Notes to Financial Statements

31 December 2006

(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 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs")

The Hong Kong Institute of Certified Public Accountants has issued the following new and amended HKFRSs, which are amendments mandatory for annual periods beginning on or after 1 January 2006:

HKAS 21 Amendment	Net Investment in a Foreign Operation
HKAS 27 Amendment	Consolidated and Separate Financial Statements: Amendments as a consequence of the Hong Kong Companies (Amendment) Ordinance 2005
HKAS 39 & HKFRS 4 Amendments	Financial Guarantee Contracts
HKAS 39 Amendment	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 Amendment	The Fair Value Option
HKFRS 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
HK(IFRIC)-Int 4	Determining whether an Arrangement contains a Lease

(a) HKAS 21 Amendment – Net Investment in a Foreign Operation

Upon the adoption of the HKAS 21 Amendment regarding a net investment in a foreign operation, all exchange differences arising from a monetary item that forms part of the Group's net investment in a foreign operation are recognised in a separate component of equity in the consolidated financial statements irrespective of the currency in which the monetary item is denominated.

(b) HKAS 27 Amendments – Consolidated and Separate Financial Statements: Amendments as a consequence of the Companies (Amendment) Ordinance 2005

The adoption of the revised HKAS 27 has resulted in a change in accounting policy relating to the definition of a subsidiary for the purpose of the consolidated financial statements as described in note 3 "Summary of significant accounting policies" below.

(c) HKAS 39 & HKFRS 4 Amendments – Financial Guarantee Contracts

This amendment has revised the scope of HKAS 39 to require financial guarantee contracts issued that are not considered insurance contracts, to be recognised initially at fair value and to be remeasured at the higher of the amount determined in accordance with HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 *Revenue*.

(d) HKAS 39 Amendment – Cash Flow Hedge Accounting of Forecast Intragroup Transactions

This amendment has revised HKAS 39 to permit the foreign currency risk of a highly probable intra-group forecast transaction to qualify as the hedged item in a cash flow hedge, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and that the foreign currency risk will affect the consolidated income statement.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

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

(e) HKAS 39 Amendment – The Fair Value Option

This amendment has changed the definition of a financial instrument at fair value through profit or loss and has restricted the use of the option to designate any financial asset or any financial liability to be measured at fair value through the income statement.

(f) HKFRS 6 – Exploration for and Evaluation of Mineral Resources

HKFRS 6 deals with the accounting for exploration for and evaluation of mineral resources, including oil and gas.

(g) HK(IFRIC)-Int 4 – Determining Whether an Arrangement contains a Lease

The Group has adopted this interpretation as of 1 January 2006, which provides guidance in determining whether arrangements contain a lease to which lease accounting must be applied.

The adoption of these new and revised Hong Kong Financial Reporting Standards, amendments and interpretation did not have a material impact on the Group's results of operations or financial position.

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

The Hong Kong Institute of Certified Public Accountants 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. Unless otherwise stated, the following HKFRSs are effective for accounting periods beginning on or after 1 January 2007:

HKAS 1 Amendment	Capital Disclosures
HKFRS 7	Financial Instruments: Disclosures
HKFRS 8	Operating Segments
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies
HK(IFRIC)-Int 8	Scope of HKFRS 2
HK(IFRIC)-Int 9	Reassessment of Embedded Derivatives
HK(IFRIC)-Int 10	Interim Financial Reporting and Impairment
HK(IFRIC)-Int 11	HKFRS 2 – Group and Treasury Share Transactions

The HKAS 1 Amendment 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 requires disclosures that enable users of the financial statements to evaluate the significance of the Group's financial statements and the nature and extent of risks arising from those financial instruments and also incorporates many of the disclosure requirements of HKAS 32.

HKFRS 8 shall be applied for annual periods beginning on or after 1 January 2009. The Standard requires the disclosure of information about the operating segments of the Group, the products and services provided by the segments, the geographical areas in which the Group operates, and revenues for the Group's major customers. This Standard will supercede HKAS 14 Segment Reporting.

HK(IFRIC)-Int 7, HK(IFRIC)-Int 8, HK(IFRIC)-Int 9, HK(IFRIC)-Int 10 and HK(IFRIC)-Int 11 shall be applied for annual periods beginning on or after 1 March 2006, 1 May 2006, 1 June 2006, 1 November 2006 and 1 March 2007 respectively.

The Group is in the process of making an assessment of the impact of these new and revised HKFRSs upon initial application. So far, it has concluded that while the adoption of the HKAS 1 Amendment and HKFRS 7 may result in new or amended disclosures, these new and revised HKFRSs are unlikely to have a significant impact on the Group's results of operations and financial position.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of preparation

These financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards ("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 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 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 2006. 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 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 identifiable 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.

Minority interests represent the interests of outside shareholders not held by the Group in the results and net assets of the Company's subsidiaries.

Subsidiaries

A subsidiary is an entity 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; or over which the Company has a contractual right to exercise a dominant influence with respect to that entity's financial and operating policies.

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

Associates

An associate is 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 interests in associates are stated in the consolidated balance sheet at the Group's share of net assets under the equity method of accounting, less any impairment losses.

The results of associates are included in the Company's income statement to the extent of dividends received and receivable. The Company's interests in associates are treated as non-current assets and are stated at cost 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.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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).

Impairment of non-financial assets other than goodwill

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 consolidated 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 other than goodwill 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 an impairment loss is credited to the consolidated income statement in the period in which it arises.

Property, plant and equipment and depreciation

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

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, plant and equipment and depreciation (continued)

(i) Oil and gas properties

For oil and gas properties, the successful efforts method of accounting is adopted. The Group capitalises the 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 that extend the economic lives of the assets, and the related borrowing costs are capitalised. The costs of unsuccessful exploratory wells and all other exploration costs are expensed as incurred.

The Group carries exploratory well costs as an asset when the well has found a sufficient quantity of reserves to justify its completion as a producing well and where the Group is making sufficient progress assessing the reserves and the economic and operating viability of the project. Exploratory well costs not meeting these criteria are charged to expense. 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 the successful completion of further exploratory work remain capitalised and are reviewed periodically for impairment.

Productive oil and gas properties and other tangible and intangible costs of producing properties are amortised using the unit-of-production method on a property-by-property basis under which the ratio of produced oil and gas to the estimated remaining proved developed reserves is used to determine the provision of depreciation, depletion and amortisation. Common facilities that are built specifically to service production directly attributed to designated oil and gas properties are amortised based on the proved developed reserves of respective oil and gas properties on a pro-rata basis. Common facilities that are not built specifically to service identified oil and gas properties are depreciated using the straight-line method over their estimated useful lives. 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 the 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. No market-risk premium has been included in the Company's calculation of asset retirement obligations balances since no reliable estimate can be made by the Company.

(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 when no future economic benefits are expected from its use or disposal. Any gain or loss on disposal or retirement recognised in the consolidated income statement in the year that the asset is derecognised is the difference between the net sales proceeds and the carrying amount of the relevant asset.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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 at least at each balance sheet date.

Research and development costs

All research costs are charged to the consolidated 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

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 considers whether a contract contains an embedded derivative when the Group first becomes a party to it. The embedded derivatives are separated from the host contract which is not measured at fair value through profit or loss when the analysis shows that the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract.

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 dates, that is, the date that the Group commits to purchase or sell 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 at fair value through profit or loss include financial assets held for trading and financial assets designated upon initial recognition as 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. Derivatives, including separated embedded derivatives, are also classified as held for trading unless they are designated as effective hedging instruments or financial guarantee contracts. Gains or losses on investments held for trading or these financial assets are recognised in the income statement.

Where a contract contains one or more embedded derivatives, the entire hybrid contract may be designated as a financial asset at fair value through profit or loss, except where the embedded derivative does not significantly modify the cash flows or it is clear that separation of the embedded derivative is prohibited.

Financial assets may be designated upon initial recognition as at fair value through profit or loss if the following criteria are met:

(i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognising gains or losses on them on a different basis;

(ii) the assets are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; or

(iii) the financial asset contains an embedded derivative that would need to be separately recorded.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments and other financial assets (continued)

(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. Such assets are subsequently carried at amortised cost using the effective interest method. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Gains and losses are recognised in the consolidated income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

(c) Held-to-maturity investments

The Group did not hold any financial assets in this category.

(d) 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. 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 consolidated income statement.

When the fair value of unlisted equity securities 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.

Fair Value

The fair value of investments that are actively traded in organised financial markets is determined by reference to the 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

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 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 the consolidated 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.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Impairment of financial assets (continued)

Assets carried at amortised cost (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 consolidated income statement, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

In relation to trade receivables, a provision for impairment is made when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Group will not be able to collect all of the amounts due under the original terms of an invoice. The carrying amount of the receivables is reduced through the use of an allowance account. Impaired debts are derecognised when they are assessed as uncollectible.

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 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.

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 consolidated income statement, is transferred from equity to the consolidated income statement. Impairment losses on equity instruments classified as available-for-sale are not reversed through the consolidated income statement.

Impairment losses on debt instruments are reversed through the consolidated 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.

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 them 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)

Financial liabilities at amortised cost (including interest-bearing loans and borrowings)

Financial liabilities including trade and other payables, an amount due to the ultimate holding company and interest-bearing loans and borrowings are initially stated at fair value less directly attributable transaction costs and are subsequently measured at amortised cost, using the effective interest method unless the effect of discounting would be immaterial, in which case they are stated at cost.

Gains and losses are recognised in the consolidated income statement when the liabilities are derecognised as well as though the amortisation process.

Financial guarantee contracts

Financial guarantee contracts in the scope of HKAS 39 are accounted for as financial liabilities. A financial guarantee contract is recognised initially as its fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial contract, except when such contract is recognised at fair value through profit or loss. Subsequent to initial recognition, the Group measures the financial guarantee contract at the higher of: (i) the amount determined in accordance with HKAS 37 *Provision, Contingent liabilities and Contingent Assets*; and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with HKAS 18 *Revenue*.

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

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 consolidated income statement.

Derivative financial instruments

The Group uses currency swaps, classified as derivative financial instruments, 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 the consolidated income statement.

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

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Inventories and supplies

Inventories primarily consist of oil and supplies, which mainly consist 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 repayable 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, including term deposits with maturity 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 consolidated income statement.

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

Income tax

Income tax comprises current and deferred tax. Income tax is recognised in the consolidated 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, associates and interests in joint ventures 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.

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax (continued)

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:

- where the deferred tax assets relating to the deductible temporary differences arise 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, associates and interests in joint ventures, 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 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:

(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 results in overlifts and underlifts. The Group records these transactions in accordance with the entitlement method under which overlifts are recorded as liabilities and underlifts are recorded as assets at year end oil prices. Settlement will be in kind when the liftings are equalised or in cash when production ceases.

The Group has entered into gas sale 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 the make-up gas is taken by those customers or the expiry of the contracts.

(ii) Marketing revenues

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

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition

(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 have been 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 recognized on a time proportion basis taking into account the effective yield on the assets.

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 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 the 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 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 dividends if any 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.

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. Investment income earned on the temporary of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs capitalised.

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 the 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 dates 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. All differences are taken to the consolidated 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 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 cumulative translation reserve. On disposal of a foreign entity, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the consolidated income statement.

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.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Repairs and maintenance

Repairs and maintenance 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 consolidated 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 the 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 its 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. Further details are given in notes 3, 18 and 31.

4. ACQUISITIONS

(i) On 8 January 2006, CNOOC Limited signed a definitive agreement with South Atlantic Petroleum Limited ("SAPETRO") to acquire a 45% working interest in the offshore Oil Mining License 130 ("OML130") in Nigeria for US$2.268 billion in cash. On 20 April 2006, the Company completed its acquisition at a total consideration of US$2.268 billion plus a working capital adjustment of US$424 million for financial, operating and capital expenditures. OML130 has not started commercial production.

(ii) On 27 January 2006, the Group signed an agreement to acquire a 92.1% equity interest in AERD Projects Nigeria Limited, which holds a 38% working interest in the Offshore Oil Prospecting License 229 ("OPL229") in Nigeria at a consideration of US$60 million. The transaction was completed on 4 December 2006. After the transaction, the Group acquired a 35% working interest in OPL229, which was still in an exploration stage as at 31 December 2006.

5. PRODUCTION SHARING CONTRACTS

The PRC

For production sharing contracts in relation to offshore China (the "China PSC"), the foreign parties to the China PSC ("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 percentage of participating interests.

In general, the Group has the option to take up to 51% participating interests in a China PSC and may exercise such option after the foreign partners have independently undertaken all the exploration costs and risks, completed all the exploration works and made viable commercial discoveries.

After the Group exercises its option to take participating interests in a China PSC, 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 China PSC. 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, currently classified as production tax, to the tax bureau at a pre-determined rate. In addition, there is a pre-agreed portion of oil and gas designated to recover all exploration costs, development costs, operating costs incurred and related interest according to the participating interests between the Group and the foreign partners. Any remaining oil after the foregoing priority allocations is first distributed to the PRC government as government share oil on a pre-determined ratio pursuant to a sliding scale, and then distributed to the Group and the foreign partners according to their respective participating interests. As the government share oil is not included in the Group's interest in the annual production, the net sales revenue 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

In certain countries, 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/or the domestic market obligation.

In other countries, the Group, as one of the title owners under certain exploration and/or production licenses or permits, is required to bear all exploration, development and operating costs together with other co-owners. Once production occurs, certain percentage of the annual production or revenue will first be distributed to the local government, which, in most of cases, with the nature of royalty, and the rest of the annual production or revenue will be allocated among the co-owners. Exploration, development and operating costs can be deductible for the purpose of income tax calculation in accordance with local tax regulations.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

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.

(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 the 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 expenditure information for the Group's business segments for the years ended 31 December 2006 and 2005.

	Independent operations		Production sharing contracts		Trading business		Unallocated		Eliminations		Consolidated	
	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000
Sales to external customers:												
Oil and gas sales	31,431,976	22,808,733	36,395,977	30,608,936	–	–	–	–	–	–	67,827,953	53,417,669
Marketing revenues	–	–	–	–	20,964,093	15,901,325	–	–	–	–	20,964,093	15,901,325
Intersegment revenues	851,604	1,598,171	11,056,807	7,467,429	–	–	–	–	(11,908,411)	(9,065,600)	–	–
Other income	19,809	13,093	89,239	103,047	–	–	46,190	20,609	–	–	155,238	136,749
Total	32,303,389	24,419,997	47,542,023	38,179,412	20,964,093	15,901,325	46,190	20,609	(11,908,411)	(9,065,600)	88,947,284	69,455,743
Segment results												
Operating expenses	(2,538,092)	(2,095,273)	(4,461,092)	(3,839,325)	–	–	–	–	–	–	(6,999,184)	(5,934,598)
Production taxes	(1,606,059)	(1,154,771)	(1,709, 602)	(1,441,772)	–	–	–	–	–	–	(3,315,661)	(2,596,543)
Exploration costs	(1,296,424)	(1,025,993)	(408,651)	(267,694)	–	–	–	–	–	–	(1,705,075)	(1,293,687)
Depreciation, depletion and amortisation	(2,502,336)	(2,554,896)	(4,430,878)	(3,409,844)	–	–	–	–	–	–	(6,933,214)	(5,964,740)
Dismantlement	(242,855)	(152,796)	(229,414)	(100,061)	–	–	–	–	–	–	(472,269)	(252,857)
Special oil gain levy	(1,928,985)	–	(2,052,185)	–	–	–	–	–	–	–	(3,981,170)	–
Impairment loss related to property, plant and equipment	(150,399)	(39,494)	(101,958)	(50,696)	–	–	–	–	–	–	(252,357)	(90,190)
Crude oil and product purchases	(851,604)	(1,598,171)	(11,056,807)	(7,467,429)	(20,572,935)	(15,704,100)	–	–	11,908,411	9,065,600	(20,572,935)	(15,704,100)
Selling and administrative expenses	(82,377)	(39,486)	(708,652)	(676,062)	–	–	(752,748)	(654,820)	–	–	(1,543,777)	(1,370,368)
Others	(6,134)	–	(101,147)	(77,062)	–	–	(10,020)	–	–	–	(117,301)	(77,062)
Interest income	–	–	82,747	7,328	–	–	698,789	351,966	–	–	781,536	359,294
Finance costs	(200,110)	(183,325)	(112,379)	(94,885)	–	–	(1,519,641)	(822,322)	–	–	(1,832,130)	(1,100,532)
Exchange gains/(losses), net	(19)	–	19,544	(5,119)	–	–	288,857	292,146	–	–	308,382	287,027
Investment income	–	–	–	–	–	–	613,028	247,893	–	–	613,028	247,893
Share of profits of associates	–	–	–	–	–	–	321,676	307,075	–	–	321,676	307,075
Non-operating income/(expenses), net	–	–	–	–	–	–	876,423	28,579	–	–	876,423	28,579
Tax	–	–	–	–	–	–	(13,196,313)	(10,977,812)	–	–	(13,196,313)	(10,977,812)
Profit for the year	20,897,995	15,575,792	22,271,549	20,756,791	391,158	197,225	(12,633,759)	(11,206,686)	–	–	30,926,943	25,323,122
Other segment information												
Segment assets	34,244,925	25,054,275	76,750,372	51,125,491	1,793,132	2,413,195	40,936,072	34,770,264	–	–	153,724,501	113,363,225
Investments in associates	–	–	–	–	–	–	1,543,515	1,401,839	–	–	1,543,515	1,401,839
Total assets	34,244,925	25,054,275	76,750,372	51,125,491	1,793,132	2,413,195	42,479,587	36,172,103	–	–	155,268,016	114,765,064
Segment liabilities	(5,505,398)	(5,187,124)	(11,105,725)	(12,876,516)	(304,333)	(667,336)	(30,538,687)	(22,430,991)	–	–	(47,454,143)	(41,161,967)
Capital expenditure	8,839,966	7,806,927	35,673,922	8,914,306	–	–	128,538	144,442	–	–	44,642,426	16,865,675

6. SEGMENT INFORMATION (continued)

(b) Geographical segments

The Group mainly engaged in the exploration, development and production of crude oil, natural gas and other petroleum products at offshore China. Any activities outside the PRC are mainly conducted in Indonesia, Australia, Canada, Singapore, Myanmar and Nigeria.

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. No further analysis of geographical segment information is presented for revenues as over 84% of the Group's revenues are generated from PRC customers, and revenues generated from customers in other locations are individually less than 10%.

The following table presents certain assets and capital expenditure information for the Group's geographical segments for the years ended 31 December 2006 and 2005.

	PRC		Africa		South East Asia		Others		Consolidation and Elimination		Total	
	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000
Segment assets	141,671,505	96,297,414	24,885,876	3,296	19,006,251	15,489,010	35,901,096	12,795,292	(66,196,712)	(9,819,948)	155,268,016	114,765,064
Capital expenditure	15,794,450	14,496,690	25,265,423	–	3,384,807	2,363,233	197,746	5,752	–	–	44,642,426	16,865,675

7. OIL AND GAS SALES

	Group	
	2006 RMB'000	2005 RMB'000
Gross sales	72,709,179	57,988,465
Less: Royalties	(752,958)	(708,537)
PRC government share oil	(4,128,268)	(3,862,259)
	67,827,953	53,417,669

8. MARKETING PROFIT

	Group	
	2006 RMB'000	2005 RMB'000
Marketing revenues	20,964,093	15,901,325
Crude oil and product purchases	(20,572,935)	(15,704,100)
	391,158	197,225

9. SPECIAL OIL GAIN LEVY

During the year, a Special Oil Gain Levy ("SOG Levy") was imposed by the Ministry of Finance of the PRC at the progressive rates from 20% to 40% on the portion of the monthly weighted average sales price of the crude oil lifted in PRC exceeding US$40 per barrel. The SOG Levy paid can be claimed as a deductible expense for corporate income tax purpose and is calculated based on the actual volume of the crude oil entitled.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

10. PROFIT BEFORE TAX

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

	Group	
	2006 RMB'000	2005 RMB'000
Crediting:		
Interest income on bank deposits	**(781,536)**	(359,294)
Exchange gains, net	**(308,382)**	(287,027)
Investment income from listed investments	**(229,506)**	(190,709)
Investment income from unlisted investments	**(383,522)**	(57,184)
Investment income	**(613,028)**	(247,893)
Charging:		
Auditors' remuneration:		
- Audit fee	**10,443**	7,961
- Other fees	**4,709**	2,098
	15,152	10,059
Employee benefit expense (including directors' remuneration (note 12)):		
- Wages, salaries and allowances	**501,563**	363,668
- Labour costs paid to contractors	**1,190,862**	750,651
- Equity-settled share option expense	**75,768**	29,123
	1,768,193	1,143,442
Depreciation, depletion and amortisation:		
- Property, plant and equipment	**6,874,340**	5,941,755
- Intangible assets	**23,864**	—
Add: Oil in tank adjustments	**35,010**	22,985
	6,933,214	5,964,740
Operating lease rentals:		
- Office properties	**83,848**	87,440
- Equipment	**580,568**	641,846
	664,416	729,286
Loss on disposal of property, plant and equipment	**408**	9,629
Repairs and maintenance	**1,233,037**	1,047,979
Research and development costs	**377,119**	401,640
Provision for inventory obsolescence	**2,004**	33,088

11. FINANCE COSTS

	Group	
	2006 **RMB'000**	2005 RMB'000
Interest on bank loans which are		
- repayable within five years	**51,345**	98,892
- repayable after five years	**10,631**	—
Interest on other loans (including convertible bonds)	**907,565**	671,849
Other borrowing costs	**1,535**	3,773
Total borrowing costs	**971,076**	774,514
Less: Amount capitalised in property, plant and equipment (note 18)	**(913,175)**	(245,987)
	57,901	528,527
Other finance costs:		
Increase in discounted amount of provisions arising from the passage of time (note 31)	**250,922**	198,945
Fair value losses on embedded derivative component of convertible bonds	**1,523,307**	373,060
	1,832,130	1,100,532

The interest rates used for interest capitalisation represented the cost of capital from raising the related borrowings and varied from 4.1% to 6.375% (2005: from 4.1% to 9.2%) per annum for the year ended 31 December 2006.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

12. DIRECTORS' REMUNERATION AND SHARE OPTION BENEFITS

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

	Fees(1) RMB'000	Salaries, allowances and benefits in kind(1) RMB'000	Performance related bonuses RMB'000	Pension scheme contributions RMB'000	Amount paid/payable during the year RMB'000	Share option benefits(4) RMB'000	Total RMB'000
2006							
Executive directors:							
Fu Chengyu	—	4,361	—	89	4,450	5,184	9,634
Zhou Shouwei	—	3,487	—	81	3,568	3,644	7,212
Wu Guangqi	—	2,385	—	80	2,465	2,196	4,661
Yang Hua	—	2,870	—	79	2,949	2,392	5,341
Subtotal	—	13,103	—	329	13,432	13,416	26,848
Non-executive directors(6):							
Luo Han	977	300	—	80	1,357	2,392	3,749
Cao Xinghe	977	300	—	80	1,357	1,538	2,895
Wu Zhenfang	977	300	—	80	1,357	1,538	2,895
Subtotal	2,931	900	—	240	4,071	5,468	9,539
Independent non-executive directors:							
Chiu Sung Hong	977	—	—	—	977	181	1,158
Evert Henks	977	—	—	—	977	181	1,158
Kenneth S. Courtis(2)	407	—	—	—	407	181	588
Tse Hau Yin, Aloysius	977	—	—	—	977	—	977
Lawrence J. Lau(5)	—	—	—	—	—	—	—
Edgar W. K. Cheng(3)	—	—	—	—	—	—	—
Subtotal	3,338	—	—	—	3,338	543	3,881
Total	6,269	14,003	—	569	20,841	19,427	40,268
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
Subtotal	—	12,988	—	104	13,092	7,196	20,288
Independent non-executive directors:							
Chiu Sung Hong	619	—	—	—	619	437	1,056
Evert Henks	619	—	—	—	619	437	1,056
Kenneth S Courtis(2)	619	—	—	—	619	437	1,056
Tse Hau Yin, Aloysius	350	—	—	—	350	—	350
Erwin Schurtenberger	153	—	—	—	153	54	207
Lawrence J. Lau(5)	—	—	—	—	—	—	—
Subtotal	2,360	—	—	—	2,360	1,365	3,725
Total	2,360	12,988	—	104	15,452	8,561	24,013

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

Notes:

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

(2) Dr. Kenneth S. Courtis, who retired as an independent non-executive director of the Company with effect from 24 May 2006, following the conclusion of the Company's annual general meeting, exercised his right to subscribe for 1,150,000 shares of options granted under the 2002 Share Option Scheme of the Company and the allotment was completed on 2 August 2006. After that, Dr. Kenneth S. Courtis does not hold any share options of the Company.

(3) On 24 May 2006, Dr. Edgar W. K. Cheng was elected as an independent non-executive director of the Company by the shareholders at the annual general meeting of the Company. Dr. Edgar W. K. Cheng waived his remuneration in 2006.

(4) 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. The fair value of such options which have been recognised to the income statement over the vesting period, was determined as at the date of grant and the amount included in the financial statements for the current year is included in the above directors' remuneration disclosures.

(5) Professor Lawrence J. Lau, appointed as an independent non-executive director of the Company on 31 August 2005, waived his remuneration in 2005 and 2006.

(6) Effective from 1 September 2006, these directors were re-designated from executive directors to non-executive directors.

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 four (2005: three) directors and one (2005: two) non-director. Their remuneration and share option benefits are as follows:

	2006 RMB'000	2005 RMB'000
Basic salaries, allowances and benefits in kind*	15,930	15,843
Performance related bonuses	808	471
Pension scheme contributions	370	542
Amount paid/payable during the year	17,108	16,856
Share option benefits**	15,653	4,975
	32,761	21,831
Number of directors	4	3
Number of employees	1	2

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

** 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. The fair value of such options which have been recognised to the income statement over the vesting period, was determined as at the date of grant and the amount included in the financial statements for the current year is included in the above five highest paid employees' remuneration disclosures.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

13. FIVE HIGHEST PAID EMPLOYEES (continued)

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

	Number of employees	
	2006	2005
Nil to HK$3,000,000	**—**	1
HK$3,000,001 to HK$3,500,000	**—**	1
HK$3,500,001 to HK$4,000,000	**—**	—
HK$4,000,001 to HK$4,500,000	**—**	1
HK$4,500,001 to HK$5,000,000	**1**	—
HK$5,000,001 to HK$5,500,000	**1**	1
HK$5,500,001 to HK$6,000,000	**1**	—
HK$6,000,001 to HK$8,000,000	**1**	1
HK$8,000,001 to HK$10,000,000	**1**	—
	5	5

14. TAX

(i) Income tax

The Group is subject to income taxes on an entity basis on profit arising in or derived from the tax jurisdictions in which the entities of the Group are domiciled and operate. 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 mainland China, CNOOC China Limited, is a wholly-owned foreign enterprise. It is exempt from the 3% local surcharge and is subject to an enterprise income tax rate 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%. According to current tax treaty between Indonesia and Malaysia, the Company's subsidiaries owning interests in oil and gas properties in Indonesia are subject to corporate and dividend tax combined at rates ranging from 43.125% to 51.875%. The Company's subsidiary owning interests in oil and gas properties in North West Shelf Project ("NWS Project") in Australia is subject to income tax at the rate of 30%. All of the Company's other subsidiaries are not subject to any income taxes in their respective jurisdictions for the years presented.

Certain of the Group's oil and gas interests in Indonesia are held through Labuan incorporated companies. Labuan incorporated companies enjoy certain current reduced tax rates provided by the tax treaty between Indonesia and Malaysia. In May 2006, certain proposed amendments to the tax treaty were agreed by the respective ministers of the two countries. According to the proposed amendments, the tax rates will increase from 43.125% to 48% and from 51.875% to 56% respectively. The proposed amendments will need to be ratified by the two countries and will take effect two months after the ratification. It is still uncertain when the ratification will be completed by the two countries as at 31 December 2006.

14. TAX (continued)

(i) Income tax (continued)

An analysis of the provision for tax in the Group's consolidated income statement is as follows:

	2006 RMB'000	2005 RMB'000
Overseas		
- Current income tax	874,378	845,390
- Deferred income tax	141,615	14,907
PRC		
- Current income tax	11,791,620	9,912,426
- Deferred income tax	388,700	205,089
Total tax charge for the year	13,196,313	10,977,812

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

	2006 %	2005 %
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	0.8	0.8
Tax credit from the government	(0.7)	(0.3)
Profit attributable to associates	(0.2)	(0.3)
Tax charge at the Group's effective rate	29.9	30.2

The movements of deferred tax liabilities during the year are as follows:

	2006 RMB'000	2005 RMB'000
Balance at beginning of the year	6,827,916	6,688,498
Credited to the consolidated income statement during the year	530,315	219,996
Exchange realignment	(122,062)	(80,578)
Balance at the end of the year	7,236,169	6,827,916

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

14. TAX (continued)

(i) Income tax (continued)

Principal components of the provision for deferred tax are as follows:

	Group	
	2006 RMB'000	2005 RMB'000
Deferred tax assets		
Provision for retirement and termination benefits	**102,521**	98,696
Provision for dismantlement	**1,623,774**	1,248,498
Impairment of property, plant and equipment and write-off of unsuccessful exploratory drillings	**1,006,260**	886,402
Overseas tax loss carryforward	**131,441**	—
	2,863,996	2,233,596
Deferred tax liabilities		
Accelerated amortisation allowance for oil and gas properties	**(10,011,208)**	(9,061,512)
Others	**(88,957)**	—
	(10,100,165)	(9,061,512)
Net deferred tax liabilities	**(7,236,169)**	(6,827,916)

As at 31 December 2006, there was no significant unrecognised deferred tax liability (2005: Nil) for taxes that would be payable on the unremitted earnings of certain of the Group's subsidiaries and associates as the Group had no liability to additional tax should such amounts be remitted.

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

(ii) Other taxes

The Company's PRC subsidiary pays the following other taxes:

— Production taxes equal to 5% of independent production and production under production sharing contracts;

— Export tariffs at a rate of 5% are levied on petroleum oils by The General Administration of Customs as from 1 November 2006; and

— Business tax at rates of 3% to 5% on other income.

15. PROFIT ATTRIBUTABLE TO THE SHAREHOLDERS

The consolidated profit attributable to the Company's shareholder for the year ended 31 December 2006 includes a profit of approximately RMB16,056,043,000 (2005: RMB13,791,976,000) which has been dealt with in the financial statements of the Company (note 33).

16. DIVIDENDS

On 29 August 2006, the Board of Directors declared an interim dividend of HK$0.12 per share (equivalent to approximately RMB0.12 per share) (2005: HK$0.05 per share), totalling HK$5,199,426,000 (equivalent to approximately RMB5,334,091,000) (2005: RMB2,138,128,000); No special interim dividend was declared (2005: HK$0.05 per share, totalling RMB2,138,128,000).

The Board of Directors have recommended a final dividend of HK$0.14 (equivalent to approximately RMB0.14) (2005: HK$0.10) per ordinary share, totalling HK$6,065,997,371 (equivalent to approximately RMB6,001,819,000) for the year ended 31 December 2006 (2005: RMB4,250,391,000). The proposed final dividend for the year is subject to the approval of the Company's shareholders at the forthcoming annual general meeting.

16. DIVIDENDS (continued)

The payment of future dividends will be determined by the Company's Board of Directors, which are based upon, among other things, the Company's future earnings, capital requirements, financial conditions, future prospects and other factors which the Board of Directors may consider relevant. 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.

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

	Group	
	2006	2005
Earnings:		
Profit from ordinary activities attributable to shareholders for the year for the basic earnings per share calculation	**RMB30,926,943,000**	RMB25,323,122,000
Interest expense and fair value losses recognised on the embedded derivative component of convertible bonds	**RMB1,915,414,568***	RMB537,468,873
Profit from ordinary activities attributable to shareholders for the year for the diluted earnings per share calculation	**RMB32,842,357,568***	RMB25,860,590,873
Number of shares:		
Number of ordinary shares issued at beginning of the year before the weighted average effects of new shares issued and share options exercised during the year	**41,054,675,375**	41,052,375,275
Weighted average effect of new shares issued during the year	**1,457,036,115**	—
Weighted average effect of share options exercised during the year	**478,904**	2,124,707
Weighted average number of ordinary shares for the basic earnings per share calculation	**42,512,190,394**	41,054,499,982
Effect of dilutive potential ordinary shares under the share option schemes	**65,650,619**	38,861,432
Effect of dilutive potential ordinary shares for convertible bonds based on the "if converted method"	**1,310,307,143***	1,292,694,352
Weighted average number of ordinary shares for the purpose of diluted earnings per share	**43,888,148,156***	42,386,055,766
Earnings per share		
- Basic	**RMB0.73**	RMB0.62
- Diluted	**RMB0.73***	RMB0.61

The calculation of basic earnings per share amounts is based on the profit from ordinary activities attributable to shareholders 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 profit for the year, adjusted to reflect the interest expenses 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.

* Since the diluted earnings per share amount is increased when taking the convertible bonds into account, the convertible bonds had an anti-dilutive effect on the basic earnings per share for the period and were ignored in the calculation of diluted earnings per share. Therefore, diluted earnings per share amounts are based on the profit for the year of approximately RMB30,926,943,000, and the weighted average of 42,577,841,013 ordinary shares.

Notes to Financial Statements

31 December 2006

(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

	Oil and gas properties RMB'000	Vehicles and office equipment RMB'000	Total RMB'000
Cost:			
At 1 January 2005	90,584,801	187,705	90,772,506
Additions	17,500,195	146,226	17,646,421
Reclassification to intangible asset (note 19)	(1,299,643)	—	(1,299,643)
Purchase price adjustment	(152,993)	—	(152,993)
Disposals and write-offs	—	(14,511)	(14,511)
Exchange realignment	(504,132)	(6)	(504,138)
At 31 December 2005	106,128,228	319,414	106,447,642
At 1 January 2006	106,128,228	319,414	106,447,642
Additions	24,299,341	132,260	24,431,601
Acquisitions	21,217,335	—	21,217,335
Reclassification to intangible asset (note 19)	(175,387)	—	(175,387)
Disposals and write-offs	—	(1,912)	(1,912)
Exchange realignment	(1,232,003)	(413)	(1,232,416)
At 31 December 2006	150,237,514	449,349	150,686,863
Accumulated depreciation, depletion and amortisation:			
At 1 January 2005	(33,546,591)	(43,889)	(33,590,480)
Depreciation provided during the year	(6,176,784)	(57,248)	(6,234,032)
Impairment recognised in the income statement during the year	(90,190)	—	(90,190)
Disposals and write-offs	—	4,881	4,881
Exchange realignment	87,346	—	87,346
At 31 December 2005	(39,726,219)	(96,256)	(39,822,475)
At 1 January 2006	(39,726,219)	(96,256)	(39,822,475)
Depreciation provided during the year	(7,268,835)	(84,290)	(7,353,125)
Impairment recognised in the income statement during the year	(252,357)	—	(252,357)
Disposals and write-offs	—	16	16
Exchange realignment	147,207	247	147,454
At 31 December 2006	(47,100,204)	(180,283)	(47,280,487)
Net book value:			
At 1 January 2006	66,402,009	223,158	66,625,167
At 31 December 2006	103,137,310	269,066	103,406,376

Included in the current year additions was an amount of approximately RMB 948,777,000 (2005: RMB245,987,000) (note 11) 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	
	2006 **RMB'000**	2005 RMB'000
Cost:		
At 1 January	**7,961**	5,833
Additions	**67**	2,128
Exchange realignment	**(272)**	—
At 31 December	**7,756**	7,961
Accumulated depreciation:		
At 1 January	**(6,887)**	(5,669)
Depreciation provided during the year	**(281)**	(1,218)
Exchange realignment	**236**	—
At 31 December	**(6,932)**	(6,887)
Net book value:		
At 1 January	**1,074**	164
At 31 December	**824**	1,074

19. INTANGIBLE ASSET

The consideration allocated to the gas processing rights regarding the NWS Project was recognised as an intangible asset of the Company. During 2006, the NWS Project started commercial production. Accordingly, the intangible asset regarding the gas processing rights has been amortised upon the commercial production of the liquefied natural gas using the unit-of-production method.

	Group	
	2006 **RMB'000**	2005 RMB'000
Cost:		
At 1 January	**1,299,643**	—
Reclassification from property, plant and equipment (note 18)	**175,387**	1,299,643
Exchange realignment	**(42,113)**	—
At 31 December	**1,432,917**	1,299,643
Accumulated amortisation:		
At 1 January	**—**	—
Amortisation provided during the year	**(23,864)**	—
At 31 December	**(23,864)**	—
Net book value:		
At 1 January	**1,299,643**	—
At 31 December	**1,409,053**	1,299,643

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

20. INVESTMENTS IN SUBSIDIARIES/LOANS TO AND DUE FROM/TO SUBSIDIARIES

	Company	
	2006 RMB'000	2005 RMB'000
Unlisted shares, at cost	**7,766,979**	7,766,971
Loans to a subsidiary	**3,918,213**	4,138,290
Due from subsidiaries	**42,074,828**	22,213,478
Due to subsidiaries	**(15,339,207)**	(14,468,726)
	38,420,813	19,650,013

The loans to a subsidiary are unsecured and bear fixed interest at a rate of 7.084% per annum and due after five years. The carrying values of the loans approximates to their fair values.

The amounts due from/to subsidiaries included in the Company's current assets and liabilities 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	RMB20 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 products 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
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

20. INVESTMENTS 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
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
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

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

20. INVESTMENTS 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 Exploration &Production Nigeria Limited	Nigeria 6 January 2006	Naira10,000,000	100%	Offshore petroleum exploration, development and production in Africa
AERD PROJECTS NIGERIA Limited	Nigeria 28 January 2005	Naira10,000,000	92.11%	Offshore petroleum exploration, development and production in Africa

* 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. INTERESTS IN ASSOCIATES

The Group's investments in associates represent (1) a 30% equity interest in Shanghai Petroleum and Natural Gas Company Limited ("SPC") through CNOOC China Limited. 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 in CNOOC Finance Corporation Limited through CNOOC China 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. Both of the associates are unlisted companies and indirectly held by the Company.

	Group	
	2006 RMB'000	2005 RMB'000
Share of net assets	**1,543,515**	1,401,839

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 credit terms of the Group are generally within 30 days after the delivery of oil and gas. Trade receivables are non-interest-bearing.

As at 31 December 2006 and 2005, substantially all the accounts receivable were aged within six months.

23. INVENTORIES AND SUPPLIES

	Group	
	2006 **RMB'000**	2005 RMB'000
Materials and supplies	**1,508,403**	969,915
Oil in tanks	**224,203**	268,834
Less: Provision for inventory obsolescence	**(41,127)**	(39,123)
	1,691,479	1,199,626

24. AVAILABLE-FOR-SALE FINANCIAL ASSETS

Current:

	Group		Company	
	2006 **RMB'000**	2005 RMB'000	**2006** **RMB'000**	2005 RMB'000
Unlisted investments, at fair value:				
Liquidity funds	**12,264,926**	13,185,139	**5,915,375**	8,424,780
Corporate bonds	**—**	199,877	**—**	199,877
Listed investments, at fair value:				
Common stock	**125,132**	461,919	**125,132**	461,919
	12,390,058	13,846,935	**6,040,507**	9,086,576

The above listed investments in common stock and liquidity funds which were designated as available-for-sale financial assets have no fixed maturity date and no coupon rate.

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 gains of the Group's and the Company's available-for-sale investments recognised directly in equity amounted to RMB60,010,176 and RMB55,241,511 respectively (2005: RMB69,069,142 and RMB64,900,590 respectively). In addition, the unrealized gains of the Group's and the Company's available-for-sale investments of RMB69,069,142 and RMB64,900,590 recognised directly in equity in 2005 were transferred from equity to the income statement during the year (2005: nil). The amounts removed from equity to the income statement were determined on specific identification basis.

Non-current:

The non-current available-for-sale financial assets consist of investments in unlisted equity securities of MEG Energy Corporation ("MEG") and is stated at cost less any impairment. MEG is principally engaged in the exploitation and production of oil sands.

25. CASH AND CASH EQUIVALENTS AND TIME DEPOSITS WITH MATURITY OVER THREE MONTHS

The Group's and the Company's cash and cash equivalents mainly consist of time deposits with maturity ranging between seven days and one month. The interest rates of the Group's RMB denominated deposits range between 1.44% and 1.62% and the interest rates of the Group's and the Company's US dollar denominated deposits range between 5.10% and 5.28%. The Group's time deposits with maturity over three months consist of all RMB denominated time deposits with interest rates ranging between 1.80% and 2.25%.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

26. ACCOUNTS PAYABLE

As at 31 December 2006 and 2005, substantially all the accounts payable were aged within six months. The accounts payable are non-interest-bearing and are normally settled within six months.

27. OTHER PAYABLES AND ACCRUED LIABILITIES

	Group	
	2006 RMB'000	2005 RMB'000
Accrued payroll and welfare payable	251,251	178,872
Provision for retirement and termination benefits	282,710	239,591
Accrued expenses	3,188,603	3,411,784
Advances from customers	183,850	22,238
Royalties payable	360,334	297,139
Special oil gain levy payable	567,387	—
Other payables	647,364	1,057,319
	5,481,499	5,206,943

Other payables are non-interest-bearing and have an average term of less than six months.

28. LONG TERM BANK LOANS

As at 31 December 2006, 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	
		2006 RMB'000	2005 RMB'000
	Effective interest rate and final maturity		
RMB denominated bank loans*	Effective interest rate of 4.05% per annum with maturity through 2016	500,000	—
US$ denominated bank loans**	Effective interest rate of LIBOR+0.23%~0.26% per annum with maturity through 2017	1,938,172	—
US$ denominated bank loans	Effective interest rate of 9.2% per annum with maturity through to 2006	—	812,759
Japanese Yen denominated bank loans	Effective interest rate of 4.1% per annum with maturity through 2007	17,816	37,307
		2,455,988	850,066
Less: Current portion of long term bank loans		(17,816)	(825,674)
		2,438,172	24,392

* During the year, the Group obtained a bank loan from the Export-Import Bank of China for the purpose of financing the ongoing capital needs of OML130 in Nigeria. The Group's total facility for the above bank borrowing amounted to RMB12.8 billion, of which RMB500 million had been utilised as at the balance sheet date.

** During the year, the Group, together with its partners on Tangguh Liquified Natural Gas Project ("Tanggah LNG Project"), borrowed bank loans amounting to approximately US$2,615,522,000 (equivalent to RMB20,423,823,000) for the purpose of financing Tangguh Project in Indonesia. The Group shared the bank loans amount according to its interest of 16.95688% in the project. As at 31 December 2006, the Group's share of the utilised bank loans amounted to approximately US$248,207,000 (equivalent to RMB1,938,172,000).

28. LONG TERM BANK LOANS (continued)

The Company, as Guarantor, has delivered a Guarantee dated 7 August 2006 in favor of Mizuho Corporate Bank, Ltd., as facility agent for and on behalf of various international commercial banks under a US$1,065.5 million commercial loan agreement dated as of 31 July 2006 in connection with the Tangguh Project in Indonesia. Pursuant to the Guarantee, the Company guarantees the payment obligations of the trustee borrower under the subject loan agreement and is subject to a maximum cap of approximately US$487,862,000.

As at 31 December 2006, all the bank loans of the Group were unsecured and none of the outstanding borrowings were guaranteed by CNOOC.

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

	Group	
	2006 RMB'000	2005 RMB'000
Repayable:		
Within one year	**17,816**	825,674
After one year but within two years	**—**	24,392
After two years but within three years	**17,316**	—
After three years but within four years	**112,556**	—
After four years but within five years	**181,820**	—
After five years	**2,126,480**	—
	2,455,988	850,066
Amount due within one year shown under current liabilities	**(17,816)**	(825,674)
	2,438,172	24,392

Supplemental information with respect to long term bank loans:

For the year ended 31 December	Balance at year end RMB'000	Weighted average interestrate 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**
2006	2,455,988	5.25%	2,455,988	1,653,027	7.11%
2005	850,066	8.98%	889,575	869,821	8.89%

* 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 2006

(All amounts expressed in Renminbi unless otherwise stated)

29. 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 and HK$5.90 per share on 7 June 2005 and 7 June 2006, respectively, as a result of the declaration of the final and special final dividends for 2004 and 2005 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.

During the year, an amount of US$1,000 (2005: Nil) of the convertible bonds was requested for conversion by an investor, and the Company exercised the cash settlement option.

30. RELATED PARTY TRANSACTIONS

The majority of the Group's business activities are conducted with state-owned enterprises (including CNOOC and its associates). As the Group is controlled by CNOOC, transactions with CNOOC and its associates are disclosed as related party transactions. The Group considers that transactions with other state-owned enterprises (other than CNOOC and its associates) are in the ordinary course of business and there are no indicators that the Group influenced, or was influenced by, those state-owned enterprises. Accordingly, the Group has not disclosed such transactions with other state-owned enterprises (other than CNOOC and its associates) as related party transactions.

In order to present a more coherent, logical and understandable picture to shareholders, and also to enable the Company to monitor the status of its connected transactions as defined under the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules") more effectively going forward, the Company has adopted a new categorisation for its related party/continuing connected transactions with CNOOC and/or its associates. On 8 December 2005, the Company entered into three comprehensive framework agreements with each of CNOOC, China Oilfield Services Limited ("COSL") and Offshore Oil Engineering Co., Ltd ("CNOOC Engineering") respectively for the provision (1) by the Group to CNOOC and/or its associates and (2) by CNOOC and/or its associates to the Group, of a range of products and services which may be required and requested from time to time by either party and/or its associates in respect of the new categories of related party/continuing connected transactions. The term of each of the comprehensive framework agreements is for a period of two years from 1 January 2006. The new categorisation of related party/continuing connected transactions as approved by the independent shareholders of the Company on 31 December 2005 applicable to the Company for the period from 1 January 2006 to 31 December 2007 is as follows:

- Provision of exploration, oil and gas development, oil and gas production as well as marketing, management and ancillary services by CNOOC and/or its associates to the Group;
- Provision of management, technical, facilities and ancillary services, including the supply of materials from the Group to CNOOC and/or its associates; and
- Sale of petroleum and natural gas products by the Group to CNOOC and/or its associates.

30. RELATED PARTY TRANSACTIONS (continued)

Since the establishment of CNOOC, certain associates of CNOOC have been specialised in exploration, development and production of oil and gas, as well as the provision of marketing, management and ancillary services to the Group through bidding process. The Group will continue to use these services provided by the associates of CNOOC, including but not limited to COSL, CNOOC Engineering and CNOOC Oil Base Group Limited ("COBGL"). CNOOC also provides certain of these services from time to time. The services provided by CNOOC and/or its associates are set out below.

(i) Provision of exploration, oil and gas development, oil and gas production as well as marketing, management and ancillary services by CNOOC and/or its associates to the Group

(a) Provision of exploration and support services to the Group

The services provided by CNOOC and/or its associates to the Group on exploration operations include:

- well site survey;
- seismic data acquisition and processing;
- integrated exploration research services;
- exploration well operation;
- related technical services on exploration wells;
- tow-boat, transportation and safety services; and
- other related technical and supporting services.

(b) Provision of oil and gas development and support services to the Group

The services provided by CNOOC and/or its associates to the Group on oil and gas development operations include:

- platform survey;
- drilling and completion well operation;
- related technical services on drilling and completion;
- design, construction, installation and tuning of production facilities;
- shipping transportation;
- provision of materials;
- integrated research on development techniques; and
- other related technical and supporting services.

(c) Provision of oil and gas production and support services to the Group

The services provided by CNOOC and/or its associates to the Group on oil and gas production operations are set out below. In addition, the scope of business of these companies also include various facilities and ancillary services, such as the provision of different types of materials, medical and employee welfare services, maintenance and repair of major equipments and the supply of water, electricity and heat to the Group, some of which may not be available from independent third parties or available on comparable terms.

- integrated research on production techniques;
- well workover;
- shipping transportation;
- oil tanker transportation;
- provision of materials;
- maintenance of platform;
- repair of equipment and pipelines;
- production operations;

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

30. RELATED PARTY TRANSACTIONS (continued)

(i) Provision of exploration, oil and gas development, oil and gas production as well as marketing, management and ancillary services by CNOOC and/or its associates to the Group (continued)

(c) Provision of oil and gas production and support services to the Group (continued)

- oil and gas production labour services;
- warehousing and storage;
- lease of equipment and buildings;
- road transportation services;
- telecommunication and network services;
- wharf services;
- construction services, including roads, wharf, buildings, factories and water barriers;
- maintenance and repair of major equipment;
- medical, childcare and social services;
- provision of water, electricity and heat;
- security and fire services;
- technical training;
- accommodation;
- maintenance and repair of buildings;
- catering services; and
- other related technical and supporting services.

(d) Provision of marketing, management and ancillary services to the Group

CNOOC and/or its associates provide marketing, administration, management of oil and gas operations and integrated research services to the Group, as well as other ancillary services relating to the exploration, development, production and research activities of the Group. Details of these services are set out below:

- marketing services;
- management;
- staff recruitment;
- publishing;
- telecommunications;
- leases of properties;
- property management;
- water, electricity and heat supply;
- car rental;
- integrated services such as record keeping, filing, repair of computers, catering and photocopying; and
- integrated research.

In addition, as part of providing administration and management services to the Group, CNOOC and/or its associates leased certain premises during the year. In addition to leasing these properties, CNOOC and/or its associates also provided management services in respect of certain properties leased to the Group.

30. RELATED PARTY TRANSACTIONS (continued)

(i) Provision of exploration, oil and gas development, oil and gas production as well as marketing, management and ancillary services by CNOOC and/or its associates to the Group (continued)

Pricing principles for transactions referred to in paragraphs (a) to (d) above

The continuing connected transactions referred to in paragraphs (a) to (d) above relate to services provided by CNOOC and/or its associates to the Group. In general, the services provided by CNOOC and/or its associates to the Group are based on negotiations with CNOOC and/or its associates on normal commercial terms, or on terms no less favourable than those available to independent third parties, under prevailing local market conditions, including considerations such as volume of sales, length of contracts, package of services, overall customer relationship and other market factors.

If, for any reason, the above pricing principle for a particular product or service ceases to be applicable or there is no open market for such services, whether due to a change in circumstances or otherwise, such product or service must then be provided in accordance with the following general pricing principles:

(i) state-prescribed prices; or

(ii) where there is no state-prescribed price, market prices, including the local, national or international market prices; or

(iii) when neither (i) nor (ii) is applicable, the cost to CNOOC and/or its associates for providing the relevant products or services (including the cost of sourcing or purchasing from third parties) plus a margin of not more than 10%, before any applicable taxes.

(e) FPSO vessel lease agreements

The Group leases floating production, storage and offloading (FPSO) vessels from COBGL for use in oil and gas production operations at market prices on normal commercial terms which are calculated on a daily basis. FPSO vessels are usually located next to the offshore oil platforms and are an integrated facility used during the offshore oil and gas production for processing, storage and channelling of crude oil. The terms of FPSO vessel leases are usually determined based on the expected term of oil and gas exploration, development and production.

The Group's transactions with related parties referred to above during the year are as follows:

	Group	
	2006 RMB'000	2005 RMB'000
Provision of exploration and support services under exploration expenses	**1,940,075**	1,290,269
Included in: capitalised under property, plant and equipment	**912,809**	536,735
Provision of oil and gas field development and support services under development expenses	**7,229,841**	6,131,879
Provision of oil and gas field production and support services under operating expenses	**2,462,513**	1,824,298
Provision of marketing, management and ancillary services under selling and administrative expenses	**424,725**	337,816
Provision of FPSO vessel leases under operating expenses	**436,783**	148,133
	12,493,937	9,732,395

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

30. RELATED PARTY TRANSACTIONS (continued)

(ii) Provision of management, technical, facilities and ancillary services, including the supply of materials from the Group to CNOOC and/or its associates

In addition to providing various services to the Group, CNOOC and/or its associates may also utilise various types of management, facilities and ancillary services, including the supply of materials provided by the Group from time to time. The pricing for such services will be determined based on the same pricing principles applicable to transactions relating to services provided by CNOOC and/or its associates to the Group under paragraphs (a) and (d) above, which will be negotiated and agreed on normal commercial terms between the parties. The services that may be provided by the Group to CNOOC and/or its associates include:

- technical consulting;
- technology transfer;
- management;
- technical research services; and
- other supporting services.

The Group did not enter into any transactions in the above category for the years ended 31 December 2006 and 2005.

(iii) Sales of petroleum and natural gas products by the Group to CNOOC and/or its associates

(a) Sale of petroleum and natural gas products

The Group sells petroleum and natural gas products, including crude oil, condensated oil, liquefied petroleum gas, natural gas and liquefied natural gas, to CNOOC and/or its associates, which engage in the downstream petroleum business at state-prescribed prices or local, national or international market prices and on normal commercial terms. It is envisaged that an individual sales contract will be entered into from time to time between the Group and CNOOC and/or its associates in relation to such sales.

(b) Long term sale of natural gas and liquefied natural gas

The Group sells natural gas to CNOOC and/or its associates, which engage in the downstream petroleum business at state-prescribed prices or local, national or international market prices and on normal commercial terms, which is subject to adjustment in accordance with movements in international oil prices as well as other factors such as the term of the sales agreement and length of the relevant pipelines. Due to the size of investment and the fact that sales are usually made to markets proximate to the exploration sites, and that purchasers tend to utilise the natural gas products in areas close to the exploration sites, and in order to ensure the return on the investment from the exploration of natural gas, the Group will usually enter into long term sales contracts with a term of 15 to 20 years. It is market practice for the term of the sales contract to be determined based on the estimated reserves and production profile of the relevant gas fields. The Group has also invested and acquired interests in liquefied natural gas related upstream projects in Tangguh of Indonesia and the North West Shelf of Australia. It is also envisaged that from time to time the Group may sell liquefied natural gas explored from these gas reserves mentioned above and other gas reserves in which the Group may invest in the future to CNOOC and/or its associates.

For the year ended 31 December 2006, the total sales amounted to approximately RMB35,493,341,000 (2005: RMB26,576,247,000), of which, under long term sales contracts of natural gas and liquefied natural gas, the sales amounted to approximately RMB1,247,561,000 (2005: RMB588,297,000), and under sales contracts of petroleum and natural gas products, the sales amounted approximately to RMB34,245,780,000 (2005: RMB25,987,950,000).

30. RELATED PARTY TRANSACTIONS (continued)

(iv) Transactions with CNOOC Finance Corporation Limited

In addition to the above related party transactions, the Company also 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 of the Company that is also a subsidiary of CNOOC. Such services include the 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 the provision of loans. The charges levied 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 the 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 2006, the maximum outstanding balance of deposits (including interest received in respect of these deposits) placed with CNOOC Finance amounted to approximately RMB6,395,706,000 (2005: RMB3,922,468,000). For the same period, the interest income earned from the deposits in CNOOC Finance amounted to approximately RMB65,499,000 (2005: RMB58,076,000). As at 31 December 2006 and 2005, the balances with CNOOC Finance of RMB3,558,171,000 (2005: RMB3,714,229,000) were unsecured, interest-free and were repayable on demand.

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 compensation of the key management personnel of the Group are disclosed in note 12 to the financial statements.

The amount due to the parent company and amounts due from/to related parties are unsecured, interest-free and are repayable on demand.

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 of property, plant and equipment in note 18.

The details of the provision for dismantlement are as follows:

	Group	
	2006 **RMB'000**	2005 RMB'000
At the beginning of year	**4,161,663**	3,089,448
Additions during the year and capitalised in oil and gas properties	**999,996**	873,270
Increase in a discounted amount of provisions arising from the passage of time included in finance costs (note 11)*	**250,922**	198,945
At the end of year	**5,412,581**	4,161,663

* The discount rate used for calculating the amount of provisions arising from the passage of time is 5% (2005: 5%).

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

32. SHARE CAPITAL

Shares	Number of shares	Share capital HK$'000	Issued share capital equivalent of RMB'000
Authorised:			
Ordinary shares of HK$0.02 each as at 31 December 2006 and 31 December 2005	75,000,000,000	1,500,000	
Issued and fully paid:			
Ordinary shares of HK$0.02 each as at 1 January 2005	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
Issue of new shares for cash	2,272,727,273	45,454	46,994
Exercise of options	1,150,000	23	24
As at 31 December 2006	43,328,552,648	866,571	923,653

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 grantees of and the number of share options. The maximum aggregate number of shares (including those that could be subscribed 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 issued upon exercise of all options 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 the 2005 Share Option Scheme, excluding shares under options which have lapsed.

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 the 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.

32. SHARE CAPITAL (continued)

Share option schemes (continued)

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

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

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 grantee for the grant of options will be HK$1.00. The subscription price of a share payable by a grantee upon the exercise of an option is determined by the directors at their discretion at the date of grant, except that such price shall be at least the higher of:

1. the nominal value of a 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 (the "HKSE") as stated in the HKSE's daily quotation sheets for the five trading days immediately preceding the date of the grant of the option; and
3. the closing price of the shares on the HKSE as stated in the HKSE's daily quotation sheets on the date of the 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.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

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 periods 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 periods 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 undertook a review of the 2002 Share Option Scheme in 2005 and noted that certain provisions could be clarified and improved. Accordingly, the Board proposed, and on 31 December 2005, the Company adopted a new share option scheme (the "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.

Under the 2005 Share Option Scheme, the Board of the Company has 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.

32. SHARE CAPITAL (continued)

Share option schemes (continued)

2005 Share Option Scheme (continued)

According to the 2005 Share Option Scheme, the consideration payable by a grantee for the grant of options will be HK$1.00. The subscription price of a share payable by a grantee 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 shall be at least the higher of:

1. the nominal value of a 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 daily HKSE's quotation sheets for the five trading days immediately preceding the date of the grant of the option; and
3. the closing price of the shares on the HKSE as stated in daily HKSE's quotation 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 the options granted under the 2005 Share Option Scheme shall end not later than 10 years from the date of the grant of the options.

On 14 June 2006, the Board of Directors approved a grant of options in respect of 82,320,000 shares to the Company's directors and senior management under the 2005 Share Option Scheme. The exercise price for such options is HK$5.56 per share. The closing market price immediately before the date on which such options were granted was HK$5.30 per share. Such options granted under the 2005 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 periods for the above options granted under the 2005 Share Option Scheme shall end not later than 10 years from 14 June 2006.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

32. SHARE CAPITAL (continued)

Share option schemes (continued)

During the year ended 31 December 2006, the movements in the options granted under all of the above share option schemes were as follows:

	Number of share options									Price of the Company's shares	Weighted average price of the Company's shares	
Name of category of grantee	At 1 January 2006	Granted during the year	Exercised during the year	Forfeited during the year	Expired during the year	At 31 December 2006	Date of grant of share options	Exercise period of share options*	Exercise price of share options HK$ per share	Immediately before the grant date of options HK$ per share	Immediately before the exercise date HK$ per share	At exercise date of options HK$ per share
Executive Directors												
Fu Chengyu	1,750,000	–	–	–	–	1,750,000	12 March 2001	12 March 2001 to 12 March 2011	1.19	1.23	–	–
	1,750,000	–	–	–	–	1,750,000	27 August 2001	27 August 2001 to 27 August 2011	1.232	1.46	–	–
	1,150,000	–	–	–	–	1,150,000	24 February 2003	24 February 2003 to 24 February 2013	2.108	2.09	–	–
	2,500,000	–	–	–	–	2,500,000	5 February 2004	5 February 2004 to 5 February 2014	3.152	3.13	–	–
	3,500,000	–	–	–	–	3,500,000	31 August 2005	31 August 2005 to 31 August 2015	5.62	5.75	–	–
	–	3,850,000	–	–	–	3,850,000	14 June 2006	14 June 2006 to 14 June 2016	5.56	5.30	–	–
Zhou Shouwei	1,400,000	–	–	–	–	1,400,000	12 March 2001	12 March 2001 to 12 March 2011	1.19	1.23	–	–
	1,750,000	–	–	–	–	1,750,000	27 August 2001	27 August 2001 to 27 August 2011	1.232	1.46	–	–
	1,750,000	–	–	–	–	1,750,000	24 February 2003	24 February 2003 to 24 February 2013	2.108	2.09	–	–
	1,750,000	–	–	–	–	1,750,000	5 February 2004	5 February 2004 to 5 February 2014	3.152	3.13	–	–
	2,450,000	–	–	–	–	2,450,000	31 August 2005	31 August 2005 to 31 August 2015	5.62	5.75	–	–
	–	2,700,000	–	–	–	2,700,000	14 June 2006	14 June 2006 to 14 June 2016	5.56	5.30	–	–
Wu Guangqi	1,610,000	–	–	–	–	1,610,000	31 August 2005	31 August 2005 to 31 August 2015	5.62	5.75	–	–
	–	1,770,000	–	–	–	1,770,000	14 June 2006	14 June 2006 to 14 June 2016	5.56	5.30	–	–
Yang Hua	1,150,000	–	–	–	–	1,150,000	12 March 2001	12 March 2001 to 12 March 2011	1.19	1.23	–	–
	1,150,000	–	–	–	–	1,150,000	27 August 2001	27 August 2001 to 27 August 2011	1.232	1.46	–	–
	1,150,000	–	–	–	–	1,150,000	24 February 2003	24 February 2003 to 24 February 2013	2.108	2.09	–	–
	1,150,000	–	–	–	–	1,150,000	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	–	–
	–	1,770,000	–	–	–	1,770,000	14 June 2006	14 June 2006 to 14 June 2016	5.56	5.30	–	–

32. SHARE CAPITAL (continued)

Share option schemes (continued)

	Number of share options									Price of the Company's shares	Weighted average price of the Company's shares	
Name of category of grantee	At 1 January 2006	Granted during the year	Exercised during the year	Forfeited during the year	Expired during the year	At 31 December 2006	Date of grant of share options	Exercise period of share options*	Exercise price of share options HK$ per share	Immediately before the grant date of options HK$ per share	Immediately before the exercise date HK$ per share	At exercise date of options HK$ per share
Non-executive Directors												
Luo Han	1,400,000	–	–	–	–	1,400,000	12 March 2001	12 March 2001 to 12 March 2011	1.19	1.23	–	–
	1,150,000	–	–	–	–	1,150,000	27 August 2001	27 August 2001 to 27 August 2011	1.232	1.46	–	–
	1,150,000	–	–	–	–	1,150,000	24 February 2003	24 February 2003 to 24 February 2013	2.108	2.09	–	–
	1,150,000	–	–	–	–	1,150,000	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	–	–
	–	1,770,000	–	–	–	1,770,000	14 June 2006	14 June 2006 to 14 June 2016	5.56	5.30	–	–
Cao Xinghe	800,000	–	–	–	–	800,000	31 August 2005	31 August 2005 to 31 August 2015	5.62	5.75	–	–
	–	1,770,000	–	–	–	1,770,000	14 June 2006	14 June 2006 to 14 June 2016	5.56	5.30	–	–
Wu Zhenfang	800,000	–	–	–	–	800,000	31 August 2005	31 August 2005 to 31 August 2015	5.62	5.75	–	–
	–	1,770,000	–	–	–	1,770,000	14 June 2006	14 June 2006 to 14 June 2016	5.56	5.30	–	–

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

32. SHARE CAPITAL (continued)

Share option schemes (continued)

Name of category of grantee	Number of share options						Date of grant of share options	Exercise period of share options*	Exercise price of share options	Price of the Company's shares	Weighted average price of the Company's shares	
	At 1 January 2006	Granted during the year	Exercised during the year	Forfeited during the year	Expired during the year	At 31 December 2006			HK$ per share	Immediately before the grant date of options HK$ per share	Immediately before the exercise date HK$ per share	At exercise date of options HK$ per share
Independent Non-executive Directors												
Chiu Sung Hong	1,150,000	–	–	–	–	1,150,000	5 February 2004	5 February 2004 to 5 February 2014	3.152	3.13	–	–
Evert Henkes	1,150,000	–	–	–	–	1,150,000	5 February 2004	5 February 2004 to 5 February 2014	3.152	3.13	–	–
Kenneth S Courtis**	1,150,000	–	(1,150,000)	–	–	–	5 February 2004	5 February 2004 to 5 February 2014	3.152	3.13	6.62	6.68
Other Employees***												
In aggregate	6,250,000	–	–	–	–	6,250,000	12 March 2001	12 March 2001 to 12 March 2011	1.19	1.23	–	–
	20,300,000	–	–	(650,000)	–	19,650,000	27 August 2001	27 August 2001 to 27 August 2011	1.232	1.46	–	–
	22,766,600	–	–	(433,300)	–	22,333,300	24 February 2003	24 February 2003 to 24 February 2013	2.108	2.09	–	–
	31,166,700	–	–	(1,433,433)	–	29,733,267	5 February 2004	5 February 2004 to 5 February 2014	3.152	3.13	–	–
	49,500,000	–	–	(4,316,667)	–	45,183,333	31 August 2005	31 August 2005 to 31 August 2015	5.62	5.75	–	–
	–	66,920,000	–	(1,000,000)	–	65,920,000	14 June 2006	14 June 2006 to 14 June 2016	5.56	5.30	–	–
Total	169,063,300	82,320,000	(1,150,000)	(7,833,400)	–	242,399,900						

* 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.

** Dr. Kenneth S. Courtis, who retired as an independent non-executive director of the Company with effect from 24 May 2006, following conclusion of the Company's annual general meeting, exercised his right to subscribe for 1,150,000 shares of options granted under the 2002 Share Option Scheme of the Company and the allotment was completed on 2 August 2006. After that, Dr. Kenneth S. Courtis does not hold any share options of the Company.

*** Mr. Jiang Longsheng retired as an executive director of the Company on 1 June 2005. The information on share options granted to Mr. Jiang was included in the category of "Other employees".

32. SHARE CAPITAL (continued)

Share option schemes (continued)

The fair value of the share options granted during the year was HK$126,795,127 and the Group recognised an equity-settled share option expenses of approximately RMB75,768,000 (2005: RMB29,123,000) during the year.

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 2006:

Dividend yield	2%
Expected volatility	32.1%
Risk-free interest rate	5.53%
Expected life of option	5 years
Weighted average share price	HK$5.56

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.

Details of the share options outstanding during the year are as follows:

	No. of share options	Weighted average exercise price HK$
Outstanding at beginning of the year	169,063,300	3.45
Granted during the year	82,320,000	5.56
Forfeited during the year	(7,833,400)	4.60
Exercised during the year	(1,150,000)	3.15
Outstanding at end of year	242,399,900	4.13
Exercisable at end of year	113,013,133	2.73

No share option had been cancelled during the year ended 31 December 2006.

At the date of approval of these financial statements, the share options outstanding under these share option schemes which represented approximately 0.56% of the Company's shares in issue as at that date. The weighted average remaining contractual life of share options outstanding at the end of the year is 7.76 years. The exercise in full of the remaining share options would, under the present capital structure of the Company, result in the issue of 242,399,900 additional ordinary shares of the Company and additional share capital of RMB4,870,638 and share premium of RMB1,000,678,131.

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 the board of directors of CNOOC China Limited, 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.

As at 31 December 2006, the general reserve fund amounted to approximately RMB9,460,631,000 (2005: RMB6,681,974,000), representing approximately 47.3% (2005: 44.5%) of the total registered capital of CNOOC China Limited.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

33. RESERVES (continued)

Included in retained earnings is an amount of approximately RMB1,183,515,000 (2005: RMB1,146,530,000), 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 principles required by the local authorities. As of 31 December 2006, the aggregate amount of the Group's retained earnings available for distribution to the Company's shareholders amounted to approximately RMB40,013,439,000 (2005: RMB30,275,453,000).

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 2005	876,586	20,761,597	—	110,144	1,742,338	23,490,665
Changes in fair value of available-for-sale financial assets	—	—	—	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)
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
Balances at 1 January 2006	876,635	20,766,048	(349,141)	204,167	7,762,096	29,259,805
Changes in fair value of available-for-sale financial assets	—	—	—	(9,659)	—	(9,659)
Exchange realignment	—	—	(1,344,135)	—	—	(1,344,135)
Total income and expense for the year recognised in equity	—	—	(1,344,135)	(9,659)	—	(1,353,794)
Profit for the year	—	—	—	—	16,056,043	16,056,043
Total income and expense for the year	—	—	(1,344,135)	(9,659)	16, 056,043	14,702,249
2005 final dividends	—	—	—	—	(4,479,620)	(4,479,620)
2006 interim dividends	—	—	—	—	(5,334,091)	(5,334,091)
Issue of shares	46,994	14,195,775	—	—	—	14,242,769
Exercise of share options	24	3,691	—	—	—	3,715
Equity-settled share option arrangements	—	—	—	75,768	—	75,768
Balances at 31 December 2006*	923,653	34,965,514	(1,693,276)	270,276	14,004,428	48,470,595

As at 31 December 2006, the distributable profits of the Company amounted to approximately RMB14,004,428,000 (2005: RMB7,762,096,000).

* These reserve accounts comprise the Company reserves of approximately RMB47,546,942,000 (2005: RMB28,383,170,000) in the Company balance sheet.

34. RETIREMENT AND TERMINATION BENEFITS

All the Group's full-time employees in the PRC are covered by a state-managed retirement benefit plan operated by the government of the PRC, 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 state-managed retirement benefit plan 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.

35. NOTES TO THE CONSOLIDATED CASH FLOW STATEMENT

Reconciliation of profit before tax to cash generated from operations

	2006 RMB'000	2005 RMB'000
Profit before tax	44,123,256	36,300,934
Adjustments for:		
Interest income	(781,536)	(359,294)
Finance costs	1,799,370	1,100,532
Exchange (gains)/losses, net	(308,382)	(287,027)
Share of profits of associates	(321,676)	(307,075)
Investment income	(613,028)	(247,893)
Provision for inventory obsolescence	2,004	33,088
Depreciation, depletion and amortisation	6,933,214	5,964,740
Loss on disposal and write-off of property, plant and equipment	408	141,574
Dismantlement	472,269	252,857
Amortisation of discount of long term guaranteed notes	32,760	41,959
Impairment losses related to property, plant and equipment	252,357	90,190
Equity-settled share option expenses	75,768	29,123
	51,666,784	42,753,708
Increase in accounts receivable	(160,089)	(1,001,296)
Increase in inventories and supplies	(493,857)	(108,405)
Increase in other current assets	(1,629,248)	(342,087)
Increase in amounts due from related companies	(241,250)	(925,824)
(Decrease)/increase in an amount due to the parent company	(31,521)	118,422
Increase in accounts payable, other payables and accrued liabilities	1,552,855	677,522
Decrease in other taxes payable	(177,165)	(24,900)
Increase in amounts due to related companies	415,337	548,508
Cash generated from operations	50,901,846	41,695,648

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

36. COMMITMENTS

(i) Capital commitments

As at 31 December 2006, the Group had the following capital commitments, principally for the construction and purchase of property, plant and equipment:

	2006 RMB'000	2005 RMB'000
Contracted, but not provided for	11,857,620	7,511,100
Authorised, but not contracted for	30,029,132	23,736,582

As at 31 December 2006, the Group had unutilised banking facilities amounting to approximately RMB47,040,884,000 (2005: RMB33,450,791,000).

(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 1 month to 5 years.

As at 31 December 2006, the Group had total minimum lease payments under non-cancellable operating leases falling due as follows:

	2006 RMB'000	2005 RMB'000
Commitments due:		
Within one year	47,458	157,181
In the first to second years, inclusive	37,712	22,351
After the second but before the fifth years, inclusive	7,962	23,972
	93,132	203,504

(b) Plant and equipment

The Group leases certain of its plant and equipment under operating lease arrangements for a term from 6 years to 10 years.

As at 31 December 2006, the Group had total minimum lease payments under non-cancellable operating leases falling due as follows:

	2006 RMB'000	2005 RMB'000
Commitments due:		
Within one year	299,619	183,137
In the first to second years, inclusive	299,619	183,137
After the second but before the fifth years, inclusive	882,329	1,006,289
	1,481,567	1,372,563

(iii) Contingent liabilities

The Company and certain of its subsidiaries are the named defendants (the "Defendants") in a case brought by a partner of a joint operating agreement ("JOA") in Indonesia (the "Plaintiff"). The Plaintiff is claiming its right under the JOA to request the Defendants to assign part of their interests acquired in the Tangguh Liquefied Natural Gas Project ("Tangguh LNG Project") based on the costs expended by the Defendants. The case is scheduled to be tried in November 2007. The Tangguh LNG Project is still under development.

As the case is still in a preliminary stage, the management considers that the outcome of any judgment on the lawsuit as quite uncertain and any expenditure from the lawsuit is not estimable. Consequently, no provision has been made for any expenses that might arise from the case.

37. FINANCIAL INSTRUMENTS

(a) Currency swap contract

As at 31 December 2006, 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 fair value loss of RMB4 million was recorded in the income statement.

The details are as follows:

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

(b) Fair value of financial instruments

The carrying value of the Group's cash and cash equivalents, time deposits, current available-for-sale investments, accounts receivables, other current assets, accounts payable, other payables and balance with related companies approximated to fair value at the balance sheet date due to the short maturity of these instruments.

The estimated fair value of the Group's long term bank loans based on current market interest rates was approximately RMB2,450,147,000 as at 31 December 2006 (2005: RMB868,886,000), which was the present value of the loans' future cash flows discounted by the interest rates as at 31 December 2006. The fair value of the floating interest rate loan equalled to the carrying amount as at 31 December 2006.

The estimated fair value of the Group's long term guaranteed notes based on current market interest rates was approximately RMB17,735,947,000 as at 31 December 2006 (2005: RMB16,592,412,000), which was calculated based on the market price as at 31 December 2006.

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:

	2006 RMB'000	2005 RMB'000
China Petroleum & Chemical Corporation	**19,250,230**	15,625,736
PetroChina Company Limited	**4,411,512**	1,776,199
Castle Peak Power Company Limited	**1,137,371**	1,107,314

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

39. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments, other than derivatives, comprise bank loans, convertible bonds, guaranteed notes, available-for-sale financial assets, 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 accounts receivable and accounts payable, which arise directly from its operations.

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

(i) Credit risk

The carrying amount of the Group's cash and cash equivalents, time deposits, liquidity funds and bond investments, accounts receivable and other receivables, and amounts due from related parties and other current assets except for prepayments represents the Group's maximum exposure to credit risk in relation to its 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 made impairment on doubtful receivables and actual losses have been within management's expectation.

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

(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 United States dollar ("US dollars"). From that day to 31 December 2006, Renminbi has appreciated by approximately 5.65% 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 Remminbi 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 97% of the Group's debts are also denominated in U.S. dollars.

As of the end of 2006, the balance of the yen-denominated loans was only RMB17.8 million. Since the Group has hedged the yen loans against foreign currency swaps, the Group does not expect any significant exchange risk relating to Japanese yen in the future.

(iii) Interest rate risk

As of the end of 2006, the interest rates for 89% of the Group's debts were fixed. The term of the weighted average balance was approximately 7.3 years. The average interest rate payable by the Group is considered to be favourable under the environment of rising interest rate hike.

(iv) Business risk

The major operations of the Group are conducted in the PRC, Indonesia, Africa 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.

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

(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 impairment is indicated based on undiscounted expected future cash flows, then 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 2006, an impairment of approximately RMB252,357,000 was recognised under Hong Kong GAAP and no impairment was recognised under US GAAP.

(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.

The Company considered whether the convertible bonds contain embedded derivative features which warrant separate accounting under the guidance provided in SFAS No. 133. To the extent that the embedded derivatives are determined to exist, the embedded derivatives are bifurcated as a single, compound derivative and are accounted for in accordance with SFAS No. 133. The Company bifurcated its embedded derivatives at fair value and determined the initial carrying value assigned to the host contract as the difference between the basis of the hybrid instrument and the fair value of the embedded derivatives, resulting in a discount attributed to the host bond contract. The host bond contract is then accreted from the initial amount to the maturity amount over the period from the date of issuance to the maturity date using the effective interest method.

Notes to Financial Statements

31 December 2006

(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)

(b) Accounting for convertible bonds (continued)

The embedded derivative features within the convertible bonds that would individually warrant separate accounting as a derivative instrument under SFAS No.133 are bundled together as a single, compound embedded derivative instrument that is bifurcated and accounted for separately from the host contract under SFAS No.133. The Company used the binominal tree valuation model to value the compound embedded derivative features both initially and at each reporting period to record the changes in fair value of the derivative instruments.

Instruments with potential embedded derivative features are evaluated at inception to determine whether such features meet the definition of a derivative. The embedded derivative feature would be separated from the host contract and accounted for as a derivative instrument only if all of the following conditions are met:

(i) the economic characteristics and risks of the embedded derivative instrument are not clearly and closely related to the economic characteristics and risks of the host contract;

(ii) the hybrid instrument that embodies both the embedded derivative instrument and the host contract is not re-measured at fair value; and

(iii) a separate instrument with the same terms as the embedded derivative instrument would meet the definition of a derivative as described in SFAS No.133.

The Group's convertible bonds include the following embedded derivative features that warrant separate accounting as a single, compound embedded derivative instrument under SFAS No.133:

(i) Holder's option to convert into CNOOC shares at a specified price. Upon the exercise of the conversion option by the holders of the convertible debts, the Company has the option to settle the exercise of the conversion option in cash; and

(ii) The convertible bonds are denominated in US dollars and are convertible into the Company's shares denominated into Hong Kong dollars using a fixed exchange rate of US$1 to HK$7.77.

(c) 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.

(d) 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.

(e) Income tax

The Group completed the acquisition of certain oil and gas interests in Nigeria in the current year. The oil and gas properties are still under exploration and development stage.

According to HKAS 12 Income Taxes, no deferred income tax liability is recognised for an asset acquisition. However, under US GAAP, a deferred income tax liability is recognised in accordance with EITF 98-11 "Accounting for acquired temporary differences in certain purchase transactions that are not accounted for as business combinations". Accordingly, both the property, plant and equipment and deferred tax liabilities related to OML130 are increased by approximately RMB16,014,569,000 under US GAAP. The difference in accounting treatment has had no impact on net equity reported under US GAAP.

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

(f) Provision for dismantlement

Hong Kong GAAP requires the provision for dismantlement to be recorded for a present obligation no matter whether the obligation is legal or constructive. The associated cost is capitalised and the liability is discounted and accretion expense is recognised using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. In cases of remeasuring the provision for dismantlement of oil and gas properties, the Group shall use such a discount rate as mentioned above no matter whether future cash flows would move upward or downward. HK(IFRIC)-Int1 requires that adjustments arising from changes in the estimated cash flows or the current discount rate should be added to or deducted from the cost of the related asset and liability.

Under US GAAP, SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be recognised in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalised as part of the carrying amount of the long-lived assets. Further, under SFAS No. 143, the liability is discounted and accretion expense is recognised using the credit-adjusted risk-free interest rate in effect when the liability is initially recognised. If the Group remeasures the provision for dismantlement of oil and gas properties, upward revisions in the amount of undiscounted estimated cash flows shall be discounted using the current credit-adjusted risk-free rate; downward revisions in the amount of undiscounted estimated cash flows shall be discounted using the credit-adjusted risk-free rate that existed when the original liability was recognised. In cases that changes occur to the discount rate, the Group shall apply the original discount rate used to initially measure the dismantlement costs, rather than remeasure the liability for changes in the discount rate. There were no differences between the amounts recorded under Hong Kong GAAP and US GAAP for the periods presented.

(g) Income tax rates

Under Hong Kong GAAP, HKAS 12 requires the application of tax rates that have been enacted or substantively enacted by the balance sheet date.

Under US GAAP, SFAS No. 109 requires that a deferred tax liability or asset shall be measured using the enacted tax rates expected to apply to taxable income in the periods in which the deferred tax liability or asset is expected to be settled or realised.

There were no differences in the tax rates used for both Hong Kong GAAP and US GAAP for the years presented.

(h) Effects on net profit and equity

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

	Net profit	
	2006 RMB'000	2005 RMB'000
As reported under Hong Kong GAAP	**30,926,943**	25,323,122
Impact of US GAAP adjustments:		
- Reversal of impairment losses related to property, plant and equipment	**252,357**	—
- Reversal of deferred tax related to impairment losses on property, plant and equipment	**(75,708)**	—
- Unrealised gains transferred from equity to the income statement	**—**	20,036
Net profit under US GAAP	**31,103,592**	25,343,158
Net profit per share under US GAAP		
- Basic	**RMB0.73**	RMB0.62
- Diluted	**RMB0.73**	RMB0.61

Notes to Financial Statements

31 December 2006

(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)

(h) Effects on net profit and equity (continued)

	Net equity	
	2006 RMB'000	2005 RMB'000
As reported under Hong Kong GAAP	**107,771,928**	73,603,097
Impact of US GAAP adjustments:		
- Reversal of impairment losses related to property, plant and equipment	**252,357**	—
- Reversal of deferred tax related to impairment losses on property, plant and equipment	**(75,708)**	—
- Reversal of additional accumulated depreciation, depletion and amortisation arising from the revaluation surplus on land and buildings	**44,207**	44,207
Net equity under US GAAP	**107,992,784**	73,647,304

(i) 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.

	2006 RMB'000	2005 RMB'000
Net income under US GAAP	**31,103,592**	25,343,158
Other comprehensive income:		
Foreign currency translation adjustments	**(1,257,594)**	(493,289)
Unrealised gains on available-for-sale investments	**60,010**	69,069
Less: Reclassification adjustment for gains included in net income	**(69,069)**	(20,036)
Comprehensive income under US GAAP	**29,836,939**	24,898,902

The movement of accumulated other comprehensive income components is 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 31 December 2004	(19,654)	20,036	382
Reversal of current year's 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)
Reversal of current year's realised gains	—	(69,069)	(69,069)
Current year's change	(1,257,594)	60,010	(1,197,584)
Balance at 31 December 2006	**(1,770,537)**	**60,010**	**(1,710,527)**

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

(j) Additional disclosure under FSP19-1

As of 1 January 2006, the Group adopted FASB Staff Position FAS19-1, "Accounting for Suspended Well Costs". Upon adoption of the FSP, the Group evaluated all existing capitalised exploratory well costs under the provisions of the FSP. The following table reflects the net changes in capitalised exploratory well costs during 2006 and 2005, and does not include amounts that were capitalised and subsequently expensed in the same period. Capitalised exploratory well costs for fiscal year ended 31 December 2005 are presented based on the Group's previous accounting policy.

	2006 **RMB'000**	2005 RMB'000
Beginning of year	**281,573**	429,461
Capitalised exploratory well costs charged to expense upon the adoption of FSP 19-1	**—**	—
Additions to capitalised exploratory well costs pending the determination of proved reserves	**803,184**	279,180
Reclassifications to oil and gas properties based on the determination of proved reserve	**(182,582)**	(328,475)
Capitalised exploratory well costs charged to expense	**(7,976)**	(98,242)
Exchange realignment	**(15,010)**	(351)
End of year	**879,189**	281,573

Aging of capitalised exploratory well costs and the number of projects for which exploratory well costs have been capitalised for a period greater than one year as follows:

	2006 **RMB'000**	2005 RMB'000
Capitalised exploratory well costs that have been capitalised for a period for one year or less	**834,333**	281,573
Capitalised exploratory well costs that have been capitalised for a period greater than one year	**44,856**	—
End of year	**879,189**	281,573
Number of projects for which exploratory well costs have been capitalised for a period greater than one year	**1***	—

* Well LD27-1-1 was completed in 2005. It was tested and confirmed to be an oil flowing well. It has been temporary capitalised according to the Company's criteria for the assessment of well status. The reservoir characteristics and geological condition of LD27-1 are relatively complex and a series of seismic, geological, reservoir and economic researches and appraisals have been conducted on it. Based on the latest research results, it has been included in the appraisal plan and the field development feasibility research is being conducted in 2007.

Notes to Financial Statements

31 December 2006

(All amounts expressed in Renminbi unless otherwise stated)

41. CHARGE OF ASSETS

CNOOC NWS Private Limited is a wholly-owned subsidiary, and together with the other joint venture partners and the operator of the NWS Project, signed a Deed of Cross Charge and an Extended Deed of Cross Charge whereby certain liabilities incurred or to be incurred, if any, by the Company in respect of the NWS Project are secured by its interests in the NWS Project.

42. SUBSEQUENT EVENTS

(a) During the 5th Session of the 10th National People's Congress, which was concluded on 16 March 2007, the PRC Corporate Income Tax Law ("the New Corporate Income Tax Law") was approved and will become effective on 1 January 2008. The New Corporate Income Tax Law introduces a wide range of changes which include, but are not limited to, the unification of the income tax rate for domestic-invested and foreign-invested enterprises at 25%. Since the detailed implementation and administrative rules and regulations have not yet been announced, the financial impact of the New Corporate Income Tax Law to the Group cannot be reasonably estimated at this stage.

(b) On 26 June, 2006, the Company announced the partial deformation of the underwater structure of the jacket for the PY30-1 project, which was discovered during an examination. The cause of the deformation is still under investigation at the date of this report. In February 2007, the Company committed to provide advanced payments for the new jacket construction.

43. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board of Directors on 29 March 2007.