

NOTES TO FINANCIAL STATEMENTS

31 December 2005

1. CORPORATE INFORMATION

The registered office of China Oilfield Services Limited (the "Company", together with its subsidiaries, the "Group") is located at 3-1516 Hebei Road, Haiyang New and Hi-Tech Development Zone, Tanggu, Tianjin 300451, People's Republic of China (the "PRC").

The principal activities of the Group consisted of the provision of oilfield services including drilling services, well services, marine support and transportation services, and geophysical services.

In the opinion of the directors, the Company's ultimate holding company is China National Offshore Oil Corporation ("CNOOC").

2.1 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

The Hong Kong Institute of Certified Public Accountants has issued a number of new and revised Hong Kong Financial Reporting Standards ("HKFRSs"), which also include all Hong Kong Accounting Standards ("HKASs") and Interpretations ("HK(SIC)-Ints"). These HKFRSs are generally effective for accounting periods beginning on or after 1 January 2005 for the preparation of these financial statements. The following new and revised HKFRSs are relevant to the Group's financial statements 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 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 39Amendment	Transition and Initial Recognition of Financial Assets and Financial Liabilities

Except for HKAS 1, HKAS 24 and HKAS 39, the adoption of the above standards has had no material impact on the accounting policies of the Group and the Company and the methods of computation in the Group's and the Company's financial statements.

2.1 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS (continued)

HKAS 1 - Presentation of Financial Statements

HKAS 1 has affected the presentation of the share of tax attributable to jointly-controlled entities on the consolidated income statement and other disclosures. In addition, in prior periods, the Group's share of tax attributable to jointly-controlled entities was presented as a component of the Group's total tax charge/(credit) in the consolidated income statement. Upon the adoption of HKAS 1, the Group's share of the post-acquisition results of jointly-controlled entities is presented net of the Group's share of tax attributable to jointly-controlled entities.

HKAS 24 - Related Party Disclosures

HKAS 24 has expanded the definition of related parties and affected the Group's related party disclosures.

HKAS 39 - Financial Instruments: Recognition and Measurement

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

Upon the adoption of HKAS 39, the Group classifies its financial assets, including investments, in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale financial assets. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition and, where allowed and appropriate, re-evaluates this designation at every reporting date.

The adoption of HKAS 39 has not resulted in any significant impact on the financial statements.

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

The Group has not applied the following relevant new and revised HKFRSs, that have been issued but are not yet effective, in these financial statements. Unless otherwise stated, these HKFRSs are effective for accounting periods beginning on or after 1 January 2007:

HKAS 1 Amendment	Capital Disclosures
HKFRS 7	Financial Instruments: Disclosures
HK(IFRIC)-Int 4	Determining whether an Arrangement contains a Lease (effective for accounting periods on or after 1 January 2006)

HKAS 1 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 7 will replace HKAS 32 and has modified the disclosure requirements of HKAS 32 relating to financial instruments. The Group expects that the adoption of HK(IFRIC)-Int 4 will not have any significant impact on the Group's financial statements during the period of initial application.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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, accounting principles generally accepted in Hong Kong and the disclosure requirements of Hong Kong Companies Ordinance. They have been prepared under the historical cost convention, except for the periodic remeasurement of short term investments as further explained below. These financial statements are presented in Renminbi ("RMB") and all amounts 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 the subsidiaries are consolidated from the date on which the Group obtains control, and continue to be consolidated until the date on which such control ceases. All significant intercompany transactions and balances within the Group are eliminated on consolidation.

Subsidiaries

A subsidiary is an entity whose financial and operating policies the Company controls, directly or indirectly, so as to obtain benefits from its activities.

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

Jointly-controlled entities

A jointly-controlled entity is a joint venture that is subject to joint control, resulting in none of the participating parties having unilateral control over the economic activity of the jointly-controlled entity.

The Group's share of the post-acquisition results and reserves of jointly-controlled entities is included in the consolidated income statement and consolidated reserves, respectively. The Group's interests in jointly-controlled entities are stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses.

The results of jointly-controlled entities are included in the Company's income statement to the extent of dividends received and receivable. The Company's interests in jointly-controlled entities are treated as non-current assets and are stated at cost less any impairment losses.

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);
- (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); or
- (g) the party is a post-employment benefit plan for the benefit of employees of the Group, or of any entity that is a related party of the Group.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of assets

Where an indication of impairment exists, or when annual impairment testing for an asset is required (other than inventories, deferred tax assets and financial assets), 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 of an asset is reversed only if there has been a change in the estimates used to determine the recoverable amount of that 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 such impairment loss is credited to the income statement in the period in which it arises.

Property, plant and equipment and depreciation

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment losses. The cost of an item of property, plant and equipment comprises its purchase price and any directly attributable costs of bringing the asset to its working condition and location for its intended use. Expenditure incurred after items of property, plant and equipment has been put into operation, such as repairs and maintenance, is normally charged to the income statement in the period in which it is incurred. In situations where it can be clearly demonstrated that the expenditure has resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment, and where the cost of the item can be measured reliably, the expenditure is capitalised as an additional cost of that asset or as a replacement.

Depreciation is calculated on the straight-line basis to write off the cost less residual value of each item of property, plant and equipment to its residual value over its estimated useful life. The estimated useful lives of property, plant and equipment are as follows:

Vessels	10 to 15 years
Tankers	20 years
Drilling equipment	25 years
Machinery and equipment	5 to 10 years
Motor vehicles	5 years
Buildings	20 years

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment and depreciation (continued)

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

Residual values, useful lives and 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 when 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 the asset is derecognised is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Construction in progress

Construction in progress represents drilling rigs, vessels and equipment under construction, which is stated at cost less any impairment losses, and is not depreciated. Cost comprises the direct costs of construction and capitalised borrowing costs on related borrowed funds during the period of construction.

Construction in progress is reclassified to the appropriate category of property, plant and equipment when completed and ready for use.

Investments and other financial assets

In prior years, short term investments held for investment purpose 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 the debt securities are credited or charged to the income statement in the period in which they arise.

Upon adoption of HKAS 39, financial assets are classified as either 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.

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 sale in the near term. Gains or losses on financial assets at fair value through profit or loss are recognised in the income statement.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are carried at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Available-for-sale financial assets

Available-for-sale financial assets are 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 three categories in the scope of HKAS 39. After initial recognition, available-for-sale financial assets are measured at fair value, with gains or losses 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Held-to-maturity investments

Non-derivative financial assets with fixed or determinable payments and fixed maturity are classified as held to maturity when the Group has the positive intention and ability to hold to maturity. Investments intended to be held for an undefined period are not included in this classification. Other long term investments that are intended to be held to maturity, such as bonds, are subsequently measured at amortised cost. Amortised cost is computed as the amount initially recognised minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between the initially recognised amount and the maturity amount. This calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts. For investments carried at amortised cost, gains and losses are recognised in the income statement when the investments are derecognised or impaired, as well as through the amortisation process.

Fair value

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices 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. For investments where there is no active market and whose values cannot be reliably measured because (a) the variability in the range of reasonable fair value estimates is significant for 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 and the relevant impairment loss shall not be reversed.

Impairment of financial assets

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

Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables 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 through the use of an allowance account. The amount of the impairment loss is recognised in the income statement.

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.

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 carrying value at the reversal date.

Assets carried at cost

If there is objective evidence that an impairment loss on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured 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 discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 the income statement, is transferred from equity to the income statement. Impairment losses on debt instruments are reversed through the income statement, if the increase in fair value of the instrument can be objectively related to an event, occurring after the impairment loss was recognised in the income statement. Impairment losses on equity instruments classified as available-for-sale are not reversed through the income statement.

Derecognition of financial assets

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 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.

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.

Derecognition of financial liabilities

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 the income statement.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Inventories

Inventories primarily consist of materials and supplies used for repairs and maintenance of plant and equipment and daily operations. Inventories are stated at the lower of cost and net realisable value after allowances for obsolete or slow-moving items. Cost is determined on the weighted average basis. Materials and supplies are capitalised to plant and equipment when used for renewals or betterments of plant and equipment or recognised as expenses when used for daily operations.

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 repayable on demand and form an integral part of the Group's cash management.

For the purpose of the balance sheets, cash and cash equivalents comprise cash on hand and at banks, including term deposits which are not restricted as 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.

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 goodwill or 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 interests in jointly-controlled entities, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax assets are recognised for all deductible temporary differences, carryforward 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 carryforward of unused tax credits and unused tax losses can be utilised, except:

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3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax (continued)

- where the deferred tax asset relating to the deductible temporary differences arises from negative goodwill or 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 interests in jointly-controlled entities, 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 difference 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 unrecognized 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 substantively 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.

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:

- income from day rate contracts is recognised as and when services have been performed;
- income from turnkey contracts is recognised to the extent of costs incurred until the specific turnkey depth and other contract requirements are met. When the turnkey depth and contract requirements are met, revenue on turnkey contracts is recognised based on the percentage of completion. Provisions for future losses on turnkey contracts are recognised when they become apparent that expenses to be incurred on a specific contract will exceed the revenue from that contract;
- interest income, on an accrual basis using the effective interest method by applying the rate that discounts the estimated future cash receipt through expected life of the financial instrument to the net carrying amount of the financial asset; and
- dividends, when the shareholders' right to receive payment has been established.

Research and development costs

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

Expenditure incurred on projects to develop new products is capitalised and deferred only when the projects are clearly defined; the expenditure is separately identifiable and can be measured reliably; there is a reasonable certainty that the projects are technically feasible; and the products have commercial value. Product development expenditure which does not meet these criteria is expensed when incurred.

Retirement benefits costs

The Company's employees in the PRC are required to participate in a central pension scheme administered by local municipal governments. The Company is required to contribute 19% to 22% of its payroll costs to the central pension scheme. The contributions are charged to the income statement as they become payable in accordance with the rules of the central pension scheme.

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

Dividends

Final and special interim dividends proposed by the directors are classified as a separate allocation of retained profits 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.

Foreign currencies

These financial statements are presented in RMB, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Foreign currency transactions are initially recorded using the functional currency rates ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency exchange rates 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.

The functional currencies of certain overseas subsidiaries and jointly-controlled entities are currencies other than the RMB. As at the balance sheet date, the assets and liabilities of these entities are translated into the presentation currency of the Company 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 exchange differences are included in the exchange fluctuation reserve.

Operating leases

Leases where substantially all the rewards and risks of ownership of assets remain with the lessor are accounted for as operating leases. Rentals applicable to such operating leases are charged to the income statement on the straight-line basis over the lease terms.

4. SEGMENT INFORMATION

The Group is engaged in a broad range of petroleum related activities through its four major business segments: drilling services, well services, marine support and transportation services, and geophysical services.

The Group's operating businesses are structured and managed separately, according to the nature of their operations and the services they provide. Each of the Group's business segments represents a strategic business unit that provides services which are subject to risks and returns that are different from those of other business segments. Summary details of the business segments are as follows:

- (a) the drilling services segment is engaged in the provision of oilfield drilling services and well workovers;
- (b) the well services segment is engaged in the provision of logging and downhole services, such as drilling fluids, directional drilling, cementing and well completion, and sales of well chemical materials;
- (c) the marine support and transportation service segment is engaged in the transportation of materials, supplies and personnel to offshore facilities, and moving and positioning drilling structures and the transportation of crude oil and refined products; and
- (d) the geophysical service segment is engaged in the provision of offshore seismic data collection, marine surveying and data processing services.

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4. SEGMENT INFORMATION (continued)

No further analysis of geographical segment information is presented as over 90% of the Group's assets, operations and customers are located in the PRC, which is considered as one geographic location in an economic environment with similar risks and returns.

The following table presents revenue, profit and certain asset, liability and expenditure information for the Group's business segments for the year ended 31 December 2005:

	Drilling RMB'000	Well services RMB'000	Marine support and transportation RMB'000	Geophysical RMB'000	Total RMB'000
TURNOVER					
Sales (including intersegment)	2,446,524	1,205,401	899,540	566,331	5,117,796
Less: Intersegment sales	240,813	40,060	31,839	16,292	329,004
Net sales to external customers	2,205,711	1,165,341	867,701	550,039	4,788,792
PROFIT FROM OPERATIONS					
Segment results	505,453	150,350	110,351	84,113	850,267
Exchange losses, net					(16,802)
Interest expenses					(104)
Interest income					16,956
Share of profits of jointly-controlled entities					106,617
Profit before tax					956,934
Tax					(135,938)
Net profit					820,996
ASSETS					
Segment assets	4,281,207	1,142,170	2,154,123	662,397	8,239,897
Interests in jointly-controlled entities	-	230,434	-	9,502	239,936
Unallocated assets					1,184,129
Total assets					9,663,962
LIABILITIES					
Segment liabilities	468,543	118,442	62,233	48,433	697,651
Unallocated liabilities					1,311,569
					2,009,220
OTHER SEGMENT INFORMATION					
Capital expenditure	1,585,820	302,085	104,772	260,325	2,253,002
Depreciation of property, plant and equipment	323,448	124,546	224,100	83,582	755,676
Provision / (write-back of provision) for doubtful debts	(60,834)	519	387	245	(59,683)
Provision against inventories	416	219	163	103	901

4. SEGMENT INFORMATION (continued)

The following table presents revenue, profit and certain asset, liability and expenditure information for the Group's business segments for the year ended 31 December 2004:

	Drilling RMB'000	Well services RMB'000	Marine support and transportation RMB'000	Geophysical RMB'000	Total RMB'000
TURNOVER					
Sales (including intersegment)	1,881,630	891,730	802,966	500,307	4,076,633
Less: Intersegment sales	165,691	37,386	29,516	20,011	252,604
Net sales to external customers	1,715,939	854,344	773,450	480,296	3,824,029
PROFIT FROM OPERATIONS					
Segment results	374,322	127,942	105,246	84,658	692,168
Exchange gains, net					199
Interest income					34,300
Share of profits of jointly-controlled entities					79,445
Profit before tax					806,112
Tax					(104,385)
Net profit					701,727
ASSETS					
Segment assets	2,977,746	1,041,864	2,343,165	396,867	6,759,642
Interests in jointly-controlled entities	-	175,009	-	9,254	184,263
Unallocated assets					2,196,915
Total assets					9,140,820
LIABILITIES					
Segment liabilities	218,414	40,293	105,090	9,916	373,713
Unallocated liabilities					1,702,431
					2,076,144
OTHER SEGMENT INFORMATION					
Capital expenditure	855,892	193,938	450,183	111,835	1,611,848
Depreciation of property, plant and equipment	272,762	111,981	218,723	63,505	666,971
Provision for doubtful debts	35,054	(21)	(20)	(11)	35,002
Provision against inventories	400	398	398	398	1,594

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5. TURNOVER AND OTHER REVENUES

Turnover represents the net invoiced value of offshore oilfield services rendered, net of sales surtaxes.

Other revenues comprise the following:

	2005 RMB'000	2004 RMB'000
Gain on disposal of scrap materials	670	-
Insurance claims received	11,483	22,352
Others	766	1,136
	12,919	23,488

6. PROFIT FROM OPERATIONS

The Group's profit from operations is arrived at after charging/(crediting):

	2005 RMB'000	2004 RMB'000
Auditors' remuneration	3,350	2,950
Employee compensation costs:		
Wages, salaries and bonuses	600,279	467,938
Social security costs	174,995	134,361
Retirement benefits contributions (note 9)	58,071	37,854
	833,345	640,153
Depreciation of property, plant and equipment	755,676	666,971
Loss/(gain) on disposal of property, plant and equipment, net	1,359	(236)
Minimum lease payments under operating leases in respect of land and buildings, berths and equipment	213,436	186,828
Provision/(write-back of provision) for doubtful debts	(59,683)	35,002
Provision against inventories	901	1,594
Repair and maintenance costs	285,166	226,733
Research and development costs included in:		
Depreciation of property, plant and equipment	27,764	10,029
Employee compensation costs	25,838	12,052
Consumption of supplies, materials, fuel, services and others	31,390	40,104
Other operating expenses	44,858	31,107
	129,850	93,292

7. DIRECTORS' AND SUPERVISORS' REMUNERATION

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

	Group	
	2005 RMB'000	2004 RMB'000
Fees	650	567
Other emoluments:		
Basic salaries, allowances and benefits in kind	634	345
Bonuses	450	750
Pension scheme contributions	92	27
	1,176	1,122
	1,826	1,689

The remuneration of each of the directors and supervisors fell within the band of nil to RMB1,000,000 for 2005 and 2004.

There was no arrangement under which a director or a supervisor waived or agreed to waive any remuneration during the year. There was no emolument paid by the Group to the directors or supervisors as an inducement to join or upon joining the Group or as compensation for loss of office during the year.

(a) Independent non-executive directors and a supervisor

The fees paid to independent non-executive directors and an independent supervisor during the year are as follows:

	Group	
	2005 RMB'000	2004 RMB'000
Independent non-executive directors:		
Gordon C. K. Kwong	200	200
Andrew Y. Yan	200	200
Simon X. Jiang (Note 3)	200	117
	600	517
Independent supervisor:		
Zhang Dunjie	50	50
	650	567

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7. DIRECTORS' AND SUPERVISORS' REMUNERATION (continued)

(b) Executive directors, a non-executive director and supervisors

	Salaries, allowances and benefits in kind RMB'000	Bonuses RMB'000	Pension scheme contributions RMB'000	Total RMB'000
2005				
Executive directors:				
Yuan Guangyu	273	231	43	547
Wu Mengfei	229	173	39	441
	502	404	82	988
Non-executive director:				
Wang Zhongan (Note 1)	11	-	-	11
Supervisors:				
Zhang Benchun	14	-	-	14
Xiao Jianwen (Note 2)	3	-	-	3
Tang Daizhi (Note 2)	87	46	10	143
Tu Zhimin (Note 1)	7	-	-	7
Liu Shoude (Note 1)	10	-	-	10
	121	46	10	177
Total	634	450	92	1,176
2004				
Executive directors:				
Yuan Guangyu	108	355	14	477
Wu Mengfei (Note 3)	45	112	3	160
Li Wenxiang (Note 4)	67	155	8	230
	220	622	25	867
Non-executive director:				
Wang Zhongan	15	-	-	15
Supervisors:				
Zhang Benchun	9	-	-	9
Tu Zhimin	3	-	-	3
Liu Shoude	98	128	2	228
	110	128	2	240
Total	345	750	27	1,122

notes: Included only the remuneration for the period when the above individuals were active directors of the Company.

1. Resigned on 19 September 2005

2. Appointed on 20 September 2005

3. Appointed on 27 May 2004

4. Resigned on 26 May 2004

8. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included two directors (2004: one), details of whose remuneration are set out in note 7 above. Details of the remuneration of the remaining three (2004: four) non-director, non-supervisor, highest paid employees for the year as follows:

	Group	
	2005 RMB'000	2004 RMB'000
Basic salaries, allowances and benefits in kind	7,578	7,048
Bonuses	900	1,167
Pension scheme contributions	651	672
	9,129	8,887

The number of non-director, non-supervisor, highest paid employees whose remuneration fell within the following band is as follows:

	Number of employees	
	2005	2004
Nil to RMB1,000,000	-	1
RMB2,500,001 - RMB3,000,000	2	2
RMB3,000,001 - RMB3,500,000	-	1
RMB3,500,001 - RMB4,000,000	1	-
	3	4

There was no emolument paid by the Group to the employees as an inducement to join or upon joining the Group or as compensation for loss of office during the year.

9. RETIREMENT BENEFITS

All the Group's full-time employees in the PRC are covered by a government-regulated pension scheme, and are entitled to an annual pension determined by their basic salaries upon their retirement. 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 19% to 22% of the employees' basic salaries. The related pension costs are expensed as incurred.

As part of the CNOOC group, the employees of the Group were entitled to supplementary pension benefits (the "Supplementary Pension Benefits") provided by CNOOC in addition to the benefits under the government-regulated pension fund described above. The Supplementary Pension Benefits were calculated based on factors including the number of years of service and salary level on the date of retirement of the employees. Following the Reorganisation, CNOOC agreed with the Group that the Supplementary Pension Benefits of the Group's current employees attributed to the period prior to the Company's public listing in Hong Kong, and that the Supplementary Pension Benefits of the Group's retired employees will continue to be assumed by CNOOC. As the obligations under the Supplementary Pension Benefits have been fully assumed by CNOOC, the costs of such Supplementary Pension Benefits have not been recorded in the Group's financial statements for the year ended 31 December 2005 (2004: Nil).

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9. RETIREMENT BENEFITS (continued)

The expenses attributed to the PRC government-regulated pension scheme are as follows:

	Group	
	2005 RMB'000	2004 RMB'000
Contributions to the PRC government-regulated pension scheme (note 6)	58,071	37,854

At 31 December 2005, the Group had no forfeited contributions available to reduce its contributions to the pension scheme in future years (2004: Nil).

10. TAX

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

In accordance with the relevant tax laws in the PRC, the Company is subject to corporate income tax at the rate of 33%.

During the year, the application by the Company as an advanced technology enterprise for tax exemption purposes was approved and the Company's corporate income tax rate for the fiscal year 2004 was reduced from 33% to 15%. As a result, a tax refund of RMB191 million relating to fiscal year 2004 has been recorded by the Company. The eligibility for such tax rate reduction in future is conditional upon the fulfilment of certain conditions on an annual basis as stipulated in the relevant tax rules, which include a minimum proportion of sales of advanced technology services to total sales and a minimum proportion of research and development expenses to each of total expenses and total revenues under the PRC accounting principles.

As the reduction in the corporate income tax rate from 33% to 15% for the year ended 31 December 2005 cannot be ascertained at the date of this report, management considers it appropriate to use 33% to accrue for the income tax liability of the Company for the year ended 31 December 2005.

The Company's principal subsidiary incorporated in Malaysia, COSL (Labuan) Company Limited, is subject to deemed profit and withholding tax of 15% based on its gross service income generated from drilling activities in Indonesia.

An analysis of the Group's provision for tax is as follows:

	Group	
	2005 RMB'000	2004 RMB'000
Hong Kong profits tax:	-	-
Overseas income taxes:		
Current income taxes	33,582	271
PRC corporate income tax:		
Current income taxes	341,078	363,434
Tax refund as an advanced technology enterprise	(191,280)	(128,907)
Tax refund from acquisition of domestic equipment	-	(22,704)
Deferred income taxes (note 24)	(47,442)	(107,709)
Total tax charge for the year	135,938	104,385

10. TAX (continued)

A reconciliation of the tax expense applicable to profit before tax using the statutory rate for the Mainland China where the Company and its jointly-controlled entities are domiciled to the tax expense at the effective tax rate and a reconciliation of the applicable rate (i.e., the statutory tax rate) to the effective tax rate are follows:

	2005		2004	
	RMB'000	%	RMB'000	%
Profit before tax	956,934		806,112	
Tax at the statutory tax rate of 33% (2004: 33%)	315,788	33.0	266,017	33.0
Profit attributable to jointly-controlled entities	(35,184)	(4.0)	(26,217)	(3.0)
Tax refund as an advanced technology enterprise	(191,280)	(20.0)	(128,907)	(16.0)
Tax refund from acquisition of domestic equipment	-	-	(22,704)	(3.0)
Expenses not deductible for tax and others	46,614	5.0	16,196	2.0
Total tax charge at the Group's effective rate	135,938	14.0	104,385	13.0

Expenses not deductible for tax and others included income tax expenses of certain overseas subsidiaries which are not deductible for PRC income tax purposes.

The share of tax attributable to jointly-controlled entities amounting to RMB27,429,000 (2004: RMB19,751,000) is included in "share of profits of jointly-controlled entities" on the face of the consolidated income statement.

11. NET PROFIT FROM ORDINARY ACTIVITIES ATTRIBUTABLE TO SHAREHOLDERS

The net profit from ordinary activities attributable to shareholders for the year ended 31 December 2005 dealt with in the financial statements of the Company was RMB858,089,000 (2004: RMB647,824,000) (note 27(b)).

12. DIVIDENDS

	2005	2004
	RMB'000	RMB'000
Special interim dividend - 1.39 Fen(2004: 2.29 Fen) per ordinary share	55,535	91,493
Proposed final dividend - 4.11 Fen (2004: 4.39 Fen) per ordinary share	164,208	175,395
	219,743	266,888

The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

Cash dividends to shareholders in Hong Kong will be paid in Hong Kong dollars and dividends to the American Depositary Receipt ('ADR') holders will be paid to the depository in Hong Kong dollars and will be converted by the depository into United States Dollars (USD) and paid to the holders of ADRs.

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12. DIVIDENDS (continued)

Following the establishment of the Company, under the PRC Company Law and the Company's articles of association, net profit after tax as reported in the PRC statutory financial statements can only be distributed as dividends after allowance has been made for the following:

- (i) making up prior years' cumulative losses, if any;
- (ii) allocations to the statutory common reserve fund of at least 10% of after-tax profit, until the fund aggregates 50% of the Company's registered capital. For the purpose of calculating the transfer to reserves, the profit after tax shall be the amount determined under the PRC accounting principles and financial regulations. Transfer to this reserve must be made before any distribution of dividends to shareholders.

The statutory common reserve can be used to offset previous years' losses, if any, and part of the statutory common reserve can be capitalised as the Company's share capital provided that the amount of such reserve remaining after the capitalisation shall not be less than 25% of the registered capital of the Company;

- (iii) allocations of 5% to 10% of after-tax profit, as determined under the PRC accounting principles and financial regulations, to the Company's statutory public welfare fund, which will be established for the purpose of providing the Company's employees with collective welfare benefits such as the construction of dormitories, canteens and other staff welfare facilities. The fund forms part of the shareholders' equity as only individual employees can use these facilities, while the title of such facilities is held by the Company. Transfer to this fund must be made before any distribution of dividends to shareholders; and

- (iv) allocations to the discretionary common reserve if approved by the shareholders. Discretionary common reserve can be used to offset prior years' losses, if any, and can be capitalised as the Company's share capital.

In accordance with the articles of association of the Company, the net profit after tax of the Company for the purpose of profit distribution will be deemed to be the lesser of (i) the net profit determined in accordance with the PRC accounting principles and financial regulations and (ii) the net profit determined in accordance with Hong Kong Financial Reporting Standards.

13. BASIC AND DILUTED EARNINGS PER SHARE

The calculation of basic and diluted earnings per share is based on the net profit attributable to shareholders for the year ended 31 December 2005 of RMB820,996,000 (2004: RMB701,727,000) and 3,995,320,000 shares in issue during the year and 2004.

There were no diluting events for the years ended 31 December 2005 and 2004.

14. PROPERTY, PLANT AND EQUIPMENT

Group

31 December 2005	Tankers and vessels	Drilling equipment	Machinery and equipment	Motor vehicles	Building	Construction in progress	Total
At 31 December 2004 and at 1 January 2005	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Cost:	5,073,806	5,593,026	2,000,544	36,999	6,862	692,804	13,404,041
Accumulated depreciation	(2,787,152)	(3,866,003)	(960,103)	(27,086)	(273)	-	(7,640,617)
Net carrying amount	2,286,654	1,727,023	1,040,441	9,913	6,589	692,804	5,763,424
At 1 January 2005, net of accumulated depreciation	2,286,654	1,727,023	1,040,441	9,913	6,589	692,804	5,763,424
Additions	-	-	339,231	15,811	5,877	1,892,083	2,253,002
Provided during the year	(239,366)	(239,387)	(273,503)	(3,155)	(265)	-	(755,676)
Disposals/write offs	-	-	(1,964)	(539)	-	-	(2,503)
Transfers from construction in progress	472,727	189,054	228,145	2,227	-	(892,153)	-
At 31 December 2005, net of accumulated depreciation	2,520,015	1,676,690	1,332,350	24,257	12,201	1,692,734	7,258,247
At 31 December 2005							
Cost	5,546,533	5,782,080	2,561,085	50,171	12,739	1,692,734	15,645,342
Accumulated depreciation	(3,026,518)	(4,105,390)	(1,228,735)	(25,914)	(538)	-	(8,387,095)
Net carrying amount	2,520,015	1,676,690	1,332,350	24,257	12,201	1,692,734	7,258,247
31 December 2004							
At 1 January 2004							
Cost:	4,300,465	5,221,929	1,435,572	40,600	-	847,651	11,846,217
Accumulated depreciation	(2,537,129)	(3,656,742)	(797,862)	(27,661)	-	-	(7,019,394)
Net carrying amount	1,763,336	1,565,187	637,710	12,939	-	847,651	4,826,823
At 1 January 2004, net of accumulated depreciation	1,763,336	1,565,187	637,710	12,939	-	847,651	4,826,823
Additions	640	350,979	200,159	1,738	200	1,058,132	1,611,848
Provided during the year	(250,023)	(209,261)	(203,143)	(4,271)	(273)	-	(666,971)
Disposals/write offs	-	-	(7,783)	(493)	-	-	(8,276)
Transfers from construction in progress	772,701	20,118	413,498	-	6,662	(1,212,979)	-
At 31 December 2004, net of accumulated depreciation	2,286,654	1,727,023	1,040,441	9,913	6,589	692,804	5,763,424
At 31 December 2004							
Cost	5,073,806	5,593,026	2,000,544	36,999	6,862	692,804	13,404,041
Accumulated depreciation	(2,787,152)	(3,866,003)	(960,103)	(27,086)	(273)	-	(7,640,617)
Net carrying amount	2,286,654	1,727,023	1,040,441	9,913	6,589	692,804	5,763,424

As of the date of these financial statements, a drilling rig with an aggregate cost and net book value of RMB438 million (2004: RMB438 million) and RMB88 million (2004: RMB105 million), respectively, has yet to complete the title re-registration procedures after the Reorganisation. The Company is in the process of re-registering the title of the rig under its name with the relevant government authorities. It is because the drilling rig has been operating in Indonesia since 2003 and the re-registration process can only be completed when the rig is physically in the PRC.

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14. PROPERTY, PLANT AND EQUIPMENT (continued)

Company

31 December 2005	Tankers and vessels	Drilling equipment	Machinery and equipment	Motor vehicles	Building	Construction in progress	Total
	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 31 December 2004 and at 1 January 2005							
Cost:	5,073,806	5,593,026	1,998,358	36,999	6,862	692,804	13,401,855
Accumulated depreciation	(2,787,152)	(3,866,003)	(958,907)	(27,086)	(273)	-	(7,639,421)
Net carrying amount	2,286,654	1,727,023	1,039,451	9,913	6,589	692,804	5,762,434
At 1 January 2005, net of accumulated depreciation	2,286,654	1,727,023	1,039,451	9,913	6,589	692,804	5,762,434
Additions	-	-	227,432	15,811	5,877	1,892,083	2,141,203
Provided during the year	(239,366)	(239,387)	(269,195)	(3,155)	(265)	-	(751,368)
Disposals/write offs	-	-	(1,959)	(539)	-	-	(2,498)
Transfers from construction in progress	472,727	189,054	228,145	2,227	-	(892,153)	-
At 31 December 2005, net of accumulated depreciation	2,520,015	1,676,690	1,223,874	24,257	12,201	1,692,734	7,149,771
At 31 December 2005							
Cost	5,546,533	5,782,080	2,447,142	50,171	12,739	1,692,734	15,531,399
Accumulated depreciation	(3,026,518)	(4,105,390)	(1,223,268)	(25,914)	(538)	-	(8,381,628)
Net carrying amount	2,520,015	1,676,690	1,223,874	24,257	12,201	1,692,734	7,149,771
31 December 2004							
At 1 January 2004							
Cost:	4,300,465	5,221,929	1,433,150	40,600	-	847,651	11,843,795
Accumulated depreciation	(2,537,129)	(3,656,742)	(796,705)	(27,661)	-	-	(7,018,237)
Net carrying amount	1,763,336	1,565,187	636,445	12,939	-	847,651	4,825,558
At 1 January 2004, net of accumulated depreciation	1,763,336	1,565,187	636,445	12,939	-	847,651	4,825,558
Additions	640	350,979	199,762	1,738	200	1,058,132	1,611,451
Provided during the year	(250,023)	(209,261)	(203,081)	(4,271)	(273)	-	(666,909)
Disposals/write offs	-	-	(7,173)	(493)	-	-	(7,666)
Transfers from construction in progress	772,701	20,118	413,498	-	6,662	(1,212,979)	-
At 31 December 2004, net of accumulated depreciation	2,286,654	1,727,023	1,039,451	9,913	6,589	692,804	5,762,434
At 31 December 2004							
Cost	5,073,806	5,593,026	1,998,358	36,999	6,862	692,804	13,401,855
Accumulated depreciation	(2,787,152)	(3,866,003)	(958,907)	(27,086)	(273)	-	(7,639,421)
Net carrying amount	2,286,654	1,727,023	1,039,451	9,913	6,589	692,804	5,762,434

15. INVESTMENTS IN SUBSIDIARIES

	2005 RMB'000	2004 RMB'000
Unlisted shares, at cost	2,712	2,712

Particulars of the principal subsidiaries are as follows:

Name of entity	Place of incorporation / operation	Nominal value of issued and paid up capital	Percentage of equity directly attributable to the Group		Principal activities
			Direct	Indirect	
COSL American Inc	United States of America	US\$100,000	100%	-	Sales of well service equipment & leasing of geophysical vessels
China Oilfield Services (BVI) Limited	British Virgin Islands	US\$1	100%	-	Investment holding
COSL (Labuan) Company Limited	Malaysia	US\$1	-	100%	Provision of drilling services in Indonesia
COSL Services Southeast Asia (BVI) Limited	British Virgin Islands	US\$1	-	100%	Investment holding

The above table lists the principal 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.

16. INTERESTS IN JOINTLY-CONTROLLED ENTITIES

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Unlisted investments, at cost	-	-	128,102	128,844
Share of net assets	236,512	184,305	-	-
Due from jointly-controlled entities	3,424	248	3,424	248
Due to jointly-controlled entities	-	(290)	-	(290)
	239,936	184,263	131,526	128,802

The amounts due from and due to jointly-controlled entities are unsecured, interest-free and have no fixed terms of repayment.

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16. INTERESTS IN JOINTLY-CONTROLLED ENTITIES (continued)

Particulars of the principal jointly-controlled entities are as follows:

Name	Business structure	Place of incorporation and operations	Percentage of		Principal activities
			Ownership interest	Profit sharing	
China-France Bohai Geoservices Co., Ltd. ("China-France")	Corporate	Tianjin, PRC	50	50	Provision of logging services
China Nanhai-Magcobar Mud Corporation Ltd. ("Magcobar")	Corporate	Shenzhen, PRC	60*	60	Provision of drilling fluids services
CNOOC-OTIS Well Completion Services Ltd. ("CNOOC-OTIS")	Corporate	Tianjin, PRC	50	50	Provision of well completion services
China Petroleum Logging-Atlas Cooperation Service Company ("Logging-Atlas")	Corporate	Shenzhen, PRC	50	50	Provision of logging services
China Offshore Fugro Geo Solutions (Tianjin) Company Ltd. ("China Offshore Fugro")	Corporate	Shenzhen, PRC	50	50	Provision of geophysical services
Tianjin Jinlong Petro-Chemical Company Ltd. ("Jinlong")	Corporate	Tianjin, PRC	50	50	Provision of drilling fluids services

The above table lists the principal jointly-controlled entities of the Company, which, in the opinion of the directors, principally affected the results for the year.

* In the opinion of the directors, the Company does not have control over Magcobar's financial and operating decisions, and accordingly, the financial statements of Magcobar have not been incorporated into the Group's consolidated financial statements. The financial statements of Magcobar have been dealt with in the Group's consolidated financial statements under the equity accounting method.

The following table illustrates the summarised financial information of the Group's jointly-controlled entities:

	2005 RMB'000	2004 RMB'000
Share of the jointly-controlled entities' assets and liabilities:		
Current assets	254,617	184,017
Non-current assets	75,841	80,555
Current liabilities	(93,946)	(80,267)
Net assets	236,512	184,305
Share of the jointly-controlled entities' results:		
Turnover	447,169	365,778
Other revenue	5,236	4,119
Total expenses	(318,359)	(270,701)
Tax	(27,429)	(19,751)
Share of profits of jointly-controlled entities	106,617	79,445

17. INVENTORIES

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Gross inventory	236,668	221,836	236,666	221,836
Less: Provisions	(6,884)	(5,983)	(6,884)	(5,983)
	229,784	215,853	229,782	215,853

Inventories consist of materials and supplies.

18. ACCOUNTS RECEIVABLE

The general credit terms of the Group range from 30 to 90 days. The Group's accounts receivable relate to a large number of diversified customers; other than CNOOC Group and CNOOC Limited Group as disclosed below, there is no significant concentration of credit risk. All accounts receivable are non-interest-bearing.

An aged analysis of the accounts receivable as at the balance sheet date is as follows:

	Group		Company	
	2005 RMB'000	2004 RMB'000	2005 RMB'000	2004 RMB'000
Outstanding balances aged:				
Within one year	708,400	659,580	817,941	660,405
One to two years	1,059	10,294	1,059	10,294
Two to three years	779	54,497	779	54,497
Over three years	704	641	704	641
	710,942	725,012	820,483	725,837
Less: Provision for doubtful debts	(1,489)	(62,464)	(1,489)	(62,464)
	709,453	662,548	818,994	663,373

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18. ACCOUNTS RECEIVABLE (continued)

Included in the accounts receivable are the following amounts due from CNOOC Limited, its subsidiaries and associates (collectively known as the "CNOOC Limited Group") and CNOOC, its subsidiaries and associates other than the CNOOC Limited Group (collectively known as the "CNOOC Group"), which are repayable on similar credit terms to those offered to independent third party customers:

	Group		Company	
	2005	2004	2005	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Due from CNOOC Group and CNOOC Limited Group	237,046	201,647	237,046	201,647

Included in the Company's accounts receivable at 31 December 2005 was an amount due from subsidiaries of RMB228,431,000 (2004: RMB151,605,000) which was repayable on similar credit terms to those offered to the major customers of the Group.

19. DUE TO THE ULTIMATE HOLDING COMPANY

Except for the loan repayment of RMB200 million due to CNOOC as disclosed in note 25, the balance of the amount due to CNOOC at 31 December 2005 under current liabilities of the Group is unsecured, interest-free and has no fixed repayment terms.

20. BALANCES WITH OTHER CNOOC GROUP COMPANIES

The balances with other CNOOC group companies at 31 December 2005 are unsecured, interest-free and have no fixed terms of repayment.

21. SHORT TERM INVESTMENTS

	Group and Company	
	2005	2004
	RMB'000	RMB'000
Government debt securities purchased with an obligation to re-sell, at market value	-	20,003

22. CASH AND CASH EQUIVALENTS AND PLEDGED DEPOSITS

	Group		Company	
	2005	2004	2005	2004
	RMB'000	RMB'000	RMB'000	RMB'000
Cash and bank balances:				
- Cash and balances with banks	720,919	1,092,702	643,927	1,055,871
- Deposit with CNOOC Finance Company Limited ("CNOOC Finance Company")	103	411	103	411
	721,022	1,093,113	644,030	1,056,282
Time deposits at banks	293,866	1,073,424	283,293	1,073,424
	293,866	1,073,424	283,293	1,073,424
Cash and balances with banks and financial institution	1,014,888	2,166,537	927,323	2,129,706
Less: Pledged time deposits for letter of credit facilities	(1,093)	(4,255)	(1,093)	(4,255)
Cash and cash equivalents	1,013,795	2,162,282	926,230	2,125,451

At the balance sheet date, the cash and bank balances of the Group denominated RMB amounted to RMB376,247,000 (2004: RMB1,292,887,000). The RMB is not freely convertible into other currencies. However, under China's Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for foreign currencies through banks authorised to conduct foreign exchange business.

Cash at banks earns interest at floating rates based on daily bank deposit rates. Time deposits are made for a period of six months depending on the immediate cash requirements of the Group, and earn interest at the respective time deposit rate. The carrying amounts of the cash and cash equivalents and the pledged deposits approximate to their fair values.

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31 December 2005

23. TRADE AND OTHER PAYABLES

An aged analysis of the trade and other payables as at the balance sheet date is as follows:

	Group		Company	
	2005	2004	2005	2004
Outstanding balances aged:	RMB'000	RMB'000	RMB'000	RMB'000
Within one year	875,912	551,974	808,110	532,694
One to two years	37,446	11,748	37,446	11,748
Two to three years	6,301	5,851	6,301	5,851
Over three years	5,647	2,301	5,647	2,301
	925,306	571,874	857,504	552,594

Trade and other payables are non-interest-bearing. Trade and other payables are normally settled on terms ranging from one month to two years.

24. DEFERRED TAX

The principal components of the provision for deferred tax are as follows:

	Group and Company	
	2005	2004
Deferred tax movement:	RMB'000	RMB'000
Balance at beginning of the year	433,258	540,967
Credited to the income statement during the year (note 10)	(47,442)	(107,709)
Balance at end of year	385,816	433,258
Deferred tax asset:		
Provision for staff bonus	(96,155)	(82,520)
Deferred tax liabilities:		
Accelerated depreciation	230,544	232,593
Revaluation surplus on Reorganisation	251,427	283,185
Net deferred tax liabilities	385,816	433,258

25. LONG TERM PAYABLE TO THE ULTIMATE HOLDING COMPANY

	Group and Company	
	2005	2004
Amounts payable:	RMB'000	RMB'000
Within one year	200,000	200,000
In the second year	200,000	200,000
In the third year	-	200,000
	400,000	600,000
Portion classified as current liabilities (note 19)	(200,000)	(200,000)
Long term portion	200,000	400,000

The long term payable to CNOOC is unsecured, interest-free and repayable over three years on an annual equal installment basis commencing on 1 May 2005.

26. ISSUED CAPITAL

	2005	2004
	RMB'000	RMB'000
Registered, issued and fully paid:	2,460,468	2,460,468
2,460,468,000 State legal person shares of RMB1.00 each	1,534,852	1,534,852
1,534,852,000 H shares of RMB1.00 each	3,995,320	3,995,320

The Company does not have any share option scheme.

There was no movement in issued share capital for the years ended 31 December 2004 and 2005.

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31 December 2005

27. RESERVES

(a) Group

The amounts of the Group's reserves and the movements therein for the current year are presented in the consolidated statement of changes in equity on page [54] of the financial statements.

(b) Company

	Capital reserve RMB'000	Statutory reserve funds RMB'000	Retained profits RMB'000	Total RMB'000
Balance at 1 January 2004	1,975,810	101,306	352,434	2,429,550
Net profit for the year (note 11)	-	-	647,824	647,824
Special interim 2004 dividend (note 12)	-	-	(91,493)	(91,493)
Proposed final 2004 dividend (note 12)	-	-	(175,395)	(175,395)
Transfer to statutory reserve funds (note (i))	-	104,259	(104,259)	-
At 31 December 2004	1,975,810	205,565	629,111	2,810,486
Balance at 1 January 2005	1,975,810	205,565	629,111	2,810,486
Net profit for the year (note 11)	-	-	858,089	858,089
Special interim 2005 dividend (note 12)	-	-	(55,535)	(55,535)
Proposed final 2005 dividend (note 12)	-	-	(164,208)	(164,208)
Transfer to statutory reserve funds (note (i))	-	123,149	(123,149)	-
At 31 December 2005	1,975,810	328,714	1,144,308	3,448,832

Notes:

- (i) As detailed in note 12 to the financial statements, the Company is required to transfer a minimum percentage of after-tax profit, if any, to the statutory common reserve fund and the statutory public welfare fund. The Company transferred 10% and 5% of after-tax profit to the statutory common reserve fund and the statutory public welfare fund, respectively, in 2005.

As at 31 December 2005, in accordance with the PRC Company Law, an amount of approximately RMB1,976 million (2004: RMB1,976 million) standing to the credit of the Company's capital reserve account and an amount of approximately RMB329 million (2004: RMB206 million) standing to the credit of the Company's statutory reserve funds, as determined under the PRC accounting principles and financial regulations, were available for distribution by way of future capitalisation issue. In addition, the Company had retained profits of approximately RMB1,144 million (2004: RMB629 million) available for distribution as dividend. Save as the aforesaid, the Company did not have any reserves available for distribution to its shareholders at 31 December 2005.

The retained profits of the Company determined under the relevant PRC accounting standards and financial regulations amounted to RMB 1,189,687,000 as of December 2005 (2004: RMB711,583,000)

28. OPERATING LEASE ARRANGEMENTS

The Group and the Company lease certain of their office properties and equipment under operating lease arrangements. Leases for properties and equipment are negotiated for terms ranging from one to six years.

At 31 December 2005, the Group had following minimum lease payments under non-cancellable operating leases falling due as follows:

	Group and Company	
	2005	2004
	RMB'000	RMB'000
Within one year	59,960	65,212
In the second to fifth years, inclusive	230,222	250,281
After five years	49,162	119,926
	339,344	435,419

29. CAPITAL COMMITMENTS

The Group and the Company had the following capital commitments, principally for construction and purchases of property, plant and equipment:

	Group and Company	
	2005	2004
	RMB'000	RMB'000
Contracted, but not provided for	450,316	531,172
Authorised, but not contracted for	1,877,503	1,893,374
	2,327,819	2,424,546

30. CONTINGENT LIABILITIES

At the balance sheet date, neither the Group, nor the Company had any significant contingent liabilities.

31. RELATED PARTY TRANSACTIONS

The Group is part of a larger group of companies under CNOOC and has extensive transactions and relationships with the members of CNOOC. Related parties refer to corporations in which CNOOC is a shareholder and is able to exercise control, joint control or significant influence. The transactions were made on terms agreed among the parties.

In addition to the transactions and balances detailed elsewhere in these financial statements, the following is a summary of significant transactions carried out between the Group and (i) the CNOOC Limited Group; (ii) the CNOOC Group; and (iii) its jointly-controlled entities.

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31 December 2005

31. RELATED PARTY TRANSACTIONS (continued)

	2005 RMB'000	2004 RMB'000
A. Included in revenue		
Gross revenue earned from provision of services to the following related parties:		
a. The CNOOC Limited Group		
Provision of drilling services	1,498,929	1,119,332
Provision of well services	772,070	640,540
Provision of marine support and transportation services	527,149	494,047
Provision of geophysical services	346,033	350,294
	3,144,181	2,604,213
b. The CNOOC Group		
Provision of drilling services	2,447	4,542
Provision of well services	222	1,552
Provision of marine support and transportation services	80,468	69,994
Provision of geophysical services	8,416	3,461
	91,553	79,549
c. Jointly-controlled entities		
Provision of drilling services	1,665	3,207
Provision of well services	11,182	26,528
Provision of marine support and transportation services	10	-
	12,857	29,735
B. Included in operating expenses		
Services provided by the CNOOC Group:		
Labour services	11,383	13,736
Materials, utilities and other ancillary services	166,139	105,517
Transportation services	3,028	3,798
Leasing of office, warehouse and berths	29,739	25,312
Leasing of equipment	-	19,532
Repair and maintenance services	10,256	26,096
Management services	29,636	28,273
	250,181	222,264
C. Included in interest income:		
Interest income earned from the CNOOC Group	-	4,495

31. RELATED PARTY TRANSACTIONS (continued)

		2005 RMB'000	2004 RMB'000
D.	Deposits:		
	Deposits placed with CNOOC Finance Company	103	411
E.	Purchases		
	Purchase of items of property, plant and equipment from the CNOOC Group	11,688	-

The Company and the above related parties are within the CNOOC Group and are under common control by the same ultimate holding company.

In connection with the Reorganisation, the Company entered into several agreements with the CNOOC Group which govern employee benefits arrangements, the provision of materials, utilities and ancillary services, the provision of technical services, the leasing of properties and various other commercial arrangements.

During the year, all pension scheme payments relating to the supplementary pension benefits of approximately RMB33 million (2004: RMB28 million) were borne by CNOOC (note 9).

Prior to the Reorganisation, the Group occupied certain properties owned by CNOOC at no consideration. The Company entered into various property lease agreements in September 2002 with the CNOOC Group to lease the aforesaid properties together with other properties for a term of one year. These leases have been renewed annually on terms leased upon corresponding market prices.

The directors of the Company are of the opinion that the above transactions with related parties were conducted in the usual course of business.

The related party transactions in respect of items listed above also constitute connected transactions or continuing connected transactions as defined in Chapter 14A of the Listing Rules.

Details of the composition of key management personnel of the Group are disclosed in notes 7 to the financial statements.

NOTES TO FINANCIAL STATEMENTS

31 December 2005

32. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments comprise related party loans 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.

It is, and has been, throughout the year under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are foreign currency risk, credit risk and liquidity risk. The board reviews and agrees policies for managing each of these risks and they are summarised below:

Foreign currency risk

The Group has transactional currency exposures. Such exposures arise as certain of the Group's sales and purchases are denominated in currencies other than the functional currency of the operating units making the sale or purchases. It is not the policy of the Group to hedge such exposures as the impact is not considered to be material to the Group.

Credit risk

The Group trades only with recognised and creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis and the Group's exposure to bad debts is not significant.

The credit risk of the Group's other financial assets, which mainly comprise cash and cash equivalents, arises from the default of the counterparty, with a maximum exposure equal to the carrying amount of these instruments. The Group manages this credit risk by only dealing with reputable financial institutions.

Since the Group trades only with recognised and creditworthy third parties, there is no requirement for collateral.

Liquidity risk

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of short term financing, including bank loans and debentures.

33. SUBSEQUENT EVENTS

On 10 February 2006, the Company issued a short term debenture amounted to RMB1 billion. The short term debenture is unsecured, for a term of one year and has a coupon rate of 3.2%. The purpose of issuing the debenture is to meet the Group's short term working capital needs.

34. COMPARATIVE AMOUNT

As further explained in notes 2.1 to the financial statements, due to the adoption of new HKFRSs during the current year, the presentation of certain items and balances in the financial statements have been revised to comply with the new requirements. Accordingly, certain comparative amounts have been reclassified to conform with the current year's presentation.

35. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the board of directors on 22 March 2006.