

# Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

## 1. CORPORATE INFORMATION

CNOOC Limited (the “Company”) was incorporated in the Hong Kong Special Administrative Region (“Hong Kong”), the People’s Republic of China (the “PRC”) on 20 August 1999 to hold the interests in certain entities 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 parent and the ultimate holding company is China National Offshore Oil Corporation (“CNOOC”), a company established in the PRC.

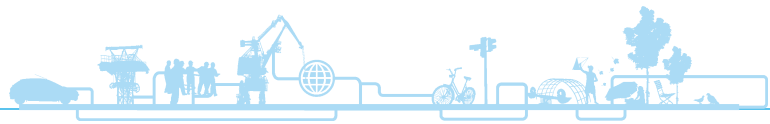
## 2.1 BASIS OF PREPARATION

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards (“HKFRSs”) (which also include Hong Kong Accounting Standards (“HKASs”) and Interpretations) issued by the Hong Kong Institute of Certified Public Accountants (“HKICPA”), accounting principles generally accepted in Hong Kong (“Hong Kong GAAP”) and the disclosure requirements of the Hong Kong Companies Ordinance. They have been prepared under the historical cost convention except for available-for-sale investments and derivative financial instruments which have been measured at fair value. These financial statements are presented in Renminbi (“RMB”) and all values are rounded to the nearest thousand (RMB’000) except when otherwise indicated.

### Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2005. The results of subsidiaries are consolidated from the date of acquisition being the date on which the Group obtains control and continue to be consolidated until the date that such control ceases. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

The acquisition of subsidiaries or an interest in a joint venture or associate during the year has been accounted for using the purchase method of accounting. This method involves allocating the cost of the business combinations to the fair value of the assets acquired, and liabilities and contingent liabilities assumed at the date of acquisition. The cost of the acquisition is measured at the aggregate of the fair value of the assets given, equity instruments issued (if any) and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition.



## 2.2 IMPACT OF NEW AND REVISED 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, Hong Kong Accounting Standards and interpretations, herein collectively referred to as the new HKFRSs, which are generally effective for accounting periods beginning on or after 1 January 2005. The following new and revised HKFRSs affect the Group and are adopted for the first time for the current year’s financial statements:

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 12	Income Taxes
HKAS 14	Segment Reporting
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 18	Revenue
HKAS 19	Employee Benefits
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 28	Investments in Associates
HKAS 31	Interests in Joint Ventures
HKAS 32	Financial Instruments: Disclosure and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 37	Provisions, Contingent Liabilities and Contingent Assets
HKAS 38	Intangible Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS 39 Amendment	Transition and Initial Recognition of Financial Assets and Financial Liabilities
HKFRS 2	Share-based Payment
HKFRS 3	Business Combinations

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 2.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS (“HKFRSs”) (continued)

The adoption of HKASs 1, 2, 7, 8, 10, 12, 14, 17, 18, 19, 21, 23, 24, 27, 28, 31, 33, 36, 37, 38 and HKFRS 3 has no material impact on the accounting policies of the Group and the methods of computation in the Group’s financial statements. The impacts of adopting other HKFRSs are detailed as follows:

#### (a) HKAS 16 – Property, Plant and Equipment

In prior years, the Group’s property, plant and equipment were classified into three categories: oil and gas properties, land and buildings (representing the onshore terminals for oil and gas processing), and vehicles and office equipment. Land and buildings were stated at valuation less accumulated depreciation. Depreciation for land and buildings 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.

According to HKAS 16, property, plant and equipment are required to be categorised by major component and different useful lives, if any, should be applied in calculating the depreciation.

Upon the adoption of HKAS 16, the Group has classified its property, plant and equipment into two categories: oil and gas properties and vehicles and office equipment. The Group has reclassified the onshore terminals previously classified as land and buildings to oil and gas properties as they will be used in similar operations and are expected to have similar economic useful lives.

The Group has also decided to change its accounting policy to state the onshore terminals at cost instead of valuation and to amortise those terminals by the unit-of-production method on a property-by-property basis computed based on the total estimated units of proved developed reserves instead of the straight line method. Management believes the new policy will provide more relevant information and consistent accounting approach for oil and gas related assets.

The effect of this change in accounting policy is to decrease both property, plant and equipment and the revaluation reserve as at 1 January 2005 and 2004 by RMB 274,671,000. No adjustment was made to the prior years’ amounts as the impact on the prior years’ consolidated income statements was not material. The effects of the above changes are summarized in note 2.4 to the financial statements.

#### (b) HKASs 32 and 39 – Financial Instruments

##### (i) Investments in equity and debt securities

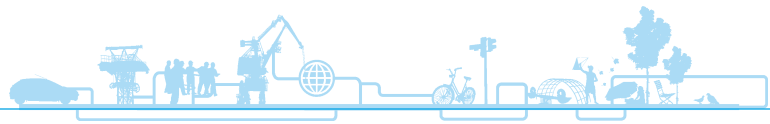
In prior periods, the Group classified its investments in short term debt and equity securities as short term investments which were not intended to be held on a continuing basis and those investments were stated at fair value at the balance sheet date, on an individual investment basis. The gains or losses arising from changes in the fair value of such securities were credited or charged to the income statement in the period in which they arose.

Upon the adoption of HKAS 39, these securities held by the Group at 1 January 2005 in the amount of RMB 5,444,113,000 were designated as available-for-sale investments under the transitional provisions of HKAS 39 and accordingly are stated at fair value with gains or losses being recognised as a separate component of equity until subsequent derecognition or impairment.

##### (ii) Convertible bonds

In prior periods, convertible bonds were stated at amortised cost.

Upon the adoption of HKAS 32 and HKAS 39, the Group’s convertible bonds issued with a cash settlement option and other derivative features are split into liability and derivative components based on their fair values for measurement purposes. The effects of the above changes are summarised in note 2.4 to the financial statements. In accordance with HKAS 32, comparative amounts have been restated.



## 2.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS (“HKFRSs”) (continued)

### (c) HKFRS 2 - Share-based Payment

In prior periods, no recognition and measurement of share-based transactions in which employees (including directors) were granted share options over shares in the Company were required until such options were exercised by employees, at which time the share capital and share premium were credited with the proceeds received.

Upon the adoption of HKFRS 2, when employees (including directors) render services as consideration for equity instruments (“equity-settled transactions”), the cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which the instruments are granted.

The main impact of HKFRS 2 on the Group is the recognition of the cost of these transactions and a corresponding entry to equity for employee share options. The revised accounting policy for share-based payment transactions is described in more detail in note 3 “Summary of significant Accounting Policies” below.

The Group has adopted the provisions of HKFRS 2 retrospectively to all stock options granted from the date of its incorporation. The effects of adopting HKFRS 2 are summarized in note 2.4 to the financial statements.

## 2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE HONG KONG FINANCIAL REPORTING STANDARDS

The HKICPA has issued a number of new and revised HKFRSs that are not mandatory for these financial statements. The Group has not early applied these HKFRSs in these financial statements. The following new and revised HKFRSs, although not early adopted by the Group, will have impact on the Group’s financial statements in the period of initial application. Unless otherwise stated, the following HKFRSs are effective for accounting periods beginning on or after 1 January 2006:

HKAS 1 Amendment	Capital Disclosures
HKAS 21 Amendment	The effects of Changes in Foreign Exchange Rate - Net Investment in a Foreign Operation
HKAS 39 Amendment	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 Amendment	The Fair Value Option
HKFRSs 1 & 6 Amendments	First-time Adoption of Hong Kong Financial Reporting Standards and Exploration for and Evaluation of Mineral Resources
HKFRS 6	Exploration for and Evaluation of Mineral Resources
HKFRS 7	Financial Instruments: Disclosures
HK(IFRIC)-Int 4	Determining whether an Arrangement contains a Lease
HK(IFRIC)-Int 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 2.3 IMPACT OF ISSUED BUT NOT YET EFFECTIVE HONG KONG FINANCIAL REPORTING STANDARDS

(continued)

The HKAS 1 Amendment shall be applied for accounting periods beginning on or after 1 January 2007. The revised standard will affect the disclosures about qualitative information about the Group's objective, policies and processes for managing capital; quantitative data about what the Company regards as capital; and compliance with any capital requirements and the consequences of any non-compliance.

HKFRS 6 deals with the accounting for exploration for and evaluation of mineral resources, including oil and gas. This HKFRS should be applied for accounting periods beginning on or after 1 January 2006. The Group expects that the adoption of HKFRS 6 will not have any significant impact on its results of operations and financial position.

HKFRS 7 will replace HKAS 32 and has modified the disclosure requirements of HKAS 32 relating to financial instruments. This HKFRS shall be applied for accounting periods beginning on or after 1 January 2007.

Except as stated above, the Group expects that the adoption of the other pronouncements listed above will not have any significant impact on the Group's financial statements in the period of initial application.

### 2.4 SUMMARY OF THE IMPACT OF CHANGES IN ACCOUNTING POLICIES

(a) Effect on the consolidated balance sheet

At 1 January 2005 Effect of new policies Increase/(decrease)	Effect of adopting		Total RMB'000
	HKAS 16# Property, plant and equipment RMB'000	HKFRS 2# Recognition of share-based payment RMB'000	
<b>Assets</b>			
Property, plant and equipment, net	(274,671)	—	(274,671)
<b>Liabilities/equity</b>			
Asset revaluation reserve	(274,671)	—	(274,671)
Other reserves	—	110,144	110,144
Retained earnings	—	(110,144)	(110,144)
			<u>(274,671)</u>



## 2.4 SUMMARY OF THE IMPACT OF CHANGES IN ACCOUNTING POLICIES (continued)

### (a) Effect on the consolidated balance sheet (continued)

	Effect of adopting				Total RMB'000
	HKAS 16# Property, plant and equipment RMB'000	HKASs 32 and 39* Convertible bonds RMB'000	HKAS 39* Change in classification of equity investments RMB'000	HKFRS 2# Recognition of share-based payment RMB'000	
At 31 December 2005					
Effect of new policies Increase/(decrease)					
<b>Assets</b>					
Property, plant and equipment, net	(274,671)	—	—	—	(274,671)
<b>Liabilities/equity</b>					
Long term guaranteed notes	—	373,060	—	—	373,060
Asset revaluation reserve	(274,671)	—	—	—	(274,671)
Other reserves	—	—	69,069	139,267	208,336
Retained earnings	—	(373,060)	(69,069)	(139,267)	(581,396)
					(274,671)

### (b) Effects on the balances of equity at 1 January 2004 and at 1 January 2005

	Effect of adopting		Total RMB'000
	HKAS 16# Property, plant and equipment RMB'000	HKFRS 2# Recognition of share-based payment RMB'000	
Effect of new policies Increase/(decrease)			
<b>1 January 2004</b>			
Asset revaluation reserve	(274,671)	—	(274,671)
Other reserves	—	63,502	63,502
Retained earnings	—	(63,502)	(63,502)
			(274,671)
<b>1 January 2005</b>			
Asset revaluation reserve	(274,671)	—	(274,671)
Other reserves	—	110,144	110,144
Retained earnings	—	(110,144)	(110,144)
			(274,671)

\* Adjustments taken effect prospectively from 1 January 2005.

# Adjustments taken effect retrospectively.

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 2.4 SUMMARY OF THE IMPACT OF CHANGES IN ACCOUNTING POLICIES (continued)

(c) Effect on the consolidated income statement for the years ended 31 December 2005 and 2004

Effect of new policies	Effect of adopting			Total RMB'000
	HKAS 16 Property, plant and equipment RMB'000	HKAS 39 Convertible bonds RMB'000	HKFRS 2 Recognition of share-based payment RMB'000	
Year ended 31 December 2005				
Increase in depreciation, depletion and amortisation	19,269	—	—	19,269
Increase in a loss on embedded derivatives in convertible bonds	—	373,060	—	373,060
Increase in selling and administrative expenses	—	—	29,123	29,123
<b>Total decrease in profit</b>	<b>19,269</b>	<b>373,060</b>	<b>29,123</b>	<b>421,452</b>
Year ended 31 December 2004				
Increase in selling and administrative expenses	—	—	46,642	46,642
<b>Total decrease in profit</b>	<b>—</b>	<b>—</b>	<b>46,642</b>	<b>46,642</b>

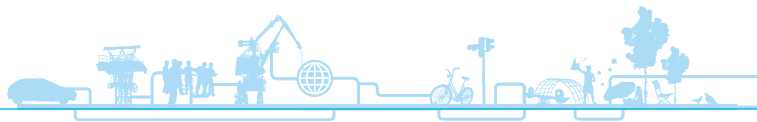
There was no material impact on basic earnings per share and diluted earnings per share for the years ended 31 December 2005 and 2004 for the adoption of the above new policies.

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### 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 an entity, 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 associates are 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.

#### Joint Ventures

Certain of the group's activities are conducted through joint arrangements, including the production sharing arrangements detailed in note 5 below. These arrangements are a form of joint venture whereby a contractual arrangement exists between two or more parties to undertake an economic activity that is subject to joint control. These joint arrangements are included in the consolidated financial statements in proportion to the group's interests in the income, expenses, assets and liabilities of these arrangements.

#### Related parties

A party is considered to be related to the Group if:

- (a) the party directly or indirectly through one or more intermediaries, (i) controls, is controlled by, or is under common control with, the Group ; (ii) has an interest in the Group that gives it significant influence over the Group; or (iii) has joint control over the Group;
- (b) the party is an associate;
- (c) the party is a jointly controlled entity;
- (d) the party is a member of the key management personnel of the Group or its parent;
- (e) the party is a close member of the family of any individual referred to in (a) or (d); or
- (f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e).



### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Impairment of assets

Where an indication of impairment exists, or when annual impairment testing for an asset (other than inventories and financial assets) is required, the asset's recoverable amount is estimated. An asset's recoverable amount is calculated as the higher of the asset's or cash-generating unit's value in use and its fair value less costs to sell, and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is recognised only if the carrying amount of an asset exceeds its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. An impairment loss is charged to the income statement in the period in which it arises.

An assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the recoverable amount is estimated.

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, in which case the reversal of the impairment loss is accounted for in accordance with the relevant accounting policy for that revalued asset.

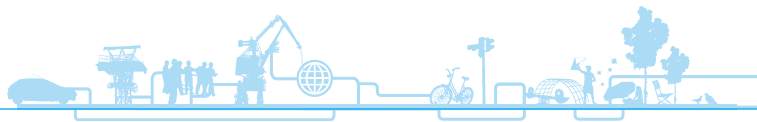
#### Property, plant and equipment

Property, plant and equipment comprise oil and gas properties, 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 expenditures on construction, installation or completion of infrastructure facilities such as platforms, pipelines, processing plants and the drilling of development wells, 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.



### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Property, plant and equipment (continued)

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##### (i) Oil and gas properties (continued)

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 according to 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) 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.

Where parts of an item of property, plant and equipment have different useful lives, the cost of that item is allocated on a recoverable basis among the parts and each part is depreciated separately.

Residual values, useful lives and the depreciation method are reviewed and, adjusted if appropriate, at each balance sheet date.

An item of property, plant and equipment is derecognised upon disposal or where no future economic benefits are expected from its use or disposal. Any gain or loss on disposal or retirement recognised in the income statement in the year that the asset is derecognised is the difference between the net sales proceeds and the carrying value of the relevant asset.

#### Intangible assets

The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

The amortisation period and the amortisation method for an intangible asset with a finite useful life are reviewed as least at each balance sheet date.

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Research and development costs

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

Expenditure (other than relating to oil and gas properties discussed above) incurred on projects to develop new products is capitalised and deferred only when the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale, its intention to complete and its ability to use or sell the asset, how the asset will generate future economic benefits, the availability of resources to complete the project and the ability to measure reliably the expenditure during the development. Product development expenditure which does not meet these criteria is expensed when incurred. No development costs were capitalised during the year.

#### Investments and other financial assets

Applicable to the year ended 31 December 2004:

##### *Short term investment*

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.

Applicable to the year ended 31 December 2005:

Financial assets in the scope of HKAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Group determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at the balance sheet date.

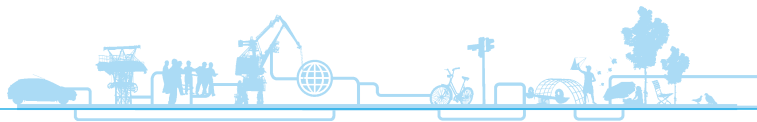
All regular way purchases and sales of financial assets are recognised on the trade date i.e., the date that the Group commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

##### *(a) Financial assets at fair value through profit or loss*

Financial assets classified as held for trading are included in the category “financial assets at fair value through profit or loss”. Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives are also classified as held for trading unless they are designated and effective hedging instruments. Gains or losses on investments held for trading are recognised in the income statement.

##### *(b) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for those with maturities greater than 12 months after the balance sheet date, which are included in non-current assets. Loans and receivables are included in trade and other receivables in the balance sheet.



### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Investments and other financial assets (continued)

(c) *Held-to-maturity investments*

During this year, the Group did not hold any investments assets in this category.

(d) *Available-for-sale financial assets*

Available-for-sale financial assets are those non-derivative financial assets in listed and unlisted equity securities that are designated as available-for-sale or are not classified in any of the other categories. After initial recognition available-for-sale financial assets are measured at fair value with gains or losses being recognised as a separate component of equity until the investment is derecognised or until the investment is determined to be impaired at which time the cumulative gain or loss previously reported in equity is included in the income statement.

When the fair value of unlisted equity securities can not be reliably measured because (a) the variability in the range of reasonable fair value estimates is significant or that investment or (b) the probabilities of the various estimates within the range cannot be reasonably assessed and used in estimating fair value, such securities are stated at cost less any impairment losses.

*Fair Value*

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid price at the close of business at the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; a discounted cash flow analysis; and option pricing models.

#### Impairment of financial assets (Applicable to the year ended 31 December 2005)

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired.

*Assets carried at amortised cost*

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced either directly or through the use of an allowance account. The amount of the impairment loss is recognised in profit or loss.

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Impairment of financial assets (Applicable to the year ended 31 December 2005) (continued)

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

#### Available-for-sale financial assets

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in profit or loss, is transferred from equity to the income statement. Impairment losses on equity instruments classified as available-for-sale are not reversed through profit or loss.

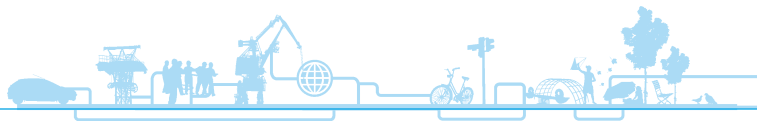
#### Derecognition of financial assets (applicable to the year ended 31 December 2005)

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Group retains the rights to receive cash flows from the asset, but has assumed an obligation to pay in full without material delay to a third party under a “pass-through” arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Group’s continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash settled option or similar provision) on the transferred asset, the extent of the Group’s continuing involvement is the amount of the transferred asset that the Group may repurchase, except that in the case of a written put option (including a cash-settled option or similar provision) on an asset measured at fair value, where the extent of the Group’s continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.



### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Interest-bearing loans and borrowings

All loans and borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method.

Gains and losses are recognised in net profit or loss when the liabilities are derecognised as well as through the amortisation process.

#### Convertible bonds

The Group's convertible bonds issued with a cash settlement option and other embedded derivative features are split into liability and derivative components according to their fair values for measurement purposes.

The fair value of the liability component is determined using the market rate for an equivalent non-convertible bond on the issuance of convertible bonds and this amount is carried as a long term liability on the amortised cost basis until extinguished on conversion or redemption. The derivative component is remeasured at each balance sheet date and any gains or losses arising from change in the fair value are recognised in the income statement. Both the liability and the related embedded derivative components are presented together for financial statements reporting purposes.

#### Derecognition of financial liabilities (applicable to the year ended 31 December 2005)

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and a recognition of a new liability, and the difference between the respective carrying amounts is recognised in profit or loss.

#### Derivative financial instruments (applicable to the year ended 31 December 2005)

The Group uses currency swaps to hedge its risks associated with currency exchange fluctuations. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Any gains or losses arising from changes in fair value on derivatives that do not qualify for hedge accounting are taken directly to net profit or loss for the year.

The fair value of currency swap contracts is determined by reference to market values for similar instruments.

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Inventories and supplies

Inventories consist primarily of oil and supplies consist mainly of items for repairs and maintenance of oil and gas properties. Inventories are stated at the lower of cost and net realisable value. Costs of inventories and supplies represent purchase or production cost of goods and are determined on a weighted average basis. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal. Supplies are capitalised to property, plant and equipment when used for renewals and betterments of oil and gas properties and have resulted in an increase in the future economic values of oil and gas properties or are recognised as expenses when used.

#### Cash and cash equivalents

For the purpose of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and demand deposits, and short term highly liquid investments which are readily convertible into known amounts of cash and which are subject to an insignificant risk of changes in value, and have a short maturity of generally within three months when acquired, less bank overdrafts which are payable on demand and form an integral part of the Group's cash management.

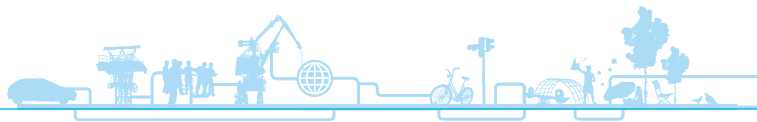
For the purpose of the balance sheet, cash and cash equivalents comprise cash on hand and at banks, and term deposits with maturities of three months or less which are not restricted to use.

#### Provisions

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

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

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



### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### 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 the same or a different period directly in equity.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

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 in a transaction that is not a business combination 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, carry forward of unused tax credits 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 carry forward of unused tax credits 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 in a transaction that is not a business combination 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 reassessed at each balance sheet date and 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.

Deferred tax assets and deferred tax liabilities are offset, if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.



### 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*

Oil and gas sales 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 result in overlifts and underlifts. The Group records these transactions in accordance with the entitlement method under which overlifts are recorded as liabilities and underlifts are recorded as assets 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 contain 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 partner 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*

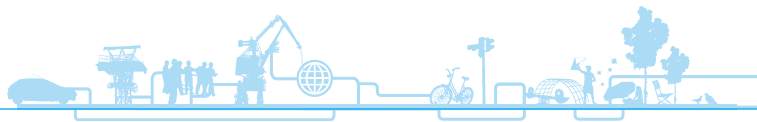
Other income mainly represents project management fees charged to the foreign partners and handling fees charged to customers and is recognised when the services are rendered.

(iv) *Dividend income*

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

(v) *Interest income*

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



### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Employee benefits

##### *Share-based payment transactions*

The Company has adopted share option schemes for the purpose of providing incentives and rewards to eligible participants who contribute to the success of the Group's operations. Employees (including directors) of the Group will from time to time receive remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments ("equity-settled transactions").

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted. The fair value is determined by using a Black-Scholes model, further details of which are given in note 32. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of the Company, if applicable.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (the "vesting date"). The cumulative expenses recognised for equity-settled transactions at each balance sheet date until the vesting date reflects the extent to which the vesting period has expired and the Group's best estimate of the number of equity instruments that will ultimately vest. The charge or credit to the income statement for a period represents the movement in cumulative expense recognised as at the beginning and end of that period.

No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity-settled award are modified, as a minimum, an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any modification, which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any expenses not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and is designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification of the original award, as described in the previous paragraph. The Group has adopted the provisions of HKFRS 2 retrospectively to all stock options granted from the date of its incorporation.

The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share.

##### *Retirement and termination benefits*

The Group participates in defined contribution plans in accordance with 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.

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Dividends

Final and special final dividends proposed by the directors are classified as a separate allocation of retained earnings within the equity 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.

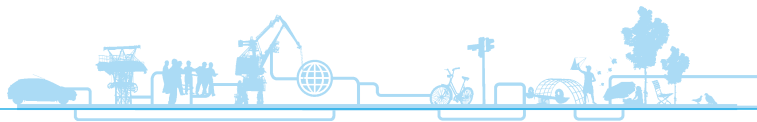
To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalisation is determined by applying a capitalisation rate to the expenditures on that asset. The capitalisation rate is the weighted average of the borrowing costs applicable to the borrowings of the group 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 the borrowing, and amortisation of ancillary costs incurred in connection with arranging the borrowing.

#### Foreign currencies

These financial statements are presented in RMB. Each entity in the Group maintains its books and records in its own functional currency. Foreign currency transactions are initially recorded using the functional currency rates ruling at the date of transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rates of exchange ruling at the balance sheet date. Exchange differences are dealt with in the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

On consolidation, the balance sheet of the Company and the overseas subsidiaries, other than the subsidiaries in the PRC, are translated into RMB at the exchange rates ruling at the balance sheet date and, their income statements are translated into RMB at the weighted average exchange rates for the year. The resulting translation differences are included in the cumulative translation reserve.



### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

#### Foreign currencies (continued)

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

#### 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 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, purchase price allocation, provision for dismantlement and impairment as well as estimates relating to certain oil and gas revenues and expenses. Actual amounts could differ from those estimates and assumptions. More details are given in notes 3, 18 and 31.

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 4. ACQUISITIONS

During the year, the Group completed the acquisition of the North West Shelf Project (“NWS Project”), including an interest of approximately 5.3% in the NWS Project and a 25% interest in the China LNG Joint Venture, a new joint venture established within the NWS Project. The Group acquired the NWS Project to expand its upstream oil and gas reserves and production. The Group’s participation in the NWS Project has not started commercial operations.

Details of the net assets acquired are as follows:

Purchase consideration:	RMB’000
Consideration paid	4,341,783
Direct costs relating to the acquisition	87,522
Total purchase consideration	<u>4,429,305</u>

The assets and liabilities arising from the acquisition are as follows:

	RMB’000
Oil and gas properties	3,129,662
Intangible assets - gas processing rights	1,299,643
Net assets acquired	<u>4,429,305</u>
Purchase consideration settled in cash	<u>4,429,305</u>

The purchase price allocation set out above is still preliminary, pending the confirmation of the tax basis of the underlying assets.

The interest of the Group in the NWS Project has been charged to the other partners of the Project as security for certain of the Group’s liabilities relating to the Project.

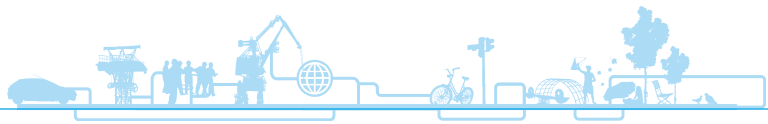
In addition, the Company, through its wholly-owned subsidiary, has signed an agreement with a Canadian based company, MEG Energy Corporation (“MEG”), to acquire a 16.69% equity interest in MEG. The Company completed the transaction and paid C\$150 million (equivalent of RMB1,017 million) for the acquisition of 13,636,364 common shares of MEG in March 2005. MEG is principally engaged in the exploitation and production of oil sands. The investment in the unlisted shares of this company is accounted for as a non-current available-for-sales asset and is stated at cost less any impairment.

### 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 interests.



## 5. PRODUCTION SHARING CONTRACTS (continued)

### PRC (continued)

In general, the Group has the option to take 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 according to 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 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 the value-added 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 according to 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 sale in the PRC market.

### Overseas

The Group and the other partners to the overseas production sharing contracts 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 overseas consists of its participating interest in the properties covered under the relevant production sharing contracts, less oil and gas distributed to the local government and the domestic market obligation.

## 6. SEGMENT INFORMATION

Segment information is presented by way of two segment formats: (i) on a primary segment 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.

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

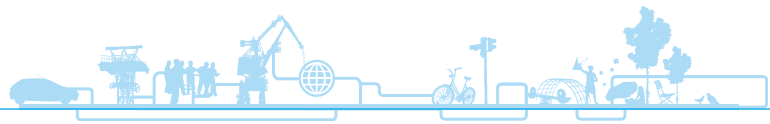
### 6. SEGMENT INFORMATION (continued)

#### (a) Business segments

The Group is organised on a worldwide basis into three major operating 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 the performance of each segment based on profit or loss from operations before income taxes.

The following table presents revenue, profit and certain assets, liabilities and expenditures information for the Group's business segments for the years ended 31 December 2005 and 2004.

	Independent operations		Production sharing contracts		Trading business		Unallocated		Eliminations		Consolidated	
	2005 RMB'000	2004 RMB'000 (Restated)	2005 RMB'000	2004 RMB'000 (Restated)	2005 RMB'000	2004 RMB'000 (Restated)	2005 RMB'000	2004 RMB'000 (Restated)	2005 RMB'000	2004 RMB'000 (Restated)	2005 RMB'000	2004 RMB'000 (Restated)
<b>Segment revenue</b>												
Sales to external customers:												
Oil and gas sales	22,808,733	15,177,621	30,608,936	21,708,398	—	—	—	—	—	—	53,417,669	36,886,019
Marketing revenues	—	—	—	—	15,901,325	18,191,353	—	—	—	—	15,901,325	18,191,353
Intersegment revenues	1,598,171	920,669	7,467,429	2,551,181	—	—	—	—	(9,065,600)	(3,471,850)	—	—
Other income	13,093	6,139	103,047	136,942	—	—	20,609	1,610	—	—	136,749	144,691
<b>Total</b>	<b>24,419,997</b>	<b>16,104,429</b>	<b>38,179,412</b>	<b>24,396,521</b>	<b>15,901,325</b>	<b>18,191,353</b>	<b>20,609</b>	<b>1,610</b>	<b>(9,065,600)</b>	<b>(3,471,850)</b>	<b>69,455,743</b>	<b>55,222,063</b>
<b>Segment results</b>												
Operating expenses	(2,095,273)	(1,828,614)	(3,839,325)	(3,241,730)	—	—	—	—	—	—	(5,934,598)	(5,070,344)
Production taxes	(1,154,771)	(775,210)	(1,444,772)	(950,464)	—	—	—	—	—	—	(2,596,343)	(1,725,674)
Exploration costs	(1,025,993)	(1,136,055)	(267,694)	(180,105)	—	—	—	—	—	—	(1,293,687)	(1,316,160)
Depreciation, depletion and amortisation	(2,554,896)	(2,235,064)	(3,409,844)	(3,219,998)	—	—	—	—	—	—	(5,964,740)	(5,455,062)
Dismantlement	(152,796)	(117,310)	(100,061)	(84,327)	—	—	—	—	—	—	(252,857)	(201,637)
Impairment loss related to property, plant and equipment	(39,494)	—	(50,696)	—	—	—	—	—	—	—	(90,190)	—
Crude oil and product purchases	(1,598,171)	(920,669)	(7,467,429)	(2,551,181)	(15,704,100)	(17,963,461)	—	—	9,065,600	3,471,850	(15,704,100)	(17,963,461)
Selling and administrative expenses	(39,486)	(50,721)	(676,062)	(557,521)	—	—	(654,820)	(496,106)	—	—	(1,370,368)	(1,104,348)
Others	—	—	(77,062)	(45,844)	—	—	—	—	—	—	(77,062)	(45,844)
Interest income	—	—	7,328	2,077	—	—	351,966	204,795	—	—	359,294	206,872
Finance costs	(183,325)	(135,119)	(94,885)	(64,956)	—	—	(822,322)	(241,750)	—	—	(1,100,532)	(441,825)
Exchange gains/(losses), net	—	—	(5,119)	(15,308)	—	—	292,146	44,577	—	—	287,027	29,269
Investment income	—	—	—	—	—	—	247,893	72,438	—	—	247,893	72,438
Share of profits of associates	—	—	—	—	—	—	307,075	344,469	—	—	307,075	344,469
Non-operating income/(expenses), net	—	—	—	—	—	—	28,579	519,206	—	—	28,579	519,206
Tax	—	—	—	—	—	—	(10,977,812)	(6,930,826)	—	—	(10,977,812)	(6,930,826)
<b>Net profit</b>	<b>15,575,792</b>	<b>8,905,667</b>	<b>20,756,791</b>	<b>13,487,164</b>	<b>197,225</b>	<b>227,892</b>	<b>(11,206,686)</b>	<b>(6,481,587)</b>	<b>—</b>	<b>—</b>	<b>25,323,122</b>	<b>16,139,136</b>
<b>Other segment information</b>												
Segment assets	25,054,275	21,120,584	51,125,491	37,851,716	2,413,195	1,712,212	34,770,264	31,790,239	—	—	113,363,225	92,474,751
Investments in associates	—	—	—	—	—	—	1,401,839	1,327,109	—	—	1,401,839	1,327,109
<b>Total assets</b>	<b>25,054,275</b>	<b>21,120,584</b>	<b>51,125,491</b>	<b>37,851,716</b>	<b>2,413,195</b>	<b>1,712,212</b>	<b>36,172,103</b>	<b>33,117,348</b>	<b>—</b>	<b>—</b>	<b>114,765,064</b>	<b>93,801,860</b>
Segment liabilities	(5,187,124)	(3,913,905)	(12,876,516)	(11,453,307)	(667,336)	(809,663)	(22,430,991)	(21,182,195)	—	—	(41,161,967)	(37,359,070)
Capital expenditure	7,806,927	6,309,397	8,914,306	13,145,839	—	—	144,442	164,775	—	—	16,865,675	19,620,011



## 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 the PRC are mainly conducted in Indonesia, Australia, Canada and Singapore. The following table presents revenue and certain asset and expenditure information for the Group's geographical segments for the years ended 31 December 2005 and 2004.

	PRC		Outside PRC		Total	
	2005 RMB'000	2004 RMB'000 (Restated)	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000 (Restated)
Total revenue	38,992,740	30,453,453	30,463,003	24,768,610	69,455,743	55,222,063
Segment assets	92,845,974	75,023,500	21,919,090	18,778,360	114,765,064	93,801,860
Capital expenditure	14,496,690	12,014,894	2,368,985	7,605,117	16,865,675	19,620,011

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

	2005 RMB'000	2004 RMB'000
<b>Production sharing contracts</b>		
China Petroleum & Chemical Corporation	9,996,768	6,932,008
PetroChina Company Limited	1,410,369	1,944,709
Castle Peak Power Company Limited	1,107,314	1,070,436
	12,514,451	9,947,153
<b>Independent operations</b>		
China Petroleum & Chemical Corporation	5,628,968	3,702,058
PetroChina Company Limited	365,830	—
	5,994,798	3,702,058
	18,509,249	13,649,211



## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 7. OIL AND GAS SALES

	2005 RMB'000	2004 RMB'000
Gross sales	57,988,465	39,955,702
Royalties	(708,537)	(610,055)
PRC government share oil	(3,862,259)	(2,459,628)
	<b>53,417,669</b>	36,886,019

### 8. MARKETING PROFIT

	2005 RMB'000	2004 RMB'000
Marketing revenues	15,901,325	18,191,353
Crude oil and product purchases	(15,704,100)	(17,963,461)
	<b>197,225</b>	227,892



## 9. PROFIT BEFORE TAX

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

	2005 RMB'000	2004 RMB'000 (Restated)
Crediting:		
Interest income on bank deposits	(359,294)	(206,872)
Exchange gains, net	(287,027)	(29,269)
Interest income on available-for-sale financial assets	(9,757)	(1,654)
Dividend income on available-for-sale financial assets	(175,416)	(93,040)
Realised gains on available-for-sale financial assets	(62,720)	(2,972)
Unrealised losses on investments	—	25,228
Investment income	(247,893)	(72,438)
Charging:		
Auditors' remuneration		
- Audit fee	7,961	6,750
- Other fees	2,098	1,093
	10,059	7,843
Employee benefit expense (including directors' remuneration (note 12)):		
- Wages, salaries and allowances	363,668	265,007
- Labour costs paid to contractors	750,651	666,599
- Equity-settled share option expense	29,123	46,642
	1,143,442	978,248
Depreciation, depletion and amortisation	5,941,755	5,410,413
Add: Oil-in tank adjustments	22,985	44,649
	5,964,740	5,455,062
Operating lease rentals		
-Office buildings	87,440	107,803
-Equipment	641,846	494,264
	729,286	602,067
Loss on disposal of property, plant and equipment	9,629	173
Repairs and maintenance	1,047,979	1,193,700
Research and development costs	401,640	268,477
Provision for/(reversal of) inventory obsolescence	33,088	(2,710)

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

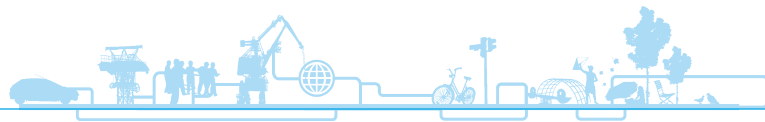
### 10. SELLING AND ADMINISTRATIVE EXPENSES

	2005 RMB'000	2004 RMB'000 (Restated)
Salary and staff benefits	392,791	311,649
Utility and office expenses	143,204	115,817
Travel and entertainment	94,590	75,675
Rentals and maintenance	111,426	128,579
Management fees	243,730	218,087
Selling expenses	32,983	36,015
Provision for/(reversal of) for inventory obsolescence	33,088	(2,710)
Other	318,556	221,236
	<b>1,370,368</b>	<b>1,104,348</b>

### 11. FINANCE COSTS

	2005 RMB'000	2004 RMB'000
Interest on bank loans which are		
- wholly repayable within five years	98,892	80,829
Interest on other loans (including convertible bonds)	671,849	485,812
Other borrowing costs	3,773	163
Total interest	774,514	566,804
Less: Amount capitalised in property, plant and equipment (note 18)	(245,987)	(244,686)
	<b>528,527</b>	<b>322,118</b>
Other finance costs:		
Increase in discounted amount of provisions arising from the passage of time (note 31)	198,945	119,707
Loss on embedded derivative component in convertible bonds	373,060	—
	<b>1,100,532</b>	<b>441,825</b>

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 2005.



## 12. DIRECTORS' REMUNERATION AND SHARE OPTION BENEFITS

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

	2005 RMB'000	2004 RMB'000 (Restated)
Fees for executive directors	—	—
Fees for non-executive directors**	2,360	851
Other emoluments for executive and independent non-executive directors		
- Basic salaries, allowances and benefits in kind**	12,988	7,756
- Bonuses	—	—
- Pension scheme contributions	104	62
Amount paid/payable during the year	15,452	8,669
Share option benefits*	8,561	9,208
	<b>24,013</b>	17,877

### (a) Independent non-executive directors

The fees paid/payable to independent non-executive directors during the year were as follows:

	2005 RMB'000	2004 RMB'000
Chiu Sung Hong	619	213
Evert Henks	619	213
Kenneth S Courtis	619	213
Erwin Schurtenberger	350	213
Tse Hau Yin, Aloysius	153	—
Lawrence J. Lau	—	—

Professor Lawrence J. Lau, appointed as the independent non-executive director of the Company on 31 August 2005, waived his remuneration in 2005.

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 12. DIRECTORS' REMUNERATION AND SHARE OPTION BENEFITS (continued)

#### (b) Executive directors and independent non-executive directors

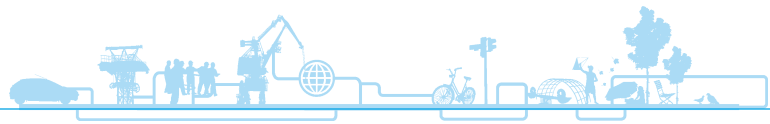
	Fees** RMB'000	Salaries, allowances and benefits In kind** RMB'000	Performance related bonuses RMB'000	Pension scheme contributions RMB'000	Amount paid/payable during the year RMB'000	Share option benefits* RMB'000	Total RMB'000
2005							
Executive directors:							
Fu Chengyu	—	4,411	—	—	4,411	2,236	6,647
Zhou Shouwei	—	3,519	—	82	3,601	1,653	5,254
Luo Han	—	1,291	—	—	1,291	1,086	2,377
Cao Xinghe	—	430	—	—	430	269	699
Wu Zhenfang	—	430	—	—	430	269	699
Wu Guangqi	—	1,377	—	—	1,377	542	1,919
Yang Hua	—	967	—	22	989	1,086	2,075
Jiang Longsheng	—	563	—	—	563	55	618
Independent non-executive director:							
Chiu Sunghong	619	—	—	—	619	437	1,056
Evert Henks	619	—	—	—	619	437	1,056
Kenneth S Courtis	619	—	—	—	619	437	1,056
Tse Hau Yin, Aloysius	350	—	—	—	350	—	350
Erwin Schurtenberger***	153	—	—	—	153	54	207
Lawrence J. Lau	—	—	—	—	—	—	—
2004							
Executive directors:							
Fu Chengyu	—	3,934	—	—	3,934	2,077	6,011
Luo Han	—	561	—	—	561	1,107	1,668
Zhou Shouwei	—	2,710	—	62	2,772	1,685	4,457
Jiang Longsheng	—	551	—	—	551	1,107	1,658
Independent non-executive director:							
Chiu Sunghong	213	—	—	—	213	808	1,021
Evert Henks	213	—	—	—	213	808	1,021
Kenneth S Courtis	213	—	—	—	213	808	1,021
Erwin Schurtenberger	213	—	—	—	213	808	1,021

\* During the year, certain directors were granted share options in respect of their services to the Group under the applicable share option schemes of the Company, further details of which are set out in note 32 to the financial statements. Share option benefits represent the fair value at grant date of share options issued under the share option schemes of the Company amortised to the income statement during the year disregarding whether the options have been exercised or not, and have been disclosed in accordance with HKFRS 2. No share options were exercised by the directors during the year.

\*\* Fees and salaries, allowances and benefits in kind represent the gross amount (before Hong Kong individual salary tax) paid/payable to individual directors.

\*\*\* On 1 April 2005, Mr. Erwin Schurtenberger surrendered 1,150,000 share options following his resignation as an independent non-executive director of the Company.

Save as disclosed above, there was no arrangement under which a director waived or agreed to waive any remuneration during the year.



### 13. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included three (2004: Nil) directors and two (2004: five) non-directors are as follows:

	2005 RMB'000	2004 RMB'000 (Restated)
Basic salaries, allowances and benefits in kind*	15,843	20,509
Bonuses	471	4,589
Pension scheme contributions	542	1,509
Amount paid/payable during the year	16,856	26,607
Share option benefits**	4,975	1,107
	<b>21,831</b>	<b>27,714</b>
Number of directors	3	—
Number of employees	2	5

\* Salaries, allowances and benefits in kind represent the gross amount (before Hong Kong individual salary tax) paid/payable to individual employees.

\*\* Share option benefits represent fair value at grant date of share options issued under the share option schemes of the Company amortised to the income statement during the year disregarding whether the options have been exercised or not, and have been disclosed in accordance with HKFRS2. No share options were exercised by the relevant employees during the year.

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

	Number of employees	
	2005	2004
Nil to HK\$3,000,000	1	—
HK\$3,000,001- HK\$3,500,000	1	1
HK\$3,500,001- HK\$4,000,000	—	1
HK\$4,000,001- HK\$4,500,000	1	1
HK\$4,500,001- HK\$5,000,000	—	—
HK\$5,000,001- HK\$5,500,000	1	—
HK\$5,500,001- HK\$6,000,000	—	1
HK\$6,000,001- HK\$8,000,000	1	—
HK\$8,000,001- HK\$8,500,000	—	1
	<b>5</b>	<b>5</b>

During the year, share options were granted to certain of the five highest paid employees in respect of their services to the Group, further details of which are included in the disclosures in note 32 to the financial statements.

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 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 in the PRC, CNOOC China Limited, is a wholly foreign-owned enterprise. 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:

	2005 RMB'000	2004 RMB'000
Overseas income taxes		
- Current	845,390	755,568
- Deferred	14,907	(170,118)
PRC enterprise income tax		
- Current	9,912,426	6,411,417
- Deferred	205,089	(66,041)
<b>Total tax charge for the year</b>	<b>10,977,812</b>	<b>6,930,826</b>

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

	2005 %	2004 % (Restated)
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 the Company and overseas subsidiaries	0.5	0.3
Tax credit from the government	(0.3)	(0.6)
Tax effect on other permanent differences	(0.0)	0.3
<b>Tax charge at the Group's effective rate</b>	<b>30.2</b>	<b>30.0</b>



#### 14. TAX (continued)

##### (i) Income tax (continued)

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

	2004 RMB'000	Recognised in income statements RMB'000	(Credited)/ charged to foreign exchange RMB'000	2005 RMB'000
Deferred tax assets				
Provision for retirement and termination benefits	112,150	(10,659)	(2,795)	98,696
Provision for dismantlement	926,834	321,664	—	1,248,498
Provision for impairment of property, plant and equipment and write-off of unsuccessful exploratory drillings	869,286	17,116	—	886,402
	1,908,270	328,121	(2,795)	2,233,596
Deferred tax liabilities				
Accelerated amortization allowance for oil and gas properties	(8,596,768)	(548,117)	83,373	(9,061,512)
Net deferred tax liabilities	(6,688,498)	(219,996)	80,578	(6,827,916)

As at 31 December 2005, there was no significant unrecognised deferred tax liability (2004: 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.



## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 14. TAX (continued)

#### (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 2005 dealt with in the financial statements of the Company, was approximately RMB13,791,976,000 (2004: RMB5,395,306,000 (restated)) (see note 33).

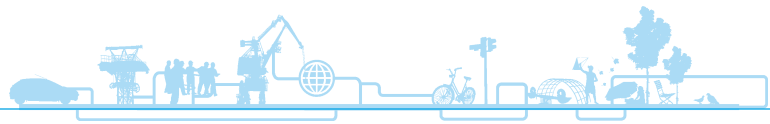
### 16. DIVIDENDS

On 30 August 2005, the Board of Directors declared an interim dividend of HK\$0.05 per share (2004: HK\$0.03 per share), totalling HK\$2,052,733,769 (equivalent to approximately RMB2,138,128,000) (2004: RMB1,306,451,000); and a special interim dividend of HK\$0.05 per share (2004: HK\$0.05 per share), totalling HK\$2,052,733,769 (equivalent to approximately RMB2,138,128,000) (2004: RMB2,177,418,000). In addition, the Company paid a special interim dividend in 2004 of HK\$0.06 per share, totalling HK\$2,464,249,697 (equivalent to approximately RMB2,617,526,000) in place of its 2003 final dividend.

The Board of Directors have recommended a final dividend of HK\$0.10 per ordinary share, totaling HK\$4,105,467,538 (approximately equivalent to RMB4,250,391,000) for the year ended 31 December 2005.

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 associates. 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. Cash 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

	2005	2004 (Restated)
<b>Earnings:</b>		
Net profit from ordinary activities attributable to shareholders for the year for the purpose of basic earnings per share	<b>RMB25,323,122,000</b>	RMB16,139,136,000
Interest expense and losses recognised on the derivative component of convertible bonds	<b>RMB 537,468,873</b>	—
Net profit from ordinary activities attributable to shareholders for the year for the purpose of diluted earnings per share	<b>RMB25,860,590,873</b>	RMB16,139,136,000
<b>Number of shares:</b>		
Weighted average number of ordinary shares for the purpose of basic earnings per share before effects of shares repurchased and share options exercised	<b>41,052,375,275</b>	41,070,828,275
Effect of shares repurchased	—	(10,587,616)
Effect of share options exercised	<b>2,124,707</b>	—
Weighted average number of ordinary shares for the purpose of basic earnings per share	<b>41,054,499,982</b>	41,060,240,659
Effect of dilutive potential ordinary shares under the share option schemes	<b>38,861,432</b>	66,720,503
Effect of dilutive potential ordinary shares for convertible bonds	<b>1,292,694,352</b>	52,552,274
Weighted average number of ordinary shares for the purpose of diluted earnings per share	<b>42,386,055,766</b>	41,179,513,436
Earnings per share – Basic	<b>RMB0.62</b>	RMB0.39
– Diluted	<b>RMB0.61</b>	RMB0.39

The calculation of basic earnings per share amounts is based on the net profit for the year and the weighted average number of ordinary shares in issue during the year.

The calculation of diluted earnings per share amounts is based on the net profit for the year, adjusted to reflect the interest expense and losses recognised on the derivative component of the convertible bonds. The weighted average number of ordinary shares used in the calculation is the ordinary shares in issue during the year, as used in the basic earnings per share calculation, and the weighted average number of ordinary shares assumed to have been issued at no consideration on the deemed exercise or conversion of all the dilutive potential ordinary shares into ordinary shares.

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

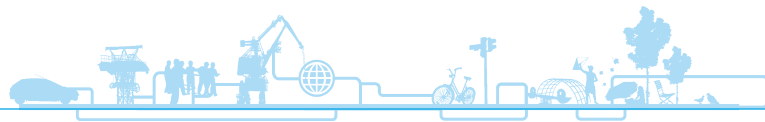
### 18. PROPERTY, PLANT AND EQUIPMENT, NET

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

Group

	2005				2004
	Oil and gas properties RMB'000	Land and buildings RMB'000	Vehicles and office equipment RMB'000	Total RMB'000	Total RMB'000 (Restated)
<b>Cost:</b>					
At beginning of the year as previously reported	89,917,894	941,578	187,705	91,047,177	71,102,511
Cumulative adjustment for the adoption of HKAS 16	666,907	(941,578)	—	(274,671)	(274,671)
At beginning of the year as restated	90,584,801	—	187,705	90,772,506	70,827,840
Additions	17,500,195	—	146,226	17,646,421	13,010,141
Acquisitions (including prepayments)	—	—	—	—	6,934,951
Transfer from prepayment to intangible assets upon completion of acquisition	(1,299,643)	—	—	(1,299,643)	—
Purchase price adjustment	(152,993)	—	—	(152,993)	—
Disposals and write-offs	—	—	(14,511)	(14,511)	(177)
Exchange realignment	(504,132)	—	(6)	(504,138)	(249)
End of year	106,128,228	—	319,414	106,447,642	90,772,506
<b>Accumulated depreciation, depletion and amortisation and amortisation:</b>					
At beginning of the year as previously reported	(33,414,136)	(132,455)	(43,889)	(33,590,480)	(27,978,710)
Cumulative adjustment for the adoption of HKAS 16	(132,455)	132,455	—	—	—
At beginning of the year as restated	(33,546,591)	—	(43,889)	(33,590,480)	(27,978,710)
Depreciation provided during the year	(6,176,784)	—	(57,248)	(6,234,032)	(5,612,050)
Impairment recognised in the income statement during the year	(90,190)	—	—	(90,190)	—
Disposals	—	—	4,881	4,881	5
Exchange realignment	87,346	—	—	87,346	275
End of year	(39,726,219)	—	(96,256)	(39,822,475)	(33,590,480)
<b>Net book value:</b>					
Beginning of year as previously reported	56,503,758	809,123	143,816	57,456,697	43,123,801
Beginning of the year as restated	57,038,210	—	143,816	57,182,026	42,849,130
End of year	66,402,009	—	223,158	66,625,167	57,182,026

Included in the current year additions was an amount of approximately RMB245,987,000 (2004: RMB244,686,000) 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	
	2005 RMB'000	2004 RMB'000
<b>Cost:</b>		
Beginning of the year	5,833	5,833
Additions	2,128	—
End of year	7,961	5,833
<b>Accumulated depreciation:</b>		
Beginning of the year	(5,669)	(5,562)
Charge for the year	(1,218)	(107)
End of year	(6,887)	(5,669)
<b>Net book value:</b>		
Beginning of year	164	271
End of year	1,074	164

#### 19. INTANGIBLE ASSETS

During the year, the Company completed the acquisition of the NWS Project. Accordingly, the consideration allocated to the gas processing rights is recorded as an intangible asset and will be amortised upon the commercial production of the liquefied natural gas using the unit of production method.

#### 20. INVESTMENT IN SUBSIDIARIES/LOANS TO AND DUE FROM/TO SUBSIDIARIES

	Company	
	2005 RMB'000	2004 RMB'000
Unlisted shares, at cost	7,766,971	7,766,971
Loans to a subsidiary	4,138,290	4,138,290
Due from subsidiaries	22,213,478	13,206,016
Due to subsidiaries	(14,468,726)	(15,256,082)
	<b>19,650,013</b>	<b>9,855,195</b>

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 20. INVESTMENT IN SUBSIDIARIES/LOANS TO AND DUE FROM/TO SUBSIDIARIES (continued)

The loans to a subsidiary are unsecured and bear interest at a rate of 7.084% per annum. The carrying value of the loans approximated to fair value. The maturities of the balance are as follows:

	2005 RMB'000	2004 RMB'000
Balances due:		
Within five years	—	—
More than five years	4,138,290	4,138,290
	<b>4,138,290</b>	<b>4,138,290</b>

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

Particulars of the principal subsidiaries are as follows:

Name of entity	Place and date of incorporation/ establishment	Nominal value of issued and paid/ registered ordinary share capital	Percentage of equity attributable to the Group	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 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



## 20. INVESTMENT IN SUBSIDIARIES/LOANS TO AND DUE FROM/TO SUBSIDIARIES (continued)

Name of entity	Place and date of incorporation/ establishment	Nominal value of issued and paid/ registered ordinary share capital	Percentage of equity attributable to the Group	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

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 20. INVESTMENT IN SUBSIDIARIES/LOANS TO AND DUE FROM/TO SUBSIDIARIES (continued)

Name of entity	Place and date of incorporation/ establishment	Nominal value of issued and paid/ registered ordinary share capital	Percentage of equity attributable to the Group	Principal activities
CNOOC NWS Private Limited	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 February 1996	US\$7,780,700	100%	Offshore petroleum exploration, development and production in Indonesia

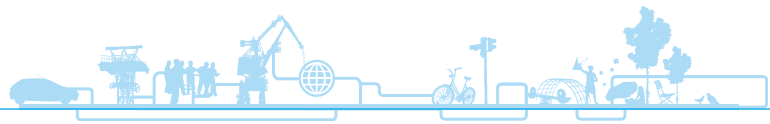
\* Indirectly held through CNOOC International Limited.

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.

### 21. INVESTMENTS IN ASSOCIATES

The Group's 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 Corporation Limited was incorporated on 14 June 2002 in the PRC with limited liability and is principally engaged in deposit-taking, transfer, settlement, loan, discounting and other financing services to CNOOC and its member entities. The issued and paid-up capital of CNOOC Finance Corporation Limited is RMB1,415 million.

	Group	
	2005 RMB'000	2004 RMB'000
Share of net assets	1,401,839	1,327,109



## 22. 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. Trade receivables are non-interest-bearing.

As at 31 December 2005 and 2004, substantially all the accounts receivable were aged within six months.

## 23. INVENTORIES AND SUPPLIES

	Group	
	2005 RMB'000	2004 RMB'000
Materials and supplies	969,915	879,300
Oil in tanks	268,834	274,029
Less: Provision for inventory obsolescence	(39,123)	(6,035)
	<b>1,199,626</b>	1,147,294

## 24. AVAILABLE-FOR-SALE FINANCIAL ASSETS (CURRENT) / SHORT TERM INVESTMENT

As at 31 December 2005, available-for-sale financial assets mainly represented investments in liquidity funds and were stated at fair value at the balance sheet date. Details of the available-for-sale financial assets were as follows:

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Unlisted investments, at fair value:				
Liquidity funds	13,185,139	3,763,959	8,424,780	2,759,400
Corporate bonds	199,877	1,639,956	199,877	1,639,956
Common stock	—	40,198	—	40,198
Listed investments, at fair value:				
Common stock	461,919	—	461,919	—
	<b>13,846,935</b>	5,444,113	<b>9,086,576</b>	4,439,554

The fair values of listed investments are based on quoted market prices. The fair values of unlisted investments are based on the prices quoted by fund managers. The directors believe that the estimated fair values quoted by fund managers, which are recorded in the consolidated balance sheet, and the related changes in fair values, which are recorded in the consolidated balance sheet or income statement, are reasonable, and that they are the most appropriate values at the balance sheet date.

During the year, the gross gain of the Group's and the Company's available-for-sale investments recognised directly in equity amounted to RMB69,069,142 and RMB64,900,590.



## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 25. ACCOUNTS PAYABLE

As at 31 December 2005 and 2004, substantially all the accounts payable were aged within six months. The accounts payable are non-interest-bearing and are normally settled within six months.

### 26. OTHER PAYABLES AND ACCRUED LIABILITIES

	Group	
	2005 RMB'000	2004 RMB'000
Accrued payroll and welfare payable	178,872	156,706
Provision for retirement and termination benefits	239,591	292,128
Accrued expenses	3,411,784	2,818,785
Advances from customers	22,238	12,588
Royalties payable	297,139	142,638
Other payables	1,057,319	768,179
	<b>5,206,943</b>	<b>4,191,024</b>

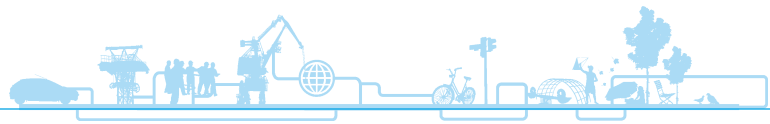
Other payables are non-interest-bearing and have an average term within six months. The fair value of the currency swaps of RMB4,725,000 (2004: RMB2,581,000) are included in the other payables of the Group.

### 27. LONG TERM BANK LOANS

As at 31 December 2005, 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	
		2005 RMB'000	2004 RMB'000
	Effective interest rate and final maturity		
US\$ denominated bank loans	Effective interest rate of 9.2% per annum with maturities through to 2006	812,759	827,650
Japanese Yen denominated bank loans	Effective interest rate of 4.1% per annum with maturities through to 2007	37,307	61,925
		<b>850,066</b>	<b>889,575</b>
Less: Current portion of long term bank loans		<b>(825,674)</b>	<b>(24,364)</b>
		<b>24,392</b>	<b>865,211</b>

As at 31 December 2005, all the bank loans of the Group were unsecured and none of the outstanding borrowings were guaranteed by CNOOC.



## 27. LONG TERM BANK LOANS (continued)

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

	Group	
	2005 RMB'000	2004 RMB'000
Balances due:		
Within one year	825,674	24,364
After one year but within two years	24,392	846,471
After two years but within three years	—	18,740
After three years but within four years	—	—
After four years but within five years	—	—
	<b>850,066</b>	889,575
Amount due within one year shown under current liabilities	<b>(825,674)</b>	(24,364)
	<b>24,392</b>	865,211

Supplemental information with respect to long term bank loans:

For the year ended 31 December	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**
2005	850,066	8.98%	889,575	869,821	8.89%
2004	889,575	8.81%	910,193	899,884	8.37%

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

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

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

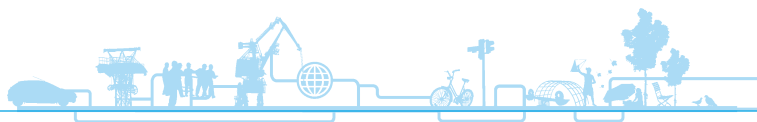
### 28. LONG TERM GUARANTEED NOTES

Long term guaranteed notes comprised the following:

- (i) The principal amount of US\$500 million of 6.375% guaranteed notes due in 2012 issued by CNOOC Finance (2002) Limited, a wholly-owned subsidiary of the Company. The obligations of CNOOC Finance (2002) Limited in respect of the notes are unconditionally and irrevocably guaranteed by the Company.
- (ii) The principal amount of US\$200 million of 4.125% guaranteed notes due in 2013 and the principal amount of US\$300 million of 5.500% guaranteed notes due in 2033 issued by CNOOC Finance (2003) Limited, a wholly-owned subsidiary of the Company. The obligations of CNOOC Finance (2003) Limited in respect of the notes are unconditionally and irrevocably guaranteed by the Company.
- (iii) The principal amount of US\$1 billion zero coupon guaranteed convertible bonds due in 2009, unconditionally and irrevocably guaranteed by, and convertible into shares of the Company issued by CNOOC Finance (2004) Limited, a wholly-owned subsidiary of the Company, on 15 December 2004. The bonds are convertible from 15 January 2005 onwards at a price of HK\$6.075 per share, subject to adjustment for, among other things, the subdivision or consolidation of shares, bond issues, rights issues, capital distribution and other dilutive events. The conversion price was adjusted to HK\$5.97 per share on 7 June 2005 as a result of the declaration of the final and special final dividends for 2004 by the Company. Unless previously redeemed, converted or purchased and cancelled, the bonds will be redeemed on the maturity date at 105.114% of the principal amount. CNOOC Finance (2004) Limited has an early redemption option at any time after 15 December 2007 (subject to certain criteria) and a cash settlement option when the holders exercise their conversion right. The bondholders also have an early redemption option to require CNOOC Finance (2004) to redeem all or part of the bonds on 15 December 2007 at an early redemption amount of 103.038% of the principal amount.

### 29. BALANCES WITH THE PARENT COMPANY

As at 31 December 2005 and 2004, the balances with CNOOC were unsecured, interest-free and were repayable on demand.



### 30. RELATED PARTY TRANSACTIONS

The Group has entered into several agreements with CNOOC and its affiliates, which govern the provision of materials, utilities and ancillary services, the provision of technical services, the provision of research and development services, 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	2005 RMB'000	2004 RMB'000
Materials, utilities and ancillary services	(i)	2,995,772	1,295,598
Technical services	(ii)	6,651,240	6,362,206
Research and development services	(iii)	8,110	7,800
Lease and property management services	(iv)	77,273	76,721
Included in:			
Exploration expenses		753,534	960,031
Operating expenses		1,972,431	1,405,877
Selling and administrative expenses		337,816	326,004
Capitalised under property, plant and equipment		6,668,614	5,050,413

#### (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;
- 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.

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 30. RELATED PARTY TRANSACTIONS (continued)

#### (ii) Technical services

Various affiliates of CNOOC, including China Oilfield Services Limited and Offshore Oil Engineering Company Limited, provide the Group with technical services for the Group's offshore oil and gas production activities, 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.

The price for technical services was determined based on local market prices.

#### (iii) Research and development services

The Group has revised the original research and development services agreement with China Offshore Oil Research Centre (the "Centre"), CNOOC's subsidiary, due to the restructuring of operations in 2003, and only pays the Centre for particular research and development services. These research and development services were determined at local market prices.

#### (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 reflect the fair and reasonable commercial market rent and management fees.

#### (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 2005, the total sales amounted to approximately RMB26,576,247,000 (2004: RMB13,945,565,000).

In the prior year, the Company, through its wholly-owned subsidiary, China Offshore Oil (Singapore) International Pte., Ltd., imported oil into the PRC for trading, using CNOOC's import license. The total sales to its customers through such arrangements amounted to approximately RMB447 million while the commission paid by the third party customers to CNOOC amounted to approximately RMB2.7 million for the year ended 31 December 2004. No such trading by using CNOOC's import license occurred during the year.



### 30. RELATED PARTY TRANSACTIONS (continued)

#### (vi) Transactions with CNOOC Finance Corporation Limited

The Company entered into a framework agreement (“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 which 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. Pursuant to the Framework Agreement, the financial services provided by CNOOC Finance also include provision of loan. The charges by CNOOC Finance for its financial services to the Group are based on the pricing policies of CNOOC Finance. Such pricing policies are subject to People’s Bank of China guidelines, including the interest rates and foreign exchange rates, as well as guidelines published by PRC self-regulatory bodies, such as associations of finance companies. Based on these guidelines, CNOOC Finance has limited discretion in setting its prices.

For the year ended 31 December 2005, the maximum outstanding balance for deposits (including interest received in respect of these deposits) placed with CNOOC Finance amounted to approximately RMB3,922,468,000 (2004: RMB5,300,381,000).

### 31. 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’s income statement charge represents the amortisation charge on the dismantlement liabilities capitalised in accordance with HKAS 37 and is included in the accumulated depreciation, depletion and amortisation in note 18.

The details of the provision for dismantlement are as follows:

	Group	
	2005 RMB’000	2004 RMB’000
At the beginning of year	3,089,448	2,646,800
Additions during the year and capitalised in oil and gas properties	873,270	322,941
Increase in a discounted amount of provisions arising from the passage of time	198,945	119,707
At the end of year	4,161,663	3,089,448

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 32. SHARE CAPITAL

Shares (after subdivision of shares*)	Number of shares	Share capital HK\$'000	Issued share capital equivalent of RMB'000
<i>Authorised:</i>			
Ordinary shares of HK\$0.02 each			
As at 31 December 2005 and 31 December 2004	75,000,000,000	1,500,000	
<i>Issued and fully paid:</i>			
Ordinary shares of HK\$0.02 each			
As at 1 January 2004	41,070,828,275	821,417	876,978
Repurchased and cancelled	(18,453,000)	(369)	(392)
As at 31 December 2004	41,052,375,275	821,048	876,586
Exercise of options	2,300,100	46	49
As at 31 December 2005	41,054,675,375	821,094	876,635

\* Adjustment has been made to take account of the subdivision of issued and unissued shares of HK\$0.10 each into five shares of HK\$0.02 each effective 17 March 2004.

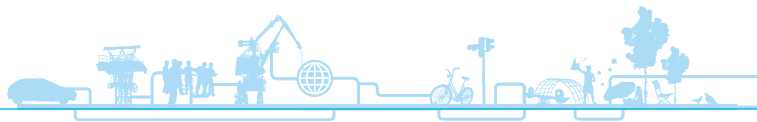
The repurchase of the Company's shares during the prior year was effected by the directors, pursuant to the mandate from shareholders received at the last annual general meeting.

#### Share option schemes

The Company has adopted the following share option schemes for the grant of options to the Company's Directors, senior management and other eligible grantees:

1. Pre-Global Offering Share Option Scheme (as defined below);
2. 2001 Share Option Scheme (as defined below);
3. 2002 Share Option Scheme (as defined below); and
4. 2005 Share Option Scheme (as defined below).

Under these share option schemes, the Remuneration Committee of the Company's Board of Directors will from time to time propose for the Board's approval for the recipient of and the number of shares underlying each option. The maximum aggregate number of shares (including those that could be substituted for under the Pre-Global Offering Share Option Scheme, the 2001 Share Option Scheme, the 2002 Share Option Scheme and the 2005 Share Option Scheme) which may be granted shall not exceed 10% of the total issued share capital of the Company as at 31 December 2005, being the date on which the shareholders of the Company approved a new share option scheme, excluding shares issued upon exercise of options granted under these schemes from time to time.



## 32. SHARE CAPITAL (continued)

### Share option schemes (continued)

125

#### Pre-Global Offering Share Option Scheme

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 rights to exercise the options shall vest 18 months after the date of the grant; and
  - (b) 50% of the rights to exercise the options shall vest 30 months after the date of the grant.

The exercise periods for options granted under the Pre-Global Offering Share Option Scheme shall end not later than 10 years from 12 March 2001. No further options may be granted under the Pre-Global Offering Share Option Scheme.

#### 2001 Share Option Scheme

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 as follows:
  - (a) one-third of the rights to exercise the options shall vest on the first anniversary of the date of the grant;
  - (b) one-third of the rights to exercise the options shall vest on the second anniversary of the date of the grant; and
  - (c) one-third of the rights to exercise the options shall vest on the third anniversary of the date of the grant.

The exercise periods 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.



### 32. SHARE CAPITAL (continued)

#### Share option schemes (continued)

##### 2002 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 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 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 shall not exceed 1% of the total issued share capital of the Company from time to time.

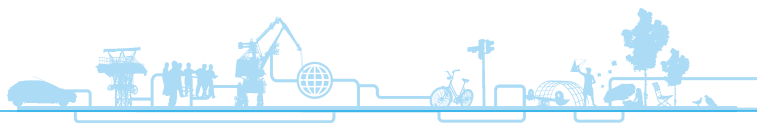
According to the 2002 Share Option Scheme, the consideration payable by a participant for the grant of an option will be HK\$1.00. The subscription price of a share payable by a participant upon the exercise of an option is determined by the Directors at their discretion at the date of grant, except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

1. the nominal value of the share of the Company on the date of the grant of the option;
2. the average closing price of the shares on The Stock Exchange of Hong Kong Limited (“HKSE”) as stated in the HKSE’s quotations sheets for the five trading days immediately preceding the date of grant of the option; and
3. the closing price of the shares on the HKSE as stated in the HKSE’s quotations sheets on the date of grant of the option.

On 24 February 2003, the Board of Directors approved to grant options in respect of 42,050,000 shares to the Company’s Directors and senior management under the 2002 Share Option Scheme. The exercise price for such options is HK\$2.108 per share. The closing market price immediately before the date on which such options were granted was HK\$2.11 per share. Such 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 rights to exercise the options shall vest on the first anniversary of the date of the grant;
2. one-third of the rights to exercise the options shall vest on the second anniversary of the date of the grant; and
3. one-third of the rights to exercise the options shall vest on the third anniversary of the date of the grant.

The exercise period for the above options granted under the 2002 Share Option Scheme shall end not later than 10 years from 24 February 2003.



## 32. SHARE CAPITAL (continued)

### Share option schemes (continued)

#### 2002 Share Option Scheme (continued)

On 5 February 2004, the Board of Directors approved a grant of options in respect of 50,700,000 shares to the Company's Directors and senior management under the 2002 Share Option Scheme. The exercise price for such options is HK\$3.152 per share. The closing market price immediately before the date on which such options were granted was HK\$3.146 per share. Such 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 rights to exercise the options shall vest on the first anniversary of the date of the grant;
2. one-third of the rights to exercise the options shall vest on the second anniversary of the date of the grant; and
3. one-third of the rights to exercise the options shall vest on the third anniversary of the date of the grant.

The exercise period for the above options granted under the 2002 Share Option Scheme shall end not later than 10 years from 5 February 2004.

On 31 August 2005, the Board of Directors approved a grant of options in respect of 65,870,000 shares to the Company's Directors and senior management under the 2002 Share Option Scheme. The exercise price of such options is HK\$5.62 per share. The closing market price immediately before the date on which such options were granted was HK\$5.75 per share. Such 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 rights to exercise the options shall vest on the first anniversary of the date of the grant;
2. one-third of the rights to exercise the options shall vest on the second anniversary of the date of the grant; and
3. one-third of the rights to exercise the options shall vest on the third anniversary of the date of the grant.

The exercise period for the above options granted under the 2002 Share Option Scheme shall end not later than 10 years from 31 August 2005.

#### 2005 Share Option Scheme

The Company had undertaken a review of the 2002 Share Option Scheme in 2005 and noted that certain provisions could be clarified and improved. Accordingly, the Board had proposed, and on 31 December 2005, the Company adopted a new share option scheme ("2005 Share Option Scheme") and terminated the 2002 Share Option Scheme. Upon termination of the 2002 Share Option Scheme, no further options may be granted under the 2002 Share Option Scheme, but in all other respects the provisions of the 2002 Share Option Scheme shall remain in force. The outstanding options under the 2002 Share Option Scheme shall continue to be subject to the provisions of the 2002 Share Option Scheme, and the adoption of the 2005 Share Option Scheme will not in any way affect the terms of the exercise of such outstanding options.

### 32. SHARE CAPITAL (continued)

#### Share option schemes (continued)

##### 2005 Share Option Scheme (continued)

Under the 2005 Share Option Scheme, the Board of the Company will have the authority to grant options to subscribe for shares to the Directors, officers and employees of the Company and its subsidiaries, and any other persons who in sole discretion of the Board have contributed or will contribute to the Group. Unless approved by the shareholders, the total number of shares issued and to be issued upon exercise of the options granted to each individual (including exercised and unexercised options) under the 2005 Share Option Scheme or any other share option scheme adopted by the Company, in any 12 months period, must not exceed 1% of the shares in issue.

According to the 2005 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 the share of the Company on the date of the grant of the option;
2. the average closing price of the shares on the HKSE as stated in the HKSE's quotations 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 quotations sheet on the date of the grant of the option.

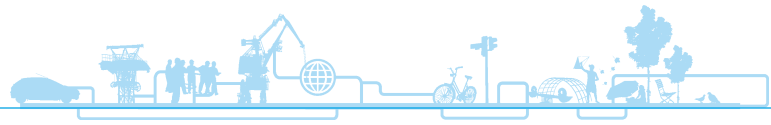
The period within which the options must be exercised, as well as any minimum holding period or performance targets which apply to the options, will be specified by the Board of the Company at the time of grant. The exercise period for options granted under the 2005 Share Option Scheme shall end not later than 10 years from the date of the grant of the option. During the year, no options have been granted or exercised under the 2005 Share Option Scheme.

### 32. SHARE CAPITAL (continued)

#### Share option schemes (continued)

During the year ended 31 December 2005, the movements in the options granted under all of the above share option schemes were as follows:

Name of category of participant	Number of share options					Date of grant of share options	Exercise period of share options**	Exercise price of share options HK\$	Price of Company's shares		Weighted average price of the Company's shares	
	At 1 January 2005	Granted during the year	Exercised during the year	Forfeited during the year	Expired during the year				At 31 December 2005	Immediately before the grant date of options HK\$		Immediately before the exercise date HK\$
<b>Executive Directors</b>												
Fu Chengyu	1,750,000	—	—	—	—	1,750,000	12 March 2001 to 12 March 2011	1.19	1.23	—	—	
	1,750,000	—	—	—	—	1,750,000	27 August 2001 to 27 August 2011	1.232	1.46	—	—	
	1,150,000	—	—	—	—	1,150,000	24 February 2003 to 24 February 2013	2.108	2.09	—	—	
	2,150,000	—	—	—	—	2,150,000	5 February 2004 to 5 February 2014	3.152	3.13	—	—	
	—	3,500,000	—	—	—	3,500,000	31 August 2005 to 31 August 2015	5.62	5.75	—	—	
Luo Han	1,400,000	—	—	—	—	1,400,000	12 March 2001 to 12 March 2011	1.19	1.23	—	—	
	1,150,000	—	—	—	—	1,150,000	27 August 2001 to 27 August 2011	1.232	1.46	—	—	
	1,150,000	—	—	—	—	1,150,000	24 February 2003 to 24 February 2013	2.108	2.09	—	—	
	1,150,000	—	—	—	—	1,150,000	5 February 2004 to 5 February 2014	3.152	3.13	—	—	
	—	1,610,000	—	—	—	1,610,000	31 August 2005 to 31 August 2015	5.62	5.75	—	—	
Zhou Shouwei	1,400,000	—	—	—	—	1,400,000	12 March 2001 to 12 March 2011	1.19	1.23	—	—	
	1,750,000	—	—	—	—	1,750,000	27 August 2001 to 27 August 2011	1.232	1.46	—	—	
	1,750,000	—	—	—	—	1,750,000	24 February 2003 to 24 February 2013	2.108	2.09	—	—	
	1,750,000	—	—	—	—	1,750,000	5 February 2004 to 5 February 2014	3.152	3.13	—	—	
	—	2,450,000	—	—	—	2,450,000	31 August 2005 to 31 August 2015	5.62	5.75	—	—	



# Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

## 32. SHARE CAPITAL (continued)

### Share option schemes (continued)

Name of category of participant	Number of share options					Date of grant of share options	Exercise period of share options**	Exercise price of share options HK\$	Price of Company's shares immediately before the grant date of options HK\$	Weighted average price of the Company's shares immediately before the exercise date HK\$	At exercise date of options HK\$
	At 1 January 2005	Granted during the year	Exercised during the year	Forfeited during the year	Expired during the year						
	At 31 December 2005										
Jiang Longsheng*	1,400,000	—	—	—	—	12 March 2001	12 March 2001 to 12 March 2011	1.19	1.23	—	—
	1,150,000	—	—	—	—	27 August 2001	27 August 2001 to 27 August 2011	1.232	1.46	—	—
	1,150,000	—	—	383,300	—	24 February 2003	24 February 2003 to 24 February 2013	2.108	2.09	—	—
	1,150,000	—	—	766,700	—	5 February 2004	5 February 2004 to 5 February 2014	3.152	3.13	—	—
	—	1,610,000	—	1,610,000	—	31 August 2005	31 August 2005 to 31 August 2015	5.62	5.75	—	—
Cao Xinghe	—	800,000	—	—	—	31 August 2005	31 August 2005 to 31 August 2015	5.62	5.75	—	—
Wu Zhenfang	—	800,000	—	—	—	31 August 2005	31 August 2005 to 31 August 2015	5.62	5.75	—	—
Wu Guangqi	—	1,610,000	—	—	—	31 August 2005	31 August 2005 to 31 August 2015	5.62	5.75	—	—
Yang Hua	1,150,000	—	—	—	—	12 March 2001	12 March 2001 to 12 March 2011	1.19	1.23	—	—
	1,150,000	—	—	—	—	27 August 2001	27 August 2001 to 27 August 2011	1.232	1.46	—	—
	1,150,000	—	—	—	—	24 February 2003	24 February 2003 to 24 February 2013	2.108	2.09	—	—
	1,150,000	—	—	—	—	5 February 2004	5 February 2004 to 5 February 2014	3.152	3.13	—	—
	—	1,610,000	—	—	—	31 August 2005	31 August 2005 to 31 August 2015	5.62	5.75	—	—

### 32. SHARE CAPITAL (continued)

#### Share option schemes (continued)

Name of category of participant	Number of share options				Date of grant of share options	Exercise period of share options**	Exercise price of share options HK\$	Price of Company's shares		Weighted average price of the Company's shares		
	At 1 January 2005	Granted during the year	Exercised during the year	Forfeited during the year				Expired during the year	At 31 December 2005		Immediately before the grant date	Immediately before the exercise date
											of options	of options
<b>Non-executive Directors</b>												
Chiu Sung Hong	1,150,000	—	—	—	5 February 2004	5 February 2004 to 5 February 2014	3.152	3.13	—	—		
Evert Henkes	1,150,000	—	—	—	5 February 2004	5 February 2004 to 5 February 2014	3.152	3.13	—	—		
Kenneth S Courtis	1,150,000	—	—	—	5 February 2004	5 February 2004 to 5 February 2014	3.152	3.13	—	—		
Erwin Schurtenberger*	1,150,000	—	—	1,150,000	5 February 2004	5 February 2004 to 5 February 2014	3.152	3.13	—	—		
<b>Other Employees</b>												
In aggregate	6,550,000	—	—	1,700,000	12 March 2001	12 March 2001 to 12 March 2011	1.19	1.23	—	—		
	22,650,000	—	1,150,000	2,350,000	27 August 2001	27 August 2001 to 27 August 2011	1.232	1.46	4.03	4.05		
	26,500,000	—	766,700	3,733,400	24 February 2003	24 February 2003 to 24 February 2013	2.108	2.09	4.16	4.19		
	35,850,000	—	383,400	4,683,200	5 February 2004	5 February 2004 to 5 February 2014	3.152	3.13	3.85	3.93		
	—	51,880,000	—	2,380,000	31 August 2005	31 August 2005 to 31 August 2015	5.62	5.75	—	—		
<b>Total</b>	<b>124,250,000</b>	<b>65,870,000</b>	<b>2,300,100</b>	<b>18,756,600</b>						<b>—</b>		

\* Mr. Erwin Schurtenberger resigned as an Independent Non-executive Director of the Company on 1 April 2005 and Mr. Jiang Longsheng retired as an Executive Director of the Company on 1 June 2005.

\*\* The share options are only exercisable by the relevant grantees upon the vesting of such share options. The vesting of the Company's share options is by stage and the details are disclosed above.

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 32. SHARE CAPITAL (continued)

#### Share option schemes (continued)

The fair value of the share options granted during the year was HK\$103,811,616.

The fair value of equity-settled share options granted during the year was estimated as at the date of grant, using the Black-Scholes model, taking into account the terms and conditions upon which the options were granted.

The following table lists the assumptions to the model used for the year ended 31 December 2005:

Dividend yield	2%
Expected volatility	31%
Risk-free interest rate	4.57%
Expected life of option	5 years
Weighted average share price	HK\$5.62

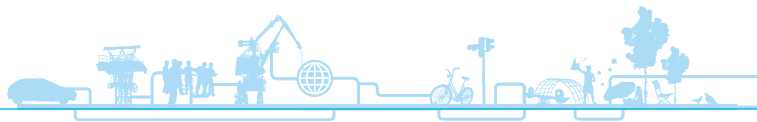
The expected life of the options is based on the historical data and is not necessarily indicative of the exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome. No other feature of the options granted was incorporated into the measurement of fair value. Any changes to the above assumptions may affect the estimation of the fair value of the option.

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. On 1 April 2005, Mr. Erwin Schurtengberger surrendered 1,150,000 share options following his resignation as an independent non-executive director of the Company. The weighted average closing price of the shares immediately on the day before the exercise of the options was HK\$4.04.

The share options exercised during the year resulted in the issue of 2,300,100 ordinary shares of the Company and new share capital of RMB49,000 and share premium of RMB4,451,000.

The total number of options exercisable as of 31 December 2005 was 70,416,522. No share options had been cancelled during the year ended 31 December 2005.

At the balance sheet date, the Company had 169,063,300 share options outstanding under these share options schemes which represented approximately 0.4% of the Company's shares in issues as at that date. The exercise in full of the remaining share options would, under the present capital structure of the Company, result in the issue of 169,063,300 additional ordinary shares of the Company and additional share capital of RMB3,517,531 and share premium of RMB602,823,748.



### 33. 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 fund, 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. The general reserve fund can only be used, upon approval by the relevant authority, to offset against accumulated losses or to increase capital.

Appropriation to the staff and workers' bonus and welfare fund, which is determined at the discretion of CNOOC China Limited's directors, is expensed as incurred under Hong Kong GAAP. 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 2005, the general reserve fund amounted to RMB6,681,974,000 (2004: RMB4,413,610,000), representing approximately 44.5% (2004: 29.4%) of the total registered capital of CNOOC China Limited.

Included in retained earnings is an amount of RMB1,146,530,000 (2004: RMB877,109,000), being the retained earnings attributable to associates.

The Company's ability to distribute dividends will largely depend 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 2005, the aggregate amount of the subsidiaries' retained earnings available for distribution to the Company amounted to approximately RMB30,275,453,000 (2004: RMB16,652,414,000).



## Notes to Financial Statements

31 December 2005

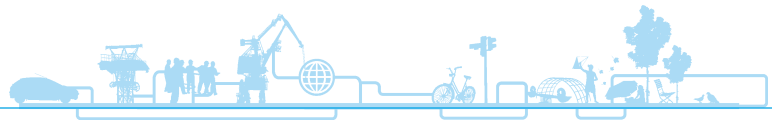
(All amounts expressed in Renminbi unless otherwise stated)

### 33. RESERVES (continued)

#### Company

	Issued share capital RMB'000	Share premium account and capital redemption reserve RMB'000	Cumulative translation reserve RMB'000	Other reserves RMB'000	Retained earnings RMB'000	Total RMB'000
Balances at 1 January 2004 as previously reported	876,978	20,761,205	—	—	2,573,082	24,211,265
Cumulative adjustment for the adoption of HKFRS 2 (note 2.2)	—	—	—	63,502	(63,502)	—
Balances at 1 January 2004 as restated Exchange realignment	876,978	20,761,205	—	63,502	2,509,580	24,211,265
	—	—	—	—	—	—
Total income and expenses for the year recognised in equity	—	—	—	—	—	—
Net profit for the year (as restated)	—	—	—	—	5,395,306	5,395,306
Total income and expenses for the year	—	—	—	—	5,395,306	5,395,306
Repurchases of shares	(392)	—	—	—	(60,761)	(61,153)
Transfer of reserve upon share repurchase	—	392	—	—	(392)	—
2004 special interim dividend declared in place of 2003 final dividends	—	—	—	—	(2,617,526)	(2,617,526)
2004 interim dividends	—	—	—	—	(1,306,451)	(1,306,451)
2004 special interim dividends	—	—	—	—	(2,177,418)	(2,177,418)
Equity-settled share option arrangements	—	—	—	46,642	—	46,642
Balances at 31 December 2004 as restated	876,586	20,761,597	—	110,144	1,742,338	23,490,665
Balances at 1 January 2005 as previously reported	876,586	20,761,597	—	—	1,852,482	23,490,665
Cumulative adjustment for the adoption of HKFRS 2 (note 2.2)	—	—	—	110,144	(110,144)	—
Balances at 1 January 2005 as restated	876,586	20,761,597	—	110,144	1,742,338	23,490,665
Changes in fair value of available-for-sale investments	—	—	—	64,900	—	64,900
Exchange realignment	—	—	(349,141)	—	—	(349,141)
Total income and expenses for the year recognised in equity	—	—	(349,141)	64,900	—	(284,241)
Net profit for the year	—	—	—	—	13,791,976	13,791,976
Total income and expenses for the year	—	—	(349,141)	64,900	13,791,976	13,507,735
2004 final dividends	—	—	—	—	(3,495,962)	(3,495,962)
2005 interim dividends	—	—	—	—	(4,276,256)	(4,276,256)
Exercise of share options	49	4,451	—	—	—	4,500
Equity-settled share option arrangements	—	—	—	29,123	—	29,123
Balances at 31 December 2005	876,635	20,766,048	(349,141)	204,167	7,762,096	29,259,805

As at 31 December 2005, the distributable profits of the Company amounted to approximately RMB7,762,096,000 (2004: RMB1,742,338,000 (restated)).



#### 34. 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.

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 35. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

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

	2005 RMB'000	2004 RMB'000 (Restated)
Profit before tax	36,300,934	23,069,962
Adjustments for:		
Interest income	(359,294)	(206,872)
Finance costs	1,100,532	441,825
Exchange (gains)/losses, net	(287,027)	(29,269)
Share of profits of associates	(307,075)	(344,469)
Investment income	(247,893)	(72,438)
Provision for/(reversal) of inventory obsolescence	33,088	(2,710)
Depreciation, depletion and amortisation	5,964,740	5,455,062
Loss on disposal and write-off of property, plant and equipment	141,574	155,876
Dismantlement	252,857	201,637
Amortisation of discount of long term guaranteed notes	41,959	15,634
Impairment losses related to property, plant and equipment	90,190	—
Equity-settled share option expenses	29,123	46,642
Operating cash flows before movements in working capital	42,753,708	28,730,880
Increase in accounts receivable	(1,001,296)	(27,466)
Increase in inventories and supplies	(108,405)	(96,307)
(Increase)/decrease in other current assets	(342,087)	267,168
Increase in amounts due from related companies	(925,824)	(417,091)
Increase in an amount due to the parent company	118,422	205,407
Increase in accounts payable, other payables and accrued liabilities	677,522	1,318,415
Decrease in other taxes payable	(24,900)	(12,447)
Increase/(decrease) in amounts due to related companies	548,508	(262,798)
Cash generated from operations	41,695,648	29,705,761



### 35. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT (continued)

#### (b) Acquisitions

137

	2005 RMB'000	2004 RMB'000
Acquisitions		
Net assets acquired:		
Property, plant and equipment, net	3,129,662	4,686,857
Intangible assets	1,299,643	—
Accounts receivable	—	453
Other current assets	—	66,744
Accounts payable	—	(81,547)
Deferred tax liabilities	—	(1,141,461)
	<b>4,429,305</b>	3,531,046
Prepayment for the NWS Project	—	4,693,809
Acquisition of interests of MEG	1,017,000	—
	<b>5,446,305</b>	8,224,855
Satisfied by:		
Prepayments made in 2004	4,582,298	2,445,715
Cash paid for the NWS project (including cash call for the Tangguh Project)	—	5,779,140
Cash paid for the interests of MEG	1,017,000	—
Tax refund from the NWS Project	(152,993)	—
	<b>5,446,305</b>	8,224,855

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

	2005 RMB'000	2004 RMB'000
Cash consideration	1,017,000	5,779,140
Cash received for tax refund of the NWS project	(152,993)	—
Net outflow of cash and cash equivalents	<b>864,007</b>	5,779,140

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

The interest in MEG has been included under long term available-for-sale financial assets.

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 36. COMMITMENTS

#### (i) Capital commitments

As at 31 December 2005, the Group and the Company had the following capital commitments, principally for the construction and purchase of property, plant and equipment:

	2005 RMB'000	2004 RMB'000
Contracted for	7,511,100	9,568,971
Authorised, but not contracted for	23,736,582	20,331,504

As at 31 December 2005, the Group had unutilised banking facilities amounting to approximately RMB33,450,791,000 (2004: RMB20,662,120,000).

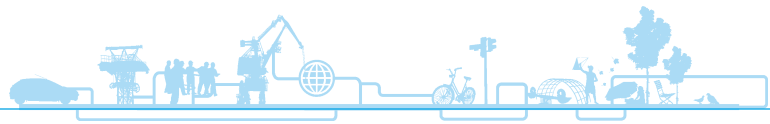
#### (ii) Operating lease commitments

##### (a) Office properties

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

As at 31 December 2005, the Group had total minimum lease payments under non-cancelable operating leases falling due as follows:

	2005 RMB'000	2004 RMB'000
Commitments due:		
Within one year	157,181	24,824
In the first to second years, inclusive	22,351	549
After the second but before the fifth years, inclusive	23,972	—
	203,504	25,373



### 36. COMMITMENTS (continued)

#### (ii) Operating lease commitments (continued)

##### (b) Plant and equipment

The Group leases certain of its plant and equipment under operating lease arrangements for a term of 10 years.

As at 31 December 2005, the Group had total minimum lease payments under non-cancelable operating lease falling due as follows:

	2005 RMB'000	2004 RMB'000
Commitments due:		
Within one year	183,137	149,360
In the first to second years, inclusive	183,137	597,442
After the second but before the fifth years, inclusive	1,006,289	1,834,023
	<b>1,372,563</b>	2,580,825

### 37. Financial instruments

#### (a) Currency swap contracts

As at 31 December 2005, 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 rate stipulated in the swap contract for the United States dollars was the floating LIBOR rate.

The details are as follows:

Year	2005		2004	
	Notional contract amount (JPY'000)	Weighted average contractual exchange rate (JPY/US\$)	Notional contract amount (JPY'000)	Weighted average contractual exchange rate (JPY/US\$)
2005	—	—	271,470	95.00
2006	271,470	95.00	271,470	95.00
2007	271,470	95.00	271,470	95.00

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 37. Financial instruments (continued)

#### (b) Fair value of financial instruments

The carrying value of cash and cash equivalents, time deposits, available-for-sale investments, accounts receivables, other current assets, accounts payable and other payables approximated to 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 RMB868,886,000 as at 31 December 2005 (2004: RMB 967,770,000).

The estimated fair value of long term guaranteed notes based on current market interest rates was approximately RMB16,592,412,000 as at 31 December 2005 (2004: RMB16,428,934,000).

### 38. 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:

	2005 RMB'000	2004 RMB'000
China Petroleum & Chemical Corporation	15,625,736	10,634,066
PetroChina Company Limited	1,776,199	1,944,709
Castle Peak Power Company Limited	1,107,314	1,070,436

### 39. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments, other than derivatives, comprise bank loans, convertible bonds, guaranteed notes, and cash and short term deposits. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

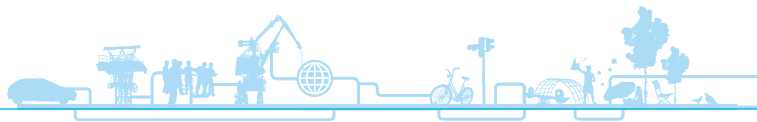
The Group also enters into a currency swap contract. The purpose is to manage the currency risks arising from the Group's operations and its sources of finance.

#### (i) Credit risk

The carrying amount of cash and cash equivalents, time deposits, liquidity funds and bond investments, accounts receivable and other receivables, and due from related parties and other current assets except for prepayments represents our maximum exposure to credit risk in relation to financial assets.

The majority of the Group's accounts receivable is related to sales of oil and natural gas to third party customers. The Group performs ongoing credit evaluations of the customers' financial condition and generally do not require collateral on accounts receivable. The Group maintains a provision for doubtful accounts and actual losses have been within management's expectation.

No other financial assets carry a significant exposure to credit risk.



### 39. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

#### (ii) Currency risk

Substantially all of the Group's oil and gas sales are denominated in Renminbi and US dollars. In the past decade, the PRC government's policies of maintaining a stable exchange rate and China's ample foreign reserves have contributed to the stability of the Renminbi. Starting from 21 July 2005, China reformed the exchange rate regime by moving into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. Renminbi would no longer be pegged to the US dollar. From that day to 31 December 2005, Renminbi has appreciated by approximately 2.5% against US dollars.

The appreciation of Renminbi against US dollars may have the following impact on the Group. On one hand, since the benchmark oil and gas prices are usually in US dollars, the Group's oil and gas sales may decrease due to the depreciation of US dollars against Renminbi. On the other hand, the depreciation of US dollars against Renminbi will also decrease the Group's costs for imported equipment and materials, most of which are denominated in US dollars. In addition, the debt repayment by the Group will decrease since more than 99% of the Group's debts are also denominated in U.S. dollars.

As of the end of 2005, the balance of the yen-denominated loans was only RMB37,307,000. Since the Group has hedged the yen loans against foreign currency swaps, the Group does not expect any exchange risk relating to Japanese yen in the future.

#### (iii) Interest rate risk

As of the end of 2005, the interest rates for all debts were fixed. The term of the weighted average balance was approximately 8 years. The average interest rate payable by the Group is favorable under the environment of interest rate hike.

#### (iv) Business risk

The major operations are conducted in the PRC, Indonesia and Australia and accordingly are subject to special considerations and significant risks not typically associated with investments in equity securities of the United States of America and Western European companies. These include risks associated with, among others, the oil and gas industry, the political, economic and legal environments, influence of the national authorities over price setting and competition in the industry.



## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 40. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN THE UNITED STATES OF AMERICA (“US GAAP “)

#### Net profit and net equity

##### (a) Impairment of long-lived assets

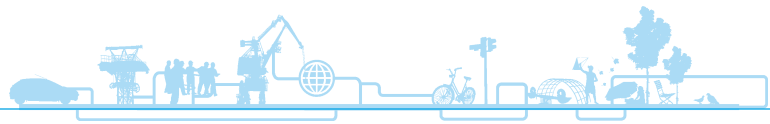
Under Hong Kong GAAP, impairment charges are recognised when a long-lived asset's carrying amount exceeds the higher of an asset's fair value less costs to sell and value in use, which incorporates discounting the asset's estimated future cash flows.

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.

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 (other than goodwill and available-for-sale equity investments) 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 2005, an impairment of approximately RMB90,190,000 was recognised under Hong Kong GAAP and US GAAP.



#### 40. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN THE UNITED STATES OF AMERICA (“US GAAP”) (continued)

##### Net profit and net equity (continued)

##### (b) Accounting for convertible bonds

With effect from 1 January 2005, under HKAS 32 Financial Instruments: Disclosure and Presentation, financial instruments with cash settlement options and other derivative components will need to be bifurcated into a debt component and a derivative component. The derivative component is marked to market at each balance sheet date and the differences will be charged/credited to the income statement. The debt component is stated at amortised cost. The requirements of HKAS 32 have been applied retrospectively with comparative amounts restated.

Under US GAAP, convertible bonds are subject to different rules on the bifurcation of the debt and derivative components. However, there is no significant difference on the accounting treatment adopted under HK GAAP and US GAAP for the Group’s convertible bonds.

##### (c) Comprehensive income

According to SFAS No. 130, “Reporting comprehensive income”, the Group is required to include a statement of other comprehensive income for revenues and expenses, gains and losses which under US GAAP are included in comprehensive income and excluded from net income.

	2005 RMB’000	2004 RMB’000
Net income under US GAAP	25,343,158	16,176,492
Other comprehensive income:		
Foreign currency translation adjustments	(493,289)	(42,301)
Unrealised gains /(losses) on available-for-sale investments/Short term investments	69,069	(25,228)
Less: Reclassification adjustment for gains included in net income	(20,036)	(2,972)
Comprehensive income under US GAAP	<b>24,898,902</b>	16,105,991

## Notes to Financial Statements

31 December 2005

(All amounts expressed in Renminbi unless otherwise stated)

### 40. SIGNIFICANT DIFFERENCES BETWEEN HONG KONG GAAP AND GENERALLY ACCEPTED ACCOUNTING PRINCIPLES IN THE UNITED STATES OF AMERICA (“US GAAP”) (continued)

#### Net profit and net equity (continued)

#### (c) Comprehensive income (continued)

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

	Foreign currency translation adjustments RMB'000	Unrealised gains on available -for-sale investments RMB'000	Accumulated other comprehensive income RMB'000
Balance at 1 January 2004	22,647	48,236	70,883
Reversal of current year's realised gains	—	(2,972)	(2,972)
Current year's change	(42,301)	(25,228)	(67,529)
Balance at 31 December 2004	(19,654)	20,036	382
Reversal of current year realised gains	—	(20,036)	(20,036)
Current year's change	(493,289)	69,069	(424,220)
Balance at 31 December 2005	(512,943)	69,069	(443,874)

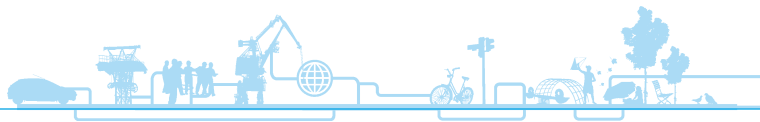
#### (d) Use of estimates in the preparation of financial statements

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.

There are no significant differences between Hong Kong GAAP and US GAAPs on the consolidated balance sheets as at 31 December 2005 and 2004 and the consolidated income statements for the years ended 31 December 2005 and 2004. As such, no reconciliation tables have been presented.



#### 41. SUBSEQUENT EVENT

On 8 January 2006, the Company signed a definitive agreement with South Atlantic Petroleum Limited (“SAPETRO”) to acquire a 45% working interest in an offshore oil mining license 130 “OML 130” in Nigeria for a cash consideration of US\$2.268 billion, subject to adjustment. Conditional on, among other things, the approval of the Nigerian National Petroleum Corporation (“NNPC”) and the PRC government, the transaction is expected to be completed in the first half of 2006.

On 27 January 2006, CNOOC Africa Limited, a wholly-owned subsidiary of the Company, signed an agreement to acquire from AERD Projects Nigeria Limited a 35% of right to Oil Prospecting Licence 229 “OPL229” in Nigeria for US\$ 60 million in cash, subject to adjustments.

#### 42. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board of Directors on 24 March 2006.