

NOTES TO FINANCIAL STATEMENTS

31 December 2006

1. CORPORATE INFORMATION

China Oilfield Services Limited (the "Company") is a limited liability company incorporated in the People's Republic of China ("the PRC" or "Mainland China"). The registered office of the Company is located at 3-1516 Hebei Road, Haiyang New and Hi-Tech Development Zone, Tanggu, Tianjin 300451, the PRC. As part of the reorganisation (the "Reorganisation") of China National Offshore Oil Corporation ("CNOOC") in preparation for the listing of the Company's shares on The Stock Exchange of Hong Kong Limited (the "HKSE") in 2002, and pursuant to an approval document obtained from the relevant government authority dated 26 September 2002, the Company was restructured into a joint stock limited liability company.

During the year, the Company and its subsidiaries (hereinafter collectively referred to as the "Group") were principally engaged in the provision of oilfield services including drilling services, well services, marine support and transportation services, and geophysical services.

In the opinion of the directors, the holding company and the ultimate holding company of the Company is CNOOC, which is a state-owned enterprise incorporated in the PRC.

2.1 BASIS OF PREPARATION

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

Basis of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries for the year ended 31 December 2006. The results of the 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 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. Acquisition of minority interests are accounted for using the parent entity extension method whereby the difference between the consideration to the book value of the share of the net assets acquired is recognised as goodwill, if any.

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2.2 IMPACT OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS

The Group has adopted the following new and revised HKFRSs for the first time for the current year's financial statements. The adoption of these new and revised standards and interpretations has had no material effect on these financial statements.

HKAS 21 Amendment	Net Investment in a Foreign Operation
HKAS 27 Amendment	Consolidated and Separate Financial Statements: Amendments as a consequence of the 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
HK(IFRIC)-Int 4	Determining whether an Arrangement contains a Lease

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

The Group has not applied the following new and revised HKFRSs, that have been issued but are not yet effective, in these financial statements.

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

HKFRS 7 shall be applied for annual periods beginning on or after 1 January 2007. The standard requires disclosures that enable users of the financial statements to evaluate the significance of the Group's financial instruments 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 2007. 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 9, HK(IFRIC)-Int 10 and HK(IFRIC)-Int 11 shall be applied for annual periods beginning on or after 1 March 2006, 1 June 2006 and 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 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.

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Subsidiaries

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

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

Jointly-controlled entities

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

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

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

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 such impairment loss is credited to the consolidated income statement in the period in which it arises.

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2.4 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);
- (f) the party is an entity that is controlled, jointly controlled or significantly influenced by or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or
- (g) the party is a post-employment benefit plan for the benefit of employees of the Group, or of any entity that is a related party of the Group.

Property, plant and equipment and depreciation

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

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

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

Where parts of an item of property, plant and equipment have different useful lives, the cost of that item is allocated on a reasonable basis among the parts and each part is depreciated separately. Residual values, useful lives and depreciation method are reviewed, and adjusted if appropriate, at each balance sheet date.

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

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Construction in progress

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

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

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.

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 date, 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.

Financial assets at fair value through profit or loss

Financial assets at fair value through profit or loss include financial assets held for trading. Financial assets are classified as held for trading if they are acquired for the purpose of sale in the near term. Gains or losses on investments held for trading are recognised in the consolidated income statement.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are 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.

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Investments and other financial assets (continued)

Held-to-maturity investments

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

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets in listed and unlisted equity securities that are designated as available for sale or are not classified in any of the other three categories. 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 and impairment losses.

Fair value

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

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 or held-to-maturity investments 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.

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Assets carried at amortised cost (continued)

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

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in the 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 accounts 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 be reliably measured has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset. Impairment losses on these assets are not reversed.

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

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Derecognition of financial assets (continued)

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

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

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 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 through the amortisation process.

Derecognition of financial liabilities

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

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

Inventories

Inventories primarily consist of materials and supplies used for the repairs and maintenance of plant and equipment and daily operations. Inventories are stated at the lower of cost and net realisable value after allowances for obsolete or slow-moving items. Cost is determined on the weighted average basis. The materials and supplies are capitalised to plant and equipment when used for renewals or betterments of plant and equipment or recognised as expenses when used for daily operations. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

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.

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Cash and cash equivalents (continued)

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

Provisions

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

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

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

Deferred tax assets are recognised for all deductible temporary differences, carryforward of unused tax 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 asset relating to the deductible temporary differences arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss; and
- in respect of deductible temporary differences associated with investments in subsidiaries and interests in jointly-controlled entities, deferred tax assets are only recognised to the extent that it is probable that the temporary differences will reverse in the foreseeable future and taxable profit will be available against which the temporary differences can be utilised.

NOTES TO FINANCIAL STATEMENTS

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income tax (continued)

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:

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

Research and development costs

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

Expenditure incurred on projects to develop new products is capitalised and deferred only when the projects are clearly defined; the expenditure is separately identifiable and can be measured reliably; there is a reasonable certainty that the projects are technically feasible; and the products have commercial value. Product development expenditure which does not meet these criteria is expensed when incurred. No development costs were capitalised during the year.

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.

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2.4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Retirement benefits costs

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

Dividends

Final and special interim dividends proposed by the directors are classified as a separate allocation of retained profits within the equity section of the balance sheet, until they have been approved by the shareholders in a general meeting. When these dividends have been approved by the shareholders and declared, they are recognised as a liability.

Foreign currencies

These financial statements are presented in RMB, which is the Company's functional and presentation currency. Each entity in the Group determines its own functional currency and items included in the financial statements of each entity are measured using that functional currency. Foreign currency transactions are initially recorded using the functional currency rates ruling at the date of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency 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 and jointly-controlled entities are currencies other than the RMB. As at the balance sheet date, the assets and liabilities of these entities are translated into the presentation currency of the Company at the exchange rates ruling at the balance sheet date, and their income statements are translated into RMB at the weighted average exchange rates for the year. The resulting exchange differences are included in the exchange fluctuation reserve. 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.

2.5 SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

The preparation of financial statements in conformity with HKFRSs 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 judgements and estimates pertain to the determination if any impairment exists, the useful lives, residual value and depreciation method of property, plant and equipment, the estimation or the percentage of completion for construction in progress, provision for doubtful debt and inventories obsolesces, classification of leases, as well as the judgement on the eligibility for the tax rate reduction as further described in note 11 to the financial statements. Actual amounts could differ from those estimates and assumptions.

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Year ended 31 December 2006

3. ACQUISITION

The Company made an additional capital injection of RMB2,527,968 into Jinlong, the jointly-controlled entity of the Group, on 16 March 2006. After the additional capital injection to Jinlong, the percentage of equity directly attributable to the Group increased from 50% to 70%. On 8 December 2006, the Company acquired the other 30% equity interest in Jinlong at RMB2,332,900 in cash, and Jinlong became a wholly-owned subsidiary as at 31 December 2006. The financial statements of Jinlong for the period from 16 March 2006 to 31 December 2006 have been incorporated into the Group's consolidated financial statements. Jinlong is registered as a limited liability company under the PRC Company Law.

4. 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.

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

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

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

Intersegment sales and transfers are transacted with reference to the selling prices used for sales made to third parties at the then prevailing market prices.

(a) Business segments

The following table presents revenue, profit and certain asset, liability and expenditure information for the Group's business segments for the year ended 31 December 2006:

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4. SEGMENT INFORMATION (continued)

	Drilling Services RMB'000	Well Services RMB'000	Marine support and transportation Services RMB'000	Geophysical Services RMB'000	Total RMB'000
TURNOVER					
Sales (including intersegment)	3,345,395	1,395,331	1,080,095	893,166	6,713,987
Less: Intersegment sales	(244,990)	(43,151)	(37,327)	(23,680)	(349,148)
Net sales to external customers	3,100,405	1,352,180	1,042,768	869,486	6,364,839
PROFIT FROM OPERATIONS					
Segment results	849,251	176,934	215,590	150,467	1,392,242
Exchange losses, net					(46,694)
Interest expenses					(36,708)
Interest income					27,856
Share of profits of jointly-controlled entities					113,505
Profit before tax					1,450,201
Tax					(321,966)
Profit for the year					1,128,235
ASSETS					
Segment assets	5,192,274	1,468,481	2,674,394	892,978	10,228,127
Interests in jointly-controlled entities	-	418,550	-	14,946	433,496
Unallocated assets					2,468,547
Total assets					13,130,170
LIABILITIES					
Segment liabilities	815,906	123,931	455,120	76,106	1,471,063
Unallocated liabilities					3,040,563
Total liabilities					4,511,626
OTHER SEGMENT INFORMATION					
Capital expenditure	1,201,664	522,684	846,721(i)	144,177	2,715,246
Depreciation of property, plant and equipment	399,094	173,279	210,708	117,163	900,244
Impairment of accounts receivable	840	117	116	83	1,156
Provision against inventories	544	207	204	147	1,102

(i) The balance included a capital contribution of US\$20.9 million (equivalent to RMB167 million) to a newly incorporated joint-controlled entity in 2006, please refer to note 17(a) for detail.

NOTES TO FINANCIAL STATEMENTS

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4. SEGMENT INFORMATION (continued)

(a) Business segments (continued)

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

	Drilling Services RMB'000	Well transportation services RMB'000	Marine support and Services RMB'000	Geophysical Services RMB'000	Total RMB'000
TURNOVER					
Sales (including intersegment)	2,446,524	1,205,401	899,540	566,331	5,117,796
Less: Intersegment sales	(240,813)	(40,060)	(31,839)	(16,292)	(329,004)
Net sales to external customers	2,205,711	1,165,341	867,701	550,039	4,788,792
PROFIT FROM OPERATIONS					
Segment results	505,453	150,350	110,351	84,113	850,267
Exchange losses, net					(16,802)
Interest expenses					(104)
Interest income					16,956
Share of profits of jointly-controlled entities					106,617
Profit before tax					956,934
Tax					(135,938)
Profit for the year					820,996
ASSETS					
Segment assets	4,281,207	1,142,170	2,154,123	662,397	8,239,897
Interests in jointly-controlled entities	-	230,434	-	9,502	239,936
Unallocated assets					1,230,042
Total assets					9,709,875
LIABILITIES					
Segment liabilities	468,543	118,442	62,233	48,433	697,651
Unallocated liabilities					1,357,482
Total liabilities					2,055,133
OTHER SEGMENT INFORMATION					
Capital expenditure	1,585,820	302,085	104,772	260,325	2,253,002
Depreciation of property, plant and equipment	323,448	124,546	224,100	83,582	755,676
Impairment/(write-back of impairment) of					
accounts receivable	(60,834)	519	387	245	(59,683)
Provision against inventories	416	219	163	103	901

NOTES TO FINANCIAL STATEMENTS

31 December 2006

4. SEGMENT INFORMATION (continued)

(b) Geographical segments

In determining the Group's geographical segments, revenues are attributed to the segments based on the location of the customers. No further analysis of geographical segment information is presented for total assets and capital expenditure incurred to acquire segment assets as over 90% of the Group's assets are located in the Mainland China.

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

Year ended	Mainland China	Others	Total
31 December 2006	RMB'000	RMB'000	RMB'000

Segment revenue:

Sales to external customers	5,260,851	1,103,988	6,364,839
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Year ended	Mainland China	Others	Total
31 December 2005	RMB'000	RMB'000	RMB'000

Segment revenue:

Sales to external customers	4,349,614	439,178	4,788,792
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5. TURNOVER AND OTHER REVENUES

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

Other revenues comprise the following:

	2006	2005
	RMB'000	RMB'000
Gain on disposal of scrap materials	8,286	670
Insurance claims received	14,999	11,483
Others	8,056	766
Total other revenues	31,341	12,919

NOTES TO FINANCIAL STATEMENTS

31 December 2006

6. PROFIT FROM OPERATIONS

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

	2006 RMB'000	2005 RMB'000
Auditors' remuneration:		
Audit fee	4,000	3,350
Non-audit fee	940	576
Employee compensation costs:		
Wages, salaries and bonuses	699,350	600,279
Social security costs	169,981	174,995
Retirement benefits contributions (note 10)	67,605	58,071
	936,936	833,345
Depreciation of property, plant and equipment	900,244	755,676
Loss on disposal of property, plant and equipment, net	20,780	1,359
Minimum lease payments under operating leases in respect of land and buildings, berths and equipment	313,431	213,436
Impairment/(write-back of impairment) of accounts receivable, net	1,156	(59,683)
Provision against inventories	1,102	901
Repair and maintenance costs	356,510	285,166
Research and development costs, included in	189,549	129,850
Depreciation of property, plant and equipment	6,105	27,764
Employee compensation costs	33,260	25,838
Consumption of supplies, materials, fuel, services and others	91,561	31,390
Other operating expenses	58,623	44,858

7. FINANCE COSTS

	2006 RMB'000	Group 2005 RMB'000
Interest on bank loans wholly repayable within five years	12,062	104
Interest on short term debentures	32,417	-
Total interest	44,479	104
Less: Interest capitalised	(7,771)	-
	36,708	104

NOTES TO FINANCIAL STATEMENTS

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8. DIRECTORS' AND SUPERVISORS' REMUNERATION

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

	Group	
	2006	2005
	RMB'000	RMB'000
Fees	1,290	650
Other emoluments:		
Basic salaries, allowances and benefits in kind	904	634
Bonuses	736	450
Pension scheme contributions	125	92
	1,765	1,176
	3,055	1,826

(a) Independent non-executive directors and a supervisor

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

	Group	
	2006	2005
	RMB'000	RMB'000
Independent non-executive directors:		
Gordon C. K. Kwong	400	200
Andrew Y. Yan	400	200
Simon X. Jiang	400	200
	1,200	600
Independent supervisor:		
Zhang Dunjie	90	50
	1,290	650

There were no other emoluments payable to the independent non-executive directors and the independent supervisor during the year (2005: Nil).

NOTES TO FINANCIAL STATEMENTS

31 December 2006

8. DIRECTORS' AND SUPERVISORS' REMUNERATION (continued)

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

	Salaries, allowances and benefits in kind RMB'000	Bonuses RMB'000	Pension scheme contributions RMB'000	Total RMB'000
2006				
Executive directors:				
Yuan Guangyu	348	258	46	652
Li Yong (note 1)	191	197	34	422
Wu Mengfei (note 2)	76	97	10	183
	615	552	90	1,257
Non-executive director:				
Fu Chengyu	-	-	-	-
Wu Mengfei (note 3)	29	-	-	29
	29	-	-	29
Supervisors:				
Zhang Benchun	24	-	-	24
Xiao Jianwen	24	-	-	24
Tang Daizhi	212	184	35	431
	260	184	35	479
Total	904	736	125	1,765
2005				
Executive directors:				
Yuan Guangyu	273	231	43	547
Wu Mengfei (note 2)	229	173	39	441
	502	404	82	988
Non-executive director:				
Fu Chengyu	-	-	-	-
Wang Zhongan	11	-	-	11
	11	-	-	11
Supervisors:				
Zhang Benchun	14	-	-	14
Xiao Jianwen	3	-	-	3
Tang Daizhi	87	46	10	143
Tu Zhimin	7	-	-	7
Liu Shoude	10	-	-	10
	121	46	10	177
Total	634	450	92	1,176

Notes: Included above is only the remuneration for the period when the above individuals were active directors or supervisors of the Company.

1. Appointed on 25 May 2006 2. Resigned on 1 April 2006 3. Appointed on 1 April 2006

NOTES TO FINANCIAL STATEMENTS

31 December 2006

8. DIRECTORS' AND SUPERVISORS' REMUNERATION (continued)

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

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

9. FIVE HIGHEST PAID EMPLOYEES

The five highest paid employees during the year included two (2005: two) directors, details of whose remuneration are set out in note 8 to the financial statements. Details of the remuneration of the remaining three (2005: three) non-director, non-supervisor, highest paid employees for the year are as follows:

	Group	
	2006 RMB'000	2005 RMB'000
Basic salaries, allowances and benefits in kind	6,528	7,578
Bonuses	1,324	900
Pension scheme contributions	87	651
	7,939	9,129

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

	Number of employees	
	2006	2005
Nil to RMB1,000,000	2	-
RMB2,500,001 to RMB3,000,000	-	2
RMB3,000,001 to RMB3,500,000	1	-
RMB3,500,001 to RMB4,000,000	-	1
	3	3

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

NOTES TO FINANCIAL STATEMENTS

31 December 2006

10. RETIREMENT BENEFITS

All the Group's full-time employees in the Mainland China are covered by a government-regulated pension scheme, and are entitled to an annual pension determined by their basic salaries upon their retirement. The PRC government is responsible for the pension liabilities to these retired employees. The Group is required to make annual contributions to the government-regulated pension at rates ranging from 19% to 22% of the employees' basic salaries. The related pension costs are expensed as incurred.

As part of the CNOOC group, the employees of the Group were entitled to the supplementary pension benefits (the "Supplementary Pension Benefits") provided by CNOOC in addition to the benefits under the government-regulated pension fund described above. The Supplementary Pension Benefits were calculated based on factors including the number of years of service and salary level on the date of retirement of the employee. Following the Reorganisation, CNOOC agreed with the Group that the Supplementary Pension Benefits of the Group's current employees attributed to the period prior to the Company's public listing in Hong Kong and the Supplementary Pension Benefits of the Group's retired employees will continue to be assumed by CNOOC. As the obligations under the Supplementary Pension Benefits have been fully assumed by CNOOC, the costs of such Supplementary Pension Benefits have not been recorded in the Group's financial statements for the year ended 31 December 2006 (2005: Nil).

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

	2006 RMB'000	Group	2005 RMB'000
Contributions to the PRC government-regulated pension scheme (note 6)	67,605		58,071

At 31 December 2006, the Group had no forfeited contributions available to reduce its contributions to the pension scheme in future years (2005: Nil).

11. TAX

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

In accordance with the relevant tax laws in the PRC, the Company and its subsidiary incorporated in PRC are subject to corporate income tax at the rate of 33%.

During the year, the application by the Company as an advanced technology enterprise for tax exemption purposes was approved and the Company's corporate income tax rate for the fiscal year 2005 was reduced from 33% to 15%. As a result, a tax refund of approximately RMB176 million relating to fiscal year 2005 has been recorded by the Company. The eligibility for such tax rate reduction in future is conditional upon the fulfilment of certain conditions on an annual basis as stipulated in the relevant tax rules, which include a minimum proportion of sales of advanced technology services to total sales and minimum proportions of research and development expenses to total expenses and total revenue under the PRC accounting principles, respectively.

NOTES TO FINANCIAL STATEMENTS

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11. TAX (continued)

As the reduction in the corporate income tax rate from 33% to 15% for the year ended 31 December 2006 cannot be ascertained, at the date of this report, management considers it is appropriate to use the rate of 33% to accrue for the income tax liability of the Company for the year ended 31 December 2006.

The Company's principal subsidiary incorporated in Malaysia, COSL (Labuan) Company Limited, is subject to a deemed profit withholding tax of 6% based on its gross service income generated from its drilling activities in Indonesia.

The Company's principal subsidiary incorporated in Australia, COSL (Australia) Pty Limited, is subject to income tax of 33% based on its taxable profit generated from its drilling activities in Australia.

The Company's operation in Myanmar is subject to an income tax rate of 3% based on its gross service income generated from its drilling activities in Myanmar.

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

	Group	
	2006	2005
	RMB'000	RMB'000
Hong Kong profits tax	-	-
Overseas income taxes:		
Current income taxes	32,901	33,582
PRC corporate income taxes:		
Current income taxes		
Tax refund as an advanced technology enterprise	502,116	341,078
Deferred income taxes (note 26)	(175,991)	(191,280)
	(37,060)	(47,442)
Total tax charge for the year	321,966	135,938

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

	2006		2005	
	RMB'000	%	RMB'000	%
Profit before tax	1,450,201		956,934	
Tax at the statutory tax rate of 33% (2005: 33%)	478,566	33.0	315,788	33.0
Profits and losses attributable to jointly-controlled entity	(37,457)	(2.6)	(35,184)	(4.0)
Tax refund as an advanced technology enterprise	(175,991)	(12.1)	(191,280)	(20.0)
Expenses not deductible for tax and others	56,848	3.9	46,614	5.0
Total tax charge at the Group's effective rate	321,966	22.2	135,938	14.0

NOTES TO FINANCIAL STATEMENTS

31 December 2006

11. TAX (continued)

Expenses not deductible for tax and others included income and deemed income tax expenses of certain overseas subsidiaries which are not deductible for Mainland China corporate income tax purposes.

The share of tax attributable to jointly-controlled entities amounting to approximately RMB29,652,000 (2005: RMB27,429,000) is included in "Share of profits of jointly-controlled entities" on the face of the consolidated income statement.

12. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The consolidated profit attributable to equity holders of the Company for the year ended 31 December 2006 includes a profit of RMB1,223,297,000 (2005: RMB858,089,000) which has been dealt with in the financial statements of the Company (note 30(b)).

13. DIVIDENDS

	2006 RMB'000	2005 RMB'000
Proposed and declared special interim dividend - nil (2005: 1.39 Fen per ordinary share)	-	55,535
Proposed final dividend - 6.00 Fen (2005: 4.11 Fen per ordinary share)	239,719	164,208
	239,719	219,743

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

Cash dividends to shareholders in Hong Kong will be paid in Hong Kong dollars.

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

- (i) making up prior years' cumulative losses, if any;
- (ii) allocations to the statutory common reserve fund of at least 10% of after-tax profit, until the fund aggregates 50% of the Company's registered capital. For the purpose of calculating the transfer to the reserves, the profit after tax shall be the amount determined under the PRC accounting principles and financial regulations. Transfer to this reserve must be made before any distribution of dividends to shareholders. The statutory common reserve can be used to offset previous years' losses, if any, and part of the statutory common reserve can be capitalised as the Company's share capital provided that the amount of such reserve remaining after the capitalisation shall not be less than 25% of the registered capital of the Company;
- (iii) until 31 December 2005, allocations of 5% to 10% of after-tax profit, as determined under the PRC accounting principles and financial regulations, to the Company's statutory public welfare fund, which was established for the purpose of providing the Company's employees with collective welfare benefits such as the construction of dormitories, canteens and other staff welfare facilities. The fund formed part of the shareholders' equity as individual employees could only use these facilities, while the title of such facilities is held by the Company. Transfer to this fund had to be made before any distribution of dividends to shareholders. Beginning 1 January 2006, the new PRC Company Law took effect and appropriation to statutory public welfare fund is no longer required and the balance in the Company's Statutory public welfare fund brought forward from 31 December 2005 are required to be transferred to the statutory common reserve fund; and
- (iv) allocations to the discretionary common reserve if approved by the shareholders. The discretionary common reserve can be used to offset prior years' losses, if any, and can be capitalised as the Company's share capital.

NOTES TO FINANCIAL STATEMENTS

31 December 2006

13. DIVIDENDS (continued)

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

14. EARNINGS PER SHARE ATTRIBUTABLE TO ORDINARY EQUITY HOLDERS OF THE COMPANY

The calculation of basic earnings per share amounts is based on the net profit attributable to shareholders for the year ended 31 December 2006 of RMB1,128,010,000 (2005: RMB820,996,000) and 3,995,320,000 shares in issue during the year and 2005.

There were no potentially diluting events for the years ended 31 December 2006 and 2005.

15. PROPERTY, PLANT AND EQUIPMENT

Group 31 December 2006	Tankers and vessels RMB'000	Drilling equipment RMB'000	Machinery and equipment RMB'000	Motor vehicles RMB'000	Building RMB'000	Construction in progress RMB'000	Total RMB'000
At 31 December 2005 and at 1 January 2006							
Cost:	5,546,533	5,782,080	2,561,085	50,171	12,739	1,692,734	15,645,342
Accumulated depreciation	(3,026,518)	(4,105,390)	(1,228,735)	(25,914)	(538)	-	(8,387,095)
Net carrying amount	2,520,015	1,676,690	1,332,350	24,257	12,201	1,692,734	7,258,247
At 1 January 2006, net of accumulated depreciation	2,520,015	1,676,690	1,332,350	24,257	12,201	1,692,734	7,258,247
Additions	26,692	-	235,393	4,534	-	2,281,439	2,548,058
Acquisition of a subsidiary (note 3)	-	-	328	153	559	274	1,314
Depreciation provided during the year	(248,485)	(291,929)	(349,228)	(9,628)	(974)	-	(900,244)
Disposals/write-offs	(891)	-	(29,402)	(188)	-	-	(30,481)
Transfers from construction in progress	6,485	1,201,777	343,230	-	294	(1,551,786)	-
At 31 December 2006, net of accumulated depreciation	2,303,816	2,586,538	1,532,671	19,128	12,080	2,422,661	8,876,894
At 31 December 2006							
Cost	5,578,819	6,983,857	3,059,160	53,202	14,077	2,422,661	18,111,776
Accumulated depreciation	(3,275,003)	(4,397,319)	(1,526,489)	(34,074)	(1,997)	-	(9,234,882)
Net carrying amount	2,303,816	2,586,538	1,532,671	19,128	12,080	2,422,661	8,876,894

NOTES TO FINANCIAL STATEMENTS

31 December 2006

15. PROPERTY, PLANT AND EQUIPMENT (continued)

Group	Tankers and vessels	Drilling equipment	Machinery and equipment	Motor vehicles	Building	Construction in progress	Total
31 December 2005	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
At 1 January 2005							
Cost:	5,073,806	5,593,026	2,000,544	36,999	6,862	692,804	13,404,041
Accumulated depreciation	(2,787,152)	(3,866,003)	(960,103)	(27,086)	(273)	-	(7,640,617)
Net carrying amount	2,286,654	1,727,023	1,040,441	9,913	6,589	692,804	5,763,424
At 1 January 2005, net of accumulated depreciation	2,286,654	1,727,023	1,040,441	9,913	6,589	692,804	5,763,424
Additions	-	-	339,231	15,811	5,877	1,892,083	2,253,002
Depreciation provided during the year	(239,366)	(239,387)	(273,503)	(3,155)	(265)	-	(755,676)
Disposals/write-offs	-	-	(1,964)	(539)	-	-	(2,503)
Transfers from construction in progress	472,727	189,054	228,145	2,227	-	(892,153)	-
At 31 December 2005, net of accumulated depreciation	2,520,015	1,676,690	1,332,350	24,257	12,201	1,692,734	7,258,247
At 31 December 2005							
Cost	5,546,533	5,782,080	2,561,085	50,171	12,739	1,692,734	15,645,342
Accumulated depreciation	(3,026,518)	(4,105,390)	(1,228,735)	(25,914)	(538)	-	(8,387,095)
Net carrying amount	2,520,015	1,676,690	1,332,350	24,257	12,201	1,692,734	7,258,247

NOTES TO FINANCIAL STATEMENTS

31 December 2006

15. PROPERTY, PLANT AND EQUIPMENT (continued)

Company							
31 December 2006	Tankers and	Drilling Machinery and	Motor	Construction			
At 31 December 2005 and	vessels	equipment	vehicles	Building	in progress		Total
at 1 January 2006	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000	RMB'000
Cost:	5,546,533	5,782,080	2,447,142	50,171	12,739	1,692,734	15,531,399
Accumulated depreciation	(3,026,518)	(4,105,390)	(1,223,268)	(25,914)	(538)	-	(8,381,628)
Net carrying amount	2,520,015	1,676,690	1,223,874	24,257	12,201	1,692,734	7,149,771
At 1 January 2006, net of accumulated depreciation	2,520,015	1,676,690	1,223,874	24,257	12,201	1,692,734	7,149,771
Additions	22	-	206,797	4,535	-	2,280,236	2,491,590
Depreciation provided during the year	(248,485)	(291,929)	(330,641)	(9,418)	(914)	-	(881,387)
Disposals/write-offs	(891)	-	(29,221)	(188)	-	-	(30,300)
Transfers from construction in progress	6,485	1,201,775	343,231	-	-	(1,551,491)	-
At 31 December 2006, net of accumulated depreciation	2,277,146	2,586,536	1,414,040	19,186	11,287	2,421,479	8,729,674
At 31 December 2006							
Cost	5,552,149	6,983,855	2,915,516	52,827	12,739	2,421,479	17,938,565
Accumulated depreciation	(3,275,003)	(4,397,319)	(1,501,476)	(33,641)	(1,452)	-	(9,208,891)
Net carrying amount	2,277,146	2,586,536	1,414,040	19,186	11,287	2,421,479	8,729,674
31 December 2005							
At 1 January 2005							
Cost:	5,073,806	5,593,026	1,998,358	36,999	6,862	692,804	13,401,855
Accumulated depreciation	(2,787,152)	(3,866,003)	(958,907)	(27,086)	(273)	-	(7,639,421)
Net carrying amount	2,286,654	1,727,023	1,039,451	9,913	6,589	692,804	5,762,434
At 1 January 2005, net of accumulated depreciation	2,286,654	1,727,023	1,039,451	9,913	6,589	692,804	5,762,434
Additions	-	-	227,432	15,811	5,877	1,892,083	2,141,203
Depreciation provided during the year	(239,366)	(239,387)	(269,195)	(3,155)	(265)	-	(751,368)
Disposals/write-offs	-	-	(1,959)	(539)	-	-	(2,498)
Transfers from construction in progress	472,727	189,054	228,145	2,227	-	(892,153)	-
At 31 December 2005, net of accumulated depreciation	2,520,015	1,676,690	1,223,874	24,257	12,201	1,692,734	7,149,771
At 31 December 2005							
Cost	5,546,533	5,782,080	2,447,142	50,171	12,739	1,692,734	15,531,399
Accumulated depreciation	(3,026,518)	(4,105,390)	(1,223,268)	(25,914)	(538)	-	(8,381,628)
Net carrying amount	2,520,015	1,676,690	1,223,874	24,257	12,201	1,692,734	7,149,771

As of the date of these financial statements, a drilling rig with an aggregate cost and net book value of RMB503 million (2005: RMB438 million) and RMB137 million (2005: RMB88 million), respectively, has yet to complete the title re-registration procedures after the Reorganisation. The drilling rig has been operating in Indonesia since 2003 and the re-registration process can only be completed when the rig is physically located in the Mainland China.

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16. INVESTMENTS IN SUBSIDIARIES

	Company	
	2006 RMB'000	2005 RMB'000
Unlisted shares, at cost	9,061	2,712

Particulars of the principal subsidiaries are as follows:

Name of entity	Place and date of incorporation/ registration and operation	Nominal value of issued and paid up capital	Percentage of equity directly attributable to the Group		Principal activities
			Direct	Indirect	
	United States of America				
COSL American Inc	2 November 1994	US\$100,000	100	-	Sales of logging equipment
	British Virgin Islands				
China Oilfield Services (BVI) Limited	19 March 2003	US\$1	100	-	Investment holding
	Malaysia				
COSL (Labuan) Company Limited	11 April 2003	US\$1	-	100	Provision of drilling services in Indonesia
	British Virgin Islands				
COSL Services Southeast Asia (BVI) Limited	29 May 2003	US\$1	-	100	Investment holding
	Tianjin, PRC				
Tianjin Jinlong Petro-Chemical Company Ltd. ("Jinlong")	7 September 1993	RMB4,639,326	100 (note3)	-	Provision of drilling fluids services
	Australia				
COSL (Australia) Pty Ltd	11 January 2006	A\$10,000	-	100	Provision of drilling services in Australia

The above table lists the principal subsidiaries of the Company, which, in the opinion of the directors, principally affected the results for the year or formed a substantial portion of the net assets of the Group. To give details of other subsidiaries would, in the opinion of the directors, result in particulars of excessive length.

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17. INTERESTS IN JOINTLY-CONTROLLED ENTITIES

	Group		Company	
	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000
Unlisted investments, at cost	-	-	125,873	128,102
Share of net assets	435,109	236,512	-	-
Due from jointly-controlled entities	1,628	3,424	1,628	3,424
Due to jointly-controlled entities	(3,241)	-	(3,241)	-
	433,496	239,936	124,260	131,526

The amounts due from and due to jointly-controlled entities are unsecured, interest-free and have no fixed terms of repayment. The carrying amounts of these amounts due from and due to jointly-controlled entities approximate to their fair values.

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

Name	Nominal value of issued and paid up capital	Place and date of Incorporation/ registration and operations	Percentage of		Principal activities
			Ownership interest	Profit sharing	
China-France Bohai Geoservices Co., Ltd. ("China-France")	USD11,650,000	Tianjin, PRC 15 November 1983	50	50	Provision of logging services
China Nanhai-Magcobar Mud Corporation Ltd. ("Magcobar")	USD1,250,000	Shenzhen, PRC 25 October 1984	60 (note b)	60	Provision of drilling fluids services
CNOOC-OTIS Well Completion Services Ltd. ("CNOOC-OTIS")	USD2,000,000	Tianjin, PRC 14 April 1993	50	50	Provision of well completion services
China Petroleum Logging-Atlas Cooperation Service Company ("Logging-Atlas")	USD2,000,000	Shenzhen, PRC 10 May 1984	50	50	Provision of logging services
China Offshore Fugro Geo Solutions (Tianjin) Company Ltd. ("China Offshore Fugro")	USD1,720,000	Tianjin, PRC 24 August 1983	50	50	Provision of geophysical services
Eastern Marine Services Ltd. ("Eastern Marine")	HKD1,000,000	Hong Kong 10 March 2006	51 (notes a & b)	51	Marine transportation services
PT Tritunggal Sinergy ("PTTS")	USD700,000	Indonesia 30 December 2004	55 (note b)	55	Provision of oilfield repair services

NOTES TO FINANCIAL STATEMENTS

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17. INTERESTS IN JOINTLY-CONTROLLED ENTITIES (continued)

All of the above investments in jointly-controlled entities are directly held by the Company except for Eastern Marine and PTTS which is indirectly held through China Oilfield Services (BVI) Limited.

Notes:

- (a) Eastern Marine was set up by the Group and Trico Marine Service, Inc ("Trico") to develop international marine support and transportation services. The Group made a capital contribution of US\$20.9 million in cash to Eastern Marine in exchange for its 51% equity interest in Eastern Marine. There was no operation during the year.
- (b) In the opinion of the directors, the Company does not have control over Magcobar's, Eastern Marine's and PTTS's financial and operating decisions, and accordingly, the financial statements of Magcobar, Eastern Marine and PTTS have not been incorporated into the Group's consolidated financial statements. The financial statements of Magcobar, Eastern Marine and PTTS have been dealt with in the Group's consolidated financial statements under the equity accounting method.

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

	2006 RMB'000	2005 RMB'000
Share of the jointly-controlled entities' assets and liabilities:		
Current assets	272,665	254,617
Non-current assets	235,374	75,841
Current liabilities	(72,930)	(93,946)
Net assets	435,109	236,512
Share of the jointly-controlled entities' results:		
Turnover	452,992	447,169
Other revenue	4,391	5,236
Total expenses	(314,226)	(318,359)
Tax	(29,652)	(27,429)
Share of profits of jointly-controlled entities	113,505	106,617

18. INVENTORIES

	Group		Company	
	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000
Gross inventory	301,146	236,668	299,045	236,666
Less: Provisions	(7,986)	(6,884)	(7,986)	(6,884)
	293,160	229,784	291,059	229,782

Inventories consist of materials and supplies.

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19. ACCOUNTS RECEIVABLE

The general credit terms of the Group range from 30 to 45 days upon the issuance of the invoices. The Group's accounts receivable relate to a large number of diversified customers. Other than the accounts receivable related to CNOOC Group and CNOOC Limited Group as disclosed below, there is no significant concentration of credit risk of the Group's accounts receivables. All accounts receivable are non-interest-bearing.

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

	Group		Company	
	2006	2005	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000
Outstanding balances aged:				
Within one year	976,219	708,400	1,347,377	817,941
One to two years	11,246	1,059	3,146	1,059
Two to three years	826	779	826	779
Over three years	1,453	704	1,453	704
	989,744	710,942	1,352,802	820,483
Less: Provision for doubtful debts	(2,645)	(1,489)	(2,645)	(1,489)
	987,099	709,453	1,350,157	818,994

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

	Group		Company	
	2006	2005	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000
Due from CNOOC Group and CNOOC Limited Group	486,569	237,046	437,746	237,046

Included in the Company's accounts receivable at 31 December 2006 was an amount due from its subsidiaries of RMB548,048,000 (2005: RMB228,431,000) was unsecured, non-interest-bearing and repayable on similar credit terms to those offered to the major customers of the Group.

20. DUE FROM/TO THE ULTIMATE HOLDING COMPANY

Except for the long term payable of RMB400 million due to CNOOC as disclosed in note 28 to the financial statements, the other balances with CNOOC at 31 December 2006 under current assets and liabilities of the Group are unsecured, interest-free and had no fixed repayment terms.

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21. BALANCES WITH OTHER CNOOC GROUP COMPANIES

The balances with other CNOOC group companies at 31 December 2006 are unsecured, interest-free and have no fixed terms of repayment.

22. AVAILABLE-FOR-SALE INVESTMENTS

	Group and Company	
	2006 RMB'000	2005 RMB'000
Listed investments, at fair value: Mainland China	75,008	-

The fair value of the listed investments are based on quoted market prices.

23. CASH AND CASH EQUIVALENTS AND PLEDGED TIME DEPOSITS

	Group		Company	
	2006 RMB'000	2005 RMB'000	2006 RMB'000	2005 RMB'000
Cash and balances with banks	1,245,496	720,919	924,548	643,927
Deposit with CNOOC Finance Company Limited ("CNOOC Finance Company")	104	103	104	103
Placements with other financial institutions with original maturity of three months or less	202,200	-	202,200	-
Time deposits at banks	884,109	293,866	873,793	283,293
Cash and balances with banks and financial institutions	2,331,909	1,014,888	2,000,645	927,323
Less: Pledged time deposits for letters of credit facilities	(22,466)	(1,093)	(12,150)	(1,093)
Cash and cash equivalents	2,309,443	1,013,795	1,988,495	926,230

At the balance sheet date, the cash and bank balances and time deposits at banks of the Group denominated in RMB amounted to RMB1,259,157,000 (2005:RMB376,247,000). RMB is not freely convertible into other currencies. However, under Mainland China's Foreign Exchange Control Regulations and Administration of Settlement, Sale and Payment of Foreign Exchange Regulations, the Group is permitted to exchange RMB for foreign currencies through banks authorised to conduct foreign exchange business.

Cash at banks earns interest at floating rates based on daily bank deposit rates. The placements with financial institutions earn interest at fixed rates and are made for a period of less than three months. The carrying amounts of the placements with financial institutions approximate to their fair value. Time deposits are made for a period of three months according to the immediate cash requirements of the Group, and earn interest at the respective time deposit rates. The carrying amounts of the cash and cash equivalents and the pledged deposits approximate to their fair values.

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24. TRADE AND OTHER PAYABLES

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

	Group		Company	
	2006	2005	2006	2005
	RMB'000	RMB'000	RMB'000	RMB'000
Outstanding balances aged:				
Within one year	1,817,032	875,912	1,750,103	808,110
One to two years	7,219	37,446	6,747	37,446
Two to three years	771	6,301	771	6,301
Over three years	5,786	5,647	5,786	5,647
	1,830,808	925,306	1,763,407	857,504

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

25. SHORT TERM DEBENTURES

In February 2006, the Group issued short term debentures with a total face value of RMB 1 billion at maturity, resulting in net proceeds of RMB965 million for working capital purposes.

The debentures are unsecured, are circulated among domestic banks, and have a term of one year.

The coupon interest rate for the short term debentures is 3.1% per annum, which has been paid upfront.

The carrying amount of the short term debentures approximate to their fair values.

26. DEFERRED TAX LIABILITIES

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

	Group and Company	
	2006	2005
	RMB'000	RMB'000
Balance at beginning of the year	385,816	433,258
Credited to the consolidated income statement during the year (note 11)	(37,060)	(47,442)
Balance at end of year	348,756	385,816

NOTES TO FINANCIAL STATEMENTS

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26. DEFERRED TAX LIABILITIES (continued)

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

	Group and Company	
	2006	2005
	RMB'000	RMB'000
Deferred tax asset:		
Provision for staff bonus	(111,567)	(96,155)
Deferred tax liabilities:		
Accelerated depreciation	248,595	230,544
Revaluation surplus on Reorganisation	211,728	251,427
Net deferred tax liabilities	348,756	385,816

27. INTEREST-BEARING BANK BORROWINGS

In June 2006, the Group borrowed a bank loan from the Export-Import Bank of China for the purpose of financing the construction of certain modular drilling rigs. The total facilities amount to RMB944 million, of which RMB600 million has been utilised as at 31 December 2006.

The Group's borrowings are unsecured, bear fixed interest at a rate of 4.05% per annum and are payable by instalments as follows:

	Group and Company	
	2006	2005
	RMB'000	RMB'000
Bank borrowings repayable:		
In the third to fifth years, inclusive	600,000	-

Group and Company	Effective interest rate (%)	2006		Effective interest rate (%)	2005	
		Maturity	RMB'000		Maturity	RMB'000
Non-current						
Bank borrowings	4.05	2008 - 2010	600,000	-	-	-

The bank borrowings are denominated in RMB.

The estimated fair value of the long term bank loans totalled approximately RMB596,201,000 as at 31 December 2006, which was the present value of the loans' future cashflows discounted by the prevailing market interest rates quoted by Export-Import Bank of China.

NOTES TO FINANCIAL STATEMENTS

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28. LONG TERM PAYABLE TO THE ULTIMATE HOLDING COMPANY

	Group and Company	
	2006 RMB'000	2005 RMB'000
Amounts payable:		
Within one year	200,000	200,000
In the second year	200,000	200,000
	400,000	400,000
Portion classified as current liabilities	(200,000)	(200,000)
Long term portion	200,000	200,000

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

29. ISSUED CAPITAL

	2006 RMB'000	2005 RMB'000
Registered, issued and fully paid:	2,460,468	2,460,468
2,460,468,000 State legal person shares of RMB1.00 each	1,534,852	1,534,852
1,534,852,000 H shares of RMB1.00 each	3,995,320	3,995,320

The Company does not have any share option scheme.

There was no movement in issued share capital for the years ended 31 December 2005 and 2006.

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30. RESERVES

(a) Group

The amounts of the Group's reserves and the movements therein for the current year are presented in the consolidated statement of changes in equity on page 68 of the financial statements.

(b) Company

	Capital reserve RMB'000	Statutory reserve funds RMB'000	Retained profits RMB'000	Total RMB'000
Balance at 1 January 2005	1,975,810	206,565	628,111	2,810,486
Profit for the year	-	-	858,089	858,089
Special interim 2005 dividend (note 13)	-	-	(55,535)	(55,535)
Proposed final 2005 dividend (note 13)	-	-	(164,208)	(164,208)
Transfer to statutory reserve funds (note (i))	-	123,149	(123,149)	-
At 31 December 2005	1,975,810	329,714	1,143,308	3,448,832
Balance at 1 January 2006	1,975,810	329,714	1,143,308	3,448,832
Profit for the year	-	-	1,223,297	1,223,297
Proposed final 2006 dividend (note 13)	-	-	(239,719)	(239,719)
Transfer to statutory reserve funds (note (i))	-	112,801	(112,801)	-
At 31 December 2006	1,975,810	442,515	2,014,085	4,432,410

Note:

- (i) As detailed in note 13 to the financial statements, the Company is required to transfer a minimum percentage of after-tax profit, if any, to the statutory common reserve fund and the statutory public welfare fund. The Company transferred 10% of after-tax profit to the statutory common reserve fund in 2006.

As at 31 December 2006, in accordance with the PRC Company Law, an amount of approximately RMB1,976 million (2005: RMB1,976 million) standing to the credit of the Company's capital reserve account and an amount of approximately RMB443 million (2005: RMB329 million) standing to the credit of the Company's statutory reserve funds, as determined under the PRC accounting principles and financial regulations, were available for distribution by way of future capitalisation issue. In addition, the Company had retained profits of approximately RMB2,015 million (2005: RMB1,144 million) available for distribution as dividend. Save as the aforesaid, the Company did not have any reserves available for distribution to its shareholders at 31 December 2006.

The retained profits of the Company determined under the relevant PRC accounting standards and financial regulations amounted to approximately RMB1,965 million (2005: RMB1,190 million) as of 31 December 2006.

NOTES TO FINANCIAL STATEMENTS

31. OPERATING LEASE ARRANGEMENTS

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

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

	Group and Company	
	2006 RMB'000	2005 RMB'000
Within one year	80,834	59,960
In the second to fifth years, inclusive	295,295	230,222
After five years	-	49,162
	376,129	339,344

32. CAPITAL COMMITMENTS

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

	Group and Company	
	2006 RMB'000	2005 RMB'000
Contracted, but not provided for	2,083,149	450,316
Authorised, but not contracted for	5,285,537	1,877,503
	7,368,686	2,327,819

33. CONTINGENT LIABILITIES

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

34. RELATED PARTY TRANSACTIONS

Companies are considered to be related if one company has the ability, directly or indirectly, to control the other company, or exercise significant influence on the other company in making financial and operating decisions. Companies are also considered to be related if they are subject to common control or common significant influence. The transactions were made on terms agreed among the parties.

The Group has extensive transactions and relationships with the members of CNOOC. The transactions were made on terms agreed among the parties.

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

NOTES TO FINANCIAL STATEMENTS

34. RELATED PARTY TRANSACTIONS (continued)

	2006 RMB'000	2005 RMB'000
A. Included in revenue-gross revenue earned from provision of services to the following related parties:		
a. The CNOOC Limited Group		
Provision of drilling services	1,786,019	1,498,929
Provision of well services	1,107,180	772,070
Provision of marine support and transportation services	699,921	527,149
Provision of geophysical services	531,059	346,033
	4,124,179	3,144,181
b. The CNOOC Group		
Provision of drilling services	9,624	2,447
Provision of well services	526	222
Provision of marine support and transportation services	147,083	80,468
Provision of geophysical services	63,887	8,416
	221,120	91,553
c. Jointly-controlled entities		
Provision of drilling services	204	1,665
Provision of well services	4,745	11,182
Provision of marine support and transportation services	54	10
	5,003	12,857
B. Included in operating expenses for services provided by the CNOOC Group:		
	10,463	11,383
Labour services	192,586	166,139
Materials, utilities and other ancillary services	5,244	3,028
Transportation services	47,651	29,739
Leasing of office, warehouse and berths	12,332	10,256
Repair and maintenance services	15,449	29,636
Management services	283,725	250,181
C. Included in interest income:		
Interest income earned from the CNOOC Group	1	-
D. Deposits:		
Deposits placed with CNOOC Finance Company	104	103
E. Purchases		
Purchase of items of property, plant and equipment from the CNOOC Group	-	11,688

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34. RELATED PARTY TRANSACTIONS (continued)

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

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

During the year, all pension scheme payments relating to the Supplementary Pension Benefits of approximately RMB36 million (2005: RMB33 million) were borne by CNOOC (note 10).

Prior to the Reorganisation, the Group occupied certain properties owned by CNOOC at nil consideration. The Company entered into various property lease agreements in September 2002 with the CNOOC Group to lease the aforesaid properties together with other properties for a term of one year. These leases have been renewed annually on terms based upon corresponding market prices.

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

Apart from the transactions disclosed above, certain of the Group's business activities were conducted with other state-owned enterprises. The Group considers that those activities are in the ordinary course of its business and has not accumulated or disclosed such transactions.

Details of the compensation of key management personnel of the Group are disclosed in note 8 to the financial statements.

35. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES

The Group's principal financial instruments comprise related party loans, short term debentures, long term bank loans, cash and short term deposits, placement with other financial institution and available-for-sale investments. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group has various other financial assets and liabilities such as trade receivables and trade payables, which arise directly from its operations.

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

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

Foreign currency risk

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

Cash flow interest rate risk

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long term debt obligations with a floating interest rate.

At 31 December 2006, all of the Group's interest-bearing borrowings bore interest at fixed rates.

NOTES TO FINANCIAL STATEMENTS

35. FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (continued)

Credit risk

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

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

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

Liquidity risk

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

36. SUBSEQUENT EVENTS

- (i) In accordance with the Company's Articles of Association, an Extraordinary General Meeting of the shareholders was convened on 31 January 2007 for the approval of the special resolution in relation to the issue of long term financing bonds with the principal amount not exceeding RMB 2 billion. The long term financing bonds will be issued to institutional investors in the PRC. The long term financing bonds are unsecured, with a term of 10 to 20 years. It is expected that the proceeds from the bonds issue will be used by the Company for building and upgrading of drilling rigs, purchase and building of chemical tankers and oilfield working vessels, upgrading of seismic vessels and building of multi-function platforms and as general working capital of the Company.
- (ii) The short term debentures of total face value of RMB1 billion were repaid in full by the Group in February 2007.
- (iii) 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.

37. COMPARATIVE AMOUNTS

Certain comparative amounts have been reclassified to conform with the current year's presentation.

38. APPROVAL OF THE FINANCIAL STATEMENTS

The financial statements were approved and authorised for issue by the Board of Directors on 23 March 2007.