



KunLun Energy Company Limited

(incorporated in Bermuda with limited liability)

昆 侖 能 源 有 限 公 司

(Stock Code: 00135.HK)



2010
Annual Report



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Corporate Information

BOARD OF DIRECTORS

Mr Li Hualin (*Chairman*)
 Mr Zhang Bowen (*Chief Executive Officer*)
 Mr Cheng Cheng
 Dr Lau Wah Sum, GBS, LLD, DBA, JP
 Mr Li Kwok Sing Aubrey
 Dr Liu Xiao Feng

COMPANY SECRETARY

Mr Lau Hak Woon

BERMUDA RESIDENT REPRESENTATIVE

Codan Services Limited
 Clarendon House
 Church Street
 Hamilton HM11, Bermuda

AUDITOR

PricewaterhouseCoopers

BANKERS

HSBC Securities Services (Bermuda) Limited
 Standard Chartered Bank
 Bank of China
 Fubon Bank (Hong Kong) Limited

STOCK CODE

The Stock Exchange of Hong Kong Limited
 00135.HK

WEBSITE

<http://www.kunlun.com.hk>
<http://www.irasia.com/listco/hk/kunlun>

PRINCIPAL BOARD COMMITTEES

Audit Committee

Dr Lau Wah Sum, GBS, LLD, DBA, JP (*Chairman*)
 Mr Li Kwok Sing Aubrey
 Dr Liu Xiao Feng

Remuneration Committee

Mr Li Kwok Sing Aubrey (*Chairman*)
 Dr Lau Wah Sum, GBS, LLD, DBA, JP
 Dr Liu Xiao Feng

SOLICITORS

Clifford Chance
 Baker & McKenzie

REGISTERED OFFICE

Clarendon House
 Church Street
 Hamilton HM11, Bermuda

PRINCIPAL OFFICE

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 Hong Kong
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PRINCIPAL REGISTRARS

HSBC Securities Services (Bermuda) Limited
 6 Front Street
 Hamilton HM11, Bermuda

REGISTRARS IN HONG KONG

Tricor Secretaries Limited
 26/F., Tesbury Centre,
 28, Queen's Road East,
 Hong Kong

Chairman's Statement

BUSINESS REVIEW

I would like to report to the shareholders on behalf of the Board that, for the year ended 31 December 2010 (the "Year"), the revenue of the Group amounted to HK\$9,068 million, representing an increase of 47.11% compared with that of the corresponding period last year. The Group's audited profit attributable to owners of the Company for the Year was HK\$2,426 million, representing an increase of HK\$1,192 million or 96.60% compared with HK\$1,234 million (restated) for the corresponding period last year.

Exploration and Production Business

The Group currently has nine oil fields located in seven countries and two of them are exploration projects.

For the Year, sales volume of crude oil of the Group was 16.38 million barrels, representing an increase of 0.18 million barrels or 1.12% compared with 16.20 million barrels for the corresponding period last year. Revenue of HK\$4,274 million was realised, an increase of HK\$1,123 million or 35.64% compared with HK\$3,151 million for the corresponding period last year. The exploration and production business contributed HK\$2,140 million to the Group's profit attributable to owners for the Year, representing an increase of HK\$1,059 million or 97.96% compared with HK\$1,081 million for the corresponding period last year. The significant increase in both revenue and profit in the exploration and production business was primarily due to (1) the surging oil price, which reached US\$71.77 per barrel, an increase of 41.58% compared with US\$50.69 for the corresponding period last year; (2) the profit attributable to the Group from CNPC-Aktobemunaigas Joint Stock Company ("Aktobe") in Kazakhstan of HK\$963 million, an increase of HK\$819 million or 568.75% compared with HK\$144 million last year. Currently, revenue from the exploration and production business accounted for 47.13% of the Group's total revenue, and its profit contribution accounted for 88.21% of the Group's profit attributable to owners for the Year. This is an increase of 35.62% and 97.99% respectively compared with the previous year. The exploration and production business so far continued to be the Group's major source of profit and cash flow.

Natural Gas Business

The Group's sales volume of natural gas was 2,198 million cubic metres for the Year, representing an increase of 522 million cubic metres or 31.15% compared with 1,676 million cubic metres (restated) for the corresponding period last year. The volume of natural gas transmission was 369 million cubic metres, representing an increase of 121 million cubic metres or 48.88% compared with 248 million cubic metres for the corresponding period last year. Revenue was HK\$4,794 million, an increase of HK\$1,781 million or 59.11% compared with HK\$3,013 million (restated) for the corresponding period last year. The natural gas business contributed HK\$372 million to the Group's profit attributable to owners for the Year, increasing by HK\$128 million or 52.46% compared with HK\$244 million (restated) for the corresponding period last year.

Revenue from the natural gas business accounted for 52.87% of the Group's total revenue, it being the first time surpassing the exploration and production business, and its profit contribution accounted for 15.30% of the Group's profit attributable to owners for the Year, representing an increase of 59.12% and 52.19%, respectively compared with the corresponding period of last year. The rapid increase in revenue and profit has provided a solid foundation for the development of the natural gas business of the Company.

Chairman's Statement

As of the date of this report, the Group has been establishing eight subsidiaries with controlling interests through equity acquisition, joint ventures and cooperation, etc. These include two LNG terminals: PetroChina LNG Jiangsu Company Ltd ("Jiangsu LNG Terminal") and PetroChina Dalian LNG Company Ltd ("Dalian LNG Terminal"); one natural gas pipeline company: PetroChina Tianjin Natural Gas Pipeline Company Limited; five regional natural gas distribution companies: Kunlun Energy (Qinghai) Company Limited, Kunlun Energy (Shandong) Company Limited, Sichuan Chuangang Gas Limited Company, Cangzhou Gas Limited Company PetroChina and Kunlun Energy (Liaoning) Company Limited.

In particular, the Group entered into an acquisition agreement with PetroChina in December 2010 in respect of the acquisition of 60% equity interests in PetroChina Beijing Gas Pipeline Co., Ltd ("Beijing Gas Pipeline") for a consideration of RMB18,871 million. Beijing Gas Pipeline owns long transmission pipelines of 2,871 km with an annual transmission capacity of approximately 35 billion cubic metres. This is an important step of the Group in acquiring strategic assets of natural gas.

Through the above actions, the Company bettered the business layout in major natural gas producing areas and key markets throughout the country, acquired some strategic assets related to the utilisation of natural gas, and provided resources guarantee for the development of the "gas in substitution of oil" business.

BUSINESS PROSPECTS

Along with the growth of its exploration and production businesses and rapid development of the natural gas businesses over the past two years, the Group's natural gas businesses have reached a relatively large scale and are becoming the major growing businesses of the Company in the future. The Group's business will be composed of four major business sectors, namely exploration and production, natural gas pipeline, liquefied natural gas ("LNG") storage and processing and natural gas sales.

1 Exploration and Production

Looking ahead to 2011, the Group will grasp the opportunities brought about by high international oil price to enhance the exploration levels of oil and gas fields, continue the steady production of mature oilfields, strengthen its control of cost as well as refine its management so as to generate greater revenue to the Group.

2 Natural Gas Pipeline

Following the establishment of PetroChina Tianjin Natural Gas Pipeline Company Limited in 2010, and acquisition of Beijing Gas Pipeline in 2011, the Group has now been increasing investments of construction of natural gas backbone and sub-line networks. The natural gas pipeline business will become one of the major businesses of the Group in the future and will contribute to the Group with steady cash flow. It can also facilitate the development of end-user markets and the Group will actively identify more investment opportunities in natural gas pipeline network.

3 LNG Processing and Storage

The Jiangsu LNG Terminal and Dalian LNG Terminal under the Group will officially commence production this year. The Bayannur LNG processing plant in Inner Mongolia successfully commenced operation in March 2011, and other LNG processing plants under construction will also commence operation from 2011 to 2012. The Company will form a resources guarantee system through the LNG terminals, storage and LNG processing plants, which will provide stable resources supply for the "gas in substitution of oil" business.

Chairman's Statement

4 Natural Gas Sales

The Group will continue to focus on the natural gas end-users sale and integrated utilisation businesses. While continuing our steady development in compressed natural gas and city gas, etc, the Group's first priority is to develop the LNG business by implementing the "gas in substitution of oil" strategy. To further expand into the LNG utilisation business, the Group will actively promote the utilisation of LNG as the fuel for vessels in 2011 based on the successful application of LNG as the fuel for heavy duty trucks, public transport vehicles and drilling rigs. To further develop the LNG utilisation market, the Group will actively deliver LNG by railways and river transportation, plan the construction of LNG refilling station for vessels and strive to establish a LNG supply network in key regions.

The trends of "Low-carbon Economy and Green Development" have provided vast development opportunities for the natural gas business. As a substitute of petroleum and diesel oil, LNG will surely win its market share by its low-emission feature and price advantages. The Group will put more effort in achieving this.

By order of the Board

Li Hualin

Chairman

Hong Kong, 17 March 2011

Management Discussion and Analysis

OPERATING RESULTS

The financial results of the Group for the year ended 31 December 2010 (the "Year") were affected by the upsurge of international crude oil price and the expansion of natural gas business. Profit before income tax expense of the Group was approximately HK\$4,393 million (2009: HK\$1,960 million (restated)), representing an increase of 124.13% compared with 2009. Profit attributable to owners of the Company was approximately HK\$2,426 million (2009: HK\$1,234 million (restated)), representing an increase of 96.60% compared with 2009.

REVENUE

Revenue increased by 47.11% from approximately HK\$6,164 million in 2009 to approximately HK\$9,068 million in 2010. This was mainly due to the increase of the selling prices and changes in the sales volume of major products including crude oil and natural gas.

OTHER GAINS, NET

Other gains, net increased by 415.00% from approximately HK\$40 million in 2009 to approximately HK\$206 million in 2010. This was mainly due to fluctuation in exchange rates of Renminbi against Hong Kong dollar during the year ended 31 December 2010.

INTEREST INCOME

Interest income increased by 72.50% from approximately HK\$40 million in 2009 to approximately HK\$69 million in 2010. This was mainly due to an increase in interest rates on bank deposits.

PURCHASES SERVICE AND OTHERS

Purchases, service and others increased by 38.73% from approximately HK\$3,075 million in 2009 to approximately HK\$4,266 million in 2010. This was mainly due to an increase in purchase volume of natural gas which is in line with the market conditions.

EMPLOYEE COMPENSATION COSTS

Employee compensation costs of the Group was approximately HK\$685 million in 2010, representing an increase of 77.00% compared with that of 2009. This increase in employee compensation costs was mainly due to expansion of the Group's natural gas businesses.

EXPLORATION COSTS

Exploration costs increased by 65.63% from approximately HK\$32 million in 2009 to approximately HK\$53 million in 2010. This was mainly due to more exploration activities undertaken in the Group's overseas oil fields.

Management Discussion and Analysis

DEPRECIATION, DEPLETION AND AMORTISATION

Depreciation, depletion and amortisation increased by 60.53% from approximately HK\$565 million in 2009 to approximately HK\$907 million in 2010. This was primarily due to an increase of capital expenditure during the Year.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses increased by 44.19% from approximately HK\$525 million in 2009 to approximately HK\$757 million in 2010. This was mainly due to an increase in royalty expenses of the Group's overseas oil fields in line with an increase in global crude oil selling prices.

TAXES OTHER THAN INCOME TAXES

Taxes other than income taxes increased by 159.84% from approximately HK\$137 million in 2009 to approximately HK\$356 million in 2010. The increase was mainly due to an increase of approximately HK\$199 million compared with 2009 in the payment of the special levy on the sale of domestic crude oil in China by the Group as the average crude oil prices increase throughout the whole year of 2010.

INTEREST EXPENSES

Interest expenses increased by 23.70% from approximately HK\$135 million in 2009 to approximately HK\$167 million in 2010. This was mainly due to increased in the borrowings from related parties financial institution for the Group's expansion in natural gas businesses.

SHARE OF PROFITS LESS LOSSES OF ASSOCIATES

Share of profits less losses of associates increased by 692.97% from approximately HK\$256 million in 2009 to approximately HK\$2,030 million in 2010. This increase was mainly due to the increase in crude oil selling price in an associate in Kazakhstan.

SHARE OF PROFITS LESS LOSSES OF JOINTLY CONTROLLED ENTITIES

Share of profits less losses of jointly controlled entities decreased by 10.32% from approximately HK\$252 million in 2009 to approximately HK\$226 million in 2010 because of the decrease in profit in 華油鋼管有限公司 ("Steel Pipes Factory").

PROFIT BEFORE INCOME TAX EXPENSE

Profit before income tax expense increased by 124.13% from approximately HK\$1,960 million in 2009 to approximately HK\$4,393 million in 2010.

INCOME TAX EXPENSE

Income tax expense increased by 141.67% from approximately HK\$420 million in 2009 (restated) to approximately HK\$1,015 million in 2010. The increase was mainly due to an increase in the taxable income for 2010.

Management Discussion and Analysis

PROFIT FOR THE YEAR AND PROFIT ATTRIBUTABLE TO OWNERS OF THE COMPANY

As a result of the factors discussed above, profit for the Year and profit attributable to owners of the Company increased by 119.35% from approximately HK\$1,540 million in 2009 to approximately HK\$3,378 million in 2010 and increased by 96.60% from approximately HK\$1,234 million in 2009 to approximately HK\$2,426 million in 2010 respectively. The table below sets out the external sales volume and profit attributable to the Group for major products sold by the Group for 2009 and 2010 and percentages of change during these two years.

	Sales volume			Profits attributable to the Group		
	2010 ('000 barrel)	2009 ('000 barrel)	Percentage of change	2010 (HK\$ million)	2009 (HK\$ million)	Percentage of change
Exploration and Production						
Liaoheng Leng Jiapu	2,714	3,267	(16.93%)	274	163	68.10%
Xinjiang Karamay	2,740	2,770	(1.08%)	619	367	68.66%
Peru Talara	575	542	6.09%	112	85	31.76%
Azerbaijan K&K	778	910	(14.51%)	(71)	18	(494.44%)
Thailand Sukhothai	300	373	(19.57%)	47	67	(29.85%)
Thailand L21/43	239	169	41.42%	13	19	(31.58%)
Indonesia Bengara – II	N/A	N/A	N/A	(29)	(33)	12.12%
Oman	2,434	2,037	19.49%	212	184	15.22%
Kazakhstan Aktobe	6,603	6,134	7.65%	963	144	568.75%
Azerbaijan Gobustan (disposed in 2010)	N/A	N/A	N/A	N/A	67	(100.00%)
Total of Exploration and Production	16,383	16,202	1.12%	2,140	1,081	97.96%
	('000 cubic metre)	('000 cubic metre)				
Natural gas distribution	2,198,283	1,379,901 ^(Note 1)	59.31%	372	214 ^(Note 1)	73.83%
– Restated	2,198,283	1,676,114 ^(Note 2)	31.15%	372	244	52.46%

Notes:

- (1) As previously reported in 2009 Annual Report
- (2) Due to business combinations under common control completed in 2010, the financial information of the Group has been restated in a manner similar to an uniting of interests to reflect the acquisitions.

LIQUIDITY AND CAPITAL RESOURCES

As at 31 December 2010, the carrying value of total assets of the Group is approximately HK\$32,226 million, representing an increase of HK\$7,562 million or 30.66% as compared with 31 December 2009 restated amount of HK\$24,664 million.

The gearing ratio of the Group was 24.44% as at 31 December 2010 compared with 16.15% (restated) as at 31 December 2009. It is computed by dividing the total borrowings of HK\$6,806 million (2009: HK\$3,358 million (restated)) by the total equity and borrowings of HK\$27,844 million (2009: HK\$20,799 million (restated)).

Management Discussion and Analysis

PLEDGED OF ASSETS

As at 31 December 2009, secured short-term borrowings were secured by property, plant and equipment and advanced operating lease payments with aggregate carrying values of HK\$41 million.

As at 31 December 2010, no short-term and long-term borrowings were secured by property, plant and equipment and advanced operating lease payment.

The Group raised new borrowings of HK\$4,488 million and repaid HK\$1,212 million to financial institutions and related parties resulting a net increase in borrowings of HK\$3,448 million.

New Companies and Major Projects

As at the date of this report, the Group has been establishing eight subsidiaries with controlling interests through acquisition, capital injection, and formation of new wholly owned company or joint ventures, etc., actively promote the development of natural gas business.

- (1) The acquisition agreement dated 17 May 2010 between the Company and PetroChina, pursuant to which the Company has conditionally agreed to purchase, and PetroChina has conditionally agreed to sell, 55% equity interest in 中石油江蘇液化天然氣有限公司 (PetroChina LNG Jiangsu Company Ltd), at a consideration of RMB500,206,200 in cash;
- (2) Kunlun Energy (Qinghai) Company Limited ("Kunlun Qinghai") was established in June 2010, Kunlun Qinghai is 100% owned by the Company. It is mainly engaged in liquefied natural gas ("LNG") production and natural gas end-users sale business in the Qinghai and Tibetan regions. Phase 1 of the project is to build a LNG plant with daily handling capacity of 350,000 cubic metres and other ancillary facilities in Geermu, Qinghai. This will provide the people of Qinghai and Tibet with cleaner green energy;
- (3) Kunlun Energy (Shandong) Company Limited was established in June 2010, and is 93% owned by the Company. It will focus on developing LNG application as a power fuel in the transportation industry with Shandong as its major market;
- (4) The acquisition and capital increase agreement dated 22 June 2010 among the Company, 四川石油管理局 (Sichuan Petroleum Management Bureau) ("Sichuan Bureau") and 四川華油集團有限責任公司 (Sichuan Huayou Group Co., Ltd.), pursuant to which (i) the Company has conditionally agreed to acquire, and Sichuan Huayou has conditionally agreed to sell 100% equity interest in 四川石中石油輸氣科技有限公司 (Sichuan Shizhong Petroleum and Gas Transmission Technology Co., Ltd.) ("Sichuan Shizhong") (change the name to 四川川港燃氣有限責任公司 (Sichuan Chuangang Gas Limited Company) ("Chuangang"), at a consideration of RMB6,683,900 payable in USD or other convertible foreign exchange; and (ii) the Company and Sichuan Bureau have conditionally agreed to increase the share capital of Sichuan Shizhong from RMB6,000,000 to RMB310,000,000 by way of: (a) capital injection by the Company in the total amount of RMB152,100,000, contributing in USD or other convertible foreign exchange in two stages; and (b) non-cash assets injection and/or cash injection by Sichuan Bureau equivalent to RMB151,900,000 to be injected into Sichuan Shizhong in two stages; the Company and Sichuan Bureau would own 51% and 49% of equity interest in Sichuan Shizhong upon completion, respectively. The supplemental agreement dated 26 November 2010 between the Company and Sichuan Bureau, pursuant to which Sichuan Bureau has agreed to conduct second stage non-cash assets injection and inject equity interest and assets in the total amount of RMB70,611,100 into Chuangang within two years from the date upon which Chuangang has converted into a wholly-foreign owned enterprise and obtained its first business registration licence;

Management Discussion and Analysis

- (5) The joint venture agreement dated 17 August 2010 between the Company and Tianjin Gas Group, pursuant to which the parties agreed to establish a Sino-foreign co-operative joint venture in the PRC, namely 中石油天津天然氣管道有限公司 (PetroChina Tianjin Natural Gas Pipeline Company Limited) (the "PetroChina Tianjin JV") and the Company agreed to contribute 51% of the registered capital of PetroChina Tianjin JV by injecting RMB51 million;
- (6) The joint venture agreement dated 26 August 2010 between the Company and 中燃燃氣實業(深圳)有限公司 (China Gas Industries (Shenzhen) Limited) and 河北渤海投資有限公司 (Hebei Bohai Investment Company Limited), pursuant to which the Company and the parties agreed to establish a Sino-foreign co-operative joint venture in the PRC, namely 滄州中油燃氣有限公司 (Cangzhou Gas Limited Company PetroChina) ("Cangzhou JV") and the Company has agreed to contribute 51% of the registered capital of Cangzhou JV by injecting RMB51 million;
- (7) The acquisition agreement dated 9 November 2010 between the Company and PetroChina, pursuant to which the Company has conditionally agreed to purchase, and PetroChina has conditionally agreed to sell, 75% equity interest in 中石油大連液化天然氣有限公司 (PetroChina Dalian LNG Company Ltd) at a consideration of RMB2,009 million;
- (8) Kunlun Energy (Liaoning) Company Limited was established in December 2010 and is wholly owned by the Company.

The acquisition agreement dated 31 December 2010 between the Company and PetroChina, pursuant to which PetroChina has conditionally agreed to sell and the Company has conditionally agreed to purchase 60% equity interest in PetroChina Beijing Gas Pipeline Co., Ltd. at a consideration of approximately RMB18,870.9 million.

EMPLOYEE

On 31 December 2010, the Group had approximately 8,773 staff (excluding the staff under entrustment contracts) (2009: 4,727 staff (restated)) globally. Remuneration package and benefits were determined in accordance with market terms, industry practice as well as the duties, performance, qualifications and experience of the staff. In addition, the Group set up a share option scheme, pursuant to which the directors and employees of the Company were granted options to subscribe shares of the Company.

MODEL CODE FOR SECURITIES TRANSACTIONS BY DIRECTORS

The Company has adopted written guidelines on terms no less exacting than the "Model Code" for Securities Transactions by Directors of Listed Issuers (the "Model Code") as set out in Appendix 10 to the Listing Rules as its code of conduct regarding directors' securities transaction.

Specific enquiry has been made of all the directors and the directors have confirmed that they have complied with the "Model Code" throughout the year ended 31 December 2010.

By order of the Board

Zhang Bowen

Chief Executive Officer

Hong Kong, 17 March 2011

Corporate Governance Report

The Board of Directors (the "Board") is pleased to present this Corporate Governance Report in the Company's annual report for the year ended 31 December 2010.

The Company recognises the importance of good corporate governance to the Company's healthy growth and has devoted considerable efforts to identifying and formulating corporate governance practices appropriate to the needs of its business.

The Company's corporate governance practices are based on the principles (the "Principles"), code provisions (the "Code Provisions") and certain recommended best practices (the "Recommended Best Practices") as set out in the Code on Corporate Governance Practices (the "CG Code") contained in Appendix 14 of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") (the "Listing Rules").

The Company has applied the Principles and the Code Provisions as set out in the CG Code and complied with all the Code Provisions.

The Company has also put in place certain Recommended Best Practices as set out in the CG Code.

The Company periodically reviews its corporate governance practices to ensure that these continue to meet the requirements of the CG Code, and acknowledges the important role of its Board in providing effective leadership and direction to Company's business, and in ensuring transparency and accountability of Company's operations.

The key corporate governance principles and practices of the Company are summarised as follows:

THE BOARD

Responsibilities

The overall management of the Company's business is vested in the Board, which assumes the responsibility for leadership and control of the Company and is collectively responsible for promoting the success of the Company by directing and supervising its affairs. All directors should take decisions objectively in the interests of the Company.

The Board takes responsibility for all major matters of the Company, including the approval and monitoring of all policy matters, overall strategies and budgets, internal control and risk management systems, material transactions (in particular those may involve conflict of interests), financial information, appointment of directors and other significant financial and operational matters.

All directors have full and timely access to all relevant information as well as the advice and services of the Company Secretary, with a view to ensuring that Board procedures and all applicable rules and regulations are followed.

Each director is normally able to seek independent professional advice in appropriate circumstances at the Company's expense, upon making request to the Board.

The day-to-day management, administration and operation of the Company are delegated to the Chief Executive Officer and the senior management. The delegated functions and work tasks are periodically reviewed. Approval has to be obtained from the Board prior to any significant transactions entered into by the abovementioned officers.

Corporate Governance Report

The Board has the full support of the Chief Executive Officer and the senior management to discharge its responsibilities.

When the Board delegates aspects of its management and administration functions to management, it has given clear directions as to the powers of management, in particular, with respect to the circumstances where management shall report back and obtain prior approval from the Board before making decisions or entering into any commitments on behalf of the Company.

The Company adopted written terms established in April 2007 on division of functions reserved to the Board and delegated to the management.

The Company has arranged for appropriate insurance cover for directors' and officers' liabilities in respect of legal actions against its directors and senior management arising out of corporate activities.

Composition

During the year, the Board composes of 3 Executive Directors and 3 Independent Non-executive Directors. It has the necessary balance of skills and experience appropriate to the requirements of the business of the Company. There is a strong element of independence in the Board, which can effectively exercise independent judgement.

The Board comprises the following six directors:

Executive Directors:

Mr Li Hualin (*Chairman*)

Mr Zhang Bowen (*Chief Executive Officer*)

Mr Cheng Cheng

Independent Non-Executive Directors:

Dr Lau Wah Sum (*Chairman of the Audit Committee and Member of the Remuneration Committee*)

Mr Li Kwok Sing Aubrey (*Chairman of the Remuneration Committee and Member of the Audit Committee*)

Dr Liu Xiao Feng (*Member of the Remuneration Committee and Audit Committee*)

The list of directors (by category) is also disclosed in all corporate communications issued by the Company pursuant to the Listing Rules from time to time.

None of the members of the Board is related to one another.

During the year ended 31 December 2010, the Board at all times met the requirements of the Listing Rules relating to the appointment of at least three Independent Non-executive Directors with at least one Independent Non-executive Director possessing appropriate professional qualifications, or accounting or related financial management expertise.

The Company has received written annual confirmation from each Independent Non-executive Director of his independence pursuant to the requirements of the Listing Rules. The Company considers all Independent Non-executive Directors to be independent in accordance with the independence guidelines set out in the Listing Rules.

Corporate Governance Report

The Independent Non-executive Directors bring a wide range of business and financial expertise, experiences and independent judgement to the Board. Through active participation in Board meetings, taking the lead in managing issues involving potential conflict of interests and serving on Board committees, all Independent Non-executive Directors make various contributions to the effective direction of the Company.

Appointment and Re-election of Directors

Code Provision A.4.1 stipulates that non-executive directors should be appointed for a specific term, subject to re-election.

Code Provision A.4.2 stipulates that all directors appointed to fill a casual vacancy should be subject to election by shareholders at the first general meeting after their appointment. Every director, including those appointed for a specific term, should be subject to retirement by rotation at least once every three years.

Pursuant to the Articles of Association of the Company which provide that every director appointed by the Board during the year shall retire at the next general meeting and every director (including those appointed for a specific term) shall be subject to retirement at least once every three years. Code Provisions A.4.1 and A.4.2 have been fully complied.

Though the Company has not set up a nomination committee, the Board as a whole is responsible for reviewing the Board composition, developing and formulating the relevant procedures for nomination and appointment of directors, monitoring the appointment and succession planning of directors and assessing the independence of Independent Non-executive Directors.

The Board reviewed its own structure, size and composition regularly to ensure that it has a balance of expertise, skills and experience appropriate to the requirements of the business of the Company.

Where vacancies on the Board exist, the Board will carry out the selection process by making reference to the skills, experience, professional knowledge, personal integrity and time commitments of the proposed candidates, the Company's needs and other relevant statutory requirements and regulations. An external recruitment agency may be engaged to carry out the recruitment and selection process when necessary.

In accordance with the Company's Bye-laws, Mr Cheng Cheng, Dr Lau Wah Sum and Mr Li Kwok Sing Aubrey shall retire by rotation and being eligible offer themselves for re-election at the forthcoming annual general meeting.

The Board recommended the re-appointment of the above directors standing for re-election at the forthcoming annual general meeting of the Company.

A circular containing detailed information of the directors standing for re-election at the forthcoming annual general meeting would be sent to the shareholders.

Corporate Governance Report

Training for Directors

Each newly appointed director receives comprehensive, formal and tailored induction on the first occasion of his appointment, so as to ensure that he has appropriate understanding of the business and operations of the Company and that he is fully aware of his responsibilities and obligations under the Listing Rules and relevant regulatory requirements.

There are also arrangements in place for providing continuing briefing and professional development to directors whenever necessary.

Board Meetings

Number of Meetings and Directors' Attendance

Regular Board meetings should be held at least four times a year at approximately quarterly intervals for reviewing and approving the financial and operating performance, and considering and approving the overall strategies and policies of the Company.

During the year ended 31 December 2010, eleven Board meetings, two Audit Committee meetings and one Remuneration Committee meeting were held.

The attendance record of each director at the meetings of the Board, the Audit Committee and the Remuneration Committee during the year ended 31 December 2010 is set out below:

Directors	Attendance/Number of Meetings		
	Board	Audit Committee	Remuneration Committee
<i>Executive Director:</i>			
Mr Li Hualin (<i>Chairman</i>)	11/11	–	–
Mr Zhang Bowen (<i>Chief Executive Officer</i>)	11/11	–	–
Mr Cheng Cheng	11/11	–	–
<i>Independent Non-Executive Director:</i>			
Dr Lau Wah Sum	11/11	2/2	1/1
Mr Li Kwok Sing Aubrey	11/11	2/2	1/1
Dr Liu Xiao Feng	11/11	2/2	1/1

Corporate Governance Report

Practices and Conduct of Meetings

Notices of regular Board meetings are served to all directors at least 14 days before the meetings and reasonable notice is generally given for other Board meetings. For committee meeting, notices are served in accordance with the required notice period stated in the relevant terms of reference.

Agenda and Board papers together with all appropriate, complete and reliable information are normally sent to all directors/committee members at least 3 days before each Board meeting or committee meeting to keep the directors abreast of the latest developments and financial position of the Company and to enable them to make informed decisions. The Board and each director also have separate and independent access to the senior management whenever necessary.

The Chief Financial Officer, Chief Executive Officer and Company Secretary will attend Board and committee meetings, when necessary, to advise on business developments, financial and accounting matters, statutory compliance, corporate governance and other major aspects of the Company.

Minutes of all Board meetings and committee meetings are kept by the Company Secretary. Minutes are prepared after each meeting and the final version is signed by the Chairman and confirmed by the Board in the following Board Meeting. The confirmed minutes are kept for future reference and directors' inspection.

According to current Board practice, any material transaction, which involves a conflict of interests for a substantial shareholder or a director, will be considered and dealt with by the Board at a duly convened Board meeting. The Company's Bye-laws also contain provisions requiring directors to abstain from voting and not to be counted in the quorum at meetings for approving transactions in which such directors or any of their associates have a material interest.

CHAIRMAN AND CHIEF EXECUTIVE OFFICER

Code Provision A.2.1 stipulates that the roles of Chairman and Chief Executive Officer should be separate and should not be performed by the same individual. The division of responsibilities between the Chairman and Chief Executive Officer should be clearly established and set out in writing.

The Company fully supports the division of responsibility between the Chairman of the Board and the Chief Executive Officer to ensure a balance of power and authority.

The positions of the Chairman and Chief Executive Officer of the Company are during the year held by Mr Li Hualin and Mr Zhang Bowen.

Corporate Governance Report

There are written terms on the general division of responsibilities between the Chairman and the Chief Executive Officer. The Chairman provides leadership and is responsible for the effective functioning of the Board in accordance with good corporate governance practice. With the support of the senior management, the Chairman is also responsible for ensuring that the directors receive adequate, complete and reliable information in a timely manner and appropriate briefing on issues arising at Board meetings. The Chief Executive Officer focuses on implementing objectives, policies and strategies approved and delegated by the Board. He is in charge of the Company's day-to-day management and operations. The Chief Executive Officer is also responsible for developing strategic plans and formulating the organisational structure, control systems and internal procedures and processes for the Board's approval.

BOARD COMMITTEES

The Board has established two committees, namely, the Audit Committee and the Remuneration Committee, for overseeing particular aspects of the Company's affairs. All Board committees of the Company are established with defined written terms of reference. The terms of reference of the Board committees are posted on the Company's website and are available to shareholders upon request.

The three Independent Non-executive Directors of the Company are the members of each of the Audit Committee and Remuneration Committee of the Company.

The Board committees are provided with sufficient resources to discharge their duties and, upon reasonable request, are able to seek independent professional advice in appropriate circumstances, at the Company's expenses.

REMUNERATION COMMITTEE

The primary objectives of the Remuneration Committee include making recommendations on and approving the remuneration policy and structure and remuneration packages of the Executive Directors and the senior management. The Remuneration Committee is also responsible for establishing transparent procedures for developing such remuneration policy and structure to ensure that no director or any of his associates will participate in deciding his own remuneration, which remuneration will be determined by reference to the performance of the individual and the Company as well as market practice and conditions.

The Remuneration Committee normally meets annually for reviewing the remuneration policy and structure and determination of the annual remuneration packages of the Executive Directors and the senior management and other related matters. The Company Secretary is responsible for collection and administration of the human resources data and making recommendations to the remuneration committee for consideration. The Remuneration Committee shall consult the Chairman and/or the Chief Executive Officer of the Company about these recommendations on remuneration policy and structure and remuneration packages.

The Remuneration Committee held one meeting during the year ended 31 December 2010 and reviewed the remuneration policy and structure of the Company and remuneration packages of the Executive Directors and the senior management for the year under review. An independent consultant on executive compensation was appointed to carry out review of the Company's executive compensation in May 2008.

Corporate Governance Report

AUDIT COMMITTEE

The Audit Committee comprises three Independent Non-executive Directors (including one Independent Non-executive Director who possesses the appropriate professional qualifications or accounting or related financial management expertise). None of the members of the Audit Committee is a former partner of the Company's existing independent auditor.

The main duties of the Audit Committee include the following:

- (a) To review the financial statements and reports and consider any significant or unusual items raised by independent auditor before submission to the Board.
- (b) To review the relationship with the independent auditor by reference to the work performed by the independent auditor, their fees and terms of engagement, and make recommendation to the Board on the appointment, re-appointment and removal of the independent auditor.
- (c) To review the adequacy and effectiveness of the Company's financial reporting system, internal control system and risk management system and associated procedures.

During the year ended 31 December 2010, the Audit Committee held two meetings, to review the financial results and reports, financial reporting and compliance procedures, the report on the Company's internal control and risk management review and processes and the re-appointment of the independent auditor.

The Company's annual results for the year ended 31 December 2010 has been reviewed by the Audit Committee.

There are no material uncertainties relating to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern.

There is no different view taken by the Audit Committee from the Board regarding the selection, appointment, resignation or dismissal of the independent auditor.

MODEL CODE FOR SECURITIES TRANSACTIONS

Code provision A.5.4 stipulates that directors must comply with their obligations under the Model Code for Securities Transactions by Directors of Listed Issuers (the "Model Code") set out in Appendix 10 and, in addition, the Board should establish written guidelines on no less exacting terms than the Model Code for relevant employees in respect of their dealings in the securities of the issuer.

The Company has adopted the Model Code as set out in Appendix 10 to the Listing Rules.

Specific enquiry has been made of all the directors and the directors have confirmed that they have complied with the Model Code throughout the year ended 31 December 2010.

The Company has also established written guidelines (the "Employees Written Guidelines") in respect of the dealings in the Company's securities by employees who are likely to be in possession of unpublished price-sensitive information of the Company.

Corporate Governance Report

RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS AND AUDITOR'S REMUNERATION

The Board is responsible for presenting a balanced, clear and understandable assessment of annual and interim reports, price-sensitive announcements and other disclosures required under the Listing Rules and other regulatory requirements.

The directors acknowledge their responsibility for preparing the financial statements of the Company for the year ended 31 December 2010.

The statement of the independent auditor of the Company about their reporting responsibilities on the financial statements is set out in the "Independent Auditor's Report" on pages 29 and 30.

The remuneration paid or payable to the independent auditor of the Company in respect of audit services and non-audit services for the year ended 31 December 2010 amounted to approximately HK\$6 million and approximately HK\$5 million (2009: HK\$5 million and HK\$2 million) respectively. The said non-audit services related to the interim review, the tax compliance services and the internal control review of the Company and its subsidiaries.

SHAREHOLDER RIGHTS AND INVESTOR RELATIONS

The rights of shareholders and the procedures for demanding a poll on resolutions at shareholders' meetings are contained in the Company's Bye-laws. Details of such rights to demand a poll and the poll procedures are included in all circulars to shareholders and will be explained during the proceedings of meetings. Whenever voting by way of a poll is required, the detailed procedures for conducting a poll will be explained.

Poll results will be posted on the website of the Stock Exchange and the Company on the business day following the shareholders meeting.

The general meetings of the Company provide an opportunity for communication between the shareholders and the Board. The Chairman of the Board as well as the Chairmen of the Remuneration Committee and Audit Committee or, in their absence, other members of the respective committees, and, where applicable, the independent Board committee, are available to answer questions at the shareholders' meetings.

Separate resolutions are proposed at shareholders meetings on each substantial issue, including the election of individual directors.

The Company continues to enhance communications and relationships with its investors. Designated senior management maintains regular dialogue with institutional investors and analysts to keep them abreast of the Company's developments. Enquiries from investors are dealt with in an informative and timely manner.

To promote effective communication, the Company also maintains two websites at <http://www.kunlun.com.hk> and <http://www.irasia.com/listco/hk/kunlun>, where extensive information and updates on the Company's business developments and operations, financial information, corporate governance practices and other information are posted.

Corporate Governance Report

INTERNAL CONTROLS

It is the responsibility of the Board to ensure that the Company maintains sound and effective internal controls to safeguard the shareholders investment and the Company's assets. The internal control system of the Company comprises a well-established organisational structure and comprehensive policies and standards.

The Board, through the Audit Committee, assesses annually the effectiveness of the Group's internal control system which covers all material controls, including financial, operational and compliance controls as well as risk management, the adequacy of resources, qualification and experiences of staff of the Company's accounting and financial functions, and their training programs and budget.

During the year, the external consulting firm of the Group reviewed the key processes of a number of management selected business units and provided recommendation on improvement of the internal control system of the Group. No major issue in relation to financial reporting has been identified.

Directors' Report

The directors are pleased to present their annual report and the audited consolidated financial statements for the year ended 31 December 2010.

PRINCIPAL ACTIVITIES

The Company acts as an investment holding company. The principal activities of its subsidiaries, associates and jointly controlled entities are the exploration and production of crude oil and natural gas in the People's Republic of China (the "PRC"), the Republic of Kazakhstan, the Sultanate of Oman, Peru, the Kingdom of Thailand, the Azerbaijan Republic and the Republic of Indonesia, and the sales of natural gas and transmission of nature gas in PRC.

RESULTS AND APPROPRIATIONS

The results of the Group for the year are set out in the consolidated statement of comprehensive income on page 31.

A final dividend for the year ended 31 December 2009 of HK7 cents per share amounting to approximately HK\$347 million was paid during the year. The directors recommend the payment of a final dividend of HK13.8 cents per share for the year ended 31 December 2010, totalling approximately HK\$684 million.

FIVE YEAR FINANCIAL SUMMARY

A summary of the results and of the assets and liabilities of the Group for the last five financial years is set out on page 113.

RESERVES

Movements in the reserves of the Group and of the Company during the year ended 31 December 2010 are set out in the consolidated statement of changes in equity on pages 36 and 37, and Note 31 to the consolidated financial statements respectively.

PROPERTY, PLANT AND EQUIPMENT

Details of the movements in property, plant and equipment of the Group and the Company during the year ended 31 December 2010 are set out in Note 18 to the consolidated financial statements.

SHARE CAPITAL

Details of the movements in share capital of the Company during the year ended 31 December 2010 are set out in Note 30 to the consolidated financial statements.

DISTRIBUTABLE RESERVES OF THE COMPANY

The Company's reserves available for distribution to shareholders as at 31 December 2010 and 2009 were as follows:

	2010 HK\$ million	2009 HK\$ million
Contributed surplus	134	134
Retained earnings	7,366	6,342
	7,500	6,476

Directors' Report

DISTRIBUTABLE RESERVES OF THE COMPANY (continued)

Under the Companies Act 1981 of Bermuda (as amended), the contributed surplus account of the Company is available for distribution. However, the Company cannot declare or pay a dividend, or make a distribution out of contributed surplus if:

- (a) it is, or would after the payment be, unable to pay its liabilities as they become due; or
- (b) the realisable value of its assets would thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts.

PRE-EMPTIVE RIGHTS

There are no provisions for pre-emptive rights under the Company's Bye-laws or the laws of Bermuda would oblige the Company to offer new shares on a pro-rata basis to existing shareholders.

PURCHASE, SALE OR REDEMPTION OF THE COMPANY'S LISTED SECURITIES

Neither the Company nor any of its subsidiaries has purchased, sold or redeemed any of the Company's shares during the year ended 31 December 2010.

DIRECTORS

The directors of the Company during the year and up to the date of this report are:

Executive Directors:

Mr Li Hualin

Mr Zhang Bowen

Mr Cheng Cheng

Independent Non-Executive Directors:

Dr Lau Wah Sum

Mr Li Kwok Sing Aubrey

Dr Liu Xiao Feng

In accordance with Article 97 of the Company's Bye-Laws, Mr Cheng Cheng, Dr Lau Wah Sum, Mr Li Kwok Sing Aubrey shall retire at the forthcoming annual general meeting and, being eligible, offer themselves for re-election.

None of the directors has a service contract with the Company which is not determinable by the Company within one year without payment of compensation, other than statutory compensation.

Directors' Report

BRIEF BIOGRAPHICAL DETAILS IN RESPECT OF DIRECTORS AND SENIOR MANAGEMENT

Directors

Mr Li Hualin (*Chairman*)

Age 48, after graduated from South West Petroleum University in 1983 with Bachelor's Degree in Oil and Gas Exploration and Prospecting Engineering, Mr Li joined China National Petroleum Corporation ("CNPC") in the same year. He was the Deputy Director of CNPC office at Houston in the U.S.A.; Chairman and General Manager of CNPC Canada Ltd in Canada and Deputy General Manager of China National Oil and Gas Exploration and Development Corporation ("CNODC"). In 2000, Mr Li was awarded the degree of Master of Business Administration from The University of Nebraska. He joined the Company as Executive Vice-Chairman and Managing Director in January 2001 and become the Chief Executive Officer in 2005. Mr Li was re-designated as the Chairman of the Company in January 2007. Mr Li was appointed by PetroChina Company Limited ("PetroChina") as Vice-President in November 2007, Company Secretary and authorised representative in June 2009.

Mr Zhang Bowen (*Chief Executive Officer*)

Aged 44, joined the Company on 1 January 2007. He holds a Bachelor degree from Xian Electronic Scientific University in computer science and a Master degree in petroleum geology from Daqing Petroleum University. Since he graduated, Mr Zhang joined CNODC, a subsidiary of CNPC. He has over 10 years of working experience in the oil and gas industry. Immediately before he joined the Company, he was the executive vice president of CNPC America Limited.

Mr Cheng Cheng (*Executive Director*)

Aged 43, was appointed as an Executive Director in June 2004. He is currently a Deputy General Manager of the Company. Before joining the Company, Mr Cheng has over 15 years industry experience working at various departments and sections of CNPC including 3 years in Canada as Vice President of CNPC International (Canada) Limited. Mr Cheng has a Master of Business Administration from the University of Calgary, Canada, a Master in Energy and Environment Economy from Scuola Superiore Enrico Mattei, Milan Italy and Diploma in Petroleum Technical Economy from Jiangnan Institute of Petroleum, the PRC.

Dr Lau Wah Sum, GBS, LLD, DBA, JP (*Independent Non-Executive Director*)

Aged 83, is a Fellow of the Chartered Institute of Management Accountants. He was the ex-Chairman of Urban Renewal Authority. He is currently the President of W S Lau & Associates Limited and Chairman of Equity Holdings Limited. He serves the community as Honorary Court Member of the University of Science and Technology of Hong Kong. He also sits on the board of Tian Teck Land Limited and Associated International Hotels Limited in Hong Kong. He joined the Company as an Independent Non-Executive Director in August 1994.

Mr Li Kwok Sing Aubrey (*Independent Non-Executive Director*)

Aged 61, was appointed as an Independent Non-Executive Director of the Company in 1998. He is chairman of MCL Partners Limited, a Hong Kong based financial advisory and investment firm, and has over 35 years' experience in merchant banking and commercial banking. He is a non-executive director of The Bank of East Asia, Limited, an independent non-executive director of Cafe de Coral Holdings Limited, China Everbright International Limited, Kowloon Development Company Limited, Pokfulam Development Company Limited and Tai Ping Carpets International Limited. He is also a non-executive director of Affin Bank Berhad, Atlantis Investment Management (Ireland) Limited, Dalton Capital (Guernsey) Limited, Melchior Global Macro Fund Limited and Melchior Global Macro (Master) Fund Limited. Within the past three years, he had been an independent non-executive director of ABC Communications (Holdings) Limited and non-executive chairman of Atlantis Asian Recovery Fund plc.. Mr Li has a Master of Business Administration from Columbia University and a Bachelor of Science in Civil Engineering from Brown University.

Directors' Report

BRIEF BIOGRAPHICAL DETAILS IN RESPECT OF DIRECTORS AND SENIOR MANAGEMENT (continued)

Directors (continued)

Dr Liu Xiao Feng (Independent Non-Executive Director)

Aged 48, was appointed as an Independent Non-Executive Director of the Company in 2004. He is currently a Managing Director at China Resources Capital Holdings Company Limited. He has worked in various international financial institutions since 1993, including N.M. Rothschild & Sons, JP Morgan, and DBS. He has many years of experience in corporate finance. Dr Liu has a Ph.D and Master degrees from the Faculty of Economics, University of Cambridge and a Bachelor of Economics from Sichuan Institute of Finance and Economics, China. Dr Liu is currently also an independent non-Executive director of Haier Electronics Group Co. Ltd and Honghua Group Limited, both of which are publicly listed companies on The Stock Exchange of Hong Kong Limited (the "Stock Exchange").

Senior Management

Mr Lau Hak Woon (Chief Financial Officer)

Aged 58, member of Hong Kong Institute of Certified Public Accountants in Hong Kong; fellow member of The Chartered Association of Certified Accountants in UK and Certified Management Accountant of the Society of Management Accountants of Ontario in Canada. Mr Lau has a Master of Business Administration from Newport University and more than 30 years' experience in accounting and financial management. He joined the Company in 1997. Before joining the Company, he was the Chief Financial Officer of several large companies in Hong Kong and overseas.

DIRECTORS' INTERESTS IN CONTRACTS

No contracts of significance in relation to the Group's business to which the Company, any of its fellow subsidiaries or its holding companies was a party and in which a director of the Company had a material interest, whether directly or indirectly, subsisted at the end of the year or at any time during the year.

DIRECTORS' INTERESTS

As at 31 December 2010, the interests or short positions of the directors and chief executive of the Company in the shares, underlying shares and debentures of the Company or any associated corporation (within the meaning of Part XV of the Commencement of the Securities and Futures Ordinance (the "SFO")) which (a) were required to be notified to the Company and the Stock Exchange pursuant to Divisions 7 and 8 of Part XV of the SFO (including interests or short positions which any such director and chief executive of the Company is taken or deemed to have under such provisions of the SFO); or which (b) were required, pursuant to section 352 of the SFO, to be entered into the register maintained by the Company; or which (c) were required, pursuant to the Model Code for Securities Transactions by Directors of Listed Issuers under the Listing Rules, to be notified to the Company and the Stock Exchange are set out below.

Ordinary Shares of HK\$0.01 Each of the Company

Name	Number of Shares	Capacity and Nature of Interests	Percentage of Issued Shares
Li Hualin (Note)	14,000,000	Beneficial owner	0.28%
Li Kwok Sing Aubrey (Note)	1,000,000	Beneficial owner	0.02%

Note:

The interests held by Mr. Li Hualin and Mr. Li Kwok Sing Aubrey represent long position in the Shares of the Company.

Directors' Report

DIRECTORS' INTERESTS (continued)

Share options are granted to directors and chief executives under the executive share option scheme approved by the Board of Directors on 3 June 2002. Details are set out in the section headed "Share Options" of this report.

Save as disclosed above, at no time during the year was the Company or any of its subsidiaries, its fellow subsidiaries and its holding companies a party to any arrangement to enable the directors and chief executives of the Company (including their spouses and children under 18 years of age) to hold any interests or short positions in the shares or underlying shares in, or debentures of, the Company or its associated corporations.

SHARE OPTIONS

Particulars of the share option schemes of the Company are set out in Note 30(b) to the consolidated financial statements.

The following table discloses the movements in the number of share options of the Company during the year ended 31 December 2010 which have been granted to the directors and employees of the Company:

Shares options were granted to the Directors, chief executives and employees of the Company under the executive share option scheme approved by the Board on 3 June 2002, details of which are set out below:

Name	Date of Grant	Exercise Period	Exercise Price HK\$	Number of Share Options			Outstanding at 31 December 2010 '000
				Outstanding at 1 January 2010 '000	Granted during the year '000	Exercised during the year '000	
Li Hualin	08/01/07	08/04/07 – 07/01/12	4.186	25,000	–	–	25,000
	26/05/08	26/08/08 – 25/05/13	4.240	3,200	–	–	3,200
	26/03/09	26/06/09 – 25/03/14	3.250	3,200	–	–	3,200
	26/03/10	26/06/10 – 25/03/15	10.320	–	3,200	–	3,200
Zhang Bowen	08/01/07	08/04/07 – 07/01/12	4.186	20,000	–	–	20,000
	26/05/08	26/08/08 – 25/05/13	4.240	2,400	–	–	2,400
	26/03/09	26/06/09 – 25/03/14	3.250	2,400	–	–	2,400
	26/03/10	26/06/10 – 25/03/15	10.320	–	2,400	–	2,400
Cheng Cheng	08/01/07	08/04/07 – 07/01/12	4.186	10,000	–	–	10,000
	26/05/08	26/08/08 – 25/05/13	4.240	1,500	–	–	1,500
	26/03/09	26/06/09 – 25/03/14	3.250	1,500	–	–	1,500
	26/03/10	26/06/10 – 25/03/15	10.320	–	1,500	–	1,500
Lau Wah Sum	26/03/10	26/06/10 – 25/03/15	10.320	–	400	–	400
Li Kwok Sing Aubrey	26/03/10	26/06/10 – 25/03/15	10.320	–	400	–	400
Liu Xiao Feng	26/03/10	26/06/10 – 25/03/15	10.320	–	400	–	400

Directors' Report

SHARE OPTIONS (continued)

Name	Date of Grant	Exercise Period	Exercise Price HK\$	Outstanding at 1 January 2010 '000	Number of Share Options		Outstanding at 31 December 2010 '000
					Granted during the year '000	Exercised during the year '000	
Employees	27/04/05	27/07/05 – 26/04/10	1.224	17,500	–	(17,500)	–
	08/01/07	08/04/07 – 07/01/12	4.186	25,000	–	–	25,000
	14/09/07	14/12/07 – 13/09/12	4.480	20,000	–	–	20,000
	26/05/08	26/08/08 – 25/05/13	4.240	7,000	–	–	7,000
	26/03/09	26/06/09 – 25/03/14	3.250	7,000	–	–	7,000
	26/03/10	26/06/10 – 25/03/15	10.320	–	7,000	–	7,000
				145,700	15,300	(17,500)	143,500

The closing prices of the Company's shares immediately before 26 March 2010, the date of grant of the options, was HK\$10.32.

The weighted average closing prices of the Company's shares immediately before the dates on which the share options were exercised was HK\$11.07.

SUBSTANTIAL SHAREHOLDERS' INTEREST IN SHARES

As at 31 December 2010, the register of substantial shareholders maintained under section 336 of the SFO, showed that the Company has been notified of the following interests, being 5% or more of the Company's issued share capital. These interests are in addition to those disclosed above in respect of the Directors and the chief executive of the Company.

Name	Number of Shares		Percentage of the total number of Shares in issue
	Direct Interest	Indirect Interest	
Sun World Limited ("Sun World") ⁽¹⁾	2,513,917,342(L)	–	50.75%
PetroChina Hong Kong (BVI) Ltd. ("PetroChina (BVI)") ⁽¹⁾	–	2,513,917,342(L)	50.75%
PetroChina Hong Kong Ltd. ("PetroChina Hong Kong") ⁽¹⁾	–	2,513,917,342(L)	50.75%
PetroChina Company Limited ("PetroChina") ⁽¹⁾	–	2,513,917,342(L)	50.75%
China National Oil and Gas Exploration and Development Corporation ("CNODC") ⁽²⁾	–	297,924,000(L)	6.01%
CNPC International Ltd. ("CNPCI") ⁽²⁾	–	297,924,000(L)	6.01%
Fairy King Investments Ltd.	297,924,000(L)	–	6.01%
CNPC ⁽¹⁾⁽²⁾	–	2,811,841,342(L)	56.76%

Notes:

⁽¹⁾ Sun World is a wholly-owned subsidiary of PetroChina (BVI), which in turn is wholly-owned by PetroChina Hong Kong. PetroChina Hong Kong is wholly owned by PetroChina, which is in turn owned as to 86.35% by CNPC. Accordingly, CNPC is deemed to have interest in the 2,513,917,342 shares held by Sun World. Mr. Li Hualin, the Chairman of the Company and Mr. Zhang Bowen, the Chief Executive Officer of the Company are also directors of Sun World, which is a substantial shareholder of the Company (within the meaning of Part XV of the SFO).

⁽²⁾ Fairy King Investments Ltd. is a wholly-owned subsidiary of CNPCI, which in turn is wholly owned by CNODC, which is in turn owned as to 100.00% by CNPC. Accordingly, CNPC is deemed to have interest in the 297,924,000 shares held by Fairy King Investments Ltd..

Directors' Report

SUBSTANTIAL SHAREHOLDERS' INTEREST IN SHARES (continued)

Save as disclosed above, as at 31 December 2010, the directors and the chief executive of the Company were not aware of any person (other than a director or chief executive of the Company) who had any interest or short position in the shares or underlying shares of the Company which would fall to be disclosed to the Company under Divisions 2 and 3 of Part XV of the SFO.

As at 31 December 2010, the directors and the chief executive of the Company were not aware of any person (other than a director or chief executive of the Company) who was, directly or indirectly, interested in 10% or more of the nominal value of any class of share capital carrying rights to vote in all circumstances at general meetings of any other member of the Group, or any options in respect of such capital.

CONVERTIBLE SECURITIES, OPTIONS, WARRANTS OR SIMILAR RIGHTS

Other than share options as set out in Note 30 to the consolidated financial statements, the Company had no outstanding convertible securities, options, warrants or other similar rights as at 31 December 2010 and there had been no other exercise of convertible securities, options, warrants or similar rights during the year.

APPOINTMENT OF INDEPENDENT NON-EXECUTIVE DIRECTORS

The Company has received, from each of the independent non-executive directors, an annual confirmation of his independence pursuant to Rule 3.13 of the Listing Rules. The Company considers all of the independent non-executive directors are independent.

CONNECTED TRANSACTIONS

(a) Continuing Connected Transactions

Certain related party transactions as disclosed in Note 37 to the consolidated financial statements constituted continuing connected transactions under the Listing Rules, which are required to be disclosed in accordance with Chapter 14A of the Listing Rules.

The aforesaid continuing connected transaction has been reviewed by independent non-executive directors of the Company. The independent non-executive directors confirmed that the aforesaid connected transactions were entered into (a) in the ordinary and usual course of business of the Group; (b) either on normal commercial terms or on terms no less favourable to the Group than terms available to or from independent third parties; and (c) in accordance with the relevant agreements governing them on terms that are fair and reasonable and in the interests of the shareholders of the Company as a whole.

In accordance with rule 14A.38 of the Listing Rules, the Board of Directors engaged the independent auditor of the Company to report on the Group's continuing connected transactions in accordance with Hong Kong Standard on Assurance Engagements 3000 "Assurance Engagements Other Than Audits or Reviews of Historical Financial Information" and with reference to Practice Note 740 "Auditor's Letter on Continuing Connected Transactions under the Hong Kong Listing Rules" issued by the Hong Kong Institute of Certified Public Accountants. The independent auditor of the Company has issued his unqualified letter containing his findings and conclusions in respect of the continuing connected transactions disclosed by the Group on page 97 of the Annual Report in accordance with Main Board Listing Rule 14A.38. A copy of the auditor's letter has been provided by the Company to The Stock Exchange of Hong Kong Limited.

(b) One-off Connected Transactions

PetroChina is the intermediate holding company of the Company and CNPC is the ultimate controlling shareholder of the Company and therefore transactions between the Group and PetroChina or CNPC constitute connected transactions of the Group under the Listing Rules.

Directors' Report

CONNECTED TRANSACTIONS (continued)

(b) One-off Connected Transactions (continued)

- (1) The acquisition agreement dated 17 May 2010 between the Company and PetroChina, pursuant to which the Company has conditionally agreed to purchase, and PetroChina has conditionally agreed to sell, 55% equity interest in 中石油江蘇液化天然氣有限公司 (PetroChina LNG Jiangsu Company Ltd), at a consideration of RMB500,206,200 in cash;
- (2) The acquisition and capital increase agreement dated 22 June 2010 among the Company, 四川石油管理局 (Sichuan Petroleum Management Bureau) ("Sichuan Bureau") and 四川華油集團有限責任公司 (Sichuan Huayou Group Co., Ltd.), pursuant to which (i) the Company has conditionally agreed to acquire, and Sichuan Huayou has conditionally agreed to sell 100% equity interest in 四川石中石油輸氣科技有限公司 (Sichuan Shizhong Petroleum and Gas Transmission Technology Co., Ltd.) ("Sichuan Shizhong") (change the name to 四川川港燃氣有限責任公司 (Sichuan Chuangang Gas Limited Company) ("Chuangang"), at a consideration of RMB6,683,900 payable in USD or other convertible foreign exchange; and (ii) the Company and Sichuan Bureau have conditionally agreed to increase the share capital of Sichuan Shizhong from RMB6,000,000 to RMB310,000,000 by way of: (a) capital injection by the Company in the total amount of RMB152,100,000, contributing in USD or other convertible foreign exchange in two stages; and (b) non-cash assets injection and/or cash injection by Sichuan Bureau equivalent to RMB151,900,000 to be injected into Sichuan Shizhong in two stages; the Company and Sichuan Bureau would own 51% and 49% of equity interest in Sichuan Shizhong upon completion, respectively. The supplemental agreement dated 26 November 2010 between the Company and Sichuan Bureau, pursuant to which Sichuan Bureau has agreed to conduct second stage non-cash assets injection and inject equity interest and assets in the total amount of RMB70,611,100 into Chuangang within two years from the date upon which Chuangang has converted into a wholly-foreign owned enterprise and obtained its first business registration licence;
- (3) The acquisition agreement dated 9 November 2010 between the Company and PetroChina, pursuant to which the Company has conditionally agreed to purchase, and PetroChina has conditionally agreed to sell, 75% equity interest in 中石油大連液化天然氣有限公司 (PetroChina Dalian LNG Company Ltd) at a consideration of RMB2,009 million;
- (4) The acquisition agreement dated 31 December 2010 between the Company and PetroChina, pursuant to which PetroChina has conditionally agreed to sell and the Company has conditionally agreed to purchase 60% equity interest in PetroChina Beijing Gas Pipeline Co., Ltd. at a consideration of approximately RMB18,870.9 million.

MANAGEMENT CONTRACTS

The Group has entered into certain entrustment contracts in relation to the management of the oil production under the Xinjiang Contract and the Leng Jiapu Contract. Details of those contracts are set out in Note 36 to the consolidated financial statements.

MAJOR CUSTOMERS AND SUPPLIERS

The percentage of the Group's purchases and sales attributable to major suppliers and customers are as follows:

Percentage of purchases attributable to the Group's largest supplier	30%
Percentage of purchases attributable to the Group's five largest suppliers	36%
Percentage of sales attributable to the Group's largest customer	48%
Percentage of sales attributable to the Group's five largest customers	68%

PetroChina, a listed subsidiary of CNPC, is the Group's largest supplier and customer.

Save for the above, none of the directors, their associates or any shareholders (which to the knowledge of the directors owns more than 5% of the Company's share capital) has an interest in the major suppliers or customers noted above.

Directors' Report

DONATIONS

During the year, the Group made charitable and other donations amounting to HK\$10,000.

EMOLUMENT POLICY

The emolument policy of the employees of the Group is set up by the Remuneration Committee on the basis of their merit, qualifications and competence.

The emoluments of the directors of the Company are decided by the Remuneration Committee, having regard to the Company's operating results, individual performance and comparable market statistics.

SUFFICIENCY OF PUBLIC FLOAT

Based on the information that is publicly available to the knowledge of the directors, it is confirmed that there is sufficient public float of more than 25% of the Company's issued shares during the year.

COMPETING BUSINESS

Save as disclosed below, as at 17 March 2011, none of the directors and their respective associates had any interest in a business which competes or may compete with the businesses of the Group (as would be required to be disclosed under Rule 8.10 of the Listing Rules if each of them were a controlling shareholder).

Name of director	Name of company	Nature of interest	Nature of competing business
Mr. Li Hualin	PetroChina	Vice-President, Company Secretary and authorised representative	Exploration, development and production and marketing of crude oil and natural gas

As the Board is independent of the board of the above entity, the Company has therefore been capable of carrying on its businesses independently of, and at arm's length from, the above business.

EVENTS AFTER THE DATE OF THE STATEMENT OF FINANCIAL POSITION

Details of events after the date of the statement of financial position are set out in Note 40 to the consolidated financial statements.

AUDITOR

Mr Deloitte Touche Tohmatsu were appointed as the auditor of the Company in 2006 upon the retirement of Mr PricewaterhouseCoopers, who acted as the auditor of the Company for the year ended 31 December 2005. Mr Deloitte Touche Tohmatsu has acted as the auditor of the Company for the years ended 31 December 2006 and 2007. During the year ended 31 December 2008, Mr PricewaterhouseCoopers were appointed as the auditor of the Company to fill the casual vacancy upon the resignation of Mr Deloitte Touche Tohmatsu.

The financial statements for the year ended 31 December 2010 have been audited by Mr PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment.

On behalf of the Board

Li Hualin

Chairman

Hong Kong, 17 March 2011

Independent Auditor's Report



羅兵咸永道會計師事務所

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TO THE SHAREHOLDERS OF KUNLUN ENERGY COMPANY LIMITED

(incorporated in Bermuda with limited liability)

We have audited the consolidated financial statements of Kunlun Energy Company Limited (the "Company") and its subsidiaries (together, the "Group") set out on pages 31 to 112, which comprise the consolidated and company statements of financial position as at 31 December 2010, and the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

DIRECTORS' RESPONSIBILITY FOR THE CONSOLIDATED FINANCIAL STATEMENTS

The directors of the Company are responsible for the preparation of the consolidated financial statements that give a true and fair view in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants and the disclosure requirements of the Hong Kong Companies Ordinance, and for such internal control as the directors determine is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

AUDITOR'S RESPONSIBILITY

Our responsibility is to express an opinion on these consolidated financial statements based on our audit and to report our opinion solely to you, as a body, in accordance with Section 90 of the Companies Act 1981 of Bermuda and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of consolidated financial statements that give a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Independent Auditor's Report



OPINION

In our opinion, the consolidated financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31 December 2010 and of the Group's profit and cash flows for the year then ended in accordance with Hong Kong Financial Reporting Standards and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

PricewaterhouseCoopers
Certified Public Accountants

Hong Kong, 17 March 2011

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2010

	Note	2010 HK\$'million	2009 HK\$'million (Note 39(a))
Revenue	6	9,068	6,164
Other gains, net	7	206	40
Interest income	8	69	40
Purchases, services and others		(4,266)	(3,075)
Employee compensation costs	9	(685)	(387)
Exploration expenses, including exploratory dry holes		(53)	(32)
Depreciation, depletion and amortisation		(907)	(565)
Selling, general and administrative expenses		(757)	(525)
Taxes other than income taxes	10	(356)	(137)
Other (expense)/income		(15)	64
Interest expenses	11	(167)	(135)
Share of profits less losses of:			
– Associates		2,030	256
– Jointly controlled entities		226	252
Profit before income tax expense	12	4,393	1,960
Income tax expense	14	(1,015)	(420)
Profit for the year		3,378	1,540
Other comprehensive income/(loss):			
Currency translation differences		273	(922)
Fair value gain on available-for-sale financial assets		9	33
Other comprehensive income/(loss)		282	(889)
Total comprehensive income for the year		3,660	651

Consolidated Statement of Comprehensive Income

For the year ended 31 December 2010

	<i>Note</i>	2010 HK\$'million	2009 HK\$'million (Note 39(a))
Profit for the year attributable to:			
– Owners of the Company	15	2,426	1,234
– Non-controlling interest		952	306
		3,378	1,540
Total comprehensive income for the year attributable to:			
– Owners of the Company		2,662	735
– Non-controlling interest		998	(84)
		3,660	651
Earnings per share for profit attributable to owners of the Company	16		
– Basic (HK cents)		49.02	27.46
– Diluted (HK cents)		48.22	27.06

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Financial Position

As at 31 December 2010

	Note	2010 HK\$'million	2009 HK\$'million (Note 39(a))
Assets			
Non-current assets			
Property, plant and equipment	18	13,697	8,691
Advanced operating lease payments	19	311	109
Investments in jointly controlled entities	20	1,497	1,113
Investments in associates	21	5,628	5,231
Available-for-sale financial assets	22	129	105
Intangibles and other non-current assets	24	701	218
Deferred tax assets	34	25	79
		21,988	15,546
Current assets			
Inventories	25	50	44
Accounts receivable	26	467	268
Prepaid expenses and other current assets	27	1,584	534
Time deposits with maturities over three months	28	-	31
Cash and cash equivalents	28	8,137	7,597
		10,238	8,474
Assets held for sale	29	-	644
		10,238	9,118
Total assets		32,226	24,664

Consolidated Statement of Financial Position

As at 31 December 2010

	Note	2010 HK\$'million	2009 HK\$'million (Note 39(a))
Equity			
Capital and reserves attributable to owners of the Company			
Share capital	30	50	49
Retained earnings		12,923	10,884
Reserves	31	3,212	3,838
		16,185	14,771
Non-controlling interest		4,853	2,670
		21,038	17,441
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	32	3,094	2,675
Income tax payable		104	88
Other tax payable		154	128
Short-term borrowings	33	4,328	1,564
		7,680	4,455
Non-current liabilities			
Long-term borrowings	33	2,478	1,794
Deferred tax liabilities	34	1,021	967
Other long-term obligations		9	7
		3,508	2,768
Total liabilities		11,188	7,223
Total equity and liabilities		32,226	24,664
Net current assets		2,558	4,663
Total assets less current liabilities		24,546	20,209

Li Hualin
Chairman

Zhang Bowen
Chief Executive Officer

The accompanying notes are an integral part of these consolidated financial statements.

Statement of Financial Position

As at 31 December 2010

	Note	2010 HK\$' million	2009 HK\$' million
Assets			
Non-current assets			
Property, plant and equipment	18	1	–
Investments in jointly controlled entities	20	312	321
Investments in associates	21	788	786
Investments in subsidiaries	23	7,197	1,418
Intangibles and other non-current assets	24	58	90
		8,356	2,615
Current assets			
Prepaid expenses and other current assets	27	3,811	4,099
Cash and cash equivalents	28	265	3,985
		4,076	8,084
Total assets		12,432	10,699
Equity			
Capital and reserves attributable to owners of the Company			
Share capital	30	50	49
Retained earnings		7,366	6,342
Reserves	31	4,306	4,242
		11,722	10,633
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities	32	710	66
Total liabilities		710	66
Total equity and liabilities		12,432	10,699
Net current assets		3,366	8,018
Total assets less current liabilities		11,722	10,633

Li Hualin
Chairman

Zhang Bowen
Chief Executive Officer

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Changes In Equity

For the year ended 31 December 2010

	Note	Attributable to owners of the Company			Non-controlling interest	Total equity	
		Share capital	Retained earnings	Reserves			Sub-total
		HK\$'million	HK\$'million	HK\$'million	HK\$'million	HK\$'million	
Balances at 31 December 2008		44	10,420	386	10,850	2,339	13,189
Business combinations under common control	39(a)	-	(26)	-	(26)	458	432
Balances at 1 January 2009		44	10,394	386	10,824	2,797	13,621
Total comprehensive income/(loss) for the year		-	1,234	(499)	735	(84)	651
Transfer between reserves		-	(75)	75	-	-	-
Final dividend for 2008	17	-	(669)	-	(669)	-	(669)
Recognition of equity settled share-based payments	31	-	-	14	14	-	14
Issue of shares upon placement	30, 31	5	-	3,717	3,722	-	3,722
Exercise of share options	30, 31	-	-	51	51	-	51
Share issue expenses	31	-	-	(79)	(79)	-	(79)
Acquisition of 2009 Natural Gas Projects		-	-	(379)	(379)	-	(379)
Acquisition of 2010 Natural Gas Projects		-	-	558	558	-	558
Dividends to non-controlling interest		-	-	-	-	(39)	(39)
Purchase of non-controlling interest	39(e)	-	-	(6)	(6)	(69)	(75)
Capital contributions from non-controlling interest		-	-	-	-	65	65
Balances at 31 December 2009		49	10,884	3,838	14,771	2,670	17,441

Consolidated Statement of Changes In Equity

For the year ended 31 December 2010

	Note	Attributable to owners of the Company				Non-controlling interest	Total equity
		Share capital	Retained earnings	Reserves	Sub-total		
		HK\$'million	HK\$'million	HK\$'million	HK\$'million		
Balances at 31 December 2009		49	10,881	3,281	14,211	2,165	16,376
Business combinations under common control	39(a)	-	3	557	560	505	1,065
Balances at 1 January 2010		49	10,884	3,838	14,771	2,670	17,441
Total comprehensive income for the year		-	2,426	236	2,662	998	3,660
Transfer between reserves		-	(40)	40	-	-	-
Final dividend for 2009	17	-	(347)	-	(347)	-	(347)
Recognition of equity settled share-based payments	31	-	-	43	43	-	43
Exercise of share options	30, 31	1	-	21	22	-	22
Acquisition of 2010 Natural Gas Projects		-	-	(858)	(858)	-	(858)
Acquisition of subsidiaries	39(c)	-	-	-	-	52	52
Dividends to non-controlling interest		-	-	-	-	(526)	(526)
Purchase of non-controlling interest	39(e)	-	-	(108)	(108)	(239)	(347)
Capital contributions from non-controlling interest		-	-	-	-	1,898	1,898
Balances at 31 December 2010		50	12,923	3,212	16,185	4,853	21,038

The accompanying notes are an integral part of these consolidated financial statements.

Consolidated Statement of Cash Flows

For the year ended 31 December 2010

	2010 HK\$'million	2009 HK\$'million (Note 39(a))
Cash flows from operating activities		
Profit for the year	3,378	1,540
Adjustments for:		
Income tax expense	1,015	420
Depreciation, depletion and amortisation	907	565
Share of profits less losses of associates	(2,030)	(256)
Share of profits less losses of jointly controlled entities	(226)	(252)
Reversal of provision for loans to and amounts due from jointly controlled entities	–	(70)
Employee share-based payment expense	43	14
Dividend income from available-for-sale financial assets	–	(1)
Loss on disposal of property, plant and equipment	1	9
Gain on disposal of assets held for sale	(52)	–
Net exchange gains	(104)	(15)
Interest income	(69)	(40)
Interest expense	167	135
Changes in working capital:		
Accounts receivable and prepaid expenses and other current assets	(434)	(8)
Inventories	(6)	106
Accounts payable and accrued liabilities	(128)	806
Cash generated from operations	2,462	2,953
Income tax paid	(759)	(216)
Net cash generated from operating activities	1,703	2,737

Consolidated Statement of Cash Flows

For the year ended 31 December 2010

	2010 HK\$'million	2009 HK\$'million (Note 39(a))
Cash flows from investing activities		
Dividends received from associates	1,671	14
Dividends received from jointly controlled entities	–	94
Dividends received from available-for-sale financial assets	1	1
Acquisitions of subsidiaries and a plant engaging in LNG business	(256)	(491)
Acquisitions of associates	(26)	(704)
Capital contributions to associates	(26)	(82)
Capital contributions to jointly controlled entities	(181)	(40)
Acquisitions of available-for-sale financial assets	(6)	(13)
Prepayments for acquisition of a subsidiary	(41)	(89)
Purchase of non-controlling interest	(347)	(75)
Loans to non-controlling interest	(532)	–
Proceeds from disposal of available-for-sale financial assets	1	17
Proceeds from disposal of property, plant and equipment	127	167
Receipt in advance on disposal of assets held for sale	–	664
Capital expenditure	(5,705)	(4,314)
Interest received	69	40
Decrease in deposits with maturities more than three months	31	446
Proceeds from disposal of assets held for sale	74	–
Net cash used in investing activities	(5,146)	(4,365)
Cash flows from financing activities		
Capital contributions from non-controlling interest	1,898	65
Capital contributions from former owner of 2010 Natural Gas Projects	–	496
Dividends paid to owners of the Company	(347)	(669)
Dividends paid to non-controlling interest	(552)	(39)
Increase in other long-term obligations	2	7
Issue of shares, net of share issue expenses	22	3,694
Increase in borrowings	4,488	3,219
Repayments of borrowings	(1,212)	(2,133)
Interest paid	(332)	(179)
Net cash generated from financing activities	3,967	4,461
Increase in cash and cash equivalents	524	2,833
Cash and cash equivalents at 1 January	7,597	4,751
Effect of foreign exchange rate changes	16	13
Cash and cash equivalents at 31 December	8,137	7,597

The accompanying notes are an integral part of these consolidated financial statements.

Notes to The Consolidated Financial Statements

1 GENERAL INFORMATION

Kunlun Energy Company Limited (the "Company") is incorporated in Bermuda as an exempted company with limited liability and its shares are listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange"). Its ultimate holding company is China National Petroleum Corporation ("CNPC") which is a company established in the People's Republic of China (the "PRC"). The immediate holding company of the Company is Sun World Limited ("Sun World"), which is a company incorporated in the British Virgin Islands. On 27 August 2008, PetroChina Company Limited ("PetroChina"), a subsidiary of CNPC, entered into a sale and purchase agreement with CNPC to acquire 100% equity interest in Sun World. On 18 December 2008, the transaction was completed. Since then, PetroChina became an intermediate holding company of the Company. As at 31 December 2010, PetroChina indirectly owned 50.75% equity interest in the Company.

The address of the Company's principal office and registered office are 39/F, 118 Connaught Road West, Hong Kong and Clarendon House, Church Street, Hamilton HM11, Bermuda, respectively.

The Company acts as an investment holding company. The principal activities of its subsidiaries, associates and jointly controlled entities are the exploration and production of crude oil and natural gas in the PRC, the Republic of Kazakhstan ("Kazakhstan"), the Sultanate of Oman ("Oman"), Peru, the Kingdom of Thailand ("Thailand"), the Azerbaijan Republic ("Azerbaijan") and the Republic of Indonesia ("Indonesia"), and the sale and transmission of natural gas in the PRC.

The Group currently has three production sharing arrangements in the PRC and Azerbaijan. On 1 July 1996, the Group entered into an oil production sharing contract (the "Xinjiang Contract") to develop and produce crude oil in Xinjiang Uygur Autonomous Region, the PRC. On 30 December 1997, the Group entered into another oil production sharing contract (the "Leng Jiapu Contract") to develop and produce crude oil in Liaohe, Liaoning Province, the PRC. In 2002, the Group acquired the third production sharing arrangement ("K&K Contract") to develop and produce crude oil in Azerbaijan. Further details in relation to these contracts and the Group's share of results and net assets in these arrangements are shown in Note 36.

The oil operations in the PRC and Azerbaijan are conducted through production sharing arrangements with PetroChina and a third party, whereby the Group is entitled to a fixed percentage of assets, liabilities, income and expenses in accordance with the respective oil production sharing contracts entered into with PetroChina and the third party.

2 BASIS OF PREPARATION

The consolidated financial statements have been prepared in accordance with the Hong Kong Financial Reporting Standards ("HKFRS") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"). They have been prepared under the historical cost convention except as disclosed in the accounting policies below.

The preparation of financial statements in conformity with HKFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 5.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

(a) Basis of consolidation

Subsidiaries are those entities in which the Group has an interest of more than one half of the voting rights or otherwise has power to govern the financial and operating policies.

A subsidiary is consolidated from the date on which control is transferred to the Group and is no longer consolidated from the date that control ceases. The acquisition method of accounting is used to account for the acquisition of subsidiaries except for business combinations under common control. The consideration transferred for the acquisition of a subsidiary is the fair values of the assets transferred, the liabilities incurred and the equity interests issued by the Group. The consideration transferred includes the fair value of any asset or liability resulting from a contingent consideration arrangement. Acquisition-related costs are expensed as incurred. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. On an acquisition-by-acquisition basis, the Group recognises any non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets.

Investments in subsidiaries are accounted for at cost less impairment. Cost is adjusted to reflect changes in consideration arising from contingent consideration amendments. Cost also includes direct attributable costs of investment.

The excess of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of any previous equity interest in the acquiree over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If this is less than the fair value of the net assets of the subsidiary acquired in the case of a bargain purchase, the difference is recognised directly in the consolidated profit or loss.

An acquisition of a business which is a business combination under common control is accounted for in a manner similar to an uniting of interests whereby the assets and liabilities acquired are accounted for at carryover predecessor values to the other party to the business combination with all periods presented as if the operations of the Group and the business acquired have always been combined. The difference between the consideration paid by the Group and the net assets or liabilities of the business acquired is adjusted against equity.

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated. Where necessary, accounting policies of subsidiaries have been changed to ensure consistency with the policies adopted by the Group.

For purposes of the presentation of the Company's statement of financial position, investments in subsidiaries are accounted for at cost less impairment.

A listing of the Group's principal subsidiaries is set out in Note 42.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(b) Investments in associates

Associates are entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for using the equity method of accounting in the consolidated financial statements and are initially recognised at cost.

Under this method of accounting the Group's share of the post-acquisition profits or losses of associates is recognised in the consolidated profit or loss and its share of post-acquisition movements in other comprehensive income is recognised in other comprehensive income. The cumulative post-acquisition movements are adjusted against the carrying amounts of the investments. When the Group's share of losses in an associate equals or exceeds its investment in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates; unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. The Group's investments in associates includes goodwill identified on acquisition, net of any accumulated loss and is tested for impairment as part of the overall balance. Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired associate at the date of acquisition. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

For purpose of the presentation of the Company's statement of financial position, investments in associates are accounted for at cost less impairment.

A listing of the Group's principal associates is shown in Note 43.

(c) Investments in jointly controlled entities

Jointly controlled entities are those entities over which the Group has contractual arrangements to jointly share control with one or more parties. The Group's investments in jointly controlled entities are accounted for using the equity method of accounting (Note 3(b)) in the consolidated financial statements.

For purpose of the presentation of the Company's statement of financial position, investments in jointly controlled entities are accounted for at cost less impairment.

A listing of the Group's principal jointly controlled entities is shown in Note 44.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(d) Accounting for production sharing contracts

Production sharing contracts constitute jointly controlled operations. The Group's interests in production sharing contracts are accounted for in the consolidated financial statements on the following bases:

- (i) the assets that the Group controls and the liabilities that the Group incurs; and
- (ii) the share of expenses that the Group incurs and its share of income from the production according to the terms stipulated in these contracts.

(e) Transactions with non-controlling interest

Transactions with non-controlling interest are treated as transactions with owners in their capacity as owners of the Group. Gains and losses resulting from disposals to non-controlling interest are recorded in equity. The differences between any consideration paid and the relevant share of the carrying value of net assets of the subsidiary acquired resulting from the purchase from non-controlling interest, are recorded in equity.

When the Group ceases to have control or significant influence, any retained interest in the equity is remeasured to its fair value, with the change in carrying amount recognised in profit or loss. The fair value is the initial carrying amount for the purposes of subsequently accounting for the retained interest as an associate, joint venture or financial asset. In addition, any amounts previously recognised in other comprehensive income in respect of that entity are accounted for as if the Group had directly disposed of the related assets or liabilities. This may mean that amounts previously recognised in other comprehensive income are reclassified to profit or loss.

If the ownership interest in an associate is reduced but significant influence is retained, only a proportionate share of the amounts previously recognised in other comprehensive income are reclassified to profit or loss where appropriate.

(f) Foreign currencies

(i) *Functional and presentation currency*

Items included in the financial statements of each entity in the Group are measured using the currency of the primary economic environment in which the entity operates ("the functional currency"). The consolidated financial statements are presented in Hong Kong dollar, which is the Group's presentation currency. The Company's functional currency is US dollar.

(ii) *Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or valuation where items are remeasured. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated profit or loss.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(f) Foreign currencies (continued)

(ii) Transactions and balances (continued)

Foreign exchange gains and losses that relate to borrowings and cash and cash equivalents are presented in the consolidated statement of comprehensive income within "interest expenses". All other foreign exchange gains and losses are presented in the consolidated statement of comprehensive income within "other gains, net".

Changes in the fair value of monetary securities denominated in foreign currency classified as available-for-sale are analysed between translation differences resulting from changes in the amortised cost of the security, and other changes in the carrying amount of the security. Translation differences related to changes in the amortised cost are recognised in consolidated profit or loss, and other changes in the carrying amount are recognised in other comprehensive income.

Translation difference on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in profit or loss as part of the fair value gain or loss. Translation differences on non-monetary financial assets such as equities classified as available-for-sale are included in the available-for-sale reserve in other comprehensive income.

(iii) Group entities

The results and financial position of all the Group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position;
- income and expenses for each statement of comprehensive income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and
- all resulting exchange differences are recognised in other comprehensive income.

On consolidation, exchange differences arising from the translation of the net investment in foreign operations, and of borrowings and other currency instruments designed as hedges of such investments, are taken to other comprehensive income. When a foreign operation is partially disposed of or sold, exchange differences that were recorded in equity are recognised in the consolidated profit or loss as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(g) Property, plant and equipment

Property, plant and equipment, including oil and gas properties (Note 3(h)), are recorded at cost less accumulated depreciation, depletion and amortisation. Cost represents the purchase price of the asset and other costs incurred to bring the asset into existing use.

Depreciation, to write off the cost of each asset, other than oil and gas properties (Note 3(h)), to their residual values over their estimated useful lives is calculated using the straight-line method.

The Group uses the following useful lives for depreciation purposes:

Buildings	40 years or over the remaining period of respective leases whichever is the shorter
Equipment and machinery	4-30 years
Motor vehicles	4-14 years
Others	5-12 years

No depreciation is provided for construction in progress until they are completed and ready for use.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each statement of financial position date.

Property, plant and equipment, including oil and gas properties (Note 3(h)), are reviewed for possible impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the carrying amount of a cash generating unit exceeds the higher of its fair value less costs to sell and its value in use, which is the estimated net present value of future cash flows to be derived from the cash generating unit.

Gains and losses on disposals of property, plant and equipment are determined by reference to their carrying amounts and are recorded in the consolidated profit or loss.

Interest and other costs on borrowings to finance the construction of property, plant and equipment are capitalised during the period of time that is required to complete and prepare the asset for its intended use. Costs for repair and maintenance activities are expensed as incurred except for costs of components that result in improvements or betterments which are capitalised as part of property, plant and equipment and depreciated over their useful lives.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(h) Oil and gas properties

The successful efforts method of accounting is used for oil and gas exploration and production activities. Under this method, all costs for development wells, support equipment and facilities, and proved mineral interests in oil and gas properties are capitalised. Geological and geophysical costs are expensed when incurred. Costs of exploratory wells are capitalised as construction in progress pending determination of whether the wells find proved oil and gas reserves. Proved oil and gas reserves are the estimated quantities of crude oil and natural gas which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future conditions. Exploratory wells in areas not requiring major capital expenditure are evaluated for economic viability within one year of completion of drilling. The related well costs are expensed as dry holes if it is determined that such economic viability is not attained. Otherwise, the related well costs are reclassified to oil and gas properties and subject to impairment review (Note 3(g)). For exploratory wells that are found to have economically viable reserves in areas where major capital expenditure will be required before production can commence, the related well costs remain capitalised only if additional drilling is underway or firmly planned. Otherwise the related well costs are expensed as dry holes. The Group does not have any significant costs of unproved properties capitalised in oil and gas properties.

The Ministry of Land and Resources in China issues production licenses to applicants on the basis of the reserve reports approved by relevant authorities.

The cost of oil and gas properties is amortised at the field level based on the unit of production method. Unit of production rates are based on oil and gas reserves estimated to be recoverable from existing facilities based on the current terms of the Group's production licenses. The Group's oil and gas reserves estimates include only crude oil and condensate and natural gas which management believes can be reasonably produced within the current terms of these production licenses.

(i) Intangible assets

(i) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary, associate and jointly controlled entity at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in "intangible assets" whereas goodwill on acquisitions of associates and jointly controlled entities is included in the investments in associates and jointly controlled entities respectively, and is tested for impairment as part of the overall balance. Separately recognised goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses on goodwill are not reversed. Gains or losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(i) Intangible assets (continued)

(i) Goodwill (continued)

Goodwill is allocated to cash-generating units for the purpose of impairment test. The allocation is made to those cash-generating units or groups of cash-generating units that are expected to benefit from the business combination in which the goodwill arose identified according to operating segment.

(ii) Other intangible assets

Expenditure on acquired patents, trademarks, technical know-how and licenses are capitalised at historical cost and amortised using straight line method over their estimated useful lives. Intangible assets are not subsequently revalued. The carrying amount of each intangible asset is reviewed annually and adjusted for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount and is recognised in the consolidated profit or loss. The recoverable amount is measured as the higher of fair value less costs to sell and value in use which is the estimated net present value of future cash flows to be derived from the assets.

(j) Financial assets

Financial assets are classified into the following categories: financial assets at fair value through profit or loss, held-to-maturity investments, loans and receivables and available-for-sale financial assets. The classification depends on the purpose for which the financial assets were acquired. Management determines the classification of its financial assets at initial recognition. The Group has only loans and receivables and available-for-sale financial assets. The detailed accounting policies for loans and receivables and available-for-sale financial assets held by the Group are set out below.

(i) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are included in current assets, except for maturities greater than 12 months after the statement of financial position date which are classified as non-current assets. The Group's loans and receivables comprise accounts receivable, other deposits and cash and cash equivalents. The recognition methods for loans and receivables are disclosed in the respective policy notes.

(ii) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories; these are included in non-current assets unless management intends to dispose of the investment within 12 months of the statement of financial position date. The Group's available-for-sale financial assets primarily comprise quoted equity instruments.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(j) Financial assets (continued)

(ii) *Available-for-sale financial assets (continued)*

Regular purchases and sales of available-for-sale financial assets are recognised on settlement date, the date that the asset is delivered to or by the Group (the effective acquisition or sale date). Available-for-sale financial assets are initially recognised at fair value plus transaction costs. Available-for-sale financial assets are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership in the investment. Available-for-sale financial assets are measured at fair value except where there are no quoted market prices in active markets and the fair values cannot be reliably measured using valuation techniques. Available-for-sale financial assets that do not have quoted market prices in active markets and whose fair value cannot be reliably measured are carried at cost. The Group assesses at each of the statement of financial position whether there is objective evidence that an available-for-sale financial asset is impaired. The amount of the impairment loss is measured as the difference between the carrying amount of the available-for-sale financial asset and the present value of the estimated cash flows.

(k) Leases

Leases of property, plant and equipment where the Group assumes substantially all the benefits and risks of ownership are classified as finance leases. The Group has no significant finance leases.

Leases of assets under which a significant portion of the risks and benefits of ownership are effectively retained by the lessors are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessors) are expensed on a straight-line basis over the lease terms. Payments made to the PRC's land authorities to secure land use rights are treated as operating leases. Land use rights are generally obtained through advance lump-sum payments and the terms of use range up to 50 years.

(l) Inventories

Inventories include crude oil and marina club debentures and wet berths held for sales which are stated at the lower of cost and net realisable value. Cost of crude oil is primarily determined by the weighted average cost method, comprises raw materials, direct labour, other direct costs and related production overheads, but excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(m) Accounts receivable

Accounts receivable are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision made for impairment of these receivables. Such provision for impairment of accounts receivable is established if there is objective evidence that the Group will not be able to collect amounts due according to the original terms of the receivables. The factors the Group considers when assessing whether an account receivable is impaired include but not limited to significant financial difficulties of the customer, probability that the debtor will enter bankruptcy or financial reorganisation and default or delinquency in payments. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

(n) Cash and cash equivalents

Cash and cash equivalents comprise cash in hand, deposits held with banks and highly liquid investments with original maturities of three months or less from the time of purchase.

(o) Accounts payable

Accounts payable are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method.

(p) Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. In subsequent periods, borrowings are stated at amortised cost using the effective yield method. Any difference between proceeds (net of transaction costs) and the redemption value is recognised in the consolidated profit or loss over the period of the borrowings.

Borrowing costs are recognised as an expense in the period in which they are incurred except for the portion eligible for capitalisation as part of qualifying property, plant and equipment.

Borrowings are classified as current liabilities unless the Group has unconditional rights to defer settlements of the liabilities for at least 12 months after the reporting period.

(q) Taxation

The income tax expense for the period comprises current and deferred tax. Tax is recognised in the consolidated statement of comprehensive income, except to the extent that it relates to items recognised directly in equity. In this case, the tax is also recognised in equity.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(q) Taxation (continued)

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the statement of financial position date in the countries where the Group, associates and jointly controlled entities operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation. It establishes provisions where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax is recognised, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, the deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, associates and jointly controlled entities except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

The Group also incurs various other taxes and levies that are not income taxes. "Taxes other than income taxes", which form part of operating expenses, primarily comprise a special levy on domestic sales of crude oil (Note 10), resource tax, urban construction tax, education surcharges and business tax.

(r) Revenue recognition

Sales are recognised upon delivery of products and customer acceptance or performance of services, net of sales taxes and discounts. Revenue is recognised only when the Group has transferred to the buyers significant risks and rewards of ownership of the goods in the ordinary course of the Group's activities, and when the amount of revenue and the costs incurred or to be incurred in respect of the transaction can be measured reliably and collectability of the related receivables is reasonably assured.

(s) Provisions

Provisions for environmental restoration, restructuring costs and legal claims are recognised when: the Group has a present legal or constructive obligation as a result of past events; it is probable that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Restructuring provisions comprise lease termination penalties and employee termination payments. Provisions are not recognised for future operating losses.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(s) Provisions (continued)

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. The increase in the provision due to passage of time is recognised as interest expense.

(t) Retirement benefit plans

The Group contributes to various employee retirement benefit plans organised by PRC municipal and provincial governments under which it is required to make monthly contributions to these plans at prescribed rates for its employees in the PRC. The relevant PRC municipal and provincial governments undertake to assume the retirement benefit obligations of existing and future retired employees of the Group in the PRC. The Group has similar retirement benefit plans for its employees in its overseas operations. Contributions to these PRC and overseas plans are charged to expense as incurred.

The Group currently has no additional material obligations outstanding for the payment of retirement and other post retirement benefits of employees in the PRC or overseas other than the monthly contributions described above.

(u) Share-based compensation

The Group operates an equity-settled, share-based compensation plan, under which the entity receives services from employees as consideration for equity instruments (options) of the Group. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense. The total amount to be expensed is determined by reference to the fair value of the options granted, excluding the impact of any non-market service and performance vesting conditions (for example, profitability, sales growth targets and remaining an employee of the entity over a specified time period). Non-market vesting conditions are included in assumptions about the number of options that are expected to vest. The total amount expensed is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. At each statement of financial position date, the entity revises its estimates of the number of options that are expected to vest based on the non-marketing vesting conditions. It recognises the impact of the revision of original estimates, if any, in the consolidated profit or loss with a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(v) Profit-sharing and bonus plans

The Group recognises a liability and an expense for bonuses and profit-sharing, based on a formula that takes into consideration the profit attributable to owners of the Company after certain adjustments. The Group recognises a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

(w) Non-current assets (or disposal groups) held for sale

Non-current assets (or disposal groups) are classified as assets held for sale when their carrying amount is to be recovered principally through a sale transaction and a sale is considered highly probable. They are stated at the lower of carrying amount and fair value less costs to sell if their carrying amount to be recovered principally through a sale transaction rather than through continuing use.

(x) New accounting developments

(i) *New and amended standards adopted by the Group*

The following new standards and amendments to standards are mandatory for the first time for the financial year beginning 1 January 2010:

HKFRS 3 (revised) "Business combinations" and consequential amendments to HKAS 27 "Consolidated and separate financial statements", HKAS 28 "Investments in associates" and HKAS 31 "Interests in joint ventures" are effective prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009.

The revised standard continues to apply the acquisition method to business combinations but with some significant changes compared with HKFRS 3. For example, all payments to purchase a business are recorded at fair value at the acquisition date, with contingent payments classified as debt subsequently re-measured through the statement of comprehensive income. There is a choice on an acquisition-by-acquisition basis to measure the non-controlling interest in the acquiree either at fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. All acquisition-related costs are expensed.

HKAS 27 (revised) requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value and a gain or loss is recognised in profit or loss. HKAS 27 (revised) has had no impact on the current year, as none of the non-controlling interest have a deficit balance; there have been no transactions whereby an interest in an entity is retained after the loss of control of that entity, and there have been no transactions with non-controlling interest.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(x) New accounting developments (continued)

(i) *New and amended standards adopted by the Group (continued)*

HKAS 17 (amendment) "Leases" deletes specific guidance regarding classification of leases of land, so as to eliminate inconsistency with the general guidance on lease classification. As a result, leases of land should be classified as either finance or operating lease using the general principles of HKAS 17, i.e. whether the lease transfers substantially all the risks and rewards incidental to ownership of an asset to the lessee. Prior to the amendment, land interest which title is not expected to pass to the Group by the end of the lease term was classified as operating lease under "Advanced lease payments", and amortised over the lease term.

HKAS 17 (amendment) has been applied retrospectively for annual periods beginning 1 January 2010 in accordance with the effective date and transitional provisions of the amendment. The Group has reassessed the classification of unexpired advanced lease payments as at 1 January 2010 on the basis of information existing at the inception of those leases, and considered the amendment did not have any significant impact on the consolidated financial statements.

HKAS 1 (amendment) "Presentation of financial statements" clarifies that the potential settlement of a liability by the issue of equity is not relevant to its classification as current or non-current. By amending the definition of current liability, the amendment permits a liability to be classified as non-current (provided that the entity has an unconditional right to defer settlement by transfer of cash or other assets for at least 12 months after the accounting period) notwithstanding the fact that the entity could be required by the counterparty to settle in shares at any time. The amendment did not have any significant impact on the consolidated financial statements.

HKAS 36 (amendment) "Impairment of assets" clarifies that the largest cash-generating unit (or group of units) to which goodwill should be allocated for the purposes of impairment testing is an operating segment, as defined by paragraph 5 of HKFRS 8 "Operating segments" (that is, before the aggregation of segments with similar economic characteristics). The amendment did not have any significant impact on the consolidated financial statements.

In addition to incorporating HK(IFRIC)-Int 8 "Scope of HKFRS 2" and HK(IFRIC)-Int 11 "HKFRS 2-Group and treasury share transactions", HKFRS 2 (amendments) "Group cash-settled share-based payment transactions" expand on the guidance in HK(IFRIC) 11 to address the classification of group arrangements that were not covered by that interpretation.

HKFRS 5 (amendment) "Non-current assets held for sale and discontinued operations" clarifies that HKFRS 5 specifies the disclosures required in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. It also clarifies that the general requirement of HKAS 1 still apply, in particular paragraph 15 (to achieve a fair presentation) and paragraph 125 (sources of estimation uncertainty) of HKAS 1.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(x) New accounting developments (continued)

(i) *New and amended standards adopted by the Group (continued)*

HK-Int 5 "Presentation of financial statements – classification by the borrower of a term loan that contains a repayment on demand clause" is effective immediately and is a clarification of an existing standard HKAS 1 "Presentation of financial statements". It sets out the conclusion reached by the HKICPA that a term loan which contains a clause which gives the lender the unconditional right to demand repayment at any time shall be classified as a current liability in accordance with HKAS 1 irrespective of the probability that the lender will invoke the clause without cause. The adoption of HK – Int 5 does not have any significant financial impact to the Group.

The following applicable amendment is mandatory for the first time for year beginning 1 January 2011:

HKFRS 1 (amendment) "First-time adoption of Hong Kong financial reporting standards" is part of the IASB's annual improvements to Hong Kong Financial Reporting Standards 2010 issued on 6 May 2010 and allows a first-time HKFRS adopter and those that adopted HKFRSs in the periods before the effective date of HKFRS 1 that has conducted a fair valuation of its assets and liabilities in connection with its initial public offering to use such fair value amounts as deemed cost retrospectively. The resulting adjustments will be recognised directly in retained earnings (or if appropriate, another category of equity) at the measurement date.

HKAS 24 (revised) "Related Party Disclosures" exempts disclosures in relation to related party transactions and outstanding balances, including commitments, with a government that has control, joint control or significant influence over the reporting entity and another entity that is related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity. The Group has early adopted the partial exemption in paragraphs 25 to 27 of the revised standard for government-related entities from 1 January 2009.

(ii) *Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group*

The following relevant HKFRSs, amendments to existing HKFRSs and interpretation of HKFRS have been published and are mandatory for accounting periods beginning on or after 1 January 2011 or later periods and have not been early adopted by the Group:

HKFRS 9 "Financial instruments", issued in November 2009. This standard is the first step in the process to replace HKAS 39 "Financial instruments: recognition and measurement". HKFRS 9 introduces new requirements for classifying and measuring financial assets and is likely to affect the Group's accounting for its financial assets. The standard is not applicable until 1 January 2013 but is available for early adoption. The Group is currently evaluating the impact of the amendment on the consolidated financial statements but it is not expected to have any significant impact.

Notes to The Consolidated Financial Statements

3 SUMMARY OF PRINCIPAL ACCOUNTING POLICIES (continued)

(x) New accounting developments (continued)

(ii) *Standards, amendments and interpretations to existing standards that are not yet effective and have not been early adopted by the Group (continued)*

"Classification of rights issues" (amendment to HKAS 32), issued in October 2009. The amendment applies to annual periods beginning on or after 1 February 2010. Earlier application is permitted. The amendment addresses the accounting for rights issues that are denominated in a currency other than the functional currency of the issuer. Provided certain conditions are met, such rights issues are now classified as equity regardless of the currency in which the exercise price is denominated. Previously, these issues had to be accounted for as derivative liabilities. The amendment applies retrospectively in accordance with HKAS 8 "Accounting policies, changes in accounting estimates and errors". The Group is currently evaluating the impact of the amendment on the consolidated financial statements but it is not expected to have any significant impact.

HK (IFRIC)-Int 19 "Extinguishing financial liabilities with equity instruments", effective 1 July 2010. The interpretation clarifies the accounting by an entity when the terms of a financial liability are renegotiated and result in the entity issuing equity instruments to a creditor of the entity to extinguish all or part of the financial liability (debt for equity swap). It requires a gain or loss to be recognised in profit or loss, which is measured as the difference between the carrying amount of the financial liability and the fair value of the equity instruments issued. If the fair value of the equity instruments issued cannot be reliably measured, the equity instruments should be measured to reflect the fair value of the financial liability extinguished. The Group will apply the interpretation from 1 January 2011. The Group is currently evaluating the impact of the amendment on the consolidated financial statements but it is not expected to have any significant impact.

4 FINANCIAL RISK MANAGEMENT

4.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: market risk (including currency risk, fair value interest rate risk, cash flow interest rate risk and price risk), credit risk, and liquidity risk. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. The Group does not use derivative financial instruments to hedge certain risk exposures.

Risk management is carried out by the management of the Company under policies approved by the Board of Directors. The management manages and monitors these exposures to ensure appropriate measures are implemented on a timely and effective manner. There has been no change to the Group's exposure to the risks mentioned above or the manner in which it manages and measures the risks.

Notes to The Consolidated Financial Statements

4 FINANCIAL RISK MANAGEMENT (continued)

4.1 Financial risk factors (continued)

(a) Market risk

- Foreign exchange rate risk

The Group conducts its business primarily in US dollar and Renminbi. Renminbi is not a freely convertible currency and is regulated by the PRC Government. Limitation in foreign exchange transactions imposed by the PRC Government could cause future exchange rates to vary significantly from current or historical exchange rates.

Entities within the Group also exposes to foreign exchange rate risk in relation to monetary balances which are denominated in a currency that is not the entity's functional currency. As at 31 December 2010 and 2009, except for bank balances amounting to approximately HK\$2,911 million (2009: HK\$4,122 million), there are no significant monetary balances held by the Group that are denominated in a non-functional currency.

The Group did not enter into material hedge contracts during any of the years presented to hedge against its foreign exchange rate risk. However, management monitors the related foreign currency exposure closely and will consider hedging significant foreign currency exposure should the need arise.

At 31 December 2010, if US dollar had weakened/strengthened by 5% against Renminbi with all other variables held constant, profit for the year would have been approximately HK\$176 million (2009: HK\$174 million) higher/lower, mainly as a result of foreign exchange gains/losses on translation of Renminbi-denominated current accounts within the Group.

- Cash flow and fair value interest rate risk

The Group's exposure to fair value interest rate risk is mainly attributable to borrowings. The fair value of borrowings is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments.

The Group is also exposed to cash flow interest rate risk which is mainly attributable to the variable rate bank balances and deposits and borrowings. The Group's cash flow interest rate is mainly concentrated on the fluctuation of the saving interest rates set by the financial institutions.

The Group currently does not have an interest rate hedging policy. However, the management will consider hedging significant interest rate exposure should the need arises.

At 31 December 2010, if interest rates on bank balances and deposits, and borrowings had been 50 base-point higher/lower with all other variables held constant, post-tax profit for the year would have been approximately HK\$44 million (2009: HK\$26 million) higher/lower, mainly as a result of higher/lower interest income on floating rate bank balances and deposits, and borrowings at floating interest rates.

Notes to The Consolidated Financial Statements

4 FINANCIAL RISK MANAGEMENT (continued)

4.1 Financial risk factors (continued)

(a) Market risk (continued)

- Price risk

The Group is engaged in a wide range of petroleum-related activities. Prices of crude oil and petroleum products are affected by a wide range of global and domestic factors which are beyond the control of the Group. The fluctuations in such prices may have favourable or unfavourable impacts to the Group.

The Group is also exposed to equity securities price risk because investments held by the Group are classified on the consolidated statement of financial position as available-for-sale financial assets. As at 31 December 2010, the available-for-sale financial assets represented approximately 0.61% (2009: 0.60%) of the total equity of the Group. There would not be any significant financial impact to the results and equity of the Group if the quoted market price of the equity investments held by the Group had significantly changed.

(b) Credit risk

Credit risk arises primarily from cash and cash equivalents, accounts receivable and loans to non-controlling interest.

A substantial portion of the Group's cash at bank and time deposits are placed with state-owned banks and financial institutions in China and management believes that the credit risk is low.

The Group performs ongoing assessment of the credit quality of its customers. The aging analysis of accounts receivable is presented in Note 26.

The carrying amounts of cash and cash equivalents, time deposits placed with banks, accounts receivable and loans to non-controlling interest included in the consolidated statement of financial position represent the Group's maximum exposure to credit risk. No other financial assets carry a significant exposure to credit risk.

The Group has no significant concentration of credit risk.

Notes to The Consolidated Financial Statements

4 FINANCIAL RISK MANAGEMENT (continued)

4.1 Financial risk factors (continued)

(c) *Liquidity risk*

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

The Group's liquidity risk management involves maintaining sufficient cash and cash equivalents and availability of funding through an adequate amount of committed credit facilities.

Given the low level of gearing and continued access to funding, the Group believes that its liquidity risk is not high.

Analysis of the Group's financial liabilities based on the remaining period at the date of the statement of financial position to the contractual maturity dates are presented in Note 33.

4.2 Capital risk management

The Group's objectives when managing capital are to safeguard its ability to continue as a going concern, so as to provide returns for owners and to reduce its cost of capital. In meeting its objectives of managing capital, the Group may issue new shares, adjust its debt levels or the mix between short-term and long-term borrowings.

The Group monitors capital on the basis of the gearing ratio which is calculated as interest-bearing borrowings divided by the sum of total equity and interest-bearing borrowings. The gearing ratio at 31 December 2010 is 24.4% (2009: 16.1%).

4.3 Fair value estimation

The methods and assumptions applied in determining the fair value of each class of financial assets and financial liabilities of the Group at 31 December 2010 and 2009 are disclosed in the respective accounting policies.

The carrying amounts of the following financial assets and financial liabilities approximate their fair values as all of them are short-term in nature: cash and cash equivalents, bank deposits with maturities over three months, accounts receivable, other receivables, accounts payable, accrued liabilities and short-term borrowings. The fair values of fixed rate long-term borrowings are likely to be different from their respective carrying amounts. Analysis of the fair values and carrying amounts of long-term borrowings are presented in Note 33.

Notes to The Consolidated Financial Statements

4 FINANCIAL RISK MANAGEMENT (continued)

4.3 Fair value estimation (continued)

Available-for-sale financial assets are the Group's only assets that are measured at fair value. A table analysing financial instruments carried at fair value, by valuation method, is presented in Note 22. The different levels have been defined as follows:

- Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The fair value of financial instruments traded in active markets is based on quoted market prices at the balance sheet date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Group is the current bid price. These instruments are included in level 1. Instruments included in level 1 comprise primarily listed equity investments classified as available for sale.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

Specific valuation techniques used to value financial instruments include:

- Quoted market prices or dealer quotes for similar instruments.
- Other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

Notes to The Consolidated Financial Statements

5 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are regularly evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The matters described below are considered to be the most critical in understanding the estimates and judgements that are involved in preparing the Group's consolidated financial statements.

(a) Estimation of oil and natural gas reserves

Estimates of oil and natural gas reserves are key elements in the Group's investment decision-making process. They are also an important element in testing for impairment. Changes in proved oil and natural gas reserves, particularly proved developed reserves, will affect unit-of-production depreciation, depletion and amortisation recorded in the Group's consolidated financial statements for property, plant and equipment related to oil and gas production activities. A reduction in proved developed reserves will increase depreciation, depletion and amortisation charges. Proved reserve estimates are subject to revision, either upward or downward, based on new information, such as from development drilling and production activities or from changes in economic factors, including product prices, contract terms or development plans.

(b) Estimation of impairment of non-financial assets

The Group tests at least annually whether goodwill has suffered any impairment. Property, plant and equipment, including oil and gas properties, are reviewed for possible impairments whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Determination as to whether and how much an asset is impaired involves management estimates and judgements such as future prices of crude oil. However, the impairment reviews and calculations are based on assumptions that are consistent with the Group's business plans. Favourable changes to some assumptions may allow the Group to avoid the need to impair any assets in these years, whereas unfavourable changes may cause the assets to become impaired.

(c) Estimation of residual values of property, plant and equipment

The Group's management determines the estimated residual values for the Group's property, plant and equipment, other than oil and gas properties. This estimate is based on the historical experience of the actual residual values of property, plant and equipment of similar nature and functions. It could change significantly as a result of technological advancement and innovations in the oil and gas industry. Management will adjust the depreciation charge where residual values vary with previously estimated, or it will write-off or write-down technically obsolete or non-strategic assets that have been abandoned or sold. Actual residual values may differ from estimated residual values. Periodic review could result in a change in residual values and therefore depreciation in the future periods.

Notes to The Consolidated Financial Statements

5 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS (continued)

(d) Estimate of natural gas consumption

Revenue for natural gas supply may include an estimation of the natural gas supplied to the customers of which actual meter reading is not available. The estimation is done mainly based on the past consumption records and recent consumption pattern of individual customers. As of the statement of financial statement date, the overall billed natural gas sales are in line with the natural gas supplied to the customers.

6 REVENUE AND TURNOVER

Turnover mainly represents revenue from the sale and transportation of crude oil and natural gas. Analysis of revenue by segment is shown in Note 38.

7 OTHER GAINS, NET

	2010 HK\$'million	2009 HK\$'million
Net exchange gains	104	15
Rental income	5	3
Dividend income from available-for-sale financial assets	–	1
Gains on disposal of assets held for sale (Note 29)	52	–
Others	45	21
	206	40

8 INTEREST INCOME

	2010 HK\$'million	2009 HK\$'million
Interest income on bank deposits	69	40

Notes to The Consolidated Financial Statements

9 EMPLOYEE COMPENSATION COSTS

	2010 HK\$'million	2009 HK\$'million
Salaries, wages and allowances	620	350
Retirement benefits scheme contributions	22	23
Share-based payment expenses (Note 30(b))	43	14
	685	387

10 TAXES OTHER THAN INCOME TAXES

Taxes other than income taxes include special levies on PRC domestic sales of crude oil of approximately HK\$305 million (2009: HK\$105 million) for the year ended 31 December 2010.

11 INTEREST EXPENSES

	2010 HK\$'million	2009 HK\$'million
Interest on:		
Bank loans, wholly repayable within five years	12	22
Loans other than bank loans, wholly repayable within five years, from:		
– An intermediate holding company	93	110
– China Petroleum Finance Company Limited (“CP Finance”)	106	37
– A fellow subsidiary	82	–
– Non-controlling interest	–	9
Loans other than bank loans, not wholly repayable within five years, from a fellow subsidiary	–	77
Less: Amounts capitalised	(126)	(120)
	167	135

Amounts capitalised are borrowing costs that are attributable to the construction of qualifying assets. The average interest rate used to capitalise such borrowing costs was 4.35% (2009: 4.37%) per annum for the year ended 31 December 2010.

Notes to The Consolidated Financial Statements

12 PROFIT BEFORE INCOME TAX EXPENSE

	2010 HK\$'million	2009 HK\$'million
Items (credited) and charged in arriving at the profit before income tax expense include:		
Amortisation on intangibles and other assets	7	3
Auditor's remuneration	12	7
Cost of inventories recognised as expense	5,496	3,961
Depreciation on property, plant and equipment	900	562
Reversal of provision for loans to and amounts due from jointly controlled entities (Note 29)	-	(70)
Operating lease expenses	42	13
Loss on disposal of property, plant and equipment	1	9

13 DIRECTORS' AND SENIOR MANAGEMENT'S EMOLUMENTS

Details of the emoluments of directors for the years ended 31 December 2010 and 2009 are as follows:

	2010					2009
	Fees HK\$'000	Salaries and other benefits HK\$'000	Retirement benefits scheme contributions HK\$'000	Share option benefit expenses HK\$'000	Total HK\$'000	Total HK\$'000
Mr Li Hualin	-	3,500	-	8,787	12,287	7,285
Mr Zhang Bowen	-	5,250	375	7,574	13,199	7,309
Mr Cheng Cheng	-	4,000	300	3,027	7,327	5,271
Dr Lau Wah Sum	450	-	-	807	1,257	450
Mr Li Kwok Sing Aubrey	300	-	-	807	1,107	300
Dr Liu Xiao Feng	250	-	-	1,262	1,512	250
	1,000	12,750	675	22,264	36,689	20,865

Notes to The Consolidated Financial Statements

13 DIRECTORS' AND SENIOR MANAGEMENT'S EMOLUMENTS (continued)

The five individuals whose emoluments were the highest in the Group for the year including three (2009: three) directors whose emoluments are reflected in the analysis presented above. The emoluments payable to the remaining two (2009: two) individual during the year are as follows:

	2010 HK\$'000	2009 HK\$'000
Salaries, wages and allowances	8,000	6,656
Retirement benefits scheme contributions	600	600
Share-based payment expenses	9,004	2,720
	17,604	9,976
The emoluments fell within the following bands:		
HK\$4,500,001 to HK\$5,000,000	-	2
HK\$8,500,001 to HK\$9,000,000	2	-

None of the directors has waived their remuneration during the year ended 31 December 2010 (2009: Nil).

During the year ended 31 December 2010, the Company did not incur any severance payment to any director for loss of office or any payment as inducement to any director to join the Company (2009: Nil).

14 INCOME TAX EXPENSE

	2010 HK\$'million	2009 HK\$'million
Current tax		
– PRC	351	205
– Overseas	443	92
	794	297
Deferred tax (Note 34)	221	123
	1,015	420

Hong Kong profits tax has not been provided for as the Group has no assessable profit for the year (2009: Nil).

Notes to The Consolidated Financial Statements

14 INCOME TAX EXPENSE (continued)

In accordance with the relevant PRC income tax rules and regulations, the PRC corporate income tax rate applicable to the Group's subsidiaries in Mainland China is principally 25% (2009: 25%). The operations of the Group's certain regions in China have qualified for certain tax incentives in the form of a preferential income tax rates ranging from 10% to 20% (2009: 10% to 20%).

Income tax on overseas (other than the PRC) profits has been calculated on the estimated assessable profit for the year at the applicable rates of taxation prevailing in the jurisdictions in which the Group operates.

Included in overseas income tax expenses is withholding tax of approximately HK\$315 million (2009: HK\$3 million) in respect of dividend received from an associate, CNPC-Aktobemunaigas Joint Stock Company ("Aktobe") which is charged at 20% (2009: 20%).

There is no tax impact relating to components of other comprehensive income for the year ended 31 December 2010 (2009: Nil).

The tax on the Group's profit before income tax expense differs from the theoretical amount that would arise using the corporate income tax rate in the PRC applicable to the Group as follows:

	2010	2009
	HK\$'million	HK\$'million
Profit before income tax expense	4,393	1,960
Tax calculated at a tax rate of 25% (2009: 25%)	1,098	490
Prior year tax return adjustment	4	5
Effect of income taxes from international operations in different of taxes at the PRC statutory tax rate	(95)	26
Effect of preferential tax rate	(115)	(86)
Tax effect of income not subject to tax	(4)	(32)
Tax effect of expenses not deductible for tax purposes	72	24
Tax effect of share of profits less losses of associates	(335)	(42)
Tax effect of share of profits less losses of jointly controlled entities	(37)	(42)
Withholding tax on dividends received and receivable	427	77
Income tax expense	1,015	420

The domestic income tax rate used in the calculation above is the PRC tax rate which is the jurisdiction where the operations of the Group are substantially based.

Notes to The Consolidated Financial Statements

15 PROFIT ATTRIBUTABLE TO OWNERS OF THE COMPANY

The profit attributable to owners of the Company is dealt with in the consolidated financial statements of the Company to the extent of approximately HK\$1,371 million (2009: HK\$121 million).

16 BASIC AND DILUTED EARNINGS PER SHARE

- (a) The calculation of basic earnings per share is based on the Group's profit attributable to owners of the Company of approximately HK\$2,426 million (2009: HK\$1,234 million) and weighted average number of ordinary shares in issue during the year of approximately 4,949 million shares (2009: 4,494 million shares).
- (b) Diluted earnings per share is calculated based on the profit attributable to owners of the Company of approximately HK\$2,426 million (2009: HK\$1,234 million), and the weighted average number of ordinary shares of approximately 5,031 million shares (2009: 4,561 million shares) which is the weighted average number of ordinary shares in issue during the year plus the weighted average number of dilutive potential ordinary shares in respect of share options of approximately 82 million shares (2009: 67 million shares) deemed to be issued at no consideration if all outstanding share option granted had been exercised.

17 DIVIDEND ATTRIBUTABLE TO OWNERS OF THE COMPANY

	2010 HK\$'million	2009 HK\$'million
Proposed final dividend attributable to owners of the Company for 2010 (Note (a))	684	–
Final dividend attributable to owners of the Company for 2009 (Notes (b) and (c))	–	346

Notes:

- (a) At the meeting on 17 March 2011, the Board of Directors proposed final dividend attributable to owners of the Company in respect of 2010 of HK13.8 cents per share amounting to a total of approximately HK\$684 million. The amount is based on approximately 4,954 million shares in issue as at 17 March 2011. These consolidated financial statements do not reflect this dividend payable as the final dividends were proposed after the date of the statement of financial position and will be accounted for in equity as an appropriation of retained earnings in the year ending 31 December 2011 when approved at the forthcoming Annual General Meeting.
- (b) Final dividend attributable to owners of the Company in respect of 2009 of HK7 cents per share amounting to a total of approximately HK\$346 million were approved by the shareholders in the Annual General Meeting on 10 June 2010 and accounted for in equity as an appropriation of retained earnings in the year ended 31 December 2010. The amount is based on approximately 4,937 million shares in issue as at 25 March 2010.
- (c) The actual final dividend for 2009 was approximately HK\$347 million due to additional shares issued during the period from 26 March 2010 to 30 April 2010, the date of closure of the register of members, and were paid on 15 June 2010.
- (d) Final dividend attributable to owners of the Company in respect of 2008 of HK15 cents per share amounting to a total of approximately HK\$669 million were approved by the shareholders in the Annual General Meeting on 25 May 2009 and accounted for in equity as an appropriation of retained earnings in the year ended 31 December 2009, and were paid on 1 June 2009. The amount is based on approximately 4,441 million shares in issue as at 25 March 2009.

Notes to The Consolidated Financial Statements

18 PROPERTY, PLANT AND EQUIPMENT

	Group						Company	
	Buildings	Oil and gas properties	Equipment and machinery	Motor vehicles	Others	Construction in progress	Total	Others
Year ended 31 December 2010	HK\$'million	HK\$'million	HK\$'million	HK\$'million	HK\$'million	HK\$'million	HK\$'million	HK\$'million
Cost								
Balances at 31 December 2009	243	9,518	1,384	377	257	408	12,187	4
Business combinations under common control (Note 39(a))	2	-	79	9	1	2,845	2,936	-
Balances at 1 January 2010	245	9,518	1,463	386	258	3,253	15,123	4
Currency translation differences	7	292	41	13	13	126	492	-
Additions	145	445	285	276	34	4,494	5,679	1
Additions through business combinations	-	-	63	-	-	-	63	-
Disposals	(56)	(1)	(30)	(6)	(34)	(28)	(155)	(1)
Transfers	2	282	619	29	554	(1,486)	-	-
Balances at 31 December 2010	343	10,536	2,441	698	825	6,359	21,202	4
Accumulated depletion, depreciation and impairment								
Balances at 31 December 2009	73	5,669	396	138	133	-	6,409	4
Business combinations under common control (Note 39(a))	-	-	20	3	-	-	23	-
Balances at 1 January 2010	73	5,669	416	141	133	-	6,432	4
Currency translation differences	2	156	22	4	3	-	187	-
Charge for the year	44	640	140	64	12	-	900	-
Additions through business combinations	-	-	13	-	-	-	13	-
Disposals	(19)	(1)	-	(6)	(1)	-	(27)	(1)
Balances at 31 December 2010	100	6,464	591	203	147	-	7,505	3
Net book value at 31 December 2010	243	4,072	1,850	495	678	6,359	13,697	1

Notes to The Consolidated Financial Statements

18 PROPERTY, PLANT AND EQUIPMENT (continued)

Year ended 31 December 2009	Group						Company	
	Buildings HK\$'million	Oil and gas properties HK\$'million	Equipment and machinery HK\$'million	Motor vehicles HK\$'million	Others HK\$'million	Construction in progress HK\$'million	Total HK\$'million	Others HK\$'million
Cost								
Balances at 31 December 2008	183	8,808	865	264	237	111	10,468	4
Business combinations under common control	1	-	61	7	2	-	71	-
Balances at 1 January 2009	184	8,808	926	271	239	111	10,539	4
Currency translation differences	-	103	1	-	5	-	109	-
Additions	29	630	168	120	162	3,283	4,392	-
Additions through business combinations	34	-	248	21	7	-	310	-
Disposals	(2)	(2)	(27)	(26)	(156)	(14)	(227)	-
Transfers	-	(21)	147	-	1	(127)	-	-
Balances at 31 December 2009	245	9,518	1,463	386	258	3,253	15,123	4
Accumulated depletion, depreciation and impairment								
Balances at 31 December 2008	63	5,243	290	97	118	-	5,811	4
Business combinations under common control	-	-	14	1	-	-	15	-
Balances at 1 January 2009	63	5,243	304	98	118	-	5,826	4
Currency translation differences	1	50	8	14	3	-	76	-
Charge for the year	8	397	111	33	13	-	562	-
Additions through business combinations	1	-	10	6	2	-	19	-
Disposals	-	(21)	(17)	(10)	(3)	-	(51)	-
Balances at 31 December 2009	73	5,669	416	141	133	-	6,432	4
Net book value at 31 December 2009	172	3,849	1,047	245	125	3,253	8,691	-

Notes to The Consolidated Financial Statements

18 PROPERTY, PLANT AND EQUIPMENT (continued)

The Group did not incur and does not anticipate to incur any material dismantlement, restoration or abandonment costs given the nature of its onshore producing activities and current regulations and contracts governing such activities.

As at 31 December 2009, certain of the Group's property, plant and equipment amounting to approximately HK\$37 million were pledged as security for certain bank borrowings of the Group (Note 33).

19 ADVANCED OPERATING LEASE PAYMENTS

The Group's advanced operating lease payments mainly represent land use rights and comprise:

	Group	
	2010 HK\$'million	2009 HK\$'million
Leasehold interest in land outside Hong Kong:		
Leases of between 10 to 50 years	277	102
Leases of over 50 years	34	7
	311	109
Balance as at 31 December	107	74
Business combinations under common control	2	1
Balance as at 1 January	109	75
Currency translation differences	5	–
Additions	202	37
Amortisation for the year	(5)	(3)
Balance as at 31 December	311	109

These advanced operating lease payments are amortised over the related lease terms using the straight-line method.

As at 31 December 2009, certain advanced operating lease payments amounting to approximately HK\$4 million were pledged as security for certain bank borrowings of the Group (Note 33).

Notes to The Consolidated Financial Statements

20 INVESTMENTS IN JOINTLY CONTROLLED ENTITIES

	Group		Company	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Unlisted shares, at cost	–	–	267	276
Share of net assets	1,452	1,068	–	–
Loans to jointly controlled entities	45	45	45	45
	1,497	1,113	312	321

Loans to jointly controlled entities are unsecured, interest free and not repayable within one year.

As at 31 December 2010 and 2009, the carrying amounts of loans to jointly controlled entities are not past due and not impaired.

Dividends received and receivable from jointly controlled entities are approximately HK\$20 million in 2010 (2009: HK\$113 million).

The Group's interests in its principal jointly controlled entities (all of which are unlisted), together with its share of their respective assets, liabilities, revenue and profit are as follows:

Name	Country of incorporation/ establishment	Assets	Liabilities	Revenue	Profit	Interest held %	Type of shares
		HK\$'million	HK\$'million	HK\$'million	HK\$'million		
As at or for the year ended							
31 December 2010							
華油鋼管有限公司	PRC	853	549	1,310	11	39.56%	Equity joint venture
Mazoon Petrogas (BVI) Limited	British Virgin Islands	1,071	220	1,464	212	50%	Ordinary shares
Others		364	67	130	3		
		2,288	836	2,904	226		
As at or for the year ended							
31 December 2009							
華油鋼管有限公司	PRC	846	539	2,102	65	39.56%	Equity joint venture
Mazoon Petrogas (BVI) Limited	British Virgin Islands	794	151	909	184	50%	Ordinary shares
Others		171	53	96	3		
		1,811	743	3,107	252		

Notes to The Consolidated Financial Statements

20 INVESTMENTS IN JOINTLY CONTROLLED ENTITIES (continued)

Movements in share of net assets of jointly controlled entities are as follows:

	2010 HK\$'million	2009 HK\$'million
At 1 January	1,068	890
Currency translation differences	4	–
Capital contributions	181	39
Share of profits	226	252
Dividend income received and receivable	(20)	(113)
Disposals	(7)	–
At 31 December	1,452	1,068

Details of the principal jointly controlled entities, which in the directors' opinion materially affect the results and/or net assets of the Group at 31 December 2010 and 2009, are set out in Note 44.

21 INVESTMENTS IN ASSOCIATES

	Group		Company	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Unlisted shares, at cost	–	–	788	786
Share of net assets	5,220	4,833	–	–
Goodwill	408	398	–	–
	5,628	5,231	788	786

Notes to The Consolidated Financial Statements

21 INVESTMENTS IN ASSOCIATES (continued)

The Group's interests in its associates (which are unlisted), together with their share of their respective assets, liabilities, revenue and profit are as follows:

Name	Country of incorporation/ establishment	Assets	Liabilities	Revenue	Profit	Interest held %	Type of shares
		HK\$'million	HK\$'million	HK\$'million	HK\$'million		
As at or for the year ended							
31 December 2010							
Aktobe	Kazakhstan	7,725	3,081	6,396	1,917	25.12%	Common shares
China City Natural Gas Investment Group Co., Ltd ("Zhongyou Zhongtai")	PRC	1,231	699	1,156	109	49.00%	Equity joint venture
Others		54	10	59	4		
		9,010	3,790	7,611	2,030		
As at or for the year ended							
31 December 2009							
Aktobe	Kazakhstan	6,437	2,059	4,576	235	25.12%	Common shares
Zhongyou Zhongtai	PRC	975	576	209	15	49.00%	Equity joint venture
Others		65	9	63	6		
		7,477	2,644	4,848	256		

During the year ended 31 December 2009, Kazakhstan Tenge, the functional currency of Aktobe, was devalued by approximately 20% against US dollar with effect from 4 February 2009 resulting a reduction of share of net assets of associates by approximately HK\$926 million and corresponding reduction in translation reserve by the same amount.

Dividends received from associates amounted to approximately HK\$1,671 million for the year ended 31 December 2010 (2009: HK\$14 million).

Notes to The Consolidated Financial Statements

21 INVESTMENTS IN ASSOCIATES (continued)

Movements in share of net assets of associates are as follows:

	2010 HK\$'million	2009 HK\$'million
At 1 January	4,833	5,164
Share of exchange reserves	(24)	(962)
Capital contributions	26	83
Acquisitions	26	306
Share of profits	2,030	256
Dividend income received	(1,671)	(14)
At 31 December	5,220	4,833

Movements in goodwill included in investments in associates are as follows:

	2010 HK\$'million	2009 HK\$'million
At 1 January	398	–
Currency translation differences	10	–
Acquisitions (Note 39(d))	–	398
At 31 December	408	398

Details of the principal associates, which in the directors' opinion materially affect the results and/or net assets of the Group at 31 December 2010 and 2009, are set out in Note 43.

22 AVAILABLE-FOR-SALE FINANCIAL ASSETS

	Group	
	2010 HK\$'million	2009 HK\$'million
Listed shares:		
Equity securities listed in Hong Kong	26	37
Equity securities listed in Australia	75	45
	101	82
Unlisted shares:		
Equity securities in the PRC	28	23
	129	105

Notes to The Consolidated Financial Statements

22 AVAILABLE-FOR-SALE FINANCIAL ASSETS (continued)

At the date of the statement of financial position, all the listed equity securities are stated at fair values, which have been determined by reference to bid prices quoted in the Hong Kong Stock Exchange and Australian Stock Exchange respectively. The equity securities in the PRC amounted to approximately HK\$28 million (2009: HK\$23 million) are stated at cost. Those securities do not have quoted market price in an active market and whose fair value cannot be reliably measured and must be settled by delivery of such unquoted equity instruments.

The carrying amounts of the available-for-sale financial assets are denominated in the following currencies:

	Group	
	2010 HK\$'million	2009 HK\$'million
Renminbi	28	23
Hong Kong dollar	26	37
Australian dollar	75	45
	129	105

Movements in available-for-sale financial assets are as follows:

	Group	
	2010 HK\$'million	2009 HK\$'million
At 1 January	105	56
Currency translation differences	10	9
Additions	6	13
Additions through business combinations	–	11
Disposals	(1)	(17)
Increase in fair value	9	33
At 31 December	129	105

Notes to The Consolidated Financial Statements

22 AVAILABLE-FOR-SALE FINANCIAL ASSETS (continued)

The following table presents the carrying amounts of the Group's available-for-sale financial assets in the statement of financial position by the measurement hierarchy as set out in Note 4.3:

	Group	
	2010 HK\$'million	2009 HK\$'million
Level 1	101	82
Level 3	28	23
	129	105

23 INVESTMENTS IN SUBSIDIARIES

	Company	
	2010 HK\$'million	2009 HK\$'million
Unlisted shares, at cost	7,197	1,418

Details of the principal subsidiaries, which in the directors' opinion materially affect the results and/or net assets of the Group at 31 December 2010 and 2009, are set out in Note 42.

24 INTANGIBLES AND OTHER NON-CURRENT ASSETS

	Group		Company	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Non-refundable prepayments for acquisitions	57	89	57	89
Intangibles (Note)	77	5	–	–
Prepaid construction costs	564	121	–	–
Others	3	3	1	1
	701	218	58	90

Notes to The Consolidated Financial Statements

24 INTANGIBLES AND OTHER NON-CURRENT ASSETS (continued)

Note:

The intangibles mainly comprise goodwill, franchised rights and computer software costs. The movements in intangibles are as follows:

	Group					
	2010			2009		
	Goodwill	Other intangible assets	Total	Goodwill	Other intangible assets	Total
HK\$'million	HK\$'million	HK\$'million	HK\$'million	HK\$'million	HK\$'million	
At 1 January	-	5	5	-	5	5
Additions	-	17	17	-	-	-
Acquisitions of subsidiaries (Note 39(c))	59	-	59	-	-	-
Amortisation for the year	-	(2)	(2)	-	-	-
Disposals	-	(2)	(2)	-	-	-
At 31 December	59	18	77	-	5	5

25 INVENTORIES

	Group	
	2010 HK\$'million	2009 HK\$'million
Crude oil in tanks	30	30
Natural gas	6	-
Marina club debentures and wet berths	14	14
	50	44

26 ACCOUNTS RECEIVABLE

The aging analysis of accounts receivable as at 31 December 2010 and 2009 is as follows:

	Group	
	2010 HK\$'million	2009 HK\$'million
Within 3 months	379	243
Between 3 to 6 months	29	3
Over 6 months	59	22
	467	268

Notes to The Consolidated Financial Statements

26 ACCOUNTS RECEIVABLE (continued)

The Group's sales of crude oil are generally collectable within a period ranging from 30 to 90 days from the invoice date while the sales of natural gas are made in cash or on credit terms no more than 90 days. As at 31 December 2010, accounts receivable of approximately HK\$88 million (2009: HK\$25 million) were past due but for which the Group has not provided for impairment loss. These accounts receivable relate to companies for whom there is no recent history of default. The aging analysis of the accounts receivable which are past due but not impaired is disclosed in the above aging analysis.

The carrying amounts of the accounts receivable are denominated in the following currencies:

	Group	
	2010 HK\$'million	2009 HK\$'million
Renminbi	391	182
US dollar	49	62
Other currencies	27	24
	467	268

27 PREPAID EXPENSES AND OTHER CURRENT ASSETS

	Group		Company	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Other receivables	507	222	2	47
Amounts due from related parties				
– Subsidiaries	–	–	4,174	4,461
– Others	3	3	–	–
	510	225	4,176	4,508
Less: Provision for impairment	(19)	–	(452)	(429)
	491	225	3,724	4,079
Loans to non-controlling interest	532	–	–	–
Dividends receivable from				
a jointly controlled entity	20	19	7	19
Prepaid income taxes	18	37	–	–
Value-added tax recoverable	138	21	–	–
Refundable prepayments for acquisitions	74	1	74	1
Prepaid expenses	292	219	6	–
Other current assets	19	12	–	–
	1,584	534	3,811	4,099

Notes to The Consolidated Financial Statements

27 PREPAID EXPENSES AND OTHER CURRENT ASSETS (continued)

The amounts due from related parties are interest free, unsecured and expected to be settled within one year. Except for amounts due from certain subsidiaries, no allowance for doubtful debts for both years.

Loans to non-controlling interest are interest bearing at 5.56% (2009: Nil) per annum, repayable within one year and secured by the equity interests in a subsidiary held by the non-controlling interest.

The carrying amounts of the prepaid expenses and other current assets are denominated in the following currencies:

	Group		Company	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Renminbi	1,537	480	3,560	3,682
US dollar	34	38	233	400
Hong Kong dollar	–	2	18	17
Other currencies	13	14	–	–
	1,584	534	3,811	4,099

28 TIME DEPOSITS, BANK BALANCES AND CASH

	Group		Company	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Cash at bank and on hand	8,137	3,904	265	606
Short-term bank deposits	–	3,724	–	3,379
	8,137	7,628	265	3,985
Less: Bank deposits with original maturity more than three months	–	(31)	–	–
Cash and cash equivalents	8,137	7,597	265	3,985

Bank deposits with original maturity more than three months carry fixed interest at market rate at 2.25% (2009: 1.98%) per annum. The original maturity ranged from 6 months to 1 year. Cash at bank and bank deposits with original maturity less than three months carry interest at prevailing market rate at 0.57% (2009: 0.27%) per annum.

Notes to The Consolidated Financial Statements

28 TIME DEPOSITS, BANK BALANCES AND CASH (continued)

The carrying amounts of the bank deposits, bank balances and cash are denominated in the following currencies:

	Group		Company	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Renminbi	4,176	2,749	–	–
US dollar	3,107	755	30	396
Hong Kong dollar	672	3,982	235	3,589
Other currencies	182	142	–	–
	8,137	7,628	265	3,985

Included in bank deposits, bank balances and cash are amounts of approximately HK\$4,176 million or RMB3,586 million (2009: HK\$2,749 million or RMB2,422 million) denominated in Renminbi which are deposited with banks in Mainland China. The conversion of these Renminbi denominated balances into foreign currencies and the remittance of funds out of Mainland China is subject to the rules and regulations of foreign exchange control promulgated by the PRC Government.

29 ASSETS HELD FOR SALE

The major classes of assets classified as held for sale are as follows:

	Group	
	2010 HK\$'million	2009 HK\$'million
Property, plant and equipment (Note (i))	–	568
Advanced operating lease payments (Note (i))	–	6
Investments in a jointly controlled entity (Note (ii))	–	70
	–	644

Notes:

- (i) As at 31 December 2009, the assets related to the transmission of crude oil business ("Pipeline Business"), which was part of the Natural Gas Distribution segment, has been presented as held for sale following the Group's decision to dispose of this operation in service provision for crude oil transmission. On 18 December 2009, the Group entered into a disposal agreement with PetroChina to dispose of its entire interest in the Pipeline Business at a consideration of approximately RMB585 million (approximately HK\$664 million) which has been received as at 31 December 2009 and classified as receipt in advance (Note 32). On 28 January 2010, the disposal was completed resulting in a gain on disposal of approximately HK\$48 million recognised during the year ended 31 December 2010 (Note 7).
- (ii) Pursuant to an agreement dated 15 January 2010, the Group disposed of its entire interest in a jointly controlled entity, Commonwealth Gobustan Limited ("CGL") for the consideration of US\$9.5 million (approximately HK\$74 million). Accordingly, the Group classified CGL as held for sale as at 31 December 2009. On 7 April 2010, the disposal was completed resulting in a gain on disposal of approximately HK\$4 million recognised during the year ended 31 December 2010 (Note 7).

Notes to The Consolidated Financial Statements

30 SHARE CAPITAL AND SHARE OPTION SCHEMES

(a) Share capital

	Number of ordinary shares 'million	Nominal value of ordinary shares HK\$'million
Authorised:		
Ordinary shares of HK\$0.01 each		
At 1 January 2009, 31 December 2009 and 2010	8,000	80
Issue and fully paid:		
Ordinary shares of HK\$0.01 each		
At 1 January 2009	4,441	44
Issue of shares upon exercise of share options (Note (i))	46	–
Issue of shares upon placement (Note (ii))	450	5
At 31 December 2009 and 1 January 2010	4,937	49
Issue of shares upon exercise of share options (Note (i))	17	1
At 31 December 2010	4,954	50

Notes:

- (i) During the year, the Company allotted and issued approximately 18 million shares (2009: 46 million shares) of HK\$0.01 each for cash at the exercise price of HK\$1.224 (2009: HK\$0.940 to HK\$1.224) per share as a result of the exercise of share options.
- (ii) On 10 December 2009, the Company completed a placement of approximately 450 million shares of HK\$0.01 each at a subscription price of HK\$8.270 per share to Sun World. Accordingly, approximately 450 million shares of HK\$0.01 each were issued at a premium of HK\$8.260 each. The premium on issue of shares of HK\$3,717 million was credited to the share premium account. These shares rank pari passu in all respects with the existing shares.

Notes to The Consolidated Financial Statements

30 SHARE CAPITAL AND SHARE OPTION SCHEMES (continued)

(b) Share option schemes

Pursuant to resolution of the Company passed on 28 May 2001, the Company adopted an executive share option scheme (the "2001 Share Option Scheme"). The 2001 Share Option Scheme was replaced by another share option scheme (the "2002 Share Option Scheme") on 3 June 2002 and no options were granted under the 2001 Share Option Scheme since its adoption. The purpose of these share option schemes is to enable the Company to grant options to eligible directors and employees as incentives and rewards for their contributions to the Company and to recruit high calibre employees and attract human resources that are valuable to the Company.

Under the 2002 Share Option Scheme, the directors of the Company are authorised, at any time within ten years after the adoption of the 2002 Share Option Scheme, to grant options to any directors or employees of the Company or any of its subsidiaries to subscribe for the Company's shares at a price not less than the average of the closing prices of the Company's shares on the five trading days immediately preceding the offer date of the options, the closing price of the Company's shares on the offer day or the nominal value of the Company's shares, whichever is the highest. Unless otherwise cancelled or amended, the 2002 Share Option Scheme will be valid and effective for a period of ten years from the date of adoption. The maximum number of shares in respect of which options may be granted under the 2002 Share Option Scheme cannot exceed 10% of the issued share capital of the Company. Notwithstanding aforesaid in this paragraph, the maximum number of shares which may be issued upon exercise of all outstanding options granted and yet to be exercised under the 2002 Share Option Scheme (and under any other shares of the Company) shall not exceed 30% of the shares in issue from time to time.

Options granted under the 2002 Share Option Scheme must be taken up within the period as specified in the offer of the options and no amount shall be payable by the grantee to the exercising of the right to accept an offer of an option. Options granted are exercisable at any time, but not less than 3 months and not more than 10 years from the date on which the option is granted and accepted by the grantee. All of the options were vested to the option holders after 3 months from the date on which the options are granted.

Pursuant to the resolution of the Company passed on 26 March 2010, approximately 8 million and 7 million share options were granted to directors and employees of the Company, respectively, under the 2002 Share Option Scheme.

All of the options are vested to the option holders after 3 months from the date on which the options are granted. The exercise period of the option is 5 years from the grant date.

The closing price of the Company's shares immediately before 26 March 2010, the date of grant of the options, was HK\$10.320.

Notes to The Consolidated Financial Statements

30 SHARE CAPITAL AND SHARE OPTION SCHEMES (continued)

(b) Share option schemes (continued)

The fair values of share options granted in 2010 and 2009 were calculated using the Binomial model. The inputs into the model were as follows:

	Granted on 26 March 2010 to		Granted on 26 March 2009 to	
	Directors	Employees	Directors	Employees
Share price at grant date	HK\$10.320	HK\$10.320	HK\$3.250	HK\$3.250
Exercise price	HK\$10.320	HK\$10.320	HK\$3.250	HK\$3.250
Expected volatility	50.10%	50.10%	46.0%	46.0%
Risk-free rate	1.865%	1.865%	1.600%	1.600%
Expected dividend yield	3.42%	3.42%	3.20%	3.20%
Exercise multiple	2.0	1.5	2.0	1.5

Expected volatility was determined by using the historical volatility of the Company's share price over the previous five years.

The Binominal model has been used to estimate the fair value of the options. The variables and assumptions used in computing the fair value of the share options are based on the independent professional valuer's best estimate. The value of an option varies with different variables of certain subjective assumptions.

The fair value of the options granted to directors and employees of the Company during the year are approximately HK\$22 million (2009: HK\$8 million) and HK\$21 million (2009: HK\$6 million), respectively.

The number of shares in respect of which options had been granted and outstanding at 31 December 2010 under the 2002 Share Option Scheme was approximately 144 million shares (2009: 146 million shares), representing 2.90% (2009: 2.95%) of the issued share capital of the Company at 31 December 2010.

Notes to The Consolidated Financial Statements

30 SHARE CAPITAL AND SHARE OPTION SCHEMES (continued)

(b) Share option schemes (continued)

The movements in the share options granted under the 2002 Share Option Scheme during the year are shown in the following table:

Name or category of participants	Option Type	Number of share options						
		Outstanding at 1 January 2009 '000	Granted during the year '000	Exercised during the year '000	Outstanding at 31 December 2009 and 1 January 2010 '000	Granted during the year '000	Exercised during the year '000	Outstanding at 31 December 2010 '000
Directors								
Mr Li Hualin	2005 (Note (ii))	20,000	-	(20,000)	-	-	-	-
	2007 (Note (iii))	25,000	-	-	25,000	-	-	25,000
	2008 (Note (v))	3,200	-	-	3,200	-	-	3,200
	2009 (Note (vi))	-	3,200	-	3,200	-	-	3,200
	2010 (Note (vii))	-	-	-	-	3,200	-	3,200
Mr Zhang Bowen	2007 (Note (iii))	20,000	-	-	20,000	-	-	20,000
	2008 (Note (v))	2,400	-	-	2,400	-	-	2,400
	2009 (note (vi))	-	2,400	-	2,400	-	-	2,400
	2010 (Note (vii))	-	-	-	-	2,400	-	2,400
Mr Cheng Cheng	2004 (Note (i))	15,640	-	(15,640)	-	-	-	-
	2007 (Note (iii))	10,000	-	-	10,000	-	-	10,000
	2008 (Note (v))	1,500	-	-	1,500	-	-	1,500
	2009 (Note (vi))	-	1,500	-	1,500	-	-	1,500
	2010 (Note (vii))	-	-	-	-	1,500	-	1,500
Dr Lau Wah Sum	2010 (Note (vii))	-	-	-	-	400	-	400
Mr Li Kwok Sing Aubrey	2010 (Note (vii))	-	-	-	-	400	-	400
Dr Liu Xiao Feng	2005 (Note (ii))	1,600	-	(1,600)	-	-	-	-
	2010 (Note (vii))	-	-	-	-	400	-	400
Sub-total		99,340	7,100	(37,240)	69,200	8,300	-	77,500
Other employees	2005 (Note (ii))	26,000	-	(8,500)	17,500	-	(17,500)	-
	2007 (Note (iii))	25,000	-	-	25,000	-	-	25,000
	2007 (Note (iv))	20,000	-	-	20,000	-	-	20,000
	2008 (Note (v))	7,000	-	-	7,000	-	-	7,000
	2009 (Note (vi))	-	7,000	-	7,000	-	-	7,000
	2010 (Note (vii))	-	-	-	-	7,000	-	7,000
Sub-total		78,000	7,000	(8,500)	76,500	7,000	(17,500)	66,000
Total		177,340	14,100	(45,740)	145,700	15,300	(17,500)	143,500

Notes to The Consolidated Financial Statements

30 SHARE CAPITAL AND SHARE OPTION SCHEMES (continued)

(b) Share option schemes (continued)

Notes:

- (i) These options were granted on 25 June 2004 with exercise price of HK\$0.940 and exercisable from 25 September 2004 to 24 June 2009.
- (ii) These options were granted on 27 April 2005 with exercise price of HK\$1.224 and exercisable from 27 July 2005 to 26 April 2010.
- (iii) These options were granted on 8 January 2007 with exercise price of HK\$4.186 and exercisable from 8 April 2007 to 7 January 2012.
- (iv) These options were granted on 14 September 2007 with exercise price of HK\$4.480 and exercisable from 14 December 2007 to 13 September 2012.
- (v) These options were granted on 26 May 2008 with exercise price of HK\$4.240 and exercisable from 26 August 2008 to 25 May 2013.
- (vi) These options were granted on 26 March 2009 with exercise price of HK\$3.250 and exercisable from 26 June 2009 to 25 March 2014.
- (vii) These options were granted on 26 March 2010 with exercise price of HK\$10.320 and exercisable from 26 June 2010 to 25 March 2015.
- (viii) The closing prices of the Company's shares at the date on which the share options were exercised for the year ended 31 December 2010 are ranged from HK\$3.550 (2009: HK\$3.210) to HK\$3.790 (2009: HK\$8.610).

Notes to The Consolidated Financial Statements

31 RESERVES

	Group								
	Share premium HK\$'million	Contributed surplus HK\$'million (Note (i))	Employee share-based compensation reserve HK\$'million	Merger reserve HK\$'million (Note (ii))	Available-for-sale financial assets reserve HK\$'million	Translation reserve HK\$'million	Other reserves HK\$'million	Retained earnings HK\$'million	Total HK\$'million
Balances at 31 December 2008	254	134	150	(740)	18	550	20	10,420	10,806
Business combinations under common control	-	-	-	60	-	-	-	(26)	34
Balances at 1 January 2009	254	134	150	(680)	18	550	20	10,394	10,840
Total comprehensive (loss)/income for the year	-	-	-	-	33	(532)	-	1,234	735
Transfer between reserves	-	-	-	-	-	-	75	(75)	-
Final dividend for 2008	-	-	-	-	-	-	-	(669)	(669)
Recognition of equity-settled share-based payments (Note 9)	-	-	14	-	-	-	-	-	14
Issue of shares upon placement	3,717	-	-	-	-	-	-	-	3,717
Exercise of share options	62	-	(11)	-	-	-	-	-	51
Share issue expenses	(79)	-	-	-	-	-	-	-	(79)
Acquisition of 2009 Natural Gas Projects	-	-	-	(379)	-	-	-	-	(379)
Acquisition of 2010 Natural Gas Projects	-	-	-	498	-	-	-	-	498
Purchase of non-controlling interest (Note 39(e))	-	-	-	(6)	-	-	-	-	(6)
Balances at 31 December 2009	3,954	134	153	(567)	51	18	95	10,884	14,722
Balances at 31 December 2009	3,954	134	153	(1,125)	51	18	95	10,881	14,161
Business combinations under common control	-	-	-	558	-	-	-	3	561
Balances at 1 January 2010	3,954	134	153	(567)	51	18	95	10,884	14,722
Total comprehensive (loss)/income for the year	-	-	-	-	9	227	-	2,426	2,662
Transfer between reserves	-	-	-	-	-	-	40	(40)	-
Final dividend for 2009	-	-	-	-	-	-	-	(347)	(347)
Recognition of equity-settled share-based payments (Note 9)	-	-	43	-	-	-	-	-	43
Exercise of share options	26	-	(5)	-	-	-	-	-	21
Acquisition of 2010 Natural Gas Projects	-	-	-	(858)	-	-	-	-	(858)
Purchase of non-controlling interest (Note 39(e))	-	-	-	(108)	-	-	-	-	(108)
Balances at 31 December 2010	3,980	134	191	(1,533)	60	245	135	12,923	16,135

Notes to The Consolidated Financial Statements

31 RESERVES (continued)

	Company				Total HK\$'million
	Share premium HK\$'million	Contributed surplus HK\$'million (Note (i))	Employee share-based compensation reserve HK\$'million	Retained earnings HK\$'million	
Balances at 1 January 2009	255	134	150	6,889	7,428
Profit for the year	-	-	-	121	121
Recognition of equity-settled share-based payments	-	-	14	-	14
Final dividend for 2008	-	-	-	(668)	(668)
Issue of shares upon placement	3,717	-	-	-	3,717
Exercise of share options	62	-	(11)	-	51
Share issue expenses	(79)	-	-	-	(79)
Balances at 31 December 2009	3,955	134	153	6,342	10,584
Profit for the year	-	-	-	1,371	1,371
Recognition of equity-settled share-based payments	-	-	43	-	43
Final dividend for 2009	-	-	-	(347)	(347)
Exercise of share options	26	-	(5)	-	21
Balances at 31 December 2010	3,981	134	191	7,366	11,672

Notes:

- (i) The contributed surplus of the Group and the Company represents the difference between the consolidated equity of the subsidiaries at the date on which they were acquired by the Group and the nominal amount of the Company's shares issued for the acquisition.
- (ii) The merge reserve of the Group represents the fair value of consideration paid and payable and the carrying amount of capital of the subsidiaries acquired under business combination under common control or net assets attributable to the additional interests in subsidiaries being acquired from non-controlling interest.

Notes to The Consolidated Financial Statements

32 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	Group		Company	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Accounts payable	735	384	–	–
Advances from customers	308	195	–	–
Salaries and welfare payable	77	73	16	17
Accrued expenses	65	612	11	–
Dividends payable by subsidiaries				
to non-controlling interest	18	44	–	–
Interest payable	29	68	–	–
Construction fee and equipment cost payables	861	120	–	–
Amounts due to related parties				
– Subsidiaries	–	–	113	45
– Others	51	51	–	–
Consideration payables (Note 39)	568	169	568	–
Receipts in advance (Note 29)	–	664	–	–
Other payables	382	295	2	4
	3,094	2,675	710	66

The aging analysis of accounts payable is as follows:

	Group	
	2010 HK\$'million	2009 HK\$'million
Within 3 months	615	345
Between 3 to 6 months	42	1
Over 6 months	78	38
	735	384

The average credit period on purchase of goods is 90 days. The Group has financial risk management policies in place to ensure that all payables fall within the credit time frame.

Notes to The Consolidated Financial Statements

32 ACCOUNTS PAYABLE AND ACCRUED LIABILITIES (continued)

The carrying amounts of the accounts payable and accrued liabilities are denominated in the following currencies:

	Group		Company	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Renminbi	2,819	2,356	568	–
US dollar	153	264	31	–
Hong Kong dollar	35	28	111	66
Other currencies	87	27	–	–
	3,094	2,675	710	66

33 BORROWINGS

	Group	
	2010 HK\$'million	2009 HK\$'million
Short-term borrowings		
Secured	–	15
Unsecured	4,136	1,549
	4,136	1,564
Current portion of long-term borrowings	192	–
	4,328	1,564
Long-term borrowings		
Unsecured	2,670	1,794
Less: Current portion of long-term borrowings	(192)	–
	2,478	1,794
	6,806	3,358

Notes to The Consolidated Financial Statements

33 BORROWINGS (continued)

The carrying amounts of the borrowings are denominated in the following currencies:

	Group	
	2010 HK\$'million	2009 HK\$'million
Renminbi	5,357	2,393
US dollar	1,449	965
	6,806	3,358

No borrowings of the Group were guaranteed by CNPC and its subsidiaries as at 31 December 2010 (2009: HK\$488 million), and borrowings of subsidiaries of the Company of approximately HK\$310 million (2009: Nil) were guaranteed by the Company as at 31 December 2010.

As at 31 December 2009, secured short-term borrowings are secured by property, plant and equipment, advanced operating lease payments and assets held for sale with aggregate carrying values of approximately HK\$41 million.

	Group	
	2010 HK\$'million	2009 HK\$'million
Total borrowings:		
– Interest free	2	–
– At fixed rates	6,299	3,355
– At floating rates	505	3
	6,806	3,358
Weighted average effective interest rates:		
– Bank loans	1.86%	4.69%
– Loan from an intermediate holding company	4.37%	4.37%
– Loans from CP Finance	4.29%	5.41%
– Loans from fellow subsidiaries	7.86%	8.00%

Notes to The Consolidated Financial Statements

33 BORROWINGS (continued)

The carrying amounts and fair values of long-term borrowings are as follows:

	Group	
	2010 HK\$'million	2009 HK\$'million
Carrying amounts	2,670	1,794
Fair values	2,904	2,074

The fair values are based on discounted cash flows using applicable discount rates based upon the prevailing market rates of interest available to the Group for financial instruments with substantially the same terms and characteristics at the dates of the statement of financial position. Such discount rates ranged from 0.23% to 4.50% per annum as of 31 December 2010 (2009: 0.23% to 4.32%) depending on the type of the borrowings. The carrying amounts of short-term borrowings approximate their fair values.

The borrowings can be analysed as follows:

	Short-term borrowings		Long-term borrowings	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Bank loans, wholly repayable within five years	327	15	32	–
Loans other than bank loans				
– Wholly repayable within five years	3,809	1,549	2,637	829
– Not wholly repayable within five years	–	–	1	965
	4,136	1,564	2,670	1,794

Loans other than bank loans are borrowings from CP Finance, a finance company controlled by CNPC, fellow subsidiaries and non-controlling interest.

Notes to The Consolidated Financial Statements

33 BORROWINGS (continued)

As at 31 December 2010 and 31 December 2009, the Group's short-term borrowings were repayable within one year and the Group's long-term borrowings were repayable as follows:

	Bank loans		Loans other than bank loans	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Within one year	-	-	192	-
Between one to two years	-	-	832	397
Between two to five years	32	-	1,613	1,203
After five years	-	-	1	194
	32	-	2,638	1,794

The following table details the Group's remaining contractual maturity for its non-derivative financial liabilities. The information presented is based on the earliest date on which the Group can be required to pay and represents the undiscounted cash flow including principal and interest:

	Bank loans		Loans other than bank loans	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Within one year	332	15	4,183	1,648
Between one to two years	1	-	951	503
Between two to five years	34	-	1,733	1,357
After five years	-	-	-	208
	367	15	6,867	3,716

Notes to The Consolidated Financial Statements

34 DEFERRED TAX

Deferred tax is calculated in full on temporary differences under the liability method using the applicable tax rates which is expected to apply at the time of reversal of the temporary difference.

The movements in net deferred tax assets/(liabilities) are as follows:

	Group	
	2010 HK\$'million	2009 HK\$'million
At 1 January	(888)	(762)
Currency translation differences	113	(3)
Charged to the consolidated statement of comprehensive income (Note 14)	(221)	(123)
At 31 December	(996)	(888)
Representing:		
Deferred tax assets	25	79
Deferred tax liabilities	(1,021)	(967)
	(996)	(888)

The movements in deferred tax assets/(liabilities)(to be recovered/settled after 12 months) during the year without taking into consideration of the offsetting of balances within the same tax jurisdiction, are as follows:

	Group			
	Accelerated tax depreciation HK\$'million	Withholding tax HK\$'million	Others HK\$'million	Total HK\$'million
At 1 January 2009	(122)	(732)	92	(762)
Currency translation differences	(3)	-	-	(3)
Charged to the consolidated statement of comprehensive income	(35)	(58)	(30)	(123)
At 31 December 2009	(160)	(790)	62	(888)
Currency translation differences	(17)	130	-	113
Charged to the consolidated statement of comprehensive income	(59)	(111)	(51)	(221)
At 31 December 2010	(236)	(771)	11	(996)

Notes to The Consolidated Financial Statements

35 COMMITMENTS

(a) Operating lease commitments

Operating lease commitments of the Group are mainly for leasing of land and buildings and equipment. Leases range from 1 to 15 years and usually do not contain renewal options. Future minimum lease payments as of 31 December 2010 and 2009 under non-cancellable operating leases are as follows:

	Group		Company	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Not later than 1 year	37	14	1	1
Later than 1 year and not later than 5 years	115	41	1	2
More than 5 years	102	119	–	–
	254	174	2	3

(b) Capital commitments

	Group		Company	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Contracted but not provided for:				
Oil field development costs	587	660	–	–
Acquisitions of/capital contributions to investments	24,312	232	25,610	595
Other property, plant and equipment	4,795	559	–	–
	29,694	1,451	25,610	595

	Group		Company	
	2010 HK\$'million	2009 HK\$'million	2010 HK\$'million	2009 HK\$'million
Authorised but not contracted for:				
Oil field development costs	723	644	–	–
Acquisitions of/capital contributions to investments	1,570	726	–	2,686
Other property, plant and equipment	10,557	6,453	–	–
	12,850	7,823	–	2,686

Notes to The Consolidated Financial Statements

36 OIL PRODUCTION SHARING CONTRACTS

(a) Xinjiang Contract

Pursuant to the Xinjiang Contract, the Group agreed to fund an enhanced oil recovery programme (the "Infill Development Programme") to be implemented under the Xinjiang Contract thereby reducing the inter-well spacing and improving oil recovery in the area as defined in the Xinjiang Contract (the "Contract Area"), at an estimated cost of US\$66 million (approximately HK\$510 million), in exchange for a 54% share in the oil production from the Contract Area.

Pursuant to the Xinjiang Contract, the Group bears all the costs required for the Infill Development Programme and share in the production from the Contract Area which shall be allocated (after deduction of local taxes and enterprise income tax) firstly towards operating costs recovery and thereafter in the proportion of 54% to the Group and 46% to PetroChina towards investment recovery and profit.

The Xinjiang Contract provides twelve consecutive years of production sharing commencing from the completion of the Infill Development Programme or such earlier date as may be determined by the Joint Management Committee (the "JMC") set up by the Group and PetroChina pursuant to the Xinjiang Contract to oversee oil operations in the Contract Area. The JMC resolved that the Group is entitled to oil production sharing as from 1 September 1996. The first phase of the Xinjiang Contract ended on 31 August 2009. In April 2008, the Group and PetroChina, having obtained the approval of the State Council of the PRC, extended the production period for further eight years to expire on 31 August 2016. The second phase of the Xinjiang Contract commenced on 1 September 2008.

In connection with the Xinjiang Contract, the Group has also entered into an Entrustment Contract with an operational entity wholly owned and operated by CNPC, whereby the latter was entrusted to take up the responsibility as an operator. Set out below is the summary of assets, liabilities and results for the year recognised in the consolidated financial statements in relation to the Group's interest in the Xinjiang Contract:

	2010 HK\$'million	2009 HK\$'million
(i) Results for the year		
Income	1,402	940
Expenses	(791)	(573)
(ii) Assets and liabilities		
Oil and gas properties	393	307
Other non-current assets	19	5
Current assets	530	449
Current liabilities	(166)	(120)
Net assets	776	641
(iii) Capital commitments		
Contracted but not provided for	128	134

Notes to The Consolidated Financial Statements

36 OIL PRODUCTION SHARING CONTRACTS (continued)

(b) Leng Jiapu Contract

Pursuant to the Leng Jiapu Contract signed in 1997, the Group agreed to acquire 70% of the production sharing interest for RMB1,008 million (approximately HK\$942 million) and to fund its share of cost of the development carried out for the realisation of oil production (the "Development Operations") in the area as defined in the Leng Jiapu Contract (the "LJP Contract Area"), at an estimated cost of US\$65.5 million (approximately HK\$506 million) in the first two years of the development period and be further responsible for 70% of the development cost after the first two years, in exchange for a 70% share in the oil production from the LJP Contract Area.

Pursuant to the Leng Jiapu Contract, the Group shall bear 70% of the costs required for the Development Operations in the LJP Contract Area which shall be allocated (after deduction of local taxes and enterprise income tax) firstly towards operating costs recovery and thereafter in the proportion of 70% to the Group and 30% to PetroChina towards investment recovery and profit.

The Leng Jiapu Contract provides twenty consecutive years of production sharing commencing from the completion of the Development Operations. The production sharing period commenced on 1 March 1998.

In connection with the Leng Jiapu Contract, the Group has also entered into an Entrustment Contract with an operational entity owned and operated by CNPC, whereby the latter is entrusted to take up the responsibility as an operator. Under the Entrustment Contract, a Joint Development Management Organisation was established for the performance of the contractual responsibilities under the operatorship.

The summary of assets, liabilities and results for the year recognised in the consolidated financial statements in relation to the Group's interest in the Leng Jiapu Contract is as follows:

	2010 HK\$'million	2009 HK\$'million
(i) Results for the year		
Income	1,432	1,146
Expenses	(1,160)	(997)
(ii) Assets and liabilities		
Oil and gas properties	2,308	2,043
Current assets	1,139	1,269
Current liabilities	(547)	(343)
Non-current liabilities	(157)	(104)
Net assets	2,743	2,865
(iii) Capital commitments		
Contracted but not provided for	452	419

Notes to The Consolidated Financial Statements

36 OIL PRODUCTION SHARING CONTRACTS (continued)

(c) K&K Contract

In 2002, the Group acquired 25% of the production sharing interest in Kursangi and Karabagli oil fields in the Azerbaijan ("K&K Contract Area") for US\$40.5 million (approximately HK\$316 million) from independent third parties.

Pursuant to the K&K Contract, the Group shall bear 25% of the costs in connection with the oil production in the K&K Contract Area.

The summary of assets, liabilities and results for the year recognised in the consolidated financial statements in relation to the Group's interest in the K&K Contract is as follows:

	2010 HK\$'million	2009 HK\$'million
(i) Results for the year		
Income	437	311
Expenses	(507)	(292)
(ii) Assets and liabilities		
Oil and gas properties	464	593
Current assets	15	30
Current liabilities	(7)	(9)
Net assets	472	614
(iii) Capital commitments		
Contracted but not provided for	31	107

37 RELATED PARTY TRANSACTIONS

CNPC, the controlling shareholder of the Company, is a state-controlled enterprise directly controlled by the PRC government. The PRC government is the ultimate controlling party of the Company. Related parties include CPNC and its subsidiaries, other state-owned enterprises and their subsidiaries which the PRC government has control, joint control or significant influence over and enterprises which the Group is able to control, jointly control or exercise significant influence over, key management personnel of the Company and CNPC and their close family members.

In addition to the related party information shown elsewhere in the consolidated financial statements, the following is a summary of significant related party transactions entered into in the ordinary course of business between the Group and its related parties during the years and balances arising from related party transactions at the end of the years indicated below:

Notes to The Consolidated Financial Statements

37 RELATED PARTY TRANSACTIONS (continued)

(a) Transactions with CNPC and its subsidiaries, associates and jointly controlled entities

The Group has extensive transactions with other companies in the CNPC Group. Due to these relationships, it is possible that the terms of the transactions between the Group and other members of the CNPC Group are not the same as those that would result from transactions with other related parties or wholly unrelated parties.

The principal related party transactions with the CNPC Group and associates and jointly controlled entities of the Group which were carried out in the ordinary course of business, are as follows:

- (i) The Group entered into (i) the Xinjiang Contract and the Leng Jiapu Contract (together, the "PSAs") with the CNPC Group in 1996 and 1997 respectively and (ii) the Master Agreement in 2003, which was subsequently amended in 2006 pursuant to the First Supplement Agreement.

On 25 March 2009 and 19 May 2010, the Group and CNPC entered into the Second and Third Supplement Agreements for expansion of the scope of products and services to be provided by the CNPC Group under the Master Agreement, and also for the expansion of the term of the Master Agreement to expire on 31 December 2011.

Under the PSAs, the Group procures from the CNPC Group on a continuing basis certain services and assistance such as personnel training, leasing of warehouses and terminal facilities and utilisation of transportation and communication facilities. Whereas, the Master Agreement provides a framework for the Group to procure a range of products and services from the CNPC Group in relation to its oil exploration and production projects.

- Provision of products and services by the CNPC Group to the Group amounted to approximately HK\$1,589 million (2009: HK\$809 million).
- Purchase of the Group's share of crude oil production by the CNPC Group amounted to approximately HK\$2,823 million (2009: HK\$2,080 million).
- Supply of crude oil, natural gas, refined oil products, chemical products and other ancillary or similar products by the CNPC Group to the Group amounted to approximately HK\$1,795 million (2009: HK\$972 million).
- Provision of products and services by the Group to the CNPC Group amounted to approximately HK\$431 million (2009: Nil).
- Assistance fee paid to the CNPC Group amounted to approximately HK\$0.7 million (2009: HK\$0.7 million) in the year ended 31 December 2010.
- Training fee paid to the CNPC Group amounted to approximately HK\$0.7 million (2009: HK\$0.7 million) in the year ended 31 December 2010.

The above transactions constituted connected transactions in accordance with Chapter 14A of the Rules Governing the Listing of Securities on the Stock Exchange.

Notes to The Consolidated Financial Statements

37 RELATED PARTY TRANSACTIONS (continued)

(a) Transactions with CNPC and its subsidiaries, associates and jointly controlled entities (continued)

- (ii) Purchases of financial service principally represent interest charged on the loans and advances obtained from CNPC and fellow subsidiaries, insurance fee, etc. The total amount of these transactions amounted to approximately HK\$281 million in the year ended 31 December 2010 (2009: HK\$233 million). Information on loans from related parties are included in Note 33.
- (iii) The Group has entered into agreement for the sales of natural gas to certain associates of the Group amounted to approximately HK\$81 million for the year ended 31 December 2010 (2009: HK\$85 million).
- (iv) The Group disposed of the Pipeline Business on 28 January 2010 (Note 29), no revenue from the provision of services in connection with the transportation of crude oil to the CNPC Group. For the year ended 31 December 2009, the amount was approximately HK\$223 million.
- (v) As at 31 December 2010 and 2009, amounts due from and to CNPC and its subsidiaries, associates and jointly controlled entities of the Group, which are unsecured and interest free, included in the following accounts captions are summarised as follows:

	2010 HK\$'million	2009 HK\$'million
Accounts receivable	225	91
Accounts payable and accrued liabilities	272	217
Borrowings	6,446	3,343

(b) Key management compensation:

	2010 HK\$'million	2009 HK\$'million
Salaries and allowances	22	20
Retirement benefits-defined contribution scheme	1	1
Share-based payments	31	10
	54	31

Notes to The Consolidated Financial Statements

37 RELATED PARTY TRANSACTIONS (continued)

(c) Transactions with other state-controlled entities in the PRC

Apart from transactions with CNPC, its subsidiaries, associates and jointly controlled entities, the Group has transactions with other state-controlled entities include but not limited to (i) sales and purchases of goods and services; (ii) purchases of assets; (iii) lease of assets; and (iv) bank deposits and borrowings.

These transactions are conducted in the ordinary course of the Group's business on terms comparable to those with other entities that are not state-controlled.

38 SEGMENT INFORMATION

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker which is determined as the Board of Directors of the Company.

The Group organises its business around products and services. From the products and services perspective, the Group is engaged in a broad range of petroleum related activities and derives its revenue from its two operating segments: Exploration and Production, and Natural Gas Distribution.

The Exploration and Production segment is engaged in the exploration, development, production and sale of crude oil and natural gas. It is further evaluated on a geographic basis (PRC, South America and other territories).

The Natural Gas Distribution segment is engaged in the sale of natural gas and the transmission of natural gas in the PRC. After the acquisitions of several natural gas projects and the continuing expansion of the Group's businesses in 2010, two new segments within Natural Gas Distribution segment are identified and evaluated by the Board of Directors of the Company. Currently, the Natural Gas Distribution segment includes Natural Gas Sales, LNG Processing and Storage and Natural Gas Pipeline.

The Natural Gas Pipeline segment does not meet the definition of reportable segment, its financial information is included in the Natural Gas Sales segment.

No sales between operating segments are undertaken. The Board of Directors assesses the performance of the operating segments based on each segment's profit/(loss) before income tax expense, share of profits less losses of associates and jointly controlled entities ("segment results").

Total assets exclude deferred and current taxes, available-for-sale financial assets, investments in associates and jointly controlled entities, all of which are managed on a central basis ("segment assets").

Corporate income and expenses, net, mainly refers to interest income earned from time deposits with maturities over three months and cash and cash equivalents, and general and administration expenses incurred at corporate level.

Corporate assets mainly comprise time deposits with maturities over three months and cash and cash equivalents held at corporate level.

Notes to The Consolidated Financial Statements

38 SEGMENT INFORMATION (continued)

The segment information provided to the Board of Directors for the reportable segments for the years ended 31 December 2010 and 2009 are as follows:

	Exploration and Production			Natural Gas Distribution		Corporate	Total
	PRC	South America	Others	Natural Gas Sales	LNG Processing and Storage		
	HK\$'million	HK\$'million	HK\$'million	HK\$'million	HK\$'million	HK\$'million	HK\$'million
For the year ended 31 December 2010							
Revenue from external customers	2,824	707	743	4,794	-	-	9,068
Segment results	1,128	354	(35)	737	(12)	(35)	2,137
Share of profits less losses of:							
– Associates							2,030
– Jointly controlled entities							226
Profit before income tax expense							4,393
Income tax expenses							(1,015)
Profit for the year							3,378
Segment results included:							
Interest income	11	1	1	39	-	17	69
Depreciation, depletion and amortisation	306	53	260	288	-	-	907
Interest expense	-	-	85	82	-	-	167
As at 31 December 2010							
Non-current assets	2,814	426	1,091	4,252	5,280	846	14,709
Current assets	1,685	228	751	6,069	1,107	380	10,220
Segment assets	4,499	654	1,842	10,321	6,387	1,226	24,929
Investments in jointly controlled entities							1,497
Investments in associates							5,628
Available-for-sale financial assets							129
Deferred tax assets							25
Prepaid income taxes							18
Total assets							32,226

Notes to The Consolidated Financial Statements

38 SEGMENT INFORMATION (continued)

	Exploration and Production			Natural Gas Distribution		Corporate HK\$'million	Total HK\$'million
	PRC HK\$'million	South America HK\$'million	Others HK\$'million	Natural Gas Sales HK\$'million	LNG		
					Processing and Storage HK\$'million		
For the year ended 31 December 2009							
Revenue from external customers	2,080	528	543	3,013	-	-	6,164
Segment results	638	252	119	511	-	(68)	1,452
Share of profits less losses of:							
- Associates							256
- Jointly controlled entities							252
Profit before income tax expense							1,960
Income tax expense							(420)
Profit for the year							1,540
Segment results included:							
Interest income	22	1	3	8	-	6	40
Depreciation, depletion and amortisation	293	32	77	162	-	1	565
Interest expense	-	-	77	58	-	-	135
As at 31 December 2009							
Non-current assets	2,463	306	1,193	1,939	3,020	97	9,018
Current assets	1,912	175	291	2,582	54	4,067	9,081
Segment assets	4,375	481	1,484	4,521	3,074	4,164	18,099
Investments in jointly controlled entities							1,113
Investments in associates							5,231
Available-for-sale financial assets							105
Deferred tax assets							79
Prepaid income taxes							37
Total assets							24,664

Neither the Group's revenue is derived from nor the Group's non-current assets are located in the place of domicile of the Company.

For the year ended 31 December 2010, revenue of approximately HK\$5,026 million (2009: HK\$2,998 million) are derived from two single customers. The revenue is attributable to the Exploration and Production and Natural Gas distribution segments.

Notes to The Consolidated Financial Statements

39 ACQUISITIONS

(a) Business combinations under common control

During the year ended 31 December 2010, the Group entered into acquisition agreements to acquire (i) a 55% equity interest in PetroChina LNG Jiangsu Company Ltd. for a cash consideration of approximately RMB500 million (approximately HK\$568 million) on 17 May 2010; (ii) a 75% equity interest in PetroChina Dalian LNG Company Ltd (“Dalian LNG”) for a cash consideration of approximately RMB2,009 million (approximately HK\$2,339 million) on 9 November 2010; (iii) a 51% equity interest in Langfang Huayou Tiancheng Gas Sales Company Limited (“Langfang”) for a cash consideration of approximately RMB408 million (approximately HK\$475 million) on 26 November 2010; (iv) a 51% equity interest in Sichuan Chuangang Gas Limited Company (“Chuangang”) for a cash consideration of approximately RMB159 million (approximately HK\$180 million) on 22 June 2010; and (v) a 60% equity interest in PetroChina Beijing Gas Pipelines Co., Ltd. (“Beijing Gas Pipeline”) for a share consideration of approximately RMB18,871 million (approximately HK\$21,973 million) on 31 December 2010. Except for the acquisitions of Dalian LNG and Beijing Gas Pipeline, all other acquisitions were completed during the year ended 31 December 2010. The acquisitions of Langfang and Chuangang were by means of capital injection. The above acquisitions are collectively referred to as the “2010 Natural Gas Projects”.

During the year ended 31 December 2009, the Group entered into acquisition agreements to acquire (i) a 50.98% equity interest in CNPC Shennan Oil Technology Development Co., Ltd. for a cash consideration of approximately RMB95 million (approximately HK\$108 million) on 19 December 2008; (ii) a 97.26% equity interest in 新疆新捷股份有限公司 for a cash consideration of approximately RMB328 million (approximately HK\$379 million) on 9 January 2009; and (iii) a 51.01% equity interest in 華油天然氣股份有限公司 for a cash consideration of approximately RMB435 million (approximately HK\$493 million) on 16 February 2009. The acquisitions were completed during the year ended 31 December 2009. The acquisitions of 華油天然氣股份有限公司 and CNPC Shennan Oil Technology Development Co., Ltd. were by means of capital injection. 新疆新捷股份有限公司, 華油天然氣股份有限公司 and CNPC Shennan Oil Technology Development Co., Ltd. are collectively referred to as the “2009 Natural Gas Projects”.

These acquisitions are business combinations under common control since the Company and 2010 Natural Gas Projects are under the common control of CNPC. As a result, the Company has accounted for the acquisitions in a manner similar to a uniting of interests, whereby the assets and liabilities acquired are accounted for at carryover predecessor values to CNPC.

Notes to The Consolidated Financial Statements

39 ACQUISITIONS (continued)

(a) Business combinations under common control (continued)

The consolidated financial statements have been restated to give effect to these acquisitions with all periods presented as if the operations of the Group and the 2010 Natural Gas Projects have always been combined. The difference between the consideration and the aggregate share capital of 2010 Natural Gas Projects acquired has been adjusted against equity.

The summarised results of operations for the year ended 31 December 2009 and the financial position as at 31 December 2009 for the separate entities and on a consolidation basis are set out below:

	The Group (as previously reported) HK\$'million	2010 Natural Gas Projects HK\$'million	The Group (as restated) HK\$'million
Results of operations for the year ended 31 December 2009			
Revenue	5,280	884	6,164
Profit for the year	1,463	77	1,540
Earnings per share for profit attributable to owners of the Company			
– Basic (HK cents)	26.79	0.67	27.46
– Diluted (HK cents)	26.40	0.66	27.06

Notes to The Consolidated Financial Statements

39 ACQUISITIONS (continued)

(a) Business combinations under common control (continued)

	The Group (as previously reported) HK\$'million	2010 Natural Gas Projects HK\$'million	The Group (as restated) HK\$'million
Financial position as at 31 December 2009			
Non-current assets			
Property, plant and equipment	5,778	2,913	8,691
Other non-current assets	6,852	3	6,855
	12,630	2,916	15,546
Current assets	8,787	331	9,118
	21,417	3,247	24,664
Current liabilities			
Short-term borrowings	163	1,401	1,564
Other current liabilities	2,113	778	2,891
	2,276	2,179	4,455
Non-current liabilities	2,765	3	2,768
	5,041	2,182	7,223
Net assets	16,376	1,065	17,441
Cash flows for the year ended 31 December 2009			
Net cash generated from operating activities	1,544	1,191	2,735
Net cash used in from investing activities	(1,608)	(2,369)	(3,977)
Net cash generated from financing activities	2,676	1,399	4,075
Increase in cash and cash equivalents	2,612	221	2,833

Notes to The Consolidated Financial Statements

39 ACQUISITIONS (continued)

(b) Acquisition of a plant in Liquefied Natural Gas (“LNG”) operation

There were no acquisitions for the year ended 31 December 2010.

On 26 October 2009, the Group acquired a LNG processing plant located at Fushan Town, Chengmai Country, Hainan Province, PRC with an annual production capacity of 80,000 tonnes and its associated assets including, but not limited to, production equipment, land and buildings on which the plant was located, vehicles, machinery and equipment and the staff of such LNG processing plant for approximately RMB202 million (approximately HK\$228 million). The acquired business contributed revenue of approximately HK\$10 million and net profit of approximately HK\$5 million to the Group for the period from 1 November 2009 to 31 December 2009. If the acquisition had occurred on 1 January 2009, revenue would have been approximately HK\$10 million, and profit before allocations would have been approximately HK\$5 million. These amounts have been calculated using the Group’s accounting policies and by adjusting the results of the subsidiary to reflect the additional depreciation and amortisation that would have been charged assuming the fair value adjustments to property, plant and equipment and intangible assets had applied from 1 January 2009, together with the consequential tax effects.

Details of net assets acquired and goodwill are as follows:

	HK\$’million
Purchase consideration:	
– Cash paid	114
– Consideration payables as at 31 December 2009	115
– Direct costs relating to the acquisition	27
Total purchase consideration	256

The assets and liabilities as of 26 October 2009 arising from the acquisition are as follows:

	Fair value HK\$’million	Acquiree’s carrying amount HK\$’million
Property, plant and equipment	238	238
Prepaid expenses and other current assets	18	18
Fair value of net assets acquired and total purchase consideration	256	256

Notes to The Consolidated Financial Statements

39 ACQUISITIONS (continued)

(c) Acquisitions of subsidiaries

For the year ended 31 December 2010, the Group acquired controlling interest in 16 subsidiaries, which are principally engaging in natural gas distribution business in the PRC for an aggregated consideration of RMB137 million (approximately HK\$158 million). The acquired businesses contributed revenue of approximately HK\$333 million and net profit of approximately HK\$28 million to the Group for the period from the respective dates of acquisition to 31 December 2010. If the acquisition had occurred on 1 January 2010, revenue would have been approximately HK\$768 million, and profit before allocations would have been approximately HK\$64 million. These amounts have been calculated using the Group's accounting policies and by adjusting the results of the subsidiary to reflect the additional depreciation and amortisation that would have been charged assuming the fair value adjustments to property, plant and equipment and intangible assets had applied from 1 January 2010, together with the consequential tax effect.

Details of net assets acquired and goodwill are as follows:

	HK\$'million
Aggregate purchase consideration	
– Cash paid	158
Less: Aggregate fair value of net assets acquired, as below	99
Goodwill	59

The aggregate assets and liabilities as of the respective dates of acquisitions arising from the acquisitions are as follows:

	Aggregate fair value HK\$'million	Aggregate acquiree's carrying amount HK\$'million
Property, plant and equipment	50	50
Intangibles and other non-current assets	55	55
Cash and cash equivalents	70	70
Accounts receivable	27	27
Prepaid expenses and other current assets	174	174
Accounts payable and accrual liabilities	(225)	(225)
Non-controlling interest	(52)	(52)
Fair value of net assets and total purchase consideration	99	99
Purchase consideration paid	158	
Cash and cash equivalents acquired	(70)	
Cash outflow on acquisition	88	

Notes to The Consolidated Financial Statements

39 ACQUISITIONS (continued)

(c) Acquisitions of subsidiaries (continued)

On 30 September 2009, the Group acquired 100% equity interest in 慶陽欣達技術工程股份有限公司, which owns a LNG processing plant in Qingyang for a consideration of RMB47 million (approximately HK\$53 million). The acquired business contributed revenue of approximately HK\$7 million and net profit of approximately HK\$2 million to the Group for the period from 1 October 2009 to 31 December 2009. If the acquisition had occurred on 1 January 2009, revenue would have been approximately HK\$46 million, and profit before allocations would have been approximately HK\$4 million. These amounts have been calculated using the Group's accounting policies and by adjusting the results of the subsidiary to reflect the additional depreciation and amortisation that would have been charged assuming the fair value adjustments to property, plant and equipment and intangible assets had applied from 1 January 2009, together with the consequential tax effect.

Details of net assets acquired and goodwill are as follows:

	HK\$'million
Total purchase consideration payables as at 31 December 2009	53

The assets and liabilities as of 30 September 2009 arising from the acquisition are as follows:

	Fair value HK\$'million	Acquiree's carrying amount HK\$'million
Property, plant and equipment	53	53
Intangibles and other non-current assets	11	11
Cash and cash equivalents	1	1
Accounts receivable	13	13
Prepaid expenses and other current assets	4	4
Accounts payable and accrual liabilities	(29)	(29)
Fair value of net assets and total purchase consideration	53	53
Cash and cash equivalents in subsidiary acquired and cash inflow on acquisition	1	

Notes to The Consolidated Financial Statements

39 ACQUISITIONS (continued)

(d) Acquisition of an associate

There were no acquisition for the year ended 31 December 2010.

On 20 October 2009, the Group successfully completed the acquisition of 49% equity interest in Zhongyou Zhongtai, a sino-foreign joint venture established under the PRC laws, from a fellow subsidiary at a total consideration of approximately RMB616 million (approximately HK\$702 million). Zhongyou Zhongtai is principally engaged in the construction, operation and management of city gas pipeline network and ancillary facilities, comprehensive development and utilisation and sale of liquefied petroleum gas, and provision of safety testing, maintenance and emergency repair of the city gas transportation and distribution equipment and other services in the PRC.

The share of assets and liabilities as of 20 October 2009 arising from the acquisition are as follows:

	HK\$'million
Purchase consideration:	
– Cash paid	702
– Direct costs relating to the acquisition	2
	<hr/> 704
Less: 49% share of fair value of net assets acquired	(306)
	<hr/> 398
Goodwill included in investments in associates	<hr/> 398

(e) Transactions with non-controlling interest

Purchase of non-controlling interest during the year ended 31 December 2010 mainly included the acquisition of an additional 26.58% equity interest in Huayou. On 30 December 2009, the Group entered into an acquisition agreement with a non-controlling interest to acquire 92 million shares in Huayou, representing approximately 26.58% equity interest in Huayou, at a consideration of approximately RMB260 million (approximately HK\$294 million). The Group's equity interest in Huayou increased from 51.01% to 77.59%. The carrying amount of the non-controlling interest in Huayou on the date of acquisition was approximately HK\$209 million. The Group recognised a decrease in non-controlling interest of approximately HK\$209 million and a decrease in equity attributable to owners of the Company of approximately HK\$85 million.

Notes to The Consolidated Financial Statements

39 ACQUISITIONS (continued)

(e) Transactions with non-controlling interest (continued)

Effects of transactions with non-controlling interest on the equity attributable to owners of the Company for the year ended 31 December 2010:

	2010 HK\$'million	2009 HK\$'million
Total comprehensive income for the year attributable to owners of the Company	2,662	735
Changes in equity attributable to owners of the Company arising from:		
– Acquisition of non-controlling interest in Huayou	(85)	–
– Acquisition of non-controlling interest in other subsidiaries	(23)	(6)
Net effect for transactions with non-controlling interest on changes in equity attributable to owners of the Company (Note 31)	(108)	(6)
	2,554	729

40 EVENTS AFTER THE DATE OF THE STATEMENT OF FINANCIAL POSITION

On 11 March 2011, the acquisition of 60% equity interest in PetroChina Beijing Pipeline was approved by the shareholders of the Company in a special general meeting.

On 28 February 2011, the Company entered into a loan agreement with a fellow subsidiary. Pursuant to which the fellow subsidiary has advanced approximately HK\$1,090 million to the Company for its daily operation of business. The loan is unsecured, interest bearing at HIBOR plus 1% per annum and repayable by 2012.

41 APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the Board of Directors on 17 March 2011 and will be submitted to the shareholders for approval at the forthcoming annual general meeting.

Notes to The Consolidated Financial Statements

42 PRINCIPAL SUBSIDIARIES

Details of the Company's principal subsidiaries, all of which are limited liability companies at 31 December 2010 and 2009, are as follows:

Name of subsidiary	Place of incorporation/ establishment	Nominal value of issued and fully paid ordinary shares/ registered capital	Type of legal entity	Percentage of equity interest attributable to the Group
<u>Exploration, production and sales of crude oil in the PRC</u>				
Hafnium Limited	British Virgin Islands	US\$1	Limited liability company	100%
Beckbury International Limited	British Virgin Islands	US\$1	Limited liability company	100%
<u>Exploration, production and sales of crude oil in Peru</u>				
SAPET Development Corporation ("SAPET")	United States of America	100 ordinary shares no par value	Limited liability company	50.00% (Note)
SAPET Development Peru Inc	United States of America	100 ordinary shares no par value	Limited liability company	50.00% (Note)
<u>Exploration, production and sales of crude oil in Thailand</u>				
Central Place Company Limited	Hong Kong	HK\$1,600	Limited liability company	100.00%
Sino-U.S. Petroleum Inc.	United States of America	US\$1,000	Limited liability company	100.00%
CNPCHK (Thailand) Limited	Thailand	Baht100 million	Limited liability company	100.00%
<u>Exploration, production and sales of crude oil in Azerbaijan</u>				
Fortunemate Assets Limited	British Virgin Islands	US\$1	Limited liability company	100.00%
<u>Exploration, production and sales of crude oil in Indonesia</u>				
Continental GeoPetro (Bengara-II) Limited	British Virgin Islands	US\$50,000	Limited liability company	70.00%

Notes to The Consolidated Financial Statements

42 PRINCIPAL SUBSIDIARIES (continued)

Name of subsidiary	Place of incorporation/ establishment	Nominal value of issued and fully paid ordinary shares/ registered capital	Type of legal entity	Percentage of equity interest attributable to the Group
<u>Natural gas distribution in the PRC</u>				
CNPC Shennan Oil Technology Development Co., Ltd.	PRC	RMB352 million	Limited liability company	96.68%
華油天然氣股份有限公司 (“Huayou”)	PRC	RMB1,041 million	Limited liability company	77.59% (Note 39(e))
新疆新捷股份有限公司	PRC	RMB550 million	Limited liability company	97.26%
河北華港燃氣有限公司	PRC	RMB1 million	Sino-foreign equity joint venture	51.00%
西安慶港潔能科技有限公司	PRC	RMB50 million	Sino-foreign equity joint venture	51.00%
新疆博瑞能源有限公司	PRC	RMB255 million	Limited liability company	88.24%
四川川港燃氣有限責任公司	PRC	RMB166 million	Limited liability company	51.00%
Kunlun Energy (Shandong) Company Limited	PRC	RMB220 million	Limited liability company	51.00%
Petrochina Tianjin Gas Pipeline Company Ltd.	PRC	RMB100 million	Limited liability company	51.00%
昆侖能源青海有限公司	PRC	RMB150 million	Limited liability company	100.00%
滄州中油燃氣有限公司	PRC	RMB100 million	Limited liability company	51.00%
中石油江蘇液化天然氣有限公司	PRC	RMB2,533 million	Limited liability company	51.00%

Note:

In accordance with the share purchase agreement dated 8 September 2001, the Group has the power to control the financial and operating policies of SAPET Development Corporation (“SAPET”). As a result, SAPET is accounted for as a subsidiary of the Company.

Since SAPET Development Peru Inc. is wholly owned by SAPET, it is also accounted for as the subsidiary of the Company.

None of the subsidiaries had any debt securities at 31 December 2010 or at any time during the year.

Notes to The Consolidated Financial Statements

43 PRINCIPAL ASSOCIATES

As at 31 December 2010 and 2009, the Group had interest in the following principal associates:

Name of associate	Place of incorporation and type of legal entity	Nominal value of issued and fully paid ordinary share	Percentage of interest held by the Group	Principal activity
CNPC-Aktobemunaigas Joint Stock Company ("Aktobe")	Kazakhstan, Joint-stock company	8,946,470 common shares of 1,500 tenge each	25.12% (Note)	Exploration and production of petroleum
China City Natural Gas Investment Group Co., Ltd	PRC, equity joint venture	RMB400 million	49.00%	Natural gas distribution

Note:

The Group through 60% owned subsidiary, hold a 25.12% interest in Aktobe. The Group effectively holds 15.072% interest in Aktobe.

44 PRINCIPAL JOINTLY CONTROLLED ENTITIES

As at 31 December 2010 and 2009, the Group had interest in the following principal jointly controlled entities:

Name of jointly controlled entity	Place of incorporation/ establishment and type of legal entity	Registered capital/particulars of issued shares	Percentage of interest in ownership and profit sharing	Principal activities and place of operations
華油鋼管有限公司	PRC, equity joint venture	RMB370 million	39.56%	Manufacturing of steel pipe in the PRC
北京中油聯合信息技術有限公司 (Note)	PRC, equity joint venture	RMB30 million	32.00%	Operation of a web portal in the PRC
青島慶昕塑料有限公司	PRC, equity joint venture	RMB124 million	25.00%	Production of petro-chemical products in the PRC
Mazoon Petrogas (BVI) Limited	British Virgin Islands, limited liability company	50,000 ordinary shares of US\$1 each	50.00%	Crude oil exploration and production in Oman
Commonwealth Gobustan Limited ("CGL") (Note)	Anguilla, limited liability company	26,900 ordinary shares no par value	31.41%	Crude oil exploration and production in Azerbaijan
山西國興煤層氣輸配有限責任公司	PRC, equity joint venture	RMB100 million	35.00%	Coal steam gas operation in the PRC

Note:

北京中油聯合信息技術有限公司 and CGL were disposed of in 2010 and 2009 respectively and were completed in 2010.

Financial Summary

	Year ended 31 December					
	2010 HK\$'million	2009 HK\$'million (restated) (Note 1)	2009 HK\$'million (unrestated) (Note 2)	2008 HK\$'million (unrestated) (Note 2)	2007 HK\$'million (unrestated) (Note 2)	2006 HK\$'million (unrestated) (Note 2)
Results						
Revenue	9,068	6,164	5,280	5,208	3,843	3,894
Profit before income tax expense	4,393	1,960	1,855	5,554	2,315	2,777
Income tax expense	(1,015)	(420)	(392)	(1,035)	(630)	(722)
Profit for the year	3,378	1,540	1,463	4,519	1,685	2,055
Non-controlling interest	(952)	(306)	(259)	(1,200)	(318)	(324)
Profit attributable to owners of the Company	2,426	1,234	1,204	3,319	1,367	1,731
Earnings per share						
– Basic (HK cents)	49.02	27.46	26.79	69.70	28.23	35.84
– Dilute (HK cents)	48.22	27.06	26.40	68.99	27.88	35.90

	As at 31 December					
	2010 HK\$'million	2009 HK\$'million	2009 HK\$'million	2008 HK\$'million	2007 HK\$'million	2006 HK\$'million
Assets and liabilities						
Total assets	32,226	24,664	21,417	14,816	22,727	21,017
Total liabilities	(11,188)	(7,223)	(5,041)	(2,538)	(2,247)	(1,597)
Total equity	21,038	17,441	16,376	12,278	20,480	19,420

Notes:

- (1) Due to business combinations under common control completed in 2010, the financial information of the Group has been restated in a manner similar to an uniting of interests to reflect the acquisitions.
- (2) The financial information of the Group has not been restated as the directors consider that the unrevised financial information is more appropriate for year-on-year comparison of the change in the Group's business operation.

Reserve Quantities Information

PROVEN DEVELOPED RESERVES (ESTIMATION)

Crude Oil

	PRC	South America	Central Asia	South East Asia	Middle East	Total
	(million barrels)	(million barrels)	(million barrels)	(million barrels)	(million barrels)	(million barrels)
As at 1 January 2010	39.4	2.7	71.2	5.9	8.9	128.1
Revision	–	(0.3)	(26.6)	(0.4)	(2.0)	(29.3)
Production	(5.9)	(0.6)	(7.6)	(0.6)	(2.4)	(17.1)
As at 31 December 2010	33.5	1.8	37.0	4.9	4.5	81.7

Natural gas

	South America	Central Asia	Total
	(million cu.feet)	(million cu.feet)	(million cu.feet)
As at 1 January 2010	1,139.0	101,120.1	102,259.1
Revision	(115.0)	16,512.1	16,397.1
Production	(389.1)	(15,431.6)	(15,820.7)
As at 31 December 2010	634.9	102,200.6	102,835.5

Notes:

- (a) Based on the Group's share of participated interest in the oil field through subsidiaries, associates and joint ventures.
- (b) Participated interest belonging to minority interest is excluded.
- (c) The revision is due to the change from proved reserve to proved developed reserve.

Locations of Natural Gas , Liquefied Natural Gas Distribution and Liquefied Natural Gas Terminal in PRC



Province	CNG Station	LNG Station	LNG Plant	LNG Terminal	Total	Under Construction					
						In Operation	CNG Station	LNG Station	LNG Plant	LNG Terminal	Total
1. Xinjiang	57	-	3	-	60	55	2	-	3	-	60
2. Hainan	21	4	1	-	26	25	-	1	-	-	26
3. Inner Mongolia	10	17	3	-	30	10	1	16	3	-	30
4. Hebei	21	1	2	-	24	13	8	1	2	-	24
5. Sichuan	13	2	2	-	17	13	-	2	2	-	17
6. Shandong	12	1	-	-	13	13	-	-	-	-	13
7. Shaanxi	7	-	1	-	8	7	-	-	1	-	8
8. Guangdong	3	4	-	-	7	7	-	-	-	-	7
9. Qinghai	5	-	2	-	7	7	-	-	-	-	7
10. Hunan	1	-	-	-	1	1	-	-	-	-	1
11. Anhui	1	-	-	-	1	1	-	-	-	-	1
12. Ningxia	1	-	-	-	1	1	-	-	-	-	1
13. Zhejiang	-	1	-	-	1	1	-	-	-	-	1
14. Beijing	-	1	-	-	1	-	-	1	-	-	1
15. Jiangsu	-	-	-	1	1	-	-	-	-	1	1
16. Dalian (Note 2)	-	-	-	1	1	-	-	-	-	1	1
	152	31	14	2	199	154	11	21	11	2	199

Notes: (1) include natural gas stations & LNG plants owned by an associated Company.
(2) The acquisition will be completed in 2011.

LOCATIONS OF CRUDE OIL EXPLORATION AND PRODUCTION BUSINESS

原油勘探及生產業務分佈圖



Existing Projects
現有項目

Headquarters
總部

