

CORPORATE GOVERNANCE REPORT

Since the Company's listing on HKSE, the Company's corporate governance for the accounting period covered by this annual report has been in compliance with the relevant local and international laws and regulations, realizing fairness and transparency in practice and meeting the basic requirements of corporate governance with effective risk control. We firmly believe that adherence to the highest standards of corporate governance will bring the Company with long-term value and create maximum return for shareholders. The Company's senior management's dedication to creating long-term interests for shareholders, their social responsibility and professional business operation style have been accepted by the capital market. The Company was awarded by Euromoney as one of the 10 Most Accessible Management in Asia for the year 2003 and by Finance Asia as one of the 10 Best Managed Companies for the year 2003.

During 2006, our corporate governance was further refined. Directors were recruited and replaced timely. As Mr. Wang Zhongan, former Non-executive Director left office upon the expiry of his term of office, and Mr. Wu Mengfei, former Executive Director no longer took executive position of the Company due to job changes, the Board proposed Mr. Wu Mengfei as Non-executive Director of the Company, and Mr. Li Yong, former Executive Vice President as Executive Director of the Company, and were approved by the Annual General Meeting of the Company held on 26 May 2006. The Articles of Association of the Company was amended in time in light of the new Company Law and Securities Law of the PRC, and the amended Articles of Association were approved by the Extraordinary General Meeting held on 22 November 2006. Meanwhile, operations of the Company's General Meeting, the Board and Supervisory Committee were more standardized and efficient, the functions of Independent Directors were effectively exercised, the Company's internal control and management systems were gradually perfected and operating risks were effectively controlled. In January 2007, COSL was once again chosen into the "2007 Standard & Poor's Global Stock Selection Portfolio" and it was ranked consecutively for three years as one of the "Standard & Poor's Global Selection' Listed H Share Companies for Stock Portfolio of Best Investment Value".

The Board is of the opinion that the Company has adhered to the principles of treating all shareholders equally, protecting their interests and has fulfilled the requirements in respect of disclosure regarding the Company's business results, thus successfully combining the concept of corporate governance with actual practices. In summary, for the year ended 31 December 2006, save as disclosed in the Report of the Directors the Company was in compliance with relevant laws, regulations and provisions of the Code on Corporate Governance Practices set out in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited ("Listing Rules").

I. Directors' Involvement in Securities transactions

Following specific enquiries of all directors, the Board confirmed that during the 12 months ended 31 December 2006, the provisions of the Model Code for Securities Transaction by Directors of Listed Issuers ("the Model Code") set out in Appendix 10 of the Listing Rules were observed. At present, the Company has not adopted any code of conduct for securities transactions by directors that exceeds the provisions set out in the Model Code. The Company has adopted all the provisions of the Model Code. Upon specific inquiries, all Director have confirmed that they were in strict compliance with the provisions of the Model Code.

II. The Board of Directors

(I) Composition of the Board of Directors

Directors during the year and /or on the date of this report are as follows:

Chairman of the Board: Fu Chengyu

Executive directors: Yuan Guangyu, Li Yong (appointed on 26 May 2006)

Non-executive director: Wu Mengfei

Independent non-executive directors: Andrew Y. Yan, Gordon C.K. Kwong, Simon X. Jiang

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The Board of Directors convened four meetings during the year, and all directors attended all meetings of the Board during the year, and additional meetings were held to discuss important issues where necessary. Adequate notices were given to directors for convening regular Board Meetings to facilitate their attendance, and reasonable notices were given for convening extraordinary Board Meetings. The Company ensured to provide proper and adequate information to the members of the Board allowing them to have command on the latest corporate developments as to exercise their responsibilities. Minutes for meetings of the Board, the Audit Committee, the Remuneration Committee and the Nomination Committee were maintained and filed by the Company Secretary.

(II) The Roles of the Board of Directors and the Management

The Articles of Association of the Company clearly define the duties and functions of the Board of Directors and the Management. The responsibilities of the Board of Directors are as follows:

1. Convene shareholders' general meetings and report the Board's work at such meetings;
2. Implement the resolutions of shareholders' general meetings;
3. Decide on the Company's business plans and investment plans;
4. Formulate the Company's annual budgets and counts;
5. Formulate the Company's plans for profit distribution and plans for recovery of losses;
6. Formulate plans for increase or decrease in the Company's registered capital and the issue of corporate debentures;
7. Formulate plans for merger, division or dissolution of the Company;
8. Decide on the establishment of the Company's internal management structure;
9. Appoint or dismiss the President of the Company, and at the recommendation of the President, appoint or dismiss the Vice President and other members of senior management (including the financial controller), and fix their remuneration; appoint or replace the members of the board of Directors and Board of Supervisors of wholly owned subsidiaries, and appoint, replace or recommend representatives of shareholders, directors and supervisors of controlled subsidiaries and subsidiaries with equity holding;
10. Formulate the Company's basic management system;
11. Formulate proposals for amendments to the Company's Articles of Association;
12. Exercise the Company's power of financing and borrowing and decide on the matters of leasing and contracting in accordance with the provisions of relevant laws, regulations, these Articles of Association as well as the authorization of shareholders' general meetings;
13. Propose to shareholders' general meetings the appointment or replacement of accounting firms as auditors for the Company;
14. Other duties and powers under the Articles of Association or conferred by shareholders' general meetings.

The duties and functions of the Company's management is mainly defined in the Articles of Association and other corporate documents of the Company and are principally concerned with the responsibilities and powers of the Chief Executive Officer and the President, which are mainly set by resolutions passed at the meetings of executive directors and their powers in respect of the day-to-day management of the company's production and operations. In particular, the Board of Directors' decision-making process and its implementation of such decisions can be gleaned from the powers and duties as granted to and carried out by the Chief Executive Officer, which include responsibility for coming up with and implement the Company's strategies.

In short, the division of functions between the Board of Directors and the management of the Company is clearly defined. In respect of delegation of powers by the Board of Directors to management, the Board is careful to prepare specific documentation stating the extent of the powers delegated and is careful to give specific guidance when such delegated powers are exercised. For instance, when the Board authorizes certain decision-making power regarding investment in view of production and operation needs, the extent and procedures for exercising such powers by the management is provided by specific documents approved by the Board. The content of annual reports and interim reports of operation results and proposals at shareholders' general meetings as disclosed or included in statements made by the Company are decided by the Board of Directors. Other announcements can be made by the management with authorization from the Board for disclosure. In addition, the directors have discharged their duties in good faith and with diligence and played an important role in decision-making in relation to the operations of and risk control by the Company.

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(III) Other matters

During the period under review, the number and qualifications of independent non-executive directors of the Company were in compliance with the Listing Rules 3.10 (1) and (2), and the independence of current independent non-executive directors of the Company is in compliance with the requirement set out in the listing Rules 3.13.

III. Chairman and Chief Executive Officer

The functions of the Chairman and the Chief Executive Officer of the Company are clearly defined and such positions are at present separately held by two persons, i.e., Fu Chengyu as Chairman and Yuan Guangyu as the Chief Executive Officer.

IV. Terms of office of non-executive directors are as follows:

The term of office of Fu Chengyu and Andrew Y. Yan is from 20 September 2005 to 19 September 2008. The term of office of Gordon C.K. Kwong is from 30 October 2005 to 29 October 2008. The term of office of Wu Mengfei and Simon X. Jiang is from 27 May 2004 to 26 May 2007.

V. Directors' Remuneration

(I) The composition and functions of the Remuneration and Review Committee

The Remuneration and Review Committee of the Company consists of five members, namely Andrew Y. Yan, Gordon C.K. Kwong, Simon X. Jiang, Yuan Guangyu and Wu mengfei, of which three are independent non-executive directors and Andrew Y. Yan, independent non-executive director, acts as Chairman.

The functions of this committee are to formulate the standard for assessing the performance of directors, supervisors and members of senior management and to conduct such assessment, formulate and review the remuneration policy and scheme for directors, supervisors, and the senior management.

(II) The work of the Remuneration and Review Committee during the year

The committee held three meetings on 20 January 2006, 22 March 2006 and 21 August 2006, respectively, during the period under review and all of these meetings were attended by all members. The work and achievements of the committee during the year are summarized as follows:

1. the 2005 annual appraisal and incentive measures for the Company's senior management;
2. researched and formulated the stock appreciation rights scheme for the senior management, which was approved by the Extraordinary General Meeting of the Company held on 22 November 2006.

VI. The Nomination of Directors

(I) The composition and functions of the Nomination Committee

The Nomination Committee of the Company consists of three members, namely Yuan Guangyu, Andrew Y. Yan, and Simon X. Jiang, of which two are independent non-executive directors and Yuan Guangyu acts as Chairman.

Major functions of the committee are to select and recommend candidates for directors of the Company and to recommend the standards and procedures for selecting such candidates.

(II) The work of the Nomination Committee during the year; procedures and standards for nomination

The Nomination Committee held one meeting during the period under review (22 March 2006) which was attended by all members. The committee also passed one resolution that proposed to the Board the nomination of a Director through by-election.

The Nomination Committee nominated directors and senior management members according to the following procedure:

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1. Communicated with the management of the Company and researched on the need of the Company for new directors and senior management members;
2. Sought extensively for candidates for directors and senior management from within the Company and from controlled (and equity holding) enterprises as well as in the market;
3. Collected information about the occupations, education information relating to part time jobs, etc of preliminary candidates;
4. Sought the consent of nominees for nomination without which they could not become candidates for directors or members of senior management;
5. Convened meeting of the Nomination Committee, examined the qualifications of preliminary candidates for directors and Secretary to the Board with reference to the requirements regarding such positions as well as the qualifications required for positions of other senior management personnel nominated by the President;
6. Before electing new directors and appointing new senior management personnel, the Nomination committee should recommend candidates for directors and new senior management personnel to be appointed and forward relevant materials to the Board.
7. Followed up on decisions of the Board and feedback opinions.

The standard of the committee to select and recommend candidates for directors and senior management is to meet the need of the company and should review candidates' working experience, ability and personal integrity.

VII The Remuneration of Auditor

The Company re-appointed Ernst & Young as auditor of the Company and the fees for the audit and non-audit work provided to the Company during the reporting period were as follows:

- I The audit fees of audit/review of annual and interim accounting reports totaled RMB 4,000,000.
- II The non-audit fees of advising the Company on its acquisition project and providing tax consultation for overseas business totaled RMB 940, 000.

VIII The Audit Committee

(I) The composition and functions of the Audit Committee

The Audit Committee consists of three members, namely, Andrew Y. Yan, Gordon C.K. Kwong and Simon X. Jiang, all of whom are independent non-executive directors and Gordon C.K. Kwong acts as the Chairman.

The functions of this committee are to review the accounting policy, financial condition and financial reporting procedures of the Company; to review the internal control structure; to recommend and engage external audit body; and to be mainly responsible for the communication, supervision and review of the internal and external audit of the Company.

(II) The work of the Audit Committee for the year

The Audit Committee held three meetings during the period under review and all members attended the meetings. The major work of the Audit Committee for the year was:

1. It reviewed the financial reports of the annual operating results of 2005 and the interim operating results of 2006 of the Company. During the review process, the members performed sufficient and necessary communication with the external auditor and the management of the Company in the process examination and fulfilled its duties in ensuring the Company's compliance with regulations, and the completeness and accuracy of the operating results disclosed by the Company.
2. Reviewed the financial reporting system and internal control system of the Company. During the reporting period, the committee reviewed the report of the management in relation to the scheme for improving the management of finance and IT system and studied the relevant recommendations in the "Report to the Audit Committee" from the auditor to the Company and issued relevant opinions to the Board of Directors and management. During the reporting period, the bulk of the review of the internal control procedure of the Company performed by the committee was to discuss and study the efficiency of internal controls and risk management with the management and help management improve the system and structure. The committee received a special report of the management in relation to the financial control system and the management of the purchase system of the Company, discussed with management these matters and put forward proposals, for improvement of the information management system of the Company and for establishing an ERP system.
3. Overseeing the auditing work and independence of the external auditor, and proposed to the Company the reappointment of the auditor.

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IX. INTERNAL CONTROL REPORT

To ensure the reliability of financial reporting, enhance the efficiency and effectiveness of operating activities and that the relevant legal framework is complied with, the Board of directors has put much emphasis on the internal control system of the Company. Based on the requirements of the COSL compliance framework, the Code on Corporate Governance Practices of HKSE and the Comprehensive Risk Management Guidelines For Centrally Controlled Enterprises and considering the actual circumstances, the Company has formulated an effective internal control mechanism.

In 2006, the Company engaged a qualified agency, China Consultant of Accounting and Financial Management Co.,Ltd., to appraise the effectiveness of the Company's internal control system. The appraisal result shows that the Company has clear concept on internal control, which is to strengthen its risk awareness and management so as to pave way for the Company's sustained development. To put such concept into practice, we have developed an internal control system covering all business areas in the following five aspects: environmental control, activity control, risk assessment, information and communication as well as supervision. We have established 11 control systems including the Financial Control System, Materials and Equipment Management System and QHSE Management System. Through internal control testing, it demonstrated that such systems and related procedures are effectively implemented. In general, the Company's internal control practices are effective and in sound position, complying with the relevant stipulations of the country and requirements of the Codes of HKSE.

In 2006, our internal control system was further standardized and scientifically formulated. Under the authorization of the Board of directors, the Company has formulated and improved a series of internal control systems, including the Materials and Equipment Management System, International Business and Marketing System, Human Resource Management System, Penalizing and Prevention of Corruption Management System and Technology Management Regulations etc. In addition, to ensure that the control procedures will still work in the long run, the Company has assigned 213 management personnel to hold the key positions in the Materials and Equipment Department, Capital Planning Department and Financial Department in shift duty.

The Company has now laid a solid foundation in internal control, however, it will continue to perfect its internal control and risk assessment mechanism, enhance the overall risk management system, with plans to adopt regular testing so that the effectiveness of its internal control system will be warranted.

X Responsibilities Undertaken

The Board of Directors acknowledges its responsibilities of preparing the financial statements of the Company and the auditors have also reported on their audit of the financial statements; the Board of Directors undertakes the responsibilities for the effective internal control of the Company and its subsidiaries and has completed the relevant review and assessment during the reporting period, and concluded that there were no major deficiencies in the internal controls of the Company and its subsidiaries; the Board of Directors undertakes herewith that, there are no major events and circumstances of uncertainty which may affect the operation of the Company as a going concern.

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Board Directors' Meeting & Professional Committee Meeting

Meeting	Time	Place	Attendant	Moderator	Notes	
First Meeting of Board of Directors	20 January 2006	Shenzhen	Fu Chengyu Wu Mengfei Gordon C.K.Kwong	Yuan Guangyu Andrew Y.Yan Simon X.Jiang	Fu Chengyu	Four supervisors attended as a non voting delegate
Second Meeting of Board of Directors	22 March 2006	Shenzhen	Fu Chengyu Wu Mengfei Gordon C.K.Kwong	Yuan Guangyu Andrew Y.Yan Simon X.Jiang	Fu Chengyu	Four supervisors attended as a non voting delegate
Third Meeting of Board of Directors	21 August 2006	Kunming	Fu Chengyu Wu Mengfei Gordon C.K.Kwong Li Yong	Yuan Guangyu Andrew Y.Yan Simon X.Jiang	Fu Chengyu	Four supervisors attended as a non voting delegate
Fourth Meeting of Board of Directors	1 December 2006	Beijing	Fu Chengyu Wu Mengfei Li Yong Simon X.Jiang	Yuan Guangyu Andrew Y.Yan Gordon C.K.Kwong	Fu Chengyu	Four supervisors attended as a non voting delegate
First Meeting of Audit Committee	20 January 2006	Shenzhen	Gordon C.K.Kwong Andrew Y.Yan	Simon X.Jiang	Gordon C.K.Kwong	
Second Meeting of Audit Committee	14 March 2006	Beijing	Gordon C.K.Kwong Andrew Y.Yan	Simon X.Jiang	Gordon C.K.Kwong	
Third Meeting of Audit Committee	21 August 2006	Kunming	Gordon C.K.Kwong Andrew Y.Yan	Simon X.Jiang	Gordon C.K.Kwong	
First Meeting of Remuneration Committee	20 January 2006	Shenzhen	Andrew Y.Yan Simon X.Jiang Wu Mengfei	Gordon C.K.Kwong Yuan Guangyu	Andrew Y.Yan	
Second Meeting of Remuneration Committee	22 March 2006	Shenzhen	Andrew Y.Yan Simon X.Jiang Wu Mengfei	Gordon C.K.Kwong Yuan Guangyu	Andrew Y.Yan	
Third Meeting of Remuneration Committee	21 August 2006	Kunming	Andrew Y.Yan Simon X.Jiang Wu Mengfei	Gordon C.K.Kwong Yuan Guangyu	Andrew Y.Yan	
Meeting of Nomination Committee	22 March 2006	Shenzhen	Yuan Guangyu Andrew Y.Yan Simon X.Jiang	Yuan Guangyu Andrew Y.Yan Simon X.Jiang	Yuan Guangyu	

The Board of Directors
China Oilfield Services Limited
23 March 2007