



CNPC (HONG KONG) LIMITED

(Incorporated in Bermuda with limited liability)

中國(香港)石油有限公司

(Stock Code: 0135)

Annual Report
2005



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CORPORATE INFORMATION

BOARD OF DIRECTORS

Mr Wang Mingcai (*Chairman*)

Mr Li Hualin (*Chief Executive Officer*)

Mr Cheng Cheng

Mr Lin Jingao

Dr Lau Wah Sum, GBS, LLD, DBA, JP

Mr Aubrey Li Kwok Sing

Dr Liu Xiao Feng

COMPANY SECRETARY

Mr Lau Hak Woon

BERMUDA RESIDENT REPRESENTATIVE

Codan Services Limited

Clarendon House

Church Street

Hamilton HM11, Bermuda

AUDITORS

PricewaterhouseCoopers

BANKERS

Bank of Bermuda Limited

Standard Chartered Bank

Bank of China

Fubon Bank (Hong Kong) Limited

STOCK CODE

The Stock Exchange of Hong Kong Limited

135.HK

WEBSITE

<http://www.cnpc.com.hk>

PRINCIPAL BOARD COMMITTEES

Audit Committee

Dr Lau Wah Sum, GBS, LLD, DBA, JP (*Chairman*)

Mr Aubrey Li Kwok Sing

Dr Liu Xiao Feng

Remuneration Committee

Mr Aubrey Li Kwok Sing (*Chairman*)

Dr Lau Wah Sum, GBS, LLD, DBA, JP

Dr Liu Xiao Feng

SOLICITORS

Baker & McKenzie

Clifford Chance

REGISTERED OFFICE

Clarendon House

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PRINCIPAL REGISTRARS

Bank of Bermuda Limited

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Hamilton HM11, Bermuda

REGISTRARS IN HONG KONG

Secretaries Limited

26/F., Tesbury Centre,

28, Queen's Road East,

Hong Kong

CHAIRMAN'S STATEMENT

I am pleased to announce to the shareholders on behalf of the Board that for the year ended 31st December 2005, the Group recorded an operating profit after tax and minority interests of HK\$1,268,563,000, representing an increase of 80.74% and a new high as compared with a profit of HK\$768,034,000 for the previous year. Besides, the Group acquired 20% interest in CNPC International (Caspian) Limited ("Caspian") from an independent third party in October 2005 and recorded negative goodwill amounting to HK\$1,705,847,000, which was credited to the income statement of the current year in accordance with HKFRS 3. With the consolidation of our share of profit in Caspian for the current year of HK\$670,104,000, the consolidated profit of the Group for the year amounted to HK\$3,644,514,000.

As compared with last year, the sales volume decreased 279,000 barrels or 2.26% but the turnover was increased by 33.25%. The weighted average price of crude oil per barrel was approximately US\$41.57, representing an increase of approximately 43.94% compared with last year's US\$28.88. The overall profit attributable to equity holders of the Company increased by 374.53% as compared with last year because of the upsurge in oil price, and the contribution from investment in a petroleum exploration and production company operating in Kazakhstan.

BUSINESS REVIEW

In October 2005, the Group acquired 20% interest in Caspian from an independent third party and its indirect interest in CNPC-Aktobemunaigas Open Joint Stock Company ("Aktobe") increased to 15.072%. In December 2005, the Group entered into an agreement with the Peruvian Government in relation to explore Zones 111 and 113 of Madre de Dios. Currently, the Group has eleven oil exploration and production projects in seven countries. Each oil field is undergoing comprehensive exploration and development, striving to generate considerable returns for shareholders by increasing production in light of the high oil price.

PETROLEUM BUSINESSES

The People's Republic of China ("PRC")

Liaohe Leng Jiapu Oil Field

With the effective implementation of various measures by our staff in stabilising production, a total of 1,174,000 tonnes (2004: 1,292,000 tonnes) of crude oil from the Liaohe Leng Jiapu Contract Area were sold, representing a decrease of 9.13% compared with the previous year. On a 70% share basis, profit after tax attributable to the Group was HK\$606,131,000 (2004: HK\$419,177,000), or an increase of 44.60% compared with last year.

According to the Leng Jiapu Contract, the Group is responsible for 70% of the development costs and contributed RMB361,109,000 (approximately HK\$342,543,000) (2004: RMB336,000,000 (approximately HK\$316,802,000)) during the year as part of the fund required for exploration, drilling and construction of ground production facilities.

Xinjiang Karamay Oil Field

The Xinjiang Karamay Contract Area sold a total of 691,000 tonnes (2004: 699,000 tonnes) of crude oil in 2005, roughly the same as the previous year. On a 54% share basis, profit after tax attributable to the Group was HK\$370,898,000 (2004: HK\$207,451,000) or an increase of approximately 78.79% compared with last year.

According to the Xinjiang Contract, the Group is responsible for 54% of the development costs and contributed RMB68,748,000 (approximately HK\$65,213,000) (2004: RMB55,887,000 (approximately HK\$52,694,000)) during the year as part of the fund required for stabilising production.

CHAIRMAN'S STATEMENT

The Republic of Kazakhstan ("Kazakhstan")

Zhanazhol, Kenkyak (pre-salt) and Kenkyak (post-salt)

On 10th December 2003, the Group acquired 40% equity interest in CNPC International (Caspian) Limited ("Caspian") which owned 25.12% equity interest in Aktobe. As a result of the acquisition, the Group indirectly owned 10.048% interest of Aktobe. Aktobe owns the Zhanazhol, Kenkyak (pre-salt) and Kenkyak (post-salt) oil fields in Kazakhstan, and its shares are listed and traded on the Kazakhstan Stock Exchange. In accordance with the accounting standards, Caspian became an associate of the Group, and Caspian's investment in Aktobe was accounted for as a long term investment by Caspian in prior year.

Pursuant to a Board Resolution dated 15th June 2005, Caspian appointed a director to the board of Aktobe to obtain significant influence over the operations of Aktobe. Pursuant to accounting standards, Aktobe was accounted for as if it has been an associate of the Group since the date of initial acquisition.

On 14th October 2005, the Group successfully acquired an addition 20% equity interest in Caspian. The Group currently holds 60% equity interest in Caspian, representing an effective indirect holding of 15.072% equity interest in Aktobe. After assessment of the fair value of underlying assets by independent professional valuer and liabilities of Caspian, a one-time non-recurring negative goodwill of HK\$1,705,847,000 was resulted in this acquisition and was charged to the income statement in year 2005 pursuant to HKFRS3.

Pursuant to accounting standards, the acquisition of Caspian achieved in stages increases the opening reserve as at 1st January 2005 by HK\$2.3 billion and the asset revaluation reserves as at 31st December 2005 by HK\$2.7 billion. The former represents the negative goodwill on acquisition of the original 40% interest in Caspian and the results attributable to the Group from the date of initial acquisition of Aktobe to 31st December 2004. The later being the changes in fair value of the 40% interest in Caspian between the date of initial acquisition and 14th October 2005.

For year 2005, the whole project contributed a profit to the Group of HK\$2,347,258,000 including negative goodwill of HK\$1,705,847,000 as mentioned above.

The Kingdom of Thailand ("Thailand")

Sukhothai Concession

During the year, the Sukhothai Concession in Thailand recorded sales volume of 378,000 barrels (2004: 291,000 barrels), an increase of 29.90% over the corresponding period of last year, and the profit after tax of HK\$73,454,000 (2004: HK\$36,192,000), an increase of 102.96% compared with last year. The Group will continue to exploit the potential of the oil field and input more resources to increase production.

L21/43 Concession

In July 2003, the Group was granted the right to carry out oil exploration in the L21/43 concession located next to Sukhothai Concession by the Thailand Government. The overall exploration, including seismic analysis and other exploration works, has commenced. So far, two exploration wells were drilled with satisfactory initial findings and in-depth analysis and investigation are now being conducted. Exploration cost of HK\$3,155,000 (2004: HK\$18,281,000) for the year was accounted for as expenses of the year.

CHAIRMAN'S STATEMENT

Peru

Talara Oil Field

The Group held 50% interest in the rights to explore and produce oil and natural gas in Blocks VI and VII of the Talara Oil Field in Peru. During the year, 1,215,000 barrels (2004: 1,323,000 barrels) of crude oil and 1,176,596,000 cu.ft. (2004: 1,513,591,000 cu.ft.) of natural gas were sold. The Group shared HK\$67,750,000 in profit after tax and minority interests, representing an increase of HK\$32,406,000, or 91.69%, over that of last year.

Blocks 111/113

In December 2005, the Group entered into a blocks exploration agreement with Perupetro, a company wholly-owned by the Peruvian Government, in relation to conducting exploration in Zones 111 and 113 of Madre de Dios, being new blocks for exploration located in Southeast Peru. Exploration will commence in 2006, hoping that findings will bring returns to the Group.

The Sultanate of Oman ("Oman")

Block 5

The Group held 25% interest in the Block 5 oil field in Oman. The Group shared 1,418,000 barrels of oil during the year, increased by 37.40% compared with 1,032,000 barrels last year, and profit after tax attributable to the Group amounted to HK\$107,806,000 (2004: HK\$63,314,000).

The Union of Myanmar

Tetma Block IOR-3, Tuyintaung Block RSF-2 and Gwegyo-Ngashandaung Block RSF-3

The Group held 50% interest in the exploration rights of the oil fields. The overall exploration, including seismic analysis and other exploration works, has commenced. Initial findings were not encouraging and further in-depth investigation would be carried out to determine crude oil reserves and commercial value. The Group's share of exploration cost in the sum of HK\$14,342,000 (2004: HK\$28,352,000) was included as expenses of the year.

The Azerbaijan Republic ("Azerbaijan")

Kursangi and Karabagli Oil Field ("K&K")

The Group owned 25% interest in K&K in Azerbaijan and shared 1,159,000 barrels of oil during the year (2004: 1,193,000 barrels). Profit after tax attributable to the Group amounted to HK\$59,970,000 (2004: HK\$47,785,000), representing an increase of HK\$12,185,000 or 25.50% as compared with last year.

Gobustan Oil Field

The Group held 31.41% equity interest in Commonwealth Gobustan Limited ("CGL"). CGL owned 80% participating interest in an oil field in the Southwest of Gobustan, Azerbaijan. A profit of HK\$30,384,000 (2004: loss of HK\$58,942,000) was contributed to the Group for the year and the profit for the year 2005 was resulted from a gain of HK\$37,740,000 related to restructuring of loan. So far, two natural gas producing wells were drilled in the Gobustan Oil Field with satisfactory initial findings. Sale of natural gas will commence in 2006 in small scale, and large scale development will depend on the results of more in-depth exploration.

CHAIRMAN'S STATEMENT

PRC manufacturing business

Steel pipes factory

華油鋼管有限公司 ("North China"), which was set up by the Group together with 華北石油管理局, is famous for the production of high quality steel pipes, providing high quality steel pipes to satisfy the demand for transportation of natural gas from Western China to the eastern part and earned high reputation for its pipes which were widely used in other pipe projects. North China has set up a branch factory in the Yangzhou Han Jiang Industrial Park, the PRC, to enhance its competitiveness and capture a larger market share in the eastern part of the PRC. The branch factory, mainly engaged in the production of steel pipes with medium to small size bore, has formally commenced operation in early 2006.

In 2005, North China had a total output of 69,000 tonnes (2004: 115,000 tonnes) steel pipe and 175,000 tonnes (2004: 125,000 tonnes) of steel pipes were processed, generating a profit of HK\$25,764,000 (2004: HK\$26,324,000) for the Group which represented a decrease of 2.13% as compared with last year.

Film factory

Biaxially Oriented Polypropylene ("BOPP") Project

The BOPP film factory jointly established by the Group with Daqing Petroleum Administrative Bureau ("Daqing Bureau") began commercial production in 2004 and the results were satisfactory as anticipated. Profit after tax attributable to the Group for the year was HK\$234,000 (2004: HK\$1,905,000). With the PRC's accession to the World Trade Organisation, demand for packaging materials will gradually increase. In this connection, the Group once again worked with Daqing Bureau to invest in the construction of a CPP film production line which was expected to commence production this year. This operation is temporarily affected by high cost, high supply and low demand in the short run, and is suffering a hard time with low profits. Competition within the industry was extremely intense and only the strong ones might survive. The management of the film factory is now actively improving quality, controlling cost and perfecting products. Its products have gained high recognitions in the market and are at the higher end of the market, laying foundation for further development in the future. The Group is confident that when various factors are stabilised, this project will provide the Group with a steady income.

BUSINESS PROSPECTS

The positioning of the Group's future development remains unchanged. It still focuses on investing in petroleum up-stream business as well as other petroleum-related business with stable income. The Group will continue to explore new business opportunities, increase oil reserves, invest in projects with lower risk and reasonable return in different regions and develop petroleum-related business in the PRC and overseas.

With a strong financial position and prudent approach, the Group aims at expanding into an international oil corporation. The future crude oil price is expected to maintain at a relatively high level. The Group will accelerate on the exploration and development of existing oil projects, increase production volume, strengthen the management, control costs, increase efficiency and stabilise income, and for the sake of the shareholders, make new acquisitions with an aim to increasing crude oil reserves and production, enhance revenue and increase shareholders' return.

CHAIRMAN'S STATEMENT

FINAL DIVIDEND

With satisfactory results for the year, the Board of Directors has recommended the payment of a final dividend of HK\$0.08 (2004: HK\$0.035) per share. The proposed dividend will be paid on or about 15th June 2006 to the shareholders whose names appear on the Register on 19th May 2006, following approval at the Annual General Meeting.

CLOSURE OF REGISTER OF MEMBERS

The register of members of the Company will be closed from 16th May 2006 to 19th May 2006 both days inclusive, during which period no transfers of shares will be registered. All transfer documents accompanied by the relevant share certificates must be lodged with the Company's Branch Registrar in Hong Kong, Secretaries Ltd. at the Level 26, Tesbury Centre, 28 Queen's Road East, Hong Kong not later than 4:00 p.m. on 15th May 2006 in order to qualify for the proposed final dividend.

By Order of the Board

Wang Mingcai

Chairman

Hong Kong, 11th April 2006

MANAGEMENT DISCUSSION AND ANALYSIS

OPERATING RESULTS

The Group has recorded a turnover of HK\$3,378,323,000 for the year ended 31st December 2005, representing an increase of 33.36% as compared with HK\$2,533,312,000 last year. The increase of turnover was mainly due to the increase of weighted average crude oil selling price from US\$28.88 per barrel last year to US\$41.57 per barrel this year.

The profit attributable to equity holders of the Company for the year was HK\$3,644,514,000, representing an increase of HK\$2,876,480,000 or 374.53%, as compared to HK\$768,034,000 last year.

LIQUIDITY AND CAPITAL RESOURCES

As at 31st December 2005, the aggregate assets value of the Group was HK\$16,065,930,000, representing an increase of HK\$10,816,669,000 or 206.06% as compared with 31st December 2004.

The major changes of the assets are as follows:

	Increase <i>HK\$'000</i>
Investments in associates	9,580,059 #
Investments in jointly controlled entities	117,492 *
Other assets	841,358 +
Cash and cash equivalents	<u>277,760</u>
Total increase in assets	<u><u>10,816,669</u></u>

* Included share of profits of HK\$107,806,000 from a jointly controlled entity in the Sultanate of Oman ("Oman").

Included investment in CNPC-Aktobemunaigas Open Joint Stock Company ("Aktobe") of US\$1,257,146,000 (approximately HK\$9,730,309,000).

+ Included a receivable of US\$64,376,000 (approximately HK\$498,267,000) due from a stock broker who has received dividend paid out from Aktobe on behalf of the Group.

The gearing ratio of the Group maintained at 14.10% as at 31st December 2005 compared with 8.73% as at 31st December 2004. It is computed by dividing the total borrowings of HK\$1,777,983,000 (2004: HK\$354,120,000) by the shareholders' funds of HK\$12,607,072,000 (2004: HK\$4,057,996,000).

On 18th July 2005, the Group repaid the syndication loan of US\$40,000,000 (approximately HK\$310,800,000).

As at 31st December 2005, a bank borrowing denominated in United States Dollars amounted to US\$120,000,000 (approximately HK\$928,800,000) was fully repaid on 13th February 2006 and replaced with a new term loan of US\$80,000,000 (approximately HK\$619,200,000).

During the year, RMB361,109,000 (approximately HK\$342,543,000) (2004: RMB336,000,000 (approximately HK\$316,802,000)) was injected out of profits into Leng Jiapu oil field as development costs.

MANAGEMENT DISCUSSION AND ANALYSIS

In accordance with the Karamay Contract RMB68,748,000 (approximately HK\$65,213,000) (2004: RMB55,887,000 (approximately HK\$52,694,000)) was paid out of profit and re-invested as development costs of the Karamay oil field during the year.

Dividend of RMB27,921,000 (approximately HK\$26,485,000) for the year 2004 was received from 華油鋼管有限公司 during the year.

Dividend of US\$7,630,000 (approximately HK\$59,285,000) was received from Oman oilfield during the year.

USE OF PROCEEDS

During the Year, the Company did not issue any new share to the public.

In June 2005, HK\$46,900,000 was received from two directors for exercising their share options.

2004 final dividend of HK\$0.035 per share amounting HK\$165,693,000 (2004: HK\$0.02 per share amounting HK\$95,130,000) was distributed to the shareholders of the Company during the year.

Taking into account the cashflow from operating activities, the Group as at 31st December 2005 had a bank balance and cash of HK\$1,831,521,000 (2004: HK\$1,553,761,000).

The Group is in a very strong financial position, ready to invest in new projects with no financial difficulty.

NEW INVESTMENT

Bestory Company Incorporated ("Bestory"), a subsidiary of the Group, entered into a share purchase agreement with Darley Investment Services Incorporated ("DIS") on 10th October 2005 in relation to the acquisition of 20% of the issued share capital of Caspian ("Acquisition") for a cash consideration of US\$140,000,000 (approximately HK\$1,087,800,000). The consideration was paid with US\$20,000,000 (approximately HK\$155,400,000) from the Group and the bank loan of US\$120,000,000 (approximately HK\$932,400,000) and the Acquisition was completed on 14th October 2005. Upon the completion of the Acquisition, Bestory holds 60% of Caspian and indirectly holds 15.072% equity interest in Aktobe.

On 7th December 2005, SAPET Development Peru Inc. ("SAPET Peru"), a subsidiary of the Group, entered into the Concession Agreement ("Agreement") with Perupetro S.A. (a company wholly-owned by the Peruvian Government) whereby SAPET Peru was granted the right to explore, develop and produce crude oil and natural gas in the two new Concession Zones known as Zone 111 and Zone 113 in Peru. These zones are located in Madre de Dios, the southeast of Peru and occupy an area of approximately 15,200 km² and 12,300 km² respectively. The Agreement is for an initial term of seven years. During the years, SAPET Peru will carrying out a series of work amounting US\$31,600,000 (approximately HK\$244,584,000).

EMPLOYEE

On 31st December 2005, the Group had approximately 337 staff (excluding the staff under entrustment contracts) 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.

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 31st December 2005.

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 save for the Code Provisions on internal controls which are to be implemented for accounting periods commencing on or after 1st July 2005 pursuant to the CG Code and certain deviations from the Code Provisions A.2.1, A.4.1, A.4.2, A.5.4 and D.1.2, details of which are explained below.

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 of Directors 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.

CORPORATE GOVERNANCE REPORT

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.

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

Code Provision D.1.2 stipulates that the Company should formalise the functions reserved to the Board and those delegated to management.

The Company has not formalised the division of functions reserved to the Board and delegated to the management. Arrangements are being taken place for the adoption of written terms on division of functions and delegation of authority between the Board and 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

The composition of the Board reflects the necessary balance of skills and experience appropriate to the requirements of the business of the Company and to the exercising of independent judgement.

The Board comprises the following seven directors:

Executive Directors:

Mr Wang Mingcai (*Chairman*)

Mr Li Hualin (*Chief Executive Officer*)

Mr Cheng Cheng

Non-Executive Director:

Mr Lin Jingao

Independent Non-Executive Directors:

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

Mr Aubrey Li Kwok Sing (*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.

CORPORATE GOVERNANCE REPORT

During the year ended 31st December 2005, 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.

The 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 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.

Each of the independent non-executive directors of the Company was appointed for a two-year term. Mr. Lin Jingao, the only non-executive director of the Company, does not have a specific term of appointment. However, he is subject to retirement by rotation at the annual general meetings in accordance with the Bye-laws of the Company. Mr. Lin will retire by rotation at the forthcoming annual general meeting and he does not offer himself for re-election.

The Company's Bye-laws deviates from Code Provision A.4.2 as it provides that one-third of the directors for the time being (save for the Chairman and Managing Director), or if their number is not three nor a multiple of three, then the number nearest to one-third, shall retire from office at each annual general meeting, when they shall be eligible for re-election and that any new director appointed by the Board to fill a causal vacancy or as an addition to the Board during the year shall hold office until the next following annual general meeting after appointment, when he/she shall be eligible for re-election.

To conform with Code Provision A.4.2, a special resolution will be proposed at the forthcoming annual general meeting of the Company to amend the Company's Bye-laws so that all directors will be subject to retirement by rotation once every three years and any new director appointed to fill a causal vacancy shall be subject to re-election by shareholders at the first general meeting after appointment.

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.

CORPORATE GOVERNANCE REPORT

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. Li Hualin and Mr. Lin Jingao shall retire by rotation and only Mr. Li Hualin, being eligible, offers himself for re-election at the forthcoming annual general meeting.

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

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

Training for Directors

Each newly appointed director receives comprehensive, formal and tailored induction on the first occasion of his/her appointment, so as to ensure that he/she has appropriate understanding of the business and operations of the Company and that he/she is fully aware of his/her 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 31st December 2005, five regular Board meetings, two Audit Committee meetings and one Remuneration Committee meeting were held.

CORPORATE GOVERNANCE REPORT

The individual attendance record of each director at the meetings of the said meetings of the Board, the Audit Committee and the Remuneration Committee during the year ended 31st December 2005 is set out below:

Directors	Attendance/Number of Meetings		
	Board	Audit Committee	Remuneration Committee
<i>Executive Director</i>			
Mr Wang Mingcai (<i>Chairman</i>)	5/5	–	–
Mr Li Hualin (<i>Chief Executive Officer</i>)	4/5	–	–
Mr Cheng Cheng	4/5	–	–
<i>Non-Executive Director</i>			
Mr Lin Jingao	2/5	–	–
<i>Independent Non-Executive Director</i>			
Dr Lau Wah Sum	4/5	2/2	1/1
Mr Aubrey Li Kwok Sing	4/5	2/2	1/1
Dr Liu Xiao Feng	4/5	1/2	1/1

Note: One of the Board meetings (with the presence of Mr Wang Mingcai, Mr Li Hualin, Mr Cheng Cheng, Mr Lin Jingao, Dr Lau Wah Sum, Mr Aubrey Li Kwok Sing and Dr Liu Xiao Feng, being all directors) has discussed the directors' nomination matters.

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 sent to all directors/committee members at least 3 days before each Board meeting or committee meeting to keep the directors apprised 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, Qualified Accountant, 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. Draft minutes are normally circulated to directors for comment within a reasonable time after each meeting and the final version is signed by the Chairman and kept for future reference and directors' inspection.

CORPORATE GOVERNANCE REPORT

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 currently held by Mr Wang Mingcai and Mr Li Hualin respectively.

There are no written terms on the general division of responsibilities between the Chairman and the Chief Executive Officer. The Board considers that the responsibilities of the Chairman and the Chief Executive Officer are clear and distinctive and hence written terms thereof are not necessary. 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.

CORPORATE GOVERNANCE REPORT

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 met once during the year ended 31st December 2005 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.

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 external auditors.

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 the qualified accountant or external auditors before submission to the Board.
- (b) To review the relationship with the external auditors by reference to the work performed by the auditors, their fees and terms of engagement, and make recommendation to the Board on the appointment, re-appointment and removal of external auditors.
- (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 31st December 2005, the Audit Committee held two meetings and once passed circular resolutions, 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 external auditors.

The Company's annual results for the year ended 31st December 2005 has been reviewed by the Audit Committee.

CORPORATE GOVERNANCE REPORT

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 external auditors.

MODEL CODE FOR SECURITIES TRANSACTIONS

The Company has adopted the Model Code for Securities Transactions by Directors of Listed Issuers (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 31st December 2005.

The Company has not 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. Arrangements are being taken for adoption of the Employees Written Guidelines on no less exacting terms than the Model Code.

RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS AND AUDITORS' 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 31st December 2005.

The statement of the external auditors of the Company about their reporting responsibilities on the financial statements is set out in the "Report of the Auditors" on page 28.

The remuneration paid to the external auditors of the Company in respect of audit services and non-audit services for the year ended 31st December 2005 amounted to HK\$2,700,000 and HK\$96,500 respectively. The said non-audit services related to the preparation and filing of the profits tax returns 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 published in newspapers on the business day following the shareholders' meeting and posted on the website of the Stock Exchange.

CORPORATE GOVERNANCE REPORT

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 a website at www.cnpc.com.hk, where extensive information and updates on the Company's business developments and operations, financial information, corporate governance practices and other information are posted.

REPORT OF THE DIRECTORS

The directors submit their report together with the audited financial statements for the year ended 31st December 2005.

PRINCIPAL ACTIVITIES AND GEOGRAPHICAL ANALYSIS OF OPERATIONS

The principal activity of the Company is investment holding. The principal activities of its principal subsidiaries are the exploration and production of crude oil and natural gas in the People's Republic of China ("PRC"), the Republic of Kazakhstan, the Sultanate of Oman, Peru, the Kingdom of Thailand ("Thailand"), the Azerbaijan Republic and the Union of Myanmar

An analysis of the Group's performance for the year by geographical segments is set out in Note 5 to the financial statements.

RESULTS AND APPROPRIATIONS

The results of the Group for the year are set out in the consolidated income statement on page 32.

The directors recommend the payment of a final dividend of HK\$0.08 per share for the year ended 31st December 2005, totaling HK\$385,927,000.

RESERVES

Movements in the reserves of the Group and the Company during the year are set out in the consolidated statement of changes in equity and Note 16 to the financial statements.

DONATIONS

Charitable and other donations made by the Group during the year amounted to HK\$10,000 (2004: HK\$10,000).

PROPERTY, PLANT AND EQUIPMENT

Details of the movements in property, plant and equipment of the Group and the Company are set out in Note 7 to the financial statements.

SHARE CAPITAL

Details of the movements in share capital of the Company are set out in Note 15 to the financial statements.

DISTRIBUTABLE RESERVES

Distributable reserves of the Company at 31st December 2005, calculated under the Companies Act 1981 of Bermuda, amounted to HK\$3,155,554,000 (2004: HK\$2,263,121,000).

PRE-EMPTIVE RIGHTS

No pre-emptive rights exist under Bermuda Law in relation to issues of new shares of the Company.

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 94.

REPORT OF THE DIRECTORS

PURCHASE, SALE OR REDEMPTION OF SHARES

The Company has not redeemed any of its shares during the year. Neither the Company nor any of its subsidiaries has purchased or sold any of the Company's shares during the year.

DIRECTORS

The directors during the year were:

Mr Wang Mingcai
Mr Li Hualin
Mr Cheng Cheng
Mr Lin Jingao
Dr Lau Wah Sum
Mr Aubrey Li Kwok Sing
Dr Liu Xiao Feng

In accordance with Article 97 of the Company's Bye-Laws, Mr Li Hualin and Mr Lin Jingao shall retire at the forthcoming Annual General Meeting and, being eligible, Mr Li Hualin offer himself for re-election and Mr Lin Jingao will be retired at the forthcoming Annual General Meeting.

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.

Dr Lau Wah Sum, Mr Aubrey Li Kwok Sing and Dr Liu Xiao Feng, Independent Non-Executive Directors, were appointed for a two-year term expiring on 31st December 2006, 31st July 2006 and 15th April 2008, respectively.

The terms of office of the Independent Non-Executive Directors are subject to retirement as required by the Company's Bye-Laws.

DIRECTORS' SERVICE CONTRACTS

None of the directors who are proposed for re-election at the forthcoming annual general meeting has a service contract with the Company which is not determinable within one year without payment of compensation, other than statutory compensation.

BRIEF BIOGRAPHICAL DETAILS IN RESPECT OF DIRECTORS AND SENIOR MANAGEMENT

Directors

Mr Wang Mingcai (*Chairman*)

Age 60, graduated from Petroleum University of Beijing in 1970 with Bachelor's Degree in Petroleum Geology and was awarded the Certificate of Mastery in English from Zhongshan University in 1987. Mr Wang has more than 30 years' experience in the petroleum industry. He has worked at Liaohe Oil Field as Engineer and Project Manager; Senior Engineer and Project Manager of China Offshore Oil Nanhai East Corp and Senior Oil Reservoir Engineer of the ACT (with Agip, Chevron and Texaco) Operation group. From 1993, Mr Wang has been assigned to be responsible for China National Petroleum Corporation ("CNPC") overseas projects. He was the President of CNPC International Venezuela Ltd. Mr Wang joined the Company as Executive Chairman in January 2001 and become the Chairman in 2005.

REPORT OF THE DIRECTORS

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

Mr Li Hualin (*Chief Executive Officer*)

Age 43, after graduated from South West Petroleum University in 1983 with Bachelor's Degree in Oil and Gas Exploration and Prospecting Engineering, Mr Li joined CNPC in the same year. He was the Deputy Director of CNPC office at Houston in the U.S.A.; Chairman & General Manager of CNPC Canada Ltd in Canada and Deputy General Manager of China National Oil and Gas Exploration and Development Corporation. 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 & Managing Director in January 2001 and become the Chief Executive Officer in 2005.

Mr Cheng Cheng (*Executive Director*)

Age 37, 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 China National Petroleum Corporation 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.

Mr Lin Jingao (*Non-Executive Director*)

Age 61, graduated from the Beijing College of Petroleum, Department of Economics in 1967. Mr Lin has more than 30 years' experience in petroleum economics and financial management. He has worked at Sichuan Petroleum Administration Bureau as Deputy Chief of Economic Research and Deputy Chief Accountant. From August 1994 to 2002, Mr Lin worked as the Chief Financial Controller and Deputy Director of CNPC's Finance Department, Deputy Section Head and Section Head of Financial Resources Department. In 1997, he joined the Company and CNPC Hong Kong (Holdings) Limited as Non-Executive Director.

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

Age 78, is a Fellow of the Chartered Institute of Management Accountants. He was the 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 Court Member of the University of Science and Technology of Hong Kong. He also sits on the Board of several listed companies in Hong Kong. He joined the Company as an Independent Non-Executive Director in August 1994.

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

Age 56, was appointed as an Independent Non-Executive Director of the Company in 1998. He is a director of Management Capital Limited, a financial advisory and direct investment firm, and has over 25 years' experience in merchant banking and commercial banking. He is also a non-executive director of ABC Communications (Holdings) Limited, The Bank of East Asia, Limited, Cafe de Coral Holdings Limited, China Everbright International Limited, Kowloon Development Company Limited, Pokfulam Development Company Limited and Value Partners China Greenchip Fund Limited. He is 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.

Dr Liu Xiao Feng (*Independent Non-Executive Director*)

Age 43, was appointed as an Independent Non-Executive Director of the Company in April 2004. He was a director of NM Rothschild & Sons (Hong Kong) Limited and has over 11 years' experience in investment banking. Mr Liu has a Ph.D and Master from the Faculty of Economics, University of Cambridge and a Bachelor of Economics from Sichuan Institute of Finance and Economics, China.

REPORT OF THE DIRECTORS

SENIOR MANAGEMENT

Mr Lau Hak Woon (General Manager – Finance and Company Secretary)

Age 53, 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 25 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 Canada.

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 parent company 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 IN SHARES

At 31st December 2005, the interests and short positions of each director and chief executive in the shares of the Company and its associated corporations (within the meaning of the Securities and Future Ordinance (the "SFO")), as recorded in the register required to be kept by the Company under section 352 of Part XV of the SFO were as follows:

- (a) Ordinary shares of HK\$0.01 each in the Company at 31st December 2005.

		Number of shares held			% of issued share capital of the Company
		Personal interest	Corporate interest (Note)	Total	
Mr Wang Mingcai	Long positions	24,200,000	2,549,317,342	2,573,517,342	53.35
Mr Li Hualin	Long positions	20,000,000	2,549,317,342	2,569,317,342	53.26

Note: Mr Wang Mingcai and Mr Li Hualin are directors of Sun World Limited ("Sun World") which beneficially owned 2,549,317,342 shares in the Company as at 31st December 2005. Sun World is a wholly owned subsidiary of CNPC, the Company's ultimate holding company incorporated in the PRC.

- (b) Share options are granted to directors and chief executives under the executive share option scheme approved by the board of directors on 23rd October 1991 and 3rd June 2002 respectively. 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, its subsidiaries, its associates, its fellow subsidiaries or its parent company 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.

REPORT OF THE DIRECTORS

SHARE OPTIONS

Pursuant to a resolution passed on 23rd October 1991, an executive share option scheme (the "1991 Share Option Scheme") was adopted by the Company. The directors of the Company may, at their discretion, invite executives of any companies within the Group, including executive directors, to take up options to subscribe for shares in the Company subject to the terms and conditions stipulated in the 1991 Share Option Scheme. The 1991 Share Option Scheme was early terminated on 28th May 2001 with the share options granted under such scheme still valid until their respective expiry dates. On the same date, another share option scheme (the "2001 Share Option Scheme") was adopted.

On 3rd June 2002, the shareholders of the Company approved the termination (to the effect that no further options shall be offered) of the 2001 Share Option Scheme and the adoption of a new share option scheme (the "2002 Share Option Scheme"). As at 31st December 2005, options to subscribe for a total of 10,000,000 option shares were still outstanding under the 1991 Share Option Scheme. No option was granted under the 2001 Share Option Scheme.

The following is a summary of the principal terms of share option schemes of the Company (for the 1991 and 2002 Share Option Schemes, only those terms applying to the outstanding option shares are set out below):

(a) 1991 Share Option Scheme

The 1991 Share Option Scheme was designed to give executive directors and full-time employees of the Group equity interest in the Company in order to enhance long-term shareholder value. The granting of options will also help the Company to attract and motivate individuals with experience and ability and to reward individuals for past and future performance.

Options may be exercised 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 grantee. No amount shall be payable by the grantee to the Company in exercising the right to accept an offer of an option.

The total number of shares may be issued upon exercise of all outstanding options granted and yet to be exercised under the 1991 Share Option Scheme as at the date of the annual report is 10,000,000, representing approximately 0.21% of the issued share capital of the Company as of that date. The maximum entitlement of any qualifying participant shall not exceed 25% of the aggregate number of shares subject to the scheme.

The 1991 Share Option Scheme was terminated on 28th May 2001 such that thereafter no further options will be granted and the existing options shall continue to be valid and exercisable in accordance with their terms of issue.

REPORT OF THE DIRECTORS

SHARE OPTIONS (continued)

(b) 2002 Share Option Scheme

The purpose of the 2002 Share Option Scheme is to provide incentives to the directors and full-time employees of the Company to contribute to the Company and to enable the Company to recruit high-calibre employees and attract human resources that are valuable to the Company.

The maximum number of shares which may be issued upon exercise of all options to be granted under the 2002 Share Option Scheme shall not in aggregate exceed 10% of the shares in issue as at the date of adoption of the 2002 Share Option Scheme (the "Scheme Mandate Limit"), provided that the Company may, at any time as the board of directors of the Company may think fit, seek approval from its shareholders to refresh the Scheme Mandate Limit in accordance with the provisions of the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the "Listing Rules"). 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 scheme of the Company) shall not exceed 30% of the shares in issue from time to time.

The total number of shares may be issued upon exercise of all outstanding options granted and yet to be exercised under the 2002 Share Option Scheme as at the date of the annual report is 85,500,000 representing approximately 1.77% of the issued share capital of the Company as at that date.

Options may be exercised 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 grantee. No amount shall be payable by the grantee to the Company in exercising the right to accept an offer of an option.

The exercise price shall be fixed at such level as the board of directors may determine save that it shall be at least the highest of (i) the closing price of the shares as stated in the Stock Exchange's daily quotations sheets on the date of grant, which must be a business day; (ii) the average closing price of the shares as stated in the Stock Exchange's daily quotations sheets for the five business days immediately preceding the date of grant, and (iii) the par value of the shares for the time being.

REPORT OF THE DIRECTORS

SHARE OPTIONS (continued)

(b) 2002 Share Option Scheme (continued)

The 2002 Share Option Scheme will expire on 2nd June 2012.

The following shows the particulars of share options granted to directors and senior executive of the Company that are required to be disclosed under Rule 17.07 of the Listing Rules:

Name	Date of grant	Exercise price HK\$	Balance at	Granted during the year	Exercised during the year	Balance at	Exercisable period
			1st January 2005			31st December 2005	
Directors:							
Mr Wang Mingcai	8th March 2001	0.41	20,000,000	–	20,000,000	–	8th June 2001 to 7th March 2006
	26th April 2001	0.61	30,000,000	–	30,000,000	–	26th July 2001 to 25th April 2006
	27th April 2005	1.224	–	25,000,000	–	25,000,000	27th July 2005 to 26th April 2010
Mr Li Hualin	8th March 2001	0.41	20,000,000	–	20,000,000	–	8th June 2001 to 7th March 2006
	26th April 2001	0.61	20,000,000	–	20,000,000	–	26th July 2001 to 25th April 2006
	27th April 2005	1.224	–	20,000,000	–	20,000,000	27th July 2005 to 26th April 2010
Mr Cheng Cheng	25th June 2004	0.94	20,000,000	–	–	20,000,000	25th September 2004 to 24th June 2009
Mr Lin Jingao	26th April 2001	0.61	10,000,000	–	–	10,000,000	26th July 2001 to 25th April 2006
Dr Lau Wah Sum	8th January 2004	1.362	3,500,000	–	–	3,500,000	8th April 2004 to 7th January 2009
Mr Aubrey Li Kwok Sing	8th January 2004	1.362	3,500,000	–	–	3,500,000	8th April 2004 to 7th January 2009
Dr Liu Xiao Feng	27th April 2005	1.224	–	3,500,000	–	3,500,000	27th July 2005 to 26th April 2010
Employee:	25th June 2004	0.94	5,000,000	–	–	5,000,000	25th September 2004 to 24th June 2009
	27th April 2005	1.224	–	5,000,000	–	5,000,000	27th July 2005 to 26th April 2010
			<u>132,000,000</u>	<u>53,500,000</u>	<u>90,000,000</u>	<u>95,500,000</u>	

SUBSTANTIAL SHAREHOLDERS INTEREST IN SHARES

The register of substantial shareholders required to be kept under section 336 of Part XV of the SFO shows that as at 31st December 2005, the Company had been notified of the following substantial shareholders' interests, being 5% or more of the Company's issued share capital.

Name	Number of shares
Sun World	2,549,317,342 ¹

¹ All shares are registered under the name of HKSCC Nominees Limited.

Sun World is a wholly owned subsidiary of CNPC, and CNPC is accordingly deemed to have interest in the 2,549,317,342 shares held by Sun World.

Save as disclosed above, no person had any interest or short position in any shares or underlying shares of the Company as recorded in the register kept under section 336 of Part XV of the SFO.

REPORT OF THE DIRECTORS

CONNECTED TRANSACTIONS

Certain related party transactions as disclosed in Note 33 to the financial statements constituted connected transactions under Listing Rules, required to be disclosed in accordance with Chapter 14A of the Listing Rules. The Independent Non-Executive Directors, Dr Lau Wah Sum, Mr Aubrey Li Kwok Sing and Dr Liu Xiao Feng, have reviewed the transactions disclosed in Note 33 to the financial statements, and confirmed that these transactions were entered into in the ordinary and usual course of business, on normal commercial terms and are fair and reasonable so far as the interests of shareholders of the Company are concerned.

MANAGEMENT CONTRACTS

Save for the Entrustment Contracts as mentioned in Notes 31 and 32 to the financial statements in relation to the management of the oil production under the Xinjiang Contract and the Leng Jiapu Contract, no other contract concerning the management and administration of the whole or any substantial part of the business of the Company were entered into or existed during the year.

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	8%
Percentage of purchases attributable to the Group's five largest suppliers	16%
Percentage of sales attributable to the Group's largest customer	69%
Percentage of sales attributable to the Group's five largest customers	99%

Xinjiang Petroleum Exploration Bureau ("XPEB") is the Group's largest supplier.

PetroChina Company Limited, a listed subsidiary of CNPC, is the Group's largest customer.

XPEB is an operational entity owned and controlled by CNPC.

Save for the above, none of the directors, their associates or any shareholder (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.

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 at the date of this annual report.

REPORT OF THE DIRECTORS

AUDITORS

The financial statements have been audited by PricewaterhouseCoopers who retire and, being eligible, offer themselves for re-appointment.

On behalf of the Board

Wang Mingcai

Chairman

Hong Kong, 11th April 2006

REPORT OF THE AUDITORS



羅兵咸永道會計師事務所

Auditors' Report to the Shareholders of CNPC (Hong Kong) Limited

(incorporated in Bermuda with limited liability)

We have audited the financial statements on pages 29 to 93 which have been prepared in accordance with accounting principles generally accepted in Hong Kong.

RESPECTIVE RESPONSIBILITIES OF DIRECTORS AND AUDITORS

The Company's directors are responsible for the preparation of financial statements which give a true and fair view. In preparing financial statements which give a true and fair view it is fundamental that appropriate accounting policies are selected and applied consistently.

It is our responsibility to form an independent opinion, based on our audit, on those financial statements 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.

BASIS OF OPINION

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the circumstances of the Company and the Group, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance as to whether the financial statements are free from material misstatement. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements. We believe that our audit provides a reasonable basis for our opinion.

OPINION

In our opinion the financial statements give a true and fair view of the state of affairs of the Company and of the Group as at 31st December 2005 and of the Group's profit and cash flows for the year then ended and have been properly prepared in accordance with the disclosure requirements of the Hong Kong Companies Ordinance.

PricewaterhouseCoopers

Certified Public Accountants

Hong Kong, 11th April 2006

CONSOLIDATED BALANCE SHEET

As at 31st December 2005

	Note	2005 HK\$'000	2004 Restated HK\$'000
ASSETS			
Non-current assets			
Property, plant and equipment	7	2,805,036	2,711,100
Leasehold land and land use rights	6	3,842	3,982
Investments in associates	9	9,730,309	150,250
Investments in jointly controlled entities	10	819,135	701,643
Deferred income tax assets	20	13,530	17,425
Available-for-sale financial assets	11	59,030	–
Other non-current assets		2,162	2,162
		13,433,044	3,586,562
Current assets			
Inventories	12	29,346	20,055
Trade and other receivables	13	772,019	88,883
Cash and cash equivalents	14	1,831,521	1,553,761
		2,632,886	1,662,699
Total assets		16,065,930	5,249,261
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	15	48,241	47,341
Other reserves	16	4,257,274	1,433,195
Retained earnings			
– Proposed final dividend		385,927	165,693
– Others		7,915,630	2,411,767
		12,607,072	4,057,996
Minority interest		969,476	134,027
Total equity		13,576,548	4,192,023

The notes on pages 35 to 93 are an integral part of these consolidated financial statements.

CONSOLIDATED BALANCE SHEET

As at 31st December 2005

	Note	2005 HK\$'000	2004 Restated HK\$'000
LIABILITIES			
Non-current liabilities			
Borrowings	18	827,511	21,840
Deferred income tax liabilities	20	197,631	206,810
		1,025,142	228,650
Current liabilities			
Trade and other payables	17	312,861	372,129
Amount due to ultimate holding company		1,185	1,171
Current income tax liabilities		199,722	98,050
Borrowings	18	950,472	332,280
Deferred charge	19	–	24,958
		1,464,240	828,588
Total liabilities		2,489,382	1,057,238
Total equity and liabilities		16,065,930	5,249,261
Net current assets		1,168,646	834,111
Total assets less current liabilities		14,601,690	4,420,673

Wang Mingcai
Chairman

Li Hualin
Chief Executive Officer

The notes on pages 35 to 93 are an integral part of these consolidated financial statements.

BALANCE SHEET

As at 31st December 2005

	Note	2005 HK\$'000	2004 Restated HK\$'000
ASSETS			
Non-current assets			
Property, plant and equipment	7	1,436	162
Investments in subsidiaries	8	3,668,116	2,805,073
Investments in jointly controlled entities	10	349,010	315,563
		<u>4,018,562</u>	<u>3,120,798</u>
Current assets			
Other receivables		566	553
Cash and cash equivalents	14	550,596	491,524
		<u>551,162</u>	<u>492,077</u>
Total assets		<u>4,569,724</u>	<u>3,612,875</u>
EQUITY			
Capital and reserves attributable to the Company's equity holders			
Share capital	15	48,241	47,341
Other reserves	16	1,493,452	1,433,542
Retained earnings			
– Proposed final dividend		385,927	165,693
– Others		2,635,832	1,963,633
Total equity		<u>4,563,452</u>	<u>3,610,209</u>
LIABILITIES			
Current liabilities			
Trade and other payables		6,272	2,666
Total liabilities		<u>6,272</u>	<u>2,666</u>
Total equity and liabilities		<u>4,569,724</u>	<u>3,612,875</u>
Net current assets		<u>544,890</u>	<u>489,411</u>
Total assets less current liabilities		<u>4,563,452</u>	<u>3,610,209</u>

Wang Mingcai

Chairman

Li Hualin

Chief Executive Officer

The notes on pages 35 to 93 are an integral part of these consolidated financial statements.

CONSOLIDATED INCOME STATEMENT

For the year ended 31st December 2005

	Note	2005 HK\$'000	2004 Restated HK\$'000
Sales	5	3,378,323	2,533,312
Cost of goods sold	21	(1,780,745)	(1,537,929)
Gross profit		1,597,578	995,383
Other gains – net	5	89,667	68,462
Negative goodwill on acquisition of additional interest in a subsidiary	30	1,705,847	–
Exploration costs	21	(3,155)	(18,281)
Administrative expenses	21	(32,705)	(23,014)
Operating profit		3,357,232	1,022,550
Finance costs	23	(33,627)	(10,735)
Share of profits less losses of			
– associates		793,281	66,143
– jointly controlled entities		134,246	1,424
Profit before income tax		4,251,132	1,079,382
Income tax expense	24	(415,660)	(275,974)
Profit for the year		3,835,472	803,408
Attributable to:			
Equity holders of the Company	25	3,644,514	768,034
Minority interest		190,958	35,374
		3,835,472	803,408
Earnings per share for profit attributable to the equity holders of the Company during the year			
– basic	26	HK76.16 cents	HK16.20 cents
– diluted	26	HK75.82 cents	HK16.01 cents
Dividends	27	385,297	165,693

The notes on pages 35 to 93 are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the year ended 31st December 2005

Note	Attributable to equity holders of the Company				Total HK\$'000
	Share capital HK\$'000	Other reserves HK\$'000 (note 16)	Retained earnings HK\$'000	Minority interest HK\$'000	
Balance at 1st January 2004 , as previously reported as equity	47,565	1,443,872	1,904,107	–	3,395,544
Balance at 1st January 2004 , as previously separately reported as minority interest	–	–	–	137,653	137,653
Balance at 1st January 2004 , as restated	47,565	1,443,872	1,904,107	137,653	3,533,197
Currency translation differences					
– Group	–	2,655	–	–	2,655
– Associates	–	–	–	–	–
Profit for the year	–	–	768,034	35,374	803,408
Share option benefits	–	7,210	–	–	7,210
Repurchase of own shares for cancellation	(224)	(20,542)	–	–	(20,766)
Dividends paid to minority interest	–	–	–	(39,000)	(39,000)
2003 final dividend	–	–	(94,681)	–	(94,681)
Balance at 31st December 2004	47,341	1,433,195	2,577,460	134,027	4,192,023
Balance at 1st January 2005 , as previously reported as equity	47,341	1,425,985	2,584,670	–	4,057,996
Balance at 1st January 2005 , as previously separately reported as minority interest	–	–	–	134,027	134,027
Balance at 1st January 2005 , as restated	47,341	1,425,985	2,584,670	134,027	4,192,023
Opening adjustment for the adoption of HKFRS 2	–	7,210	(7,210)	–	–
Opening adjustment for the adoption of HKFRS 3	–	38,227	2,245,276	–	2,283,503
Balance at 1st January 2005 , as restated	47,341	1,471,422	4,822,736	134,027	6,475,526
Fair value gain – available-for-sale financial assets	–	53,006	–	–	53,006
Asset revaluation reserve – business combination	–	2,713,131	–	–	2,713,131
Currency translation differences					
– Group	–	(44,273)	–	(4,273)	(48,546)
– Associates	–	4,078	–	–	4,078
Profit for the year	–	–	3,644,514	190,958	3,835,472
Share option benefits	–	13,910	–	–	13,910
Exercise of share options	900	46,000	–	–	46,900
Minority interest – business combination	–	–	–	687,614	687,614
Dividends paid to minority interest	–	–	–	(38,850)	(38,850)
2004 final dividend	–	–	(165,693)	–	(165,693)
Balance at 31st December 2005	48,241	4,257,274	8,301,557	969,476	13,576,548

The notes on pages 35 to 93 are an integral part of these consolidated financial statements.

CONSOLIDATED CASH FLOW STATEMENT

For the year ended 31st December 2005

	Note	2005 HK\$'000	2004 HK\$'000
Cash flows from operating activities			
Cash generated from operations	28	1,732,708	1,616,707
Interest paid		(33,627)	(10,735)
Overseas taxes paid		(320,872)	(209,500)
Net cash generated from operating activities		<u>1,378,209</u>	<u>1,396,472</u>
Cash flow from investing activities			
Purchase of property, plant and equipment	7	(594,401)	(557,552)
Purchase of leasehold land and land use rights	6	–	(4,042)
Increase in investments in jointly controlled entities		–	(84,708)
Acquisition of additional interest in a subsidiary, net of cash acquired	30	(1,010,495)	–
Decrease in amounts due from associates		8,112	–
Increase in amounts due from jointly controlled entities		(71,115)	(74,964)
Dividend received from jointly controlled entities		85,766	16,019
Dividend received from available-for-sale financial assets		1,722	–
Purchase of available-for-sale financial assets	11	(9,752)	–
Purchase of a club debenture		–	(234)
Decrease in funds placed in deposits maturing after three months		271,359	70,338
Proceeds from sale of property, plant and equipment	28	20,526	9,101
Interest received		22,347	21,599
Net cash used in investing activities		<u>(1,275,931)</u>	<u>(604,443)</u>
Cash flow from financing activities			
Repurchase of own shares		–	(20,766)
Exercise of share options		46,900	–
Proceeds from borrowings		932,400	–
Repayments of borrowings		(332,280)	(20,280)
Dividends paid	27	(165,693)	(94,681)
Dividends paid to minority interest		(38,850)	(39,000)
Net cash generated from/(used in) financing activities		<u>442,477</u>	<u>(174,727)</u>
Net increase in cash and cash equivalents			
Cash and cash equivalents at 1st January		1,282,402	665,949
Effect of foreign exchange rate changes		4,364	(849)
Cash and cash equivalents at 31st December		<u>1,831,521</u>	<u>1,282,402</u>
Analysis of balances of cash and cash equivalents			
Cash and cash equivalents at 31st December		1,831,521	1,282,402
Term deposits maturing after three months		–	271,359
Bank balances and cash at 31st December		<u>1,831,521</u>	<u>1,553,761</u>

The notes on pages 35 to 93 are an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

1. GENERAL INFORMATION

The principal activities of CNPC (Hong Kong) Limited (the "Company") and its subsidiaries (collectively, the "Group") are the exploration and production of crude oil and natural gas in the People's Republic of China ("PRC"), the Republic of Kazakhstan ("Kazakhstan"), the Sultanate of Oman ("Oman"), Peru, the Azerbaijan Republic ("Azerbaijan"), the Kingdom of Thailand ("Thailand") and the Union of Myanmar ("Myanmar").

The oil operation in the PRC is conducted through production sharing arrangements with PetroChina Company Limited ("PetroChina"), a listed subsidiary of China National Petroleum Corporation ("CNPC"), the Company's ultimate holding company, whereby the Group is entitled to a fixed percentage of production in accordance with the respective oil production sharing contracts entered into with PetroChina.

The Group currently has two production sharing arrangements in the PRC. On 1st 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 30th 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.

Further details in relation to these contracts and the Group's share of results and net assets in these arrangements are shown in Notes 31 and 32.

The Company is a limited liability company incorporated in Bermuda. The address of its principal office is Room 3907-3910, 39/F, 118 Connaught Road West, Hong Kong.

The Company is listed on The Stock Exchange of Hong Kong Limited.

These consolidated financial statements are presented in thousands of units of Hong Kong dollars (HK\$'000), unless otherwise stated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

2.1 Basis of preparation

The consolidated financial statements of CNPC (Hong Kong) Limited have been prepared in accordance with the Hong Kong Financial Reporting Standards ("HKFRS"). The consolidated financial statements have been prepared under the historical cost convention as modified by the available-for-sale financial assets, financial assets and financial liabilities at fair value through profit or loss which are carried at fair value.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

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 Company'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 4.

In 2005, the Group adopted the new/revised standards and interpretations of HKFRS below, which are relevant to its operations. The 2004 comparatives have been amended as required, in accordance with the relevant requirements.

HKAS 1	Presentation of Financial Statements
HKAS 2	Inventories
HKAS 7	Cash Flow Statements
HKAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
HKAS 10	Events after the Balance Sheet Date
HKAS 16	Property, Plant and Equipment
HKAS 17	Leases
HKAS 21	The Effects of Changes in Foreign Exchange Rates
HKAS 23	Borrowing Costs
HKAS 24	Related Party Disclosures
HKAS 27	Consolidated and Separate Financial Statements
HKAS 28	Investments in Associates
HKAS 31	Investments in Joint Ventures
HKAS 32	Financial Instruments: Disclosures and Presentation
HKAS 33	Earnings per Share
HKAS 36	Impairment of Assets
HKAS 39	Financial Instruments: Recognition and Measurement
HKAS 39 Amendment	Transition and Initial Recognition of Financial Assets and Financial Liabilities
HKAS-Int 15	Operating Leases – Incentives
HKFRS 2	Share-based Payments
HKFRS 3	Business Combinations

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

The adoption of new/revised HKASs 1, 2, 7, 8, 10, 16, 21, 23, 24, 27, 28, 33, 36 and HKAS-Int 15 did not result in substantial changes to the Group's accounting policies. In summary:

- HKAS 1 has affected the presentation of minority interest, share of net after-tax results of associates and other disclosures.
- HKASs 2, 7, 8, 10, 16, 23, 27, 28, 33, 36 and HKAS-Int 15 had no material effect on the Group's policies.
- HKAS 21 had no material effect on the Group's policy. The functional currency of each of the consolidated entities has been re-evaluated based on the guidance to the revised standard.
- HKAS 24 has affected the identification of related parties and some other related-party disclosures.

The adoption of revised HKAS 17 has resulted in a change in the accounting policy relating to the reclassification of leasehold land and land use rights from property, plant and equipment to operating leases. The up-front prepayments made for the leasehold land and land use rights are expensed in the income statement on a straight-line basis over the period of the lease or when there is impairment, the impairment is expensed in the income statement. In prior years, the leasehold land was accounted for at cost less accumulated depreciation and accumulated impairment.

The Group has adopted HKAS 31 and elected to continue applying equity method to account for its interests in jointly controlled entities.

The adoption of HKASs 32 and 39 has resulted in a change in the accounting policy relating to the classification of financial assets at fair value through profit or loss and available-for-sale financial assets.

The adoption of HKFRS 2 has resulted in a change in the accounting policy for share-based payments. Until 31st December 2004, the provision of share options to employees did not result in an expense in the income statement. Effective on 1st January 2005, the Group expenses the cost of share options in the income statement. As a transitional provision, the cost of share options granted after 7th November 2002 and had not yet vested on 1st January 2005 was expensed retrospectively in the income statement of the respective periods (Note 2.14).

The adoption of HKFRS 3 results in a change in the accounting policy for negative goodwill whereby negative goodwill arising on acquisition is derecognised and credited to equity. Prior to 1st January 2005, the Group did not have any goodwill or negative goodwill recognised in these financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

All changes in the accounting policies have been made in accordance with the transition provisions in the respective standards, wherever applicable. All standards adopted by the Group require retrospective application other than:

- HKAS 39 – does not permit to recognise, derecognise and measure financial assets and liabilities in accordance with this standard on a retrospective basis. The Group applied the previous Statement of Standard Accounting Practice (“SSAP”) 24 “Accounting for investments in securities” to investment securities for the 2004 comparative information. The adjustments required for the accounting differences between SSAP 24 and HKAS 39 are determined and recognised at 1st January 2005.
 - HKAS-Int 15 – does not require the recognition of incentives for leases beginning before 1st January 2005.
 - HKFRS 2 – only retrospective application for all equity instruments granted after 7th November 2002 and not vested at 1st January 2005; and
 - HKFRS 3 – prospectively after 1st January 2005.
- (i) The adoption of revised HKAS 17 resulted in:

	31st December 2005 HK\$'000	As at 31st December 2004 HK\$'000
Decrease in property, plant and equipment	(3,842)	(3,982)
Increase in leasehold land and land use rights	3,842	3,982

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

(ii) The adoption of HKFRS 2 resulted in:

	As at	
	31st December	31st December
	2005	2004
	HK\$'000	HK\$'000
Decrease in retained earnings	(21,120)	(7,210)
Increase in share-based compensation reserve	21,120	7,210
	For the year	For the year
	ended 31st	ended 31st
	December	December
	2005	2004
	HK\$'000	HK\$'000
Increase in staff costs	13,910	7,210
Decrease in basic earnings per share	(HK0.29 cents)	(HK0.16 cents)
Decrease in diluted earnings per share	(HK0.28 cents)	(HK0.15 cents)

(iii) The adoption of HKFRS 3 resulted in increase in opening reserves and investments in associates:

	As at
	1st January
	2005
	HK\$'000
Increase in retained earnings	2,245,276
Increase in exchange reserves	38,227
Increase in investments in associates	2,283,503

There was no significant impact on basic and diluted earnings per share from the adoption of HKAS 17 and HKFRS 3.

There was no significant impact on opening retained earnings at 1st January 2004 from the adoption of revised HKAS 17.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.1 Basis of preparation (continued)

No early adoption of the following new Standards or Interpretations or Amendments that have been issued but are not yet effective. The Directors anticipate that the adoption of these Standards or Interpretations or Amendments will have no material impact on the accounts of the Group and will not result in substantial changes to the Group's accounting policies.

HKAS 1 (Amendment)	Presentation of Financial Statements: Capital Disclosures
HKAS 19 (Amendment)	Actuarial Gains and Losses, Group Plans and Disclosures
HKAS 21 (Amendment)	Net Investment in a Foreign Operation
HKAS 39 (Amendment)	Cash Flow Hedge Accounting of Forecast Intragroup Transactions
HKAS 39 (Amendment)	The Fair Value Option
HKAS 39 & HKFRS 4 (Amendment)	Financial Guarantee Contracts
HKFRS 1 (Amendment)	First-time Adoption of Hong Kong Financial Reporting Standards
HKFRS 6 (Amendment)	Exploration for and Evaluation of Mineral Resources
HKFRS 7	Financial Instruments: Disclosures
HKFRS-Int 4	Determining whether an Arrangement contains a Lease
HKFRS-Int 5	Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
HK(IFRIC)-Int 6	Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies

2.2 Consolidation

The consolidated financial statements include the financial statements of the Company and all its subsidiaries made up to 31st December.

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Consolidation (continued)

(a) Subsidiaries (continued)

The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated but considered an impairment indicator of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

In the Company's balance sheet the investments in subsidiaries are stated at cost less provision for impairment losses. The results of subsidiaries are accounted for by the Company on the basis of dividend received and receivable.

(b) Transactions with minority interests

The Group applies a policy of treating transactions with minority interests as transactions with parties external to the Group. Disposals to minority interests result in gains and losses for the Group that are recorded in the income statement. Purchases from minority interests result in goodwill, being the difference between any consideration paid and the relevant share acquired of the carrying value of net assets of the subsidiary.

(c) Associates

Associates are all 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 and are initially recognised at cost.

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in an associate equals or exceeds its interest 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.2 Consolidation (continued)

(c) *Associates (continued)*

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. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

(d) *Joint ventures entities*

A jointly controlled entity is a joint venture whereby the Group and other parties undertake an economic activity which is subject to joint control and none of the participating parties has unilateral control over the economic activity. Investments in jointly controlled entities are accounted for using the equity method of accounting and are initially recognised at cost. The Group's investments in joint ventures entities includes goodwill (net of any accumulated impairment loss) identified on acquisition.

The Group's share of its jointly controlled entities' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment. When the Group's share of losses in a jointly controlled entity equals or exceeds its interest in the jointly controlled entity, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the jointly controlled entity.

In the Company's balance sheet, the investments in jointly controlled entities are stated at cost less provision for impairment losses. The results of jointly controlled entities are accounted for by the Company on the basis of dividends received and receivable.

(e) *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:

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.3 Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

Unallocated costs represent corporate expenses. Segment assets consist primarily of property, plant and equipment, inventories, receivables and operating cash, and mainly exclude investments in jointly controlled entities and associates. Segment liabilities comprise operating liabilities and exclude items such as taxation, deferred taxation, minority interests and certain corporate borrowings. Capital expenditure comprises additions to leasehold land and land use rights, and property, plant and equipment, including additions resulting from acquisitions through purchases of subsidiaries.

In respect of geographical segments reporting, turnover are based on the country in which the customer is located. Total assets and capital expenditure are where the assets are located.

2.4 Foreign currency translation

(a) Functional and presentation currency

Items included in the financial statements of each of the Group's entities 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 Dollars ("HK\$"), which is also the Company's presentation currency. The Company's functional currency is United States Dollars ("US\$").

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. 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 income statement.

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 are recognised in profit or loss, and other changes in carrying amount are recognised in equity.

Translation differences on non-monetary financial assets and liabilities are reported as part of the fair value gain or loss. Translation differences on non-monetary financial assets and liabilities such as equities held at fair value through profit or loss are recognised in the income statement 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 fair value reserve in equity.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.4 Foreign currency translation (continued)

(c) Group companies

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:

- (i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;
- (ii) income and expenses for each income statement 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
- (iii) all resulting exchange differences are recognised as a separate component of equity.

2.5 Property, plant and equipment

Property, plant and equipment comprise oil and gas properties, other fixed assets and construction in progress.

(a) Oil and gas properties

Oil and gas properties are accounted for using the successful efforts costing method whereby costs including lease acquisition costs, lease of equipment and drilling costs associated with exploration efforts which result in the discovery of proved reserves and costs associated with production wells are capitalised. Exploration costs are capitalised when incurred pending determination of commercial reserves. Should the exploration efforts be determined unsuccessful, such costs are then taken to the income statement.

Depletion and depreciation of capitalised costs of productive oil and gas properties is calculated on the unit-of-production basis over the total proved reserves of the relevant area. Depreciation of other equipment, furniture and fixtures (capitalised in oil and gas properties) is provided on a straight-line basis at annual rates of between 16.67% and 20%.

Major costs incurred in restoring oil and gas properties to their normal working condition are charged to the income statement. Improvements are capitalised and depreciated over the total proved reserves of the relevant area.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.5 Property, plant and equipment (continued)

(b) Other fixed assets

Other fixed assets, comprising buildings, furniture and fixtures and motor vehicles, are stated at historical cost less depreciation and impairment losses. Historical cost included expenditure that is directly attributable to the acquisition of the items.

Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All other repairs and maintenance are expensed in the income statement during the financial period in which they are incurred.

Other fixed assets are depreciated at rates sufficient to write off their cost less accumulated impairment losses over their estimated useful lives on a straight-line basis. The principal annual rates are as follows:

Buildings	4%
Furniture and fixtures	20% to 25%
Motor vehicles	25%

Major costs incurred in restoring fixed assets in their normal working condition are charged to the income statement. Improvements are capitalised and depreciated over their estimated useful lives to the Group.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

(c) Construction in progress

Construction in progress represents oil and gas properties under construction, and is stated at cost. When the assets concerned are brought into use, the costs will be reclassified to oil and gas properties and depleted in accordance with the policy as stated in Note 2.5(a).

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount.

2.6 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/jointly controlled entity at the date of acquisition. Goodwill on acquisitions of subsidiaries and jointly controlled entities is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity included the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.7 Impairment of non-financial assets

Assets that have an indefinite useful life are not subject to amortisation, which are at least tested annually for impairment and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to amortisation are reviewed for 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 asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

2.8 Financial assets

From 1st January 2004 to 31st December 2004:

The Group classified its investments in securities, other than subsidiaries, associates and jointly controlled entities, as long-term investment which represented investments in securities which were stated at cost less provision for impairment losses. The carrying amounts of the individual investments were reviewed at each balance sheet date to assess whether the fair value had declined below the carrying amounts. When a decline other than temporary had occurred, the carrying amount of such securities would be reduced to the fair value. The amount of the reduction was recognised as an expense in the income statement.

From 1st January 2005 onwards:

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.8 Financial assets (continued)

(a) *Financial assets at fair value through profit or loss*

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Assets in this category are classified as current assets if they are either held for trading or are expected to be realised within 12 months of the balance sheet date.

(b) *Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are classified as trade and other receivables in the balance sheet (Note 2.10).

(c) *Held-to-maturity investments*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. If the Group were to sell other than an insignificant amount of held-to-maturity financial assets, the whole category would be tainted and reclassified as available-for-sale. Held to maturity financial assets are included in non-current assets, except for those with maturities less than 12 months from the balance sheet date, which are classified as current assets. During the year, the Group did not hold any investments in this category.

(d) *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. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Purchases and sales of investments are recognised on trade-date – the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Financial assets carried at fair value through profit or loss are initially recognised at fair value and transaction costs are expensed in the income statement. Investments 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. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.8 Financial assets (continued)

(d) Available-for-sale financial assets (continued)

Gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category including interest and dividend income, are presented in the income statement within "other (losses)/gains – net", in the period in which they arise.

Changes in the fair value of monetary securities denominated in a foreign currency and classified as available-for-sale are analysed between translation differences resulting from changes in amortised cost of the security and other changes in the carrying amount of the security. The translation differences are recognised in profit or loss, and other changes in carrying amount are recognised in equity. Changes in the fair value of monetary securities classified as available-for-sale and non-monetary securities classified as available-for-sale are recognised in equity.

When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments recognised in equity are included in the income statement as 'gains and losses from investment securities'. Interest on available-for-sale securities calculated using the effective interest method is recognised in the income statement. Dividends on available-for-sale equity instruments are recognised in the income statement when the Group's right to receive payments is established.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models, making maximum use of market inputs and relying as little as possible on entity-specific inputs.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss-measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. Impairment testing of trade receivables is described in Note 2.10.

2.9 Inventories

Inventories consist of crude oil and marina club debentures and wet berths held for sales. Inventories are stated at the lower of cost and net realisable value. Cost of crude oil, calculated on a weighted average basis, comprises materials, direct labour and an appropriate proportion of all production overhead expenditure. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.10 Trade and other receivables

Trade and other receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade and other receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. Significant financial difficulties of the debtor, probability that the debtor will enter bankruptcy or financial reorganisation, and default or delinquency in payments are considered indicators that the trade receivable is impaired. 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 effective interest rate. The amount of the provision is recognised in the income statement.

2.11 Cash and cash equivalents

Cash and cash equivalents include cash in hand, deposits held at call with banks, and cash investments with original maturities of three months or less, and bank overdrafts.

2.12 Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability, including fees and commissions paid to agents, advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Borrowings are subsequently stated at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

2.13 Deferred income tax

Deferred income tax is provided in full, 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, if the deferred income tax 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, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially 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 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.14 Employee benefits

(a) Employee leave entitlements

Employee entitlements to annual leave and long service leave are recognised when they accrue to employees. A provision is made for the estimated liability for annual leave and long service leave as a result of services rendered by employees up to the balance sheet date.

Employee entitlements to sick leave and maternity leave are not recognised until the time of leave.

(b) Pension obligation

The Group operates defined contribution provident fund schemes for its employees, the assets of which are held separately from those of the Group in independently administered funds. The Group's contributions under the schemes are charged to the income statement as incurred. The amount of the Group's contributions is based on specified percentages of basic salaries of employees.

(c) Share-based compensation

The Group operates an equity-settled, share-based compensation plan. 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 over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the entity revises its estimates of the number of options that are expected to become exercisable. It recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity over the remaining vesting period.

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.

2.15 Provisions

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events; it is more likely than not that an outflow of resources will be required to settle the obligation; and the amount has been reliably estimated. Provisions are not recognised for future operating losses. Where the Group expects a provision to be reimbursed, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

2.16 Revenue recognition

Revenue comprises the fair value of the consideration received or receivable for the sale of goods in the ordinary course of the Group's activities. Revenue is shown, net of value-added tax, and after eliminating sales within the Group. Revenue is recognised as follows:

(a) *Sales of crude oil and natural gas*

Sales of crude oil and natural gas are recognised when a Group entity has delivered products to the customer, the customer has accepted the products and collectibility of the related receivables is reasonably assured.

(b) *Rental income*

Rental income is recognised on a straight-line accrual basis over the terms of the respective leases.

(c) *Interest income*

Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised using the original effective interest rate.

(d) *Dividend income*

Dividend income is recognised when the right to receive payment is established.

2.17 Operating leases

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged in the income statement on a straight-line basis over the period of the lease.

2.18 Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

3. FINANCIAL RISK MANAGEMENT

3.1 Financial risk factors

The Group's activities expose it to a variety of financial risks: market risk (including currency risk, price risk and industry risk), credit risk, liquidity risk and cash flow interest-rate risk.

(a) *Market risk*

(i) Foreign exchange risk

The Group operates mainly in US dollars and Renminbi. Renminbi is not a freely convertible currency. Future exchange rates of Renminbi against other currencies could vary significantly from the current or historical exchange rates as a result of controls that could be imposed by the PRC government. The exchange rates of Renminbi are also affected by economic developments and political changes domestically and internationally, and supply and demand for Renminbi. As Renminbi is the measurement currency of certain principal subsidiaries, the fluctuation of exchange rates of Renminbi may have positive or negative impacts on the results of operations of the Group. To the extent that the Renminbi appreciates further against US and HK dollars, our results of operations, which are presented in HK dollars, will increase, and to the extent that the Renminbi depreciates in value our results of operations, as presented in HK dollars, will decrease. The Group has not used any forward contracts to hedge its exposure to foreign exchange risks.

(ii) Price risk

The Group is engaged in a wide range of petroleum related activities. The global oil and gas market is affected by international political, economic and military developments and global demand for and supply of oil and gas. A decrease in the world prices of crude oil and gas could adversely affect the Group's financial position. The Group has not used any derivative instruments to hedge against potential price fluctuations of crude oil and refined products.

(iii) Industry risk

Like other oil and gas companies, the Group's business activities are subject to regulations and controls prevailing in countries in which the Group operates. These regulations and controls, including but not limited to grant of exploration and production licences, the imposition of industry-specific taxes and levies and the implementation of environmental and safety standards, are expected to have an impact on the Group's business operations. As a result, the Group may be subject to fairly stringent restrictions when implementing its business strategy, developing and expanding its business or maximising its profitability.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

3. FINANCIAL RISK MANAGEMENT (continued)

3.1 Financial risk factors (continued)

(b) *Credit risk*

The Group has no significant concentration of credit risk. The carrying amount of accounts receivables represent the Group's maximum exposure to credit risks in relation to its financial assets. The Group has policies in place to ensure that sales of services are made to customers with an appropriate credit history and the Group performs periodic credit evaluations of its customers. The Group's historical experience in collection of trade and other receivables falls within the recorded allowances.

(c) *Liquidity risk*

The Group has minimal liquidity risk.

(d) *Cash flow and fair value interest rate risk*

The Group's income and operating cash flows are substantially independent of changes in market interest rates and the Group has no significant interest-bearing assets. The Group's exposure to changes in interest rates is mainly attributable to its borrowing, details of which have been disclosed in Note 18 to this report. The Group has not used any interest rate swaps to hedge its exposure to interest rate risks.

3.2 Fair value estimation

The carrying amounts of the Group's financial assets including cash and cash equivalents, trade receivables and other receivables; and financial liabilities including trade payables, short term borrowings and other payables, approximate their fair value due to their short maturities.

The fair value of fixed rate long-term borrowing is likely to be different from their carrying amounts. The fair value of financial liabilities is estimated by discounting the future contractual cash flows at the current market interest rate available to the Group for similar financial instruments. Details of analysis of the fair value and carrying amounts of long-term borrowings are set out in Note 18 to this report.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

4. CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS

Estimates and judgements are continually 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 Group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(a) Estimation of oil and natural gas reserves

Oil and 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 reserves, will affect unit-of-production depreciation charges to the income statement. 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. In general, changes in the technical maturity of oil and gas reserves resulting from new information becoming available from development and production activities have tended to be the most significant cause of annual revisions. Changes to the Group's estimates of proved reserves, particularly proved reserves, may affect the amount of depreciation, depletion and amortisation recorded in the Group's financial statements for property, plant and equipment related to oil and gas production activities. A reduction in proved reserves will increase depreciation, depletion and amortisation charges (assuming constant production) and reduce net income.

(b) Estimated impairment of property, plant and equipment

Property, plant and equipment, including oil and gas properties, are reviewed for possible impairment when 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 on highly uncertain matters, such as future prices of crude oil, natural gas, production profile, estimation of oil and natural gas reserves, etc. However, the impairment reviews and calculations are based on assumptions that are consistent with the Group's business plan. Favourable changes to some assumptions might have avoided the need to impair any assets in these periods, whereas unfavourable changes might have caused an additional unknown number of other assets to become impaired.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

5. SALES, OTHER GAINS-NET AND SEGMENT INFORMATION

The Group is principally engaged in the exploration and production of crude oil and natural gas in the PRC, Kazakhstan, Oman, Peru, Azerbaijan, Thailand and Myanmar. Revenues recognised during the year are as follows:

	2005 HK\$'000	2004 HK\$'000
Sales		
Sale of crude oil and natural gas	<u>3,378,323</u>	<u>2,533,312</u>
Other gains-net		
Interest income	22,347	21,599
Refund of PRC income tax resulting from reinvestment of profits generated from oil production sharing contracts	64,886	45,586
Dividend income	1,722	–
Rental income	78	138
Others	634	1,139
	<u>89,667</u>	<u>68,462</u>

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

As the Group derives all of its turnover and trading results from exploration and production of crude oil and natural gas, no business segment information is presented. The Group operates, through its subsidiaries companies, associates and jointly ventures, in the PRC, Kazakhstan, Oman, Peru, Azerbaijan, Thailand and Myanmar. Information about the Group's operations by geographical segments is as follows:

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

5. SALES, OTHER GAINS-NET AND SEGMENT INFORMATION (continued)

The segment results, capital expenditure, depletion, depreciation and amortisation for the year ended 31st December 2005 are as follows:

	PRC HK\$'000	South America HK\$'000	Central and South East Asia HK\$'000	Middle East HK\$'000	Unallocated HK\$'000	Total HK\$'000
Sales	<u>2,329,252</u>	<u>503,791</u>	<u>545,280</u>	-	-	<u>3,378,323</u>
Segment results	<u>1,310,520</u>	<u>221,618</u>	<u>126,321</u>	(16)	(7,058)	<u>1,651,385</u>
Negative goodwill on acquisition of additional interest in a subsidiary (Note 30)	-	-	1,705,847	-	-	<u>1,705,847</u>
Operating profit before finance costs						<u>3,357,232</u>
Finance costs						(33,627)
Share of profits less losses of Associates	-	-	793,281	-	-	<u>793,281</u>
Jointly controlled entities	23,283	-	3,141	107,822	-	<u>134,246</u>
Profit before income tax						<u>4,251,132</u>
Income tax expense						(415,660)
Profit for the year						<u>3,835,472</u>
Capital expenditure	<u>393,864</u>	<u>34,514</u>	<u>164,309</u>	-	<u>1,714</u>	<u>594,401</u>
Depletion, depreciation and amortisation	<u>393,648</u>	<u>42,259</u>	<u>48,871</u>	-	<u>548</u>	<u>485,326</u>
The segment assets and liabilities at 31st December 2005 are as follows:						
Segment assets	<u>3,034,848</u>	<u>446,878</u>	<u>1,400,316</u>	-	<u>634,444</u>	<u>5,516,486</u>
Investments in associates	-	-	9,730,309	-	-	<u>9,730,309</u>
Investments in jointly controlled entities	<u>304,595</u>	-	<u>176,666</u>	<u>337,874</u>	-	<u>819,135</u>
Total assets	<u>3,339,443</u>	<u>446,878</u>	<u>11,307,291</u>	<u>337,874</u>	<u>634,444</u>	<u>16,065,930</u>
Total liabilities	<u>264,682</u>	<u>86,777</u>	<u>1,931,255</u>	<u>9</u>	<u>206,659</u>	<u>2,489,382</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

5. SALES, OTHER GAINS-NET AND SEGMENT INFORMATION (continued)

The restated segment results, capital expenditure, depletion, depreciation and amortisation for the year ended 31st December 2004 are as follows:

	PRC	South America	Central and South East Asia	Middle East	Unallocated	Total
	HK'\$000	HK'\$000	HK'\$000	HK'\$000	HK'\$000	HK'\$000
Sales	<u>1,797,175</u>	<u>391,017</u>	<u>345,120</u>	<u>–</u>	<u>–</u>	<u>2,533,312</u>
Segment results	<u>851,652</u>	<u>126,464</u>	<u>69,054</u>	<u>301</u>	<u>(24,921)</u>	<u>1,022,550</u>
Finance costs						(10,735)
Share of profits less losses of						
Associates	–	–	66,143	–	–	66,143
Jointly controlled entities	26,464	–	(88,053)	63,013	–	<u>1,424</u>
Profit before income tax						1,079,382
Income tax expense						<u>(275,974)</u>
Profit for the year						<u>803,408</u>
Capital expenditure	<u>392,229</u>	<u>33,049</u>	<u>130,549</u>	<u>–</u>	<u>5,767</u>	<u>561,594</u>
Depletion, depreciation and amortisation	<u>405,560</u>	<u>54,099</u>	<u>44,565</u>	<u>–</u>	<u>166</u>	<u>504,390</u>
The segment assets and liabilities						
at 31st December 2004 are as follows:						
Segment assets	2,792,978	390,468	689,271	–	524,651	4,397,368
Investments in associates	–	–	150,250	–	–	150,250
Investments in jointly controlled entities	<u>290,358</u>	<u>–</u>	<u>119,513</u>	<u>291,772</u>	<u>–</u>	<u>701,643</u>
Total assets	<u>3,083,336</u>	<u>390,468</u>	<u>959,034</u>	<u>291,772</u>	<u>524,651</u>	<u>5,249,261</u>
Total liabilities	<u>291,667</u>	<u>62,320</u>	<u>47,215</u>	<u>23,415</u>	<u>632,621</u>	<u>1,057,238</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

6. LEASEHOLD LAND AND LAND USE RIGHTS – GROUP

The Group's interests in leasehold land and land use rights represent prepaid operating lease payments and their net book value are analysed as follows:

	2005 HK\$'000	2004 HK\$'000
Outside Hong Kong held on:		
Lease of over 50 years	155	157
Leases of between 10 to 50 years	3,687	3,825
	3,842	3,982
	3,842	3,982
Opening	3,982	–
Additions	–	4,042
Amortisation of prepaid operating lease payments	(140)	(60)
	3,842	3,982
	3,842	3,982

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

7. PROPERTY, PLANT AND EQUIPMENT

Group

	Oil and gas properties HK\$'000	Buildings HK\$'000	Furniture and fixtures HK\$'000	Motor vehicles HK\$'000	Construction in progress HK\$'000	Total HK\$'000
At 1st January 2004						
Cost	4,443,215	–	2,066	2,224	35,666	4,483,171
Accumulated depletion and depreciation	(1,817,777)	–	(1,898)	(1,735)	–	(1,821,410)
Net book amount	<u>2,625,438</u>	<u>–</u>	<u>168</u>	<u>489</u>	<u>35,666</u>	<u>2,661,761</u>
Year ended 31st December 2004						
Opening net book amount	2,625,438	–	168	489	35,666	2,661,761
Exchange differences	3,501	–	–	–	3	3,504
Additions	501,080	1,365	360	422	54,325	557,552
Disposal	(7,384)	–	(3)	–	–	(7,387)
Depletion and depreciation	(504,181)	(36)	(69)	(44)	–	(504,330)
Transfer	36,208	–	(53)	(489)	(35,666)	–
Closing net book amount	<u>2,654,662</u>	<u>1,329</u>	<u>403</u>	<u>378</u>	<u>54,328</u>	<u>2,711,100</u>
At 31st December 2004						
Cost	4,914,125	1,365	2,341	2,133	54,328	4,974,292
Accumulated depletion and depreciation	(2,259,463)	(36)	(1,938)	(1,755)	–	(2,263,192)
Net book amount	<u>2,654,662</u>	<u>1,329</u>	<u>403</u>	<u>378</u>	<u>54,328</u>	<u>2,711,100</u>
Year ended 31st December 2005						
Opening net book amount	2,654,662	1,329	403	378	54,328	2,711,100
Exchange differences	2,758	–	–	4	558	3,320
Additions	554,558	–	181	1,533	38,129	594,401
Disposal	(18,599)	–	–	–	–	(18,599)
Depletion and depreciation	(484,672)	(41)	(169)	(304)	–	(485,186)
Transfer	54,649	–	–	–	(54,649)	–
Closing net book amount	<u>2,763,356</u>	<u>1,288</u>	<u>415</u>	<u>1,611</u>	<u>38,366</u>	<u>2,805,036</u>
At 31st December 2005						
Cost	5,484,959	1,365	2,522	3,670	38,366	5,530,882
Accumulated depletion and depreciation	(2,721,603)	(77)	(2,107)	(2,059)	–	(2,725,846)
Net book amount	<u>2,763,356</u>	<u>1,288</u>	<u>415</u>	<u>1,611</u>	<u>38,366</u>	<u>2,805,036</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

7. PROPERTY, PLANT AND EQUIPMENT (continued)

Depletion of oil and gas properties of HK\$484,327,000 (2004: HK\$504,060,000) and HK\$345,000 (2004:HK\$121,000) has been expensed in cost of goods sold and exploration costs respectively. Depreciation expenses of other fixed assets of HK\$514,000 (2004: HK\$149,000) have been expensed in administrative expenses.

Company

	Furniture and fixtures	Motor vehicles	Total
	HK\$'000	HK\$'000	HK\$'000
At 1st January 2004			
Cost	1,961	403	2,364
Accumulated depreciation	(1,845)	(403)	(2,248)
Net book amount	<u>116</u>	<u>–</u>	<u>116</u>
Year ended 31st December 2004			
Opening net book amount	116	–	116
Additions	108	–	108
Disposal	(3)	–	(3)
Depreciation	(59)	–	(59)
Closing net book amount	<u>162</u>	<u>–</u>	<u>162</u>
At 31st December 2004			
Cost	2,039	403	2,442
Accumulated depreciation	(1,877)	(403)	(2,280)
Net book amount	<u>162</u>	<u>–</u>	<u>162</u>
Year ended 31st December 2005			
Opening net book amount	162	–	162
Additions	1	1,532	1,533
Depreciation	(61)	(198)	(259)
Closing net book amount	<u>102</u>	<u>1,334</u>	<u>1,436</u>
At 31st December 2005			
Cost	2,040	1,935	3,975
Accumulated depreciation	(1,938)	(601)	(2,539)
Net book amount	<u>102</u>	<u>1,334</u>	<u>1,436</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

8. INVESTMENTS IN SUBSIDIARIES

	Company	
	2005	2004
	HK'000	HK\$'000
Unlisted shares		
– at 1991 directors' valuation	156,034	156,034
Less: Provision for impairment loss	–	(110,087)
	156,034	45,947
Amounts due from subsidiaries less provision	2,557,610	2,099,122
Dividends receivable	954,472	660,004
	3,668,116	2,805,073

Details of principal subsidiaries, which in the directors' opinion, materially affect the results and/or net assets of the Group at 31st December 2005 are given in Note 36.

9. INVESTMENTS IN ASSOCIATES

	Group	
	2005	2004
	HK'000	HK\$'000
Group's share of net assets		
– Unlisted shares in CNPC International (Caspian) Limited (Note (i))	–	142,138
– Listed shares in CNPC-Aktobemunaigas Open Joint Stock Company (Note (ii))	9,730,309	–
	9,730,309	142,138
– Amounts due from associates	–	8,112
	9,730,309	150,250
Market value of listed shares		
– Investment in Aktobe	5,391,123	–

Notes:

- (i) On 10th December 2003, Bestory Company Inc., a wholly owned subsidiary of the Company, entered into a Sale and Purchase Agreement with CNPC International Limited, a subsidiary of CNPC, to acquire 40% equity interest in CNPC International (Caspian) Limited ("Caspian") for a consideration of US\$10,950,000 (equivalent to HK\$85,410,000). Caspian then became an associate of the Group. The major asset of Caspian is a 25.12% equity interest in CNPC-Aktobemunaigas Open Joint Stock Company ("Aktobe").

On 14th October 2005, the Group acquired an additional 20% equity interest in Caspian at a consideration of US\$140 million (approximately HK\$1,087,800,000) from a third party, Darley Investment Service Incorporated. Caspian became a subsidiary of the Group thereafter.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

9. INVESTMENTS IN ASSOCIATES (continued)

Notes: (continued)

- (ii) Aktobe is a joint stock company listed on the Kazakhstan Stock Exchange, the principal activity of which is the exploration and production of petroleum in Zhanazhol, Kenkyak (pre-salt) and Kenkyak (post-salt) oil fields located in the north-western region of the Republic of Kazakhstan. Before 1st July 2005, the 25.12% equity interest in Aktobe was accounted for by Caspian as a long term investment instead of as an associate and was carried at cost on the basis that the directors did not believe that Caspian had significant influence over the operations of Aktobe. The results of Aktobe were accounted for by Caspian on the basis of dividends received and receivable.

Pursuant to a Board Resolution dated 15th June 2005, Caspian appointed a director to the board of Aktobe whereby Caspian obtained significant influence over the operations of Aktobe. According to HKAS 28 "Investments in Associates", associates are recognised at cost plus the investor's share of post acquisition movements in equity. Hence, Aktobe was accounted for as if it has been an associate of the Group since the date of initial acquisition.

Pursuant to HKFRS 3, the acquisition of Caspian achieved in stages described above increases the opening reserve as at 1st January 2005 by HK\$2.3 billion and the asset revaluation reserves as at 31st December 2005 by HK\$2.7 billion. The former represents the negative goodwill on acquisition of the original 40% interest in Caspian and the results attributable to the Group from the date of initial acquisition of Aktobe to 31st December 2004. The later represents the changes in fair value of the 40% interest in Caspian between the date of initial acquisition and 14th October 2005.

The financial positions and results of the Group's investment in its major associate, Aktobe, are summarised below:

	2005 HK\$'000
Assets and liabilities	
Assets	16,389,170
Liabilities	(7,304,121)
Net assets	9,085,049
Results for the year	
Income	14,411,918
Expenses	(8,178,264)
Profit after tax	6,233,654

Details of major associate, which in the director's opinion, materially affect the results and/or assets of the Group at 31st December 2005 are given in Note 37.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

10. INVESTMENTS IN JOINTLY CONTROLLED ENTITIES

	Group		Company	
	2005 HK\$'000	2004 HK\$'000	2005 HK\$'000	2004 HK\$'000
Unlisted shares, at cost	–	–	236,364	236,364
Share of net assets	591,135	542,827	–	–
Amounts due from jointly controlled entities	229,931	158,816	112,646	79,199
Exchange differences	(1,931)	–	–	–
	<u>819,135</u>	<u>701,643</u>	<u>349,010</u>	<u>315,563</u>

The Group's share of net assets as at 31st December 2005 and its share of results for the year then ended are as follows:

	2005 HK\$'000	2004 HK\$'000
Assets and liabilities		
Current assets	614,696	505,460
Non-current assets	624,416	335,846
Current liabilities	(485,267)	(164,870)
Non-current liabilities	(162,710)	(133,609)
Net assets	<u>591,135</u>	<u>542,827</u>
Results for the year		
Income	673,634	516,337
Expenses	(539,388)	(514,913)
Profit after tax	<u>134,246</u>	<u>1,424</u>

There are no contingent liabilities relating to the Group's investments in joint ventures, and no contingent liabilities of the venture itself.

Details of principal jointly controlled entities, which in the directors' opinion, materially affect the results and/or net assets of the Group at 31st December 2005 are given in Note 38.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

11. AVAILABLE-FOR-SALE FINANCIAL ASSETS

	Group 2005 HK\$'000
Beginning of the year	–
Exchange differences	(3,728)
Additions	9,752
Revaluation surplus transfer to equity (Note 16)	53,006
	<hr/>
End of the year	59,030
Less: non current portion	(59,030)
	<hr/>
Current portion	–
	<hr/> <hr/>

There were no disposals or impairment provisions on available-for-sale financial assets in 2005.

Available-for-sale financial assets include the following:

	2005 HK\$'000
Listed securities:	
– Equity securities – Hong Kong	7,920
– Equity securities – Australia	51,110
	<hr/>
	59,030
	<hr/> <hr/>
Market value of listed securities	59,030
	<hr/> <hr/>

12. INVENTORIES

	Group 2005 HK\$'000	2004 HK\$'000
Crude oil in tanks	15,744	10,799
Marina club debentures and wet berths	13,602	9,256
	<hr/>	<hr/>
	29,346	20,055
	<hr/> <hr/>	<hr/> <hr/>

As at 31st December 2005, the carrying amount of inventories that are carried at net realisable value amounted to HK\$12,892,000 (2004: HK\$8,720,000).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

13. TRADE AND OTHER RECEIVABLES

	Group	
	2005	2004
	HK\$'000	HK\$'000
Trade receivables (Note (a))		
– from third parties	62,899	45,326
– from related parties (Note (b))	203,334	34,188
	<u>266,233</u>	<u>79,514</u>
Prepayments and other receivables (Note (c))	505,601	8,586
Amounts due from related parties	185	783
	<u>772,019</u>	<u>88,883</u>

- (a) The Group granted a credit period of 30 to 60 days to its customers. As at 31st December 2005 and 31st December 2004, all trade receivables were aged within three months.
- (b) The amounts represent trade receivables arising from transactions entered into in the normal course of business.
- (c) Included a receivable of US\$64,376,000 (approximately HK\$498,267,000) from a stock broker, who received dividend paid out by Aktobe on behalf of the Group. The amount was fully settled after the balance sheet date.

14. CASH AND CASH EQUIVALENTS

	Group		Company	
	2005	2004	2005	2004
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Cash at bank and in hand	1,119,376	733,630	29,207	3,255
Short-term bank deposits	712,145	820,131	521,389	488,269
	<u>1,831,521</u>	<u>1,553,761</u>	<u>550,596</u>	<u>491,524</u>

The effective interest rate on short-term bank deposits was 3.9% (2004: 2.1%); these deposits have an average maturity of 38 days (2004: 324 days).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

15. SHARE CAPITAL

	Number of shares (thousands)	Ordinary shares HK\$'000	Share premium HK\$'000	Total HK\$'000
At 1st January 2004	4,756,504	47,565	1,313,079	1,360,644
Repurchase of own shares for cancellation	(22,410)	(224)	(20,542)	(20,766)
At 31st December 2004	4,734,094	47,341	1,292,537	1,339,878
Exercise of share options	90,000	900	46,000	46,900
At 31st December 2005	4,824,094	48,241	1,338,537	1,386,778

The total authorised number of ordinary shares is 8,000 million shares (2004: 8,000 million shares) with a par value of HK\$0.01 per share (2004: HK\$0.01 per share). All issued shares are fully paid.

Share options

The 1991 Share Option Scheme was adopted by the Company in 1991 and early terminated on 28th May 2001 with the share options granted under such scheme still valid until their respective expiry dates. On the same date, another share option scheme (the "2001 Share Option Scheme") was adopted.

On 3rd June 2002, the shareholders of the Company approved the termination (to the effect that no further options shall be offered) of the 2001 Share Option Scheme and the adoption of a new share option scheme (the "2002 Share Option Scheme"). As at 31st December 2005, options to subscribe for a total of 10,000,000 option shares were still outstanding under the 1991 Share Option Scheme. No option was granted under the 2001 Share Option Scheme.

Under the 2002 Share Option Scheme, options may be granted to the directors and full-time employees of the Company. No amount shall be payable by the grantee to the Company in exercising the right to accept an offer of the option. Options may be exercised 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. The 2002 Share Option Scheme will expire on 2nd June 2012. As at 31st December 2005, options to subscribe for a total of 85,500,000 option shares were still outstanding under the 2002 Share Option Scheme.

On 27th April 2005, a total of 53,500,000 options were granted to two directors, an independent director and an employee at an exercise price of HK\$1.224 per share expiring on 26th April 2010. The closing price of the Company's shares on 27th April 2005, the date of grant, was HK\$1.20.

During the year, 40,000,000 and 50,000,000 options were exercised at exercise price of HK\$0.41 and HK\$0.61 per share respectively on 6th June 2005. The closing price of the Company's shares immediately before the day on which these options being exercised was HK\$1.14.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

15. SHARE CAPITAL (continued)

Share options (continued)

Movement in the number of share options outstanding during the year is as follows:

	Number of options	
	2005	2004
At beginning of the year	132,000,000	100,000,000
Granted	53,500,000	32,000,000
Exercised	(90,000,000)	–
At end of the year	95,500,000	132,000,000

Share options outstanding as at the year end 2005 and 2004 have the following terms:

Exercisable period	Exercised price	Number of options	
		2005	2004
Directors:			
8th June 2001 to 7th March 2006	0.41	–	40,000,000
26th July 2001 to 25th April 2006	0.61	10,000,000	60,000,000
8th April 2004 to 7th January 2009	1.362	7,000,000	7,000,000
25th September 2004 to 24th June 2009	0.94	20,000,000	20,000,000
27th April 2005 to 26th April 2010	1.224	48,500,000	–
		85,500,000	127,000,000
Employees:			
25th September 2004 to 24th June 2009	0.94	5,000,000	5,000,000
27th July 2005 to 26th April 2010	1.224	5,000,000	–
		95,500,000	132,000,000

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

16. OTHER RESERVES

	Contributed surplus	Share-based Share compensation premium	Share-based compensation reserve	Asset revaluation reserve	Available- for-sale financial assets reserve	Exchange reserve	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Group							
Balance at 1st January 2004, as previously reported	134,323	1,313,079	–	–	–	(3,530)	1,443,872
Currency translation differences							
– Group	–	–	–	–	–	2,655	2,655
– Associate	–	–	–	–	–	–	–
Share option benefits	–	–	7,210	–	–	–	7,210
Repurchase of own shares for cancellation	–	(20,542)	–	–	–	–	(20,542)
Balance at 31st December 2004, as restated	<u>134,323</u>	<u>1,292,537</u>	<u>7,210</u>	<u>–</u>	<u>–</u>	<u>(875)</u>	<u>1,433,195</u>
Balance at 1st January 2005, as previously reported	134,323	1,292,537	–	–	–	(875)	1,425,985
Opening adjustment for the adoption of HKFRS 2	–	–	7,210	–	–	–	7,210
Opening adjustment for the adoption of HKFRS 3	–	–	–	–	–	38,227	38,227
Balance at 1st January 2005, as restated	<u>134,323</u>	<u>1,292,537</u>	<u>7,210</u>	<u>–</u>	<u>–</u>	<u>37,352</u>	<u>1,471,422</u>
Fair value gain – available-for-sale financial assets	–	–	–	–	53,006	–	53,006
Asset revaluation reserve arising from – business combination	–	–	–	2,713,131	–	–	2,713,131
Currency translation differences							
– Group	–	–	–	–	–	(44,273)	(44,273)
– Associate	–	–	–	–	–	4,078	4,078
Share option benefits	–	–	13,910	–	–	–	13,910
Exercise of share options	–	46,000	–	–	–	–	46,000
Balance at 31st December 2005	<u>134,323</u>	<u>1,338,537</u>	<u>21,120</u>	<u>2,713,131</u>	<u>53,006</u>	<u>(2,843)</u>	<u>4,257,274</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

16. OTHER RESERVES (continued)

	Contributed surplus	Share premium	Share-based compensation reserve	Total
	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Company				
Balance at 1st January 2004, as previously reported	133,795	1,313,079	–	1,446,874
Share option benefits	–	–	7,210	7,210
Repurchase of own shares for cancellation	–	(20,542)	–	(20,542)
Balance at 31st December 2004, as restated	<u>133,795</u>	<u>1,292,537</u>	<u>7,210</u>	<u>1,433,542</u>
Balance at 1st January 2005, as previously reported	133,795	1,292,537	–	1,426,332
Opening adjustment for the adoption of HKFRS 2	–	–	7,210	7,210
Balance at 1st January 2005, as restated	133,795	1,292,537	7,210	1,433,542
Share option benefits	–	–	13,910	13,910
Exercise of share options	–	46,000	–	46,000
Balance at 31st December 2005	<u>133,795</u>	<u>1,338,537</u>	<u>21,120</u>	<u>1,493,452</u>

The contributed surplus of the Company represents the difference between the consolidated shareholders' funds of the subsidiaries at the date on which they were acquired by the Company and the nominal amount of the Company's shares issued for the acquisition.

Under the Companies Act 1981 of Bermuda, the contributed surplus of the Company is distributable to shareholders. Accordingly, total distributable reserves of the Company amounted to HK\$3,155,554,000 (2004: HK\$2,263,121,000) as at 31st December 2005.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

17. TRADE AND OTHER PAYABLES

	Group	
	2005	2004
	HK\$'000	HK\$'000
Trade payables		
– to third parties	10,375	40,921
– to related parties (Note)	35,063	13,829
	<hr/>	<hr/>
	45,438	54,750
Other payables to third parties and accrued expenses	138,832	136,008
Other payables to related parties	128,591	181,371
	<hr/>	<hr/>
	312,861	372,129
	<hr/>	<hr/>

Note: The amounts represent trade payables arising from transactions entered into in the normal course of business.

The ageing analysis of the trade payables (including amounts due to related parties of trading in nature) is as follows:

	Group	
	2005	2004
	HK\$'000	HK\$'000
Within three months	37,956	45,999
Between three months to six months	21	2,154
Over six months	7,461	6,597
	<hr/>	<hr/>
	45,438	54,750
	<hr/>	<hr/>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

18. BORROWINGS

	Group	
	2005	2004
	HK\$'000	HK\$'000
Non-current		
Loan from an immediate holding company (note (a))	774,000	–
Loan from a fellow subsidiary (note (b))	53,511	–
Loan from a related company (note (c))	–	21,840
	<u>827,511</u>	<u>21,840</u>
Current		
Bank borrowings	928,800	312,000
Loan from a related company (note (c))	21,672	20,280
	<u>950,472</u>	<u>332,280</u>
Total borrowings	<u>1,777,983</u>	<u>354,120</u>

Note

- (a) The loan is acquired during acquisition of additional interest in a subsidiary. The loan is unsecured, bears interest at 8% per annum and repayable in full on 10th February 2010.
- (b) The loan is acquired during acquisition of additional interest in a subsidiary. The loan is unsecured, bears interest at 8% per annum and repayable in full on 2nd June 2010.
- (c) The loan is borrowed from a related party company in 2003 for working capital purpose. The loan is unsecured, bears interest at London Interbank Offered Rate plus 6.5% per annum and is repayable before 31st December 2006.

The maturity of borrowings is as follows:

	Bank borrowings		Other loans	
	2005	2004	2005	2004
Within 1 year	928,800	312,000	21,672	20,280
Between 1 and 2 years	–	–	154,800	21,840
Between 2 and 5 years	–	–	672,711	–
Wholly repayable within 5 years	<u>928,800</u>	<u>312,000</u>	<u>849,183</u>	<u>42,120</u>
Over 5 years	<u>–</u>	<u>–</u>	<u>–</u>	<u>–</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

18. BORROWINGS (continued)

The effective interest rates at the balance sheet date were as follows:

	2005	2004
Bank borrowings	4.28%	2.91%
Other loans	8.08%	9.28%

All the borrowings are denominated in US dollars, and the carrying amounts of borrowings approximate their fair value.

19. DEFERRED CHARGE

	Group	
	2005	2004
	HK\$'000	HK\$'000
At 1st January	24,958	51,311
Movement for the year (Note 31)	(24,958)	(26,353)
At 31st December	–	24,958
Representing:		
Group's share of investment recovery of oil properties recorded by the Joint Development Department ("JDD")	601,683	501,798
Depletion and depreciation charge incurred by the Group	(601,683)	(476,840)
	–	24,958

In accordance with the Xinjiang Contract, with effect from 1st September 1996, the Group is entitled to a 54% share of revenue and expenses arising from the operations recorded by the JDD including a 54% share of the depletion and depreciation of oil properties charged for the year in the financial statements of JDD. However, pursuant to the terms of the Xinjiang Contract, CNPC contributed all its share of the oil property assets at the commencement of the Xinjiang Contract whereas the Group contributed its share over a period of two years. Due to the timing difference in their respective contributions, the Group has an investment recovery in excess of the depletion and depreciation charge incurred by the Group, resulting in a deferred charge which is carried forward.

20. DEFERRED INCOME TAX

	Group	
	2005	2004
	HK\$'000	HK\$'000
At 1st January	189,385	192,424
Credited to income statement (Note 24)	(6,884)	(3,039)
Exchange differences	1,600	–
At 31st December	184,101	189,385

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

20. DEFERRED INCOME TAX (continued)

The movement in deferred tax assets and liabilities during the year is as follows:

Deferred tax assets

	2005	Others
	HK\$'000	2004 HK\$'000
At 1st January	17,425	23,119
Charged to income statement	(3,776)	(5,694)
Exchange differences	(119)	–
At 31st December	13,530	17,425

Deferred tax liabilities

	2005	Accelerated tax depreciation and deferred development costs
	HK\$'000	2004 HK\$'000
At 1st January	206,810	215,543
Credited to income statement	(10,660)	(8,733)
Exchange differences	1,481	–
At 31st December	197,631	206,810

As at 31st December 2005, the Group had tax losses carried forward for Thailand income tax purpose and Hong Kong profits tax purpose amounting to HK\$10,960,000 (2004: HK\$66,721,000) and HK\$15,275,000 (2004: HK\$21,047,000), respectively. The tax losses are available to reduce future taxable income, if any, however, the deferred tax effect amounting to HK\$8,153,000 (2004: HK\$37,044,000) has not been accounted for as, in the opinion of Directors, it is uncertain whether the losses will be utilised in the foreseeable future.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred income tax rates relate to the same fiscal authority. The amounts disclosed on the consolidated balance sheet are stated after appropriate offsetting.

All deferred tax assets and liabilities are to be recovered and settled after more than 12 months.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

21. EXPENSES BY NATURE

Expenses included in cost of goods sold, exploration costs and administrative expenses are analysed as follows:

	2005	2004
	HK\$'000	Restated HK\$'000
Cost of inventories sold	1,296,418	1,060,179
Depletion, depreciation and amortisation	485,326	504,390
Operating lease rental in respect of land and buildings	2,483	1,445
Employee benefit expense (Note 22)	89,667	87,485
Auditors' remuneration	3,303	3,141
	<u>3,303</u>	<u>3,141</u>

22. EMPLOYEE BENEFIT EXPENSE

	2005	2004
	HK\$'000	Restated HK\$'000
Wages and salaries	60,666	63,831
Social security costs	7,738	9,108
Share options granted to directors and employees (Note 15)	13,910	7,210
Unutilised annual leave	660	624
Termination benefits	730	785
Pension costs – defined contribution plan	1,146	1,074
Other staff costs	4,817	4,853
	<u>4,817</u>	<u>4,853</u>
	<u>89,667</u>	<u>87,485</u>

(a) Pensions – defined contribution plans

With effect from 1st December 2000, a Mandatory Provident Fund Scheme ("MPF Scheme") has been set up for employees, including executive directors of the Company, in Hong Kong, in accordance with the Mandatory Provident Scheme Ordinance. Under the MPF Scheme, the Group's contributions are at 7.5% of employees' relevant income for non-executive staff and 12.5% of employees' relevant income for executive staff. The employees also contribute 5% of relevant income to the MPF Scheme from 31st December 2000. The MPF contributions, excluding the voluntary contributions from employer, are fully and immediately vested in the employees as accrued benefits once they are paid, while the MPF voluntary portion of contributions from employer is vested based on the vesting scales as stated in the Participation Agreement.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

22. EMPLOYEE BENEFIT EXPENSE (continued)

(a) Pensions – defined contribution plans (continued)

The Group also contributes to employee pension schemes established by municipal governments in respect of operations in the PRC. The municipal and provincial governments undertake to assume the retirement benefit obligations of all existing and future retired employees of these operations in the PRC. Contributions to these schemes are charged to the income statement as incurred. For overseas operations, the Group made contributions to pension schemes in accordance with the schemes set up by the overseas entities and/or as required by statutory requirements.

The Group's contribution to the MPF Scheme charged to the income statement during the year amounted to approximately HK\$966,000 (2004: HK\$923,000).

(b) Directors' and senior management's emoluments

The remuneration of every Director for the year ended 31st December 2005 is set out below:

Name of Director	Fees	Salary	Share	Employer's	Total
	HK\$'000	HK\$'000	options	contribution to	
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Mr Wang Mingcai	1,890	1,260	6,500	157	9,807
Mr Li Hualin	–	2,710	5,200	339	8,249
Mr Cheng Cheng	–	1,571	–	196	1,767
Mr Lin Jingao	–	–	–	–	–
Dr Lau Wah Sum	450	–	–	–	450
Mr Aubrey Li Kwok Sing	300	–	–	–	300
Dr Liu Xiao Feng	250	–	910	–	1,160

The remuneration of every Director for the year ended 31st December 2004 is set out below:

Name of Director	Fees	Salary	Share	Employer's	Total
	HK\$'000	HK\$'000	options	contribution to	
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	Restated HK\$'000
Mr Wang Mingcai	–	2,880	–	360	3,240
Mr Li Hualin	–	2,080	–	260	2,340
Mr Cheng Cheng	–	1,196	4,200	149	5,545
Mr Lin Jingao	–	–	–	–	–
Dr Lau Wah Sum	450	–	980	–	1,430
Mr Aubrey Li Kwok Sing	300	–	980	–	1,280
Dr Liu Xiao Feng (Note)	177	–	–	–	177

Note: Appointed on 16th April 2004.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

22. EMPLOYEE BENEFIT EXPENSE (continued)

(c) Five highest paid individuals

The five individuals whose emoluments were the highest in the Group for the year include four (2004: four) directors whose emoluments are reflected in the analysis presented above. The emoluments received and receivable by the remaining one (2004: one) highest paid individuals during the year are as follows:

	2005	2004
	HK\$'000	Restated HK\$'000
Salaries and other emoluments	1,440	1,440
Pension costs	180	180
Share options	1,300	1,050
	2,920	2,670

23. FINANCE COSTS

	2005	2004
	HK\$'000	HK\$'000
Interest on loan from an immediate holding company wholly repayable within five years	14,567	–
Interest on loan from a fellow subsidiary wholly repayable within five years	4,859	4,641
Interest on bank loan wholly repayable within five years	14,201	6,094
	33,627	10,735

24. INCOME TAX EXPENSE

	2005	2004
	HK\$'000	HK\$'000
Overseas taxation	423,181	273,422
Deferred taxation (Note 20)	(6,884)	(3,039)
(Over)/under provision in prior years	(637)	5,591
	415,660	275,974

No provision for Hong Kong profits tax has been made as the Group has no assessable profit for the year (2004: nil). Taxation on overseas profit has been calculated on the estimated assessable profit for the year at the rates of taxation prevailing in the countries in which the Group operates.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

24. INCOME TAX EXPENSE (continued)

Taxation charge does not include any share of taxation from jointly controlled entities because the jointly controlled entities are either at loss positions or on tax holidays, and the jointly controlled entity, Mazoon Petrogas (BVI) Limited, has no tax liability as taxation is deducted from the government of the Sultanate of Oman's share of production.

Share of taxation attributable to associates for the year ended 31st December 2005 of HK\$153,806,000 (2004: nil) is included in the consolidated income statement as share of profits less losses of associates.

The taxable income in respect of the oil production under the Leng Jiapu Contract is subjected to the income tax rate of 33% (2004: 33%) for the year.

Pursuant to an approval from Karamay Tax Bureau on 6th July 2004, the taxable income in respect of the oil production under the Xinjiang Contract is entitled to preferential income tax rate of 15% for six years from 1st January 2003 to 31st December 2008.

The tax on the Group's profit before income tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated companies as follows:

	2005	2004
	HK\$'000	Restated HK\$'000
Profit before income tax	4,251,132	1,079,382
Calculated at the weighted average applicable tax rate	1,293,046	332,023
Effect of different tax rates	(36,466)	(21,441)
Income not subject to taxation	(819,912)	(31,029)
Utilisation of previously unrecognised tax losses	(22,342)	(11,095)
(Over)/under provision in prior years	(637)	5,591
Tax losses not recognised	1,971	1,925
Income tax expense	415,660	275,974

The weighted average applicable tax rate is the average of the aggregate of all domestic rates applicable for each of the Group companies. The weighted average applicable rate for the year ended 31 December 2005 is 30.42% (2004: 30.76%).

25. PROFIT ATTRIBUTABLE TO EQUITY HOLDERS OF THE COMPANY

The profit attributable to equity holders of the Company is dealt with in the financial statements of the Company to the extent of HK\$1,058,126,000 (2004: HK\$661,516,000).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

26. EARNINGS PER SHARE

Basic

Basic earnings per share is calculated by dividing the profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year, excluding ordinary shares purchased by the Company.

	2005	2004 Restated
Profit attributable to equity holders of the Company (HK\$'000)	<u>3,644,514</u>	<u>768,034</u>
Weighted average number of ordinary shares in issue (thousands)	<u>4,785,628</u>	<u>4,742,267</u>
Basic earnings per share (HK cent per share)	<u>76.16</u>	<u>16.20</u>

Diluted

Diluted earnings per share is calculated adjusting the weighted average number of ordinary shares outstanding to assume conversion of all dilutive potential ordinary shares. For the share options a calculation is done to determine the number of shares that could have been acquired at fair value (determined as the average annual market share price of the Company's shares) based on the monetary value of the subscription rights attached to outstanding share options. The number of shares calculated as above is compared with the number of shares that would have been issued assuming the exercise of the share options.

	2005	2004 Restated
Profit attributable to equity holders of the Company (HK\$'000)	<u>3,644,514</u>	<u>768,034</u>
Weighted average number of ordinary shares in issue (thousands)	<u>4,785,628</u>	<u>4,742,267</u>
Share options (thousands)	<u>20,932</u>	<u>56,081</u>
Weighted average number of ordinary shares for diluted earnings per share (thousands)	<u>4,806,560</u>	<u>4,798,348</u>
Diluted earnings per share (HK cent per share)	<u>75.82</u>	<u>16.01</u>

27. DIVIDENDS

The dividends paid during the year ended 2005 and 2004 were HK\$165,693,000 (HK cent 3.5 per share) and HK\$94,681,000 (HK cent 2.0 per share) respectively. A dividend in respect of 2005 of HK cent 8.0 per share, amounting to a total dividend of HK\$385,927,000 is to be proposed at the Annual General Meeting on 25th May 2006. These financial statements do not reflect this dividend payable.

	2005 HK\$'000	2004 HK\$'000
Proposed final dividend of HK cent 8.0 (2004: HK cent 3.5) per ordinary share	<u>385,927</u>	<u>165,693</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

28. CASH GENERATED FROM OPERATIONS

Reconciliation of operating profit to net cash inflow generated from operations

	2005	2004
	HK\$'000	Restated HK\$'000
Operating profit	3,357,232	1,022,550
Depletion and depreciation of property, plant and equipment	485,186	504,330
Amortisation of leasehold land and land use rights	140	60
Negative goodwill on acquisition of additional interest in a subsidiary	(1,705,847)	–
Profit on disposal of property, plant and equipment	(1,927)	(1,714)
Employee share option benefits	13,910	7,210
Dividend income	(1,722)	–
Interest income	(22,347)	(21,599)
	<hr/>	<hr/>
Operating profit before working capital changes	2,124,625	1,510,837
(Increase)/decrease in inventories	(9,291)	9,274
(Increase)/decrease in trade receivables and other receivables	(179,916)	15,947
(Decrease)/increase in trade payables and other payables	(177,752)	107,002
Decrease in deferred charge	(24,958)	(26,353)
	<hr/>	<hr/>
Cash generated from operations	<u>1,732,708</u>	<u>1,616,707</u>

In the cash flow statement, proceeds from sale of property, plant and equipment comprise:

	2005	2004
	HK\$'000	HK\$'000
Net book value (Note 7)	18,599	7,387
Profit on sale of property, plant and equipment	1,927	1,714
	<hr/>	<hr/>
Proceeds from sale of property, plant and equipment	<u>20,526</u>	<u>9,101</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

29. COMMITMENTS

(a) Capital commitments

	2005	2004
	HK\$'000	HK\$'000
Contracted but not provided for		
Development cost under the Leng Jiapu Contract	469,823	290,402
Development cost under the Xinjiang Contract	48,670	65,233
Development cost for Onshore Exploration Block No. L21/43 in Thailand (Note)	60,500	77,307
	578,993	432,942
Authorised but not contracted for		
Development cost for Azerbaijan Kursangi and Kurabagli oil field	99,730	141,720
Development cost for Peru Talara oil field	16,486	18,486
Development cost for Thailand Sukhothai oil field	83,592	39,780
	199,808	199,986

Note: The amount represents the remaining minimum work obligation, as required to be incurred before the end of the Petroleum Exploration Period, 17th July 2009, in the Petroleum Concession awarded by The Minister of Energy of Thailand.

(b) Operating lease commitments

As 31st December 2005, the Group had future aggregate minimum lease payments under non-cancellable operating leases in respect of land and buildings as follows:

	2005	2004
	HK\$'000	HK\$'000
Not later than one year	1,995	781
Later than one year and not later than five years	4,391	2,264
Later than five years	1,363	924
	7,749	3,969

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

30. BUSINESS COMBINATIONS

On 14th October 2005, the Group acquired additional 20% equity interest in Caspian. Prior to this acquisition, the Group already owned 40% of the issued share capital of Caspian. As at 31st December 2005, Caspian is held as to 60% by the Group and hence accounted for as a subsidiary. Caspian is set up to hold an equity interest of 25.12% in Aktobe, the results of which are equity accounted for in Caspian for the year ended 31st December 2005. There is no contribution to revenue from the acquired business.

During the year, Caspian contributed net profits of US\$22,837,000 (approximately HK\$177,441,000) for the period from 14th October 2005 to 31st December 2005.

Details of net assets acquired, representing 20% interest in Caspian, are as follows:

	HK\$'000
Purchase consideration – cash paid	1,087,800
Fair value of net assets acquired – shown as below	<u>2,793,647</u>
Negative goodwill on acquisition of additional interest in a subsidiary (Note (a))	<u><u>(1,705,847)</u></u>

The assets and liabilities arising from the acquisition of the 20% interest in Caspian are as follows:

	Fair value	Acquiree's carrying amount
	HK\$'000	HK\$'000
Cash and cash equivalents	15,461	15,461
Investment in associate (Note (b))	2,968,119	518,279
Payables	(23,789)	(23,789)
Borrowings	<u>(166,144)</u>	<u>(166,144)</u>
Net assets acquired	<u><u>2,793,647</u></u>	<u><u>343,807</u></u>
Purchase consideration, settled in cash		1,087,800
Cash and cash equivalents in subsidiary acquired		<u>(77,305)</u>
Cash outflow on acquisition		<u><u>1,010,495</u></u>

Notes:

- (a) Negative goodwill represents excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost.
- (b) The fair value of property, plant and equipment of the associate has been estimated by determining the net present value of future cash flows.

There were no acquisitions in the year ended 31st December 2004.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

31. OIL PRODUCTION SHARING CONTRACT – 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\$66,000,000 (approximately HK\$510,000,000), in exchange for a 54% share in the oil production from the Contract Area.

Pursuant to the Xinjiang Contract, the Group shall bear 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 1st September 1996.

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:

	2005	2004
	HK\$’000	HK\$’000
(a) Results for the year		
Sales	787,235	529,605
Operating profit	431,567	241,036
Operating profit is arrived at after charging/(crediting) the following:		
Depletion and depreciation of oil properties	119,806	109,766
Deferred charge (Note 19)	(24,958)	(26,353)
(b) Assets and liabilities		
Oil properties	320,663	377,910
Current assets	334,928	197,668
Current liabilities (excluding amount due to a group company)	(68,420)	(67,060)
Amount due to a group company	(309,277)	(168,974)
Non-current liabilities	(15,854)	(1,957)
Net assets	262,040	337,587
(c) Capital commitments		
Authorised but not contracted for	48,670	65,233

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

32. OIL PRODUCTION SHARING CONTRACT – LENG JIAPU CONTRACT

Pursuant to the Leng Jiapu Contract, the Group agreed to acquire 70% of the production sharing interest for RMB1,008,000,000 (approximately HK\$942,000,000) 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 "Contract Area"), at an estimated cost of US\$65,500,000 (approximately HK\$506,000,000) 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 Contract Area.

Pursuant to the Leng Jiapu Contract, the Group shall bear 70% of the costs required for the Development Operations in 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 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 1st 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

32. OIL PRODUCTION SHARING CONTRACT – LENG JIAPU CONTRACT (continued)

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 Leng Jiapu Contract:

	2005	2004
	HK\$'000	HK\$'000
(a) Results for the year		
Turnover	1,542,019	1,267,570
Operating profit	809,592	557,864
Operating profit is arrived at after charging the following:		
Depletion and depreciation of oil properties	273,735	295,749
(b) Assets and liabilities		
Oil properties	1,496,890	1,430,213
Current assets	882,009	786,729
Current liabilities (excluding amount due to a group company)	(188,080)	(288,200)
Amount due to a group company	(702,153)	(508,354)
Non-current liabilities	(128,181)	(132,701)
Net assets	1,360,485	1,287,687
(c) Capital commitments		
Authorised but not contracted for	431,452	290,402
Contracted but not provided for	38,371	–

33. RELATED-PARTY TRANSACTIONS

The Company is ultimately controlled by CNPC established in the PRC.

CNPC itself is a state-owned enterprise and is controlled by the PRC government, which also owns a significant portion of the productive assets in the PRC. In accordance with HKAS 24 "Related Party Disclosure" issued by the HKICPA, other state-owned enterprises and their subsidiaries (other than CNPC Group companies), directly or indirectly controlled by the PRC government, are also defined as related parties of the Company. On that basis, related parties include CNPC and its subsidiaries, other state-owned enterprises and their subsidiaries directly or indirectly controlled by the PRC government, other entities and corporations in which the Company is able to control or exercise significant influence and key management personnel of the Company and CNPC as well as their close family members.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

33. RELATED-PARTY TRANSACTIONS (continued)

For the purpose of the related party transaction disclosures, the Company has identified, to the extent practicable, its customers and suppliers as to whether they are state-owned enterprises. The directors believe that meaningful information relating to related party transactions has been adequately disclosed.

(1) Other than those disclosed elsewhere in the financial statements, significant related party transactions were carried out in the normal course of the Company's business as follows:

(a) In connection with the Xinjiang Contract entered into in July 1996, the Group has entered into the following transactions with related parties:

	Note	2005 HK\$'000	2004 HK\$'000
Sale of crude oil	(i)	787,234	529,605
Operating management	(ii)	178,141	132,242
Perforation fees	(ii)	816	1,283
Assistance fee		210	211
Training fee		210	211
Construction work	(ii)	5,587	–

Notes:

- (i) The oil price was set by CNPC with reference to the trend of the international oil price.
- (ii) Various fees were paid for the provision of operating crews, purchase of materials and supplies, provision of utilities, repair and maintenance services and provision of construction work. The provision of the above was partly governed by contracts. The pricing of principal transactions, including those with contracts, was set with reference to the rates used in the region.

In accordance with the Xinjiang Contract, all of the above amounts represent the Group's 54% share of oil production and the respective cost items.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

33. RELATED-PARTY TRANSACTIONS (continued)

(1) (continued)

(b) In connection with the Leng Jiapu Contract entered into in December 1997, the Group has entered into the following transactions with related parties:

	Note	2005 HK\$'000	2004 HK\$'000
Sale of crude oil	(i)	1,542,019	1,267,570
Operating management	(ii)	312,755	249,024
Drilling fees	(ii)	167,336	167,565
Surveying fees	(ii)	13,318	13,556
Perforation fees	(ii)	8,505	10,585
Quantifying fees	(ii)	1,951	3,692
Construction work	(ii)	29,857	17,468
Purchases of equipment	(ii)	20,589	45,109
Operation and support services fee	(ii)	1,694	1,759
Assistance fee		266	272
Training fee		533	272
Facturing fee	(ii)	8,122	11,253

Notes:

- (i) The oil price was set by CNPC with reference to the trend of the international oil price.
- (ii) Various fees were paid for the provision of operating crews, purchase of materials and supplies, provision of utilities, repair and maintenance services and provision of construction and development work. The provision of the above was partly governed by contracts. The pricing of principal transactions, including those with contracts, was set with reference to the rates used in the region.

In accordance with the Leng Jiapu Contract, all of the above amounts represent the Group's 70% share of oil production and the respective cost items.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

33. RELATED-PARTY TRANSACTIONS (continued)

(1) (continued)

(c) In connection with the Sukhothai oil concession in Thailand, the Group entered into the following transactions with related parties:

	2005	2004
	HK\$'000	HK\$'000
Lease rental of oil field equipment	12,623	17,260
Purchase of materials	13,961	20,190
Purchase of drilling spare parts	991	2,074
Geophysical and geological studies	356	–
	<u>356</u>	<u>–</u>

The above transactions were conducted in accordance with the terms of respective contracts.

(d) In connection with the Onshore Exploration Block NO. L21/43 in Thailand, the Group entered into the following transactions with related parties:

	2005	2004
	HK\$'000	HK\$'000
Geophysical and geological studies	880	2,919
Geophysical services	1,932	7,277
Purchase of materials	870	2,595
Lease rental of oil field equipment	4,242	–
	<u>4,242</u>	<u>–</u>

The above transactions were conducted in accordance with the terms of respective contracts.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

33. RELATED-PARTY TRANSACTIONS (continued)

(1) (continued)

(e) Rental expense amounting to HK\$373,000 (2004: HK\$373,000) was paid to a fellow subsidiary in accordance with a lease agreement at a monthly rate of HK\$31,000.

(f) Technical services fee amounting to HK\$4,004,000 (2004: HK\$3,893,000) was paid to China Petroleum Technology & Development Corporation by SAPET Development Corporation for the year. Such fee was charged in accordance with the terms stipulated in the technical services contract.

(g) Interest expense paid to:

	2005	2004
	HK\$'000	HK\$'000
Fellow subsidiaries	4,859	4,641
An immediate holding company	14,567	–
	19,426	4,641
	19,426	4,641
(2) Transactions with other state-owned enterprises		
	2005	2004
	HK\$'000	HK\$'000
Interest income from bank deposit	15,950	12,995
	15,950	12,995
(3) Balances with related parties		
	2005	2004
	HK\$'000	HK\$'000
Deposits with state-owned banks and other state-owned non-bank financial institutions	1,102,004	1,291,532
	1,102,004	1,291,532

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

33. RELATED-PARTY TRANSACTIONS (continued)

(4) Key management compensation

	2005	2004
	HK\$'000	HK\$'000
Salaries and emolument	6,981	7,746
Directors' fee	2,890	927
Retirement benefit cost	873	968
Share options	13,910	7,210
	24,654	16,851

34. IMMEDIATE HOLDING COMPANY AND ULTIMATE HOLDING COMPANY

The Directors of the Company consider Sun World Limited and China National Petroleum Corporation, companies incorporated in the British Virgin Islands and the PRC respectively, as being the Company's immediate holding company and ultimate holding company respectively.

35. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the board of directors on 11th April 2006.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

36. PRINCIPAL SUBSIDIARIES

As at 31st December 2005

Name	Place of incorporation and type of legal entity	Particulars of issued shares	Percentage of equity shares held	
			By the Company	By the Group
(a) Investment holding				
Operated in Hong Kong				
FSC (B.V.I.) Limited	British Virgin Islands, limited liability company	50,000 ordinary shares of US\$1 each	100	–
FSC Investment Holdings Limited	Hong Kong, limited liability company	2,223,966,170 ordinary shares of HK\$0.10 each	–	100
Operated in Peru				
Goldstein International Limited	British Virgin Islands, limited liability company	1 ordinary share of US\$1	100	–
Operated in Oman				
Bestcode Company Limited	British Virgin Islands, limited liability company	1 ordinary share of US\$1	100	–
Operated in Thailand				
Thai Offshore Petroleum Limited	Thailand, limited liability company	1,750,000 ordinary shares of Baht100 each (fully paid up) 1,250,000 ordinary shares of Baht100 each (25% paid up)	–	74
Modern Ahead Developments Limited	Thailand, limited liability company	1 ordinary share of US\$1	100	–
Operated in Kazakhstan				
Bestory Company Inc.	British Virgin Islands, limited liability company	1 ordinary share of US\$1	100	–
CNPC International (Caspian) Limited	British Virgin Islands, limited liability company	100 ordinary shares of US\$1 each	–	60
Operated in Azerbaijan				
Smart Achieve Developments Limited	British Virgin Islands, limited liability company	1 ordinary share of US\$1	100	–

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

36. PRINCIPAL SUBSIDIARIES (continued)

As at 31st December 2005

Name	Place of incorporation and type of legal entity	Particulars of issued shares	Percentage of equity shares held	
			By the Company	By the Group
(b) Oil and gas exploration and production				
Operated in the PRC				
Hafnium Limited	British Virgin Islands, limited liability company	1 ordinary share of US\$1	100	–
Beckbury International Limited	British Virgin Islands, limited liability company	1 ordinary share of US\$1	100	–
Operated in Peru				
SAPET Development Corporation	United States of America, limited liability company	100 ordinary shares no par value	–	50
SAPET Development Peru Inc	United States of America, limited liability company	100 ordinary shares no par value	–	50
Operated in Thailand				
Central Place Company Limited	Hong Kong, limited liability company	160 ordinary shares of HK\$10 each	–	100
Sino-Thai Energy Limited	Thailand, limited liability company	1,200,000 ordinary shares of Baht100 each	–	100
Sino-U.S. Petroleum Inc.	United States of America, limited liability company	1,000 ordinary shares of US\$1 each	–	100
Thai Energy Resources Limited	Thailand, limited liability company	1,000 ordinary shares of Baht100 each	–	74
CNPCHK (Thailand) Limited	Thailand, limited liability company	100,000 ordinary shares of Baht1,000 each	–	100
Operated in Azerbaijan				
Fortunemate Assets Limited	British Virgin Islands, limited liability company	1 ordinary share of US\$1	100	–

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

36. PRINCIPAL SUBSIDIARIES (continued)

As at 31st December 2005

Name	Place of incorporation and type of legal entity	Particulars of issued shares	Percentage of equity shares held	
			By the Company	By the Group
(c) Marina club debentures and wet berths holding				
Operated in Hong Kong				
Marina Ventures Hong Kong Limited	Hong Kong, limited liability company	1,000 ordinary shares of HK\$1 each	–	65

37. MAJOR ASSOCIATE

As at 31st December 2005

Name	Place of incorporation and type of legal entity	Principal activity and place of operation	Particulars of issued shares	Particular of interest in ownership by the Group
CNPC-Aktobemunaigas Open Joint Stock Company	Kazakhstan, Joint-stock company	Exploration and production of petroleum in Kazakhstan	8,946,470 common shares of 1,500 tenge each	15.072

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

For the year ended 31st December 2005

38. JOINTLY CONTROLLED ENTITIES

As at 31st December 2005

Name	Place of incorporation and type of legal entity	Principal activities and place of operation	Registered capital/particulars of issued shares	Percentage of interest in ownership and profit sharing
華油鋼管有限公司	PRC, equity joint ventures	Manufacturing of steel pipe in the PRC	RMB370,000,000	50
北京中油聯合信息技術有限公司	PRC, equity joint ventures	Operation of a web portal in the PRC	RMB30,000,000	32
青島慶昕塑料有限公司	PRC, equity joint ventures	Production of petro-chemical products in the PRC	RMB124,157,250	25
青島凱姆拓塑膠工業有限公司	PRC, equity joint ventures	Production of petro-chemical products in the PRC	RMB99,318,000	25
Chinnery Assets Limited	British Virgin Islands, limited liability company	Crude oil exploration and production in Myanmar	200 ordinary shares of US\$1 each	50
Mazoon Petrogas (BVI) Limited	British Virgin Islands, limited liability company	Crude oil exploration and production in Oman	50,000 ordinary shares of US\$1 each	50
Commonwealth Gobustan Limited	Anguilla, limited liability company	Crude oil exploration and production in Azerbaijan	26,900 ordinary shares no par value	31.41

FIVE YEAR FINANCIAL SUMMARY

	2005	Year ended 31st December			
		2004 Restated	2003	2002	2001
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Results					
Sales	3,378,323	2,533,312	2,098,686	1,663,591	1,477,763
Profit before income tax	4,251,132	1,079,382	711,323	498,860	607,082
Income tax expense	(415,660)	(275,974)	(175,993)	(136,704)	(149,161)
Profit for the year	3,835,472	803,408	535,330	362,156	457,921
Minority interest	(190,958)	(35,374)	(18,927)	(9,515)	(545)
Profit attributable to equity holders of the Company	3,644,514	768,034	516,403	352,641	457,376
Earnings per share					
– Basic	HK76.16 cents	HK16.20 cents	HK10.74 cents	HK7.18 cents	HK9.06 cents
– Fully diluted	HK75.82 cents	HK16.01 cents	HK10.67 cents	HK7.17 cents	HK9.03 cents
As at 31st December					
	2005	2004	2003	2002	2001
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Assets and liabilities					
Total assets	16,065,930	5,249,261	4,469,286	4,168,290	3,620,611
Total liabilities and minority interest	(3,458,858)	(1,191,265)	(1,073,742)	(1,036,128)	(715,551)
Shareholders' funds	12,607,072	4,057,996	3,395,544	3,132,162	2,905,060

RESERVE QUANTITIES INFORMATION

PROVED RESERVES (ESTIMATION)

Crude Oil

	PRC (million barrels)	Central and South East Asia (million barrels)	South America (million barrels)	Middle East (million barrels)	Total (million barrels)
As at 1st January 2005	60.8	38.2	7.0	16.6	122.6
Acquisition	–	81.1	–	–	81.1
Revaluation	–	–	3.8	–	3.8
Production	(8.6)	(6.2)	(1.2)	(1.3)	(17.3)
As at 31st December 2005	<u>52.2</u>	<u>113.1</u>	<u>9.6</u>	<u>15.3</u>	<u>190.2</u>

Natural gas

	Central and South East Asia (million cu.feet)	South America (million cu.feet)	Total (million cu.feet)
As at 1st January 2005	–	7,212.5	7,212.5
Acquisition	95,827.1	–	95,827.1
Production	(5,356.1)	(1,176.6)	(6,532.7)
As at 31st December 2005	<u>90,471.0</u>	<u>6,035.9</u>	<u>96,506.9</u>

Note: Based on the Group's share of participated interest in the oil field through subsidiaries, associates and joint ventures.



LOCATIONS OF BUSINESS ACTIVITIES

業務分佈圖



Existing Projects
現有項目



New Projects in 2005
二零零五年新增項目



Headquarter
總部



Kazakhstan
哈薩克斯坦



Xinjiang
新疆



Beijing
北京



Liaohé
遼河(遼寧)



Azerbaijan
阿塞拜疆



Hebei-Qingxian
河北-青縣



Qingdao
青島



Yangzhou
揚州



Oman
阿曼



Myanmar
緬甸



Hong Kong
香港



Thailand
泰國

