marketing revenues represent sales of oil purchased from the foreign partners under the production sharing contracts and revenues from the trading of oil through the Company's subsidiary in Singapore. The title, together with the risks and rewards of the ownership of such oil purchased from the foreign partners, is 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.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Revenue recognition (continued)

(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 taking into account the effective yield on the assets.

(v) Dividend income

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

Retirement and termination benefits

The Group provides defined contribution plans based on local laws and regulations for full-time employees in the PRC and other countries in which it operates. The plans provide for contributions ranging from 5% to 22.5% of employees' basic salaries. The Group's contributions to these defined contribution plans are charged to expense in the year to which they relate.

Share option schemes

The Company operates share option schemes for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. The financial impact of share options granted under the share option schemes is not recorded in the Company's or the Group's balance sheet until such time as the options are exercised, and no charge is recorded in the income statement or balance sheet for their cost. Upon the exercise of share options, the resulting shares issued are recorded by the Company as additional share capital at the nominal value of the shares, and the excess of the exercise price per share over the nominal value of the shares is recorded by the Company in the share premium account. Options which are cancelled prior to their exercise date, or which lapse, are deleted from the register of outstanding options.

Dividends

Final and final special dividends proposed by the directors are classified as a separate allocation of retained earnings within the capital and reserves section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Interim and interim special dividends are simultaneously proposed and declared, because the Company's memorandum and articles of association grant the directors the authority to declare interim dividends. Consequently, interim dividends are recognised immediately as a liability when they are proposed and declared.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, i.e. assets that necessarily take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the cost of those assets. The capitalisation of such borrowing costs ceases when the assets are substantially ready for their intended use or sale.

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.

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.

Foreign currencies

The books and records of the Company and its subsidiary in China are maintained in Renminbi ("RMB"). Foreign currency transactions are recorded at the applicable exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the applicable rates of exchange ruling at that date. Exchange differences are dealt with in the income statement.

On consolidation, the financial statements of overseas subsidiaries are translated into RMB using the net investment method. The income statements of overseas subsidiaries are translated into RMB at the weighted average exchange rates for the year, and their balance sheets are translated into RMB at the exchange rate ruling at the balance sheet date. The resulting translation differences are included in the cumulative translation reserve.

For the purpose of the consolidated cash flow statement, the cash flows of overseas subsidiaries are translated into RMB at the exchange rates ruling at the dates of the cash flows. Frequently recurring cash flows of overseas subsidiaries which arise throughout the year are translated into RMB at the weighted average exchange rates for the year.

Repairs, maintenance and overhaul costs

Repairs, maintenances and overhaul costs are normally charged to the income statement as operating expenses in the period in which they are incurred.

Financial instruments

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 terms.

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 are disclosed when an inflow of economic benefits is probable.

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.

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.

4. ACQUISITIONS

(i) During the year, the Company acquired from British Petroleum ("BP") an equivalent of 12.5% stake in the proposed joint venture known as the Tangguh LNG Project of Indonesia ("Tangguh LNG Project") for approximately US$275 million through the acquisition of certain interests in production sharing contracts ("PSCs") which was effective as at 1 January 2003 (the "Tangguh Acquisition"). The Tangguh LNG Project comprises three PSC areas: the Berau PSC, the Muturi PSC and the Wiriagar PSC. The Tangguh LNG Project partners have signed a conditional 25-year Liquefied Natural Gas ("LNG") Supply Contract (the "LNG Supply Contract") to provide up to 2.6 million tonnes per annum of LNG to the Fujian LNG terminal project in the PRC, beginning in 2007. The Company completed the Tangguh Acquisition on 8 February 2003. CNOOC has an equity interest in the Fujian LNG terminal project.

In addition, a repurchase agreement (the "Repurchase Agreement") was entered into whereby put options and call options are granted to the Company and the sellers, respectively, to sell or to repurchase the interests in the above-mentioned PSCs. The options are exercisable if:

(1) the LNG Supply Contract is terminated due to the non-satisfaction of the conditions precedent to the LNG Supply Contract on or before 31 December 2004; or

(2) the LNG Supply Contract is otherwise legally ineffective on or before 31 December 2004.

4. ACQUISITIONS (CONTINUED)

The exercise prices of the options are determined based on the original consideration paid plus adjustments stipulated in the Repurchase Agreement.

The consideration paid of approximately US$275 million (equivalent to approximately RMB2,276,578,000) and subsequent cash calls paid are included as a prepayment in property, plant and equipment as at 31 December 2003.

(ii) In addition, the Company increased its interest in Qinhuangdao 32-6, a PSC oilfield in Bohai Bay, from 51% to 75.5% by acquiring the 24.5% interest of BP China Exploration and Production Company for a cash consideration of US$150 million, plus working capital adjustments . The acquisition was completed in July 2003.

(iii) The Company also acquired the remaining 49% interest in Liuhua 11-1, a PSC oilfield in Southern China, from BP China Exploration and Production Company and Kerr-McGee China Petroleum Limited, for a total cash consideration of US$40 million, plus working capital adjustments. The acquisition was completed in July 2003.

(iv) Pursuant to a conditional agreement dated 27 August 2001, the Group finalised the agreement to acquire a 30% interest in certain oil and gas fields in the Xihu Trough in the East China Sea of the PRC from CNOOC. The total consideration of US$45 million was paid in 2001 and the transaction was completed in August 2003.

(v) During the year, the Company invested RMB450 million in CNOOC Finance Corporation Limited ("CNOOC Finance"), a share treasury operation of its parent company, China National Offshore Oil Corporation and other affiliated group companies. The Company's investment represents 31.8% share of the registered capital of CNOOC Finance. The consideration was paid in full on 31 December 2003.

5. PRODUCTION SHARING CONTRACTS

PRC

For production sharing contracts in the PRC, the foreign parties to the contracts ("foreign partners") are normally 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.

After the initial exploration stage, 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 as mutually agreed by both participants 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.

After the Group exercises its 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 either the exploration costs incurred by its foreign partners or the foreign partners' share of development costs and revenues and expenses from such operations.

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5. PRODUCTION SHARING CONTRACTS (CONTINUED)

PRC (continued)

Part of the Group's annual gross production of oil and gas in the PRC is distributed to the PRC government as settlement of royalties which are payable 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. 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 priority allocations is first distributed to the PRC government as government 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 either 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.

Overseas

The Group and the other partners to the production sharing contracts in Indonesia are required to bear all exploration, development and operating costs according to their respective participating interests. Exploration, development and operating costs which qualify for recovery can be recovered according to the production sharing formula after commercial discoveries are made and production begins.

The Group's net interest in the production sharing contracts in Indonesia consists of its participating interest in the properties covered under the relevant production sharing contracts, less oil and gas distributed to the Indonesian government and the domestic market obligation.

6. SEGMENT INFORMATION

The Group is organised on a worldwide basis into three major operating segments. Segment information is presented by way of two segment formats: (i) on a primary reporting basis, by business segment; and (ii) on a secondary segment reporting basis, by geographical segment.

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 on consolidation.

(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 Group evaluates performance based on profit or loss from operations before income taxes.

6. SEGMENT INFORMATION (CONTINUED)

(a) Business segments (continued)

The following tables present revenues, profit and certain assets, liabilities and expenditures information for the Group's business segments.

	Independent operations		Production sharing contracts		Trading business		Unallocated		Eliminations		Consolidated	
Segment revenue	**2003**	2002	**2003**	2002	**2003**	2002	**2003**	2002	**2003**	2002	**2003**	2002
	RMB'000	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000	**RMB'000**	RMB'000
Sales to external customers:												
Oil and gas sales	**12,040,587**	10,318,549	**16,076,244**	13,460,745	**-**	-	**-**	-	**-**	-	**28,116,831**	23,779,294
Marketing revenues	**-**	-	**-**	-	**12,398,661**	2,377,469	**-**	-	**-**	-	**12,398,661**	2,377,469
Intersegment revenues	**-**	-	**3,730,797**	1,023,547	**-**	-	**-**	-	**(3,730,797)**	(1,023,547)	**-**	-
Other income	**8,468**	43,513	**424,493**	133,108	**-**	-	**1,820**	40,431	**-**	-	**434,781**	217,052
Total	**12,049,055**	10,362,062	**20,231,534**	14,617,400	**12,398,661**	2,377,469	**1,820**	40,431	**(3,730,797)**	(1,023,547)	**40,950,273**	26,373,815
Segment results												
Operating expenses	**(1,579,004)**	(1,268,360)	**(2,933,805)**	(2,506,974)	**-**	-	**-**	-	**-**	-	**(4,512,809)**	(3,775,334)
Production taxes	**(626,897)**	(556,583)	**(611,701)**	(466,466)	**-**	-	**-**	-	**-**	-	**(1,238,598)**	(1,023,049)
Exploration costs	**(590,541)**	(1,241,759)	**(257,531)**	(76,564)	**-**	-	**-**	-	**-**	-	**(848,072)**	(1,318,323)
Depreciation, depletion and amortisation	**(1,855,983)**	(1,635,131)	**(2,786,770)**	(2,384,401)	**-**	-	**-**	-	**-**	-	**(4,642,753)**	(4,019,532)
Dismantlement	**(96,206)**	(72,751)	**(71,120)**	(53,388)	**-**	-	**-**	-	**-**	-	**(167,326)**	(126,139)
Crude oil and product purchases	**-**	-	**(3,730,797)**	(1,023,547)	**(12,295,238)**	(2,326,338)	**-**	-	**3,730,797**	1,023,547	**(12,295,238)**	(2,326,338)
Selling and administrative expenses	**(62,247)**	(38,548)	**(666,369)**	(553,537)	**-**	-	**(483,907)**	(414,455)	**-**	-	**(1,212,523)**	(1,006,540)
Other	**(36,406)**	-	**(313,826)**	(30,866)	**-**	-	**-**	-	**-**	-	**(350,232)**	(30,866)
Interest income	**-**	-	**14,302**	3,831	**-**	-	**169,274**	144,039	**-**	-	**183,576**	147,870
Interest expense	**(60,358)**	(62,081)	**(20,817)**	(17,100)	**-**	-	**(273,765)**	(215,611)	**-**	-	**(354,940)**	(294,792)
Exchange gain/(losses), net	**-**	-	**124**	794	**-**	-	**(6,870)**	(114,608)	**-**	-	**(6,746)**	(113,814)
Short term investment income	**-**	-	**-**	-	**-**	-	**123,483**	193,277	**-**	-	**123,483**	193,277
Share of profit of an associate	**-**	-	**-**	-	**-**	-	**220,263**	165,387	**-**	-	**220,263**	165,387
Non-operating income/(expense), net	**-**	(85,414)	**-**	(220)	**-**	-	**314,968**	14,255	**-**	-	**314,968**	(71,379)
Tax	**-**	-	**-**	-	**-**	-	**(4,627,836)**	(3,541,416)	**-**	-	**(4,627,836)**	(3,541,416)
Net profit	**7,141,413**	5,401,435	**8,853,224**	7,508,962	**103,423**	51,131	**(4,562,570)**	(3,728,701)	**-**	-	**11,535,490**	9,232,827
Other segment information												
Segment assets	**36,087,581**	16,899,455	**26,821,223**	22,446,447	**2,629,009**	630,704	**6,848,849**	20,581,722	**-**	-	**72,386,662**	60,558,328
Investments in associates	**-**	-	**-**	-	**-**	-	**1,117,640**	537,377	**-**	-	**1,117,640**	537,377
Total assets	**36,087,581**	16,899,455	**26,821,223**	22,446,447	**2,629,009**	630,704	**7,966,489**	21,119,099	**-**	-	**73,504,302**	61,095,705
Segment liabilities	**(3,554,720)**	(3,033,327)	**(12,620,113)**	(10,200,032)	**(2,173,828)**	(21,665)	**(8,419,109)**	(7,272,193)	**-**	-	**(26,767,770)**	(20,527,217)
Capital expenditure	**5,960,071**	2,770,640	**2,264,625**	4,396,933	**-**	-	**46,868**	37,652	**-**	-	**8,271,564**	7,205,225

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6. SEGMENT INFORMATION (CONTINUED)

(b) Geographical segments

In determining the Group's geographical segments, revenues and results are attributed to the segments based on the location of the Group's customers, and assets are attributed to the segments based on the location of the Group's assets.

The Group mainly engaged in the exploration, development and production of crude oil and natural gas in offshore China. Approximately 62% of the total revenue of the Group is contributed by PRC customers, and therefore, the Group's activities are conducted predominantly in the PRC. Any activities outside PRC are conducted in Indonesia and Singapore. An analysis by geographical segment is as follows:

	PRC		Outside PRC		Total	
	2003 RMB'000	2002 RMB'000	**2003 RMB'000**	2002 RMB'000	**2003 RMB'000**	2002 RMB'000
External sales	**25,416,466**	22,781,301	**15,533,807**	3,592,514	**40,950,273**	26,373,815
Segment assets	**61,357,931**	50,647,452	**12,146,371**	10,448,253	**73,504,302**	61,095,705
Capital expenditure	**7,727,171**	6,453,798	**544,393**	751,427	**8,271,564**	7,205,225

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

	2003 RMB'000	2002 RMB'000
Production sharing contracts		
China Petroleum & Chemical Corporation	**3,848,361**	3,707,536
PetroChina Company Limited	**1,446,169**	1,187,571
Castle Peak Power Company Limited	**841,285**	1,247,639
	6,135,815	6,142,746
Independent operations		
China Petroleum & Chemical Corporation	**3,126,708**	3,183,341
	9,262,523	9,326,087

7. OIL AND GAS SALES

	2003 RMB'000	2002 RMB'000
Gross sales	**30,556,967**	26,086,646
Royalties	**(478,454)**	(464,113)
PRC government share oil	**(1,961,682)**	(1,843,239)
	28,116,831	23,779,294

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8. MARKETING PROFIT

	2003 RMB'000	2002 RMB'000
Marketing revenues	**12,398,661**	2,377,469
Crude oil and product purchases	**(12,295,238)**	(2,326,338)
	103,423	51,131

9. PROFIT BEFORE TAX

The Group's profit before tax is arrived at after (crediting)/charging:

	2003 RMB'000	2002 RMB'000
Crediting:		
Interest income on bank deposits	**(183,576)**	(147,870)
Interest income on investments	**(28,752)**	(52,739)
Dividend income on investments	**(46,140)**	(76,633)
Realised gains on investments	**(27,088)**	(26,940)
Unrealised gains on investments	**(21,503)**	(36,965)
Short term investment income	**(123,483)**	(193,277)
Charging:		
Auditors' remuneration	**5,790**	4,500
Staff costs		
– Wages, salaries and allowances	**393,165**	390,376
– Labour costs paid to contractors	**542,292**	660,029
– Pension scheme contributions and termination benefits	**95,147**	53,392
Depreciation, depletion and amortisation	**4,643,364**	4,032,970
Less: Amount included in inventories	**(611)**	(13,438)
	4,642,753	4,019,532
Operating lease rentals	**72,708**	54,157
Loss on disposal of property, plant and equipment	**21**	85,202
Repairs and maintenance	**608,603**	521,561
Research and development costs	**165,793**	167,354

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10. SELLING AND ADMINISTRATIVE EXPENSES

	2003 RMB'000	2002 RMB'000
Salary and staff benefits	**393,165**	390,376
Utility and office expenses	**90,801**	100,502
Transportation and entertainment	**74,218**	64,319
Rentals and maintenance	**107,310**	75,738
Management fee	**219,771**	151,860
Selling expenses	**30,686**	38,548
Provision for inventory obsolescence	**8,745**	–
Other	**287,827**	185,197
	1,212,523	1,006,540

11. INTEREST EXPENSES

	2003 RMB'000	2002 RMB'000
Interest on bank loans which are:		
– wholly repayable within five years	**81,539**	177,156
– not wholly repayable within five years	**–**	–
Interest on long term guaranteed notes	**391,005**	215,028
Other borrowing costs	**34,933**	12,426
Total interest	**507,477**	404,610
Less: Amount capitalised in property, plant and equipment (note 18)	**(245,783)**	(187,714)
	261,694	216,896
Other finance costs:		
Increase in discounted amount of provisions arising from the passage of time (note 30)	**93,246**	77,896
	354,940	294,792

The interest rates used for interest capitalisation represented the cost of capital from raising the related borrowings and varied from 4.1% to 9.15% per annum for the year ended 31 December 2003.

12. DIRECTORS' REMUNERATION

Directors' remuneration for the year disclosed pursuant to the Listing Rules and Section 161 of the Companies Ordinance is as follows:

	2003	2002
	RMB'000	RMB'000
Fees for executive directors	**–**	–
Fees for non-executive directors	**1,000**	890
Other emoluments for executive directors		
– Basic salaries and allowances	**6,327**	6,654
– Bonuses	**2,100**	1,109
– Pension scheme contributions	**207**	214
– Other	**1,425**	1,500

The number of directors whose remuneration fell within the following bands is as follows:

	Number of directors	
	2003	2002
Nil to HK$1,000,000	**6**	8
HK$1,000,001- HK$1,500,000	**1**	–
HK$1,500,001- HK$2,000,000	**–**	2
HK$2,000,001- HK$2,500,000	**–**	1
HK$2,500,001- HK$3,000,000	**2**	–
	9	11

There was no arrangement under which a director waived or agreed to waive any remuneration during the year.

No value in respect of the share options granted during the year (note 31) has been charged to the income statement, or is otherwise included in the above directors' remuneration disclosures.

13. FIVE HIGHEST PAID EMPLOYEES

Details of the remuneration of the five highest paid employees during the year are as follows:

	2003	2002
	RMB'000	RMB'000
Basic salaries and allowances	**15,857**	8,227
Bonuses	**2,550**	2,518
Pension scheme contributions	**1,332**	505
Other	**2,743**	2,732
Number of directors	**–**	4
Number of employees	**5**	1

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13. FIVE HIGHEST PAID EMPLOYEES (CONTINUED)

The number of highest paid employees whose remuneration fell within the following bands is as follows:

	Number of employees 2003	2002
Nil to HK$1,000,000	**–**	1
HK$1,500,001- HK$2,000,000	**–**	2
HK$2,500,001- HK$3,000,000	**–**	1
HK$3,500,001- HK$4,000,000	**3**	–
HK$4,500,001- HK$5,000,000	**–**	1
HK$5,000,001- HK$5,500,000	**2**	–
	5	5

No value in respect of the share options granted during the year (note 31) has been charged to the income statement, or is otherwise included in the above five highest paid employees disclosures.

14. TAX

(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 operated. The Company 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 the 3% local surcharge and is subject to an enterprise income tax of 30% under the prevailing tax rules and regulations.

The Company's subsidiary in Singapore, China Offshore Oil (Singapore) International Pte Ltd., is subject to income tax at rates of 10% and 22%, for its oil trading activities and other income generating activities, respectively. The Company's subsidiaries owning interests in oil and gas properties in Indonesia along the Malacca Strait are subject to corporate and dividend tax at the rate of 44%. The Company's subsidiaries owning interests in oil and gas properties in Indonesia acquired from Repsol YPF, S.A. are subject to corporate and dividend tax at the rate of 43.125% instead of the standard rate of 48% after the application of the Malaysian Tax Treaty as recognised by the Indonesian tax authorities. All of the Company's other subsidiaries are not subject to any income taxes in their respective jurisdictions for the year presented.

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

	2003 RMB'000	2002 RMB'000
Overseas income taxes		
– Current	**654,988**	406,493
– Deferred	**(179,134)**	26,094
PRC enterprise income tax		
– Current	**3,623,157**	2,786,938
– Deferred	**528,825**	321,891
Total tax charge for the year	**4,627,836**	3,541,416

14. TAX (CONTINUED)

(i) Income tax (continued)

A reconciliation of the statutory PRC enterprise income tax rate to the effective income tax rate of the Group is as follows:

	2003	2002
	%	%
Statutory PRC enterprise income tax rate	**33.0**	33.0
Effect of tax exemption granted	**(3.0)**	(3.0)
Effect of different tax rates for overseas subsidiaries	**(0.1)**	0.2
Tax credit from government	**(1.5)**	(2.1)
Tax effect on other permanent differences	**0.2**	(0.4)
Effective income tax rate	**28.6**	27.7

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

	2003	2002
	RMB'000	RMB'000
Deferred tax assets		
– Provision for retirement and termination benefits	**114,758**	86,602
– Provision for dismantlement	**775,725**	671,796
– Provision for impairment of property, plant and equipment and write-off of unsuccessful exploratory drillings	**759,454**	933,636
	1,649,937	1,692,034
Deferred tax liabilities		
– Accelerated amortisation allowance for oil and gas properties	**(7,433,133)**	(7,833,190)
Net deferred tax liabilities	**(5,783,196)**	(6,141,156)

As at 31 December 2003, there was no significant unrecognised deferred tax liability (2002: Nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries and associates as the Group had no liability to additional tax should such amounts be remitted.

There are no income tax consequences attaching to the payment of dividends by the Company to its shareholders.

SSAP 12 (Revised) was adopted during the year, as further explained in note 2 to the financial statements. There was no material impact on the Group's financial statements upon the adoption of the SSAP.

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14. TAX (CONTINUED)

(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; and
– business tax of 3% to 5% on other income.

15. NET PROFIT AFTER TAX

The net profit after tax for the year ended 31 December 2003 dealt with in the financial statements of the Company, was approximately RMB5,031,491,000 (2002: RMB4,990,207,000) (see note 32).

16. DIVIDENDS

	2003	2002
	RMB'000	RMB'000
Dividends paid:		
Final dividend 2002/2001 – HK$0.15/HK$0.15 per ordinary share	**1,307,408**	1,306,740
Special final dividend 2002/2001 – HK$0.15/Nil per ordinary share	**1,307,408**	–
Interim dividend 2003/2002 – HK$0.14/HK$0.11 per ordinary share	**1,220,132**	958,314
Special interim dividend 2003/2002 – HK$0.18/Nil per ordinary share	**1,568,741**	–
	5,403,689	2,265,054

The directors have recommended a final dividend of HK$0.12 per ordinary share totaling HK$985,699,879 (approximately equivalent to RMB 1,050,460,000) and a special final dividend of HK$0.18 per ordinary share totaling HK$1,478,549,818 (approximately equivalent to RMB 1,575,691,000) for the year ended 31 December 2003.

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 conditions 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 companies. 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 American Depositary Share ("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.

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17. EARNINGS PER SHARE

The calculations of basic and diluted earnings per share are based on:

	2003	2002
Earnings		
Net profit attributable to shareholders, used in the basic and diluted earnings per share calculations	**RMB 11,535,490,000**	RMB 9,232,827,000

	2003	2002
Shares		
Weighted average number of ordinary shares in issue during the year used in basic earnings per share calculation	**8,214,165,655**	8,214,165,655
Weighted average number of ordinary shares assumed issued at no consideration on deemed exercise of all share options outstanding during the year	**7,902,164**	5,119,729
Weighted average number of ordinary shares used in diluted earnings per share calculation	**8,222,067,819**	8,219,285,384

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18. PROPERTY, PLANT AND EQUIPMENT, NET

Movements in the property, plant and equipment of the Group are as follows:

Group

	2003				2002
	Oil and gas properties RMB'000	**Land and buildings** RMB'000	**Vehicles and office equipment** RMB'000	**Total** RMB'000	**Total** RMB'000
Cost or valuation:					
At beginning of the year	**58,321,780**	**824,781**	**93,720**	**59,240,281**	43,575,228
Purchase price allocation adjustment	**(707,623)**	**–**	**–**	**(707,623)**	–
Additions	**8,538,930**	**–**	**46,868**	**8,585,798**	7,457,609
Acquisitions (including prepayments)	**4,025,441**	**–**	**–**	**4,025,441**	8,646,487
Disposals and write-off	**(39,798)**	**–**	**(604)**	**(40,402)**	(440,022)
Exchange realignment	**(902)**	**–**	**(82)**	**(984)**	979
End of year	**70,137,828**	**824,781**	**139,902**	**71,102,511**	59,240,281
Analysis of cost or valuation:					
At cost	**70,137,828**	**–**	**139,902**	**70,277,730**	58,415,500
At revaluation	**–**	**824,781**	**–**	**824,781**	824,781
	70,137,828	**824,781**	**139,902**	**71,102,511**	59,240,281
Accumulated depreciation, depletion and amortisation:					
At beginning of the year	**(23,059,600)**	**(81,027)**	**(27,834)**	**(23,168,461)**	(19,010,881)
Depreciation provided during the year	**(4,779,271)**	**(25,374)**	**(6,045)**	**(4,810,690)**	(4,159,109)
Disposals	**–**	**–**	**584**	**584**	1,777
Exchange realignment	**(234)**	**–**	**91**	**(143)**	(248)
End of year	**(27,839,105)**	**(106,401)**	**(33,204)**	**(27,978,710)**	(23,168,461)
Net book value:					
Beginning of year	**35,262,180**	**743,754**	**65,886**	**36,071,820**	24,564,347
End of year	**42,298,723**	**718,380**	**106,698**	**43,123,801**	36,071,820
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	**70,137,828**	**550,110**	**139,902**	**70,827,840**	58,965,610
Accumulated depreciation, depletion and amortisation	**(27,839,105)**	**(71,348)**	**(33,204)**	**(27,943,657)**	(23,142,565)
	42,298,723	**478,762**	**106,698**	**42,884,183**	35,823,045

18. PROPERTY, PLANT AND EQUIPMENT, NET (CONTINUED)

During the year, the Company finalised the purchase price allocation for the oil and gas properties acquired as a result of the acquisition of the subsidiaries from Repsol YPF, S.A. in April 2002 and an adjustment of approximately RMB707 million was made to reduce the fair value of the oil and gas properties acquired with a corresponding adjustment made to reduce the deferred tax liabilities.

The consideration paid of US$275 millions (equivalent to approximately RMB 2,276,578,000) and subsequent cash paid of approximately US$19,200,000 for the Tangguh LNG Project (see note 4(i)) has been included as a prepayment in oil and gas properties as at 31 December 2003.

Included in the current year additions represented an amount of RMB 245,783,000 (2002: RMB 187,714,000) in respect of interest capitalised in property, plant and equipment.

The property, plant and equipment of the Company mainly comprised office equipment and were stated at cost less accumulated depreciation. The movements in property, plant and equipment of the Company are as follows:

Company

	2003	2002
	RMB'000	RMB'000
Cost:		
Beginning of the year	**5,764**	5,751
Additions	**69**	13
End of year	**5,833**	5,764
Accumulated depreciation:		
Beginning of the year	**(5,108)**	(3,003)
Charge for the year	**(454)**	(2,105)
End of year	**(5,562)**	(5,108)
Net book value:		
Beginning of year	**656**	2,748
End of year	**271**	656

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

The land and buildings were revalued by an independent valuer, 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. Certain land use rights which were previously granted by the PRC government at no cost.

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19. INTERESTS IN SUBSIDIARIES

	Company	
	2003	2002
	RMB'000	RMB'000
Unlisted shares, at cost	**7,766,971**	7,766,963
Loan to a subsidiary	**4,138,290**	4,138,290
Due from subsidiaries	**12,245,592**	6,039,152
Due to subsidiaries	**(7,588,883)**	(3,946,247)
	16,561,970	13,998,158

The loan due to a subsidiary is unsecured and bear interest at 7.084% per annum. The maturities of the balance are as follows:

	2003	2002
	RMB'000	RMB'000
Balances due:		
– Within five years	**–**	1,489,082
– More than five years	**4,138,290**	2,649,208
	4,138,290	4,138,290

The amounts due from/to subsidiaries are unsecured, interest-free and are repayable on demand.

Particulars of the principal subsidiaries are as follows:

Name	Place and date of incorporation	Nominal value of issued ordinary share capital	Percentage of equity attributable to the Company	Principal activities
Directly held subsidiaries:				
CNOOC China Limited	Tianjin, the PRC 15 September 1999	RMB15 billion	100%	Offshore petroleum exploration, development, production and sale in the PRC
CNOOC International Limited	British Virgin Islands 23 August 1999	US$2	100%	Investment holding
China Offshore Oil (Singapore) International Pte., Ltd.	Singapore 14 May 1993	S$3 million	100%	Sale and marketing of petroleum outside of the PRC
CNOOC Finance (2002) Limited	British Virgin Islands 24 January 2002	US$1,000	100%	Bond issuance
CNOOC Finance (2003) Limited	British Virgin Islands 2 April 2003	US$1,000	100%	Bond issuance

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19. INTERESTS IN SUBSIDIARIES (CONTINUED)

Name	Place and date of incorporation	Nominal value of issued ordinary share capital	Percentage of equity attributable to the Company	Principal activities
Indirectly held subsidiaries*:				
Malacca Petroleum Limited	Bermuda 2 November 1995	US$12,000	100%	Offshore petroleum exploration, development and production in Indonesia
OOGC America, Inc.	State of Delaware, United States of America 2 September 1997	US$1,000	100%	Investment holding
OOGC Malacca Limited	Bermuda 2 November 1995	US$12,000	100%	Offshore petroleum exploration, development and production in Indonesia
CNOOC Southeast Asia Limited	Bermuda 16 May 1997	US$12,000	100%	Investment holding
CNOOC ONWJ Ltd.	Labuan, F.T., Malaysia 27 March 2002	US$1	100%	Offshore petroleum exploration, development and production in Indonesia
CNOOC SES Ltd.	Labuan, F.T., Malaysia 27 March 2002	US$1	100%	Offshore petroleum exploration, development and production in Indonesia
CNOOC Poleng Ltd.	Labuan, F.T., Malaysia 27 March 2002	US$1	100%	Offshore petroleum exploration, development and production in Indonesia
CNOOC Madura Ltd.	Labuan, F.T., Malaysia 27 March 2002	US$1	100%	Offshore petroleum exploration, development and production in Indonesia
CNOOC Blora Ltd.	Labuan, F.T., Malaysia 27 March 2002	US$1	100%	Onshore petroleum exploration, development and production in Indonesia

* Indirectly held through CNOOC International Limited.

The above table lists the subsidiaries of the Company which, in the opinion of the directors, principally affected the results for the year or formed a substantial portion of the net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

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20. INVESTMENTS IN ASSOCIATES

Investments in associates represent (1) 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 sale in the South Yellow Sea and East China Sea areas. The issued and paid-up capital of SPC is RMB900 million; and (2) a 31.8% equity interest of CNOOC China Limited in CNOOC Finance Corporation Limited ("CNOOC Finance"). CNOOC Finance was incorporated on 13 May 2002 in the PRC with limited liability and is principally engaged in deposit-takings and money lending activities for the CNOOC Group. The issued and paid-up capital of CNOOC Finance is RMB1,415 million.

	Group	
	2003	2002
	RMB'000	RMB'000
Share of net assets	**1,117,640**	537,377

The directors are of the opinion that the underlying value of the investments in associates is not less than the carrying amount of the associates as at 31 December 2003.

21. ACCOUNTS RECEIVABLE, NET

The Group's trading terms with its customers are mainly on credit, except for new customers, where payment in advance is normally required. The customers are required to make payment within 30 days after the delivery of oil and gas. As at 31 December 2003 and 2002, substantially all the accounts receivable were aged within six months.

22. INVENTORIES AND SUPPLIES

	Group	
	2003	2002
	RMB'000	RMB'000
Materials and supplies	**809,827**	585,431
Oil in tanks	**291,844**	263,174
Less: Provision for inventories obsolescence	**(8,745)**	–
	1,092,926	848,605

23. SHORT TERM INVESTMENTS

As at 31 December 2003, short term investments mainly represented investments in liquidity funds and were stated at fair value at the balance sheet date. Details of the short term investments were as follows:

	Group		Company	
	2003	2002	**2003**	2002
	RMB'000	RMB'000	**RMB'000**	RMB'000
Unlisted investments, at fair value:				
Liquidity funds	**3,767,179**	5,537,191	**3,769,179**	5,537,191
Corporate bonds	**1,876,880**	951,876	**1,876,880**	951,876
Common stock	**40,274**	42,211	**40,274**	42,211
	5,684,333	6,531,278	**5,684,333**	6,531,278

24. ACCOUNTS PAYABLE

As at 31 December 2003 and 2002, substantially all the accounts payable were aged within six months.

25. OTHER PAYABLES AND ACCRUED LIABILITIES

	Group	
	2003	2002
	RMB'000	RMB'000
Accrued payroll and welfare payable	**149,532**	149,501
Provision for retirement and termination benefits	**290,955**	211,321
Accrued expenses	**926,867**	793,823
Advances from customers	**10,864**	60,101
Royalties payable	**205,113**	208,214
Other payables	**372,452**	289,448
	1,955,783	1,712,408

As at 31 December 2003, deferred revenue from gas sales contracts amounted to approximately RMB1,208,000 (2002: RMB5,582,000) and was included in other payables.

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26. LONG TERM BANK LOANS

As at 31 December 2003, the 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.

		Group	
		2003	2002
		RMB'000	RMB'000
	Interest rate and final maturity		
RMB denominated bank loans	Fixed interest rate at 5.94% per annum through to 2005	**–**	57,270
US$ denominated bank loans	Floating LIBOR rate with maturities through to 2003	**–**	259,907
	Fixed interest rate of 9.15% per annum with maturities through to 2006	**827,615**	827,730
Japanese Yen denominated bank	Fixed interest rate of 4.1% per annum with maturities through to 2007	**82,578**	93,704
		910,193	1,238,611
Less: Current portion of long term bank loans		**(20,618)**	(297,518)
		889,575	941,093

As at 31 December 2003, all the bank loans of the Group were unsecured and none (2002: RMB259,907,000) of the outstanding borrowings were guaranteed by CNOOC.

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

	Group	
	2003	2002
	RMB'000	RMB'000
Balances due:		
– Within one year	**20,618**	297,518
– After one year but within two years	**24,364**	27,541
– After two years but within three years	**846,471**	48,341
– After three years but within four years	**18,740**	846,471
– After four years but within five years	**–**	18,740
	910,193	1,238,611
Amount due within one year shown under current liabilities	**(20,618)**	(297,518)
	889,575	941,093

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26. LONG TERM BANK LOANS (CONTINUED)

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					
2003	910,193	8.69%	1,238,611	1,074,403	7.94%
2002	1,238,611	7.19%	4,487,539	2,863,075	6.11%

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

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

27. LONG TERM GUARANTEED NOTES

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 million of principal amount of 6.375% guaranteed notes due in 2012. The obligations of CNOOC Finance (2002) Limited in respect of the notes are unconditionally and irrevocably guaranteed by the Company.

On 21 May 2003, CNOOC Finance (2003) Limited, a company incorporated in the British Virgin Islands on 2 April 2003 and a wholly-owned subsidiary of the Company, issued US$200 million of principal amount of 4.125% guaranteed notes due in 2013 and US$300 million of principal amount of 5.500% guaranteed notes due in 2033. The obligations of CNOOC Finance (2003) Limited in respect of the notes are unconditionally and irrevocably guaranteed by the Company.

28. BALANCES WITH THE PARENT COMPANY

As at 31 December 2003 and 2002, the balances with CNOOC were unsecured, interest-free and were repayable on demand.

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29. RELATED PARTY TRANSACTIONS

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.

In addition to the transactions and balances detailed elsewhere in these financial statements, the Group had the following material transactions with related parties during the year:

	Notes	**2003**	2002
		RMB'000	RMB'000
Materials, utilities and ancillary services	(i)	**1,018,066**	789,167
Technical services	(ii)	**3,828,282**	3,279,596
Research and development services	(iii)	**83,280**	167,354
Lease and property management services	(iv)	**56,867**	54,421
Included in:			
Exploration expenses		**487,293**	593,059
Operating expenses		**1,176,601**	993,825
Selling and administrative expenses		**191,349**	190,449
Capitalised under property, plant and equipment		**3,131,252**	2,513,205

(i) 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.

The materials, utilities and ancillary services are provided at:

– state-prescribed prices; or

– where there is no state-prescribed price, at 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, at 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 certain affiliates of CNOOC. According to the agreements, the Group uses the technical services including:

– offshore drilling;

– ship tugging, oil tanker transportation and security services;

29. RELATED PARTY TRANSACTIONS (CONTINUED)

(ii) Technical services (continued)

- well survey, well logging, well cementation and other related technical services;
- collection of geophysical data, ocean geological prospecting, and data processing;
- platform fabrication service and maintenance; 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 subsidiary, China Offshore Oil Research Centre (the "Centre"), the Group pays the Centre for a term of three years from 31 December 2002, with an annual amount of RMB110 million In addition, the Group also pays the Centre for research and development for particular projects. The services include the following:

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

(iv) Lease and property management services

The Group has entered into lease and property agreements with the affiliates of CNOOC for the leasing of various office, warehouse and residential premises. The lease charges are based on the prevailing market rates.

(v) Sales of crude oil, condensated 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 2003, the total sales amounted to approximately RMB8,324,108,000 (2002: RMB4,361,852,000).

During the year, the Group placed certain deposits with CNOOC Finance Corporation Limited ("CNOOC Finance"), a subsidiary of CNOOC. CNOOC Finance is a non-bank finance company supervised by the People's Bank of China (the "PBOC") and the Company is one of its customers. In the PRC, deposit rate is set by PBOC which is applicable to all financial institutions. The interest rates offered by CNOOC Finance were the same as the rates promulgated by the PBOC which were applicable to account deposits with PRC banks or finance companies and ranged from 1.44% to 1.89% per annum. The deposits placed with CNOOC Finance as at 31 December 2003 amounted to approximately RMB3,898,000. As explained in note 4 to the financial statements, the Company also acquired a 31.8% interests in CNOOC Finance as at 31 December 2003.

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29. RELATED PARTY TRANSACTIONS (CONTINUED)

During the year, the Company, through its wholly-owned subsidiary, China Offshore Oil (Singapore) International Pte Ltd., imported oil into the PRC for trading, using CNOOC's import licence. For year ended 31 December 2003, the total sales to its customers through such arrangements amounted to approximately RMB1,470,832,000 (2002: Nil). The commission paid by the third party customers to CNOOC for the year amounted to approximately RMB 8,825,000 (2002: Nil).

30. PROVISION FOR DISMANTLEMENT

Provision for dismantlement represents the estimated costs of dismantling offshore oil platforms and abandoning oil and gas properties. The provision for dismantlement has been classified under long term liabilities. The associated cost is capitalised and the liability is discounted and an accretion expense is recognised during the credit-adjusted risk-free interest rate in effect when the liability is initially recognised. The current year income statement charge represents the amortisation charge on the dismantlement liabilities capitalised in accordance with SSAP 28 and is included in the accumulated depreciation, depletion and amortisation in note 18.

The details of the provision for dismantlement are as follows:

	Group	
	2003	2002
	RMB'000	RMB'000
At the beginning of year	**2,239,320**	1,909,041
Additions during the year and capitalised in oil and gas properties	**314,234**	252,383
Increase in discounted amount of provisions arising from the passage of time	**93,246**	77,896
End of year	**2,646,800**	2,239,320

31. SHARE CAPITAL

Shares

	Number of shares	**Share capital**
		HK$'000
Authorised:		
Ordinary shares of HK$0.10 each		
At 31 December 2003 and 2002	15,000,000,000	1,500,000

	Number of shares	**Share capital**	**Share capital equivalent of**
		HK$'000	RMB'000
Issued and fully paid:			
Ordinary shares of HK$0.10 each			
At 31 December 2003 and 2002	8,214,165,655	821,417	876,978

31. SHARE CAPITAL (CONTINUED)

Share options scheme

The Company has adopted share option schemes which provide for the grant for options to the Company's senior management. Under these share option schemes, the remuneration committee of the Company's board of directors will from time to time propose for the board's approval for the recipient of and number of shares underlying each option. These schemes provide for issuance of options exercisable for shares granted under these schemes 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 schemes from time to time.

On 4 February 2001, the Company adopted a pre-global offering share option scheme (the "Pre-Global Offering Share Option Scheme"). Pursuant to the Pre-Global Offering Share Option Scheme:

1. options for an aggregate of 4,620,000 shares have been granted;

2. the subscription price per share is HK$5.95; and

3. the period during which an option may be exercised is as follows:

   (a) 50% of the shares underlying the option shall vest 18 months after the date of the grant; and

   (b) 50% of the shares underlying the option shall vest 30 months after the date of the grant.

The exercise period for options granted under the Pre-Global Offering Share Option Scheme shall end not later than 10 years from 12 March 2001.

On 4 February 2001, the Company adopted a share option scheme (the "2001 Share Option Scheme") for the purposes of recognising the contribution that certain individuals had made to the Company and attracting and retaining the best available personnel to the Company. Pursuant to the 2001 Share Option Scheme:

1. options for an aggregate of 8,820,000 shares have been granted;

2. the subscription price per share is HK$6.16; and

3. the period during which an option may be exercised is follows:

   (a) one-third of the shares underlying the option shall vest on the first anniversary of the date of the grant;

   (b) one-third of the shares underlying the option shall vest on the second anniversary of the date of the grant; and

   (c) one-third of the shares underlying the option shall vest on the third anniversary of the date of the grant.

The exercise period for options granted under the 2001 Share Option Scheme shall end not later than 10 years from 27 August 2001.

In view of the amendments to the relevant provisions of the Listing Rules regarding the requirements of share option schemes of a Hong Kong listed company effective on 1 September 2001, no further options will be granted under the 2001 Share Option Scheme.

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31. SHARE CAPITAL (CONTINUED)

Share option scheme (continued)

In June 2002, the Company adopted a new share option scheme (the "2002 Share Option Scheme").

Under the 2002 Share Option Scheme, the directors of the Company may, at their discretion, invite employees, including executive directors, of the Company or any of its subsidiaries, to take up options to subscribe for shares in the Company. The maximum aggregate number of shares (including those that could be subscribed for under the Pre-Global Offering Share Option Scheme and the 2001 Share Option Scheme) which may be granted shall not exceed 10% of the total issued share capital of the Company. The maximum number of shares which may be granted under the 2002 Share Option Scheme to any individual in any 12-month period up to the next grant of share options shall not exceed 1% of the total issued share capital of the Company from time to time.

According to the 2002 Share Option Scheme, the consideration payable by a participant for the grant of an option will be HK$1.00. The subscription price of a share payable by a participant upon the exercise of an option will be determined by the directors at their discretion at the date of the grant, except that such price may not be set below a minimum price which is the highest of:

1. the nominal value of shares;

2. the average closing price of the shares on The Stock Exchange of Hong Kong Limited (the "HKSE") as stated in the HKSE's quotation sheets for the five trading days immediately preceding the date of the grant of the option; and

3. the closing price of the shares on the HKSE as stated in the HKSE's quotation sheet on the date of the grant of the option.

On 24 February 2003, the board of directors approved to grant options in respect of 8,410,000 shares to the Company's senior management under the 2002 Share Option Scheme. The exercise price for the options is HK$10.54 per share. The market price was HK$10.55 per share preceding the options granted. Options granted under the 2002 Share Option Scheme may be exercised, in whole or in part, in accordance with the following vesting schedule;

1. one-third of the shares underlying the option shall vest on the first anniversary of the date of the grant;

2. one-third of the shares underlying the option shall vest on the second anniversary of the date of the grant; and

3. one-third of the shares underlying the option shall vest on the third anniversary of the date of the grant.

The exercise period for options granted under the 2002 Share Option Scheme shall end not later than 10 years from the date on which the option is granted.

No options granted under the share option scheme and the pre-global offering share option scheme have been exercised since the date of the grant and up to the date when the board of directors approved the financial statements. The total number of options exercisable as of 31 December 2003 was 10,500,000.

32. RESERVES

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, the general reserve fund and staff and workers' bonus and welfare funds, 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 funds, which is determined at the discretion of CNOOC China Limited's directors, is expensed as incurred under Hong Kong GAAP. The general reserve fund can only be used, upon approval by the relevant authority, to offset against accumulated losses or increase capital. The 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 2003, the general reserve fund appropriated amounted to RMB3,050,489,000 (2002: RMB2,232,410,000), representing approximately 20.4% (2002: 22.3%) of the total registered capital of CNOOC China Limited.

Included in retained earnings is an amount of RMB577,640,000 (2002: RMB456,377,000), being the retained earnings attributable to an associate.

The cumulative translation reserves and revaluation reserves are accounted for in accordance with the accounting policies adopted for foreign currency translation and the revaluation of land and buildings.

Company	**Share premium account**	**Retained earnings**	**Total**
	RMB'000	RMB'000	RMB'000
Balances at 1 January 2002	20,761,205	220,127	20,981,332
Net profit for the year	–	4,990,207	4,990,207
Dividends (Note 16)	–	(2,265,054)	(2,265,054)
Balances at 1 January 2003	20,761,205	2,945,280	23,706,485
Net profit for the year	–	5,031,491	5,031,491
Dividends (Note 16)	–	(5,403,689)	(5,403,689)
Balances at 31 December 2003	20,761,205	2,573,082	23,334,287

As at 31 December 2003, the distributable profits of the Company amounted to approximately RMB 2,573,082,000 (2002: RMB2,945,280,000).

33. RETIREMENT AND TERMINATION 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 12% to 22.5% of the employees' basic salaries.

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33. RETIREMENT AND TERMINATION BENEFITS (CONTINUED)

The contribution made by the Group to the PRC government pension plan for the year ended 31 December 2003 amounted to approximately RMB15,513,000 (2002: RMB7,042,000).

The Company is required to make contributions to a defined contribution of a 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.

The Group provides retirement and termination benefits for all local employees in Indonesia in accordance with Indonesia labour law, and provides employee benefits to expatriate staff in accordance with the relevant employment contracts. The Group has adopted an accounting policy to record liabilities for the retirement and termination benefits. The provisions for retirement and termination benefits in Indonesia for the year ended 31 December 2003 amounted to approximately RMB79,634,000 (2002: RMB46,350,000).

34. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

(a) Reconciliation of profit before tax to cash generated from operations

	2003 RMB'000	2002 RMB'000
Profit before tax	**16,163,326**	12,774,243
Adjustments for:		
Interest income	**(183,576)**	(147,870)
Interest expense	**354,940**	294,792
Exchange losses, net	**6,746**	113,814
Share of profit of an associate	**(220,263)**	(165,387)
Short term investment income	**(123,483)**	(193,277)
Provision for inventory obsolescence	**8,745**	–
Depreciation, depletion and amortisation	**4,642,753**	4,019,532
Loss on disposal and write-off of property, plant and equipment	**39,818**	437,799
Dismantlement	**167,326**	126,139
Amortisation of discount of long term guaranteed notes	**11,276**	6,100
Operating cash flows before movements in working capital	**20,867,608**	17,265,885
(Increase)/decrease in accounts receivable	**(1,185,304)**	497,959
Increase in inventories and supplies	**(129,678)**	(20,211)
Decrease/(increase) in other current assets	**312,559**	(705,664)
Increase in amounts due from related companies	**(302,993)**	(276,771)
(Decrease)/increase in an amount due to the parent company	**(105,785)**	144,945
Increase in accounts payable, other payables and accrued liabilities	**1,448,645**	353,452
(Decrease)/increase in other taxes payable	**(4,772)**	73,551
Increase in amounts due to related companies	**242,631**	73,769
Cash generated from operations	**21,142,911**	17,406,915

34. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (CONTINUED)

(b) Acquisitions and prepayment

	2003 RMB'000
Acquisitions	
Net assets acquired:	
Property, plant and equipment, net	1,579,726
Other current assets	8,959
Inventories and supplies	122,777
Cash and bank balances	17,580
Accounts payable	(8,294)
Other payables and accrued liabilities	(47,983)
	1,672,765
Prepayment for Tangguh Project	2,445,715
Satisfied by:	
Cash	4,118,480

An analysis of the net outflow of cash and cash equivalents in respect of the acquisition and prepayment is as follows:

	2003 RMB'000
Cash consideration	4,118,480
Cash and bank balances acquired	(17,580)
Net outflow of cash and cash equivalents	4,100,900

In July 2003, the Group acquired a 24.5% interest in Qinhuangdao 32-6, a PSC oilfield in Bohai Bay and a 49% interest in Liuhua 11-1, a PSC oilfield in Southern China. Further details of these transactions are included in note 4 to the financial statements.

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35. COMMITMENTS

(i) Capital commitments

As at 31 December 2003, the Group and the Company had the following capital commitments, principally for the construction and purchase of property, plant and equipment:

	2003	2002
	RMB'000	RMB'000
Contracted for	**2,534,468**	1,715,173
Authorised, but not contracted for	**17,489,791**	9,060,722

As at 31 December 2003, the Group had unutilised banking facilities amounting to approximately RMB32,455,229,500 (2002: RMB31,646,389,000).

(ii) General research and development services commitments

The remaining commitments for research and development services to be provided by the Centre (note 29(iii)) as at 31 December 2003 amounted to approximately RMB220,000,000 (2002: RMB450,000,000).

(iii) Operating lease commitments

Operating lease commitments as at 31 December 2003 amounted to approximately RMB20,396,000(2002: RMB50,645,000) and were as follows:

	2003	2002
	RMB'000	RMB'000
Commitments due:		
– Within one year	**17,222**	47,017
– After one year but within two years	**3,174**	2,131
– After two years but within three years	**–**	1,497
	20,396	50,645

(iv) Commitment to invest in Australia's project

On 15 May 2003, the Company entered into an Equity Sale and Purchase Agreement and a Gas Production and Processing Agreement (the "Agreements") with the existing North West Shelf partners to acquire an interest in the upstream production and reserves of Australia's North West Shelf Project (the "NWS Project"). Under the Agreement, the Company will acquire an interest of approximately 5.3% in the NWS Project and a 25% stake in the China LNG Joint Venture, a new joint venture to be established within the NWS Project. According to the Agreements, the Company has the right to acquire further interests in the NWS Project should the final quantity of LNG committed under the LNG supply agreement to the facilities in Guangdong Province be increased. The total consideration of the acquisition is US$348 million, subject to certain conditions, including the LNG supply agreement to Guangdong becoming unconditional, being fulfilled. In addition, the Company will be required to make an upfront tariff payment relating to certain LNG processing facilities amounting to US$180 million. CNOOC has an equity interest in the Guangdong Province LNG project.

35. COMMITMENTS (CONTINUED)

(iv) Commitment to invest in Australia's project (continued)

On 23 December 2003, the Company signed a Deed of Amendment to the Equity Sale and Purchase Agreement and a Deed of Amendment to the Gas Production and Processing Agreements (the "Deeds") and agreed to pay US$483,577,000 representing a 90% deposit of the consideration and tariff payment, to the NWS Project participants by 2 January 2004. The payment was made by the Company on 2 January 2004 and such amount will be refunded to the Company if the acquisition is not completed by 30 June 2004.

(v) Commitment to invest in Gorgon Joint Venture

In October 2003, the Company entered into an agreement with the participants in Gorgon Joint Venture to place a significant volume of Gorgon LNG to supply the growing Chinese market. Subject to the completion of formal contracts, the Company will purchase a certain equity stake in the Gorgon gas development and its parent company, CNOOC, will arrange to purchase LNG directly from Gorgon.

(vi) Financial instruments

(a) Currency swap contracts

As at 31 December 2003, 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 against future repayments of certain Japanese Yen denominated loans. The hedged Japanese Yen loans bore interest at a fixed rate of 4.5% per annum. The interest stipulated in the swap contract for the United States dollars was the floating LIBOR rate.

The details are as follows:

	2003		2002	
	Notional contract amount (JPY'000)	**Weighted average contractual exchange rate (JPY/US$)**	Notional contract amount (JPY'000)	Weighted average contractual exchange rate (JPY/US$)
Year				
2003	–	–	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

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35. COMMITMENTS (CONTINUED)

(vi) Financial instruments (continued)

(b) Interest rate swap contracts

During the year, the Group also entered into interest rate swap agreements with three financial institution to partially hedge the fixed-rate debt for interest rate risk exposure management purposes with notional contract amount of US$200 million. The interest rate swap agreement utilised by the Company effectively modifies the Company's exposure to interest risk by converting the Company's fixed-rate debt to a floating rate. This agreement involves the receipt of fixed rate amounts in exchange for floating rate interest payments over the life of the agreement without an exchange of the underlying principal amount.

(c) 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 was approximately RMB1,064,895,000 as at 31 December 2003 (2002: RMB1,388,720,000).

The estimated fair value of long term guaranteed notes based on current market interest rates was approximately RMB8,304,647,000 as at 31 December 2003 (2002: RMB4,482,378,000).

36. 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. Details of the sales to these customers are as follows:

	2003	2002
	RMB'000	RMB'000
China Petroleum & Chemical Corporation	**6,975,069**	6,890,877
PetroChina Company Limited	**1,446,169**	1,187,571
Castle Peak Power Company Limited	**841,285**	1,247,639

37. ADDITIONAL FINANCIAL INFORMATION

As at 31 December 2003, net current assets and total assets less current liabilities of the Group amounted to approximately RMB19,956,331,000 and RMB64,197,772,000 (2002: RMB17,352,044,000 and RMB53,961,241,000), respectively.

As at 31 December 2003, net current assets and total assets less current liabilities of the Company amounted to approximately RMB7,649,024,000 and RMB24,211,265,000 (2001: RMB10,584,649,000 and RMB24,583,463,000), respectively.

38. SUBSEQUENT EVENTS

(i) On 27 January 2004, the Company proposed for a 1-for-5 stock split where each share in the Company will be split into five new shares. The Company will submit to shareholders for approval a proposal to subdivide each of the existing issued and unissued shares of HK$0.10 each in the capital of the Company into five shares of HK$0.02 each, and to increase the board lot size for trading on the Stock Exchange of Hong Kong Limited from 500 shares at HK$0.10 each to 1,000 subdivided shares of HK$0.02 each in the coming extraordinary general meeting. It is also proposed that upon the share subdivision proposal becoming effective, the ratio of the Company's American Depository Receipts (ADR) listed on the New York Stock Exchange will also be changed such that the ADR, which currently represents 20 shares of HK$0.10 each to 100 subdivided shares of HK$0.02 each.

(ii) On 2 February 2004, one of the Company's subsidiary signed a sale and purchase agreement with the BG Group to acquire a 20.767% interest in the Muturi Production Sharing Contract ("Muturi PSC") for a consideration of US$98.1 million pursuant to the exercise of its pre-emption rights. The purchase will increase the Company's interest in the "Muturi PSC" to 64.767%, and its interest in the Tangguh LNG Project will increase from 12.5% to 16.96%.

(iii) On 5 February 2004, the board of directors approved a grant of options in respect of 10,140,000 shares to the Company's senior management under the 2002 Share Option Scheme. The exercise price for the options is HK$15.76 per share. Options granted under the 2002 Share Option Scheme may be exercised, in whole or in part, in accordance with the following vesting schedule:

1. one-third of the shares underlying the option shall vest on the first anniversary of the date of the grant;

2. one-third of the shares underlying the option shall vest on the second anniversary of the date of the grant; and

3. one-third of the shares underlying the option shall vest on the third anniversary of the date of the grant.

The exercise period for options granted under the 2002 Share Option Scheme shall end not later than 10 years from the date on which the option is granted.

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39. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US 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 ("US GAAP").

(a) Net profit and net equity

(i) Revaluation of land and buildings

The Group revalued certain land and buildings on 31 August 1999 and 31 December 2000 and the related revaluation surplus was recorded on the respective dates. 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 for the year ended 31 December 2003 was approximately RMB9,156,000 (2002: RMB9,156,000). Under US GAAP, property, plant and equipment are required to be stated at cost. Accordingly, no additional depreciation, depletion and amortisation from the revaluation is recognised under US 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 the current period's earnings. According to US GAAP, such investments are also measured at fair value and classified in accordance with Statement of Financial Accounting Standards ("SFAS") No.115. Under US GAAP, related unrealised gains and losses on available-for-sale securities are excluded from the current period's earnings and included in other comprehensive income.

(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 US GAAP, long-lived assets are assessed for possible impairment in accordance with SFAS No.144, "Accounting for the impairment or disposal of long-lived assets". SFAS No. 144 requires the Group 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. SFAS No. 144 requires that a long-lived asset to be abandoned, exchanged for a similar productive asset, or distributed to owners in a spin-off be considered held and used until it is disposed of.

SFAS No. 144 also 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. The impairment was determined based on the difference between the carrying value of the assets and the present value of future cash flows. 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.

39. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (continued)

(a) Net profit and net equity (continued)

(iii) Impairment of long-lived assets (continued)

In addition, under Hong Kong GAAP, a subsequent increase in the recoverable amount of assets 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 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 US 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.

For the year ended 31 December 2003, there were no impairment losses recognised under Hong Kong GAAP and US GAAP.

(iv) Stock compensation schemes

As at 31 December 2003, the Company has three stock-based employee compensation plans, which are described more fully in Note 31. Prior to 2003, the Company accounted for those plans under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations. Since certain of the options granted under those plans had an exercise price below the market value of the underlying common stock on the date of grant, stock-based employee compensation costs of Rmb2,755,000 and Rmb5,632,000 for year ended 31 December 2001 and 2002, respectively, were reflected in previously reported results. During 2003, the Company adopted the fair value recognition provisions of FASB Statement No. 123, "Accounting for Stock-Based Compensation", for stock-based employee compensation. All prior periods presented have been restated to reflect the compensation cost that would have been recognised had the recognition provisions of Statement 123 been applied to all awards granted to employees after 1 January 1995.

Weighted average fair value of the options at the grant dates for awards under the schemes was RMB3.40 per share which was estimated using the Black-Scholes model with the following assumptions: dividend yield of 2.0%, an expected life of five years; expected volatility of 44%; and risk-free interest rates of 5.25%. Weighted average exercise price of the stock options was HK$7.80 per share.

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39. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (continued)

(a) Net profit and net equity (continued)

(v) Provision for dismantlement

Hong Kong GAAP requires the provision for dismantlement to be recorded for a present obligation whether that obligation is legal or constructive. The associated cost is capitalised and the liability is discounted and accretion expense is recognised using the credit-adjusted risk-free interest rate in effect when the liability is initially recognised.

On 15 August 2001, SFAS No. 143 "Accounting for asset retirement obligation" was released and is effective for the fiscal years beginning after 15 June 2002. SFAS No. 143 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 SFAS No. 143, the liability is discounted and accretion expense is recognised using the credit-adjusted risk-free interest rate in effect when the liability is initially recognised.

The company adopted SFAS No. 143 on 1 January 2003, which resulted in an increase in net property, plant and equipment of RMB863,093,000, an increase in the provision for dismantlement of RMB240,077,000, an increase in retained earnings of RMB436,112,000 and an increase in deferred income tax liabilities of RMB186,904,000 to recognise the cumulative effect of retrospectively applying the new accounting standard.

This adjustment is due to the difference in the method of accruing for dismantlement costs under SFAS No. 143 compared with the method required by SFAS No. 19 "Financial accounting and reporting by oil and gas producing companies", the accounting standard that the Company has been adopted since its establishment. Under SFAS No. 19, the dismantlement costs are accrued on a unit-of-production basis of accounting as the oil and gas is produced. The SFAS No. 19 method matches the accruals with the revenues generated from production and results in most of the costs being accrued early in field life, when production is at the highest level. Because SFAS No. 143 requires accretion of the liability as a result of the passage of time using an interest method of allocation, the majority of the costs will be accrued towards the end of field life, when production is at the lowest level. The cumulative income adjustment described above resulted from reversing the higher liability accumulated under SFAS No. 19 in order to adjust it to the lower present value amount resulting from transition to SFAS No. 143. This amount being reversed in transition, which was previously charged to the income statement under SFAS No. 19, will again be charged to the income statement under SFAS No. 143 in future years.

A summary of the changes in the asset retirement obligation during the year is included in the table below:

	2003
	RMB'000
Asset retirement obligation upon adoption of SFAS No., 143 on 1 January 2003	**2,239,320**
Addition of dismantlement cost	**314,234**
Accretion expenses	**93,246**
Asset retirement obligation at 31 December 2003	**2,646,800**

39. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (continued)

(a) Net profit and net equity (continued)

(v) Provision for dismantlement (continued)

The pro forma effects of the application of SFAS No.143 as if it had been adopted on 1 January 2002 (rather than 1 January 2003) are presented below:

	As reported 31 December 2003 RMB'000	Pro forma 31 December 2002 RMB'000 (Restated)
Net income	**11,543,397**	9,223,477
Earnings per share		
– Basic	**RMB1.41**	RMB1.12
– Diluted	**RMB1.41**	RMB1.12

(vi) Acquisition of CNOOC Finance

Under HK GAAP, the Company adopted the purchase method to account for the acquisition of 31.8% equity interest in CNOOC Finance in December 2003. Under the purchase method, the acquired results are included in the consolidated results of operations of the Company from the date of the acquisition.

As the Company and CNOOC Finance are under common control of CNOOC, under US GAAP, the acquisition is considered to be a transfer of businesses under common control and the acquired assets and liabilities are accounted at historical cost in a manner similar to the pooling of interests method. Accordingly, the consolidated financial statements for all periods presented have been retroactively restated as if the current structure and operations had been in existence since inception. The cash consideration paid by the Company is treated as an equity transaction in the year of the acquisition for US GAAP purpose.

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39. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (continued)

(a) Net profit and net equity (continued)

The effects on net profit and equity of the above significant differences between Hong Kong GAAP and US GAAP are summarised below:

	Net Profit	
	2003	2002
	RMB'000	RMB'000
		(Restated)
As reported under Hong Kong GAAP	**11,535,490**	9,232,827
Impact of US GAAP adjustments:		
– Reversal of additional depreciation, depletion and amortisation charges arising from the revaluation surplus on land and buildings	**9,156**	9,156
– Equity accounting for the results of CNOOC Finance	**30,913**	10,663
– Unrealised holding gains from available-for-sale investments in marketable securities	**(21,503)**	(36,965)
– Realised holding gains from available-for-sale marketable securities	**27,088**	26,940
– Additional dismantlement based on unit-of-production method	**–**	(197,079)
– Impact of income tax	**–**	59,124
– Recognition of stock compensation cost	**(37,747)**	(19,144)
Income before cumulative effect of change in accounting policy	**11,543,397**	9,085,522
Cumulative effect of change in accounting policy for dismantlement liabilities	**436,112**	–
Net profit under US GAAP	**11,979,509**	9,085,522
Net profit per share under US GAAP		
– Basic		
Before cumulative effect of change in accounting policy for dismantlement liabilities	**RMB1.41**	RMB 1.11
Cumulative effect of change in accounting policy for dismantlement liabilities	**RMB 0.05**	–
	RMB1.46	RMB1.11
– Diluted		
Before cumulative effect of change in accounting policy for dismantlement liabilities	**RMB1.41**	RMB 1.11
Cumulative effect of change in accounting policy for dismantlement liabilities	**RMB 0.05**	–
	RMB1.46	RMB1.11

39. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (continued)

(a) Net profit and net equity (continued)

	Net equity	
	2003	2002
	RMB'000	RMB'000
		(Restated)
As reported under Hong Kong GAAP	**46,736,532**	40,568,488
Impact of US GAAP adjustments:		
– Reversal of revaluation surplus on land and buildings	**(274,671)**	(274,671)
– Reversal of additional accumulated depreciation, depletion and amortisation arising from the revaluation surplus on land and buildings	**35,051**	25,895
– Equity accounting for the results of CNOOC Finance	**41,576**	10,663
– Contribution from CNOOC in respect of CNOOC Finance	**–**	(450,000)
– Dividend distribution made by CNOOC Finance to CNOOC	**(41,576)**	–
– Cumulative adjustment for provision for dismantlement	**–**	(436,112)
Net equity under US GAAP	**46,496,912**	39,444,263

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) Comprehensive income

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

	2003	2002
	RMB'000	RMB'000
		(Restated)
Net profit under US GAAP	**11,979,509**	9,085,522
Other comprehensive income:		
Foreign currency translation adjustments	**36,243**	(7,948)
Unrealised gains on short-term investments	**21,503**	36,965
Less: Reclassification adjustment for gains included in net income	**(27,088)**	(26,940)
Comprehensive income under US GAAP	**12,010,167**	9,087,599

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39. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (continued)

(b) Comprehensive income (continued)

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

	Foreign currency translation adjustments RMB'000	Unrealised gains on short term investments RMB'000	Accumulated other comprehensive income RMB'000
Balance at 1 January 2002	(5,648)	43,796	38,148
Current year change	(7,948)	10,025	2,077
Balance at 1 January 2003	(13,596)	53,821	40,225
Reversal of current year realised gains	–	(27,088)	(27,088)
Current year change	36,243	21,503	57,746
Balance at 31 December 2003	22,647	48,236	70,883

(c) 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. The derivative contract was recorded as "Other payable and accrued liabilities" in the consolidated balance sheet at fair value. For the year ended 31 December 2003, the Group recognised related changes in fair value, a gain of RMB10,038,000 (2002: RMB14,485,000), and included the amount in "Exchange (loss)/gain, net" in the consolidated income statement.

During the year, the Group also entered into interest rate swap agreements to partially hedge the fixed-rate debt for interest rate risk exposure management purposes with notional contract amount of US$200 million. The interest rate swap agreements utilised by the Company effectively modifies the Company's exposure to interest risk by converting the Company's fixed-rate debt to a floating rate. These agreements involve the receipt of fixed rate amounts in exchange for floating rate interest payments over the life of the agreement without an exchange of the underlying principal amount. The net gain as of 31 December 2003 related to the ineffective portion of the interest rate swap agreements was approximately Rmb938,000 (2002: nil).

(d) 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, provision for dismantlement as well as estimates relating to certain oil and gas revenues and expenses. Actual amounts could differ from those estimates and assumptions.

39. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND US GAAP (continued)

(e) 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.

40. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 15 March 2004.