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 whereby 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 products.

The registered office address is 65/F, Bank of China Tower, 1 Garden Road, Hong Kong.

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 RECENTLY ISSUED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs")

The Hong Kong Institute of Certified Public Accountants has issued a number of new Hong Kong Financial Reporting Standards and Hong Kong Accounting Standards, herein collectively referred to as the new HKFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005. The Group has not early adopted these new HKFRSs in the financial statements for the year ended 31 December 2004. The Group has already commenced an assessment of the impact of these new HKFRSs, but is not yet in a position to state when these new HKFRSs would have a significant impact on its results of operations and financial position.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (which also include Statements of Standard Accounting Practice and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants, accounting principles generally accepted in Hong Kong ("Hong Kong GAAP") and the Companies Ordinance. They have been prepared under the historical cost convention as modified by the revaluation of land and buildings and short term investments.

On 16 March 2004, the Company's shareholders approved a five-for-one stock split of the Company's shares (the "Stock Split"). The Stock Split was effected by dividing each of the Company's issued and unissued shares of HK$0.10 each 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 (the "HKSE") from 500 shares of HK$0.10 each to 1,000 subdivided shares of HK$0.02 each. The ratio of the Company's American Depository Receipts ("ADR") listed on the New York Stock Exchange also changed such that each ADR now represents 100 subdivided common shares of HK$0.02 each, as opposed to 20 common shares of HK$0.10 each prior to the Stock Split. All references in the consolidated financial statements referring to share, share option and per share amounts of the shares of the Company have been adjusted retroactively for the Stock Split.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2004. 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.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 associates are included in the Company's income statement to the extent of dividends received and receivable. The Company's investments in associates are treated as long term assets and are stated at cost less any impairment losses.

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 and 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.

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 an 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 costs (other than relating to oil and gas properties discussed above) incurred on projects are capitalised and deferred only when the projects are clearly defined; the expenditures are 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 on the basis of their quoted market prices 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 consisting 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.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 interest expenses 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
- 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 PRC government 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 gas sales contracts with customers which contains take-or-pay clauses. The clauses require those customers to take a specified minimum volume of gas each year. If the minimum volume of gas is not taken, those customers must pay for the deficiency gas, even though the gas is not taken. Those customers 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 those customers or the expiry of the contracts.

(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.

(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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Retirement and termination benefits

The Group participates in 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% of the 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 special final 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 special interim 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.

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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 exchange rates 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 rates 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.

Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Where the Company is the lessee, rentals payable under the operating leases are charged to the income statement on the 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) In 2003, the Company acquired from British Petroleum ("BP") an equivalent of 12.5% interest in the proposed joint venture known as the Tangguh LNG Project of Indonesia ("Tangguh LNG Project") for approximately US$275 million (equivalent to approximately RMB 2,276,578,000) through the acquisition of certain interest in production sharing contracts ("PSCs") which was effective from 1 January 2003. 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 project in the PRC, beginning in 2008. The Company completed the Tangguh acquisition on 8 February 2003. CNOOC has an equity interest in the Fujian LNG 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.

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

The options lapsed on 31 December 2004. As such, although the consideration was paid in full in 2003, the acquisition date for accounting purpose is 31 December 2004.

During the year, the Company acquired from British Gas International Limited a 20.767% interest in the Muturi Production Sharing Contract ("Muturi PSC") for a consideration of US$105.1 million (equivalent to approximately RMB869,881,000), subject to a final price adjustment. The purchase increased the Company's interest in the Muturi PSC to 64.767% and its interest in the Tangguh LNG Project increased from 12.5% to 16.96%. The Company completed the acquisition on 13 May 2004. As at 31 December 2004, Tangguh LNG project was still in the development stage.

(ii) 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 ("NWS Project") partners to acquire an interest in the upstream production and reserves of the NWS Project. Under the Agreement, the Company will acquire an interest of approximately 5.3% in the NWS Project and a 25% interest in the China LNG Joint Venture, a new joint venture to be established within the NWS Project. According to the Agreement, the Company has the right to acquire more interest 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, have been 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 LNG Project.

On 23 December 2003, the Company signed a Deed of Amendment to the Agreement and a Deed of Amendment to the Gas Production and Processing Agreements (the "Deeds") and agreed to pay US$483,577,000 representing deposit of the consideration and tariff payment, to the NWS project participants by 2 January 2004. The Company made the payment on 2 January 2004.

4. ACQUISITIONS (continued)

On 18 December 2004, the Company paid the balance of the consideration payable and concurrently entered into a side letter for the fulfillment of a condition precedent to the purchase. As such, the consideration paid of approximately US$567 million (equivalent to approximately RMB4,693,809,000) including the payment of the tariff of US$180 million plus direct incremental costs relating to the acquisition were included as a prepayment in property, plant and equipment as at 31 December 2004. As at 31 December 2004, NWS Project was still in the development stage.

(iii) Apart from the acquisitions above, during the year, the Company also acquired from VANCO Energy Company an 11.25% interest in a petroleum agreement in Ras Tafelney, Morocco for approximately US$7.75 million. The PSC was still in an exploration stage as of 31 December 2004.

(iv) In addition, the Company also entered in production sharing contracts with Golden Aaron Pte. Ltd. and China Global Construction Limited in Myanmar during the year. The PSCs were still in a pre-exploration stage as of 31 December 2004. The Company is the operator.

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.

In general, the Group has the option to take a up to 51% participating interest 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.

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 interest 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.

5. PRODUCTION SHARING CONTRACTS (continued)

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 independent operations, production sharing contracts with foreign partners 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 revenue, 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	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Sales to external customers:												
Oil and gas sales	15,177,621	12,040,587	21,708,398	16,076,244	—	—	—	—	—	—	36,886,019	28,116,831
Marketing revenues	—	—	—	—	18,191,353	12,398,661	—	—	—	—	18,191,353	12,398,661
Intersegment revenues	920,669	—	2,551,181	3,730,797	—	—	—	—	(3,471,850)	(3,730,797)	—	—
Other income	6,139	8,468	136,942	424,493	—	—	1,610	1,820	—	—	144,691	434,781
Total	16,104,429	12,049,055	24,396,521	20,231,534	18,191,353	12,398,661	1,610	1,820	(3,471,850)	(3,730,797)	55,222,063	40,950,273
Segment results												
Operating expenses	(1,828,614)	(1,579,004)	(3,241,730)	(2,933,805)	—	—	—	—	—	—	(5,070,344)	(4,512,809)
Production taxes	(775,210)	(626,897)	(950,464)	(611,701)	—	—	—	—	—	—	(1,725,674)	(1,238,598)
Exploration expenses	(1,136,055)	(590,541)	(180,105)	(257,531)	—	—	—	—	—	—	(1,316,160)	(848,072)
Depreciation, depletion and amortisation	(2,235,064)	(1,855,983)	(3,219,998)	(2,786,770)	—	—	—	—	—	—	(5,455,062)	(4,642,753)
Dismantlement	(117,310)	(96,206)	(84,327)	(71,120)	—	—	—	—	—	—	(201,637)	(167,326)
Crude oil and product purchases	(920,669)	—	(2,551,181)	(3,730,797)	(17,963,461)	(12,295,238)	—	—	3,471,850	3,730,797	(17,963,461)	(12,295,238)
Selling and administrative expenses	(50,721)	(62,247)	(557,521)	(666,369)	—	—	(449,464)	(483,907)	—	—	(1,057,706)	(1,212,523)
Others	—	(36,406)	(45,844)	(313,826)	—	—	—	—	—	—	(45,844)	(350,232)
Interest income	—	—	2,077	14,302	—	—	204,795	169,274	—	—	206,872	183,576
Interest expenses	(135,119)	(60,358)	(64,956)	(20,817)	—	—	(241,750)	(273,765)	—	—	(441,825)	(354,940)
Exchange gains/(losses), net	—	—	(15,308)	124	—	—	44,577	(6,870)	—	—	29,269	(6,746)
Short term investment income	—	—	—	—	—	—	72,438	123,483	—	—	72,438	123,483
Share of profits of associates	—	—	—	—	—	—	344,469	220,263	—	—	344,469	220,263
Non-operating income/ (expenses), net	—	—	—	—	—	—	519,206	314,968	—	—	519,206	314,968
Tax	—	—	—	—	—	—	(6,930,826)	(4,627,836)	—	—	(6,930,826)	(4,627,836)
Net profit	8,905,667	7,141,413	13,487,164	8,853,224	227,892	103,423	(6,434,945)	(4,562,570)	—	—	16,185,778	11,535,490
Other segment information												
Segment assets	20,670,651	14,055,898	37,767,197	26,821,223	1,712,212	2,629,009	32,599,362	28,880,532	—	—	92,749,422	72,386,662
Investments in associates	—	—	—	—	—	—	1,327,109	1,117,640	—	—	1,327,109	1,117,640
Total assets	20,670,651	14,055,898	37,767,197	26,821,223	1,712,212	2,629,009	33,926,471	29,998,172	—	—	94,076,531	73,504,302
Segment liabilities	(3,913,905)	(3,554,720)	(11,453,307)	(12,620,113)	(809,663)	(2,173,828)	(21,182,195)	(8,419,109)	—	—	(37,359,070)	(26,767,770)
Capital expenditure	6,309,397	5,960,071	13,145,839	2,264,625	—	—	164,775	46,868	—	—	19,620,011	8,271,564

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. Any activities outside PRC are mainly conducted in Indonesia and Singapore. An analysis by geographical segment is as follows:

	PRC		Outside PRC		Total	
	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000	2004 RMB'000	2003 RMB'000
Total revenue	30,453,453	25,416,466	24,768,610	15,533,807	55,222,063	40,950,273
Total assets	75,298,171	61,357,931	18,778,360	12,146,371	94,076,531	73,504,302
Capital expenditure	12,014,894	7,727,171	7,605,117	544,393	19,620,011	8,271,564

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

	2004 RMB'000	2003 RMB'000
Production sharing contracts		
China Petroleum & Chemical Corporation	6,932,008	3,848,361
PetroChina Company Limited	1,944,709	1,446,169
Castle Peak Power Company Limited	1,070,436	841,285
	9,947,153	6,135,815
Independent operations		
China Petroleum & Chemical Corporation	3,702,058	3,126,708
	13,649,211	9,262,523

7. OIL AND GAS SALES

	2004 RMB'000	2003 RMB'000
Gross sales	39,955,702	30,556,967
Royalties	(610,055)	(478,454)
PRC government share oil	(2,459,628)	(1,961,682)
	36,886,019	28,116,831

8. MARKETING PROFIT

	2004 RMB'000	2003 RMB'000
Marketing revenues	18,191,353	12,398,661
Crude oil and product purchases	(17,963,461)	(12,295,238)
	227,892	103,423

9. PROFIT BEFORE TAX

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

	2004 RMB'000	2003 RMB'000
Crediting:		
Interest income on bank deposits	(206,872)	(183,576)
Interest income on investments	(1,654)	(28,752)
Dividend income on investments	(93,040)	(46,140)
Realised (gains)/losses on investments	(2,972)	(27,088)
Unrealised losses/(gains) on investments	25,228	(21,503)
Short term investment income	(72,438)	(123,483)
Charging:		
Auditors' remuneration	6,750	5,790
Staff costs		
– Wages, salaries and allowances*	265,007	393,165
– Labour costs paid to contractors	666,599	542,292
Depreciation, depletion and amortisation	5,410,413	4,643,364
Less: Oil-in tank adjustments	44,649	(611)
	5,455,062	4,642,753
Operating lease rentals		
– Office	107,803	72,708
– Equipment	494,264	190,581
Loss on disposal of property, plant and equipment	173	21
Repairs and maintenance	1,193,700	608,603
Research and development costs	268,477	165,793

* *Including in wages, salaries and allowances, an amount of Rmb30,304,000 (2003: Rmb95,147,000) for pension scheme contributions and termination benefits.*

10. SELLING AND ADMINISTRATIVE EXPENSES

	2004 RMB'000	2003 RMB'000
Salary and staff benefits	265,007	393,165
Utility and office expenses	115,817	90,801
Travel and entertainment	75,675	74,218
Rentals and maintenance	128,579	107,310
Management fees	218,087	219,771
Selling expenses	36,015	30,686
(Reversal) of/provision for inventory obsolescence	(2,710)	8,745
Other	221,236	287,827
	1,057,706	1,212,523

11. INTEREST EXPENSES

	2004 RMB'000	2003 RMB'000
Interest on bank loans which are:		
– Wholly repayable within five years	80,829	81,539
– Not wholly repayable within five years	—	—
Interest on long term guaranteed notes	485,812	391,005
Other borrowing costs	163	34,933
Total interest	566,804	507,477
Less: Amount capitalised in property, plant and equipment (note 18)	(244,686)	(245,783)
	322,118	261,694
Other finance costs:		
Increase in discounted amount of provisions arising from the passage of time (note 30)	119,707	93,246
	441,825	354,940

The interest rates used for interest capitalisation represented the cost of capital from raising the related borrowings and varied from 4.1% to 9.2% per annum for the year ended 31 December 2004.

12. DIRECTORS' REMUNERATION

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

	2004 RMB'000	2003 RMB'000
Fees for executive directors	—	—
Fees for non-executive directors	851	1,000
Other emoluments for executive directors		
– Basic salaries and allowances	6,556	6,327
– Bonuses	—	2,100
– Pension scheme contributions	62	207
– Other	1,200	1,425
	8,669	11,059

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

	Number of directors	
	2004	2003
Nil to HK$1,000,000	6	6
HK$1,000,001- HK$1,500,000	—	1
HK$1,500,001- HK$2,000,000	—	—
HK$2,000,001- HK$2,500,000	—	—
HK$2,500,001- HK$3,000,000	1	2
HK$3,000,001- HK$3,500,000	1	—
	8	9

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:

	2004 RMB'000	2003 RMB'000
Basic salaries and allowances	18,227	15,857
Bonuses	4,589	2,550
Pension scheme contributions	1,509	1,332
Other	2,282	2,743
	26,607	22,482
Number of directors	—	—
Number of employees	5	5

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

	Number of employees	
	2004	2003
Nil to HK$3,000,000	—	—
HK$3,000,001- HK$3,500,000	1	—
HK$3,500,001- HK$4,000,000	1	3
HK$4,000,001- HK$4,500,000	1	—
HK$4,500,001- HK$5,000,000	—	—
HK$5,000,001- HK$5,500,000	—	2
HK$5,500,001- HK$6,000,000	1	—
HK$6,000,001- HK$8,000,000	—	—
HK$8,000,001- HK$8,500,000	1	—
	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 20%, 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% to 51.875%. 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:

	2004 RMB'000	2003 RMB'000
Overseas income taxes		
– Current	755,568	654,988
– Deferred	(170,118)	(179,134)
PRC enterprise income tax		
– Current	6,411,417	3,623,157
– Deferred	(66,041)	528,825
Total tax charge for the year	6,930,826	4,627,836

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

	2004 %	2003 %
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	0.3	(0.1)
Tax credit from government	(0.3)	(1.5)
Tax effect on other permanent differences	0.3	0.2
Effective income tax rate	30.3	28.6

14. TAX (continued)

(i) Income tax (continued)

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

	2004 RMB'000	2003 RMB'000
Deferred tax assets		
– Provision for retirement and termination benefits	112,150	114,758
– Provision for dismantlement	926,834	775,725
– Provision for impairment of property, plant and equipment and write-off of unsuccessful exploratory drillings	869,286	759,454
	1,908,270	1,649,937
Deferred tax liabilities		
– Accelerated amortisation allowance for oil and gas properties	(8,596,768)	(7,433,133)
Net deferred tax liabilities	(6,688,498)	(5,783,196)

As at 31 December 2004, there was no significant unrecognised deferred tax liability (2003: 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.

(ii) Other taxes

The Company's PRC subsidiary pays the following other 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 2004 dealt with in the financial statements of the Company, was approximately RMB5,441,948,000 (2003: RMB5,031,491,000) (see note 32).

16. DIVIDENDS

On 28 April 2004, the board of directors declared an interim dividend and a special interim dividend of HK$0.06 per share in place of 2003 final dividend and final special dividend, totaling HK$2,464,249,697 (equivalent to approximately RMB2,617,526,000) (2003: nil). The board of directors also withdrew its recommendation that the Company declared any final or special final dividend for the year ended 31 December 2003.

On 25 August 2004, the board of directors declared an interim dividend of HK$0.03 per share (2003: HK$0.028 per share), totaling HK$1,231,618,058 (equivalent to approximately RMB1,306,451,000) (2003: RMB1,220,132,000), and a special interim dividend of HK$0.05 per share (2003: HK$0.036 per share), totaling HK$2,052,696,764 (equivalent to approximately RMB2,177,418,000) (2003: RMB1,568,741,000).

16. DIVIDENDS (continued)

The board of directors have recommended a final dividend of HK$0.03 per ordinary share, totaling HK$1,231,571,258 (approximately equivalent to RMB1,310,022,000), and a special final dividend of HK$0.05 per ordinary share, totaling HK$2,052,618,764 (approximately equivalent to RMB2,183,371,000) for the year ended 31 December 2004.

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, 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 Receipts ("ADR") 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 ADRs.

17. EARNINGS PER SHARE

	2004	2003
Earnings:		
Net profit attributable to shareholders, used in the basic and diluted earnings per share calculations	RMB 16,185,778,000	RMB 11,535,490,000
Number of shares (after stock split):		
Weighted average number of ordinary shares for the purpose of basic earnings per share before effects of shares repurchased	41,070,828,275	41,070,828,275
Effect of shares repurchased	(10,587,616)	—
Weighted average number of ordinary shares for the purpose of basic earnings per share	41,060,240,659	41,070,828,275
Effect of dilutive potential ordinary shares under the share option scheme	66,720,503	39,510,820
Effect of dilutive potential ordinary shares for convertible bonds	52,552,274	—
Weighted average number of ordinary shares for the purpose of diluted earnings per share	41,179,513,436	41,110,339,095
Earnings per share		
– Basic	RMB0.39	RMB0.28
– Diluted	RMB0.39	RMB0.28

18. PROPERTY, PLANT AND EQUIPMENT, NET

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

	Group				
	2004				2003
	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	70,137,828	824,781	139,902	71,102,511	59,240,281
Purchase price allocation adjustment	—	—	—	—	(707,623)
Additions	12,845,367	116,797	47,977	13,010,141	8,585,798
Acquisitions (including prepayments)	6,934,951	—	—	6,934,951	4,025,441
Disposals and write-offs	(3)	—	(174)	(177)	(40,402)
Exchange realignment	(249)	—	—	(249)	(984)
End of year	89,917,894	941,578	187,705	91,047,177	71,102,511
Analysis of cost or valuation:					
At cost	89,917,894	116,797	187,705	90,222,396	70,277,730
At revaluation	—	824,781	—	824,781	824,781
	89,917,894	941,578	187,705	91,047,177	71,102,511
Accumulated depreciation, depletion and amortisation:					
At beginning of the year	(27,839,105)	(106,401)	(33,204)	(27,978,710)	(23,168,461)
Depreciation provided during the year	(5,575,114)	(26,054)	(10,882)	(5,612,050)	(4,810,690)
Disposals	—	—	5	5	584
Exchange realignment	83	—	192	275	(143)
End of year	(33,414,136)	(132,455)	(43,889)	(33,590,480)	(27,978,710)
Net book value:					
Beginning of year	42,298,723	718,380	106,698	43,123,801	36,071,820
End of year	56,503,758	809,123	143,816	57,456,697	43,123,801

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

	Group				
	2004				2003
	Oil and gas properties RMB'000	Land and buildings RMB'000	Vehicles and office equipment RMB'000	Total RMB'000	Total RMB'000
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	89,917,894	666,907	187,705	90,772,506	70,827,840
Accumulated depreciation, depletion and amortisation	(33,414,136)	(88,246)	(43,889)	(33,546,271)	(27,943,657)
	56,503,758	578,661	143,816	57,226,235	42,884,183

During the year, additions to the Group's property, plant and equipment amounted to approximately RMB13,010,141,000 (2003: RMB8,585,798,000). The consideration paid of US$567 million (equivalent to RMB4,693,809,000) for the NWS project (see note 4(ii)) has been included as a prepayment in oil and gas properties as at 31 December 2004.

Included in the current year additions was an amount of approximately RMB244,686,000 (2003: RMB245,783,000) in respect of interest capitalised in property, plant and equipment.

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

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	
	2004	2003
	RMB'000	RMB'000
Cost:		
Beginning of the year	5,833	5,764
Additions	—	69
End of year	5,833	5,833
Accumulated depreciation:		
Beginning of the year	(5,562)	(5,108)
Charge for the year	(107)	(454)
End of year	(5,669)	(5,562)
Net book value:		
Beginning of year	271	656
End of year	164	271

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.

19. INTERESTS IN SUBSIDIARIES

	Company	
	2004	2003
	RMB'000	RMB'000
Unlisted shares, at cost	7,766,971	7,766,971
Loan to subsidiaries	4,138,290	4,138,290
Due from subsidiaries	13,206,016	12,245,592
Due to subsidiaries	(15,256,082)	(7,588,883)
	9,855,195	16,561,970

19. INTERESTS IN SUBSIDIARIES (continued)

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

	2004 RMB'000	2003 RMB'000
Balance due:		
Within five years	—	—
More than five years	4,138,290	4,138,290
	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/registered ordinary share capital	Percentage of equity attributable to the Company	Principal activities
Directly held subsidiaries:				
CNOOC China Limited	Tianjin, 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
CNOOC Finance (2004) Limited	British Virgin Islands 9 December 2004	US$1,000	100%	Bond issuance

19. INTERESTS IN SUBSIDIARIES (continued)

Name	Place and date of incorporation	Nominal value of issued/registered 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

19. INTERESTS IN SUBSIDIARIES (continued)

Name	Place and date of incorporation	Nominal value of issued/registered ordinary share capital	Percentage of equity attributable to the Company	Principal activities
CNOOC NWS Private Ltd.	Singapore 8 October 2002	S$1	100%	Offshore petroleum exploration, development and production in Australia
CNOOC Wiriagar Overseas Ltd.	British Virgin Islands 15 January 2003	US$1	100%	Offshore petroleum exploration, development and production in Indonesia
CNOOC Muturi Ltd.	The Isle of Man 8 Feburary 1996	US$7,780,700	100%	Offshore 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.

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-taking and money lending activities for the CNOOC Group. The issued and paid-up capital of CNOOC Finance is RMB1,415 million.

	Group	
	2004 RMB'000	2003 RMB'000
Share of net assets	**1,327,109**	1,117,640

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 2004.

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 2004 and 2003, substantially all the accounts receivable were aged within six months.

22. INVENTORIES AND SUPPLIES

	Group	
	2004	2003
	RMB'000	RMB'000
Materials and supplies	879,300	809,827
Oil in tanks	274,029	291,844
Less: Provision for inventory obsolescence	(6,035)	(8,745)
	1,147,294	1,092,926

23. SHORT TERM INVESTMENTS

As at 31 December 2004, 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	
	2004	2003	2004	2003
	RMB'000	RMB'000	RMB'000	RMB'000
Unlisted investments, at fair value:				
Liquidity funds	3,763,959	3,767,179	2,759,400	3,767,179
Corporate bonds	1,639,956	1,876,880	1,639,956	1,876,880
Common stock	40,198	40,274	40,198	40,274
	5,444,113	5,684,333	4,439,554	5,684,333

24. ACCOUNTS PAYABLE

As at 31 December 2004 and 2003, substantially all the accounts payable were aged within six months.

25. OTHER PAYABLES AND ACCRUED LIABILITIES

	Group	
	2004	2003
	RMB'000	RMB'000
Accrued payroll and welfare payable	156,706	149,532
Provision for retirement and termination benefits	292,128	290,955
Accrued expenses	2,818,785	926,867
Advances from customers	12,588	10,864
Royalties payable	142,638	205,113
Other payables	768,179	372,452
	4,191,024	1,955,783

As at 31 December 2004, deferred revenue from gas sales contracts amounted to approximately RMB1,050,000 (2003: RMB1,208,000) and was included in other payables.

26. LONG TERM BANK LOANS

As at 31 December 2004, 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	
		2004	2003
		RMB'000	RMB'000
	Interest rate and final maturity		
US$ denominated bank loans	Fixed interest rate of 9.2% per annum with maturities through to 2006	827,650	827,615
Japanese Yen denominated bank loans	Fixed interest rate of 4.1% per annum with maturities through to 2007	61,925	82,578
		889,575	910,193
Less: Current portion of long term bank loans		(24,364)	(20,618)
		865,211	889,575

As at 31 December 2004, all the bank loans of the Group were unsecured and none of the outstanding borrowings were guaranteed by CNOOC.

26. LONG TERM BANK LOANS (continued)

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

	Group 2004 RMB'000	Group 2003 RMB'000
Balances due:		
– Within one year	**24,364**	20,618
– After one year but within two years	**846,471**	24,364
– After two years but within three years	**18,740**	846,471
– After three years but within four years	**—**	18,740
– After four years but within five years	**—**	—
	889,575	910,193
Amount due within one year shown under current liabilities	**(24,364)**	(20,618)
	865,211	889,575

Supplemental information with respect to long term bank loans:

	Balance at year end RMB'000	Weighted average interest rate at year end	Maximum amount outstanding during the year RMB'000	Average amount outstanding during the year* RMB'000	Weighted average interest rate during the year**
For the year ended 31 December					
2004	889,575	8.81%	910,193	899,884	8.37%
2003	910,193	8.69%	1,238,611	1,074,403	7.94%

* *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 a 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 a principal amount of 4.125% guaranteed notes due in 2013 and US$300 million of a 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.

On 15 December 2004, CNOOC Finance (2004) Limited, a company incorporated in the British Virgin Islands on 9 December 2004 and a wholly-owned subsidiary of the Company, issued US$1 billion zero coupon guaranteed convertible bonds due 2009, unconditionally and irrevocably guaranteed by, and convertible into shares of the Company. The bonds are converted at HK$6.075 per share, subject to adjustment for, among other things, subdivision or consolidation of shares, bond issues, right issues, capital distribution and other dilutive events. Unless previous redeemed, converted or purchased and cancelled, the bonds will be redeemed on the maturity date at 105.114% of the principal amount.

28. BALANCES WITH THE PARENT COMPANY

As at 31 December 2004 and 2003, the balances with CNOOC were unsecured, interest-free and were repayable on demand.

29. RELATED PARTY TRANSACTIONS

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

The Group has entered into several agreements with CNOOC and its affiliates, which govern the provision of materials, utilities and ancillary services, the provision of technical services, the provision of research and development services, 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	2004 RMB'000	2003 RMB'000
Materials, utilities and ancillary services	(i)	1,295,598	1,018,066
Technical services	(ii)	6,362,206	3,828,282
Research and development services	(iii)	7,800	83,280
Lease and property management services	(iv)	76,721	56,867
Included in:			
Exploration expenses		960,031	487,293
Operating expenses		1,405,877	1,176,601
Selling and administrative expenses		326,004	191,349
Capitalised under property, plant and equipment		5,050,413	3,131,252

29. RELATED PARTY TRANSACTIONS (continued)

(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;

— 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

The Group has revised the original research and development services agreement with CNOOC's subsidiary, China Offshore Oil Research Centre, due to the restructuring of operations in 2004.

(iv) Lease and property management services

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

29. RELATED PARTY TRANSACTIONS (continued)

(v) Sale of crude oil, condensated oil and liquefied petroleum gas

The Group sells crude oil, condensated 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 2004, the total sales amounted to approximately RMB13,945,565,000 (2003: RMB8,324,108,000).

During the period, 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 license. For the year ended 31 December 2004, the total sales to its customers through such arrangements amounted to approximately RMB446,923,000 (2003: RMB1,470,832,000). The commission paid by the third party customers to CNOOC for the year amounted to approximately RMB2,682,000 (2003: RMB8,825,000).

(vi) Deposits with CNOOC Finance Corporation Limited

The Company entered into a framework agreement with CNOOC Finance Corporation Limited ("CNOOC Finance") on 8 April 2004. Under the framework agreement, the Group utilises the financial services provided by CNOOC Finance, a 31.8% owned associate company of the Company that is also a subsidiary of CNOOC. Such services include placing of the Group's cash deposits with CNOOC Finance, and settlement services for transactions between the Group and other entities including CNOOC and its subsidiaries. The charges by CNOOC Finance for its financial services to the Group are comparable to those charged by PRC banks for similar services.

For the year ended 31 December 2004, the maximum outstanding balance for deposits (including interest received in respect of these deposits) placed with CNOOC Finance amounted to approximately RMB5,300,381,000.

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 using 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	
	2004 RMB'000	2003 RMB'000
At the beginning of year	2,646,800	2,239,320
Additions during the year and capitalised in oil and gas properties	322,941	314,234
Increase in discounted amount of provisions arising from the passage of time	119,707	93,246
End of year	3,089,448	2,646,800

31. SHARE CAPITAL

Shares (after Stock Split)	Number of shares	Share capital HK$'000	Issued share capital Equivalent of RMB'000
Authorised:			
Ordinary shares of HK$0.02 each			
As at 31 December 2003 and 2004	75,000,000,000	1,500,000	
Issued and fully paid:			
Ordinary shares of HK$0.02 each			
As at 1 January 2003 and 1 January 2004	41,070,828,275	821,417	876,978
Repurchased and cancelled	(18,453,000)	(369)	(392)
As at December 31 2004	41,052,375,275	821,048	876,586

The repurchase of the Company's shares during the year were effected by the directors, pursuant to the mandate from shareholders received at the last annual general meeting.

Share options

The Company has adopted share option schemes which provide for the grant of 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, the recipient of and number of shares underlying each option. These schemes provide for the 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 23,100,000 shares have been granted;
2. the subscription price per share is HK$1.19; 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.

31. SHARE CAPITAL (continued)

Share options (continued)

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 44,100,000 shares have been granted;
2. the subscription price per share is HK$1.232; 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 Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (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.

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.

31. SHARE CAPITAL (continued)

Share options (continued)

On 24 February 2003, the board of directors approved a grant of options in respect of 42,050,000 shares to the Company's senior management under the 2002 Share Option Scheme. The exercise price for the options is HK$2.108 per share. The market price was HK$2.11 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 24 February 2003.

On 5 February 2004, the board of directors approved a grant of options in respect of 50,700,000 shares to the Company's senior management under the 2002 Share Option Scheme. The exercise price for the options is HK$3.152 per share. The market price was HK$3.146 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 5 February 2004.

2,300,100 share options granted under the 2002 Share Option Scheme and the 2001 Share Option Scheme have been exercised since the respective dates of 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 2004 was 54,533,267.

32. RESERVES

According to the laws and regulations of the PRC and the 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 (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 the 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 to 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 2004, the general reserve fund appropriated amounted to RMB4,413,610,000 (2003: RMB3,050,489,000), representing approximately 29.4% (2003: 20.4%) of the total registered capital of CNOOC China Limited.

32. RESERVES (continued)

Included in retained earnings is an amount of RMB877,109,000 (2003: RMB577,640,000), being the retained earnings attributable to associates.

The company's ability to distribute dividends will largely depends on the dividends it receives from its subsidiaries. The dividends distributable by the company's subsidiaries to the company are determined in accordance with the relevant accounting principle required by the local authorities. As of 31 December 2004 the aggregate amount of the subsidiaries' retained earnings available for distributions to the company amounted to approximately RMB 16,652,414,000.

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 RMB'000	Retained earnings RMB'000	Total RMB'000
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 1 January 2004	20,761,205	2,573,082	23,334,287
Net profit for the year	—	5,441,948	5,441,948
Dividends (note 16)	—	(6,101,395)	(6,101,395)
Repurchase of shares	—	(60,761)	(60,761)
Transfer of reserves upon share repurchase	392	(392)	—
Balances at 31 December 2004	20,761,597	1,852,482	22,614,079

As at 31 December 2004, the distributable profits of the Company amounted to approximately RMB1,852,482,000 (2003: RMB2,573,082,000).

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. The PRC government is responsible for the pension liabilities to these retired employees. The Group is required to make annual contributions to the government-regulated pension at rates ranging from 9% to 22% of the employees' basic salaries.

The Company is required to make contributions to a defined contribution mandatory provident fund at a rate of 5% of the basic salaries of 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 Indonesian 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 total amount of contributions and provisions made by the Group for the above mentioned retirement and termination benefits for the year ended 31 December 2004 amounted to approximately RMB30,304,000 (2003: RMB95,147,000).

34. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

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

	2004 RMB'000	2003 RMB'000
Profit before tax	23,116,604	16,163,326
Adjustments for:		
Interest income	(206,872)	(183,576)
Interest expenses	441,825	354,940
Exchange (gains)/losses, net	(29,269)	6,746
Share of profits of associates	(344,469)	(220,263)
Short term investment income	(72,438)	(123,483)
(Reversal) of/provision for inventory obsolescence	(2,710)	8,745
Depreciation, depletion and amortisation	5,455,062	4,642,753
Loss on disposal and write-off of property, plant and equipment	155,876	39,818
Dismantlement	201,637	167,326
Amortisation of discount of long term guaranteed notes	15,634	11,276
Operating cash flows before movements in working capital	28,730,880	20,867,608
Increase in accounts receivable	(27,466)	(1,185,304)
Increase in inventories and supplies	(96,307)	(129,678)
Decrease in other current assets	267,168	312,559
Increase in amounts due from related companies	(417,091)	(302,993)
Increase/(decrease) in an amount due to the parent company	205,407	(105,785)
Increase in accounts payable, other payables and accrued liabilities	1,318,415	1,448,645
Increase/(decrease) in other taxes payable	(12,447)	(4,772)
(Decrease)/increase in amounts due to related companies	(262,798)	242,631
Cash generated from operations	29,705,761	21,142,911

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

(b) Acquisitions

	2004 RMB'000	2003 RMB'000
Acquisitions		
Net assets acquired:		
Property, plant and equipment, net	4,686,857	1,579,726
Accounts receivable	453	—
Other current assets	66,744	8,959
Inventories and supplies	—	122,777
Cash and bank balances	—	17,580
Accounts payable	(81,547)	(8,294)
Other payables and accrued liabilities	—	(47,983)
Deferred tax liabilities	(1,141,461)	—
	3,531,046	1,672,765
Prepayment for NWS Project	4,693,809	—
Prepayment for Tangguh Project	—	2,445,715
	8,224,855	4,118,480
Satisfied by:		
Prepayment made in 2003	2,445,715	—
Cash paid (including cash calls for Tangguh Project)	5,779,140	4,118,480
	8,224,855	4,118,480

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

	2004 RMB'000	2003 RMB'000
Cash consideration	5,779,140	4,118,480
Cash and bank balances acquired	—	(17,580)
Net outflow of cash and cash equivalents	5,779,140	4,100,900

Further details of the acquisition of the Tangguh LNG Project and NWS Project are included in note 4 to the financial statements. The purchase price allocations for Tangguh Project are still preliminary pending for the confirmation of the tax basis of the underlying assets.

35. COMMITMENTS

(i) Capital commitments

As at 31 December 2004, the Group and the Company had the following capital commitments, principally for the construction and purchase of property, plant and equipment:

	2004 RMB'000	2003 RMB'000
Contracted for	9,568,971	2,534,468
Authorised, but not contracted for	20,331,504	17,489,791

As at 31 December 2004, the Group had unutilised banking facilities amounting, to approximately RMB20,662,120,000 (2003: RMB32,455,229,500).

(ii) Operating lease commitments

(a) Office properties

The Group leases certain, of its office properties under operating lease arrangements, leases properties are negotiated for terms ranging from 10 months to 3 years.

As at 31 December 2004, the Group had total minimum lease payments under non-cancelable operating leases falling due as follows:

	2004 RMB'000	2003 RMB'000
Commitments due:		
— Within one year	24,824	17,222
— After one year but within two years	549	3,174
	25,373	20,396

(b) Plant and equipment

During the year, the Group also entered into an operating lease arrangement for certain plant and equipment for a term of 20 years. As at 31 December 2004, the total minimum lease payments under non-cancelable operating lease attributable to the Group falling within one year were RMB 149,360,000, in the second to fifth years were RMB 597,442,000 and after five years were RMB 1,834,023,000.

(iii) Commitment to invest in the Gorgon Joint Venture

In October 2003, the Company entered into an agreement with the participants in the 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.

35. COMMITMENTS (continued)

(iv) Financial instruments

(a) Currency swap contracts

As at 31 December 2004, 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:

	2004		2003	
	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				
2004	—	—	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

(b) Fair value of financial statements

The carrying value 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 RMB 967,770,000 as at 31 December 2004 (2003: RMB 1,064,895,000).

The estimated fair value of long term guaranteed notes based on current market interest rates was approximately RMB1,985,009,900 as at 31 December 2004 (2003: RMB 8,304,647,000).

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:

	2004 RMB'000	2003 RMB'000
China Petroleum & Chemical Corporation	10,634,066	6,975,069
PetroChina Company Limited	1,944,709	1,446,169
Castle Peak Power Company Limited	1,070,436	841,285

37. ADDITIONAL FINANCIAL INFORMATION

As at 31 December 2004, net current assets and total assets less current liabilities of the Group amounted to approximately RMB24,890,362,000 and RMB83,674,168,000 (2003: RMB19,956,331,000 and RMB64,197,772,000), respectively.

As at 31 December 2004, net current assets and total assets less current liabilities of the Company amounted to approximately RMB13,635,306,000 and RMB23,490,665,000 (2003: RMB7,649,024,000 and RMB24,211,265,000), respectively.

38. 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 2004 was approximately RMB9,156,000 (2003: 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 are 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 as held and used until it is disposed of.

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

(a) Net profit and net equity (continued)

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

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.

In addition, under Hong Kong GAAP, a subsequent increase in the recoverable amount of an asset is reversed to the income statement to the extent that an impairment loss on the same asset was previously recognised as an expense when the circumstances and events that led to the write-down or write-off cease to exist. The reversal is reduced by the amount that would have been recognised as depreciation had the write-down or 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 2004, there were no impairment losses recognised under Hong Kong GAAP and US GAAP.

(iv) Stock compensation schemes

As at December 31, 2004, the Company had three stock option schemes, which are described more fully in note 31. The Company accounted for those plans under the fair value recognition provision of FASB Statement No. 123, "Accounting for Stock-Based Compensation", as amended by FASB statement No. 148, for stock-based employee compensation. Compensation costs recognised for the stock option schemes amounted to RMB46,642,000 (2003: RMB37,747,000) for the year ended 31 December 2004.

The weighted average fair value of the options at the grant dates for award under the schemes was HK$0.84 per share which was estimated using the Black-Scholes model with the following assumptions: dividend yield of 2%; and expected life of five years; expected volatility of 44%; and risk-free interest rates of 5.25%. The weighted average exercise price of the stock options was HK$2.06 per share.

(v) 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.

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

(a) Net profit and net equity (continued)

(vi) Accounting for convertible debt

Under HK GAAP, prior to December 31, 2004, there were no requirements to segregate the equity and derivative components of convertible debt. As such, convertible debt was stated at amortised cost.

Under US GAAP, the derivative components will need to be bifurcated from the debt components if it contains a compound derivative or fails to fulfill certain criteria for not bifurcating. The derivative components are marked to market at each balance sheet date and the differences will be charged/credited to income. The debt components are stated at amortised cost.

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

	Net Profit	
	2004 RMB'000	2003 RMB'000
As reported under Hong Kong GAAP	16,185,778	11,535,490
Impact of U.S 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
— Unrealised holding (gains)/losses from available-for-sale investments in marketable securities	25,228	(21,503)
— Realised holding gains/(losses) from available-for-sale marketable securities	2,972	27,088
— Recognition of stock compensation cost	(46,642)	(37,747)
Income before cumulative effect of change in accounting policy	16,176,492	11,543,397
Cumulative effect of change in accounting policy for dismantlement liabilities	—	436,112
Net profit under US GAAP	16,176,492	11,979,509
Net profit per share under US GAAP		
— Basic (after Stock Split)		
Before cumulative effect of change in accounting policy for dismantlement liabilities	RMB 0.39	RMB 0.28
Cumulative effect of change in accounting policy for dismantlement liabilities	—	RMB 0.01
	RMB 0.39	RMB0.29

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

(a) Net profit and net equity (continued)

	Net Profit	
	2004	2003
	RMB'000	RMB'000
— Diluted (after Stock Split)		
Before cumulative effect of change in accounting policy for dismantlement liabilitie	RMB 0.39	RMB 0.28
Cumulative effect of change in accounting policy for dismantlement liabilities	—	RMB 0.01
	RMB 0.39	RMB 0.29

	Net equity	
	2004	2003
	RMB'000	RMB'000
As reported under Hong Kong GAAP	56,717,461	46,736,532
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	44,207	35,051
— Equity accounting for the results of CNOOC Finance	—	41,576
— Dividend distribution made by CNOOC Finance to CNOOC	—	(41,576)
Net equity under US GAAP	56,486,997	46,496,912

Apart from the derivative components with a total credit balance of approximately RMB 450 million that are required to be bifurcated from the convertible debt, there are no other significant GAAP differences that affect classifications within the balance sheet or income statement but do not affect net income or shareholders' equity.

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

(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.

	2004 RMB'000	2003 (Restated) RMB'000
Net income under US GAAP	**16,176,492**	11,979,509
Other comprehensive income:		
Foreign currency translation adjustments	**(42,301)**	36,243
Unrealised gains on short-term investment	**(25,228)**	21,503
Less: Reclassification adjustment for gains included in net income	**(2,972)**	(27,088)
Comprehensive income under US GAAP	**16,105,991**	12,010,167

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 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 1 January 2004	22,647	48,236	70,883
Reversal of current year realised gains	—	(2,972)	(2,972)
Current year change	(42,301)	(25,228)	(67,529)
Balance at 31 December 2004	(19,654)	20,036	382

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

(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. In accordance with SFAS No. 133 "Accounting for derivatives instruments and hedging activities", the derivative contract was recorded as "Other payables and accrued liabilities" in the accompanying consolidated balance sheet at fair value. For the year ended 31 December 2004, the Group recognised related changes in fair value, a gain of RMB2,581,000 (2003: RMB10,038,000), and included the amount in "Exchange gains /(losses), net" in the consolidated income statement.

During 2003, 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 interest rate swap agreements were settled during the year and the total net gain was RMB84,168,000.

(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.

(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.

39. SUBSEQUENT EVENT

The Company, through its wholly owned subsidiary has signed an agreement with a Canadian based Company, MEG Energy Corporation ("MEG"), to acquire a 16.69% stake of MEG. The Company completed the transaction and paid C$150 million for the acquisition of 13,636,364 common shares of MEG in March 2005. MEG is principally engaged in the production of the oil sands.

40. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 29 March 2005.