

CNOOC LTD  
Form 6-K  
December 21, 2012

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 6-K

Report of Foreign Private Issuer

Pursuant to Rule 13a-16 or 15d-16  
of the Securities Exchange Act of 1934

For the month of December 2012

Commission File Number 1-14966

CNOOC Limited  
(Translation of registrant's name into English)

65th Floor  
Bank of China Tower  
One Garden Road  
Central, Hong Kong  
(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F.

Form 20-F ☒ Form 40-F ☐

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1): ☐

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7): ☐

Indicate by check mark whether by furnishing the information contained in this Form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934.

Yes ☐ No ☒

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): Not applicable

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CNOOC Limited

By: /s/ Hua Zhong  
Name: Hua Zhong  
Title: Joint Company Secretary

Dated: December 21, 2012

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EXHIBIT INDEX

Exhibit No.	Description
99.1	Circular dated December 20, 2012, entitled “Major Transaction in Relation to the Proposed Acquisition of Nexen”.
99.2	Announcement dated December 20, 2012, entitled “Notification Letter and Request Form for Non-Registered Holders”.

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Exhibit 99.1

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THIS CIRCULAR IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION

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If you are in any doubt as to any aspect of this circular or as to the action to be taken, you should consult your stockbroker or other registered dealer in securities, bank manager, solicitor, professional accountant or other professional adviser.

If you have sold or transferred all your shares in CNOOC Limited you should at once pass this circular to the purchaser or to the bank, stockbroker or other agent through whom the sale was effected for transmission to the purchaser.

Hong Kong Exchanges and Clearing Limited and The Stock Exchange of Hong Kong Limited take no responsibility for the contents of this circular, and make no representation as to its accuracy or completeness and expressly disclaim any liability whatsoever for any loss howsoever arising from or in reliance upon the whole or any part of the contents of this circular.

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(Incorporated in Hong Kong with limited liability under the Companies Ordinance)  
(Stock Code: 00883)

MAJOR TRANSACTION  
IN RELATION TO THE PROPOSED ACQUISITION OF NEXEN

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A letter from the Board is set out from pages 8 to 27 of this circular.

20 December 2012

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DEFINITIONS

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In this circular, unless the context otherwise requires, the following expressions have the following meanings:

“Announcement”	the announcement dated 23 July 2012 made by the Company in relation to the Proposed Acquisition
“APEGA”	the Association of Professional Engineers and Geoscientists of Alberta
“Arrangement”	an arrangement under Section 192 of the CBCA on the terms and subject to the conditions set out in the Plan of Arrangement, subject to any amendments or variations to the Plan of Arrangement made in accordance with the terms of the Arrangement Agreement or made at the direction of the Court in the Final Order with the prior written consent of Nexen and the Purchaser, each acting reasonably
“Arrangement Agreement”	the agreement dated 23 July 2012, Canada local time (23 July 2012, Hong Kong time) entered into by the Company, the Purchaser and Nexen in relation to the Proposed Acquisition
“Arrangement Resolution”	the special resolution approving the Plan of Arrangement considered by holders of Common Shares at the Nexen company meeting
“Articles of Arrangement”	the articles of arrangement of Nexen in respect of the Arrangement, required by the CBCA to be sent to the director appointed pursuant to Section 260 of the CBCA after the Final Order is made, which shall include the Plan of Arrangement and otherwise be in a form and content satisfactory to Nexen and the Purchaser, each acting reasonably
“associate(s)”	has the meaning ascribed to it under the Listing Rules
“Board”	the board of Directors
“C\$” or “Cdn\$”	Canadian dollars, the lawful currency of Canada
“Canadian GAAP”	Canadian Generally Accepted Accounting Principles
“Canadian GAAS”	Canadian Generally Accepted Auditing Standards
“CBCA”	Canada Business Corporations Act

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DEFINITIONS

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“Certificate of Arrangement”	means the certificate of arrangement to be issued by the director appointed pursuant to Section 260 of the CBCA pursuant to Section 192(7) of the CBCA in respect of the Articles of Arrangement
“CICA”	Canadian Institute of Chartered Accountants
“CNOOC”	China National Offshore Oil Corporation , an indirect controlling shareholder of the Company holding approximately 64.45% of the Shares of the Company in issue through OOGC and CNOOC (BVI) as at the Latest Practicable Date
“COGEH”	Canadian Oil and Gas Evaluation Handbook prepared jointly by the SPEE (Calgary Chapter) and the Canadian Institute of Mining, Metallurgy & Petroleum (Petroleum Society), as amended from time to time
“Collective Agreement”	all collective bargaining agreements or union agreements currently applicable to Nexen and/or any of its subsidiaries and all related documents, including letters of understanding, letters of intent and other written communications with bargaining agents for any Nexen Employee which impose any obligations upon Nexen and/or any of its subsidiaries
“Common Shares”	the common shares in the capital of Nexen
“Company”	CNOOC Limited, a company incorporated in Hong Kong with limited liability, whose shares are listed on the Hong Kong Stock Exchange and whose American depositary receipts are listed on the NYSE
“Controlling Shareholder” or “CNOOC (BVI)”	CNOOC (BVI) Limited, a company incorporated in the British Virgin Islands with limited liability
“Conditions”	the conditions precedent to completion of the Proposed Acquisition
“connected person(s)”	has the meaning ascribed to it under the Listing Rules
“Consideration”	the consideration of US\$27.50 in cash per Common Share, without interest, and C\$26.00 in cash per Preferred Share, together with accrued and unpaid dividends thereon up to, but excluding, the Effective Date, without interest, as applicable



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DEFINITIONS

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“Court”	the Court of Queen’s Bench of Alberta, or other court as applicable
“Deloitte Canada”	Deloitte & Touche LLP, Independent Registered Chartered Accountants, Canada
“Deloitte Hong Kong”	Deloitte Touche Tohmatsu, Certified Public Accountants, Hong Kong
“Director(s)”	the directors of the Company
“D&M”	DeGolyer and MacNaughton
“Effective Date”	the date shown on the Certificate of Arrangement giving effect to the Arrangement
“Effective Time”	12:01 a.m. (Calgary local time) on the date shown on the Certificate of Arrangement giving effect to the Arrangement
“Enlarged Group”	the Group as enlarged by the Proposed Acquisition
“Final Order”	the final order of the Court approving the Plan of Arrangement
“Group”	the Company and its subsidiaries from time to time
“HK\$”	Hong Kong dollars, the lawful currency of Hong Kong
“HKFRS”	Hong Kong Financial Reporting Standards
“Hong Kong”	the Hong Kong Special Administrative Region of the People’s Republic of China
“Hong Kong Stock Exchange”	The Stock Exchange of Hong Kong Limited
“IFRS”	International Financial Reporting Standards
“Independent Reserves Evaluators”	the independent reserves evaluators engaged by Nexen to assess its reserves estimates
“Interim Order”	the interim order of the Court providing for, among other things, the calling and holding of the meeting of the holders of Common Shares and Preferred Shares
“IQRE”	the internal qualified reserves evaluator of Nexen

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DEFINITIONS

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“Latest Practicable Date”	17 December 2012, being the latest practicable date prior to the printing of this circular for ascertaining certain information herein
“Listing Rules”	the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited
“McDaniel”	McDaniel & Associates Consultants Ltd.
“Nexen”	Nexen Inc., a company incorporated under the CBCA whose securities are listed on the TSX and the NYSE under the symbol NXY
“Nexen Board”	the board of directors of Nexen
“Nexen Constatng Documents”	the restated articles of incorporation and by-laws of Nexen and all amendments to such articles or by-laws
“Nexen Employees”	the officers, employees and independent contractors of Nexen and its subsidiaries
“Nexen Group”	Nexen and its subsidiaries
“Nexen Shares”	collectively, the Common Shares and the Preferred Shares
“NI 51-101”	the Canadian National Instrument 51-101 “Standards of Disclosure of Oil and Gas Activities” of the Canadian Securities Administrators
“NYSE”	New York Stock Exchange
“OOGC”	Overseas Oil and Gas Corporation, Ltd., a company incorporated in Bermuda with limited liability, a direct wholly owned subsidiary of CNOOC, the sole shareholder of CNOOC (BVI), and a shareholder of the Company directly holding five Shares of the Company in issue as at the Latest Practicable Date
“Permitted Dividends”	in respect of Common Shares, a dividend not in excess of C\$0.05 per Common Share per quarter consistent with Nexen’s current practice (including with respect to timing), and in respect of the Preferred Shares, regular quarterly dividends payable on the Preferred Shares in accordance with the terms of such Preferred Shares, as set out in Nexen’s Constatng Documents

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DEFINITIONS

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“Plan of Arrangement”	the plan of arrangement, substantially in the form set out in Schedule A to the Arrangement Agreement and any amendments or variations thereto
“PRC”	the People’s Republic of China, excluding for the purpose of this circular, Hong Kong, Macau and Taiwan
“Preferred Shareholder Resolution”	the special resolution approving the Plan of Arrangement considered by the holders of Preferred Shares at the Nexen company meeting
“Preferred Shares”	the second series of preferred shares in the capital of Nexen designated as “Cumulative Redeemable Class A Rate Reset Preferred Shares, Series 2”, as constituted on the date of the Arrangement Agreement
“PRMS”	the Petroleum Resources Management System published by the Society of Petroleum Engineers, American Association of Petroleum Geologists, World Petroleum Council and the SPEE in March 2007 as amended from time to time
“Proposed Acquisition”	the proposed acquisition of all the Common Shares and, as the proposed acquisition has been approved by more than two-thirds of the votes cast by the holders of the Preferred Shares as one class, the Preferred Shares, by the Purchaser in accordance with the Arrangement Agreement
“Purchaser”	CNOOC Canada Holding Ltd., a wholly-owned subsidiary of the Company
“RMB”	the lawful currency of the PRC
“Ryder Scott”	Ryder Scott Company L.P.
“SEC”	U.S. Securities and Exchange Commission
“SFO”	the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong)
“Share(s)”	ordinary share(s) of HK\$ 0.02 each in the share capital of the Company
“Shareholder(s)”	registered holder(s) of the Share(s)
“SPE”	the Society of Petroleum Engineers

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## DEFINITIONS

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“SPEE”	the Society of Petroleum Evaluation Engineers
“TSX”	Toronto Stock Exchange
“US\$”	United States dollars, the lawful currency of United States of America
“2011 AIF”	Annual Information Form of Nexen for the year ended 31 December 2011

The estimates of contingent recoverable resource in this circular reflect Nexen’s low, best, and high estimates. A “best estimate” is the estimate of the quantity of resources that will actually be recovered. It is equally likely that the actual quantities recovered will be greater or less than the best estimate. Those resources that fall within the best estimate have a 50% confidence level that the actual quantities recovered will equal or exceed the estimate. The ‘low estimate’ and ‘high estimate’ are considered to be conservative and optimistic estimates of resources with 90% and 10% confidence, respectively. Contingent resources are quantities of petroleum estimated, as of a given date, to be potentially recoverable from known accumulations using established technology or technology under development, but which are not currently considered to be commercially recoverable due to one or more contingencies. Contingencies on resources may include, but are not limited to, factors such as economic, legal, environmental, political and regulatory matters or a lack of markets. Specific contingencies precluding these contingent resources being classified as reserves include but are not limited to: future drilling program results, drilling and completions optimization, stakeholder and regulatory approval of future drilling and infrastructure plans, access to required infrastructure, economic fiscal terms, a lower level of delineation, the absence of regulatory approvals, detailed design estimates and near-term development plans, and general uncertainties associated with this early stage of evaluation. There is no certainty that it will be commercially viable to produce any portion of the resources.

For the purpose of illustration only, unless otherwise stated, in this circular, (i) the amounts denominated in C\$ have been translated into HK\$ at the exchange rate of C\$1.00 to HK\$7.66; and (ii) the amounts denominated in US\$ have been translated into HK\$ at the exchange rate of US\$1.00 to HK\$7.76, both being the exchange rates prevailing at the market closing on 20 July 2012. Such translations should not be construed as a representation that the relevant amounts have been, could have been, or could be converted at that or any other rate or at all.

Conversions of gas volumes to boe in this circular were made on the basis of 1 boe to 6 mcf of natural gas. A boe conversion ratio of 6 mcf:1 bbl is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead. Disclosure provided herein in respect of boes may be misleading, particularly if used in isolation.

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GLOSSARY

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This glossary of technical terms contains terms used in this circular in connection with the Enlarged Group. As such, these terms and their meanings may not correspond to standard industry meaning or usage of these terms.

“/d”	per day
“AECO”	natural gas storage facility located in Alberta
“bbl”	barrel
“boe”	barrels-of-oil-equivalent
“Brent”	Dated Brent
“mboe”	thousand barrels-of-oil equivalent
“mcf”	thousand cubic feet
“mmboe”	million barrels-of-oil equivalent
“mmbtu”	million British thermal units
“NGL”	natural gas liquid
“NYMEX”	New York Mercantile Exchange
“PSC(tm)”	Premium Synthetic Crude(tm)
“WTI”	West Texas Intermediate
“%”	per cent

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LETTER FROM THE BOARD

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(Incorporated in Hong Kong with limited liability under the Companies Ordinance)  
(Stock Code: 00883)

Board of Directors

Executive Directors

Li Fanrong  
Wu Guangqi

Registered office  
65th Floor, Bank of China Tower  
1 Garden Road  
Hong Kong

Non-executive Directors

Wang Yilin (Chairman)  
Yang Hua (Vice Chairman)  
Zhou Shouwei  
Wu Zhenfang

Independent Non-executive Directors

Chiu Sung Hong  
Lawrence J. Lau  
Tse Hau Yin, Aloysius  
Wang Tao

20 December 2012

To the Shareholders

Dear Sir or Madam,

MAJOR TRANSACTION  
IN RELATION TO THE PROPOSED ACQUISITION OF NEXEN

INTRODUCTION

Reference is made to the Announcement in relation to the Proposed Acquisition. On 23 July 2012, Canada local time (23 July 2012, Hong Kong time), the Company, the Purchaser and Nexen entered into the Arrangement Agreement in relation to the Proposed Acquisition by the Company (through its wholly-owned subsidiary, the Purchaser) of Nexen Shares pursuant to a Plan of Arrangement under the CBCA.

As further announced by the Company on 21 September 2012 that, on 20 September 2012 (Canada local time), the Court has granted the Final Order which approved the Plan of Arrangement pursuant to CBCA. The Final Order was granted following a meeting of



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LETTER FROM THE BOARD

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Nexen's shareholders on the same day at which the Plan of Arrangement was approved by approximately 99% of the votes cast by the holders of the Common Shares. As approximately 87% of the votes cast by the holders of Preferred Shares also approved the Plan of Arrangement, the Plan of Arrangement will also include the Preferred Shares.

Nexen is listed on the TSX and the NYSE. Upon completion of the Proposed Acquisition, Nexen will become a wholly-owned subsidiary of the Company.

As one of the applicable percentage ratios calculated under Chapter 14 of the Listing Rules in respect of the Proposed Acquisition exceeds 25% but is less than 100%, the Proposed Acquisition will constitute a major transaction of the Company for the purposes of, and is subject to, the notification, publication and shareholders' approval requirements under the Listing Rules.

As no Shareholder of the Company is required to abstain from voting if the Company were to convene a general meeting for approving the Proposed Acquisition, and as the Company has obtained a written approval of the Proposed Acquisition from the Controlling Shareholder, which directly held approximately 64.45% of the issued and outstanding Shares as at the date of the Announcement, pursuant to Rule 14.44 of the Listing Rules, the Company is not required to convene a general meeting for approving the Proposed Acquisition.

The purpose of this circular is to provide you with, among other things, (i) further information in respect of the Proposed Acquisition; (ii) financial and other information of the Group; (iii) unaudited pro forma financial information of the Enlarged Group; (iv) financial and reserves information of Nexen; and (v) other information as required under the Listing Rules.

THE ARRANGEMENT AGREEMENT

Date

23 July 2012, Canada local time (23 July 2012 Hong Kong time)

Parties

(i) the Company

(ii) the Purchaser

(iii) Nexen

The Company confirms that, to the best of the Directors' knowledge, information and belief, having made all reasonable enquiries, as at the date of the Announcement, Nexen and its ultimate beneficial owners are third parties independent of the Company and are not connected persons of the Company or its subsidiaries or their respective associates.





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LETTER FROM THE BOARD

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Shares to be acquired

Pursuant to the Arrangement Agreement, the Company will (through its wholly-owned subsidiary, the Purchaser) acquire all of the Common Shares, and as the Preferred Shareholder Resolution has been passed, all of the Preferred Shares, through a Plan of Arrangement under the CBCA.

Consideration

The aggregate value of the Consideration of the Proposed Acquisition is approximately US\$15.1 billion (approximately HK\$117.2 billion), and is to be payable in cash. The Consideration is related to acquisition of common and preferred shares and settlement of share options of Nexen. The indebtedness of Nexen as at the date of the Announcement of approximately US\$4.3 billion (approximately HK\$33.6 billion) will remain outstanding. The Purchaser shall, immediately prior to the sending by Nexen of the Articles of Arrangement to the director appointed pursuant to Section 260 of the CBCA, provide the depositary with sufficient funds to be held in escrow to satisfy (i) the aggregate Consideration per Common Share as provided in the Plan of Arrangement; and (ii) as the Preferred Shareholder Resolution has been passed, the aggregate Consideration per Preferred Share.

If, on or after the date of the Arrangement Agreement, Nexen sets a record date for any dividend or other distribution on Nexen Shares (other than certain Permitted Dividends) that is prior to the Effective Time or Nexen pays any dividend or other distribution on Nexen Shares (other than certain Permitted Dividends) prior to the Effective Time: (i) to the extent that the amount of such dividends or distributions per Nexen Share do not exceed the applicable Consideration per Nexen Share, the applicable Consideration per Nexen Share shall be reduced by the amount of such dividends or distributions; and (ii) to the extent that the amount of such dividends or distributions per Nexen Share exceeds the applicable Consideration per Nexen Share, such excess amount shall be placed in escrow for the account of the Purchaser or another person designated by the Purchaser.

Basis of the Consideration

The Consideration of the Proposed Acquisition was determined after arm's length negotiations between the Company and Nexen and with reference to recent market trading prices of the Common Shares and the Company's view of the value of the assets and business of Nexen. The Consideration price of US\$27.50 per Common Share represents a premium of 61% relative to the closing price of the Common Shares on the NYSE on 20 July 2012 and a premium of 66% relative to the volume weighted average price of the Common Shares over the 20 trading days ended 20 July 2012.

Employees

Unless otherwise agreed in writing between the parties, each of the Company and the Purchaser has covenanted and agreed that Nexen Employees shall be provided with compensation not less than, and benefits that are, in the aggregate, no less favorable than, those provided to such Nexen Employees immediately prior to the Effective Time.



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LETTER FROM THE BOARD

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Each of the Company and the Purchaser has covenanted and agreed to honor and comply in all material respects with the terms of all the existing employment agreements, change of control agreements and severance obligations of Nexen Group and all obligations of Nexen Group under any employee plans.

Each of the Company and the Purchaser has further covenanted and agreed to cause Nexen to allocate and pay out to Nexen Employees bonus amounts in respect of the calendar year ending 31 December 2012 in accordance with Nexen's customary year-end bonus practices consistently applied in accordance with prior years as determined by Nexen Board.

Each of the Company and the Purchaser has agreed and acknowledged that Nexen shall institute a special transition bonus program, and subject to completion of the Arrangement, each of the Company and the Purchaser has covenanted and agreed to cause Nexen to allocate and pay out to Nexen Employees bonus amounts pursuant to the terms of such bonus program as determined by Nexen Board.

The above terms shall not apply to any Nexen Employee who is covered by a Collective Agreement and instead, the terms and conditions of employment of each such Nexen Employee following the Effective Time shall be governed by the terms of the applicable Collective Agreement.

Guarantee

The Company has unconditionally and irrevocably guaranteed in favour of Nexen the due and punctual performance by the Purchaser of the Purchaser's obligations under the Arrangement Agreement.

Regulatory Approvals

Completion of the Proposed Acquisition is subject to receipt of applicable governmental and regulatory approvals by the relevant authorities in, among others, Canada, the European Union, the United States and the People's Republic of China. As soon as reasonably practicable after the date of the Arrangement Agreement, each party, or where appropriate, the parties jointly, shall identify any such approvals necessary to complete the Arrangement and make all notifications, filings, applications and submissions with governmental entities required or advisable.

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LETTER FROM THE BOARD

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Conditions

Mutual Conditions

The parties to the Arrangement Agreement are not required to complete the Arrangement unless each of the following Conditions, summarized below, is satisfied on or prior to the Effective Time, which Conditions may only be waived, in whole or in part, by the mutual consent of each of the parties:

- (a) the Arrangement Resolution has been approved and adopted by the holders of Common Shares at the special meeting in accordance with the Interim Order;
- (b) the Interim Order and the Final Order have each been obtained on terms consistent with the Arrangement Agreement;
- (c) each of the key regulatory approvals (as set forth in the Arrangement Agreement) has been made, given or obtained on terms acceptable to Nexen, the Company and the Purchaser, each acting reasonably, and in the case of the Company and the Purchaser subject to compliance with their respective covenants in respect of the regulatory approvals and each such key regulatory approval is in force and has not been modified;
- (d) no law is in effect that makes the consummation of the Arrangement illegal or otherwise prohibits or enjoins Nexen, the Company or the Purchaser from consummating the Arrangement;
- (e) the Articles of Arrangement to be filed under the CBCA in accordance with the Arrangement Agreement shall be in a form and content satisfactory to Nexen and the Purchaser, each acting reasonably; and
- (f) absence of certain actions or proceedings (whether by a governmental entity or any other person).

Additional Conditions to the Obligations of the Purchaser

The Purchaser is not required to complete the Arrangement unless each of the following Conditions, summarized below, is satisfied on or before the Effective Time:

- (a) the representations and warranties of Nexen set forth in the Arrangement Agreement being true and correct as of the date of the Arrangement Agreement and at the Effective Time, subject, in most cases, to a material adverse effect standard;
- (b) material compliance by Nexen with each of its covenants in the Arrangement Agreement;

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LETTER FROM THE BOARD

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- (c) receipt of all regulatory approvals (other than key regulatory approvals) and all other third party consents, waivers and the similar approvals, subject to the standards and exceptions set forth in the Arrangement Agreement;
- (d) rights of dissent have not been exercised with respect to more than 5% of the issued and outstanding Common Shares; and
- (e) there shall not have been or occurred a material adverse effect on Nexen.

Additional Conditions to the Obligations of Nexen

Nexen is not required to complete the Arrangement unless each of the following Conditions, summarized below, is satisfied on or before the Effective Time:

- (a) the representations and warranties of the Company and the Purchaser set forth in the Arrangement Agreement being true and correct as of the date of Arrangement Agreement and the Effective Time, subject, in most cases, to a material adverse effect standard; and
- (b) material compliance by the Company and the Purchaser with each of its covenants in the Arrangement Agreement.

Effecting the Plan of Arrangement

The Proposed Acquisition will be effected by way of a Plan of Arrangement. The Plan of Arrangement involves a Court-supervised process and will be effected through the proceedings under the CBCA.

As announced by the Company on 21 September 2012 that, on 20 September 2012 (Canada local time), the Court has granted the Final Order which approved the Plan of Arrangement pursuant to CBCA. The Final Order was granted following a meeting of Nexen's shareholders on the same day at which the Plan of Arrangement was approved by approximately 99% of the votes cast by the holders of the Common Shares. As approximately 87% of the votes cast by the holders of Preferred Shares also approved the Plan of Arrangement, the Plan of Arrangement will also include the Preferred Shares.

Termination Date

Either the Company, the Purchaser or Nexen may terminate the Arrangement Agreement, among other events, if the Arrangement does not occur by 31 January 2013, subject, if certain regulatory approvals are not received, to any party's right to extend such date for successive periods of 15 days (but not in excess of 75 business days in the aggregate).

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LETTER FROM THE BOARD

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Non-Solicitation and Termination Fee

The Arrangement Agreement includes a non-solicitation covenant on the part of Nexen, subject to customary “fiduciary out” provisions that entitle Nexen to consider and accept an acquisition proposal that is a superior proposal, provided that the Purchaser has a right to match any superior proposal.

If the Arrangement Agreement is terminated under certain circumstances, including if Nexen enters into an agreement with respect to a superior proposal or if the Nexen Board changes, withdraws or modifies its recommendation with respect to the Proposed Acquisition, Nexen shall pay the Purchaser a termination fee in the amount of US\$425 million.

Reverse Termination Fee

If the Arrangement Agreement is terminated solely as a result of the PRC approvals having not been obtained, the Purchaser shall pay Nexen a reverse termination fee in the amount of US\$425 million.

INFORMATION ON THE COMPANY AND THE PURCHASER

The Group is China’s largest producer of offshore crude oil and natural gas and one of the largest independent oil and gas exploration and production companies in the world. The Group mainly engages in exploration, development, production and sales of oil and natural gas. The Group’s core operation areas are Bohai, Western South China Sea, Eastern South China Sea and East China Sea in offshore China. In overseas, the Group has oil and gas assets in Asia, Africa, North America, South America and Oceania. As of 31 December 2011, the Group owned net proved reserves of approximately 3.19 billion boe, and its average daily net production was 909,000 boe. The Group had 5,377 employees and total assets of approximately RMB384.26 billion.

The Purchaser is a limited liability company incorporated in Canada and is a wholly owned subsidiary of the Company. The principal business activity of the Purchaser is investment holding.

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LETTER FROM THE BOARD

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INFORMATION OF NEXEN AND ITS PETROLEUM ASSETS

Information of Nexen

To the best of the Directors' knowledge, information and belief, having made all reasonable enquiries, the following sets out the information relating to Nexen.

Nexen is an independent Canadian-based global energy company, listed on the TSX and the NYSE under the symbol NXY. Nexen adds value for shareholders through successful full-cycle oil and gas exploration and development, as well as leadership in ethics, integrity, governance and environmental stewardship.

Nexen currently focuses on three core businesses:

Conventional Oil & Gas: Nexen has major positions in three of the world's most significant conventional basins – the UK North Sea, Offshore West Africa and the deep-water Gulf of Mexico. It is the second largest oil producer in the UK North Sea.

Oil Sands: Nexen has an interest in more than 625,000 undeveloped acres (gross) in the Athabasca oil sands region, with net proved plus probable reserves of 1,350 million barrels and approximately 4 billion barrels of contingent recoverable oil sands resource. Nexen is a 65% owner and the operator of Long Lake, an integrated steam assisted gravity drainage (SAGD) and upgrading operation. Nexen also has a 7.23% interest in the Syncrude Canada oil sands mining and upgrading facility.

Shale Gas: Shale gas is expected to be a source of growth for Nexen in the future. With 300,000 acres (gross) of shale gas lands in the Horn River, Cordova and Liard basins in northeastern British Columbia, it has enough resources to significantly increase Nexen's proved reserves. Nexen has a joint venture shale gas exploration project in Poland and is exploring for shale gas in Colombia.

Nexen had average production of 207 mboe/d (after royalties) in the second quarter of 2012. In accordance with the SEC rules, Nexen had 900 mmboe of proved reserves and 1,122 mmboe of probable reserves as of 31 December 2011. In addition, Nexen had best estimate contingent resources of 5.6 billion boe in accordance with NI 51-101, predominately in the Canadian oil sands, as of 31 December 2011.



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LETTER FROM THE BOARD

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Set out below are the net profits (both before and after taxation and extraordinary items) of Nexen, prepared under IFRS, for the two financial years immediately preceding the date of the Announcement:

	For the financial year ended 31 December			
	2011		2010	
	C\$ million	HK\$ Equivalent million	C\$ million	HK\$ Equivalent million
Net profits before taxation and extraordinary items	1,723	13,193	1,130	8,652
Net profits after taxation and extraordinary items	697	5,337	1,127	8,629

As at 31 December 2011, the shareholders' equity of Nexen was approximately C\$8,373 million (approximately HK\$64,112 million).

Nexen is in material compliance with all host country laws, regulations and permits. Please refer to the 2011 AIF as set out in Appendix IV to this circular for the detailed information on the petroleum assets of Nexen.

#### Risks Relating to the Operations of Nexen

Nexen's operations are exposed to various risks, some of which are common to other operations in the oil and gas industry and some of which are unique to Nexen's operations. See the section entitled "Risk Factors" in the 2011 AIF of Nexen as set out in Appendix IV to this circular.

#### Long Term Prospects of Nexen

Nexen has several development and appraisal projects underway, and a large resource base to support long-term growth which is described in the 2011 AIF as set out in Appendix IV to this circular. Since then, on 2 April 2012, Nexen announced completion of the evaluation of its drilling success on the northeast fault block of the Appomattox structure. Nexen has demonstrated contingent recoverable resource in the northeast block of approximately 215 mmboe (50 mmboe net to Nexen), with a range of 120 to 370 mmboe (25 to 90 mmboe net to Nexen) of light oil (based on NI 51-101). Nexen holds a 20% interest in Appomattox and a 25% interest in Vicksburg and various other blocks in the area; Shell Gulf of Mexico Inc. ("Shell") holds the remaining interest and is operator.

Nexen and operator Shell plan to conduct additional exploration and appraisal activity in the Appomattox area during 2012 and extending into 2013. The current discovered resource has hub potential with production capacity of more than 100,000 barrels of oil equivalent per day. Nexen's Appomattox area discoveries enhances Nexen resource base at

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## LETTER FROM THE BOARD

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Appomattox and complement its previous exploration successes at Rochelle, West Rochelle and Golden Eagle in the North Sea, Knotty Head in the Gulf of Mexico and Owowo South offshore West Africa.

Upon the completion of the Proposed Acquisition, the Company will implement and enhance Nexen's current planned capital expenditure program, thereby investing significant capital in Canada and in Nexen's other international assets. The Company will bring greater financial capacity to better realize the full potential of Nexen's significant resource base.

## REASONS FOR THE PROPOSED ACQUISITION

The Group has been a significant investor in Canada since 2005, with total capital investment of C\$2.8 billion. These investments include a stake in MEG Energy Inc. ([www.megenergy.com](http://www.megenergy.com)), OPTI Canada Inc. (Nexen's partners in the Long Lake SAGD and Upgrader) and a 60% interest in Northern Cross (Yukon) Limited ([www.northerncrossyukon.ca](http://www.northerncrossyukon.ca)).

The acquisition of Nexen will expand the Group's overseas businesses and resource base in order to deliver long-term, sustainable growth. Nexen will complement the Group's large offshore production footprint in China and extends the Group's global presence with a high-quality asset base in many of the world's most significant producing regions – including Western Canada, the U.K. North Sea, the Gulf of Mexico and offshore Nigeria – focused on conventional oil and gas, oil sands and shale gas. In addition, Nexen management's current mandate will be expanded to include all of the Group's North American and Caribbean assets.

Taking into account the benefits of the Proposed Acquisition, the Board is of the view that the terms of the Proposed Acquisition are fair and reasonable and the Proposed Acquisition is in the interests of the Company and the Shareholders as a whole.

## FINANCIAL EFFECT OF THE PROPOSED ACQUISITION ON THE GROUP

Upon completion, Nexen will become a subsidiary of the Company and their results will be consolidated with that of the Group. In light of the business potential of Nexen and the future prospect of the oil and gas industry, the Directors are of the view that the Proposed Acquisition would widen the earnings base of the Group.

Set out in Appendix III to this circular is the unaudited pro forma financial information of the Enlarged Group which illustrates the financial effect of the Proposed Acquisition on the assets and liabilities of the Group assuming completion had taken place on 30 June 2012. The unaudited pro forma financial information has been prepared based on the assumption that the Company will obtain and utilise external banking facility of US\$6 billion (or approximately RMB37,949 million) and receive gross cash proceeds of approximately RMB37,691 million from corporate wealth management products and RMB17,809 million from time deposits with maturity over three months, which will mature on or before the completion of the Proposed Acquisition, to satisfy the cash consideration for the Proposed Acquisition. Based on the unaudited pro forma financial information in Appendix III to this circular, the total assets of the Group would increase from



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approximately RMB414.2 billion to approximately RMB550.0 billion; and its total liabilities would increase from approximately RMB130.0 billion to approximately RMB266.2 billion, as a result of the Proposed Acquisition. Shareholders should note that the earnings contribution from Nexen after completion will depend on the future performance of Nexen, and the actual effect of the Proposed Acquisition on the assets and liabilities of the Group will depend on the financial position of Nexen as at the date of completion, which cannot be quantified as at the Latest Practicable Date.

FINANCIAL AND TRADING PROSPECT OF THE ENLARGED GROUP

The Group is one of the largest independent oil and gas exploration and production companies in the world with oil and gas assets in Asia, Africa, North America, South America and Oceania. In the first half of this year, the global economic situation was critical, and China's economic growth encountered challenges. Under this environment, the Group actively sought opportunities amidst crisis, and realized steady growth in its different areas of business. The Group overcame the difficulties including a small decline in production and escalating costs and maintained strong profitability. The net profit of the Group of the first half of this year reached RMB31.87 billion and once again delivered satisfactory results for the Shareholders.

Since the beginning of the year, the Company has achieved satisfactory development in its overseas business, with overseas oil and gas production increasing significantly. The acquisition of one-third working interest in each of Exploration Area of 1, 2 and 3A in Uganda was also completed on 21 February 2012. The Proposed Acquisition was consistent with the Company's established value-driven merger and acquisition strategy. The Proposed Acquisition will not only increase the net proved reserves of the Company by around 30% and its net production by around 20%, but also bring to the Company invaluable experience in the area of unconventional oil and gas resources such as oil sands and shale gas, as well as a high-quality management team and employees.

The Proposed Acquisition will enhance the Company's presence in Canada, Nigeria and the Gulf of Mexico, adds a significant presence in the U.K. North Sea and diversifies the Company's growth platform. On 8 December 2012, the Proposed Acquisition was approved by Canada's Minister of Industry under the Investment Canada Act. In connection with the Proposed Acquisition and also to demonstrate its commitment to Canada and the Canadian oil and gas industry, the Company has agreed to carry out a number of commitments, including to establish Calgary as the head office of its North and Central American operations, responsible for approximately US\$8 billion of additional assets; retain Nexen's current management team and employees; invest significant capital as long-term commitment to the development of oil and gas resources in Canada and maintain and enhance community and social commitments. The Company will also list its Shares on the TSX subject to regulatory approvals.

Upon the closing of the Proposed Acquisition, the Company will become a truly global oil and gas exploration and production company with a balanced resources portfolio and important presences in the world's major oil and gas production areas. At the same time, the Group will be able to acquire the world-class management team and employees from Nexen

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and establish a leading international development platform. The Directors are confident that the Proposed Acquisition will benefit the Group's long term sustainable growth and create long term value for the Shareholders.

IMPLICATIONS OF THE PROPOSED ACQUISITION UNDER THE LISTING RULES

As one of the applicable percentage ratios calculated under Chapter 14 of the Listing Rules in respect of the Proposed Acquisition exceeds 25% but is less than 100%, the Proposed Acquisition will constitute a major transaction of the Company for the purposes of, and is subject to the notification, publication and shareholders' approval requirements under the Listing Rules.

As no Shareholder of the Company is required to abstain from voting if the Company were to convene a general meeting for approving the Proposed Acquisition, and as the Company has obtained a written approval of the Proposed Acquisition from the Controlling Shareholder, which directly held approximately 64.45% of the issued and outstanding shares of the Company as at the date of the Announcement, pursuant to Rule 14.44 of the Listing Rules, the Company is not required to convene a general meeting for approving the Proposed Acquisition.

WAIVERS FROM STRICT COMPLIANCE WITH THE LISTING RULES

Waiver from the Requirement to Prepare an Accountants' Report on Nexen

Pursuant to Rule 14.67(6)(a)(i) of the Listing Rules, the Company is required to include in this circular an accountants' report on Nexen prepared in accordance with Chapter 4 of the Listing Rules. The accountants' report for the purpose of the Proposed Acquisition is supposed to include the financial information of Nexen for each of the three financial years ended 31 December 2011 and interim accounts for a period ended six months or less from the date of this circular prepared using accounting policies which should be materially consistent with the Company.

Nexen is listed on the TSX and the NYSE. The consolidated financial statements of Nexen for each of the two financial years ended 31 December 2010 were prepared in accordance with Canadian GAAP and have been made publicly available. These financial statements have been audited by Nexen's auditor, Deloitte Canada in accordance with Canadian GAAS and the standards of the Public Company Accounting Oversight Board (United States).

Deloitte Canada is a member of the Canadian Institute of Chartered Accountants and a registered firm with the Canadian Public Accountability Board.

As a company listed on the TSX, Nexen is also required to file quarterly condensed financial statements in accordance with standards established by the CICA for a review of interim financial statements by an entity's auditor.

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In 2010, the Handbook of the CICA was revised to incorporate IFRS and require Canadian publicly accountable enterprises to apply such accounting standards effective for financial periods beginning on or after 1 January 2011. Nexen consequently prepared its financial statements for the financial year ended 31 December 2011 in accordance with IFRS, together with a restatement of the financial statements for the financial year ended 31 December 2010 in accordance with IFRS.

Complying with the strict requirements of Rule 14.67(6)(a)(i) of the Listing Rules in having to produce an accountants' report on Nexen in this circular would create practical difficulties, and require Nexen to undertake a considerable amount of work, which would have significant timing, resource and cost implications for the parties involved.

In replacement of an accountants' report on Nexen, the following disclosure has been included in this circular:

- (a) the audited financial information for the year ended 31 December 2010 (with 2009 comparative financial statements) prepared under Canadian GAAP (the "Nexen 2010 Canadian GAAP Accounts") extracted from the 2010 annual report of Nexen as set out in the section entitled "Appendix II – Financial Information of Nexen Group – Published Financial Information of Nexen Group for Each of the Three Years Ended 31 December 2009, 2010 and 2011 and Six Months Ended 30 June 2012";
- (b) the audited financial information for the year ended 31 December 2011 (with 2010 comparative financial statements) (the "Nexen 2011 IFRS Accounts") and the unaudited (but reviewed) financial information for the six months ended 30 June 2012 prepared under IFRS extracted from the 2011 annual report and the second quarter 2012 report of Nexen, respectively, as set out in the section entitled "Appendix II – Financial Information of Nexen Group – Published Financial Information of Nexen Group for Each of the Three Years Ended 31 December 2009, 2010 and 2011 and Six Months Ended 30 June 2012";
- (c) a summary of the material differences between the accounting policies adopted by Nexen (Canadian GAAP or IFRS) and the accounting policies adopted by the Company (IFRS and HKFRS), including a line-by-line reconciliation of the consolidated statements of income and consolidated balance sheets, addressing the material differences, other than presentational differences, which would have a significant effect on Nexen's financial statements in (a) and (b) above had they been prepared in accordance with the accounting policies presently adopted by the Company and reported on by Deloitte Hong Kong in accordance with Hong Kong Standard of Assurance Engagements 3000, as set out in the section entitled "Appendix II – Financial Information of Nexen Group – Differences between Accounting Policies Adopted by the Company (IFRS and HKFRS) and Nexen (Canadian GAAP or IFRS)"; and
- (d) supplemental financial information of Nexen Group for the three years ended 31 December 2011 and six months ended 30 June 2012, which is required for an accountants' report under the Listing Rules but not disclosed in the published

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accounts of Nexen excluding the information required under Rule 4.08(3) of the Listing Rules, as set out in the section entitled “Appendix II – Financial Information of Nexen Group – Supplemental Financial Information of Nexen Group”.

The Directors consider that the published financial disclosure concerning Nexen reproduced in this circular, when taken together with the abovementioned additional financial disclosure, will afford the Shareholders with all material information necessary to assess the financial performance of Nexen throughout the period presented, such information being broadly commensurate in all material respects to the disclosure that would otherwise have been provided if an accountants’ report on Nexen had been produced under Rule 14.67(6)(a)(i). As such, the Company has applied to the Hong Kong Stock Exchange and was granted a waiver from strict compliance with Rule 14.67(6)(a)(i) of the Listing Rules such that the Company is not required to include an accountants’ report on Nexen in this circular.

Waivers from the Requirement to Prepare a Competent Person’s Report and a Valuation Report on the Petroleum Assets of Nexen

Pursuant to Rule 18.09(2) of the Listing Rules, the circular is required to include a Competent Person’s Report on the petroleum assets of Nexen.

As a company listed on the TSX and the NYSE, Nexen has disclosed its reserves information in accordance with NI 51-101 in its annual information forms and annual reports. Nexen also voluntarily reports on reserves under the requirements of the SEC as supplementary information in order to provide direct comparability to the reserves statements of its U.S. peer group and improve access to U.S. capital markets.

Disclosures under NI 51-101 are based upon reserve and resource estimates prepared in accordance with the standards of the COGEH. COGEH is generally based upon the PRMS definition and classification framework system. The standards are interpreted and applied similarly by reserves evaluators. Accordingly, there are generally no material differences between reserve or resource estimates prepared under PRMS and estimates prepared under NI 51-101 (COGEH) (under an equivalent price and cost assumption). In addition, the modifications to the PRMS under Chapter 18 of the Listing Rules and disclosure requirements are materially consistent with the NI 51-101 disclosure requirements.

Nexen has received an exemption from the NI 51-101 requirements to have its reserves estimates independently assessed. The estimates of reserves and future net revenue disclosed by Nexen were based on its internal evaluations. Nexen has put in place an internal evaluation system to ensure that the reliability of the internally generated estimates of reserves and future net revenue is commensurate with that generated by an independent qualified reserves evaluator. The IQRE of Nexen is responsible for the reserves data and related disclosures and assessing whether the reserves estimates and related disclosures have been prepared in accordance with applicable regulatory requirements, Canadian and SEC reserves regulations and related reporting requirements. The IQRE is a professional engineer and meets all professional and statutory requirements in regards to experience, education and professional membership associated with the role. With over 30 years of experience, the

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IQRE has an in-depth knowledge of reserves estimation techniques and professional guidelines. As set out in Appendix V to the circular, the IQRE has the relevant professional qualifications and experience to act as a Competent Person under Chapter 18 of the Listing Rules.

Nexen has adopted a corporate policy that prescribes the procedures and standards to be followed in the evaluation of its reserves. This policy is reviewed and amended annually as required to conform to changes in law or industry accepted evaluation practices. Due to the extent and expertise of the internal reserves evaluation resources, the staff's familiarity with the properties of Nexen, and the controls applied to the evaluation process, the reliability of the internally generated estimates of reserves and future net revenue are not materially less than would be generated by an independent qualified reserves evaluator.

Notwithstanding the above mentioned internal evaluation procedure and the exemption from the NI 51-101 requirements to have its reserves estimates independently assessed, the policy of the Nexen is to have at least 80% of its NI 51-101 reserves estimates either evaluated or audited annually by the Independent Reserves Evaluators using applicable NI 51-101 requirements.

Given that reserves estimates are based on a large number of assumptions, interpretations and judgments, differences frequently arise between the estimates prepared by different qualified estimators. When the initial estimate of proved reserves on the portfolio of properties differs by greater than 10%, Nexen works with the Independent Reserves Evaluators to reconcile the difference to within 10%. Estimates pertaining to individual properties within the portfolio may differ by more than 10%, either positively or negatively. Nexen does not attempt to resolve each property to within 10% as it would be time and cost prohibitive given the number of wells in which Nexen has an interest. Nexen follows a similar process in connection with its probable reserves estimates whereby Nexen reconciles any differences on a proved plus probable basis to be within 10%.

The estimates of the Independent Reserves Evaluators are prepared using standard geological and engineering methods generally accepted by the petroleum industry and the reserves principles, definitions and standards required by NI 51-101 and the COGEH. Generally recognized methods for estimating reserves include volumetric calculations, material balance techniques, production and pressure decline curve analysis, analogy with similar reservoirs and reservoir simulation. The method or combination of methods used is based on the professional judgment and experience of the Independent Reserves Evaluators. In preparing their estimates, the Independent Reserves Evaluators obtain information from Nexen with respect to property interests, production from such properties, current costs of operations, expected future development and abandonment costs, current prices for production, agreements relating to current and future operations and sale of production, and various other information and data. They may rely on the information without independent verification. However, if in the course of their evaluation they question the validity or sufficiency of any information, Nexen requests that they not rely on such information until they satisfactorily resolve their questions or independently verify such information.



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The Independent Reserves Evaluators do not undertake site visits. Site visits are part of the regular job duties for many of Nexen's qualified reserves evaluators. However, site visits by the Independent Reserves Evaluators are not considered necessary or appropriate for the purpose of evaluating or auditing Nexen's properties due to the following reasons:

- (i) unlike hard rock mining operations, oil and gas reserves are not generally accessible for physical inspection;
- (ii) Nexen's reserves are located in remote locations in four continents and site visits are prohibitively time consuming and expensive; and
- (iii) reserve evaluations are based on electronic data and reports and site visits do not provide any information that would improve the quality of the reserve estimate.

The estimates of the reserves as disclosed in the 2011 AIF have been prepared by Nexen's IQRE with regard to the opinions of the Independent Reserves Evaluators. They have been substantiated by evidence that is supported by analysis and takes into account information supplied to the Independent Reserves Evaluators. In aggregate, the Independent Reserves Evaluators evaluated or audited 96% of the proved and 98% of the proved plus probable reserves of Nexen as of 31 December 2011 as follows:

- (i) Nexen engaged D&M to evaluate 100% of its proved and proved plus probable reserves in the UK North Sea, Nigeria, and Canadian shale gas properties. D&M provided an opinion on 26 January 2012, as set out in Appendix IV of this circular, that the proved and proved plus probable reserves for the reviewed properties are reasonable because, in aggregate, they are within 10% of their estimates;
- (ii) Nexen engaged McDaniel to evaluate approximately 100% of Nexen's proved and proved plus probable reserves for its in situ oil sands properties. McDaniel provided an opinion on 26 January 2012, as set out in Appendix IV of this circular, that the proved and proved plus probable reserves for the reviewed properties are reasonable because, in aggregate, they are within 10% of their estimates;
- (iii) Nexen engaged McDaniel to audit 100% of its proved and proved plus probable reserves for its Syncrude interest. McDaniel provided an opinion on 26 January 2012, as set out in Appendix IV of this circular, that the proved and proved plus probable reserves estimates for the Syncrude property are reasonable because they expect it would be within 10% of their own estimate were they to perform their own detailed evaluation of the property; and
- (iv) Nexen engaged Ryder Scott to evaluate 94% of its proved and 97% of its proved plus probable US Gulf of Mexico properties. Ryder Scott provided an opinion on 26 January 2012, as set out in Appendix IV of this circular, that the proved and proved plus probable reserves for the reviewed properties are reasonable because, in aggregate, they are within 10% of their estimates.

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Against this background, the Company has applied to the Hong Kong Stock Exchange for a waiver from strict compliance with Rule 18.09(2) of the Listing Rules in respect of preparation of a Competent Person's Report on the petroleum assets of Nexen on the following grounds:

- (i) the petroleum assets of Nexen are extensive and are located in various countries around the world. The preparation of a Competent Person's Report for such assets would involve an extraordinary of time and costs, and would be unduly burdensome. Nexen estimates that the preparation of a Competent Person's Report in respect of its reserves and resource estimates as of December 31, 2012 would take approximately 6 months and cost approximately US\$2 million;
- (ii) Nexen has reported reserves information as of 31 December 2011 in accordance with NI 51-101, which is in broad agreement with PRMS. The estimates of reserves and future net revenue as of 31 December 2011 were prepared in accordance with its strict internal evaluation procedures. Further, in aggregate the Independent Reserves Evaluators evaluated or audited 96% of the proved and 98% of the proved plus probable reserves of Nexen as of 31 December 2011. All these Independent Reserves Evaluators are firms with international names and reputation and as set out in Appendix V to this circular, the primary technical persons of these firms responsible for overseeing the estimate of reserves have the relevant professional qualifications and experience to act as Competent Persons under Chapter 18 of the Listing Rules; and
- (iii) as the Shareholders would not need to vote on the Proposed Acquisition and there is sufficient public information in respect of the reserves of the Nexen, the benefit of disclosing the Competent Person's Report in the circular is disproportionate with the costs, time and efforts the Company would need to spend on the preparation of such reports.

In replacement of a Competent Person's Report, the following disclosure has been included in this circular:

- (i) the 2011 AIF as set out in Appendix IV to this circular;
- (ii) the opinion letters of the Independent Reserves Evaluators as set out in Appendix IV to this circular;
- (iii) the qualifications and experience of the IQRE and the primary technical persons of D&M, McDaniel and Ryder Scott responsible for overseeing the estimate of reserves of Nexen as set out in Appendix V to this circular;
- (iv) details of information provided to the Independent Reserve Evaluators as set out in this section; and
- (v) long term prospects of Nexen as set out in the section entitled "Letter from the Board – Information of Nexen and Its Petroleum Assets – Long Term Prospects of Nexen".

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The Company believes that the above disclosure is comparable to the disclosure in a Competent Person's Report as required under Rule 18.09(2) of the Listing Rules except for the disclosure of gross production profiles of the reserves of Nexen and sensitivity analyses for oil and gas prices.

Gross production profiles of the reserves of Nexen are not disclosed in this circular as it is not the common practise for a large oil and gas company like Nexen to disclose such gross production data. Nexen is a large and diversified company with widely varying ownership interests in both operated and non-operated fields. Providing gross production profiles (100% of field production profiles) would introduce large production numbers that cannot be aggregated towards meaningful company data.

Further, this circular does not contain sensitivity analyses for oil and gas prices. Nexen provides NI 51-101 reserves data, which is based upon forecast assumptions. Nexen also provides SEC reserves information based upon SEC existing (constant) assumptions. Both of these analyses are vetted through internal due-diligence, including the effects that pricing may have on project commitment and timing. With a large and diversified portfolio, running meaningful sensitivities involve not only differences in price assumptions but also the corresponding changes to the business decisions and development commitment assumptions involved under each price scenario. The time and resources required to perform an accurate sensitivity analysis are prohibitively high. In addition, generally a sensitivity analysis is more suitable for a junior issuer. It is less relevant for a company with a large and diverse asset base such as Nexen because it is less sensitive to commodity price fluctuations than a junior issuer with few assets. For these reasons, the Company considers that a sensitivity analysis is inappropriate and unnecessary for the Shareholders to assess the Proposed Acquisition.

According to the Canadian Securities Law, in the event that there is any material change in the reserve information in the 2011 AIF, Nexen would need to issue and file a news release and file a material change report discussing its reasonable expectation as to how the material change has affected its reserve data and/or information disclosed in public reports. Nexen has confirmed that it has not filed, nor anticipates filing, a material change report relating to the reserves information in the 2011 AIF prior to the Latest Practicable Date.

Nexen monitors actual production results at least quarterly to assess whether they are consistent with the forecasts used for the most recent reserves estimates. Nexen also reviews reserves changes generated by exploration, development, acquisition and divestiture activities on an ongoing basis as well as changes to price and cost assumptions and the legal and regulatory environment applicable to its operations. Quarterly, Nexen management reviews preliminary estimates of potential reserves changes that may occur by year-end with regard to the above factors stated. Nexen has further confirmed that in its most recent reserves review completed mid-November 2012, with regard to the above factors stated, the expected changes are not material to its proved and proved plus probable reserves since 31 December 2011.

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Taking into account of the above, the Company confirms that, as of the Latest Practicable Date, there has been no material changes to the proved and probable reserves of Nexen as disclosed in the 2011 AIF since 31 December 2011.

Based on the above, the Hong Kong Stock Exchange has granted a waiver from strict compliance with Rule 18.09(2) of the Listing Rules such that the Company is not required to include in the circular a Competent Person's Report on the petroleum assets of Nexen.

Pursuant to Listing Rule 18.09(3) of the Listing Rules, the circular is required to include a Valuation Report on the petroleum assets of Nexen.

For the Proposed Acquisition, the target of the acquisition is the shares of Nexen, a publicly listed company, and not specific assets, nor a privately owned asset with no readily available reference point for valuation. Nexen's shares are traded on the TSX and the NYSE which are well-developed and recognized stock exchanges with substantial market capitalization and liquidity. The Company believes that the share trading prices and market capitalization of Nexen serves as a reasonable reference in assessing Nexen's fair market value. The Company used multiple methodologies in determining the Consideration and offer price for the Proposed Acquisition, with a strong emphasis on Nexen's share price, liquidity and trading movement as well market-based analysis. The Company has performed various financial analysis, including, but not limited to: (a) market-based analysis; (b) reserves and resources based analysis; and (c) fundamental valuation analyses (e.g. discounted cash flow, metrics of comparable companies, precedent transactions and premiums paid) in order to determine an appropriate offer price. As the Consideration for the Proposed Acquisition was primarily based on the above approaches rather than an asset valuation approach, it would be unduly burdensome and irrelevant for the Company to prepare a separate Valuation Report on the petroleum assets of Nexen.

Therefore, the Company has applied to the Hong Kong Stock Exchange and the Hong Kong Stock Exchange has granted a waiver from strict compliance with Rule 18.09(3) of the Listing Rules such that the Company is not required to include a Valuation Report on the petroleum assets of Nexen.

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RECOMMENDATION OF THE BOARD

The Directors are of the opinion that the terms of the Arrangement Agreement and the transactions contemplated thereunder are fair and reasonable and in the interests of the Company and its Shareholders as a whole.

Shareholders and potential investors should note that the Proposed Acquisition is subject to various Conditions which may or may not be fulfilled. There is therefore no assurance that the Proposed Acquisition will proceed and, if it proceeds, on what terms it may proceed. Shareholders and potential investors are reminded to exercise caution when dealing in the Shares of the Company.

Yours faithfully,  
For and on behalf of the Board  
CNOOC Limited  
Wang Yilin  
Chairman of the Board of Directors

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APPENDIX IFINANCIAL INFORMATION OF THE GROUP

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## 1. FINANCIAL INFORMATION OF THE GROUP FOR EACH OF THE THREE YEARS ENDED 31 DECEMBER 2009, 2010 AND 2011 AND THE SIX MONTHS ENDED 30 JUNE 2012

Financial information of the Group for each of the three years ended 31 December 2009, 2010 and 2011 and for the six months ended 30 June 2012 is disclosed in the following documents which have been published on the websites of the Hong Kong Stock Exchange (<http://www.hkexnews.hk>) and the Company (<http://www.cnoocld.com>):

Interim report of the Company for the six months ended 30 June 2012 published on 31 August 2012 (Pages 8 to 36);

Annual report of the Company for the year ended 31 December 2011 published on 12 April 2012 (pages 61 to 116);

Annual report of the Company for the year ended 31 December 2010 published on 7 April 2011 (pages 57 to 114);  
and

Annual report of the Company for the year ended 31 December 2009 published on 9 April 2010 (pages 49 to 104).

## 2. INDEBTEDNESS STATEMENT

As at the close of business on 31 October 2012, being the latest practicable date for the purpose of this indebtedness statement prior to the printing of this circular, the Enlarged Group had the following outstanding borrowings:

	Secured RMB million	Guaranteed RMB million	Unsecured RMB million	Total RMB million
Bank loans	8,631	2,669	19,217	30,517
Long-term notes	–	28,048	24,761	52,809
Subordinated debentures	–	–	2,900	2,900
	8,631	30,717	46,878	86,226

The general bank loan of US\$1,370 million (equivalent to RMB8,631 million) was secured by time deposits placed by CNOOC China Limited, a wholly-owned subsidiary of the Company.

The specific borrowing of US\$424 million (equivalent to RMB2,669 million) represented the Enlarged Group's share of utilised bank loans in Tangguh Liquefied Natural Gas Project (the "Tangguh LNG Project"). The Company delivered a guarantee in favour of Mizuho Corporate Bank, Ltd., which acts as the facility agent for and on behalf of various international commercial banks under a commercial loan agreement in connection with the Tangguh LNG Project in Indonesia. The Company guarantees the payment obligations of the trustee borrower under the subject loan agreement and is subject to a maximum cap of



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APPENDIX IFINANCIAL INFORMATION OF THE GROUP

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approximately US\$164.89 million. Together with the loan agreement dated 31 July 2006 with a maximum cap of approximately US\$487.86 million, the total maximum guarantee cap is US\$652.75 million.

The long-term notes amounting to RMB28,048 million are unconditionally and irrevocably guaranteed by the Company.

#### Banking facilities

As at 31 October 2012, the banking facilities amounting to RMB116,543 million were granted to the Enlarged Group, of which RMB17,618 million were utilised as follows:

- (i) RMB5,390 million of these facilities were utilised to support letter of credit;
- (ii) RMB2,148 million of these facilities were utilised to support bank guarantee; and
- (iii) RMB10,080 million of these facilities were utilised to withdraw bank borrowings.

#### Financial lease

As at 31 October 2012, the Enlarged Group had an outstanding finance lease of approximately RMB497 million of which RMB106 million is repayable within the next five years.

#### Guarantees

On 6 August 2012, the Enlarged Group guaranteed a drilling rig sublease contract for approximately 180 days with potential exposure of C\$90 million (equivalent to RMB567 million). As at 31 October 2012, this contract had approximately 135 days outstanding and C\$67 million potential exposure amount remaining (equivalent to RMB422 million).

#### Contingencies

- (a) On 8 January 2006, a subsidiary of the Company signed a definitive agreement with South Atlantic Petroleum Limited ("SAPETRO") to acquire a 45% working interest in the Offshore Oil Mining Lease 130 ("OML130") in Nigeria (the "OML130 Transaction") and the OML130 Transaction was completed on 20 April 2006.

In 2007, a local tax office in Nigeria (the "Nigerian Local Tax Office") conducted a tax audit on SAPETRO. According to the preliminary tax audit results, the Nigerian Local Tax Office has raised a disagreement with the tax filings made for the OML130 Transaction.

The tax audit assessment made by the Nigerian Local Tax Office has been contested by the Company in accordance with Nigerian laws. The Company then filed a suit in the Nigerian Federal High Court. In March 2011, the Nigeria Federal High Court delivered a binding judgement in favour of the Company, agreeing that the Company is not subject to Value Added Tax for the OML130 Transaction. The judgement was appealed





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by counterparties. After seeking legal advice, the Company's management believes that the Company has reasonable grounds in defending for such an appeal. Consequently, no provision has been made for any expenses which might arise as a result of the dispute.

(b) On 26 October 2011, CNOOC Exploration & Production Nigeria Limited ("CNOOC Nigeria"), a subsidiary of the Company, received notice of assessment from Federal Inland Revenue Service of Nigeria ("FIRS"), confirming that the effective Petroleum Profit Tax ("PPT") and related tax in the year of 2010 for the Company's investment in the OML130 project, shall be calculated and payable on the basis of the PPT Tax Return prepared by Nigerian National Petroleum Corporation. CNOOC Nigeria contested the notice of assessment. On 13 January 2012, CNOOC Nigeria, together with SAPETRO (collectively referred to as the "PSC Partners"), filed an appeal in relation thereto to the local Tax Appeal Tribunal ("TAT").

CNOOC Nigeria received a notice of assessment issued by FIRS on 13 June 2012, stating that investment tax allowance ("ITA"), instead of investment tax credit ("ITC"), should be applied for the PPT calculation of the Company's investment in the OML130 project. In July 2012, PSC Partners filed an appeal in relation thereto to the local TAT. However, whether TAT has jurisdiction over this dispute is uncertain under the Nigerian law, in order to protect the right of action, the PSC Partners filed an application to the Nigeria Federal High Court ("FHC") on 13 September 2012, seeking the permission to file a lawsuit over the application of ITA/ITC dispute at FHC; and the appeal over ITA/ITC dispute at TAT was withdrawn on 9 November 2012.

No verdict has been issued to date, and the results of the appeals are still uncertain.

(c) The Company has extended interest-free intercompany loans to CNOOC International Limited, a wholly-owned subsidiary, to provide onward funding to its subsidiaries domiciled outside the PRC. Upon receipt of the Chinese resident enterprise approval, the Company may be liable to pay taxes on the deemed interest income for the intercompany loan to CNOOC International Limited starting from 1 January 2008. The Company is currently applying to, and awaiting confirmation from its in-charge tax authority for an exemption on this possible deemed interest income. In July 2011, the Company completed the transfer of the interest-free intercompany loans to the capital investment in CNOOC International Limited, in order to reduce the future tax exposure arising from any deemed interest income for the intercompany loans.

(d) Two oil spill accidents occurred on 4 June and 17 June 2011 respectively at Platforms B and C of Penglai 19-3 oilfield, which is being operated under a production sharing contract ("PSC") among CNOOC China Limited, the subsidiary of the Company, and two subsidiaries of ConocoPhillips ("ConocoPhillips"), the US based oil company, among which ConocoPhillips China Inc. ("COPC") is the operator and responsible for the daily operations of the oilfield.

On 21 June 2012, the State Oceanic Administration of the PRC announced the Accident Investigation and Settlement Report by a Joint Investigation Team on the Penglai 19-3 Oilfield Oil Spill Accidents, pointing out that "the Joint Investigation Team has concluded that COPC violated the oilfield Overall Development Program, had defects



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APPENDIX IFINANCIAL INFORMATION OF THE GROUP

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in its operation procedures and management, and failed to take necessary precautionary measures against foreseen risks, all of which eventually resulted in the oil spills. The Penglai 19-3 Oilfield Oil Spill Accidents were accidents involving liabilities, causing significant marine pollution by oil spill. Pursuant to the PSC, COPC (the operator of the oilfield) shall bear full responsibility for the oil spill accidents”.

The Company is of the view that the Company’s obligations, if any, arising from the above mentioned accidents shall be determined in accordance with relevant laws and regulations, the PSC and related agreements, among others. Based on evaluations performed as of the date of this indebtedness statement, the Company believes that it is not possible to determine provisions, if any, for the above mentioned accidents. The financial impact of such oil spill accidents on the Company is still uncertain, and the Company has not made any provision for the accidents in the financial statements.

(e)The Company has been served with (via its designated agent for service of process in the United States) process on 11 October 2012 for a purported class action complaint filed by Sam Siany, individually and on behalf of all others similarly situated in the United States District Court for the Southern District of New York (the “Complaint”). The Complaint is lodged against the Company and certain of its directors and/or officers, which alleges that during the period between 27 January 2011 and 16 September 2011, the Company made materially false and misleading statements regarding its business and financial results and the oil spill accidents occurred at the Penglai 19-3 oilfield. No verdict has been issued to the date. The Company believes the allegations and the claims in the Complaint are without merit and intends to defend itself vigorously against such claims.

#### Liquidity

The Enlarged Group’s debt levels are directly related to its operating cash flows, capital expenditures and acquisition and divestiture activity. Management generally relies on operating cash flows to fund capital requirements and maintain liquidity. Given the long development cycle of our projects, and fluctuations in commodity prices and exchange rates, it is not unusual for capital expenditures to exceed operating cash flows in any given period. Management covers these differences by drawing on existing liquidity or obtaining additional banking facilities.

As at 31 October 2012, the Enlarged Group had outstanding debt of approximately RMB86,226 million of which RMB31,627 million is repayable within the next five years. The Enlarged Group had liquidity of approximately RMB137,409 million, primarily comprised of cash and undrawn term credit facilities. Management expects to be able to fund all planned capital expenditures, repay our debt when it comes due, and meet all other obligations that arise from the Enlarged Group’s oil and gas operations.

#### Currency risk

Management of the Group has assessed the Group’s exposure to foreign currency risk by using a sensitivity analysis on the change in foreign exchange rate of US dollars, to which the Group is mainly exposed to.

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APPENDIX IFINANCIAL INFORMATION OF THE GROUP

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Nexen Group manages its exposure to fluctuations in exchange rates by matching its expected net cash flows and borrowings in the same currency. Cash flows generated by its foreign operations and borrowings on its US dollar debt facilities are generally used to fund US dollar capital expenditures and debt repayments. Nexen Group maintains revolving Canadian and US dollar borrowing facilities that can be drawn upon or repaid depending on expected net cash flows. Nexen Group designates most of its US dollar borrowings as a hedge against its US dollar net investment in its foreign operations.

Save as aforesaid or as otherwise mentioned herein, and apart from intra-group liabilities, none of the companies in the Enlarged Group had, at the close of business on 31 October 2012, any outstanding loan capital issued and outstanding or agreed to be issued, bank overdrafts, charges or debentures, mortgages, loans or other similar indebtedness or any finance lease commitments, hire purchase commitments, liabilities under acceptances, acceptance credits or any guarantees or other material contingent liabilities.

The Directors have confirmed that there have been no material changes in the indebtedness and contingent liabilities of the Enlarged Group since 31 October 2012.

For the purpose of the above indebtedness statement, foreign currency amounts have been translated into RMB at the exchange rates of US\$1.00 to RMB6.3002 and C\$1.00 to RMB6.3037 prevailing at the close of business on 31 October 2012.

### 3. WORKING CAPITAL

The Directors are of the opinion that, upon the completion of the proposed acquisition of all the common shares and preferred shares of Nexen, taking into account the present financial resources available to the Enlarged Group, including internally generated funds, access to financing and available banking facilities, and in the absence of unforeseeable circumstances, the Enlarged Group will have sufficient working capital for its present requirements for at least the next 12 months from the date of this circular.

### 4. NO MATERIAL ADVERSE CHANGE

As at the Latest Practicable Date, the Directors were not aware of any material adverse change in the financial or trading position or prospect of the Group since 31 December 2011, the date to which the latest published audited financial statements of the Group were made up.

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APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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## I. PUBLISHED FINANCIAL INFORMATION OF NEXEN GROUP FOR EACH OF THE THREE YEARS ENDED 31 DECEMBER 2009, 2010 AND 2011 AND THE SIX MONTHS ENDED 30 JUNE 2012

(1) The following is an extract of the unaudited condensed interim financial statements of Nexen Group for the six months ended 30 June 2012, which were prepared in accordance with IFRS. These condensed interim financial statements were presented in C\$ million dollars except for otherwise stated.

Nexen's interim financial statements are available free of charge, in read only, printable format on Nexen's website.

Unaudited Condensed Consolidated Statement of Income  
For the Three and Six Months Ended June 30

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
(Cdn\$ millions, except per-share amounts)				
Revenues and Other Income				
Net Sales	1,659	1,507	3,355	3,105
Marketing and Other Income (Note 8)	128	95	158	141
	1,787	1,602	3,513	3,246
Expenses				
Operating	376	341	715	704
Depreciation, Depletion and Amortization	488	335	885	705
Transportation and Other	105	112	225	179
General and Administrative	115	76	241	181
Exploration	155	93	215	219
Finance (Note 5)	81	60	145	134
Loss on Debt Redemption and Repurchase	–	1	–	91
Gain from Dispositions (Note 10)	(45 )	–	(45 )	–
	1,275	1,018	2,381	2,213
Income from Continuing Operations before Provision for Income Taxes	512	584	1,132	1,033

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
(Cdn\$ millions, except per-share amounts)				
Provision for (Recovery of) Income Taxes				
Current	396	384	876	808
Deferred	7	(52 )	(24 )	73
	403	332	852	881
Net Income from Continuing Operations	109	252	280	152
Net Income from Discontinued Operations, Net of Tax	–	–	–	302
Net Income Attributable to Nexen Inc. Shareholders	109	252	280	454
Earnings Per Common Share from Continuing Operations				
(\$/share)				
(Note 6)				
Basic	0.20	0.48	0.52	0.29
Diluted	0.19	0.45	0.52	0.27
Earnings Per Common Share (\$/share)				
(Note 6)				
Basic	0.20	0.48	0.52	0.86
Diluted	0.19	0.45	0.52	0.84

See accompanying notes to the Unaudited Condensed Consolidated Financial Statements.

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APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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## Unaudited Condensed Consolidated Balance Sheet

	June 30 2012	December 31 2011
(Cdn\$ millions)		
Assets		
Current Assets		
Cash and Cash Equivalents	1,255	845
Restricted Cash	102	45
Accounts Receivable	1,685	2,247
Derivative Contracts	155	119
Inventories and Supplies	283	320
Other	137	115
Total Current Assets	3,617	3,691
Non-Current Assets		
Property, Plant and Equipment (Note 3)	16,030	15,571
Goodwill	292	291
Deferred Income Tax Assets	442	338
Derivative Contracts	5	25
Other Long-Term Assets	112	152
Total Assets	20,498	20,068
Liabilities		
Current Liabilities		
Accounts Payable and Accrued Liabilities	2,285	2,867
Income Taxes Payable	849	458
Derivative Contracts	105	103
Total Current Liabilities	3,239	3,428
Non-Current Liabilities		
Long-Term Debt	4,391	4,383
Deferred Income Tax Liabilities	1,561	1,488
Asset Retirement Obligations	2,020	2,010
Derivative Contracts	5	24
Other Long-Term Liabilities	443	362
Equity (Note 6)		
Share Capital		
Common Shares	1,183	1,157
Preferred Shares	195	—
Retained Earnings	7,435	7,211
Cumulative Translation Adjustment	26	5
Total Equity	8,839	8,373
Total Liabilities and Equity	20,498	20,068

See accompanying notes to Unaudited Condensed Consolidated Financial Statements.





## APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

Unaudited Condensed Consolidated Statement of Cash Flows  
For the Three and Six Months Ended June 30

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
(Cdn\$ millions)				
Operating Activities				
Net Income from Continuing Operations	109	252	280	152
Net Income from Discontinued Operations	—	—	—	302
Charges and Credits to Income not Involving Cash (Note 9)	455	261	906	610
Exploration Expense	155	93	215	219
Changes in Non-Cash Working Capital (Note 9)	446	419	300	485
Other	(6 )	(5 )	(34 )	(18 )
	1,159	1,020	1,667	1,750
Financing Activities				
Repayment of Long-Term Debt	—	(525 )	—	(871 )
Issue of Preferred Shares	—	—	195	—
Dividends Paid on Common Shares	(27 )	(26 )	(53 )	(52 )
Issue of Common Shares	8	8	26	31
Other	(4 )	(6 )	(6 )	1
	(23 )	(549 )	162	(891 )
Investing Activities				
Capital Expenditures				
Exploration, Evaluation and Development	(718 )	(516 )	(1,454 )	(992 )
Corporate and Other	(25 )	(20 )	(46 )	(37 )
Proceeds from Dispositions (Note 10)	46	12	53	474
Changes in Restricted Cash	(82 )	(2 )	(56 )	(11 )
Changes in Non-Cash Working Capital (Note 9)	23	31	65	115
Other	(4 )	(23 )	5	(75 )
	(760 )	(518 )	(1,433 )	(526 )
Effect of Exchange Rate Changes on Cash and Cash Equivalents	23	(15 )	14	(26 )
Increase (Decrease) in Cash and Cash Equivalents	399	(62 )	410	307
Cash and Cash Equivalents – Beginning of Period	856	1,374	845	1,005
Cash and Cash Equivalents – End of Period <sup>1</sup>	1,255	1,312	1,255	1,312

1 Cash and cash equivalents at June 30, 2012 consists of cash of \$319 million and short-term investments of \$936 million (June 30, 2011 — cash of \$218 million and short-term investments of \$1,094 million).

See accompanying notes to the Unaudited Condensed Consolidated Financial Statements.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Unaudited Condensed Consolidated Statement of Changes in Equity  
For the Three and Six Months Ended June 30

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
(Cdn\$ millions)				
Share Capital				
Common Shares, Beginning of Period	1,175	1,134	1,157	1,111
Issue of Common Shares	8	8	26	31
Common Shares, Balance at End of Period	1,183	1,142	1,183	1,142
Preferred Shares, Beginning of Period	195	–	–	–
Issue of Preferred Shares	–	–	195	–
Preferred Shares, Balance at End of Period	195	–	195	–
Retained Earnings, Beginning of Period	7,356	6,868	7,211	6,692
Net Income Attributable to Nexen Inc. Shareholders	109	252	280	454
Dividends on Common and Preferred Shares (Note 6)	(30 )	(26 )	(56 )	(52 )
Balance at End of Period	7,435	7,094	7,435	7,094
Cumulative Translation Adjustment,				
Beginning of Period	(8 )	(48 )	5	(37 )
Currency Translation Adjustment	23	(7 )	5	(18 )
Realized Translation Adjustments <sup>1</sup>	11	–	16	–
Balance at End of Period	26	(55 )	26	(55 )

<sup>1</sup>Net of income tax recovery for the three months ended June 30, 2012 of \$5 million (2011 – net of income tax expense of \$11 million) and net of income tax recovery for the six months ended June 30, 2012 of \$7 million (2011 – net of income tax expense of \$20 million).

See accompanying notes to the Unaudited Condensed Consolidated Financial Statements.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Unaudited Condensed Consolidated Statement of Comprehensive Income  
For the Three and Six Months Ended June 30

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
(Cdn\$ millions)				
Net Income Attributable to Nexen Inc. Shareholders	109	252	280	454
Other Comprehensive Income (Loss):				
Currency Translation Adjustment				
Net Translation Gains (Losses) of Foreign Operations	98	(35 )	14	(139 )
Net Translation Gains (Losses) on US\$-Denominated Debt Hedging of Foreign Operations <sup>1</sup>	(75 )	28	(9 )	121
Total Currency Translation Adjustment	23	(7 )	5	(18 )
Total Comprehensive Income	132	245	285	436

<sup>1</sup>Net of income tax recovery for the three months ended June 30, 2012 of \$10 million (2011 – net of income tax expense of \$4 million) and net of income tax recovery for the six months ended June 30, 2012 of \$1 million (2011 – net of income tax expense of \$17 million).

See accompanying notes to the Unaudited Condensed Consolidated Financial Statements.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Notes to Unaudited Condensed Consolidated Financial Statements

Cdn\$ millions, except as noted

1. BASIS OF PRESENTATION

Nexen Inc. (Nexen, we or our) is an independent, global energy company with operations in the UK North Sea, US Gulf of Mexico, offshore Nigeria, Canada, Yemen, Colombia and Poland. Nexen is incorporated and domiciled in Canada and our head office is located at 801-7th Avenue SW, Calgary, Alberta, Canada. Nexen's shares are publicly traded on both the Toronto Stock Exchange and the New York Stock Exchange.

These Unaudited Condensed Consolidated Financial Statements for the three and six months ended June 30, 2012 have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Specifically, they have been prepared in accordance with International Accounting Standard (IAS) 34 Interim Financial Reporting. The Unaudited Condensed Consolidated Financial Statements do not include all of the information required for annual financial statements and should be read in conjunction with the Audited Consolidated Financial Statements for the year ended December 31, 2011, which have been prepared in accordance with IFRS.

The Unaudited Condensed Consolidated Financial Statements were authorized for issue by Nexen's Board of Directors on July 18, 2012.

2. ACCOUNTING POLICIES

The accounting policies we follow are described in Note 2 of the Audited Consolidated Financial Statements for the year ended December 31, 2011. There have been no changes to our accounting policies since December 31, 2011.

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APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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## 3. PROPERTY, PLANT AND EQUIPMENT (PP&amp;E)

Carrying amount of PP&amp;E

	Exploration and Evaluation	Assets Under Construction	Producing Oil & Gas Properties	Corporate and other	Total
Cost					
As at December 31, 2011	2,206	2,347	19,832	837	25,222
Addition	390	335	729	46	1,500
Disposals/Derecognitions	(9 )	—	(74 )	(15 )	(98 )
Transfers <sup>1</sup>	—	(1,862 )	1,862	—	—
Exploration Expense	(215 )	—	—	—	(215 )
Other	(17 )	—	51	17	51
Effect of Changes in Exchange Rate	5	1	40	1	47
As at June 30, 2012	2,360	821	22,440	886	26,507
Accumulated Depreciation, Depletion & Amortization (DD&A)					
As at December 31, 2011	368	—	8,860	423	9,651
DD&A	33	—	809	43	885
Disposals/Derecognitions	(8 )	—	(74 )	(12 )	(94 )
Other	—	—	(8 )	17	9
Effect of Changes in Exchange Rate	—	—	26	—	26
As at June 30, 2012	393	—	9,613	471	10,477
Net Book Value					
As at December 31, 2011	1,838	2,347	10,972	414	15,571
As at June 30, 2012	1,967	821	12,827	415	16,030

<sup>1</sup>Includes PP&E costs related to our Usan development, offshore Nigeria which came on-stream February 2012.

Exploration and evaluation assets mainly comprise of unproved properties and capitalized exploration drilling costs. Assets under construction at June 30, 2012 primarily include our developments in the UK North Sea.

## 4. LONG-TERM DEBT

During the three and six months ended June 30, 2012, we borrowed and repaid nil and \$254 million on our term credit facilities, respectively. We recorded \$85 million and \$10 million, respectively, of unrealized foreign exchange losses on long-term debt in other comprehensive income.

We have undrawn, committed, unsecured term credit facilities of \$3.8 billion, of which \$700 million is available until 2014 and \$3.1 billion is available until 2017. As at June 30, 2012, \$232 million of our term credit facilities were utilized to support letters of credit (December 31, 2011 – \$367 million).





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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Nexen has undrawn, uncommitted, unsecured credit facilities of approximately \$180 million. We utilized \$21 million of these facilities to support outstanding letters of credit at June 30, 2012 (December 31, 2011 – \$17 million).

Nexen has uncommitted, unsecured credit facilities of approximately \$214 million exclusively to support letters of credit. We utilized \$3 million of these facilities to support outstanding letters of credit at June 30, 2012 (December 31, 2011 – \$4 million).

## 5. FINANCE EXPENSE

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Interest on Long-Term Debt	73	74	148	158
Accretion Expense Related to Asset Retirement Obligations	13	12	26	23
Other Interest and Fees	7	3	12	10
Total	93	89	186	191
Less: Capitalized at 6.7% (2011 – 6.6%)	(12 )	(29 )	(41 )	(57 )
Total	81	60	145	134

Capitalized interest relates to and is included as part of the cost of our oil and gas properties. The capitalization rates are based on our weighted-average cost of borrowings.

## 6. EQUITY

## (a) Common Shares

Authorized share capital consists of an unlimited number of common shares of no par value. At June 30, 2012, there were 529,335,905 common shares outstanding (December 31, 2011 – 527,892,635 common shares).

## (b) Preferred Shares

Authorized share capital consists of an unlimited number of Class A preferred shares of no par value, issuable in series. At June 30, 2012, there were 8,000,000 Cumulative Redeemable Class A Rate Reset Preferred Shares, Series 2 outstanding (December 31, 2011 – nil).

## (c) Earnings Per Common Share (EPS)

We calculate basic EPS using net income attributable to Nexen Inc. shareholders, adjusted for preferred share dividends and divided by the weighted-average number of common shares outstanding. We calculate diluted EPS in the same manner as basic, except we adjust basic earnings for the potential conversion of the subordinated debentures and potential exercise of outstanding tandem options for shares, if dilutive. We use the weighted-average number of diluted common shares outstanding in the denominator of our diluted EPS calculation.

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## APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
(Cdn\$ millions)				
Net Income Attributable to Nexen Inc. Shareholders	109	252	280	454
Preferred Share Dividends	(2 )	–	(3 )	–
Net Income Attributable to Nexen Inc. Shareholders, Basic	107	252	277	454
Potential Tandem Options Exercises	(7 )	(14 )	(3 )	(9 )
Potential Conversion of Subordinated Debentures	–	6	13	12
Net Income Attributable to Nexen Inc. Shareholders, Diluted	100	244	287	457
(millions of shares)				
Weighted Average Number of Common Shares Outstanding, Basic	529	527	529	527
Common Shares Issuable Pursuant to Tandem Options	–	2	–	2
Common Shares Notionally Purchased from Proceeds of Tandem Options	–	(2 )	–	(2 )
Common Shares Issuable Pursuant to Potential Conversion of Subordinated Debentures	–	20	26	19
Weighted Average Number of Common Shares Outstanding, Diluted	529	547	555	546

In calculating the weighted-average number of diluted common shares outstanding and related earnings adjustments for the three and six months ended June 30, 2012, we excluded 14,910,152 and 14,879,437 tandem options, respectively (2011 – 15,068,347 and 15,210,923, respectively) because their exercise price was greater than the average common share market price in the quarter. During the three months ended June 30, 2012, the potential conversion of tandem options was the only dilutive instrument. During the six months ended June 30, 2012, and the three and six months ended June 30, 2011, the potential conversion of tandem options and subordinated debentures were the only dilutive instruments.

## (d) Dividends

We paid dividends of \$0.05 and \$0.10 per common share, for the three and six months ended June 30, 2012 (\$0.05 and \$0.10 per common share for the respective periods ended June 30, 2011). Dividends paid to holders of common shares have been designated as “eligible dividends” for Canadian tax purposes.

On July 18, 2012, the board of directors declared a quarterly dividend of \$0.05 per common share, payable October 1, 2012 to the shareholders of record on September 10, 2012. Also, the board of directors declared a quarterly dividend of \$0.3125 per preferred share, payable September 30, 2012 to the shareholders of record on September 10, 2012.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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## 7. COMMITMENTS, CONTINGENCIES AND GUARANTEES

As described in Note 19 to the 2011 Audited Consolidated Financial Statements, there are a number of lawsuits and claims pending, the ultimate results of which cannot be ascertained at this time. We record costs as they are incurred or become determinable. We believe that payments, if any, related to existing indemnities would not have a material adverse effect on our liquidity, financial condition or results of operations.

We assume various contractual obligations and commitments in the normal course of our operations. During the quarter, we entered into drilling rig commitments in the UK North Sea.

	2012	2013	2014	2015	2016	Thereafter
Drilling Rig Commitments	–	74	46	–	–	–

The commitments above are in addition to those included in Note 19 to the 2011 Audited Consolidated Financial Statements and Note 7 to the Unaudited Condensed Consolidated Financial Statements for the three months ended March 31, 2012.

## 8. MARKETING AND OTHER INCOME

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Marketing Revenue, Net	110	51	175	102
Foreign Exchange Gains (Losses)	12	6	(4 )	(16 )
Change in Fair Value of Crude Oil Put Options	2	–	(34 )	(7 )
Insurance Proceeds	–	26	–	26
Other	4	12	21	36
Total	128	95	158	141

## 9. CASH FLOWS

## (a) Charges and credits to income not involving cash

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Depreciation, Depletion and Amortization	488	335	885	705
Gain from Dispositions	(45 )	–	(45 )	–
Change in Fair Value of Crude Oil Put Options	(2 )	–	34	7
Stock-Based Compensation	(2 )	(29 )	24	(2 )
Foreign Exchange	(8 )	(6 )	8	17
Provision for (Recovery of) Deferred Income Taxes	7	(52 )	(24 )	73

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Loss on Debt Redemption and Repurchase	–	1	–	91
Non-Cash Items Included in Discontinued Operations	–	–	–	(290 )
Other	17	12	24	9
Total	455	261	906	610

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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## (b) Changes in non-cash working capital

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Accounts Receivable	348	240	513	(134 )
Inventories and Supplies	47	163	40	184
Other Current Assets	(15 )	(17 )	(17 )	(9 )
Accounts Payable and Accrued Liabilities	(283 )	(248 )	(546 )	169
Current Income Taxes Payable	372	312	375	390
Total	469	450	365	600
Relating to:				
Operating Activities	446	419	300	485
Investing Activities	23	31	65	115
Total	469	450	365	600

## (c) Other cash flow information

	Three Months Ended June 30		Six Months Ended June 30	
	2012	2011	2012	2011
Interest Paid	58	66	148	130
Income Taxes Paid	17	69	497	460

## 10. DISPOSITIONS

## Asset Dispositions

## Canadian Undeveloped Leases

During the quarter, we sold non-core leases in Canada for proceeds of \$46 million and recognized a gain of \$45 million.

## 11. OPERATING SEGMENTS AND RELATED INFORMATION

Nexen has the following operating segments:

**Conventional Oil and Gas:** We explore for, develop and produce crude oil and natural gas from conventional sources around the world. Our operations are focused in the UK North Sea, North America (Canada and US) and other countries (offshore Nigeria, Colombia, Yemen and Poland).

**Oil Sands:** We develop and produce synthetic crude oil from the Athabasca oil sands in northern Alberta. We produce bitumen using in situ and mining technologies and upgrade it into synthetic crude oil before ultimate sale. Our in situ

activities are comprised of our operations at Long Lake and future development phases. Our mining activities are conducted through our 7.23% ownership of the Syncrude Joint Venture.

Shale Gas: We explore for and produce unconventional gas from shale formations in northeast British Columbia. Production and results of operations are included within Conventional Oil and Gas until they become significant.

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APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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Corporate and Other includes energy marketing and unallocated items. The results of Canexus have been presented as discontinued operations.

The accounting policies of our operating segments are the same as those described in Note 2 of our Audited Consolidated Financial Statements for the year ended December 31, 2011. Net income (loss) of our operating segments excludes interest income, interest expense, income tax expense, unallocated corporate expenses and foreign exchange gains and losses. Identifiable assets are those used in the operations of the segments.

Segmented net income for the three months ended June 30, 2012

	Conventional United Kingdom	North America	Other Countries <sup>1</sup>	Oil Sands In Situ	Syncrude	Corporate and Other	Total
Net Sales	1,028	88	217	173	145	8	1,659
Marketing and Other Income	3	—	—	—	1	124	128
	1,031	88	217	173	146	132	1,787
Less: Expenses							
Operating	109	41	43	107	70	6	376
Depreciation, Depletion and Amortization	224	72	112	51	16	13	488
Transportation and Other	5	9	—	51	6	34	105
General and Administrative	3	22	9	11	—	70	115
Exploration	19	139	(3 ) <sup>2</sup>	—	—	—	155
Finance	6	4	1	—	2	68	81
Gain on Dispositions	—	(13 )	—	(32 )	—	—	(45 )
Income (Loss) before Income Taxes	665	(186 )	55	(15 )	52	(59 )	512
Less: Provision for Income Taxes							403
Net Income							109
Capital Expenditures	243	177	122	127	62	12	743

<sup>1</sup>Includes results of operations in Nigeria, Yemen and Colombia.

<sup>2</sup>Includes exploration activities primarily in Colombia and Poland, and recovery of previously expensed exploration costs in Norway.

<sup>3</sup>Includes UK current tax expense of \$380 million.

<sup>4</sup>Includes capital expenditures in Nigeria of \$91 million.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Segmented net income for the three months ended June 30, 2011

	Conventional			Oil Sands		Corporate and Other	Total
	United Kingdom	North America	Other Countries <sup>1,2</sup>	In Situ	Syncrude		
Net Sales	764	134	229	188	181	11	1,507
Marketing and Other Income	1	30	3	–	1	60	95
	765	164	232	188	182	71	1,602
Less: Expenses							
Operating	61	36	35	127	75	7	341
Depreciation, Depletion and							
Amortization	133	116	23	36	14	13	335
Transportation and Other	–	11	11	51	6	33	112
General and							
Administrative	2	19	8	2	–	45	76
Exploration	13	41	37	3 2	–	–	93
Finance	5	4	1	–	2	48	60
Loss on Debt Redemption	–	–	–	–	–	1	1
Income (Loss) before Income Taxes	551	(63 )	117	(30 )	85	(76 )	584
Less: Provision for Income Taxes							332 4
Net Income							252
Capital Expenditures	104	123	171	5 91	27	14	530

<sup>1</sup>Includes results of operations in Yemen and Colombia.<sup>2</sup>Includes Yemen Masila net sales of \$169 million and net income before taxes of \$78 million.<sup>3</sup>Includes exploration activities primarily in Norway, Colombia and Poland.<sup>4</sup>Includes UK current tax expense of \$323 million.<sup>5</sup>Includes capital expenditures in Nigeria of \$114 million.



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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Segmented net income for the six months ended June 30, 2012

	Conventional		Other Countries <sup>1</sup>	Oil Sands		Corporate and Other	Total
	United Kingdom	North America		In Situ	Syncrude		
Net Sales	2,194	194	251	391	303	22	3,355
Marketing and Other Income	9	3	7	—	1	138	158
	2,203	197	258	391	304	160	3,513
Less: Expenses							
Operating	213	85	52	221	131	13	715
Depreciation, Depletion and Amortization	470	138	118	100	32	27	885
Transportation and Other	5	16	—	128	12	64	225
General and Administrative	8	46	18	22	—	147	241
Exploration	30	177	8	2	—	—	215
Finance	12	8	1	1	4	119	145
Gain on Dispositions	—	(13 )	—	(32 )	—	—	(45 )
Income (Loss) before Income Taxes	1,465	(260 )	61	(49 )	125	(210 )	1,132
Less: Provision for Income Taxes							852 3
Net Income							280
Capital Expenditures	438	432	252	4 276	82	20	1,500

<sup>1</sup>Includes results of operations in Nigeria, Yemen and Colombia.<sup>2</sup>Includes exploration activities primarily in Colombia and Poland, and recovery of previously expensed exploration costs in Norway.<sup>3</sup>Includes UK current tax expense of \$856 million.<sup>4</sup>Includes capital expenditures in Nigeria of \$187 million.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Segmented net income for the six months ended June 30, 2011

	Conventional United Kingdom	North America	Other Countries <sup>1</sup>	Oil Sands In Situ	Syncrude	Corporate and Other	Total
Net Sales	1,726	267	414	303	370	25	3,105
Marketing and Other Income	17	32	7	–	1	84	141
	1,743	299	421	303	371	109	3,246
Less: Expenses							
Operating	159	76	70	234	150	15	704
Depreciation, Depletion and Amortization	315	221	48	65	30	26	705
Transportation and Other	–	15	16	69	12	67	179
General and Administrative	(10 )	52	23	13	–	103	181
Exploration	17	100	100 <sup>3</sup>	2	–	–	219
Finance	10	8	1	1	3	111	134
Loss on Debt Redemption	–	–	–	–	–	91	91
Income (Loss) before Income Taxes	1,252	(173 )	163	(81 )	176	(304 )	1,033
Less: Provision for Income Taxes							881 <sup>4</sup>
Income from Continuing Operations							152
Add: Net Income from Discontinued Operations							302
Net Income							454
Capital Expenditures	178	242	317 <sup>5</sup>	220	46	26	1,029

<sup>1</sup>Includes results of operations in Yemen and Colombia.<sup>2</sup>Includes Yemen Masila net sales of \$315 million and net income before taxes of \$135 million.<sup>3</sup>Includes exploration activities primarily in Norway, Colombia and Poland.<sup>4</sup>Includes UK current tax expense of \$749 million.

5Includes capital expenditures in Nigeria of \$214 million.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Segmented assets as at June 30, 2012

	Conventional		Other Countries	Oil Sands		Corporate and Other	1	Total
	United Kingdom	North America		In Situ	Syncrude			
Total Assets	5,073	3,516	2,295	6,027	1,436	2,151	1	20,498
Property, Plant and Equipment Cost	7,519	7,502	2,814	6,191	1,811	670		26,507
Less: Accumulated DD&A	4,122	4,418	783	301	439	414		10,477
Net Book Value	3,397	3,084	2 2,031	3 5,890	4 1,372	256		16,030

1Includes cash of \$667 million, and Energy Marketing accounts receivable, current derivative assets and inventory of \$935 million.

2Includes net book value of \$1,495 million associated with our Canadian shale gas operations.

3Includes net book value of \$1,896 million related to our Usan development, offshore Nigeria.

4Includes net book value of \$5,162 million for Long Lake Phase 1 and \$728 million for future phases of our in situ oil sands projects.

Segmented assets as at December 31, 2011

	Conventional		Other Countries	Oil Sands		Corporate and Other	1	Total
	United Kingdom	North America		In Situ	Syncrude			
Total Assets	4,817	3,403	2,138	5,881	1,423	2,406	1	20,068
Property, Plant and Equipment Cost	7,103	7,256	2,566	5,915	1,733	649		25,222
Less: Accumulated DD&A	3,707	4,299	648	205	411	381		9,651
Net Book Value	3,396	2,957	2 1,918	3 5,710	4 1,322	268		15,571

1Includes cash of \$453 million, and Energy Marketing accounts receivable, current derivative assets and inventory of \$1,449 million.

2Includes net book value of \$1,293 million associated with our Canadian shale gas operations.

3Includes net book value of \$1,821 million related to our Usan development, offshore Nigeria.



<sup>4</sup>Includes net book value of \$5,050 million for Long Lake Phase 1 and \$660 million for future phases of our in situ oil sands projects.

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APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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(2) The following is an extract of the audited financial statements of Nexen Group for the year ended 31 December 2011, which were prepared in accordance with IFRS, from the 2011 annual report and financial statements of Nexen Group. These financial statements were presented in C\$ million dollars except for otherwise stated.

Nexen's 2011 annual report and financial statements are available free of charge, in read only, printable format on Nexen's website.

## REPORT OF MANAGEMENT

February 15, 2012

To the Shareholders of Nexen Inc.

We are responsible for the preparation and fair presentation of the Consolidated Financial Statements, as well as the financial reporting process that gives rise to such Consolidated Financial Statements. This responsibility requires us to make significant accounting judgments and estimates. For example, we are required to choose accounting principles and methods that are appropriate to the company's circumstances, and we are required to make estimates and assumptions that affect amounts reported. Fulfilling this responsibility requires the preparation and presentation of our Consolidated Financial Statements in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Historically, we prepared our Consolidated Financial Statements under previous Canadian generally accepted accounting principles. During the year, we transitioned to IFRS. To ensure a successful transition, we initiated a company-wide project, established a qualified project team and engaged external advisors, all under the oversight of senior management and the Audit Committee.

We are responsible for developing and implementing internal controls over the financial reporting process. These controls are designed to provide reasonable assurance that relevant and reliable financial information is produced. To gather and control financial data, we have established accounting and reporting systems supported by internal controls over financial reporting and an internal audit program. We believe that our internal controls over financial reporting provide reasonable assurance that our assets are safeguarded against loss from unauthorized use or disposition, that receipts and expenditures of the company are made only in accordance with authorization of management and directors of the company and that our records are reliable for preparing our Consolidated Financial Statements and other financial information in accordance with IFRS and in accordance with applicable securities rules and regulations. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

We have established disclosure controls and procedures, internal controls over financial reporting and corporate-wide policies to ensure that Nexen's consolidated financial position, results of operations and cash flows are presented fairly. Our disclosure controls and procedures are designed to ensure timely disclosure and communication of all material information required by regulators. We oversee, with assistance from our Disclosure Review Committee, these controls and procedures and all required regulatory disclosures.



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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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To ensure the integrity of our financial statements, we carefully select and train qualified personnel. We also ensure our organizational structure provides appropriate delegation of authority and division of responsibilities. Our policies and procedures are communicated throughout the organization and include a written ethics and integrity policy that applies to all employees, including the Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer or Controller.

Our board of directors is responsible for reviewing and approving the Consolidated Financial Statements and for overseeing management's performance of its financial reporting responsibilities. Their financial statement-related responsibilities are fulfilled mainly through the Audit and Conduct Review Committee (Audit Committee), with assistance from the Reserves Review Committee regarding the annual review of our crude oil and natural gas reserves, and the Finance Committee regarding the assessment and mitigation of financial risk. The Audit Committee is composed entirely of independent directors and includes five directors with financial expertise. The Audit Committee meets regularly with management, the internal auditors and the independent registered Chartered Accountants to review accounting policies, financial reporting and internal control issues and to ensure each party is properly discharging its responsibilities. The Audit Committee is responsible for the appointment and compensation of the independent registered Chartered Accountants and also ensures their independence, reviews their fees and (subject to applicable securities laws) preapproves their retention for any permitted non-audit services. The internal auditors and independent registered Chartered Accountants have full and unlimited access to the Audit Committee, with and without the presence of management.

(signed) "Kevin J. Reinhart"  
Interim President and Chief Executive Officer

(signed) "Una M. Power"  
Interim Chief Financial Officer

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13(a)-15(f)). Under the supervision and with the participation of our management, including our principal executive officer (CEO) and principal financial officer (CFO), we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation, we concluded that our internal control over financial reporting is effective as of December 31, 2011. We have documented this assessment and made this assessment available to our independent registered Chartered Accountants. We recognize that all internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Deloitte & Touche LLP audited our Consolidated Financial Statements as stated in their report and has provided an attestation report on our internal control over financial reporting.

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APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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REPORTS OF INDEPENDENT REGISTERED CHARTERED ACCOUNTANTS

To the Board of Directors and Shareholders of Nexen Inc.

We have audited the accompanying Consolidated Financial Statements of Nexen Inc. and subsidiaries (the “Company”), which comprise the consolidated balance sheet as at December 31, 2011 and 2010, and January 1, 2010, and the consolidated statements of income, cash flows, changes in equity, and comprehensive income for the years ended December 31, 2011 and 2010, and notes to the consolidated financial statements.

Management’s Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these Consolidated Financial Statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board, and for such internal control as management determines is necessary to enable the preparation of Consolidated Financial Statements that are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility

Our responsibility is to express an opinion on these Consolidated Financial Statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Consolidated Financial Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Consolidated Financial Statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the Consolidated Financial Statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the Consolidated Financial Statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the Consolidated Financial Statements.

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

Opinion

In our opinion, the Consolidated Financial Statements present fairly, in all material respects, the financial position of Nexen Inc. and subsidiaries as at December 31, 2011 and 2010, and January 1, 2010, and their financial performance and cash flows for the years ended December 31, 2011 and 2010 in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.



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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Other Matter

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2011, based on the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 15, 2012 expressed an unqualified opinion on the Company's internal control over financial reporting.

(signed) "Deloitte & Touche LLP"  
Independent Registered Chartered Accountants  
Calgary, Canada

February 15, 2012

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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To the Board of Directors and Shareholders of Nexen Inc.

We have audited the internal control over financial reporting of Nexen Inc. and subsidiaries (the “Company”) as of December 31, 2011, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the Consolidated Financial Statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States), the Consolidated Financial Statements of the Company as of and for the year ended December 31, 2011 and our report February 15, 2012 expressed an unqualified opinion on those financial statements.

(signed) “Deloitte & Touche LLP”  
Independent Registered Chartered Accountants  
Calgary, Canada

February 15, 2012

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APPENDIX II FINANCIAL INFORMATION OF NEXEN GROUP

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## CONSOLIDATED STATEMENT OF INCOME

For the Years Ended December 31

	2011	2010
(Cdn\$ millions, except per-share amounts)		
Revenues and Other Income		
Net Sales	6,169	5,496
Marketing and Other Income (Note 20)	295	323
	6,464	5,819
Expenses		
Operating	1,431	1,336
Depreciation, Depletion, Amortization and Impairment (Note 5)	1,913	1,628
Transportation and Other	425	566
General and Administrative	300	428
Exploration	368	328
Finance (Note 12)	251	362
Loss on Debt Redemption and Repurchase (Note 11)	91	—
Net (Gain) Loss from Dispositions (Note 23)	(38 )	41
	4,741	4,689
Income from Continuing Operations before Provision for Income		
Taxes	1,723	1,130
Provision for (Recovery of) Income Taxes (Note 21)		
Current	1,584	1,125
Deferred	(256 )	(449 )
	1,328	676
Net Income from Continuing Operations	395	454
Net Income from Discontinued Operations, Net of Tax (Note 23)	302	673
Net Income Attributable to Nexen Inc. Shareholders	697	1,127
Earnings Per Common Share from Continuing Operations		
(\$/share) (Note 22)		
Basic	0.75	0.87
Diluted	0.69	0.86
Earnings Per Common Share (\$/share) (Note 22)		
Basic	1.32	2.15
Diluted	1.24	2.09

See accompanying notes to the Consolidated Financial Statements.

## APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

CONSOLIDATED BALANCE SHEET  
2011 AND 2010

	December 31 2011	December 31 2010	January 1 2010
(Cdn\$ millions)			
<b>ASSETS</b>			
Current Assets			
Cash and Cash Equivalents	845	1,005	1,700
Restricted Cash	45	40	198
Accounts Receivable (Note 3)	2,247	1,789	2,322
Derivative Contracts (Note 8)	119	158	479
Inventories and Supplies (Note 4)	320	550	680
Other	115	133	172
Assets Held for Sale (Note 23)	–	729	–
Total Current Assets	3,691	4,404	5,551
Non-Current Assets			
Property, Plant and Equipment (Note 5)	15,571	14,579	14,669
Goodwill (Note 6)	291	286	330
Deferred Income Tax Assets (Note 21)	338	160	75
Derivative Contracts (Note 8)	25	116	229
Other Long-Term Assets (Note 7)	152	102	101
<b>TOTAL ASSETS</b>	<b>20,068</b>	<b>19,647</b>	<b>20,955</b>
<b>LIABILITIES</b>			
Current Liabilities			
Accounts Payable and Accrued Liabilities (Note 10)	2,867	2,223	2,591
Current Income Taxes Payable	458	345	179
Derivative Contracts (Note 8)	103	168	482
Liabilities Held for Sale (Note 23)	–	582	–
Total Current Liabilities	3,428	3,318	3,252
Non-Current Liabilities			
Long-Term Debt (Note 11)	4,383	5,090	7,259
Deferred Income Tax Liabilities (Note 21)	1,488	1,487	1,678
Asset Retirement Obligations (Note 14)	2,010	1,516	1,397
Derivative Contracts (Note 8)	24	115	210
Other Long-Term Liabilities (Note 15)	362	307	372
<b>EQUITY (Note 18)</b>			
Nexen Inc. Shareholders' Equity			

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Share Capital	1,157	1,111	1,050
Retained Earnings	7,211	6,692	5,704
Cumulative Translation Adjustment	5	(37 )	–
Total Nexen Inc. Shareholders' Equity	8,373	7,766	6,754
Canexus Non-Controlling Interests (Note 23)	–	48	33
Total Equity	8,373	7,814	6,787
TOTAL LIABILITIES AND EQUITY	20,068	19,647	20,955

See accompanying notes to the Consolidated Financial Statements.

Approved on behalf of the Board

Kevin J. Reinhart  
Director

Thomas C. O' Neill  
Director

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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CONSOLIDATED STATEMENT OF CASH FLOWS  
FOR THE YEARS ENDED DECEMBER 31

	2011	2010
(Cdn\$ millions)		
Operating Activities		
Net Income from Continuing Operations	395	454
Net Income from Discontinued Operations	302	673
Charges and Credits to Income not Involving Cash (Note 24)	1,335	727
Exploration Expense	368	328
Changes in Non-Cash Working Capital (Note 24)	255	338
Other	(158 )	(128 )
	2,497	2,392
Financing Activities		
Repayment of Term Credit Facilities, Net	–	(1,538 )
Repayment of Long-Term Debt (Note 11)	(871 )	–
Proceeds from Canexus Long-Term Debt, Net	–	112
Dividends Paid on Common Shares (Note 18)	(105 )	(104 )
Issue of Common Shares and Exercise of Tandem Options for Shares (Note 18)	46	55
Other	(2 )	(31 )
	(932 )	(1,506 )
Investing Activities		
Capital Expenditures		
Exploration, Evaluation and Development	(2,431 )	(2,334 )
Proved Property Acquisitions	–	(79 )
Corporate and Other	(93 )	(243 )
Proceeds from Dispositions	518	1,264
Changes in Restricted Cash	(4 )	37
Changes in Non-Cash Working Capital (Note 24)	321	(59 )
Other	(68 )	(51 )
	(1,757 )	(1,465 )
Effect of Exchange Rate Changes on Cash and Cash Equivalents	32	(116 )
Increase (Decrease) in Cash and Cash Equivalents	(160 )	(695 )
Cash and Cash Equivalents, Beginning of Year	1,005	1,700
Cash and Cash Equivalents, End of Year <sup>1</sup>	845	1,005

<sup>1</sup> Cash and cash equivalents at December 31, 2011 consists of cash of \$283 million and short-term investments of \$562 million (December 31, 2010 – cash of \$345 million and short-term investments of \$660 million).

See accompanying notes to the Consolidated Financial Statements.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

For the Years Ended December 31

	2011	2010
(Cdn\$ millions)		
Share Capital, Beginning of Year (Note 18)	1,111	1,050
Issue of Common Shares	45	50
Exercise of Tandem Options for Shares	1	5
Accrued Liability Relating to Tandem Options Exercised for Common Shares	–	6
Balance at End of Year	1,157	1,111
Retained Earnings, Beginning of Year	6,692	5,704
Net Income Attributable to Nexen Inc. Shareholders	697	1,127
Actuarial Losses of Defined Benefit Pension Plans	(73 )	(35 )
Dividends on Common Shares	(105 )	(104 )
Balance at End of Year	7,211	6,692
Cumulative Translation Adjustment, Beginning of Year	(37 )	–
Currency Translation Adjustment	33	(37 )
Realized Translation Adjustments <sup>1</sup>	9	–
Balance at End of Year	5	(37 )
Canexus Non-Controlling Interests, Beginning of Year	48	33
Net Income Attributable to Non-Controlling Interests	1	5
Distributions Declared to Non-Controlling Interests	–	(17 )
Issue of Partnership Units to Non-Controlling Interests	–	27
Disposition of Canexus (Note 23)	(49 )	–
Balance at End of Year	–	48

<sup>1</sup> Net of income tax expense for the year ended December 31, 2011 of \$18 million (2010 – net of income tax expense of \$4 million).

See accompanying notes to the Consolidated Financial Statements.



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APPENDIX II FINANCIAL INFORMATION OF NEXEN GROUP

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## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the Years Ended December 31

	2011	2010
(Cdn\$ millions)		
Net Income Attributable to Nexen Inc. Shareholders	697	1,127
Other Comprehensive Income (Loss):		
Currency Translation Adjustment		
Net Translation Gains (Losses) of Foreign Operations	109	(264 )
Net Translation Gains (Losses) on US-Denominated Debt Hedging of Foreign Operations <sup>1</sup>	(76 )	227
Total Currency Translation Adjustment	33	(37 )
Actuarial Losses of Defined Benefit Pension Plans <sup>2</sup>	(73 )	(35 )
Other Comprehensive Loss	(40 )	(72 )
Total Comprehensive Income	657	1,055

<sup>1</sup> Net of income tax recovery for the year ended December 31, 2011 of \$11 million (2010 – net of income tax expense of \$32 million).

<sup>2</sup> Net of income tax recovery for the year ended December 31, 2011 of \$24 million (2010 – net of income tax recovery of \$11 million).

See accompanying notes to the Consolidated Financial Statements.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Cdn\$ millions, except as noted

1. BASIS OF PRESENTATION

Nexen Inc. (Nexen, we or our) is an independent, global energy company with operations in the North Sea, Gulf of Mexico, offshore West Africa, Canada, Yemen and Colombia. Nexen is incorporated and domiciled in Canada and our head office is located at 801-7th Avenue SW, Calgary, Alberta, Canada. Nexen's shares are publicly traded on both the Toronto Stock Exchange and the New York Stock Exchange.

These Consolidated Financial Statements for the year ended December 31, 2011 have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB). Amounts relating to the year ended December 31, 2010 were previously presented in accordance with Canadian GAAP. These amounts have been restated as necessary to be compliant with our accounting policies under IFRS (see Note 2). Reconciliations and descriptions relating to the transition from Canadian GAAP to IFRS are included in Note 26.

The Consolidated Financial Statements were authorized by the board of directors for issue on February 15, 2012.

2. ACCOUNTING POLICIES

The accounting policies set out below were used to prepare the opening IFRS consolidated balance sheet at January 1, 2010 for the purposes of transitioning to IFRS, and have been applied consistently for all periods presented in these Consolidated Financial Statements.

(A)CONSOLIDATION

The Consolidated Financial Statements include the accounts of Nexen and our subsidiary companies. All subsidiary companies are wholly owned, with the exception of Canexus. All intercompany balances, transactions and profit or loss are eliminated upon consolidation.

In February 2011, we completed the sale of our 62.7% interest in Canexus. Prior to the sale, all assets, liabilities and results of operations of Canexus were consolidated and included in our 2010 Consolidated Financial Statements. Non-Nexen ownership interests in Canexus were shown as non-controlling interests. The operating results of Canexus for the twelve months ended December 31, 2011 and 2010 have been included in discontinued operations and the assets and liabilities were reclassified as held for sale as at December 31, 2010 (see Note 23).

We proportionately consolidate our undivided interests in oil and gas exploration, development and production activities conducted under joint venture arrangements. While the joint ventures under which these activities are carried out do not comprise distinct legal entities, they are operating entities. The significant operating policies of which are, by contractual arrangement, jointly controlled by all working interest parties.

(B)USE OF ESTIMATES AND JUDGMENTS

The preparation of financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities,

income and expenses. Judgments, estimates and underlying assumptions are reviewed on a continuous basis and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

In preparing our financial statements, we make judgments regarding the application of IFRS for our accounting policies. Significant judgments relate to the capitalization and depletion of oil and gas exploration and development costs, determination of functional currency for subsidiaries, recognition of tax assets, application of tax rules and regulations, interpretation of contracts and regulations as to what constitutes removal and remediation activities, and the identification of cash-generating units.

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## APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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The financial statement areas that require significant estimates and assumptions are set out in the following paragraphs:

### Oil and Gas Accounting-Reserves Determination

The process of estimating reserves is complex. It requires significant estimates based on available geological, geophysical, engineering and economic data. To estimate the economically recoverable crude oil and natural gas reserves and related future net cash flows, we incorporate many factors and assumptions including the expected reservoir characteristics, future commodity prices and costs and assumed effects of regulation by governmental agencies. Reserves are used to calculate the depletion of the capitalized oil and gas costs and for impairment purposes as described in Note 2(G).

### Property, Plant and Equipment

We evaluate our long-lived assets (oil and gas properties and goodwill) for impairment if indicators exist. Cash flow estimates for our impairment assessments require assumptions and estimates about the following primary elements-future prices, future operating and development costs, remaining recoverable reserves and discount rates. In assessing the carrying values of our unproved properties, we make assumptions about our future plans for those properties, the remaining terms of the leases and any other factors that may be indicators of potential impairment.

### Asset Retirement Obligations

In estimating our future asset retirement obligations, we make assumptions about activities that occur many years into the future including the cost and timing of such activities. The ultimate financial impact is not clearly known as asset removal and remediation techniques and costs are constantly changing, as are legal, regulatory, environmental, political, safety and other such considerations. In arriving at amounts recorded, numerous assumptions and estimates are made on ultimate settlement amounts, inflation factors, discount rates, timing and expected changes in legal, regulatory, environmental, political and safety environments.

### Contingencies

By their nature, contingencies will only be resolved when one or more future events transpire. The assessment of contingencies inherently involves estimating the outcome of future events.

### Income Taxes

We carry on business in several countries and as a result, are subject to income taxes in numerous jurisdictions. The determination of income tax is inherently complex and we are required to make certain estimates and assumptions about future events. While income tax filings are subject to audits and reassessments, we believe we have adequately provided for all income tax obligations. However, changes in facts and circumstances as a result of income tax audits, reassessments, jurisprudence and any new legislation may result in an increase or decrease in our provision for income taxes.

### Derivatives and Fair Value Measurements

The fair value of derivative contracts is estimated wherever possible, based on quoted market prices, and if not available, on estimates from third-party brokers. Another significant assumption that we use in determining the fair value of derivatives is market data or assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. The actual settlement of derivatives could differ materially from the fair value recorded and could impact future results.

(C)

#### CASH AND CASH EQUIVALENTS

Cash and cash equivalents includes short-term, highly liquid investments that mature within three months of their purchase.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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(D)

RESTRICTED CASH

Restricted cash includes margin deposits relating to our exchange-traded derivative contracts used in our energy marketing business.

(E)

ACCOUNTS RECEIVABLE

Accounts receivable are recorded based on our revenue recognition policy (see Note 2(N)). Our allowance for doubtful accounts provides for specific doubtful receivables, as well as general counterparty credit risk evaluated using observable market information and internal assessments.

(F)

INVENTORIES AND SUPPLIES

Inventories and supplies, other than inventory held for trading purposes by our energy marketing group, are stated at the lower of cost and net realizable value. Cost is determined using the first-in, first-out method. Inventory costs include expenditures and other costs, including depletion and depreciation, directly or indirectly incurred in bringing the inventory to its location and existing condition.

Commodity inventories in our energy marketing operations that are held for trading purposes are carried at fair value, less any costs to sell. Any changes in fair value are included as gains or losses in marketing and other income during the period of change.

(G)

PROPERTY, PLANT AND EQUIPMENT (PP&E)

PP&E includes capitalized costs related to our exploration and evaluation expenditures, assets under construction and producing oil and gas properties.

Exploration and Evaluation (E&E) Expenditures

Pre-License Expenditures

Pre-license expenditures are expensed in the period in which they are incurred.

License and Property Acquisition Expenditures

Exploration license and leasehold property acquisition expenditures are intangible assets that are capitalized as E&E costs in PP&E and are reviewed periodically for indications of potential impairment. This review includes confirming that exploration drilling is under way, firmly planned or that it has been determined or work is under way to determine, that the discovery is economically viable based on a range of technical and commercial considerations, and sufficient progress is being made to establish development plans and timing. If no future activity is planned, the remaining balance of the capitalized license and property acquisition costs is expensed. Licenses are amortized on a straight-line basis over the estimated period of exploration. Once proved reserves are discovered, technical feasibility and commercial viability are established and we decide to proceed with development, the remaining capitalized expenditure is transferred to either assets under construction or producing oil and gas properties.

Other Exploration and Evaluation Expenditures

Other exploration and evaluation costs, including drilling costs directly attributable to an identifiable exploration or appraisal well, are initially capitalized as an intangible asset until evaluation activities of the exploration play are completed. If hydrocarbons are not found, or not found in commercial quantities, the costs are expensed. If hydrocarbons are found and are likely to be capable of commercial development, the costs continue to be capitalized. These costs are reviewed periodically for indications of potential impairment. Capitalized costs are transferred to assets under construction or producing oil and gas properties after assessing the estimated fair value of the property and recognizing any potential impairment loss. Geological and geophysical costs and annual lease rental costs are expensed as incurred.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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### Producing Oil and Gas Properties

Producing oil and gas properties are carried at cost less accumulated depletion, depreciation, amortization, and impairment losses. The cost of an asset includes the initial purchase price and directly attributable expenditures to find, develop, construct and complete the asset. This includes installation or completion of infrastructure facilities such as platforms, pipelines and the drilling of development wells, including unsuccessful development or delineation wells. Any costs directly attributable to bringing the asset to the location and condition necessary to operate as intended by management and which result in an identifiable future benefit are also capitalized. This includes the estimate of any asset retirement obligation and, for qualifying assets, capitalized interest. Improvements that increase capacity or extend the useful lives of the related assets are capitalized. Major spare parts and standby equipment whose useful life is expected to last longer than one year are included in capitalized costs.

### Major Maintenance and Repairs

Expenditures on major maintenance of our producing assets include the cost of replacement assets or parts of assets, inspection costs or overhaul costs. Where an asset, or part of an asset that was separately depreciated, is replaced and it is probable that there are future economic benefits associated with the item, the expenditure is capitalized and the carrying amount of the replaced item is derecognized. Inspection costs associated with major maintenance programs and necessary for continued operation of the asset are capitalized and amortized over the period to the next inspection.

All other maintenance costs are expensed as incurred.

### Research and Development

We engage in research and development activities to develop or improve processing techniques to extract crude oil and natural gas. Research involves investigations to gain new knowledge. Development involves translating that knowledge into a new technology or process. Research costs are expensed as incurred. Development costs are deferred once technical feasibility is established and we intend to proceed with development. We defer these costs in PP&E until the asset is substantially complete and ready for productive use. Otherwise, development costs are expensed as incurred.

### Non-Monetary Asset Swaps

Exchanges or swaps of non-monetary assets are measured at fair value unless the exchange transaction lacks commercial substance or neither the fair value of the assets given up nor the assets received can be reliably estimated. The cost of the acquired asset is measured at the fair value of the asset given up, unless the fair value of the asset received is more clearly evident. Where fair value is not used, the cost of the acquired asset is measured at the carrying amount of the asset given up. Any gain or loss on derecognition of the asset given up is included in net income.

### Depreciation, Depletion, Amortization and Impairment (DD&A)

Unproved property costs and major projects under construction or development are not depreciated or depleted until commercial production commences. We amortize unproved land acquisition costs over the remaining lease term.



We review the useful lives of capitalized costs for producing oil and gas properties to determine the appropriate method of amortization. We deplete oil and gas capitalized costs using the unit-of-production method. Development drilling, equipping costs and other facility costs are depleted over remaining proved developed reserves and proved property acquisition costs are depleted over remaining proved reserves. Other facilities, plant and equipment which have significantly different useful lives than the associated proved reserves are depreciated in accordance with the asset's future use which range from two to 40 years. Depletion is considered a cost of inventory when the oil and gas is produced. When the inventory is sold, the depletion is charged to DD&A expense.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Depreciation methods, useful lives and residual values are reviewed annually, with any amendments considered to be a change in estimate and accounted for prospectively.

#### Impairment

Each reporting date, we assess whether there is an indication that an asset may be impaired. If any indication exists, we estimate the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's (CGU) fair value less any costs to sell or value-in-use. Where an asset does not generate separately identifiable cash flows, we perform an impairment test on CGUs, which are the smallest grouping of assets that generate independent, identifiable cash inflows. Where the carrying amount of an asset or CGU exceeds its recoverable amount, the asset is considered impaired and written down to its recoverable amount. In assessing value-in-use, the estimated future cash flows are discounted to their present value using a discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by external valuation metrics or other available fair value indicators wherever possible.

In assessing the carrying values of our unproved properties, we take into account future plans for those properties, the remaining terms of the leases and any other factors that may be indicators of potential impairment.

For assets excluding goodwill, an assessment is made each reporting date as to whether there is an indication that previously recognized impairment losses no longer exist or have decreased. If such indication exists, an estimate of the asset's or CGU's recoverable amount is reviewed. A previously recognized impairment loss is reversed to the extent that the events or circumstances that triggered the original impairment have changed. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of DD&A, had no impairment loss been recognized for the asset in prior periods.

#### (H)CAPITALIZED BORROWING COSTS

We capitalize interest on major development projects until construction is complete using the weighted-average interest rate on all of our borrowings. Capitalized interest cannot exceed the actual interest incurred.

#### (I)CARRIED INTEREST

We conduct certain international operations jointly with foreign governments in accordance with production-sharing agreements pursuant to which proved reserves are recognized using the economic interest method. Under these agreements, we pay both our share and the government's share of operating and capital costs. We recover the government's share of these costs from future revenues or production over several years. The government's share of operating costs is included in operating expense when incurred, and capital costs are included in PP&E and expensed to DD&A in the year recovered. All recoveries are recorded as revenue in the year of recovery.

#### (J)GOODWILL

Goodwill acquired in a business combination is initially recorded at cost, and for impairment testing purposes, is allocated to each of the CGUs that are expected to benefit from the expenditure. After initial recognition, goodwill is measured at cost less any accumulated impairment losses. We test goodwill for impairment at least annually as at December 31, or more frequently if events or circumstances indicate that goodwill may be impaired. We base our test

on the assessment of the recoverable amount of the CGU. Where the recoverable amount of the CGU is less than the carrying amount, we reduce the carrying value to the estimated recoverable amount and a goodwill impairment loss is included in net income.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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(K)FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

All financial assets and liabilities are recognized on the balance sheet initially at fair value when we become a party to the contractual provisions of the instrument. Subsequent measurement of the financial instruments is based on their classification. We classify each financial instrument into one of the following categories: financial assets and liabilities at fair value through profit or loss, loans or receivables, financial assets held to maturity, financial assets available for sale and other financial liabilities. The classification depends on the characteristics and the purpose for which the financial instruments were acquired. Except in limited circumstances, the classification of financial instruments is not subsequently changed.

Financial instruments carried at fair value on our balance sheet include cash and cash equivalents, restricted cash and derivatives. Realized and unrealized gains and losses from financial assets and liabilities carried at fair value are recognized in net income in the periods such gains and losses arise. Transaction costs related to these financial assets and liabilities are included in net income when incurred.

Financial instruments carried at cost or amortized cost include our accounts receivable, accounts payable and accrued liabilities, short-term borrowings and long-term debt. These transaction costs are included with the initial fair value, and the instrument is carried at amortized cost using the effective interest rate method. Gains and losses on financial assets and liabilities carried at cost or amortized costs are recognized in net income when these assets and liabilities settle.

Derivatives

We use derivative instruments such as physical purchase and sales contracts, exchange-traded futures and options, and non-exchange traded forwards, swaps and options for marketing crude oil and natural gas and to manage fluctuations in commodity prices, foreign currency exchange rates and interest rates. We record these instruments at fair value at each balance sheet date and changes in fair value are included in marketing and other income during the period of change unless the requirements for hedge accounting are met.

Hedge accounting

Hedge accounting is allowed when there is a high degree of correlation between price movements in the derivative instruments and the items designated as being hedged. Nexen formally documents all hedges and the risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges.

For cash flow hedges, changes in the fair value of a financial instrument designated as a cash flow hedge are recognized in net income in the same period as the hedged item. Any fair value change in the financial instrument before that period is recognized on the balance sheet. The effective portion of this fair value change is recognized in other comprehensive income, with any ineffectiveness recognized in net income during the period of change.

For fair value hedges, both the financial instrument designated as a fair value hedge and the underlying commitment are recognized on the balance sheet at fair value. Changes in the fair value of both are reflected in net income.

For hedges of net investments, gains and losses resulting from foreign exchange translation of our net investments in foreign operations and the effective portion of the hedging items are recorded in other comprehensive income.

Amounts included in cumulative translation adjustment are reclassified to net income when realized.

(L)PROVISIONS AND CONTINGENCIES

Provisions are recognized when we have a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where appropriate, the future cash flow estimates are adjusted to reflect the risks specific to the liability.

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## APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a discount rate that reflects current market assessments of the time value of money. Where discounting is used, the accretion of the provision due to the passage of time is recognized within finance costs.

Contingent liabilities are possible obligations which will be confirmed by future events that are not necessarily within our control, or are present obligations where the obligation cannot be measured reliably or it is not probable that settlement will be required. Contingent liabilities are disclosed only if the possibility of settlement is greater than remote. Contingent liabilities are not recorded in the financial statements.

### Asset Retirement Obligations and Environmental Expenditures

We provide for asset retirement obligations (ARO) on our resource properties, facilities, production platforms, pipelines and other facilities based on estimates established by current legislation and industry practices. ARO is initially measured at fair value and capitalized to PP&E as an asset retirement cost. The liability is estimated by discounting expected future cash flows required to settle the liability using a risk-free rate. The estimated future asset retirement costs may be adjusted for risks such as project, physical, regulatory and timing. The estimates are reviewed periodically. Changes in the provision as a result of changes in the estimated future costs or discount rates are added to or deducted from the cost of the PP&E in the period of the change. The liability accretes for the effect of time value of money until it is expected to settle. The asset retirement cost is amortized through DD&A over the life of the related asset. Actual asset retirement expenditures are recorded against the obligation when incurred. Any difference between the accrued liability and the actual expenditures incurred is recorded as a gain or loss in the settlement period.

Liabilities for environmental costs are recognized when a clean-up is probable and the associated costs can be reliably estimated. Environmental expenditures that relate to current or future revenues are expensed or capitalized as appropriate.

### (M)PENSION AND OTHER POST-RETIREMENT BENEFITS

Our employee post-retirement benefit programs consist of defined benefit and defined contribution pension plans, as well as other post-retirement benefit programs.

For our defined benefit plans, we provide retirement benefits to employees based on their length of service and final average earnings. The cost of pension benefits earned by employees in our defined benefit pension plans is actuarially determined using the projected-benefit method prorated on service and our best estimate of the plans' investment performance, salary escalations and retirement ages of employees. To calculate the plans' expected returns, assets are measured at fair value. Fair value measurement of the defined benefit assets are limited to the sum of any recognized net actuarial losses and past service costs, and the net present value of any economic benefit available in the form of surplus refunds to the plan or reductions in future contributions to the plan. Vested past service costs arising from plan amendments are recognized in other comprehensive income (OCI) immediately. Unvested past service costs are amortized over the expected average service life until they become vested. Net actuarial gains and losses are included in OCI as incurred with immediate recognition in retained earnings. Benefits paid out of Nexen's defined benefit plan are indexed to 75% of the annual rate of inflation less 1% to a maximum increase of 5%. The measurement date for our defined benefit plans is December 31.

Our defined contribution pension plan benefits are based on plan contributions. Company contributions to the defined contribution plan are expensed as incurred.

Other post-retirement benefits include group life and supplemental health insurance for eligible employees and their dependants. Costs are accrued as compensation in the period employees work; however, these future obligations are not funded.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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(N)REVENUE RECOGNITION

Revenue from the production of oil and gas is recognized when title passes to the customer. In Canada and the US, our customers primarily take title when the oil or gas reaches the end of the pipeline. For our other international operations, our customers generally take title when the crude oil is loaded onto tankers. When we sell more or less crude oil or natural gas than we produce, production overlifts and underlifts occur. We record overlifts as liabilities at fair value and underlifts as assets at cost. We settle these over time as liftings are equalized or in cash when production ends.

Revenue represents Nexen's share and is recorded net of royalty obligations to governments and other mineral interest owners. For our international operations, all government interests, except for income taxes, are considered royalty obligations. Our revenue also includes the recovery of carried interest costs paid on behalf of foreign governments in international locations.

(O)FOREIGN CURRENCY TRANSLATION

Our foreign operations are translated from their functional currency into Canadian dollars at the balance sheet date exchange rate for assets and liabilities and at the monthly average exchange rate for revenues and expenses. Gains and losses resulting from this translation are included in other comprehensive income.

We have designated our US-dollar debt as a hedge against our net investment in US-dollar foreign operations. Gains and losses resulting from the translation of the designated US-dollar debt are included in other comprehensive income. If our US-dollar debt, net of income taxes, exceeds our US-dollar investment in foreign operations, then the translation gains or losses attributable to such excess are included in net income.

Monetary balance sheet amounts denominated in a currency other than a functional currency are translated into the functional currency using exchange rates at the balance sheet dates. Gains and losses arising from this translation are included in net income. Non-monetary balance sheet amounts denominated in a currency other than a functional currency are translated using historical exchange rates at the time of the transaction.

(P)TRANSPORTATION

We pay to transport the oil and gas products that we have sold and often bill our customers for the transportation. This transportation cost is included in transportation and other expense. Amounts billed to our customers are presented within marketing and other income.

(Q)LEASES

We classify leases entered into as either finance or operating leases. Leases that transfer substantially all of the risks and benefits of ownership to us are capitalized as finance leases within PP&E and other liabilities. All other leases are recorded as operating leases and expensed as incurred within operating expenses.

(R)STOCK-BASED COMPENSATION

Our stock-based compensation programs consist of tandem option (TOPs), stock appreciation right (STARs), restricted share unit (RSUs) and deferred share unit (DSUs) plans.



TOPs to purchase common shares are granted to officers and employees at the discretion of the board of directors. Each TOP gives the holder a right to either purchase one Nexen common share at the exercise price or to receive a cash payment equal to the excess of the market price of the common share over the exercise price. TOPs granted vest over three years and are exercisable on a cumulative basis over five years. At the time of the grant, the exercise price equals the market price of the common share. In 2010, certain TOPs granted contained a performance vesting condition.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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We record obligations for the outstanding TOPs using the fair-value method of accounting and recognize compensation expense in net income. Obligations are accrued on a graded vesting basis and revalued each reporting period based on the change in the estimated fair value of the options outstanding. We reduce the liability when the options are surrendered for cash. When the options are exercised for stock, the accrued liability is transferred to share capital.

Under our STARs plan, employees are entitled to cash payments equal to the excess of market price of the common share over the exercise price of the right. The vesting period and other terms of the plan are similar to the TOPs plan and include a performance vesting condition for certain awards. At the time of grant, the exercise price equals the market price of the common share. We account for STARs to employees on the same basis as our TOPs. Obligations are accrued as compensation expense over the graded vesting period of the STARs.

The fair value of each TOP and STAR is estimated using a Black-Scholes option pricing methodology, which takes into account share performance, market conditions, and other terms and conditions. For those awards that contain a performance vesting condition, we use the Monte Carlo option pricing model to simulate expected returns and estimate the fair value. This is applied to the reward criteria of the performance TOPs and STARs to give an expected value each measurement date.

Under our RSU plan, employees are entitled to receive a cash payment equal to the average closing market price of one common share for the 20 days prior to the vesting date for each RSU granted. All RSUs vest evenly over three years and are exercised and paid automatically as they vest. The liability for RSUs is revalued each period based on the market price of our common shares and the number of graded vested RSUs outstanding. Beginning in 2011, certain RSUs granted contain a performance vesting condition.

For employees eligible to retire during the vesting period, the compensation expense is recognized over the period from the grant date to the retirement eligibility date on a graded vesting basis. In instances where an employee is eligible to retire on the grant date of the stock-based award, compensation expense is recognized in full at that date.

DSUs are equity-based awards granted to directors. The units accumulate over a director's term of service and vest when the director leaves the board. Payments may be made in cash or in Nexen common shares purchased on the open market at the company's discretion. At the time of grant, the exercise price equals the market value of Nexen common shares.

### (S)INCOME TAXES

The provision for income taxes comprises current amounts payable and deferred tax provisions. The provision for income taxes is recognized in net income except to the extent that it relates to items recognized directly in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to taxes payable in respect of previous years. Current tax assets and liabilities are offset to the extent the entity has the legal right to settle on a net basis.

Deferred tax assets and liabilities are recognized for temporary differences between reported amounts for financial statement and tax purposes. Deferred tax is not recognized for the following temporary differences: i) initial recognition of tax assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, ii) differences relating to investments in subsidiaries to the extent that it is

probable that they will not reverse in the foreseeable future, and iii) the initial recognition of goodwill. Deferred tax assets are only recognized for temporary differences, unused tax losses and unused tax credits if it is probable that future tax amounts will arise to utilize those amounts.

Deferred tax assets and liabilities are measured at tax rates that are expected to be applied to temporary differences when they reverse, based on the tax rates and laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and tax liabilities are offset to the extent there is a legal right to settle on a net basis.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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We do not provide for foreign withholding taxes on the undistributed earnings of our foreign subsidiaries, as we intend to invest such earnings in the respective foreign operations.

(T)CHANGES IN ACCOUNTING POLICIES

As part of our transition to IFRS, we have adopted all IFRS accounting standards in effect on December 31, 2011.

The following standards and interpretations have not been adopted as they apply to future periods. They may result in future changes to our existing accounting policies and other note disclosures. We are evaluating the impacts that these standards may have on our results of operations, financial position and disclosure, except where indicated.

IFRS 7 Financial Instruments: Disclosures – in December 2011, the International Accounting Standards Board (IASB) issued final amendments to the disclosure requirements for the offsetting of a financial asset and financial liabilities when offsetting is permitted under IFRS. The disclosure amendments are required to be adopted retrospectively for periods beginning January 1, 2013.

IFRS 9 Financial Instruments – in November 2009, the IASB issued IFRS 9 to address classification and measurement of financial assets. In October 2010, the IASB revised the standard to include financial liabilities. The standard is required to be adopted for periods beginning January 1, 2015. Portions of the standard remain in development and the full impact of the standard will not be known until the project is complete.

IFRS 10 Consolidated Financial Statements – in May 2011, the IASB issued IFRS 10 which provides additional guidance to determine whether an investee should be consolidated. The guidance applies to all investees, including special purpose entities. The standard replaces IAS 27 (which still contains guidance on separate financial statements) and is required to be adopted for periods beginning January 1, 2013. We do not expect the adoption of this standard to impact our results of operations or financial position.

IFRS 11 Joint Arrangements – in May 2011, the IASB issued IFRS 11 which presents a new model for determining whether an entity should account for joint arrangements using proportionate consolidation or the equity method. An entity will have to follow the substance rather than legal form of a joint arrangement and will no longer have a choice of accounting method. The standard also amends IAS 28 to include joint ventures and is required to be adopted for periods beginning January 1, 2013.

IFRS 12 Disclosure of Interests in Other Entities – in May 2011, the IASB issued IFRS 12 which aggregates and amends disclosure requirements included within other standards. The standard requires companies to provide disclosures about subsidiaries, joint arrangements, associates and unconsolidated structured entities. The standard is required to be adopted for periods beginning January 1, 2013. We expect this standard to result in additional disclosures in our financial statements.

IFRS 13 Fair Value Measurement – in May 2011, the IASB issued IFRS 13 to provide comprehensive guidance for instances where IFRS requires fair value to be used. The standard provides guidance on determining fair value and requires disclosures about those measurements. The standard is required to be adopted for periods beginning January 1, 2013. We do not expect a material impact on our results of operations or financial position.

IAS 1 Presentation of Items of Other Comprehensive Income – in June 2011, the IASB issued amendments to IAS 1 Presentation of Financial Statements to separate items of other comprehensive income (OCI) between those that are

reclassified to income and those that do not. The standard is required to be adopted for periods beginning on or after July 1, 2012. We do not expect a significant change to our presentation of items of other comprehensive income.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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IAS 19 Employee Benefits – in June 2011, the IASB issued amendments to IAS 19 to revise certain aspects of the accounting for pension plans and other benefits. The amendments eliminate the corridor method of accounting for defined benefit plans, change the recognition pattern of gains and losses and require additional disclosures. The standard is required to be adopted for periods beginning on or after January 1, 2013.

IAS 32 Financial Instruments: Presentation – in December 2011, the IASB issued amendments to address inconsistencies when applying the offsetting criteria outlined in this standard. These amendments clarify certain of the criteria required to be met in order to permit the offsetting of financial assets and financial liabilities. The standard is required to be adopted retrospectively for periods beginning January 1, 2014.

### 3. ACCOUNTS RECEIVABLE

	December 31 2011	December 31 2010	January 1 2010
Trade			
Energy Marketing	1,146	929	1,410
Oil and Gas	1,037	822	823
Other	3	2	44
	2,186	1,753	2,277
Non-Trade	73	80	99
	2,259	1,833	2,376
Allowance for Doubtful Receivables <sup>1</sup>	(12 )	(44 )	(54 )
Total <sup>2</sup>	2,247	1,789	2,322

<sup>1</sup> Includes a general provision of \$1 million and a specific provision against certain accounts. In 2011, allowance for doubtful receivables decreased as a result of reassessing prior impairment provisions. In 2010, allowance for doubtful receivables decreased primarily from a reduction in counterparty credit reserves.

<sup>2</sup> At December 31, 2010, accounts receivable related to our chemicals operations have been included with assets held for sale (see Note 23).

Receivables terms are up to 30 days and were current as of December 31, 2011, December 31, 2010 and January 1, 2010.

### 4. INVENTORIES AND SUPPLIES

	December 31 2011	December 31 2010	January 1 2010
Finished Products			

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Energy Marketing	230	452	548
Oil and Gas	36	35	25
Other	—	—	12
	266	487	585
Work in Process	6	5	7
Field Supplies	48	58	88
Total <sup>1</sup>	320	550	680

<sup>1</sup> At December 31, 2010, inventories and supplies related to our chemicals operations have been included with assets held for sale (see Note 23).

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## APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

## 5. PROPERTY, PLANT AND EQUIPMENT

## (A) CARRYING AMOUNT OF PP&amp;E

	Exploration and Evaluation	Assets Under Construction	Producing Oil & Gas Properties	Corporate and Other	Total
<b>Cost</b>					
As at January 1, 2010	2,393	1,045	20,020	1,849	25,307
Additions	1,092	693	696	243	2,724
Disposals/Derecognitions	(70 )	(8 )	(1,638 )	(122 )	(1,838 )
Transfers	(82 )	78	4	—	—
Exploration Expense	(328 )	—	—	—	(328 )
Transferred to Held for Sale	—	—	—	(1,207 )	(1,207 )
Other	36	15	408	(3 )	456
Effect of Changes in Exchange Rate	(51 )	(75 )	(603 )	(3 )	(732 )
As at December 31, 2010	2,990	1,748	18,887	757	24,382
Additions	1,056	734	693	92	2,575
Disposals/Derecognitions	(303 )	—	(2,004 )	(18 )	(2,325 )
Transfers	(1,253 )	(216 )	1,469	—	—
Exploration Expense	(368 )	—	—	—	(368 )
Other	65	31	493	—	589
Effect of Changes in Exchange Rate	19	50	294	6	369
As at December 31, 2011	2,206	2,347	19,832	837	25,222
<b>Accumulated Depreciation, Depletion &amp; Amortization (DD&amp;A)</b>					
As at January 1, 2010	360	11	9,325	942	10,638
DD&A	41	—	1,384	119	1,544
Disposals/Derecognitions	(59 )	(8 )	(1,378 )	(62 )	(1,507 )
Impairments	—	—	139	—	139
Transferred to Held for Sale	—	—	—	(578 )	(578 )
Other	1	—	(7 )	(5 )	(11 )
Effect of Changes in Exchange Rate	(12 )	(3 )	(409 )	2	(422 )
As at December 31, 2010	331	—	9,054	418	9,803
DD&A	50	—	1,210	78	1,338
Disposals/Derecognitions	(12 )	—	(1,938 )	(75 )	(2,025 )
Impairments	—	—	322	—	322
Other	(6 )	—	(8 )	—	(14 )
Effect of Changes in Exchange Rate	5	—	220	2	227
As at December 31, 2011	368	—	8,860	423	9,651



Net Book Value

As at January 1, 2010	2,033	1,034	10,695	907	14,669
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As at December 31, 2010	2,659	1,748	9,833	339	14,579
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As at December 31, 2011	1,838	2,347	10,972	414	15,571
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Exploration and evaluation assets mainly comprise of unproved properties and capitalized exploration drilling costs. Assets under construction primarily include our Usan development, offshore Nigeria and developments in the UK North Sea.

## (B) IMPAIRMENT

DD&A expense for 2011 includes non-cash impairment charges of \$322 million for our oil and gas properties in our Conventional North America segment. Canadian natural gas assets were impaired \$234 million in the second half of 2011 due to lower estimated future natural gas prices and performance-related negative reserve revisions. In the fourth quarter, lower estimated future natural gas prices and higher estimated future abandonment costs resulted in an \$88 million impairment of mature Gulf of Mexico properties.

DD&A expense for 2010 includes non-cash impairment charges of \$139 million for properties in the US Gulf of Mexico and Canada. In the second half of 2010, low natural gas prices, higher estimated future abandonment costs and declining production performance impaired these properties.

The properties were written down to the higher amount of value-in-use and estimated fair value less costs to sell. We estimated fair value based on discounted future net cash flows using estimated future prices, a discount rate of 9% and management's estimate of future production, capital and operating expenditures.

## (C) ASSET DERECOGNITIONS

Nexen's original strategy for future oil sands development was to build duplicates of the existing Long Lake SAGD facilities and upgrader. We now expect to pursue smaller, phased, SAGD-only projects and we will consider adding upgrading capacity once we are bitumen-long and economic conditions are favourable. As a result, previously capitalized design and engineering costs of \$253 million on the future phases have been expensed.

## 6. GOODWILL

## (A) CARRYING AMOUNT OF GOODWILL

Goodwill

As at January 1, 2010	330
Effect of Changes in Exchange Rate	(15 )
Dispositions	(29 )
As at December 31, 2010	286
Effect of Changes in Exchange Rate	7
Dispositions	(2 )
As at December 31, 2011	291

December 31      December 31      January 1

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	2011	2010	2010
UK Conventional	284	277	292
Corporate and Other	7	9	38
Total	291	286	330

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## (B) IMPAIRMENT TESTING OF GOODWILL

Goodwill is attributable to our UK Conventional and Corporate and Other segments which have been allocated for impairment testing purposes to the cash-generating units that reflect the lowest level at which goodwill is attributable.

## UK Conventional

The recoverable amount of the UK group was based on cash flow projections discounted at a rate of 9%. The significant assumptions used in the cash flow projections are:

Commodity prices: these assumptions are based on estimated future prices, the global supply-demand balance for each commodity, other macroeconomic factors, historical trends and variability.

Discount rates: the rates used in the calculation are based on an industry-specific discount rate, adjusted to take into consideration country and project risks specific to the cash-generating unit.

Production volumes, capital investment and operating costs: estimated future operational activities and costs are based on current estimated asset development plans, past experience and available knowledge about costs and reservoir performance.

## 7. OTHER LONG-TERM ASSETS

	December 31 2011	December 31 2010	January 1 2010
Long-Term Capital Prepayments	46	43	27
Defined Benefit Pension Asset (Note 16)	–	21	21
Long-Term Investments	41	–	–
Other	65	38	53
Total <sup>1</sup>	152	102	101

<sup>1</sup> At December 31, 2010, other long-term assets related to our chemical operations have been included in assets held for sale (see Note 23).

## 8. FINANCIAL INSTRUMENTS

Financial instruments carried at fair value on our balance sheet include cash and cash equivalents, restricted cash and derivatives used for trading and non-trading purposes. Our other financial instruments, including accounts receivable, accounts payable and accrued liabilities, current income taxes payable, short-term borrowings and long-term debt, are carried at cost or amortized cost. The carrying value of our short-term receivables and payables approximates fair value because the instruments are near maturity.

## (A) DERIVATIVES

In our energy marketing group, we enter into contracts to purchase and sell crude oil, natural gas and other energy commodities, and use derivative contracts, including futures, forwards, swaps and options, for hedging and trading purposes (collectively derivative contracts). We also use derivatives to manage commodity price risk and foreign currency risk for non-trading purposes. We categorize our derivative instruments between trading and non-trading activities and carry the instruments at fair value on our balance sheet. The fair values are included in derivative contracts and are classified as long-term or short-term based on anticipated settlement date and, where applicable, are presented net on the balance sheet in accordance with netting arrangements. Any change in fair value is included in marketing and other income. Related amounts posted as margin for exchange-traded positions are recorded in restricted cash.

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Total carrying value of derivative contracts

The fair value and carrying amounts related to derivative contracts are as follows:

	December 31 2011	December 31 2010	January 1 2010
Commodity Contracts	119	158	476
Foreign Exchange Contracts	–	–	3
Derivative Contracts – Current	119	158	479
Commodity Contracts	25	116	229
Derivative Contracts – Long-Term <sup>1</sup>	25	116	229
Total Derivative Assets	144	274	708
Commodity Contracts	103	168	436
Foreign Exchange Contracts	–	–	46
Derivative Contracts – Current	103	168	482
Commodity Contracts	24	115	210
Derivative Contracts – Long-Term <sup>1</sup>	24	115	210
Total Derivative Liabilities	127	283	692
Total Net Derivative Contracts	17	(9 )	16

1 These derivative contracts settle beyond 12 months and are considered non-current.

#### Derivative contracts related to trading

Our energy marketing group primarily focuses on crude oil marketing activities in North American and international markets. During 2010, we sold substantially all of our North American natural gas marketing operations, our oil lease gathering, pipeline and storage assets in North Dakota and Montana and our European gas and power marketing operations, as described in Note 23.

Trading revenues generated by our energy marketing group include gains and losses on derivative instruments and non-derivative instruments such as physical inventory. During the years ended December 31, 2011 and 2010, the following revenues were recognized in marketing and other income:

	2011	2010
Commodity	200	342
Foreign Exchange	(5 )	(5 )
Marketing Revenue, Net	195	337

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## Derivative contracts related to non-trading activities

During 2011, we purchased crude oil put options on 100,000 bbls/d of our 2012 crude oil production for \$52 million. These options establish a monthly Dated Brent floor price of US\$65/bbl on 60,000 bbls/d and an annual Dated Brent floor price of \$75/bbl on 40,000 bbls/d. The put options provide a base level of price protection without limiting our upside to higher prices. The options settle monthly or annually and unexpired options are recorded at fair value throughout their term. As a result, changes in forward crude oil prices create gains or losses on these options at each reporting period. At December 31, 2011, higher crude oil prices reduced the fair value of the options to approximately \$38 million, and we recorded a fair value loss during the period of \$14 million in marketing and other income.

In 2010, we purchased put options on 100,000 bbls/d of our 2011 crude oil production for \$33 million. These options established a monthly WTI floor price between US\$50/bbl and US\$63/bbl on these volumes. At December 31, 2010, higher crude oil prices reduced the fair value of the options to \$9 million, and we recorded a fair value loss of \$24 million during 2010 in marketing and other income. Strengthening crude prices in 2011 reduced the fair value of these options to nil and we recorded a fair value loss of \$9 million in 2011.

			December 31, 2011		
			Average		
	Notional		Floor		Change in
	Volumes	Term	Price	Fair Value (Cdn\$ millions)	Fair Value (Cdn millions)
	(bbls/d)		(US\$/bbl)		
Dated Brent Crude Oil					
Put Options (annual)	40,000	2012	75	16	
Dated Brent Crude Oil					
Put Options (monthly)	60,000	2012	65	22	
			December 31, 2010		
			Average		
	Notional		Floor		Change in
	Volumes	Term	Price	Fair Value (Cdn\$ millions)	Fair Value (Cdn millions)
	(bbls/d)		(US\$/bbl)		
WTI Crude Oil Put					
Options (monthly)	100,000	2011	56	9	(24 )

(B)

## FAIR VALUE OF FINANCIAL INSTRUMENTS

Fair value of derivatives

For purposes of estimating the fair value of our derivative contracts, wherever possible, we utilize quoted market prices and, if not available, estimates from third-party brokers. These broker estimates are corroborated with multiple sources and/or other observable market data utilizing assumptions that market participants would use when pricing the asset or liability, including assumptions about risk and market liquidity. Inputs may be readily observable, market-corroborated or generally unobservable. We utilize valuation techniques that seek to maximize the use of observable inputs and minimize the use of unobservable inputs. To value longer-term transactions and transactions in less active markets for which pricing information is not generally available, unobservable inputs may be used.

We classify financial instruments carried at fair value according to the following hierarchy based on the amount of observable inputs used to value the instruments.

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Level – Quoted prices are available in active markets  
1 for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 consists of financial instruments such as exchange-traded derivatives, and we use information from markets such as the New York Mercantile Exchange.

Level – Pricing inputs are other than quoted prices in  
2 active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reported date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value, volatility factors and broker quotations, which can be substantially observed or corroborated in the marketplace. Instruments in this category include non-exchange traded derivatives such as over-the-counter physical forwards and options, including those that have prices similar to quoted market prices. We obtain information from sources such as the Natural Gas Exchange, independent price publications and over-the-counter broker quotes.

Level – Valuations in this level are those with inputs  
3 that are less observable, unavailable or where the observable data does not support the majority of the instrument's fair value. Level 3 instruments may include items based on pricing services or broker quotes where we are unable to verify the observability of inputs into their prices. Level 3 instruments include longer- term transactions, transactions in less active markets or transactions at locations for which pricing information is not available. In these instances, internally developed methodologies are used to determine fair value, which primarily includes extrapolation of observable future prices to

similar locations, similar instruments or later time periods.

Cash and restricted cash are valued using level 1 inputs. The following tables include our derivatives carried at fair value for our trading and non-trading activities as at December 31, 2011 and 2010 and as at January 1, 2010. Financial assets and liabilities are classified in the fair value hierarchy in their entirety based on the lowest level of input that is significant to the fair value measurement. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect placement within the fair value hierarchy levels.

Net Derivatives at December 31, 2011	Level 1	Level 2	Level 3	Total
Trading Derivatives	(17 )	(1 )	(3 )	(21 )
Non-Trading Derivatives	–	38	–	38
Total	(17 )	37	(3 )	17

Net Derivatives at December 31, 2010	Level 1	Level 2	Level 3	Total
Trading Derivatives	(17 )	(18 )	17	(18 )
Non-Trading Derivatives	–	9	–	9
Total	(17 )	(9 )	17	(9 )

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Net Derivatives at January 1, 2010	Level 1	Level 2	Level 3	Total
Trading Derivatives	(143 )	126	42	25
Non-Trading Derivatives	–	(9 )	–	(9 )
Total	(143 )	117	42	16

A reconciliation of changes in the fair value of our derivatives classified as Level 3 for the years ended December 31, 2011 and 2010 is provided below:

	2011	2010
Level 3 Net Derivatives at January 1	17	42
Realized and Unrealized Gains (Losses)	(34 )	19
Settlements	14	(44 )
Level 3 Net Derivatives at December 31	(3 )	17
Unsettled Gains (Losses) Relating to Instruments Still Held as of December 31	(3 )	19

Items classified in Level 3 are generally economically hedged such that gains or losses on positions classified in Level 3 are often offset by gains or losses on positions classified in Level 1 or 2. We performed a sensitivity analysis of inputs used to calculate the fair value of Level 3 instruments. Using reasonably possible alternative assumptions, the fair value of Level 3 instruments at December 31, 2011 could change by \$8 million.

#### Fair value of long-term debt

We carry our long-term debt at amortized cost using the effective interest method. At December 31, 2011, the estimated fair value of our long-term debt was \$4,848 million (December 31, 2010 – \$5,290 million) as compared to the carrying value of \$4,383 million (December 31, 2010 – \$5,090 million). The fair value of long-term debt is estimated based on prices provided by quoted markets and third-party brokers.

## 9. RISK MANAGEMENT

### (A) MARKET RISK

We invest in significant capital projects, purchase and sell commodities, issue short-term borrowings and long-term debt, and invest in foreign operations. These activities expose us to market risks from changes in commodity prices, foreign currency rates and interest rates, which could affect our earnings and the value of the financial instruments we hold. We use derivatives as part of our overall risk management policy to manage these market exposures.

The following market risk discussion focuses on the commodity price risk and foreign currency risk related to our financial instruments as our exposure to interest rate risk is immaterial given that the majority of our debt is fixed rate.

#### Commodity price risk

We are exposed to commodity price movements as part of our normal oil and gas operations, particularly in relation to the prices received for our crude oil and natural gas. Commodity price risk related to crude oil prices is our most significant market risk exposure. Crude oil and natural gas prices are sensitive to numerous worldwide factors, many of which are beyond our control, and are generally sold at contract or posted prices. Changes in the global supply and demand fundamentals in

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the crude oil market and geopolitical events can significantly affect crude oil prices. Changes in crude oil and natural gas prices may significantly affect our results of operations and cash generated from operating activities. Consequently, these changes may also affect the value of our oil and gas properties, our level of spending for exploration and development, and our ability to meet our obligations as they come due.

The majority of our oil and gas production is sold under short-term contracts, exposing us to the risk of price movements. Other energy contracts we enter into also expose us to commodity price risk between the time we purchase and sell contracted volumes. We actively manage these risks by using derivative contracts such as commodity put options.

We market and trade physical energy commodities, including crude oil, natural gas and other commodities in selected regions of the world. We accomplish this by buying and selling physical commodities, by acquiring and holding rights to physical transportation and storage assets for these commodities, and by building relationships with our customers and suppliers. In order to manage the commodity and foreign exchange price risks that come from this physical business, we use financial derivative contracts including energy-related futures, forwards, swaps and options, as well as foreign currency swaps or forwards.

Our risk management activities make use of tools such as Value-at-Risk (VaR) and stress testing. VaR is a statistical estimate of the expected profit or loss of a portfolio of positions assuming normal market conditions. We use a 95% confidence interval and an assumed five-day holding period in our measure, although actual results can differ from this estimate in abnormal market conditions, or if positions are held longer than five days based on market views or a lack of market liquidity to exit them. We estimate VaR primarily by using the Variance-Covariance method based on historical commodity price volatility and correlation inputs where available, and by historical simulation in other situations. Our estimate is based upon the following key assumptions:

changes in commodity prices are either normally or “T” distributed;

price volatility is comparable to prior periods; and

price correlation relationships remain stable.

We have defined VaR limits for different segments of our energy marketing business. These limits are calculated on an economic basis and include physical and financial derivatives, as well as physical transportation and storage capacity contracts accounted for as executory contracts in our financial statements. We monitor our positions against these VaR limits daily. Our year-end, annual high, annual low and average VaR amounts are as follows:

	2011	2010
(Cdn\$ millions)		
Value-at-Risk		
Year-End	7	17
High	17	24
Low	2	6
Average	9	16

If a significant market shock occurred, the key assumptions underlying our VaR estimate could be exceeded and the potential loss could be greater than our estimate. We perform stress tests on a regular basis to complement VaR and assess the impact of abnormal changes in prices on our positions.

Foreign currency risk

Foreign currency risk is created by fluctuations in the fair values or cash flows of financial instruments due to changes in foreign exchange rates. A substantial portion of our activities are transacted in or referenced to US dollars including:

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sales of crude oil and natural gas products;

capital spending and expenses in our oil and gas activities;

commodity derivative contracts used primarily by our energy marketing group; and

short-term borrowings and long-term debt.

We manage our exposure to fluctuations between the US and Canadian dollar by matching our expected net cash flows and borrowings in the same currency. Cash flows generated by our foreign operations and borrowings on our US-dollar debt facilities are generally used to fund US-dollar capital expenditures and debt repayments. We maintain revolving Canadian and US-dollar borrowing facilities that can be drawn upon or repaid depending on expected new cash flows.

We designate most of our US-dollar borrowings as a hedge against our US-dollar net investment in our foreign operations. The accumulated foreign exchange gains or losses related to the effective portion of our designated US-dollar debt are included in cumulative translation adjustment in shareholders' equity. Our net investment in foreign operations and our designated US-dollar debt at December 31, 2011 and 2010 are as follows:

	December 31 2010	December 31 2011
(US\$ millions)		
Net Investment in Foreign Operations	4,191	4,680
Designated US-Dollar Debt	3,673	3,842

A one-cent change in the US dollar to Canadian dollar exchange rate would increase or decrease our cumulative translation adjustment by approximately \$37 million, net of income tax, and would not have a material impact on our net income.

We also have exposures to currencies other than the US dollar, including a portion of our UK operating expenses, capital spending and future asset retirement obligations, which are denominated in British Pounds and Euros. We do not have any material exposure to highly inflationary foreign currencies. Our energy marketing group enters into transactions in various currencies including Canadian and US dollars, British Pounds and Euros. We may actively manage significant currency exposures using forward contracts and swaps.

Our sensitivities to the US/Canadian dollar exchange rate and the expected impact of a one-cent change on our 2012 cash flow from operating activities, net income, capital expenditures and long-term debt are as follows:

	Cash Flow	Net Income	Capital Expenditures	Long-Term Debt
(Cdn\$ millions)				
\$0.01 Change in US to Cdn	30	14	20	44

(B) CREDIT RISK

Credit risk affects our oil and gas operations and our energy marketing activities, and is the risk of loss if counterparties do not fulfill their contractual obligations. Most of our credit exposures are with counterparties in the energy industry, including integrated oil companies, refiners and utilities, and are subject to normal industry credit risk. Over 75% of our exposure is with these large energy companies. This concentration of risk within the energy industry is reduced because of our broad base of domestic and international counterparties. We take the following measures to reduce this risk:

assess the financial strength of our counterparties through a credit analysis process;

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limit the total exposure extended to individual counterparties, and may require collateral from some counterparties;

routinely monitor credit risk exposures, including sector, geographic and corporate concentrations of credit, and report these to management and the board of directors;

set and regularly review counterparty credit limits based on rating agency credit ratings and internal assessments of company and industry analysis; and

use standard agreements where possible that allow for the netting of exposures associated with a single counterparty.

We believe these measures minimize our overall credit risk; however, there can be no assurance that these processes will protect us against all losses from non-performance.

At December 31, 2011, only three counterparties individually made up more than 10% of our credit exposure. These counterparties are major integrated oil companies with strong investment-grade credit ratings.

The following table illustrates the composition of credit exposure by credit rating:

	December 31 2010		December 31 2011	
Credit Rating				
A or higher	60	%	71	%
BBB	31	%	20	%
Non-Investment Grade	9	%	9	%
Total	100	%	100	%

Our maximum counterparty credit exposure at the balance sheet date consists primarily of the carrying amounts of non-derivative financial assets such as cash and cash equivalents, restricted cash, accounts receivable, as well as the fair value of derivative financial assets. We have provided a general allowance of \$1 million for credit risk with our counterparties.

Collateral received from customers at December 31, 2011 includes \$17 million of cash and \$568 million of letters of credit. The cash received is included in accounts payable and accrued liabilities.

### (C) LIQUIDITY RISK

Liquidity risk is the risk that we will not be able to meet our financial obligations as they fall due. We require liquidity specifically to fund capital requirements, satisfy financial obligations as they become due, and to operate our energy marketing business. We generally rely on operating cash flows to provide liquidity as well as maintain significant undrawn committed credit facilities. At December 31, 2011, we had approximately \$4.2 billion of cash and available committed lines of credit. This includes \$845 million of cash and cash equivalents on hand and undrawn term credit facilities of \$3.8 billion, of which \$367 million was supporting letters of credit at December 31, 2011. Of these term credit facilities, \$3.1 billion is available until 2016, with the remainder available until 2014. We also had \$393 million

of uncommitted, unsecured credit facilities, of which \$21 million was supporting letters of credit outstanding at December 31, 2011. Of these uncommitted facilities, \$213 million is available exclusively for supporting letters of credit.

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The following table details the contractual maturities for our non-derivative financial liabilities, including both the principal and interest cash flows at December 31, 2011:

(Cdn\$ millions)	Total	< 1 Year	1-3 Years	4-5 Years	> 5 Years
Long-Term Debt	4,463	–	–	128	4,335
Cumulative Interest on Long-Term Debt <sup>1</sup>	6,978	301	601	589	5,487
Total	11,441	301	601	717	9,822

<sup>1</sup> At December 31, 2011, none of our variable interest rate debt was drawn.

The following table details contractual maturities for our derivative financial liabilities at December 31, 2011. The consolidated balance sheet amounts for derivative financial liabilities included below are not materially different from the contractual amounts due on maturity.

(Cdn\$ millions)

Net Derivative Contracts

(Note 8)	Total	< 1 Year	1-3 Years	4-5 Years	> 5 Years
	127	103	23	1	–

At December 31, 2011, collateral posted with counterparties includes \$388 million of letters of credit. Cash posted is included with accounts receivable. Cash collateral is not normally applied to contract settlement. Once a contract has been settled, the collateral amounts are refunded. If there is a default, the cash is retained.

The commercial agreements our energy marketing group enter into often include financial assurance provisions that allow us and our counterparties to effectively manage credit risk. The agreements normally require collateral to be posted if an adverse credit-related event occurs, such as a drop in credit ratings to non-investment grade. Based on the derivative contracts in place and commodity prices at December 31, 2011, we could be required to post collateral of approximately \$704 million if we were downgraded to non-investment grade. These obligations are reflected on our balance sheet and the posting of collateral merely secures the payment of such amounts. We have significant undrawn credit facilities and cash to fund these potential collateral requirements.

Our exchange-traded derivative contracts are also subject to margin requirements. We have margin deposits at December 31, 2011 of \$45 million (2010 – \$40 million), which have been included in restricted cash.

# 10. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	December 31 2011	December 31 2010	January 1 2010
Energy Marketing Payables	1,287	1,016	1,366
Accrued Payables	1,035	676	619

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Trade Payables	288	164	210
Other	122	147	108
Accrued Interest Payable	78	83	89
Stock-Based Compensation	31	111	173
Dividends Payable	26	26	26
Total <sup>1</sup>	2,867	2,223	2,591

<sup>1</sup>At December 31, 2010, accounts payable and accrued liabilities related to our chemical operations have been included in liabilities held for sale (see Note 23).

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## 11. LONG-TERM DEBT

	December 31 2011	December 31 2010	January 1 2010
Term Credit Facilities (A)	–	–	1,570
Notes, due 2013 (B)	–	497	523
Notes, due 2015 (US\$126 million) (C)	128	249	262
Notes, due 2017 (US\$62 million) (D)	63	249	262
Notes, due 2019 (US\$300 million) (E)	305	298	314
Notes, due 2028 (US\$200 million) (F)	203	199	209
Notes, due 2032 (US\$500 million) (G)	509	497	523
Notes, due 2035 (US\$790 million) (H)	804	786	827
Notes, due 2037 (US\$1,250 million) (I)	1,271	1,243	1,308
Notes, due 2039 (US\$700 million) (J)	712	696	733
Subordinated Debentures, due 2043 (US\$460 million) (K)	468	457	481
	4,463	5,171	7,012
Unamortized Debt Issue Costs	(80 )	(81 )	(88 )
	4,383	5,090	6,924
Canexus Debt <sup>1</sup>	–	–	335
Total	4,383	5,090	7,259

<sup>1</sup>At December 31, 2010, long term debt related to our chemical operations have been included in liabilities held for sale (see Note 23).

## (A) TERM CREDIT FACILITIES

We have committed unsecured term credit facilities of \$3.8 billion (US\$3.7 billion), which were not drawn at either December 31, 2011 or December 31, 2010 (January 1, 2010 – \$1.6 billion (US\$1.5 billion)). Of these facilities, \$700 million is available until 2014 and \$3.1 billion is available until 2016. Borrowings are available as Canadian bankers' acceptances, LIBOR-based loans, Canadian prime rate loans, US-dollar base rate loans or British pound call-rate loans. Interest is payable at floating rates. At December 31, 2011, \$367 million of these facilities were utilized to support outstanding letters of credit (December 31, 2010 – \$322 million and January 1, 2010 – \$407 million).

## (B) NOTES, DUE 2013

During November 2003, we issued US\$500 million of notes. Interest was payable semi-annually at a rate of 5.05% and the principal was to be repaid in November 2013. In 2011, we redeemed and cancelled these notes. We paid \$525 million for the redemption. We recorded a \$52 million loss as the difference between carrying value and the

redemption price.

(C) NOTES, DUE 2015

During March 2005, we issued US\$250 million of notes. Interest is payable semi-annually at a rate of 5.2% and the principal is to be repaid in March 2015. In 2011, we repurchased and cancelled US\$124 million of principal of these notes. We paid \$135 million for the repurchase and recorded a \$14 million loss as the difference between the carrying value and the redemption price. At December 31, 2011, US\$126 million of notes remain outstanding. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.15%.

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## (D) NOTES, DUE 2017

During May 2007, we issued US\$250 million of notes. Interest is payable semi-annually at a rate of 5.65% and the principal is to be repaid in May 2017. In 2011, we repurchased and cancelled US\$188 million of principal of these notes. We paid \$211 million for the repurchase and recorded a \$25 million loss as the difference between the carrying value and the redemption price. At December 31, 2011, US\$62 million of notes remain outstanding. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to maturity equal to the remaining term of the notes plus 0.20%.

## (E) NOTES, DUE 2019

During July 2009, we issued US\$300 million of notes. Interest is payable semi-annually at a rate of 6.2% and the principal is to be repaid in July 2019. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.40%.

## (F) NOTES, DUE 2028

During April 1998, we issued US\$200 million of notes. Interest is payable semi-annually at a rate of 7.4% and the principal is to be repaid in May 2028. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.25%.

## (G) NOTES, DUE 2032

During March 2002, we issued US\$500 million of notes. Interest is payable semi-annually at a rate of 7.875% and the principal is to be repaid in March 2032. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.375%.

## (H) NOTES, DUE 2035

During March 2005, we issued US\$790 million of notes. Interest is payable semi-annually at a rate of 5.875% and the principal is to be repaid in March 2035. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.20%.

## (I) NOTES, DUE 2037

During May 2007, we issued US\$1,250 million of notes. Interest is payable semi-annually at a rate of 6.4% and the principal is to be repaid in May 2037. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.35%.

## (J) NOTES, DUE 2039

During July 2009, we issued US\$700 million of notes. Interest is payable semi-annually at a rate of 7.5% and the principal is to be repaid in July 2039. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.45%.

(K) SUBORDINATED DEBENTURES, DUE 2043

During November 2003, we issued US\$460 million of unsecured subordinated debentures. Interest is payable quarterly at a rate of 7.35%, and the principal is to be repaid in November 2043. We may redeem part or all of the debentures at any time. The redemption price is equal to the par value of the principal amount plus any accrued and unpaid interest to the redemption date. We may choose to redeem the principal amount with either cash or common shares.

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## (L) LONG-TERM DEBT REPAYMENTS

The following schedule outlines the required timetable of debt repayments and does not preclude earlier repayments as per the provisions of the respective notes.

2012	–
2013	–
2014	–
2015	128
2016	–
Thereafter	4,335
Total	4,463

## (M) DEBT COVENANTS

Some of our debt instruments contain covenants with respect to certain financial ratios and our ability to grant security. We are required to maintain a debt to EBITDA ratio of less than 3.5. For the year ended December 31, 2011, this ratio was 0.95 times (2010 – 1.29). At December 31, 2011, December 31, 2010 and January 1, 2010, we were in compliance with all covenants.

## (N) CREDIT FACILITIES

Nexen has uncommitted, unsecured credit facilities of approximately \$180 million (US\$178 million), none of which were drawn at December 31, 2011, December 31, 2010 or January 1, 2010. We utilized \$17 million of these facilities to support outstanding letters of credit at December 31, 2011 (December 31, 2010– \$112 million and January 1, 2010 – \$86 million). Interest is payable at floating rates. Nexen has uncommitted, unsecured credit facilities exclusive to letters of credit of approximately \$213 million (US\$210 million). We utilized \$4 million of these facilities to support outstanding letters of credit at December 31, 2011 (December 31, 2010 – nil and January 1, 2010 – nil).

## 12. FINANCE EXPENSE

	2011	2010
Long-Term Debt Interest Expense	304	361
Accretion Expense Related to Asset Retirement Obligations	44	47
Other Interest Expense and Fees	27	34
Total	375	442
Less: Capitalized at 6.7% (2010 – 5.8%)	(124 )	(80 )
Total	251	362

1 Excludes finance expense related to our chemical operations (see Note 23).

Capitalized interest relates to and is included as part of the cost of our oil and gas properties. The capitalization rates are based on our weighted-average cost of borrowings.

### 13. CAPITAL MANAGEMENT

Our objective for managing our capital structure is to ensure that we have the financial capacity, liquidity and flexibility to fund our investment in full-cycle exploration and development of conventional and unconventional resources and for our energy marketing activities. We generally rely on operating cash flows to fund capital investments. However, given the long cycle-time of some of our development projects, which require

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significant capital investment prior to cash flow generation, and volatile commodity prices, it is not unusual for capital expenditures to exceed our cash flow from operating activities in any given period. As such, our financing needs depend on the timing of expected net cash flows in a particular development or commodity cycle. This requires us to maintain financial flexibility and liquidity. Our capital management policies are aimed at:

maintaining an appropriate balance between short-term borrowings, long-term debt and equity;

maintaining sufficient undrawn committed credit capacity to provide liquidity;

ensuring ample covenant room permitting us to draw on credit lines as required; and

ensuring we maintain a credit rating that is appropriate for our circumstances.

We have the ability to change our capital structure by issuing additional equity or debt, returning cash to shareholders and making adjustments to our capital investment programs. Our capital consists of equity, short-term borrowings, long-term debt and cash and cash equivalents as follows:

	December 31 2011	December 31 2010	January 1 2010
Net Debt <sup>1</sup>			
Long-Term Debt	4,383	5,090	7,259
Less: Cash and Cash Equivalents	(845 )	(1,005 )	(1,700 )
Total <sup>2</sup>	3,538	4,085	5,559
Equity <sup>3</sup>	8,373	7,814	6,787

<sup>1</sup>Includes all of our borrowings and is calculated as long-term debt and short-term borrowings less cash and cash equivalents.

<sup>2</sup>December 31, 2010 excludes net debt related to our chemical operations that are included in assets and liabilities held for sale (see Note 23).

<sup>3</sup>Equity is the historical issue of equity and accumulated retained earnings.

We monitor the leverage in our capital structure and the strength of our balance sheet by reviewing the ratio of net debt to adjusted cash flow (cash flow from operating activities before changes in non-cash working capital and other).

Net debt and adjusted cash flow are non-GAAP measures that are unlikely to be comparable to similar measures presented by others. We calculate net debt using the GAAP measures of long-term debt and short-term borrowings less cash and cash equivalents (excluding restricted cash).

For the twelve months ended December 31, 2011 the net debt to adjusted cash flow was 1.5 times compared to 1.9 times at December 31, 2010. While we typically expect the target ratio to fluctuate between 1.0 and 2.0 times under normalized commodity prices, this can be higher or lower depending on commodity price volatility, where we are in the investment cycle, or when we identify strategic opportunities requiring additional investment. Whenever we

exceed our target ratio, we assess whether we need to develop a strategy to reduce our leverage and lower this ratio back to target levels over time. Our objectives for managing our capital structure or targets have not changed from last year.

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## 14. ASSET RETIREMENT OBLIGATIONS

Changes in carrying amounts of our ARO provision are as follows:

	2011	2010
ARO, Beginning of Year	1,571	1,432
Obligations Incurred with Development Activities	69	81
Changes in Estimates	450	332
Obligations Related to Dispositions	(9 )	(224 )
Obligations Settled	(72 )	(43 )
Accretion	44	47
Effects of Changes in Foreign Exchange Rates	23	(54 )
ARO, End of Year <sup>1</sup>	2,076	1,571
Of which:		
Due Within Twelve Months <sup>2</sup>	66	55
Due After Twelve Months	2,010	1,516

<sup>1</sup>At December 31, 2010, asset retirement obligations related to our chemicals operations have been included in liabilities held for sale (see Note 23).

<sup>2</sup>Included in accounts payable and accrued liabilities.

ARO represents the present value of estimated remediation and reclamation costs associated with our PP&E. We discounted the estimated asset retirement obligation using a weighted-average credit-adjusted risk-free rate of 2.6% (2010 – 3.3%). While the provision for abandonment is based on our best estimates of future costs and the economic lives of the assets involved, there is uncertainty regarding both the amount and timing of incurring these costs. We expect approximately \$428 million included in our ARO will be settled over the next five years with the balance settling beyond that. We expect to fund ARO from future cash flows from our operations.

## 15. OTHER LONG-TERM LIABILITIES

	December 31 2011	December 31 2010	January 1 2010
Defined Benefit Pension Obligations	208	159	139
Finance Lease Obligations	41	42	61
Other	113	106	172
Total <sup>1</sup>	362	307	372

<sup>1</sup>At December 31, 2010, other long-term liabilities related to our chemicals operations have been included in liabilities held for sale (see Note 23).

16. PENSION AND OTHER POST-RETIREMENT BENEFITS

Nexen has defined benefit and defined contribution pension plans, as well as other post-retirement benefit programs, which cover substantially all employees. Syncrude has a defined benefit plan for its employees, and we disclose only our proportionate share of this plan.

(A) DEFINED BENEFIT PENSION PLANS

The cost of pension benefits earned by employees is determined using the projected-benefit method prorated on employment services and is expensed as services are rendered. We fund these plans according to federal and provincial government regulations by contributing to trust funds administered by an

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independent trustee. These funds are invested primarily in equities and bonds. Nexen's supplemental benefit plan is funded from our operating cash flows and the year-end obligation of \$120 million is backed by an irrevocable letter of credit.

	2011				
	Registered (Funded)	Nexen Supplemental1 (Unfunded)	Total	Syncrude	Total
<b>Benefit Obligations</b>					
Beginning of Year	291	97	388	151	539
Service Cost	21	5	26	6	32
Interest Cost	16	5	21	8	29
Plan Participants' Contributions	6	—	6	1	7
Actuarial Loss	25	16	41	29	70
Benefits Paid	(15 )	(3 )	(18 )	(6 )	(24 )
End of Year1	344	120	464	189	653
<b>Plan Assets</b>					
Beginning of Year	312	—	312	87	399
Expected Return on Plan Assets2	21	—	21	7	28
Employer's Contribution	26	3	29	13	42
Plan Participants Contributions	6	—	6	1	7
Actuarial (Loss) Gain on Plan Assets2	(22 )	—	(22 )	(5 )	(27 )
Benefits Paid	(15 )	(3 )	(18 )	(5 )	(23 )
End of Year	328	—	328	98	426
Net Pension Liability	(16 )	(120 )	(136 )	(91 )	(227 )
<b>Pension Liability</b>					
Accounts Payable and Accrued Liabilities	(6 )	(4 )	(10 )	(9 )	(19 )
Other Long-Term Liabilities(Note 15)	(10 )	(116 )	(126 )	(82 )	(208 )
Net Pension Liability	(16 )	(120 )	(136 )	(91 )	(227 )
<b>Assumptions (%)</b>					
Accrued Benefit Obligation at December 31					
Discount Rate			4.50	4.25	
Long-Term Rate of Employee Compensation Increase			4.00	4.50	
Inflation Rate			2.00	5.00	
Benefit Cost for Year Ended December 31					

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Discount Rate	5.25	4.25
Long-Term Annual Rate of Return on Plan Assets <sup>3</sup>	6.75	7.30

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	2010				
	Registered (Funded)	Nexen Supplemental (Unfunded)	Total	Syncrude	Total
Projected Benefit Obligations					
Beginning of Year	243	76	319	125	444
Service Cost	17	4	21	5	26
Interest Cost	15	5	20	7	27
Plan Participants' Contributions	6	—	6	1	7
Actuarial Loss (Gain)	26	15	41	19	60
Benefits Paid	(16 )	(3 )	(19 )	(6 )	(25 )
End of Year <sup>1</sup>	291	97	388	151	539
Plan Assets					
Beginning of Year	264	—	264	69	333
Expected Return on Plan Assets <sup>2</sup>	20	—	20	6	26
Employer's Contribution	30	3	33	14	47
Plan Participants' Contribution	6	—	6	1	7
Actuarial (Loss) Gain on Plan Assets <sup>2</sup>	8	—	8	2	10
Benefits Paid	(16 )	(3 )	(19 )	(5 )	(24 )
End of Year	312	—	312	87	399
Net Pension Liability	21	(97 )	(76 )	(64 )	(140 )
Pension Liability					
Other Long-Term Assets	21	—	21	—	21
Accounts Payable and Accrued Liabilities	—	(2 )	(2 )	—	(2 )
Other Long-Term Liabilities	—	(95 )	(95 )	(64 )	(159 )
Net Pension Liability	21	(97 )	(76 )	(64 )	(140 )
Assumptions (%)					
Accrued Benefit Obligation at December 31					
Discount Rate			5.25	5.25	
Long-Term Rate of Employee Compensation Increase			4.00	4.45	
Inflation Rate			2.50	3.00	
Benefit Cost for Year Ended December 31					
Discount Rate			6.00	5.25	
Long-Term Annual Rate of Return on Plan Assets <sup>3</sup>			7.00	7.50	

Includes self-funded obligations for supplemental benefits to the extent that the benefit is limited by statutory guidelines. The self-funded obligations for supplemental benefits are backed by irrevocable letters of credit.

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## 2Reconciliation between expected and actual return on plan assets:

	2011	2010
Expected Return on Plan Assets	28	26
Actuarial Gain (Loss) on Plan Assets	(27 )	10

Actual Return on Plan Assets	1	36
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3The long-term annual rate of return on plan assets assumption is based on a mix of historical market returns for debt and equity securities.

## Defined Benefit Pension Plan Expense

	2011	2010
Nexen		
Cost of Benefits Earned by Employees	26	21
Interest Cost on Benefits Earned	21	20
Expected Return on Plan Assets <sup>1</sup>	(21 )	(20 )
Net Pension Expense	26	21

Syncrude <sup>2</sup>		
Cost of Benefit Earned by Employees	6	5
Interest Cost on Benefits Earned	8	7
Expected Return on Plan Assets <sup>3</sup>	(7 )	(6 )
Net Pension Expense	7	6

Total Net Pension Expense <sup>4</sup>	33	27
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<sup>1</sup>Actual loss on Nexen plan assets was \$1 million (2010 – \$28 million).

<sup>2</sup>Nexen's share of Syncrude's employee pension plans.

<sup>3</sup>Actual gain on Syncrude plan assets was \$2 million (2010 – \$8 million gain).

<sup>4</sup>Net pension expense is reported principally within operating expense and general and administrative expense in the Consolidated Statement of Income.

## (B) PLAN ASSET ALLOCATION AT DECEMBER 31

Our investment goal for the assets in our defined benefit pension plans is to preserve capital and earn a long-term rate of return on assets, net of all management expenses, in excess of the inflation rate. Investment funds are managed by external fund managers based on policies approved by the board of directors and pension management committee of Nexen. Nexen's investment strategy is to diversify plan assets between debt and equity securities of Canadian and non-Canadian corporations that are traded on recognized stock exchanges. Allowable and prohibited investment types are also prescribed in Nexen's investment policies.

Nexen's investment strategy is to ensure appropriate diversification between and within asset classes in order to optimize the return/risk trade-off. Nexen's policy allows investment in equities, fixed income, cash and real estate assets. Derivative instruments can be utilized as deemed appropriate by the pension

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management committee. Nexen's expected long-term annual rate of return on plan assets assumption is based on a mix of historical market returns for debt and equity securities. The returns that are used as the basis for future expectations are derived from the major asset categories that Nexen is currently invested in.

The target allocations for plan assets are identified in the table below. Equity securities primarily include investments in large-cap companies, both Canadian and foreign, and debt securities primarily include corporate bonds of companies from diversified industries and Canadian Treasury issuances. The Canadian fixed income pooled funds invest in low-cost fixed income index funds that track the DEX Universe Bond Index. The Canadian equity pooled funds invest in low-cost equity funds that track the S&P/TSX Composite Index. The foreign equity pooled funds invest in low-cost equity index funds that track the S&P 500 and MSCI EAFE Indexes.

Nexen also has an unregistered self-funded supplemental defined benefits pension plan that covers obligations that are limited by statutory guidelines. These benefits are backed by an irrevocable letter of credit and payments are made from Nexen's general operating revenues. Syncrude's pension plan is governed and administered separately from ours. Syncrude's plan assets are subject to similar investment goals, policies and strategies.

Plan Asset Allocation (%)	Expected 2012	2011	2010
Nexen			
Equity Securities	65	65	65
Debt Securities	35	35	35
Total	100	100	100
Syncrude			
Equity Securities	60	60	60
Debt Securities	40	40	40
Total	100	100	100

i) The fair value of Nexen's defined benefit pension plan assets at December 31, 2011 by asset category are as follows:

Fair Value Measurements at December 31, 2011				
Asset Category	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Cash	2	—	—	2

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Pooled Funds

Canadian Fixed Income	–	114	–	114
Canadian Equity	–	80	–	80
Foreign Equity	–	132	–	132
Total	2	326	–	328

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ii)The fair value of Nexen's defined benefit pension plan assets at December 31, 2010 by asset category are as follows:

Asset Category	Fair Value Measurements at December 31, 2010			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash	3	–	–	3
Pooled Funds				
Canadian Fixed Income	–	105	–	105
Canadian Equity	–	78	–	78
Foreign Equity	–	126	–	126
Total	3	309	–	312

iii)The fair value of Syncrude's defined benefit pension plan assets at December 31, 2011 by asset category are as follows:

Asset Category	Fair Value Measurements at December 31, 2011			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash	1	–	–	1
Pooled Funds				
Canadian Fixed Income	–	38	–	38
Canadian Equity	–	25	–	25
Foreign Equity	–	33	–	33
Other Types of Investments				
Other	–	–	1	1
Total	1	96	1	98





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iv) The fair value of Syncrude's defined benefit pension plan assets at December 31, 2010 by asset category are as follows:

Asset Category	Fair Value Measurements at December 31, 2010			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Cash	1	–	–	1
Pooled Funds				
Canadian Fixed Income	–	32	–	32
Canadian Equity	–	22	–	22
Foreign Equity	–	31	–	31
Other Types of Investments				
Other	–	–	1	1
<b>Total</b>	<b>1</b>	<b>85</b>	<b>1</b>	<b>87</b>

(C) DEFINED CONTRIBUTION PENSION PLANS

Under these plans, pension benefits are based on plan contributions. During 2011, Canadian pension expense for these plans was \$7 million (2010 – \$7 million). During 2011, US pension expense for these plans was \$6 million (2010 – \$6 million) and UK pension expense for these plans was \$6 million (2010 – \$6 million).

(D) POST-RETIREMENT BENEFITS

Nexen provides certain post-retirement benefits, including group life and supplemental health insurance, to eligible employees and their dependents. The present value of Nexen employees' future post-retirement benefits at December 31, 2011 was \$18 million (2010 – \$15 million).

(E) EMPLOYER FUNDING CONTRIBUTIONS AND BENEFIT PAYMENTS

Canadian regulators have prescribed funding requirements for our defined benefit plans. Our funding contributions over the last three years have met these requirements and also included additional discretionary contributions permitted by law to ensure the plans are adequately funded in light of potential future changes in assumptions. For our defined contribution pension plans, we make contributions on behalf of our employees and no further obligation exists. Our funding contributions for our defined benefit plans are:

Expected 2012	2011	2010
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Nexen	20	29	33
Syncrude	13	13	14
Total Defined Benefit Contribution	33	42	47

Our most recent funding valuation was prepared as of June 30, 2011. Our next funding valuation is required by June 30, 2014. Syncrude's most recent funding valuation was prepared as of December 31, 2010, and their next funding valuation is required by December 31, 2013.

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Our total benefit payments in 2011 were \$18 million for Nexen (2010 – \$19 million). Our share of Syncrude’s total benefit payments in 2011 was \$6 million (2010 – \$6 million).

## 17. RELATED PARTY DISCLOSURES

### (A) MAJOR SUBSIDIARIES

The Consolidated Financial Statements include the financial statements of Nexen Inc. and our subsidiaries as at December 31, 2011. The following is a list of the major subsidiaries of our operations. Transactions between subsidiaries are eliminated on consolidation. Nexen did not have any material related party transactions with entities outside the consolidated group in the years ended December 31, 2011 and 2010.

Major Subsidiaries	Jurisdiction of Incorporation	Principal Activities	Ownership
Nexen Petroleum UK Limited	England and Wales	Oil & Gas	100%
Nexen Petroleum Nigeria Limited	Nigeria	Oil & Gas	100%
Nexen Petroleum Offshore USA Inc.	Delaware	Oil & Gas	100%
Nexen Marketing	Alberta	Marketing	100%
Canadian Nexen Petroleum Yemen	Yemen	Oil & Gas	100%
Nexen Oil Sands Partnership	Alberta	Oil & Gas	100%

### (B) KEY MANAGEMENT PERSONNEL COMPENSATION

Key management personnel compensation includes all compensation paid to executive management and members of the board of directors of Nexen Inc. during the year.

	2011	2010
Short-Term Benefits <sup>1</sup>	9	9
Post Employment Benefits <sup>2</sup>	3	4
Share-Based Compensation <sup>3</sup>	(11)	) 2
Total Compensation	1	15

<sup>1</sup>Includes employee salary and director’s fees, non-equity incentive plan compensation and other short-term compensation.

<sup>2</sup>Represents the pension current service cost, plus changes in compensation in excess of managerial assumptions, less required member contributions to the plan.

<sup>3</sup>Stock-based compensation computed for executive management and the board of directors as described in Note 18 and represents change in fair value of outstanding awards.

18. EQUITY

(A) AUTHORIZED CAPITAL

Authorized share capital consists of an unlimited number of common shares of no par value and an unlimited number of Class A preferred shares of no par value, issuable in series. At December 31, 2011, there were 527,892,635 common shares outstanding (December 31, 2010 – 525,706,403 shares; and January 1, 2010 – 522,915,843 shares). There were no preferred shares issued and outstanding as at December 31, 2011 (December 31, 2010 – nil; and January 1, 2010 – nil). The rights, privileges, restrictions and conditions attached to common shares include a vote at all meetings of shareholders they are invited to, the receipt of any dividend declared by the board of directors on the common shares, and receipt of all remaining property of Nexen upon dissolution.

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## (B) ISSUED COMMON SHARES AND DIVIDENDS

Dividends per common share for the year ended December 31, 2011 were \$0.20 per common share (2010 – \$0.20 per common share). Dividends paid to holders of common shares have been designated as “eligible dividends” for Canadian tax purposes.

On February 15, 2012, the board of directors declared a quarterly dividend of \$0.05 per common share, payable April 1, 2012 to the shareholders of record on March 9, 2012.

	2011	2010
(thousands of shares)		
Issued Common Shares, Beginning of Year	525,706	522,916
Issue of Common Shares for Cash Exercise of Tandem Options	59	527
Dividend Reinvestment Plan	1,542	1,654
Employee Flow-Through Shares	586	609
End of Year	527,893	525,706

(Cdn\$ millions)

## Cash Consideration

Exercise of Tandem Options	1	5
Dividend Reinvestment Plan	30	35
Employee Flow-Through Shares	15	15
Total	46	55

During the year, 1,541,707 common shares were issued under the Dividend Reinvestment Plan and a balance of 3,079,464 common shares (2010 – 621,171) was reserved for issuance at December 31, 2011.

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## (C) TANDEM OPTIONS

Tandem and performance tandem options to purchase common shares are awarded to officers and employees. Each option permits the holder the right to either purchase one Nexen common share at the exercise price or receive a cash payment equal to the excess of market price over the exercise price. The following tandem and performance tandem options have been granted:

(thousands of shares)	2011		2010	
	Options (thousands)	Weighted Average Exercise Price (\$/option)	Options (thousands)	Weighted Average Exercise Price (\$/option)
Outstanding TOPs, Beginning of Year	18,435	25	23,130	25
Granted	1,582	17	4,615	1 22
Exercised for Stock	(59 )	16	(527 )	9
Surrendered for Cash	(394 )	20	(2,191 )	11
Cancelled	(1,248 )	25	(2,704 )	28
Expired	(3,462 )	31	(3,888 )	27
End of Year	14,854	23	18,435	25
TOPs Exercisable at End of Year	8,878	24	9,949	27
Weighted Average Share Price During Year	20.80		22.48	

1 Approximately 29% of options granted in 2010 contain performance vesting conditions. No options granted in 2011 contain these conditions as those eligible were granted Performance Share Units (PSU).

The range of exercise prices of options outstanding at December 31, 2011 is as follows:

	Outstanding Tandem and Performance Tandem Options		
	Number of Options (thousands)	Weighted Average Exercise Price (\$/option)	Weighted Average Years to Expiry (years)
\$15.00 to \$19.99	3,765	18	3
\$20.00 to \$24.99	8,405	23	3
\$25.00 to \$29.99	2,624	28	1
\$30.00 to \$34.99	35	31	—

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\$35.00 to \$39.99	20	36	—
\$40.00 to \$44.99	5	40	1
Total	14,854		

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Fair values and associated details for tandem and performance tandem options granted during the year:

	2011		2010	
Option Pricing Model Used for TOPs	Black-Scholes <sup>1</sup>		Black-Scholes <sup>1</sup>	
Weighted Average Fair Value (\$/option)	3.86		8.542	
Expected Volatility	40	%	56	%
Weighted-Average Expected Life (years)	3.14		3.18	
Expected Annual Dividends per Common Share (\$/share)	0.20		0.20	
Risk-Free Interest Rate	1.21	%	1.83	%
Expected Annual Forfeiture Rate	4	%	4	%

<sup>1</sup>The Monte-Carlo pricing model is used for the performance component of certain instruments. The assumptions used in this model do not differ significantly from those for non-performance TOPs.

<sup>2</sup>The weighted average fair value of performance tandem options granted in 2010 was \$8.17 per option at December 31, 2010.

These assumptions are based on multiple factors, including: i) historical exercise patterns of employees in relatively homogenous groups with respect to exercise and post-vesting employment termination behaviors; ii) expected future exercising patterns for those same homogenous groups; iii) the implied volatility of our stock price (based on the prior three years historic volatility); iv) our expected future dividend levels; and v) the interest rate for Government of Canada bonds.

The total expense recovery arising from tandem options for the year ended December 31, 2011 was \$39 million (2010 – \$28 million). The total carrying value of liabilities arising from tandem options at December 31, 2011 amounted to \$15 million (2010 – \$56 million). The total intrinsic value of all vested tandem options at December 31, 2011 amounted to nil (2010 – \$11 million).

#### (D) STOCK APPRECIATION RIGHTS

STARs and performance STARs are awarded to eligible employees. They permit the holder to receive a cash payment equal to the excess of the market price of the common shares over the exercise price of the right. The following STARs and performance STARs have been granted:

	2011		2010	
	STARs	Weighted Average Exercise Price	STARs	Weighted Average Exercise Price
(thousands of shares)	(thousands)	(\$/STAR)	(thousands)	(\$/STAR)
Outstanding STARs, Beginning of Year	18,993	25	19,480	25
Granted	377	18	3,354	22
Exercised for Cash	(578)	18	(444)	16
Cancelled	(1,163)	24	(1,806)	27



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Expired	(3,222 )	31	(1,591 )	27
End of Year	14,407	23	18,993	25
STARs Exercisable at End of Year	10,512	24	10,938	26
Weighted Average Share Price During Year	20.80		22.48	

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1 Approximately 9% of STARs granted in 2010 contain performance vesting conditions. No STARs granted in 2011 contain these conditions as those eligible were granted PSUs.

The range of exercise prices of STARs outstanding at December 31, 2011 is as follows:

Outstanding STARs and Performance STARs			
	Number of Options (thousands)	Weighted Average Exercise Price (\$/STAR)	Weighted Average Years to Expiry (years)
\$10.00 to \$14.99	17	14	2
\$15.00 to \$19.99	3,675	18	2
\$20.00 to \$24.99	7,541	24	3
\$25.00 to \$29.99	3,001	28	1
\$30.00 to \$34.99	112	33	-
\$35.00 to \$39.99	60	36	-
\$40.00 to \$44.99	1	40	1
Total	14,407		

Fair values and associated details for STARs and performance STARs granted during the period:

	2011		2010	
Option Pricing Model Used for STARs	Black-Scholes <sup>1</sup>		Black-Scholes <sup>1</sup>	
Weighted Average Fair Value (\$/STAR)	3.48		8.34	2
Expected Volatility	40	%	56	%
Weighted-Average Expected Life (years)	2.84		2.98	
Expected Annual Dividends per Common Share (\$/share)	0.20		0.20	
Risk-Free Interest Rate	1.21	%	1.83	%
Expected Annual Forfeiture Rate	5	%	4-5	%

1 The Monte-Carlo pricing model is used for the performance component of certain instruments. The assumptions used in this model do not differ significantly from those for non-performance STARs.

2 The weighted average fair value of performance STARs granted in 2010 was \$8.17 per performance STAR at December 31, 2010.

These assumptions are based on multiple factors, including: i) historical exercise patterns of employees in relatively homogenous groups with respect to exercise and post-vesting employment termination behaviors; ii) expected future exercising patterns for those same homogenous groups; iii) the implied volatility of our stock price (based on the prior three years historic volatility); iv) our expected future dividend levels; and v) the interest rate for Government of Canada bonds.

The total recovery arising from STARs for the year ended December 31, 2011 was \$45 million (2010 - expense \$1 million). The total carrying value of liabilities arising from STARs at December 31, 2011 amounted to \$12 million (2010 – \$61 million). The total intrinsic value of all vested STARs at December 31, 2011 amounted to nil (2010 – \$17 million).

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## (E) SHARE UNIT PLANS

Restricted Share Units (RSUs) are awarded to eligible employees and permit the holder to receive a cash payment equal to the market value of the stock on the vesting date. Performance Share Units (PSUs) are RSUs with a performance-vesting condition. Deferred Share Units (DSUs) are awarded to directors. The following RSUs, PSUs and DSUs have been granted:

	RSU	PSU	DSU
(thousands of units)			
Outstanding January 1, 2010	-	-	489
Granted	925	-	87
Outstanding December 31, 2010	925	-	576
Granted	1,458	390	143
Redeemed for Cash	(302 )	-	-
Cancelled	(56 )	-	-
Outstanding December 31, 2011	2,025	390	719
Weighted Average Fair Value per Unit (\$/unit)	16.21	9.59	16.21
Liability (\$/millions)	7	-	12
Weighted Average Remaining Time to Expiry (years)	1.7	1.8	

For the year ended December 31, 2011, we recognized compensation expense related to RSUs and PSUs in the amount of \$10 million (2010 - \$2 million). RSUs and PSUs are paid immediately once they vest. We recognized a compensation recovery related to DSUs in the amount of \$1 million (2010 - expense \$1 million).

## 19. COMMITMENTS, CONTINGENCIES AND GUARANTEES

We assume various contractual obligations and commitments in the normal course of our operations. Our operating leases, transportation, processing and storage commitments, finance leases, and drilling rig commitments as at December 31, 2011 are comprised of the following:

	2012	2013	2014	2015	2016	Thereafter
Operating Leases	66	64	46	26	25	89
Transportation, Processing and Storage Commitments	99	84	69	42	38	129
Drilling Rig Commitments	305	1 208	16	-	-	-
Finance Leases	4	4	4	4	4	62

<sup>1</sup>Total drilling rig commitments are disclosed net of \$102 million of subleases.

During 2011, total rental expense under operating leases was \$53 million (2010 - \$62 million).

We have a number of lawsuits and claims pending, including tax audits, the ultimate results of which cannot be ascertained at this time. We record costs as they are incurred or become determinable.

From time to time, we enter into contracts that require us to indemnify parties against certain types of possible third-party claims, particularly when these contracts relate to divestiture transactions. On occasion, we may provide routine indemnifications. The terms of such obligations vary and, generally, a maximum is not explicitly stated. Because the obligations in these agreements are often not explicitly stated, the overall maximum

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of the obligations cannot be reasonably estimated. Historically, we have not been obligated to make significant payments for these obligations. We believe that payments, if any, related to existing indemnities would not have a material adverse effect on our liquidity, financial condition or results of operations.

## 20.MARKETING AND OTHER INCOME

	2011	2010
Marketing Revenue, Net	195	337
Insurance Proceeds	26	-
Change in Fair Value of Crude Oil Put Options	(23 )	(41 )
Foreign Exchange Gains (Losses)	36	(38 )
Other	61	65
Total	295	323

## 21. INCOME TAXES

## (A) PROVISION FOR (RECOVERY OF) INCOME TAXES

	2011	2010
Current Tax		
Charge for the Year	1,584	1,125
Deferred Tax		
Temporary Differences in the Current Year	(526 )	(449 )
Impact of Changes in Tax Rates and Laws	270	-
Total Income Tax Expense Recognized in Net Income	1,328	676

## (B) DEFERRED INCOME TAX

	Consolidated Statement of Income		Consolidated Balance Sheet	
	2011	2010	2011	2010
Property, Plant and Equipment and Other	(25 )	(91 )	3,027	2,850
Tax Losses and Credits <sup>1</sup>	(215 )	(347 )	(1,985 )	(1,669 )
Foreign-Denominated Debt	(16 )	(11 )	108	146
Net Deferred Income Tax	(256 )	(449 )	1,150	1,327

1 Deferred tax assets have been recognized as it is probable there will be sufficient future taxable profits.



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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Net Deferred Income Tax Liability	2011	2010
Balance, Beginning of Year	1,327	1,603
Annual Recovery in Net Income	(256 )	(449)
Provision (Recovery) in Other Comprehensive Income	(35 )	21
Provision (Recovery) in Equity	18	4
Discontinued Operations	51	224
Effects of changes in Foreign Exchange Rates	35	(61)
Other	10	(15)
Balance, End of Year	1,150	1,327

## (C) RECONCILIATION OF EFFECTIVE TAX RATE TO THE CANADIAN STATUTORY TAX RATE

	2011	2010
Income before Provision for Income Taxes	1,723	1,130
Provision for Income Taxes Computed at the Canadian Statutory Rate	431	284
Add (Deduct) the Tax Effect of:		
Foreign Tax Rate Differential	701	355
Effect of Changes in Tax Rates <sup>1</sup>	270	—
Lower Tax Rates on Capital Losses	16	11
Recognition of Previously Unrecognized Tax Assets	(70 )	-
Stock-Based Compensation	(10 )	13
Non-Deductible Expenses and Other	(10 )	13
Provision for Income Taxes	1,328	676
Effective Tax Rate	77 %	60 %

<sup>1</sup>Effective March 24, 2011, the UK government substantively enacted an increase to the supplementary charge tax rate on our North Sea oil and gas activities of 12%, which increased the statutory oil and gas income tax rate to 62%. This rate change increased our deferred income tax liabilities, resulting in a one-time charge of \$270 million to deferred tax expense.

## (D) UNRECOGNIZED DEFERRED TAX ASSETS

At December 31, 2011, we had unrecognized deferred tax assets related to unused tax credits totaling \$977 million (2010 - \$724 million). This includes \$871 million (2010 - \$604 million) of Nigeria investment tax credits with no fixed expiry date. The remainder expires between 2015 and 2031.

We had no significant unrecognized deferred tax assets related to tax losses or other deductible temporary differences as at December 31, 2011.

## (E) INCOME TAX AUDITS



Nexen's income tax filings are subject to audit by taxation authorities in numerous jurisdictions. There are audits in progress and items under review, some of which may increase our tax liability. In addition, we have filed appeals and have disputed certain issues. While the results of these items cannot be ascertained at this time, we believe we have an adequate provision for income taxes based on available information.

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22.

## EARNINGS PER COMMON SHARE

We calculate basic earnings per common share using net income attributable to Nexen Inc. shareholders divided by the weighted-average number of common shares outstanding. We calculate diluted earnings per common share in the same manner as basic, except we adjust basic earnings for the potential conversion of the subordinated debentures and potential exercise of outstanding tandem options for shares, and use the weighted-average number of diluted common shares outstanding in the denominator.

	2011	2010
(\$Cdn millions)		
Net Income Attributable to Nexen Inc. Shareholders, Basic	697	1,127
Potential Tandem Options Exercises	(40 )	(8 )
Potential Conversion of Subordinated Debentures	25	26
Net Income Attributable to Nexen Inc. Shareholders, Diluted	682	1,145
(millions of shares)		
Weighted Average Number of Common Shares Outstanding, Basic	527.2	524.7
Shares Issuable Pursuant to Tandem Options	2.5	4.0
Shares Notionally Purchased from Proceeds of Tandem Options	(2.3 )	(2.7 )
Common Shares Issuable Pursuant to Potential Conversion of Subordinated Debentures	21.5	21.0
Weighted Average Number of Common Shares Outstanding, Diluted	548.9	547.0

In calculating the weighted-average number of diluted common shares outstanding and related earnings adjustments for the year ended December 31, 2011, we excluded 14,596,971 tandem options (2010 - 17,118,617) because their exercise price was greater than the average common share market price in the year. In 2011 and 2010, outstanding tandem options and potential conversion of subordinated debentures were the only potential dilutive instruments.

## 23. DISPOSITIONS

## (A) DISCONTINUED OPERATIONS

In February 2011, we completed the sale of our 62.7% investment in Canexus, which operates a chemicals business, for net proceeds of \$458 million and we realized a gain on disposition of \$348 million in the first quarter. In the fourth quarter of 2010, we received board approval to sell our interest in Canexus and classified the assets and liabilities as held for sale at December 31, 2010. The gain on sale and results of our chemicals business have been presented as discontinued operations.

In July 2010, we completed the sale of our heavy oil properties in Canada. We received proceeds of \$939 million, net of closing adjustments and realized a gain on disposition of \$828 million in the third quarter of 2010. The gain on sale and results of operations of these properties have been presented as discontinued operations.

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	Year Ended December 31			
	2011		2010	
	Chemicals	Canada	Chemicals	Total
Revenues and Other Income				
Net Sales	42	138	456	594
Other	(1 )	-	25	25
Gain on Disposition	348	828	-	828
	389	966	481	1,447
Expenses				
Operating	25	50	308	358
Depreciation, Depletion, Amortization and Impairment	4	20	35	55
Transportation and Other	2	2	60	62
General and Administrative	2	10	38	48
Finance	2	3	19	22
	35	85	460	545
Income before Provision for Income Taxes	354	881	21	902
Less: Provision for Deferred Income Taxes	51	220	4	224
Income before Non-Controlling Interests	303	661	17	678
Less: Non-Controlling Interests	1	-	5	5
Net Income from Discontinued Operations, Net of Tax	302	661	12	673
Earnings Per Common Share				
Basic	0.57			1.28
Diluted	0.55			1.23

The following table provides the assets and liabilities that are associated with our chemicals business at December 31, 2010 and January 1, 2010. There were no assets or liabilities related to our chemical operations at December 31, 2011.

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	December 31 2010	January 1 2010
Cash and Cash Equivalents	3	14
Accounts Receivable	48	54
Inventories and Supplies	35	33
Other Current Assets	1	3
Property, Plant and Equipment, Net of Accumulated DD&A	629	535
Deferred Income Tax Assets	7	4
Other Long-Term Assets	6	11
Assets	729	1 654
Accounts Payable and Accrued Liabilities	59	64
Accrued Interest Payable	3	-
Long-Term Debt	414	335
Deferred Income Tax Liability	15	11
Asset Retirement Obligations	73	74
Other Long-Term Liabilities	18	16
Liabilities	582	1 500
Equity – Canexus Non-Controlling Interest	48	33

1 Included in assets and liabilities held for sale at December 31, 2010. Amounts related to prior periods have not been reclassified.

## (B) ASSET DISPOSITIONS

## UK North Sea

During the fourth quarter of 2011, we sold our non-operated working interest in the Duart field for proceeds of \$38 million. The sale closed in December 2011 and we recognized a gain on sale of \$38 million in the fourth quarter of 2011.

## UK Undeveloped Leases

During the fourth quarter of 2010, we sold non-core lands in the UK North Sea for proceeds of \$17 million. We had no plans to develop these leases. We recognized a gain on disposition of \$17 million in the fourth quarter of 2010.

## North Dakota/Montana Crude Oil Marketing

During the fourth quarter of 2010, we sold our oil lease gathering, pipelines and storage assets in North Dakota and Montana for proceeds of \$201 million. The sale closed in December 2010 and we recognized a gain on disposition of \$121 million in the fourth quarter of 2010.

## Natural Gas Energy Marketing

During the third quarter of 2010, we sold our North American natural gas marketing operations. The sale, which generated proceeds of \$11 million, closed in the third quarter of 2010 and we recognized a non-cash loss of \$259 million, primarily related to the transfer of long-term physical transportation commitments. On closing, the purchaser acquired our North American natural gas storage and transportation commitments, natural gas inventory, and related financial and physical derivative positions.

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## Canadian Undeveloped Oil Sand Leases

During the second quarter of 2010, we sold non-core lands in the Athabasca region for proceeds of \$81 million. We had no plans to develop these lands for at least a decade. We recognized a gain on sale of \$80 million in the second quarter of 2010.

## European Gas and Power Marketing

During the first quarter of 2010, we sold our European Gas and Power marketing business for cash proceeds of \$15 million. There was no gain or loss on the disposition.

## 24. CASH FLOWS

## (A) CHARGES AND CREDITS TO INCOME NOT INVOLVING CASH

	2011	2010
Depreciation, Depletion, Amortization and Impairment	1,913	1,628
Stock-Based Compensation	(85 )	(52 )
Loss on Debt Redemption and Repurchase	91	-
Net (Gain) Loss on Dispositions	(38 )	41
Non-Cash Items Included in Discontinued Operations	(290 )	(549 )
Provision for Deferred Income Taxes	(256 )	(449 )
Foreign Exchange	(33 )	26
Other	33	82
Total	1,335	727

## (B)CHANGES IN NON-CASH WORKING CAPITAL

	2011	2010
Accounts Receivable	(381 )	96
Inventories and Supplies	208	(105 )
Other Current Assets	26	47
Accounts Payable and Accrued Liabilities	723	241
Total	576	279
Relating to:		
Operating Activities	255	338
Investing Activities	321	(59 )
Total	576	279

## (C) OTHER CASH FLOW INFORMATION

	2011	2010
Interest Paid	305	380

Income Taxes Paid	1,448	951
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APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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25. OPERATING SEGMENTS AND RELATED INFORMATION

Effective in the first quarter of 2011, we amended our segment reporting to reflect changes in our business. In 2010, we disposed of non-core operations including heavy oil operations in Canada, chemicals and certain energy marketing businesses, and increased production at our Long Lake oil sands project. We report our segments to align with our key growth areas, specifically, Conventional Oil and Gas, Oil Sands and Shale Gas. Prior year results have been revised to reflect the presentation changes made in the current year.

Nexen has the following operating segments:

**Conventional Oil and Gas:** We explore for, develop and produce crude oil and natural gas from conventional sources around the world. Our operations are focused on the UK, North America (Canada and US) and other countries (offshore West Africa, Colombia and Yemen).

**Oil Sands:** We develop and produce synthetic crude oil from the Athabasca oil sands in northern Alberta. We produce bitumen using in situ and mining technologies and upgrade it into synthetic crude oil before ultimate sale. Our in situ activities are comprised of our operations at Long Lake and future development phases. Our mining activities are conducted through our 7.23% ownership of the Syncrude Joint Venture.

**Shale Gas:** We explore for and produce unconventional gas from shale formations in northeastern British Columbia. Production and results of operations are included within Conventional Oil and Gas until they become significant.

**Corporate and Other** includes energy marketing, unallocated items and the results of Canexus prior to its sale in February 2011. The results of Canexus have been presented as discontinued operations.

The accounting policies of our operating segments are the same as those described in Note 2. Net income (loss) of our operating segments excludes interest income, interest expense, unallocated corporate expenses and foreign exchange gains and losses. Identifiable assets are those used in the operations of the segments.

## APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

Segmented Net Income for the Year Ended December 31, 2011

	Conventional United Kingdom	North America	Other Countries <sup>1,2</sup>	Oil Sands In Situ	Syncrude	Corporate and Other	Total
(Cdn\$ millions)							
Net Sales	3,432	499	781	688	713	56	6,169
Marketing and Other Income	21	39	21	–	3	211	295
	3,453	538	802	688	716	267	6,464
Less: Expenses							
Operating	353	156	164	439	287	32	1,431
Depreciation, Depletion, Amortization and Impairment	631	708	3 76	384	4 60	54	1,913
Transportation and Other	7	35	28	220	23	112	425
General and Administrative	(8 )	74	31	19	1	183	300
Exploration	84	148	134	5 2	–	–	368
Finance	17	16	2	3	6	207	251
Net Loss on Debt Redemption	–	–	–	–	–	91	91
Net Gain from Dispositions	(38 )	–	–	–	–	–	(38 )
Income (Loss) from Continuing Operations before Income Taxes	2,407	(599 )	367	(379 )	339	(412 )	1,723
Less: Provision for (Recovery of) Income Taxes	1,697	(164 )	68	(95 )	84	(262 )	1,328
Income (Loss) from Continuing Operations	710	(435 )	299	(284 )	255	(150 )	395
Add: Net Income from Discontinued Operations	–	–	–	–	–	302	302
Net Income (Loss)	710	(435 )	299	(284 )	255	152	697

Capital Expenditures	583	694	718	6	397	124	59	2,575
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- 1 Includes results of operations in Yemen and Colombia.
- 2 Includes Masila net sales of \$588 million and net income of \$161 million.
- 3 Includes non-cash impairment charges of \$322 million in Canada and the US.
- 4 Includes non-cash expenses of \$253 million related to previously capitalized engineering and design costs.
- 5 Includes exploration activities primarily in Nigeria, Norway, Colombia and Poland.
- 6 Includes capital expenditures in Nigeria of \$542 million.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Segmented Net Income for the Year Ended December 31, 2010

	Conventional United Kingdom	North America	Other Countries	Oil Sands In Situ	Syncrude	Corporate and Other	Total
(Cdn\$ millions)							
Net Sales	3,115	569	750	443	580	39	5,496
Marketing and Other Income	17	3	16	–	5	282	323
	3,132	572	766	443	585	321	5,819
Less: Expenses							
Operating	337	166	163	373	265	32	1,336
Depreciation, Depletion, Amortization and Impairment	783	519	3 120	94	53	59	1,628
Transportation and Other	2	22	27	181	21	313	566
General and Administrative	22	90	28	14	1	273	428
Exploration	67	156	104	4 1	–	–	328
Finance	17	17	1	3	4	320	362
Net (Gain) Loss from Dispositions	(17 )5	–	–	(80 )6	–	138 7	41
Income (Loss) from Continuing Operations before Income Taxes	1,921	(398 )	323	(143 )	241	(814 )	1,130
Less: Provision for (Recovery of) Income Taxes	960	(119 )	64	(36 )	60	(253 )	676
Income (Loss) from Continuing Operations	961	(279 )	259	(107 )	181	(561 )	454
Add: Net Income from Discontinued Operations	–	635	–	–	–	38	673
Net Income (Loss)	961	356	259	(107 )	181	(523 )	1,127
Capital Expenditures	699	815	652	8 228	119	211	2,724

- 1 Includes results of operations in Yemen and Colombia.
- 2 Includes Masila net sales of \$570 million and net income of \$156 million.
- 3 Includes non-cash impairment charges of \$139 million in Canada and the US.
- 4 Includes exploration activities primarily in Yemen, Nigeria, Norway and Colombia
- 5 Gain on disposition of UK undeveloped lease
- 6 Gain on disposition of non-core lands in the Athabasca region.
- 7 Net loss on disposition of Natural Gas Energy Marketing Business and North Dakota/Montana Crude Oil Marketing assets.
- 8 Includes capital expenditures in Nigeria of \$495 million.

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## Segmented Assets as at December 31, 2011

	Conventional United Kingdom	North America	Other Countries	Oil Sands		Corporate and Other		Total
				In Situ	Syncrude			
(Cdn\$ millions)								
Total Assets	4,817	3,403	2,138	5,881	1,423	2,406	1	20,068
Property, Plant and Equipment Cost	7,103	7,256	2,566	5,915	1,733	649		25,222
Less: Accumulated DD&A	3,707	4,299	648	205	411	381		9,651
Net Book Value	3,396	2,957	2 1,918	3 5,710	4 1,322	268		15,571

- 1 Includes cash of \$453 million, and Energy Marketing accounts receivable and inventory of \$1,449 million.
- 2 Includes capitalized costs of \$1,293 million associated with our Canadian shale gas operations.
- 3 Includes \$1,821 million related to our Usan development, offshore Nigeria.
- 4 Includes net book value of \$5,050 million for Long Lake Phase 1 and \$660 million for future phases of our in situ oil sands projects.

## Segmented Assets as at December 31, 2010

	Conventional United Kingdom	North America	Other Countries	Oil Sands		Corporate and Other		Total
				In Situ	Syncrude			
(Cdn\$ millions)								
Total Assets	4,249	3,195	1,646	5,782	1,259	3,516	1	19,647
Property, Plant and Equipment Cost	6,389	6,422	3,700	5,756	1,519	596		24,382
Less: Accumulated DD&A	3,055	3,597	2,370	91	359	331		9,803
Net Book Value	3,334	2,825	2 1,330	3 5,665	4 1,160	265		14,579

- 1 Includes cash of \$817 million, and Energy Marketing accounts receivable and inventory of \$1,498 million and Chemicals assets of \$729 million.
- 2 Includes capitalized costs of \$938 million associated with our Canadian shale gas operations.
- 3 Includes \$1,210 million related to our Usan development, offshore Nigeria.
- 4 Includes net book value of \$4,865 million for Long Lake Phase 1 and \$800 million for future phases of our in situ oil sands projects.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Segmented Assets as at January 1, 2010

	Conventional United Kingdom	North America	Other Countries	Oil Sands		Corporate and Other		Total
				In Situ	Syncrude			
(Cdn\$ millions)								
Total Assets	4,840	3,146	1,320	5,616	1,165	4,868	1	20,955
Property, Plant and Equipment Cost	5,884	7,464	3,344	5,523	1,390	1,702		25,307
Less: Accumulated DD&A	2,458	4,600	2,387	7	319	867		10,638
Net Book Value	3,426	2,864	2 957	3 5,516	4 1,071	835		14,699

- 1 Includes cash of \$1,016 million, Energy Marketing accounts receivable and inventory of \$2,392 million and Chemicals assets of \$654 million.
- 2 Includes capitalized costs of \$477 million associated with our Canadian shale gas operations.
- 3 Includes \$760 million related to our Usan development, offshore Nigeria.
- 4 Includes net book value of \$4,776 million for Long Lake Phase 1 and \$740 million for future phases of our in situ oil sands projects.

## 26. TRANSITION TO IFRS

For all periods up to and including the year ended December 31, 2010, we prepared our Consolidated Financial Statements in accordance with Canadian generally accepted accounting principles (Canadian GAAP). As a publicly listed company in Canada, we are required to prepare consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) for all periods after January 1, 2011, including comparative historical information.

In accordance with transitional provisions, we prepared our opening balance sheet as at January 1, 2010 (the transition date) and 2010 comparative financial information using the accounting policies set out in Note 2. These consolidated financial statements for the year ended December 31, 2011 are the first annual financial statements that comply with IFRS by applying existing IFRS with an effective date of December 31, 2011 or earlier. This transition note explains the material adjustments we made to convert our financial statements to IFRS.

## Elected Exemptions from Full Retrospective Application

In preparing these Consolidated Financial Statements in accordance with IFRS 1 First-time Adoption of International Financial Reporting Standards (IFRS 1), we applied the following optional exemptions from full retrospective application of IFRS.

## (I) BUSINESS COMBINATIONS



We applied the business combinations exemption to not apply IFRS 3 Business Combinations retrospectively to past business combinations. Accordingly, we have not restated business combinations that took place prior to the transition date.

(II)FAIR VALUE OR REVALUATION AS DEEMED COST

We elected to measure certain producing oil and gas properties at fair value as at the transition date and use that amount as its deemed cost in the opening IFRS balance sheet.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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(III)CUMULATIVE TRANSLATION DIFFERENCES

We elected to set the cumulative translation account to nil at January 1, 2010. This exemption has been applied to all subsidiaries.

(IV)SHARE-BASED PAYMENT TRANSACTIONS

We elected to use the IFRS 1 exemption whereby the liabilities for share-based payments that settled prior to January 1, 2010 were not required to be retrospectively restated.

(V)EMPLOYEE BENEFITS

We elected to apply the exemption for employee benefits to recognize the accumulated unrecognized net actuarial loss in retained earnings at January 1, 2010. This exemption has been applied to all defined benefit pension plans.

(VI) ASSET RETIREMENT OBLIGATIONS

We applied the exemption from full retrospective application of our asset retirement obligations as permitted for first-time adoption of IFRS. As such, we re-measured ARO as at January 1, 2010. We estimated the amount to be included in the related asset by discounting the liability to the date when the obligation first arose using our best estimates of the historical risk-free discount rates applicable during the intervening period.

(VII)BORROWING COSTS

We applied an IFRS transitional exemption to prospectively capitalize borrowing costs only from the transition date. As a result, borrowing costs previously capitalized under Canadian GAAP were expensed to retained earnings.

Mandatory Exceptions to Retrospective Application

In preparing these Consolidated Financial Statements in accordance with IFRS 1, we were required to apply the following mandatory exceptions from full retrospective application of IFRS.

(I)HEDGE ACCOUNTING

Only hedging relationships that satisfied the hedge accounting criteria as of the transition date are reflected as hedges in our results under IFRS. Any derivatives not meeting the IAS 39 Financial Instruments: Recognition and Measurement criteria for hedge accounting were recorded as a non-hedging derivative financial instrument.

(II)ESTIMATES

Hindsight was not used to create or revise estimates and accordingly, our estimates previously made under Canadian GAAP are consistent with their application under IFRS.



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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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## Reconciliations of Canadian GAAP to IFRS

IFRS 1 requires the presentation of a reconciliation of shareholders' equity, net income, comprehensive income, and cash flows for prior periods. The transition from Canadian GAAP to IFRS had no material effect upon previously reported cash flows. The following represents the reconciliations from Canadian GAAP to IFRS for the respective periods for shareholders' equity, net income, and comprehensive income:

## RECONCILIATION OF SHAREHOLDERS' EQUITY

	Note	January 1 2010	December 31 2010
(Cdn\$ millions)			
Shareholders' Equity under Canadian GAAP		7,646	8,791
Differences Increasing (Decreasing) Reported Shareholders' Equity			
Borrowing Costs	(I)	(841 )	(778 )
Asset Retirement Obligations	(II)	(228 )	(241 )
Employee Benefits	(III)	(104 )	(150 )
Stock-Based Compensation	(IV)	(96 )	(92 )
Property, Plant & Equipment	(V)	(124 )	(90 )
Foreign Exchange	(VI)	(11 )	–
Long-Term Debt	(VII)	(9 )	(28 )
Income Taxes	(VIII)	554	429
Other		–	(27 )
Shareholders' Equity under IFRS		6,787	7,814

## (I)BORROWING COSTS

We applied the IFRS 1 exemption to prospectively capitalize borrowing costs only from the transition date as described above.

## (II)ASSET RETIREMENT OBLIGATIONS (ARO)

We applied the IFRS 1 exemption for asset retirement obligations and re-measured our ARO as at January 1, 2010 as described above.

## (III)EMPLOYEE BENEFITS

We have chosen to include previously unrecognized actuarial gains and losses of our defined benefit pension plans on the balance sheet under IFRS. Under Canadian GAAP, we amortized actuarial gains and losses to income over the estimated average remaining service life, with disclosure of the unrecognized amount in the notes to the Consolidated Financial Statements. On January 1, 2010, we applied the IFRS 1 exemption to recognize the accumulated unrecognized net actuarial loss in retained earnings on transition to IFRS.

(IV) STOCK-BASED COMPENSATION (SBC)

Under Canadian GAAP, we recorded obligations for liability based stock compensation plans using the intrinsic-value method of accounting. IFRS requires that we record these SBC obligations at fair value and subsequently re-measure the obligation each reporting period. Our tandem option, stock appreciation rights and restricted share unit plans are considered liability-based stock compensation plans. On transition, we recorded the liability at fair value for unsettled awards.

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APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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(V) PROPERTY, PLANT AND EQUIPMENT

Impairment

Under Canadian GAAP, if indications of impairment exist and the asset's estimated undiscounted future cash flows were lower than its carrying amount, the carrying value was written down to fair value. Under IFRS, if indications of impairments exist, the asset's carrying value is immediately compared to its estimated recoverable amount, which could trigger additional impairment under IFRS. We elected to measure certain producing oil and gas properties at fair value as at the transition date and use that amount as its deemed cost in the opening IFRS balance sheet. As a result, oil and gas properties were written down to fair value of \$460 million and resulted in an impairment expense of \$91 million on transition.

Componentization

Under Canadian GAAP, we depleted oil and gas capitalized costs using the unit-of-production method on a field-by-field basis and depreciated non-resource capitalized costs based on their estimated useful life. On adoption of IFRS, we reviewed our PP&E to identify each material component that has a significantly different useful life and as a result, adjustments to the accumulated depletion of certain assets resulted in an expense of \$51 million on transition to IFRS.

Major Maintenance

Under Canadian GAAP, operating expenses included major maintenance costs that were expensed as incurred. Under IFRS, \$18 million was capitalized and depreciated separately until the next planned major maintenance project.

(VI) FOREIGN EXCHANGE

Foreign Currency Translation

We applied the first-time IFRS adoption exemption to reset our cumulative translation differences to nil on the transition date. Accumulated foreign exchange gains and losses of our foreign operations, net of foreign exchange translation gains and losses of long-term debt designated as hedges are included in retained earnings on the transition date. This one-time adjustment had no impact on shareholders' equity on transition.

Change in Functional Currency

As a result of additional guidance under IFRS, our assessment of the functional currency of a subsidiary changed from Canadian dollars to US dollars to better reflect the economic environment in which it operates.

(VII) LONG-TERM DEBT

Canexus Convertible Debentures

Canexus unitholders have the ability to redeem fund units for cash pursuant to the terms of the trust indenture. Under IFRS, these convertible debentures are considered to be financial liabilities containing an embedded derivative. Under Canadian GAAP, the convertible debentures were considered to be compound instruments with an equity component.

Accordingly, the equity component and unamortized deferred transaction costs recorded under Canadian GAAP were derecognized on January 1, 2010 and charged to retained earnings. We elected to recognize the convertible debentures at fair value and to recognize changes in fair value in net income during the period of change.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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## (VIII) INCOME TAXES

## Recognition of Deferred Tax Credit

In 2008, we completed an internal reorganization and financing of our assets in the North Sea, which provided us with a one-time tax deduction in the UK. Canadian GAAP precluded us from recognizing the full estimated benefit of the tax deductions until the assets were recognized in net income either by a sale or depletion through use. As a result, we deferred the initial recognition of the benefit and were amortizing it to future income tax expense over the life of the underlying assets under Canadian GAAP. On adoption of IFRS, no such prohibition exists and we recognized the remaining deferred tax credit in retained earnings on transition to IFRS.

## Exceptions

Under Canadian GAAP, deferred taxes were generally provided on all temporary differences. Conversely, IFRS does not recognize deferred taxes on temporary differences arising from the initial recognition of assets or liabilities in transactions that are not business combinations and that affect neither accounting nor taxable profit or loss.

## RECONCILIATION OF NET INCOME

	Note	Twelve Months Ended December 31 2010
(Cdn\$ millions)		
Net Income under Canadian GAAP		1,197
Differences Increasing (Decreasing) Reported Net Income		
Borrowing Costs	(I)	63
Asset Retirement Obligations	(II)	(13 )
Stock-Based Compensation	(III)	3
Property, Plant & Equipment	(IV)	34
Long-Term Debt	(V)	(19 )
Income Taxes	(VI)	(136 )
Other		(2 )
Total Differences in Net Income		(70 )
Net Income under IFRS		1,127

## (I)BORROWING COSTS

We applied an IFRS transitional exemption to prospectively capitalize borrowing costs from the transition date. As a result, borrowing costs previously capitalized under Canadian GAAP were expensed to shareholders' equity. The reduced capitalized amounts decreased DD&A expense during 2010.

## (II)ASSET RETIREMENT OBLIGATIONS (ARO)



Under Canadian GAAP, foreign exchange translation gains and losses arising from the revaluation of GBP-denominated asset retirement obligations were included in net income in the period in which they occurred. Under IFRS, these translation gains and losses are treated as a change in estimate and therefore increase or decrease PP&E with a corresponding impact on net income.

### (III) STOCK-BASED COMPENSATION (SBC)

As described above, we record obligations for liability-based stock compensation plans at fair value each reporting period. Our tandem option, stock appreciation rights and restricted share unit plans are considered liability-based stock compensation plans. The changes in the SBC fair value in 2010 were recognized in net income.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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(IV)PROPERTY, PLANT AND EQUIPMENT

Impairment

As described above, certain properties were impaired and written down to fair value on transition. These adjustments reduced IFRS DD&A expense during 2010 by immaterial amounts. In the last half of 2010, additional properties were impaired and written down to fair value. The impairment expense of \$46 million reduced net income in the third and fourth quarters.

Major Maintenance Costs

As described above, Canadian GAAP operating expenses included major maintenance costs that were expensed as incurred. Under IFRS, these costs are capitalized and depreciated separately until the next planned major maintenance project. During 2010, we capitalized \$18 million of maintenance costs under IFRS that were expensed as operating costs under Canadian GAAP.

Gain on Sale of Heavy Oil Properties

We completed the sale of our Canadian heavy oil properties in the third quarter of 2010. As the adoption of IFRS resulted in different carrying values of property, plant & equipment and asset retirement obligations prior to the sale, our gain on sale under IFRS was \$47 million higher.

(V)LONG-TERM DEBT

Canexus Convertible Debentures

As described above, we elected to carry the Canexus convertible debentures at fair value under IFRS. The change in fair value during 2010 was included in net income.

(VI)INCOME TAXES

Recognition of Deferred Tax Credit

As described above, we amortized a deferred tax credit to income over the life of the underlying asset under Canadian GAAP. Under IFRS, the deferred tax credit was recognized in retained earnings on transition. Therefore, IFRS net income was lower by \$117 million for the twelve months ended December 31, 2010.

Other

All other adjustments to IFRS net income were tax effected which increased deferred tax expense by \$19 million for the twelve months ended December 31, 2010.

RECONCILIATION OF COMPREHENSIVE INCOME

Twelve Months

	Note	Ended December 31 2010
(Cdn\$ millions)		
Comprehensive Income under Canadian GAAP		1,168
Differences Increasing (Decreasing) Reported Comprehensive Income, Net of Income Taxes:		
Differences in Net Income		(70 )
Foreign Currency Translation	(I)	(8 )
Employee Benefits	(II)	(35 )
Comprehensive Income under IFRS		1,055

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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(I)FOREIGN CURRENCY TRANSLATION

Transitional adjustments reflect the foreign currency exchange impact of the IFRS adjustments during the respective periods.

(II)EMPLOYEE BENEFITS

As described in Note 2, actuarial gains and losses are recognized directly in other comprehensive income in the period in which they occur. For the twelve months ended December 31, 2010, actuarial losses on our defined benefit plans reduced other comprehensive income by \$35 million.

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APPENDIX II FINANCIAL INFORMATION OF NEXEN GROUP

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(3) The following is an extract of the audited financial statements of Nexen Group for the year ended 31 December 2010, which were prepared in accordance with Canadian GAAP, from the 2010 annual report and financial statements of Nexen Group. These financial statements were presented in C\$ million dollars except for otherwise stated.

Nexen's 2010 annual report and financial statements are available free of charge, in read only, printable format on Nexen's website.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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REPORT OF MANAGEMENT

February 16, 2011

To the Shareholders of Nexen Inc.

We are responsible for the preparation and fair presentation of the Consolidated Financial Statements, as well as the financial reporting process that gives rise to such Consolidated Financial Statements. This responsibility requires us to make significant accounting judgments and estimates. For example, we are required to choose accounting principles and methods that are appropriate to the company's circumstances, and we are required to make estimates and assumptions that affect amounts reported. Fulfilling this responsibility requires the preparation and presentation of our Consolidated Financial Statements in accordance with generally accepted accounting principles in Canada with a reconciliation to generally accepted accounting principles in the US.

We also have responsibility for the preparation and fair presentation of other financial information in this report and to ensure the consistency of this information with the financial statements.

We are responsible for developing and implementing internal controls over the financial reporting process. These controls are designed to provide reasonable assurance that relevant and reliable financial information is produced. To gather and control financial data, we have established accounting and reporting systems supported by internal controls over financial reporting and an internal audit program. We believe that our internal controls over financial reporting provide reasonable assurance that our assets are safeguarded against loss from unauthorized use or disposition, that receipts and expenditures of the company are made only in accordance with authorization of management and directors of the company and that our records are reliable for preparing our Consolidated Financial Statements and other financial information in accordance with applicable generally accepted accounting principles and in accordance with applicable securities rules and regulations. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

We have established disclosure controls and procedures, internal controls over financial reporting and corporate-wide policies to ensure that Nexen's consolidated financial position, results of operations and cash flows are presented fairly. Our disclosure controls and procedures are designed to ensure timely disclosure and communication of all material information required by regulators. We oversee, with assistance from our Disclosure Review Committee, these controls and procedures and all required regulatory disclosures.

To ensure the integrity of our financial statements, we carefully select and train qualified personnel. We also ensure our organizational structure provides appropriate delegation of authority and division of responsibilities. Our policies and procedures are communicated throughout the organization and include a written ethics and integrity policy that applies to all employees, including the Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer or Controller.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Our Board of Directors is responsible for reviewing and approving the Consolidated Financial Statements and for overseeing management's performance of its financial reporting responsibilities. Their financial statement-related responsibilities are fulfilled mainly through the Audit and Conduct Review Committee (Audit Committee), with assistance from the Reserves Review Committee regarding the annual review of our crude oil and natural gas reserves, and the Finance Committee regarding the assessment and mitigation of financial risk. The Audit Committee is composed entirely of independent directors and includes five directors with financial expertise. The Audit Committee meets regularly with management, the internal auditors and the independent registered Chartered Accountants to review accounting policies, financial reporting and internal control issues and to ensure each party is properly discharging its responsibilities. The Audit Committee is responsible for the appointment and compensation of the independent registered Chartered Accountants and also considers their independence, reviews their fees and (subject to applicable securities laws) pre-approves their retention for any permitted non-audit services and their fee for such services. The internal auditors and independent registered Chartered Accountants have full and unlimited access to the Audit Committee, with and without the presence of management.

(signed) "Marvin F. Romanow  
President and Chief Executive Officer

(signed) "Kevin J. Reinhart"  
Executive Vice President and Chief Financial Officer

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13(a)-15(f)). Under the supervision and with the participation of our management, including our principal executive officer (CEO) and principal financial officer (CFO), we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the Internal Control –Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation, we concluded that our internal control over financial reporting is effective as of December 31, 2010. We have documented this assessment and made this assessment available to our independent registered Chartered Accountants. We recognize that all internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Deloitte & Touche LLP audited our Consolidated Financial Statements as stated in their report and has provided an attestation report on our internal control over financial reporting.

REPORTS OF INDEPENDENT REGISTERED CHARTERED ACCOUNTANTS

To the Board of Directors and Shareholders of Nexen Inc.

We have audited the accompanying consolidated financial statements of Nexen Inc. and subsidiaries (the “Company”), which comprise the consolidated balance sheets as at December 31, 2010 and 2009, and the consolidated statements of income, cash flows, equity and comprehensive income for each of the years in the three year period ended December 31, 2010, and the notes to the consolidated financial statements.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.



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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2010 and 2009, and the results of their operations and cash flows for each of the years in the three year period ended December 31, 2010 in accordance with Canadian generally accepted accounting principles.

Emphasis of Matter

We draw your attention to Note 1(U) to the consolidated financial statements which describe the adoption of the Financial Accounting Standards Board guidance for Oil and Gas Reserve Estimation and Disclosure, which is effective for years ended on or after December 31, 2009. Our opinion is not qualified in respect of this matter.

Other Matter

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 16, 2011 expressed an unqualified opinion on the Company's internal control over financial reporting.

(signed) "Deloitte & Touche LLP"  
Independent Registered Chartered Accountants  
Calgary, Canada

February 16, 2011

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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To the Board of Directors and Shareholders of Nexen Inc.

We have audited the internal control over financial reporting of Nexen Inc. and subsidiaries (the “Company”) as of December 31, 2010, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed by, or under the supervision of, the company’s principal executive and principal financial officers, or persons performing similar functions, and effected by the company’s board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the year ended December 31, 2010, and our report dated February 16, 2011, expressed an unqualified opinion on those financial statements.

(signed) “Deloitte & Touche LLP”  
Independent Registered Chartered Accountants  
Calgary, Canada

February 16, 2011

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## APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

CONSOLIDATED STATEMENT OF INCOME  
FOR THE THREE YEARS ENDED DECEMBER 31, 2010

(Cdn\$ millions, except per-share amounts)	2010	2009	2008
Revenues and Other Income			
Net Sales	5,411	4,203	6,576
Marketing and Other (Note 16)	415	859	863
	5,826	5,062	7,439
Expenses			
Operating	1,354	916	924
Depreciation, Depletion, Amortization and Impairment (Note 4)	1,662	1,615	1,899
Transportation and Other	566	732	907
General and Administrative	439	434	210
Exploration	328	302	401
Interest (Note 9)	310	305	82
Net Loss on Dispositions (Note 18)	41	—	—
	4,700	4,304	4,423
Income from Continuing Operations before Provision for Income Taxes	1,126	758	3,016
Provision for (Recovery of) Income Taxes (Note 17)			
Current	1,127	773	857
Future	(573 )	(527 )	557
	554	246	1,414
Net Income from Continuing Operations	572	512	1,602
Net Income from Discontinued Operations, Net of Tax (Note 20)	625	24	113
Net Income Attributable to Nexen Inc.	1,197	536	1,715
Earnings Per Common Share from Continuing Operations (\$/share) (Note 21)			
Basic	1.09	0.98	3.05
Diluted	1.08	0.96	3.01
Earnings Per Common Share (\$/share) (Note 21)			
Basic	2.28	1.03	3.26

Diluted	2.27	1.01	3.22
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See accompanying notes to the Consolidated Financial Statements.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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CONSOLIDATED BALANCE SHEET  
DECEMBER 31, 2010 AND 2009

(Cdn\$ millions, except per-share amounts)	2010	2009
<b>ASSETS</b>		
Current Assets		
Cash and Cash Equivalents	1,005	1,700
Restricted Cash	40	198
Accounts Receivable (Note 2)	1,938	2,788
Inventories and Supplies (Note 3)	549	680
Other	142	185
Assets Held for Sale (Note 20)	748	–
<b>Total Current Assets</b>	<b>4,422</b>	<b>5,551</b>
Property, Plant and Equipment (Note 4)	15,249	15,492
Future Income Tax Assets (Note 17)	1,678	1,148
Goodwill	286	339
Deferred Charges and Other Assets (Note 5)	272	370
<b>TOTAL ASSETS</b>	<b>21,907</b>	<b>22,900</b>
<b>LIABILITIES</b>		
Current Liabilities		
Accounts Payable and Accrued Liabilities (Note 8)	2,545	3,038
Accrued Interest Payable	83	89
Dividends Payable	26	26
Liabilities Held for Sale (Note 20)	540	–
<b>Total Current Liabilities</b>	<b>3,194</b>	<b>3,153</b>
Long-Term Debt (Note 9)	5,079	7,251
Future Income Tax Liabilities (Note 17)	3,138	2,811
Asset Retirement Obligations (Note 11)	1,009	1,018
Deferred Credits and Other Liabilities (Note 12)	696	1,021
<b>EQUITY (Note 14)</b>		
Nexen Inc. Shareholders' Equity		
Common Shares, no par value		
Authorized: Unlimited		
Outstanding: 2010 – 525,706,403 shares		
2009 – 522,915,843 shares	1,111	1,049
Contributed Surplus	–	1

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Retained Earnings	7,815	6,722
Accumulated Other Comprehensive Loss	(219 )	(190 )

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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(Cdn\$ millions, except per-share amounts)	2010	2009
Total Nexen Inc. Shareholders' Equity	8,707	7,582
Canexus Non-Controlling Interests (Note 20)	84	64
Total Equity	8,791	7,646
Commitments, Contingencies and Guarantees (Notes 15, 17 and 18)		
<b>TOTAL LIABILITIES AND EQUITY</b>	<b>21,907</b>	<b>22,900</b>

See accompanying notes to the Consolidated Financial Statements.

Approved on behalf of the Board:

(signed) "Marvin F. Romanow"

Director

(signed) "Thomas C. O'Neill"

Director

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APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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CONSOLIDATED STATEMENT OF CASH FLOWS  
FOR THE THREE YEARS ENDED DECEMBER 31, 2010

(Cdn\$ millions)	2010	2009	2008
<b>Operating Activities</b>			
Net Income from Continuing Activities	572	512	1,602
Net Income from Discontinued Operations (Note 20)	630	44	109
Charges and Credits to Income not Involving Cash (Note 22)	640	1,371	2,140
Exploration Expense	328	302	402
Changes in Non-Cash Working Capital (Note 22)	338	(25 )	119
Other	(159 )	(318 )	(18 )
	2,349	1,886	4,354
<b>Financing Activities</b>			
Proceeds from Long-Term Notes	--	1,081	--
Repayment of Medium-Term Notes and Debentures	--	--	(125 )
Proceeds from (Repayment of) Term Credit Facilities, Net	(1,538 )	728	803
Repayment of Short-Term Borrowings, Net	--	(1 )	(4 )
Proceeds from Canexus Long-Term Debt, Net	112	94	31
Dividends on Common Shares	(104 )	(104 )	(92 )
Distributions Paid to Canexus Non-Controlling Interests	(17 )	(14 )	(17 )
Issue of Common Shares and Exercise of Tandem Options for Shares (Note 14)	55	57	64
Repurchase of Common Shares for Cancellation (Note 14)	--	--	(338 )
Other	(14 )	(20 )	--
	(1,506 )	1,821	322
<b>Investing Activities</b>			
<b>Capital Expenditures</b>			
Exploration and Development	(2,313 )	(2,467 )	(2,895 )
Proved Property Acquisitions	(79 )	(755 )	(22 )
Energy Marketing, Chemicals, Corporate and Other	(210 )	(275 )	(149 )
Proceeds on Disposition of Assets	1,262	17	6
Changes in Non-Cash Working Capital (Note 22)	(59 )	(110 )	(124 )
Changes in Restricted Cash	37	(140 )	106
Other	(60 )	(13 )	(111 )
	(1,422 )	(3,743 )	(3,189 )

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APPENDIX II FINANCIAL INFORMATION OF NEXEN GROUP

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(Cdn\$ millions)	2010	2009	2008
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(116 )	(267 )	310
Increase (Decrease) in Cash and Cash Equivalents	(695 )	(303 )	1,797
Cash and Cash Equivalents, Beginning of Year	1,700	2,003	206
Cash and Cash Equivalents, End of Year	1,005	1,700	2,003

Cash and cash equivalents at December 31, 2010 consists of cash of \$345 million (2009 – \$210 million; 2008 – \$355 million) and short-term investments of \$660 million (2009 – \$1,490 million; 2008 – \$1,648 million).

See accompanying notes to Consolidated Financial Statements.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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## CONSOLIDATED STATEMENT OF EQUITY

FOR THE THREE YEARS ENDED DECEMBER 31, 2010

(Cdn\$ millions)

	2010	2009	2008
Common Shares, Beginning of Year	1,049	981	917
Issue of Common Shares	50	45	41
Exercise of Tandem Options for Shares	5	12	23
Accrued Liability Relating to Tandem Options Exercised for Common Shares	7	11	22
Repurchased Under Normal Course Issuer Bid (Note 14)	--	--	(22 )
End of Year	1,111	1,049	981
Contributed Surplus, Beginning of Year	1	2	3
Exercise of Tandem Options	(1 )	(1 )	(1 )
End of Year	--	1	2
Retained Earnings, Beginning of Year	6,722	6,290	4,983
Net Income Attributable to Nexen Inc.	1,197	536	1,715
Dividends Declared on Common Shares	(104 )	(104 )	(92 )
Repurchase of Common Shares for Cancellation (Note 14)	--	--	(316 )
End of Year	7,815	6,722	6,290
Accumulated Other Comprehensive Loss, Beginning of Year	(190 )	(134 )	(293 )
Other Comprehensive Income (Loss) Attributable to Nexen Inc.	(29 )	(56 )	159
End of Year1	(219 )	(190 )	(134 )

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APPENDIX II FINANCIAL INFORMATION OF NEXEN GROUP

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(Cdn\$ millions)	2010	2009	2008
Canexus Non-Controlling Interests, Beginning of Year	64	52	67
Net Income (Loss) Attributable to Non-Controlling Interests	5	27	(5 )
Distributions Declared to Non-Controlling Interests	(20 )	(18 )	(20 )
Issue of Partnership Units to Non-Controlling Interests	27	4	3
Estimated Fair Value of Conversion Feature of Convertible Debenture Issue Attributable to Non-Controlling Interests	8	4	-
Other Comprehensive Income (Loss) Attributable to Canexus Non-Controlling Interests	-	(5 )	7
End of Year	84	64	52

1 Comprised of unrealized foreign currency translation adjustment.

See accompanying notes to Consolidated Financial Statements.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME  
FOR THE THREE YEARS ENDED DECEMBER 31, 2010

(Cdn\$ millions)	2010	2009	2008
Net Income Attributable to Nexen Inc.	1,197	536	1,715
Other Comprehensive Income (Loss), Net of Income Taxes:			
Foreign Currency Translation Adjustment: Net Gains (Losses) on Investment in Self-Sustaining Foreign Operations	(257 )	(810 )	1,228
Net Gains (Losses) on Foreign-Denominated Debt Hedges of Self-Sustaining Foreign Operations <sup>1</sup>	228	757	(1,062 )
Realized Translation Adjustments Recognized in Net Income	–	(3 )	(7 )
Other Comprehensive Income (Loss) Attributable to Nexen Inc.	(29 )	(56 )	159
Comprehensive Income Attributable to Nexen Inc.	1,168	480	1,874

<sup>1</sup>Net of income tax expense for the year ended December 31, 2010 of \$33 million (2009 – \$109 million expense; 2008 – \$145 million recovery).

See accompanying notes to Consolidated Financial Statements.

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APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Cdn\$ millions, except as noted

1. ACCOUNTING POLICIES

Our Consolidated Financial Statements are prepared in accordance with Canadian Generally Accepted Accounting Principles (GAAP). The impact of significant differences between Canadian and United States (US) GAAP on the Consolidated Financial Statements is disclosed in Note 24.

(A) CONSOLIDATION

The Consolidated Financial Statements include the accounts of Nexen and our subsidiary companies (Nexen, we or our). All subsidiary companies, with the exception of Canexus Limited Partnership and its subsidiaries (Canexus), are wholly owned. All intercompany accounts and transactions are eliminated upon consolidation.

At December 31, 2010, we had a 62.7% interest in Canexus represented by 66.2 million Exchangeable LP Units. We had the right to nominate a majority of the members of the Board of Directors, who have the power to determine the strategic operating, investing and financing policies of Canexus. All assets, liabilities and results of operations of Canexus are consolidated and have been included in our Consolidated Financial Statements. Non-Nexen ownership interests in Canexus are shown as non-controlling interests. As disclosed in Notes 19 and 20, we sold our interest in Canexus in early 2011 and the assets, liabilities and operating results were reclassified as held for sale and discontinued operations as at December 31, 2010.

We proportionately consolidate our undivided interests in our oil and gas exploration, development and production activities conducted under joint venture arrangements. While the joint ventures under which these activities are carried out do not comprise distinct legal entities, they are operating entities. The significant operating policies of which are, by contractual arrangement, jointly controlled by all working interest parties.

(B) USE OF ESTIMATES

We make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements, and revenues and expenses during the reporting period. Our management reviews these estimates on an ongoing basis, including those related to accruals, litigation, environmental and asset retirement obligations, recoverability of assets, income taxes, fair values of commodity trading inventories, fair values of derivative assets and liabilities, capital adequacy and the determination of proved reserves. Changes in facts and circumstances may result in revised estimates, and actual results may differ from these estimates.

(C) CASH AND CASH EQUIVALENTS

Cash and cash equivalents includes short-term, highly liquid investments that mature within three months of their purchase. These investments are recorded at cost, which approximates fair value.

(D) RESTRICTED CASH

Restricted cash includes margin deposits relating to our exchange-traded derivative contracts used in our energy marketing business.

(E) ACCOUNTS RECEIVABLE

Accounts receivable are recorded based on our revenue recognition policy (see Note 1(O)). Our allowance for doubtful accounts provides for specific doubtful receivables, as well as general counterparty credit risk evaluated using observable market information and internal assessments.

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**APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP**

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**(F) INVENTORIES AND SUPPLIES**

Inventories and supplies, other than inventory held for trading purposes, are stated at the lower of cost and net realizable value. Cost is determined using the first-in, first-out method. Inventory costs include expenditures and other costs, including depletion and depreciation, directly or indirectly incurred in bringing the inventory to its existing condition.

Commodity inventories in our energy marketing operations that are held for trading purposes are carried at fair value, less any costs to sell. Any changes in fair value are included as gains or losses in marketing and other income during the period of change.

**(G) PROPERTY, PLANT AND EQUIPMENT (PP&E)**

PP&E is recorded at cost and includes only recoverable costs that directly result in an identifiable future benefit. Unrecoverable costs, maintenance and turnaround costs are expensed as incurred. Improvements that increase capacity or extend the useful lives of the related assets are capitalized to PP&E. Major spare parts and standby equipment whose useful life is expected to last longer than one year are included with PP&E.

We follow successful efforts accounting for our oil and gas operations. Costs are initially capitalized to PP&E as unproved property costs. Once proved reserves are discovered, the costs are reclassified to proved property costs. Exploration drilling costs are capitalized as suspended exploration well costs pending evaluation as to whether sufficient quantities of reserves have been found to justify commercial production. If commercial quantities of reserves are not found, exploration drilling costs are expensed. All exploratory wells are evaluated for commercial viability on a regular basis following completion of drilling. Exploration drilling costs remain capitalized if a determination is made that a sufficient quantity of reserves has been found and sufficient progress is being made to assess the reserves and the economic and operating viability of a potential development. All other exploration costs, including geological and geophysical costs and annual lease rentals, are expensed as incurred. All development costs are capitalized as proved property costs. General and administrative costs that directly relate to acquisition, exploration and development activities are capitalized to PP&E.

We engage in research and development activities to develop or improve processes and techniques to extract oil and gas. Research involves investigating new knowledge. Development involves translating that knowledge into a new technology or process. Research costs are expensed as incurred. Development costs are deferred once technical feasibility is established and we intend to proceed with development. We defer these costs in PP&E until the asset is substantially complete and ready for productive use. Otherwise, development costs are expensed as incurred.

**(H) DEPRECIATION, DEPLETION, AMORTIZATION AND IMPAIRMENT (DD&A)**

Under successful efforts accounting, we deplete oil and gas capitalized costs using the unit-of-production method. Development and exploration drilling and equipping costs are depleted over remaining proved developed reserves and proved property acquisition costs are depleted over remaining proved reserves. DD&A is considered a cost of inventory when the oil and gas are produced. When the inventory is sold, the depletion is charged to DD&A expense.

We depreciate other plant and equipment costs using the straight-line method based on the estimated useful lives of the assets, which range from 3 to 30 years. Unproved property costs and major projects that are under construction or



development are not depreciated, depleted or amortized.

We evaluate the carrying value of our PP&E whenever events or conditions occur which might indicate that the carrying value of properties on our balance sheet may not be recoverable from future cash flows. If the carrying value exceeds the sum of estimated undiscounted future cash flows, the property's value is impaired. The property is then assigned a fair value equal to its estimated future discounted net cash flows, and we expense the excess carrying value to DD&A. Our cash flow estimates require assumptions about future commodity prices, ultimate recoverability of oil and gas reserves, operating costs and other factors. Actual results can differ from these estimates.

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## APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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In assessing the carrying values of our unproved properties, we take into account our future plans for these properties, the remaining terms of the leases and any other factors that may be indicators of potential impairment.

### (I) CAPITALIZED INTEREST

We capitalize interest on major development projects until construction is complete using the weighted-average interest rate on all of our borrowings. Capitalized interest cannot exceed the actual interest incurred.

### (J) CARRIED INTEREST

We conduct certain international operations jointly with foreign governments in accordance with production-sharing agreements pursuant to which proved reserves are recognized using the economic interest method. Under these agreements, we pay both our share and the government's share of operating and capital costs. We recover the government's share of these costs from future revenues or production over several years. The government's share of operating costs is recorded in operating expense when incurred, and capital costs are recorded in PP&E and expensed to DD&A in the year recovered. All recoveries are recorded as revenue in the year of recovery.

### (K) GOODWILL

Our goodwill is primarily attributable to our United Kingdom operating segment. It has been recorded at cost and is not amortized. We test goodwill for impairment at least annually or whenever events or circumstances indicate that goodwill may be impaired. We base our test on the estimated fair value of the reporting unit. If goodwill is impaired, we reduce the carrying value to estimated fair value and an impairment loss is included in net income.

### (L) FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

All financial assets and liabilities are recognized on the balance sheet initially at fair value when we become a party to the contractual provisions of the instrument. Subsequent measurement of the financial instruments is based on their classification. We have classified each financial instrument into one of the following categories: financial assets and liabilities held for trading, loans or receivables, financial assets held to maturity, financial assets available for sale and other financial liabilities. The classification depends on the characteristics and the purpose for which the financial instruments were acquired. Except in limited circumstances, the classification of financial instruments is not subsequently changed.

Financial instruments carried at fair value on our balance sheet include cash and cash equivalents, restricted cash and derivatives used for trading and non-trading purposes. Realized and unrealized gains and losses from financial assets and liabilities carried at fair value are recognized in net income in the periods such gains and losses arise. Transaction costs related to these financial assets and liabilities are included in net income when incurred.

Financial instruments we carry at cost or amortized cost include our accounts receivable, accounts payable and accrued liabilities, accrued interest payable, dividends payable, short-term borrowings and long-term debt. Transaction costs are included in net income when incurred for these types of financial instruments except for short-term borrowings and long-term debt. These transaction costs are included with the initial fair value, and the instrument is carried at amortized cost using the effective interest rate method. Gains and losses on financial assets and liabilities carried at cost or amortized cost are recognized in net income when these assets or liabilities settle.

#### DERIVATIVES RELATED TO NON-TRADING ACTIVITIES

We may use derivative instruments such as physical purchase and sales contracts, forwards, futures, swaps and options for non-trading purposes to manage fluctuations in commodity prices, foreign currency exchange rates and interest rates (see Notes 6 and 7). We record these instruments at

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APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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fair value at the balance sheet date and record changes in fair value as net gains or losses in marketing and other income during the period of change unless the requirements for hedge accounting are met.

#### DERIVATIVES RELATED TO TRADING ACTIVITIES

Our energy marketing operations use derivative instruments for marketing and trading crude oil, natural gas, natural gas liquids and power, including commodity contracts settled with physical delivery, exchange-traded futures and options, and non-exchange traded forwards, swaps and options.

We record these instruments at fair value at the balance sheet date and record changes in fair value as net gains or losses in marketing and other income during the period of change. The fair value of these instruments is included with accounts receivable or payable if we anticipate settling the instruments within a year of the balance sheet date. If we anticipate settling the instruments beyond 12 months, we include them with deferred charges and other assets or deferred credits and other liabilities.

#### HEDGE ACCOUNTING

Hedge accounting may be used when there is a high degree of correlation between price movements in the derivative instruments and the items designated as being hedged. Nexen formally documents all hedges and the risk management objectives at the inception of the hedge. Derivative instruments that have been designated and qualify for hedge accounting are classified as either cash flow or fair value hedges.

For cash flow hedges, changes in the fair value of a financial instrument designated as a cash flow hedge are recognized in net income in the same period as the hedged item. Any fair value change in the financial instrument before that period is recognized on the balance sheet. The effective portion of this fair value change is recognized in other comprehensive income, with any ineffectiveness recognized in marketing and other income during the period of change.

For fair value hedges, both the financial instrument designated as a fair value hedge and the underlying commitment are recognized on the balance sheet at fair value. Changes in the fair value of both are reflected in net income.

Nexen had no cash flow or fair value hedges in place at December 31, 2010 or 2009.

For hedges of net investments, gains and losses resulting from foreign exchange translation of our net investments in self-sustaining foreign operations and the effective portion of the hedging items are recorded in other comprehensive income. Amounts included in accumulated other comprehensive income are reclassified to income when realized.

#### (M) ASSET RETIREMENT OBLIGATIONS

We provide for future asset retirement obligations on our resource properties, facilities, production platforms and pipelines based on estimates established by current legislation and industry practices. The asset retirement obligation is initially measured at fair value and capitalized to PP&E as an asset retirement cost. The obligation is accreted through DD&A expense until it is expected to settle, and the cost is amortized through DD&A expense over the life of the respective asset. The fair value of the obligation is estimated by discounting expected future cash outflows to settle the asset retirement obligation using a weighted-average, credit-adjusted risk-free interest rate. Nexen recognizes

period-to-period changes due to the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash outflows. Actual retirement costs are recorded against the obligation when incurred. Any difference between the recorded asset retirement obligation and the actual retirement costs incurred is recorded as a gain or loss in the settlement period.

We own interests in assets for which the fair value of the asset retirement obligations cannot be reasonably determined because the assets currently have an indeterminate life and we cannot determine when remediation activities would take place. These assets include our interest in Syncrude's upgrader and

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APPENDIX I FINANCIAL INFORMATION OF NEXEN GROUP

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sulphur pile, and our interest in the Long Lake upgrader. The estimated future recoverable reserves at Syncrude and Long Lake are significant and, given the long life of these assets, we are unable to determine when asset retirement activities would take place. Furthermore, the Syncrude plant and the Long Lake upgrader can both continue to run indefinitely with ongoing maintenance activities. The retirement obligations for these assets will be recorded in the first year in which the obligation to remediate becomes determinable.

#### (N) PENSION AND OTHER POST-RETIREMENT BENEFITS

Our employee post-retirement benefit programs consist of contributory and non-contributory defined benefit and defined contribution pension plans, as well as other postretirement benefit programs.

For our defined benefit plans, we provide benefits to retirees based on their length of service and final average earnings. The cost of pension benefits earned by employees in our defined benefit pension plans is actuarially determined using the projected-benefit method prorated on service and our best estimate of the plans' investment performance, salary escalations and retirement ages of employees. To calculate the plans' expected returns, assets are measured at fair value. Past service costs arising from plan amendments, and net actuarial gains and losses that exceed 10% of the greater of the accrued benefit obligation and the fair value of plan assets, are expensed in equal amounts over the expected average remaining service life of the employee group. Benefits paid out of Nexen's defined benefit plan are indexed to 75% of the annual rate of inflation less 1% to a maximum increase of 5%. Measurement date for our defined benefit plans is December 31.

Our defined contribution pension plan benefits are based on plan contributions. Company contributions to the defined contribution plan are expensed as incurred.

Other post-retirement benefits include group life and supplemental health insurance for eligible employees and their dependants. Costs are accrued as compensation in the period employees work; however, these future obligations are not funded.

#### (O) REVENUE RECOGNITION

##### OIL AND GAS

Revenue from the production of crude oil and natural gas is recognized when title passes to the customer. In Canada and the US, our customers primarily take title when the crude oil or natural gas reaches the end of the pipeline. For our other international operations, our customers generally take title when the crude oil is loaded onto tankers. When we produce or sell more or less oil or natural gas than our share, production overlifts and underlifts occur. We record overlifts as liabilities and underlifts as assets. We settle these over time as liftings are equalized or in cash when production ends.

Revenue represents Nexen's share and is recorded net of royalty obligations to governments and other mineral interest owners. For our international operations, all government interests, except for income taxes, are considered royalty obligations. Our revenue also includes the recovery of costs paid on behalf of foreign governments in international locations.

##### CHEMICALS

Revenue from our chemicals operations is only recognized when our products are delivered to our customers. Delivery takes place when we have a sales contract specifying delivery volumes and sales prices. We assess customer credit-worthiness before entering into sales contracts to minimize collection risk.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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ENERGY MARKETING

Substantially all of the physical purchase and sales contracts entered into by our energy marketing operation are considered to be derivative instruments. Accordingly, financial and physical commodity contracts (collectively, derivative instruments) held by our energy marketing operation are stated at fair value on the balance sheet. We record any change in fair value as a gain or loss in marketing and other income unless requirements for hedge accounting are met.

Any margin earned by our energy marketing operation on the sale of our proprietary oil and gas production is included in marketing and other income. Sales of our proprietary production are recorded at average monthly market-based prices and reported in our oil and gas segments. Intercompany profits and losses between segments are eliminated.

We assess customer credit-worthiness before entering into contracts and provide for netting terms to minimize collection risk. Amounts are recorded on a net basis where we have a legally enforceable right and intention to offset.

(P) FOREIGN CURRENCY TRANSLATION

Our foreign operations, which are considered financially and operationally independent, are translated from their functional currency into Canadian dollars at the balance sheet date exchange rate for assets and liabilities and at the monthly average exchange rate for revenues and expenses. Gains and losses resulting from this translation are included in other comprehensive income.

We have designated our US-dollar debt (excluding debt related to Canexus) as a hedge against our net investment in US-dollar self-sustaining foreign operations. Gains and losses resulting from the translation of the designated US-dollar debt are included in other comprehensive income. If our US-dollar debt, net of income taxes, exceeds our US-dollar investment in foreign operations, then the gains or losses attributable to such excess are included in marketing and other income in the Consolidated Statement of Income.

Monetary balance sheet amounts denominated in a currency other than a functional currency are translated into the functional currency using exchange rates at the balance sheet dates. Gains and losses arising from this translation are included in marketing and other income in the Consolidated Statement of Income.

(Q) TRANSPORTATION

We pay to transport the crude oil, natural gas and chemical products that we have sold and often bill our customers for the transportation. This transportation is presented in our Consolidated Financial Statements as transportation and other expense. Amounts billed to our customers are presented within marketing and other income. Our energy marketing operation has received cash payments in exchange for assuming certain transportation obligations from third parties. These cash payments were recorded as deferred liabilities and were recognized in net income as the transportation is used. These obligations were sold in 2010.

(R) LEASES

We classify leases entered into as either capital or operating leases. Leases that transfer substantially all of the benefits and risks of ownership to us are accounted for as capital leases, and the related assets are included with PP&E and



amortized on a straight-line basis over the period of expected use, consistent with other PP&E. Rental payments under operating leases are expensed as incurred.

(S) STOCK-BASED COMPENSATION

Our stock-based compensation consists of tandem option (TOPs), stock appreciation right (STARs), and restricted share unit (RSUs) plans.

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**APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP**

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Tandem options to purchase common shares are granted to officers and employees at the discretion of the board of directors. Each tandem option gives the holder a right to either purchase one Nexen common share at the exercise price or to receive a cash payment equal to the excess of the market value of the common share over the exercise price. Options granted vest over three years and are exercisable on a cumulative basis over five years. At the time of the grant, the exercise price equals the market value of the common share. Beginning in 2010, certain awards contain a performance vesting condition.

We record obligations for the tandem options using the intrinsic-value method of accounting and recognize compensation expense in the Consolidated Statement of Income. Obligations are accrued on a graded vesting basis and represent the difference between the market value of our common shares and the exercise price of the options. The obligations are revalued each reporting period based on the change in the market value of our common shares and the number of graded vested options outstanding. We reduce the liability when the options are surrendered for cash. When the options are exercised for stock, the accrued liability is transferred to share capital.

For employees eligible to retire during the vesting period, the compensation expense is recognized over the period from the grant date to the retirement eligibility date on a graded vesting basis. In instances where an employee is eligible to retire on the grant date of the stock-based award, compensation expense is recognized in full at that date.

Under our STARs plan, employees are entitled to cash payments equal to the excess of market price of the common share over the exercise price of the right. The vesting period and other terms of the plan are similar to the tandem option plan and include a performance vesting feature for certain awards. At the time of grant, the exercise price equals market value of the common share. We account for stock appreciation rights to employees on the same basis as our tandem options. Obligations are accrued as compensation expense over the graded vesting period of the stock appreciation rights.

Under our RSU plan, employees are entitled to receive a cash payment equal to the market value of one common share on the vesting date for each RSU granted. All RSUs vest evenly over three years and are exercised and paid as they vest. The obligation for RSUs are revalued each period based on the market value of our common shares and the number of graded vested RSUs outstanding.

**(T) INCOME TAXES**

We follow the liability method of accounting for income taxes. This method recognizes income tax assets and liabilities at current rates, based on temporary differences in reported amounts for financial statement and tax purposes. The effect of a change in income tax rates on future income tax assets and future income tax liabilities is recognized in income when substantively enacted.

We do not provide for foreign withholding taxes on the undistributed earnings of our foreign subsidiaries, as we intend to invest such earnings indefinitely in foreign operations.

**(U) CHANGES IN ACCOUNTING PRINCIPLES****OIL AND GAS RESERVE ESTIMATES**

On January 6, 2010, the Financial Accounting Standards Board issued guidance for Oil and Gas Reserve Estimation and Disclosure, which is effective for years ended on or after December 31, 2009. The guidance: i) expands the definition of oil and gas producing activities to include unconventional sources such as oil sands; ii) changes the price used in reserve estimation from the year-end price to the simple average of the first-day-of-the-month price for the previous 12 months; and iii) requires disclosures for geographic areas that represent 15% or more of proved reserves. The information required by this standard has been included in the Supplementary Data (Unaudited).

We follow the successful efforts method of accounting for our oil and gas activities, which uses the estimated proved reserves we believe are recoverable from our oil and gas properties. Specifically, reserves estimates are used to calculate our unit-of-production depletion rates and to assess, when necessary, our oil and gas assets for impairment. Adoption of the amendments changed

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APPENDIX II FINANCIAL INFORMATION OF NEXEN GROUP

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our estimate of reserves used to calculate depletion in 2010. As a result of the amendments, depletion expense increased by \$47 million, net income decreased by \$32 million, and earnings per common share decreased by \$0.07/share, for the year ended December 31, 2010.

## NEW ACCOUNTING PRONOUNCEMENTS

Nexen will be required to adopt International Financial Reporting Standards (IFRS) for interim and annual reporting purposes for fiscal years beginning on or after January 1, 2011.

## 2. ACCOUNTS RECEIVABLE

	2010	2009
Trade		
Energy Marketing	929	1,410
Energy Marketing Derivative Contracts (Note 6)	149	466
Oil and Gas	822	823
Chemicals and Other	2	44
	1,902	2,743
Non-Trade	80	99
	1,982	2,842
Allowance for Doubtful Receivables	(44 )	(54 )
Total	1,938	2,788

1 At December 31, 2010, accounts receivable related to our chemicals operations have been included with assets held for sale (see Notes 19 and 20).

## 3. INVENTORIES AND SUPPLIES

	2010	2009
Finished Products		
Energy Marketing	452	548
Oil and Gas	34	25
Chemicals and Other	–	12
	486	585
Work in Process	5	7
Field Supplies	58	88
Total	549	680

1 At December 31, 2010, inventories and supplies related to our chemicals operations have been included with assets held for sale (see Notes 19 and 20).



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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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## 4. PROPERTY, PLANT AND EQUIPMENT

	Cost	2010 Accumulated DD&A	Net Book Value	Cost	2009 Accumulated DD&A	Net Book Value
Oil and Gas						
Canada <sup>1</sup>	8,729	883	7,846	9,664	2,038	7,626
UK	6,610	3,273	3,337	6,115	2,664	3,451
Syncrude	1,545	305	1,240	1,463	270	1,193
US	3,913	2,689	1,224	3,900	2,529	1,371
Yemen	765	727	38	800	728	72
Yemen – Carried Interest	1,614	1,585	29	1,662	1,594	68
Other Countries <sup>2</sup>	1,362	88	1,274	930	99	831
	24,538	9,550	14,988	24,534	9,922	14,612
Energy Marketing	195	66	129	259	83	176
Chemicals <sup>3</sup>	–	–	–	1,135	562	573
Corporate and Other	397	265	132	371	240	131
Total	25,130	9,881	15,249	26,299	10,807	15,492

<sup>1</sup>Includes capitalized costs related to our insitu oil sands (Long Lake and future phases) of \$6,179 million (2009 – \$6,045 million).

<sup>2</sup>Includes capitalized costs related to Usan development, offshore west Africa of \$1,222 million (2009 – \$779 million).

<sup>3</sup>Chemicals net book value of \$643 million is included in assets held for sale at December 31, 2010 (see Notes 19 and 20).

Capitalized costs includes \$4,514 million (2009 – \$8,740 million) relating to unproved properties and projects under construction or development. These costs are currently not being depreciated, depleted or amortized and relate to projects under construction and not yet in service such as our Usan development offshore Nigeria, future oil sands phases, shale gas development and suspended exploratory well costs.

## DEPRECIATION, DEPLETION, AMORTIZATION AND IMPAIRMENT

Our DD&A expense for 2010 includes non-cash impairment charges of \$93 million on properties in the Gulf of Mexico. In the third quarter, low natural gas prices resulted in impairment on three shelf properties. We impaired two properties during the fourth quarter where declining production performance and higher estimated future abandonment costs reduced the properties' estimated future cash flows.

Our DD&A expense in 2009 included non-cash impairment charges of \$78 million at three natural gas properties in Canada and the US Gulf of Mexico. Year-end natural gas proved reserves at these properties were lower as a result of weak natural gas prices throughout 2009. DD&A expense in 2009 also includes \$49 million of costs for our Perth discovery in the North Sea, where we expensed allocated acquisition costs as we are unlikely to proceed with

development of this prospect.

These properties were written down to their estimated fair value based on their estimated future discounted net cash flows. The estimated future cash flows incorporate a risk-adjusted discount rate and management's estimates of future prices, capital expenditures and production. Based on these significant unobservable inputs, the measurements were considered Level 3 within the fair value hierarchy.

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## SUSPENDED EXPLORATION WELL COSTS

The following table shows the changes in capitalized exploratory well costs for the two years ended December 31, 2010, and does not include amounts that were initially capitalized and subsequently expensed in the same period. Suspended exploration well costs are included in property, plant and equipment.

	2010	2009
Beginning of Year	794	518
Exploratory Well Costs Capitalized Pending the Determination of Proved Reserves	232	396
Capitalized Exploratory Well Costs Charged to Expense	(14 )	(56 )
Transfers to Wells, Facilities and Equipment Based on Determination of Proved Reserves	(517 )	(21 )
Effects of Foreign Exchange Rate Changes	(30 )	(43 )
End of Year	465	794

The following table provides an aging of capitalized exploratory well costs based on the date drilling was completed as at December 31, 2010.

Aging of Suspended Exploration Wells	United States	Canada	United Kingdom	Nigeria	Total
Less than 1 year	88	4	98	–	190
1-3 years	–	93	4	13	110
4-5 years	111	–	37	–	148
Greater than 5 years	–	–	–	17	17
Total	199	97	139	30	465

As at December 31, 2010, we have exploratory costs that have been capitalized for more than one year relating to our interests in two exploratory blocks in the Gulf of Mexico (\$111 million), certain shale gas and coalbed methane exploratory activities in Canada (\$93 million), three exploratory blocks in the UK North Sea (\$41 million) and our interest in an exploratory block offshore Nigeria (\$30 million). These costs relate to projects with successful exploration wells for which we have not been able to recognize proved reserves. We are assessing all of these wells and projects and are working with our partners to prepare development plans, drill additional appraisal wells or otherwise assess commercial viability.

## 5. DEFERRED CHARGES AND OTHER ASSETS

	2010	2009
Long-Term Energy Marketing Derivative Contracts (Note 6)	116	225
Defined Benefit Pension Asset (Note 13)	75	60
Long-Term Capital Prepayments	12	27
Other	69	58
Total	272	370



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6. FINANCIAL INSTRUMENTS

Financial instruments carried at fair value on our balance sheet include cash and cash equivalents, restricted cash and derivatives used for trading and non-trading purposes. Our other financial instruments, including accounts receivable, accounts payable, accrued interest payable, dividends payable, short-term borrowings and long-term debt, are carried at cost or amortized cost. The carrying value of our short-term receivables and payables approximates their fair value because the instruments are near maturity.

In our energy marketing group, we enter into contracts to purchase and sell crude oil, natural gas and other energy commodities and use derivative contracts, including futures, forwards, swaps and options, for hedging and trading purposes (collectively derivatives). We also use derivatives to manage commodity price risk and foreign currency risk for non-trading purposes. We categorize our derivative instruments as trading or non-trading activities and carry the instruments at fair value on our balance sheet. The fair values are included with amounts receivable or payable and are classified as long-term or short-term based on anticipated settlement date. Any change in fair value is included in marketing and other income.

We carry our long-term debt at amortized cost using the effective interest rate method. At December 31, 2010, the estimated fair value of our long-term debt was \$5,290 million (2009 – \$7,594 million) as compared to the carrying value of \$5,079 million (2009 – \$7,251 million). The fair value of long-term debt is estimated based on prices provided by quoted markets and third-party brokers.

DERIVATIVES

(A) DERIVATIVE CONTRACTS RELATED TO TRADING ACTIVITIES

During 2010, we sold substantially all of our North American natural gas marketing operations, our oil lease gathering, pipeline and storage assets in North Dakota and Montana and our European gas and power marketing operations, as described in Note 18. Our energy marketing group primarily focuses on our crude oil marketing activities in North America, Europe and Asia.

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Our energy marketing group engages in various activities, including the purchase and sale of physical commodities and the use of financial instruments such as commodity and foreign exchange futures, forwards and swaps to economically hedge exposures and generate revenue. These contracts are accounted for as derivatives and, where applicable, are presented net on the balance sheet in accordance with netting arrangements. The fair value and carrying amounts related to derivative instruments held by our energy marketing operations are as follows:

	2010	2009
Commodity Contracts	149	463
Foreign Exchange Contracts	–	3
Accounts Receivable (Note 2)	149	466
Commodity Contracts	116	225
Deferred Charges and Other Assets (Note 5) <sup>1</sup>	116	225
Total Trading Derivative Assets	265	691
Commodity Contracts	168	410
Foreign Exchange Contracts	–	46
Accounts Payable and Accrued Liabilities (Note 8)	168	456
Commodity Contracts	115	212
Deferred Credits and Other Liabilities (Note 12) <sup>1</sup>	115	212
Total Trading Derivative Liabilities	283	668
Total Net Trading Derivative Contracts	(18 )	23

<sup>1</sup>These derivative contracts settle beyond 12 months and are considered non-current; once settlement is within 12 months, they are included in accounts receivable or accounts payable.

Excluding the impact of netting arrangements, the fair value of derivative instruments is as follows:

	2010	2009
Current Trading Assets	467	2,625
Non-Current Trading Assets	156	716
Total Trading Derivative Assets	623	3,341
Current Trading Liabilities	486	2,615
Non-Current Trading Liabilities	155	703
Total Trading Derivative Liabilities	641	3,318
Total Net Trading Derivative Contracts	(18 )	23

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APPENDIX IIFINANCIAL INFORMATION OF NEXEN GROUP

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Trading revenues generated by our energy marketing group include gains and losses on derivative instruments and non-derivative instruments such as physical inventory. The following trading revenues were recognized in marketing and other income:

	2010	2009
Commodity	342	1,011
Foreign Exchange	(8 )	(68 )
Marketing Revenue, Net (Note 16)	334	943

As an energy marketer, we may undertake several transactions during a period to execute a single sale of physical product. Each transaction may be represented by one or more derivative instruments including a physical buy, physical sell, and in many cases, numerous financial instruments for economically hedging and trading purposes. The absolute notional volumes associated with our derivative instrument transactions are as follows:

	2010	2009
Natural Gas (bcf/d)	6.5	21.1
Crude Oil (mmbbls/d)	3.1	3.5
Power (GWh/d)	69.5	217.3
Foreign Exchange (US\$ millions)	2,457	2,981
Foreign Exchange (Euro millions)	53	376

## (B) DERIVATIVE CONTRACTS RELATED TO NON-TRADING ACTIVITIES

The fair value and carrying amounts of derivative instruments related to non-trading activities are as follows:

	2010	2009
Accounts Receivable	9	13
Deferred Charges and Other Assets <sup>1</sup>	–	4
Total Non-Trading Derivative Assets	9	17
Accounts Payable and Accrued Liabilities	–	26
Total Non-Trading Derivative Liabilities	–	26
Total Net Non-Trading Derivative Contracts <sup>2</sup>	9	(9 )

<sup>1</sup>These derivative contracts settle beyond 12 months and are considered non-current.

<sup>2</sup>The net fair value of these derivatives is equal to the gross fair value before consideration of netting arrangements and collateral posted or received with counterparties.

## CRUDE OIL PUT OPTIONS

During 2010, we purchased put options on 100,000 bbls/d of our 2011 crude oil production. These options establish a monthly WTI floor price of between US\$50/bbl and US\$63/bbl and provide a base level of price protection without limiting our upside to higher prices. The options settle monthly and unexpired options are recorded at fair value throughout their term. As a result, changes in forward crude oil prices

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created gains or losses on these options at each period end. The put options were purchased for \$33 million and are carried at fair value. As at December 31, 2010 the fair value of the options was approximately \$9 million and we recorded a fair value loss of \$24 million in the year.

In 2009, we purchased put options on 90,000 bbls/d of our 2010 crude oil production. These options were purchased for \$39 million and established a WTI floor price of US\$50/bbl on these volumes. At December 31, 2009, higher crude oil prices reduced the fair value of the options to \$17 million and we recorded a fair value loss of \$22 million in 2009. Strengthening crude oil prices in 2010 reduced the fair value of these options to nil and we recorded a fair value loss of \$17 million in 2010.

In 2008, we purchased put options on approximately 70,000 bbls/d of our 2009 crude oil production. These options were purchased for \$14 million and established an annual Dated Brent floor price of US\$60/ bbl on these volumes. At December 31, 2008, the put options had an estimated fair value of \$233 million due to lower crude oil prices. Strengthening crude oil prices in 2009 reduced the fair value of these options to nil and we recorded a fair value loss of \$229 million in 2009.

The crude oil put options are carried at fair value and are classified as long-term or short-term based on their anticipated settlement date. Fair value of the put options is supported by multiple quotes obtained from third-party brokers, which were validated with observable market data to the extent possible. Any change in fair value is included in marketing and other income.

	December 31, 2010				
	Notional	Term	Average	Fair Value	Change in
	Volumes		Floor Price	(Cdn\$	Fair Value
	(bbls/d)		(US\$/bbl)	millions)	(Cdn\$
					millions)
WTI Crude Oil Put Options (monthly)	100,000	2011	56	9	(24 )
	December 31, 2009				
	Notional	Term	Average	Fair Value	Change in
	Volumes		Floor Price	(Cdn\$	Fair Value
	(bbls/d)		(US\$/bbl)	millions)	(Cdn\$
					millions)
WTI Crude Oil Put Options (monthly)	60,000	2010	50	13	(12 )
WTI Crude Oil Put Options (annual)	30,000	2010	50	4	(10 )
				17	(22 )

## (C) FAIR VALUE OF DERIVATIVES

For purposes of estimating the fair value of our derivative contracts, wherever possible, we utilize quoted market prices and, if not available, estimates from third-party brokers. These broker estimates are corroborated with multiple sources and/or other observable market data utilizing assumptions that market participants would use when pricing the

asset or liability, including assumptions about risk and market liquidity. Inputs to fair valuations may be readily observable, market-corroborated or generally unobservable. We utilize valuation techniques that seek to maximize the use of observable inputs and minimize the use of unobservable inputs. To value longer-term transactions and transactions in less active markets for which pricing information is not generally available, unobservable inputs may be used.

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We classify the fair value of our derivatives according to the following hierarchy based on the amount of observable inputs used to value the instruments.

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 consists of financial instruments such as exchange-traded derivatives, and we use information from markets such as the New York Mercantile Exchange.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1. Prices in Level 2 are either directly or indirectly observable as of the reported date. Level 2 valuations are based on inputs, including quoted forward prices for commodities, time value, volatility factors and broker quotations, which can be substantially observed or corroborated in the marketplace. Instruments in this category include non-exchange traded derivatives such as over-the-counter physical forwards and options, including those that have prices similar to quoted market prices. We obtain information from sources such as the Natural Gas Exchange (formerly Netthruput), independent price publications and over-the-counter broker quotes.

Level 3 – Valuations in this level are those with inputs that are less observable, unavailable or where the observable data does not support the majority of the instrument's fair value. Level 3 instruments may include items based on pricing services or broker quotes where we are unable to verify the observability of inputs into their prices. Level 3 instruments include longer-term transactions, transactions in less active markets or transactions at locations for which pricing information is not available. In these instances, internally developed methodologies are used to determine fair value, which primarily includes extrapolation of observable future prices to similar locations, similar instruments or later time periods.

The following table includes our derivatives that are carried at fair value for our trading and non-trading activities as at December 31, 2010 and 2009. Financial assets and liabilities are classified in the fair value hierarchy in their entirety based on the least observable input that is significant to the fair value measurement. Assessment of the significance of a particular input to the fair value measurement requires judgment and may affect placement within the fair value hierarchy levels.

Net Derivatives at December 31, 2010	Level 1	Level 2	Level 3	Total
Trading Derivatives (Commodity Contracts)	(17 )	(18 )	17	(18 )
Non-Trading Derivatives	–	9	–	9
Total	(17 )	(9 )	17	(9 )
Net Derivatives at December 31, 2009	Level 1	Level 2	Level 3	Total
Commodity Contracts	(143 )	167	42	66
Foreign Exchange Contracts	–	(43 )	–	(43 )
Trading Derivatives	(143 )	124	42	23
Non-Trading Derivatives	–	(9 )	–	(9 )
Total	(143 )	115	42	14



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A reconciliation of changes in the fair value of our derivatives classified as Level 3 for the years ended December 31, 2010 and 2009 is provided below:

	2010	2009
Level 3 Net Derivatives at January 1	42	(82 )
Realized and unrealized gains (losses)	19	74
Purchases	–	4
Settlements	(44 )	54
Transfers into Level 3	–	–
Transfers out of Level 3	–	(8 )
Level 3 Net Derivatives at December 31	17	42
Unsettled gains (losses) relating to instruments still held as of December 31	19	66

Items classified in Level 3 are generally economically hedged such that gains or losses on positions classified in Level 3 are often offset by gains or losses on positions classified in Level 1 or 2. Transfers into or out of Level 3 represent existing assets and liabilities that were either previously categorized as a higher level for which the inputs became unobservable or assets and liabilities that were previously classified as Level 3 for which the lowest significant input became observable during the period. Fair values of instruments in Level 3 are determined using broker quotes, pricing services and internally-developed inputs. We performed a sensitivity analysis of inputs used to calculate the fair value of Level 3 instruments. Using reasonably possible alternative assumptions, the fair value of Level 3 instruments at December 31, 2010 would change by \$5 million.

## 7. RISK MANAGEMENT

### (A) MARKET RISK

We invest in significant capital projects, purchase and sell commodities, issue short-term borrowings and long-term debt, and invest in foreign operations. These activities expose us to market risks from changes in commodity prices, foreign currency rates and interest rates, which could affect our earnings and the value of the financial instruments we hold. We use derivatives for trading and non-trading purposes as part of our overall risk management policy to manage these market risk exposures.

The following market risk discussion relates primarily to commodity price risk and foreign currency risk related to our financial instruments as our exposure to interest rate risk is immaterial given that the majority of our debt is fixed rate.

#### COMMODITY PRICE RISK

We are exposed to commodity price movements as part of our normal oil and gas operations, particularly in relation to the prices received for our crude oil and natural gas. Commodity price risk related to conventional and synthetic crude oil prices is our most significant market risk exposure. Crude oil and natural gas are sensitive to numerous worldwide factors, many of which are beyond our control, and are generally sold at contract or posted prices. Changes in global supply and demand fundamentals in the crude oil market and geopolitical events can significantly affect crude oil prices. Changes in crude oil and natural gas prices may significantly affect our results of operations and cash generated from operating activities. Consequently, these changes also may affect the value of our oil and gas properties, our level of spending for exploration and development, and our ability to meet our obligations as they

come due.

The majority of our oil and gas production is sold under short-term contracts, exposing us to the risk of near-term price movements. Other energy contracts we enter into also expose us to commodity price risk between the time we purchase and sell contracted volumes. We actively manage these risks by using derivative contracts such as commodity put options.

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Our energy marketing business is focused on maximising the value of our equity production and, to a lesser extent, providing services to customers and suppliers to meet their energy commodity needs. We primarily market and trade physical crude oil in selected regions of the world. We accomplish this by buying and selling physical commodities, by acquiring and holding rights to physical transportation and storage assets for these commodities, and by building strong relationships with our customers and suppliers. Prior to the related disposition in 2010, we also marketed and traded physical natural gas, electricity and other commodities. In order to manage the commodity and foreign exchange price risks that come from this physical business, we use financial derivative contracts, including energy-related futures, forwards, swaps and options, as well as currency swaps or forwards.

Our risk management activities make use of tools such as Value-at-Risk (VaR) and stress testing. VaR is a statistical estimate of the expected profit or loss of a portfolio of positions assuming normal market conditions. We use a 95% confidence interval and an assumed two-day holding period in our measure, although actual results can differ from this estimate in abnormal market conditions or if positions are held longer than two days based on market views or a lack of market liquidity to exit them. We estimate VaR primarily by using the Variance-Covariance method based on historical commodity price volatility and correlation inputs where available and by historical simulation in other situations. Our estimate is based upon the following key assumptions:

changes in commodity prices are either normally or “T” distributed;

price volatility remains stable; and

price correlation relationships remain stable.

We have defined VaR limits for different segments of our energy marketing business. These limits are calculated on an economic basis and include physical and financial derivatives, as well as physical transportation and storage capacity contracts accounted for as executory contracts in our financial statements. We monitor our positions against these VaR limits daily. Our year-end, annual high, annual low and average VaR amounts are as follows:

Value-at-Risk (Cdn\$ millions)	2010	2009
Year-End	11	11
High	15	24
Low	4	9
Average	10	15

If a market shock occurred, the key assumptions underlying our VaR estimate could be exceeded and the potential loss could be greater than our estimate. We perform stress tests on a regular basis to complement VaR and assess the impact of abnormal changes in prices on our positions.

#### Foreign currency risk

Foreign currency risk is created by fluctuations in the fair values or cash flows of financial instruments due to changes in foreign exchange rates. A substantial portion of our activities are transacted in or referenced to US dollars, including:

sales of crude oil and natural gas products;

capital spending and expenses for our oil and gas operations;  
commodity derivative contracts used primarily by our energy marketing group; and  
short-term borrowings and long-term debt.

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We manage our exposure to fluctuations between the US and Canadian dollar by maintaining our expected net cash flows and borrowings in the same currency. Cash inflows generated by our foreign operations and borrowings on our US-dollar debt facilities are generally used to fund US-dollar capital expenditures and debt repayments. We maintain revolving Canadian and US-dollar borrowing facilities that can be used or repaid depending on expected net cash flows.

We designate most of our US-dollar borrowings as a hedge against our US-dollar net investment in self-sustaining foreign operations. The foreign exchange gains or losses related to the effective portion of our designated US-dollar debt are included in accumulated other comprehensive income in equity. Our net investment in self-sustaining foreign operations and our designated US-dollar debt at December 31, 2010 and 2009 are as follows:

(US\$ millions)	December 31, 2010	December 31, 2009
Net Investment in Self-Sustaining Foreign Operations	4,443	4,492
Designated US-Dollar Debt	4,393	4,492

For the year ended December 31, 2010, the undesignated portion of our US-dollar debt resulted in a net foreign exchange loss of \$3 million (\$3 million, net of income tax expense) and is included in marketing and other income (2009 – \$151 million (\$132 million, net of income tax expense)). A one-cent change in the US dollar to Canadian dollar exchange rate would increase or decrease our accumulated other comprehensive income by approximately \$38 million, net of income tax, and would increase or decrease our net income by approximately \$3 million, net of income tax.

We also have exposures to currencies other than the US dollar, including a portion of our UK operating expenses, capital spending and future asset retirement obligations, which are denominated in British pounds and Euros. We do not have any material exposure to highly inflationary foreign currencies. In our energy marketing group, we enter into transactions in various currencies, including Canadian and US dollars, British pounds and Euros. We actively manage significant currency exposures using forward contracts and swaps.

### (B) CREDIT RISK

Credit risk affects our oil and gas operations and our energy marketing activities, and is the risk of loss if counterparties do not fulfill their contractual obligations. Most of our credit exposures are with counterparties in the energy industry, including integrated oil companies, refiners and utilities, and are subject to normal industry credit risk. Over 80% of our exposure is with these large energy companies. This concentration of risk within the energy industry is reduced because of our broad base of domestic and international counterparties. We take the following measures to reduce this risk:

assess the financial strength of our counterparties through a rigorous credit analysis process;

limit the total exposure extended to individual counterparties, and may require collateral from some counterparties;

routinely monitor credit risk exposures, including sector, geographic and corporate concentrations of credit, and report these to our Executive Risk Management Committee and the Finance Committee of the board;

set counterparty credit limits based on rating agency credit ratings and internal assessments of company and industry analysis;

review counterparty credit limits regularly; and

use standard agreements where possible that allow for the netting of exposures associated with a single counterparty.

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We believe these measures minimize our overall credit risk; however, there can be no assurance that these processes will protect us against all losses from non-performance.

At December 31, 2010, three counterparties individually made up more than 10% of our credit exposure. These counterparties are major integrated oil companies with strong investment-grade ratings. Two other counterparties made up more than 5% of our credit exposure. The following table illustrates the composition of credit exposure by credit rating:

Credit Rating	2010		2009	
A or higher	71	%	67	%
BBB	20	%	26	%
Non-Investment Grade	9	%	7	%
Total	100	%	100	%

Our maximum counterparty credit exposure at the balance sheet date consists primarily of the carrying amounts of non-derivative financial assets such as cash and cash equivalents, restricted cash, accounts receivable, as well as the fair value of derivative financial assets. We have provided an allowance of \$44 million for credit risk with our counterparties. In addition, we incorporate the credit risk associated with counterparty default, as well as Nexen's own credit risk, into our estimates of fair value.

Collateral received from customers at December 31, 2010 includes \$38 million of cash and \$104 million of letters of credit. The cash received is included in accounts payable and accrued liabilities.

## (C) LIQUIDITY RISK

Liquidity risk is the risk that we will not be able to meet our financial obligations as they fall due. We require liquidity specifically to fund capital requirements, satisfy financial obligations as they become due and to operate our energy marketing business. We generally rely on operating cash flows to provide liquidity and we also maintain significant undrawn committed credit facilities. At December 31, 2010, we had \$4 billion of cash and available undrawn committed lines of credit. This includes \$1 billion of cash and cash equivalents on hand and undrawn committed term credit facilities of \$3 billion, of which \$322 million was supporting letters of credit at December 31, 2010. Our committed term credit facilities are available until 2014 unless extended. We also have \$464 million of undrawn, uncommitted credit facilities, of which \$112 million was supporting letters of credit at year end.

The following table details the contractual maturities for our non-derivative financial liabilities, including both the principal and interest cash flows at December 31, 2010:

	December 31, 2010				
	Total	< 1 Year	1-3 Years	4-5 Years	> 5 Years
Long-Term Debt (Note 9)	5,171	—	497	249	4,425
Cumulative Interest on Long-Term Debt <sup>1</sup>	7,286	336	670	612	5,668
Total	12,457	336	1,167	861	10,093

<sup>1</sup>At December 31, 2010 none of our variable interest rate debt was drawn.

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The following table details contractual maturities for our derivative financial liabilities. The balance sheet amounts for derivative financial liabilities included below are not materially different from the contractual amounts due on maturity.

	December 31, 2010				
	Total	< 1 Year	1-3 Years	4-5 Years	> 5 Years
Trading Derivatives (Note 6)	283	168	105	5	5

At December 31, 2010, the collateral we have posted with counterparties includes \$4 million of cash and \$185 million of letters of credit related to our trading activities. Cash posted is included with our accounts receivable. Cash collateral is not normally applied to contract settlement. Once a contract has been settled, the collateral amounts are refunded. In the event of a default, the cash would likely be retained.

The commercial agreements our energy marketing group enters into often include financial assurance provisions that allow us and our counterparties to effectively manage credit risk. The agreements can require collateral to be posted if an adverse credit-related event occurs, such as a drop in credit ratings to non-investment grade. These obligations are reflected on our balance sheet. The posting of collateral secures the payment of such amounts. We have significant undrawn credit facilities and cash to fund these potential collateral requirements.

Our exchange-traded derivative contracts are also subject to margin requirements. We have margin deposits of \$40 million (2009 – \$198 million), which have been included in restricted cash.

## 8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	2010	2009
Energy Marketing Payables	1,015	1,366
Energy Marketing Derivative Contracts (Note 6)	168	456
Accrued Payables	676	619
Trade Payables	164	210
Income Taxes Payable	345	179
Stock-Based Compensation	30	72
Other	147	136
Total	2,545	3,038

1At December 31, 2010, accounts payable and accrued liabilities related to our chemical operations have been included in liabilities held for sale (see Notes 19 and 20).

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## 9. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

	2010	2009
Canexus Term Credit Facilities, due 2012 <sup>1</sup>	–	233
Canexus Notes, due 2013 <sup>1</sup>	–	52
Notes, due 2013 (US\$500 million) (A)	497	523
Term Credit Facilities, due 2014 (B)	–	1,570
Canexus Convertible Debentures, due 2014 <sup>1</sup>	–	46
Notes, due 2015 (US\$250 million) (C)	249	262
Notes, due 2017 (US\$250 million) (D)	249	262
Notes, due 2019 (US\$300 million) (E)	298	314
Notes, due 2028 (US\$200 million) (F)	199	209
Notes, due 2032 (US\$500 million) (G)	497	523
Notes, due 2035 (US\$790 million) (H)	786	827
Notes, due 2037 (US\$1,250 million) (I)	1,243	1,308
Notes, due 2039 (US\$700 million) (J)	696	733
Subordinated Debentures, due 2043 (US\$460 million) (K)	457	481
	5,171	7,343
Unamortized Discount and Debt Issue Costs	(92)	(92)
Total	5,079	7,251

<sup>1</sup>Included in liabilities held for sale at December 31, 2010 (see Notes 19 and 20).

## (A) NOTES, DUE 2013

During November 2003, we issued US\$500 million of notes. Interest is payable semi-annually at a rate of 5.05% and the principal is to be repaid in November 2013. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.2%.

## (B) TERM CREDIT FACILITIES

We have unsecured term credit facilities of \$3 billion (US\$3 billion) available until July 2014, none of which were drawn at December 31, 2010 (2009 – \$1.6 billion (US\$1.5 billion)). Borrowings are available as Canadian bankers' acceptances, LIBOR-based loans, Canadian prime rate loans, US-dollar base rate loans or British pound call-rate loans. Interest is payable at floating rates. During 2010, the weighted-average interest rate was 1.6% (2009 – 1.0%). At December 31, 2010, \$322 million (US\$324 million) of these facilities was utilized to support outstanding letters of credit (2009 – \$407 million (US\$389 million)).

## (C) NOTES, DUE 2015

During March 2005, we issued US\$250 million of notes. Interest is payable semi-annually at a rate of 5.2% and the principal is to be repaid in March 2015. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.15%.

(D) NOTES, DUE 2017

During May 2007, we issued US\$250 million of notes. Interest is payable semi-annually at a rate of 5.65% and the principal is to be repaid in May 2017. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.20%.

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(E) NOTES, DUE 2019

During July 2009, we issued US\$300 million of notes. Interest is payable semi-annually at a rate of 6.2% and the principal is to be repaid in July 2019. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.40%.

(F) NOTES, DUE 2028

During April 1998, we issued US\$200 million of notes. Interest is payable semi-annually at a rate of 7.4% and the principal is to be repaid in May 2028. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.25%.

(G) NOTES, DUE 2032

During March 2002, we issued US\$500 million of notes. Interest is payable semi-annually at a rate of 7.875% and the principal is to be repaid in March 2032. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.375%.

(H) NOTES, DUE 2035

During March 2005, we issued US\$790 million of notes. Interest is payable semi-annually at a rate of 5.875% and the principal is to be repaid in March 2035. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.20%.

(I) NOTES, DUE 2037

During May 2007, we issued US\$1,250 million of notes. Interest is payable semi-annually at a rate of 6.4% and the principal is to be repaid in May 2037. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.35%.

(J) NOTES, DUE 2039

During July 2009, we issued US\$700 million of notes. Interest is payable semi-annually at a rate of 7.5% and the principal is to be repaid in July 2039. We may redeem part or all of the notes at any time. The redemption price will be the greater of par and an amount that provides the same yield as a US Treasury security having a term-to-maturity equal to the remaining term of the notes plus 0.45%.

(K) SUBORDINATED DEBENTURES, DUE 2043

During November 2003, we issued US\$460 million of unsecured subordinated debentures. Interest is payable quarterly at a rate of 7.35%, and the principal is to be repaid in November 2043. We may redeem part or all of the debentures at any time. The redemption price is equal to the par value of the principal amount plus any accrued and unpaid interest to the redemption date. We may choose to redeem the principal amount with either cash or common shares.

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## (L) LONG-TERM DEBT REPAYMENTS

The following schedule outlines the required timetable of debt repayments and does not preclude earlier repayments as per the provisions of the respective notes.

2011	—
2012	—
2013	497
2014	—
2015	249
Thereafter	4,425
Total <sup>1</sup>	5,171

<sup>1</sup> Excludes repayments related to our chemical operations (see Notes 19 and 20).

## (M) DEBT COVENANTS

Some of our debt instruments contain covenants with respect to certain financial ratios and our ability to grant security. At December 31, 2010 and 2009, we were in compliance with all covenants.

## (N) SHORT-TERM BORROWINGS

Nexen has uncommitted, unsecured credit facilities of approximately \$464 million (US\$467 million), (2009 – \$492 million (US\$470 million)), none of which were drawn at either December 31, 2010 or 2009. We utilized \$112 million (US\$112 million) of these facilities to support outstanding letters of credit at December 31, 2010 (2009 – \$86 million (US\$82 million)). Interest is payable at floating rates. During 2010, the weighted-average interest rate on our short-term borrowings was 0.9% (2009 -2.1%).

## (O) INTEREST EXPENSE

	2010	2009	2008
Long-Term Debt	361	360	303
Other	29	17	19
Total	390	377	322
Less: Capitalized	(80 )	(72 )	(240 )
Total <sup>1</sup>	310	305	82

<sup>1</sup>Excludes interest expense related to our chemical operations (see Notes 19 and 20).

Capitalized interest relates to and is included as part of the cost of oil and gas properties. The capitalization rates are based on our weighted-average cost of borrowings. In 2009, we ceased capitalizing interest on Phase 1 of Long Lake.

## 10. CAPITAL DISCLOSURE

Our objective for managing our capital structure is to ensure that we have the financial capacity, liquidity and flexibility to fund our investment in full-cycle exploration and development of conventional and unconventional resources and for energy marketing activities. We generally rely on operating cash flows to fund capital investments. However, given the long cycle-time of some of our development projects, which require significant capital investment prior to cash flow generation, and volatile commodity prices, it is not unusual for

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capital expenditures to exceed our cash flow from operating activities in any given period. As such, our financing needs depend on the timing of expected net cash flows in a particular development or commodity cycle. This requires us to maintain financial flexibility and liquidity. Our capital management policies are aimed at:

maintaining an appropriate balance between short-term borrowings, long-term debt and equity;

maintaining sufficient undrawn committed credit capacity to provide liquidity;

ensuring ample covenant room, permitting us to draw on credit lines as required; and

ensuring we maintain a credit rating that is appropriate for our circumstances.

We have the ability to make adjustments to our capital structure by issuing additional equity or debt, returning cash to shareholders and making adjustments to our capital investment programs. Our capital consists of equity, short-term borrowings, long-term debt, and cash and cash equivalents as follows:

	2010	2009
Net Debt <sup>1</sup>		
Long-Term Debt	5,079	7,251
Less: Cash and Cash Equivalents	(1,005 )	(1,700 )
Total <sup>2</sup>	4,074	5,551
Equity <sup>3</sup>	8,707	7,582

<sup>1</sup>Includes all of our borrowings and is calculated as long-term debt and short-term borrowings less cash and cash equivalents.

<sup>2</sup>December 31, 2010 excludes Net Debt related to our chemical operations that are included in assets and liabilities held for sale (see Notes 19 and 20).

<sup>3</sup>Equity is the historical issue of equity and accumulated retained earnings.

We monitor the leverage in our capital structure by reviewing the ratio of net debt to cash flow from operating activities and interest coverage ratios at various commodity prices.

We use the ratio of net debt to cash flow from operating activities as a key indicator of our leverage and to monitor the strength of our balance sheet. Net debt is a non-GAAP measure that does not have any standard meaning prescribed by GAAP and is therefore unlikely to be comparable to similar measures presented by others. We calculate net debt using the GAAP measures of long-term debt and short-term borrowings less cash and cash equivalents (excluding restricted cash).

For the 12 months ended December 31, 2010, the net debt to cash flow from operating activities ratio (before changes in non-cash working capital and other) was 1.9 times compared to 2.5 times at December 31, 2009. While we typically expect the target ratio to fluctuate between 1.0 and 2.0 times under normalized commodity prices, this can be higher or lower depending on commodity price volatility, where we are in the investment cycle or when we identify strategic opportunities requiring additional investment. Whenever we exceed our target ratio, we assess whether we need to develop a strategy to reduce our leverage and lower this ratio back to target levels over time.



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Our interest coverage ratio monitors our ability to fund the interest requirements associated with our debt. Our interest coverage increased from 8.5 times at the end of 2009 to 9.3 times at December 31, 2010. Interest coverage is calculated by dividing our twelve-month trailing earnings before interest, taxes, DD&A, exploration expense and other non-cash items (adjusted EBITDA) by interest expense before capitalized interest. Adjusted EBITDA is a non-GAAP measure that is calculated using net income excluding interest expense, provision for income taxes, exploration expense, DD&A, impairment and other non-cash expenses. The calculation of adjusted EBITDA is set out in the following table and is unlikely to be comparable to similar measures presented by others:

	2010	2009
Net Income Attributable to Nexen Inc.	1,197	536
Add:		
Interest Expense	310	305
Provision for Income Taxes	554	246
Depreciation, Depletion, Amortization and Impairment	1,662	1,615
Exploration Expense	328	302
Recovery of Non-Cash Stock-Based Compensation	(41 )	(10 )
Change in Fair Value of Crude Oil Put Options	41	251
Items Related to Discontinued Operations	(475 )	–
Other Non-Cash Items	50	72
Adjusted EBITDA	3,626	3,317

## 11. ASSET RETIREMENT OBLIGATIONS

Changes in carrying amounts of the asset retirement obligations associated with our PP&E are as follows:

	2010	2009
Asset Retirement Obligations, Beginning of Year	1,053	1,059
Obligations Incurred with Development Activities	32	27
Obligations Settled	(43 )	(42 )
Accretion Expense	66	70
Revisions to Estimates	169	13
Obligations Related to Dispositions <sup>1</sup>	(166 )	–
Effects of Changes in Foreign Exchange Rate	(47 )	(74 )
End of Year <sup>2, 3</sup>	1,064	1,053

<sup>1</sup>Includes obligations associated with discontinued operations of \$163 million.

<sup>2</sup>Obligations due within 12 months of \$55 million (2009 – \$35 million) have been included in accounts payable and accrued liabilities.

<sup>3</sup>Obligations relating to our oil and gas activities amount to \$1,064 million (2009 – \$1,002 million), and obligations relating to our chemicals business amount to nil (2009 – \$51 million). At December 31, 2010, asset retirement obligations associated with our chemicals business are included in liabilities held for sale (see Note 20).

Our total estimated undiscounted inflated asset retirement obligations amount to \$2,552 million (2009 – \$2,341 million). We discounted the total estimated asset retirement obligations using a weighted-average, credit-adjusted risk-free rate of 6% (2009 – 5.9%). Approximately \$306 million included in our asset retirement obligations will be settled over the next five years. The remaining obligations settle beyond five years and will be funded by future cash flows from our operations.

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## 12. DEFERRED CREDITS AND OTHER LIABILITIES

	2010	2009
Deferred Tax Credit	367	503
Long-Term Marketing Derivative Contracts (Note 6)	115	212
Defined Benefit Pension Obligations (Note 13)	75	74
Capital Lease Obligations	42	61
Deferred Transportation Revenue	–	55
Other	97	116
Total	696	1,021

During 2008, we completed an internal reorganization and financing of our assets in the North Sea, which provided us with an additional one-time tax deduction in the UK. As these transactions were completed within our consolidated group, we are unable to recognize the benefit of the tax deductions until the assets are recognized in income by way of a sale to a third party or depletion through use. At December 31, 2010, we deferred recognizing \$367 million (2009 – \$503 million) of tax credits in net income.

## 13. PENSION AND OTHER POST-RETIREMENT BENEFITS

Nexen has contributory and non-contributory defined benefit and defined contribution pension plans, as well as other postretirement benefit programs, which cover substantially all employees. Syncrude has a defined benefit plan for its employees, and we disclose only our proportionate share of this plan.

## (A) DEFINED BENEFIT PENSION PLANS

The cost of pension benefits earned by employees is determined using the projected-benefit method prorated on employment services and is expensed as services are rendered. We fund these plans according to federal and provincial government regulations by contributing to trust funds administered by an independent trustee. These funds are invested primarily in equities and bonds. The supplemental plan is not tax-efficient to fund. Instead, obligations are secured by an irrevocable letter of credit.

	2010			Syncrude	Total
	Registered (Funded)	Nexen Supplemental (Unfunded)	Total		
Change in Projected Benefit Obligation (PBO)					
Beginning of Year	243	76	319	125	444
Service Cost	17	4	21	5	26
Interest Cost	15	5	20	7	27
Plan Participants' Contributions	6	–	6	1	7
Actuarial Loss/(Gain)	26	15	41	19	60
Benefits Paid	(16 )	(3 )	(19 )	(6 )	(25 )
End of Year 1, 2	291	97	388	151	539
Change in Fair Value of Plan Assets					
Beginning of Year	264	–	264	69	333

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Actual Return on Plan Assets	28	—	28	8	36
Employer's Contribution	30	3	33	14	47
Plan Participants' Contributions	6	—	6	1	7
Benefits Paid	(16 )	(3 )	(19 )	(5 )	(24 )
End of Year	312	—	312	87	399

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			2010		
	Registered	Nexen		Syncrude	Total
	(Funded)	Supplemental	Total		
	(Funded)	(Unfunded)			
Reconciliation of Funded Status					
Funded Status1	21	(97 )	(76 )	(64 )	(140 )
Items Not Yet Recognized in Earnings					
Unamortized Prior Service Costs	1	(1 )	–	–	–
Unamortized Net Actuarial Loss	53	32	85	52	137
Net Recognized Pension Asset (Liability)	75	(66 )	9	(12 )	(3 )
Accounts Recorded in the Consolidated Balance Sheet					
Deferred Charges and Other Assets (Note 5)	75	–	75	–	75
Accounts Payable and Accrued Liabilities	–	(3 )	(3 )	–	(3 )
Deferred Credits and Other Liabilities (Note 12)	–	(63 )	(63 )	(12 )	(75 )
Net Recognized Pension Asset (Liability)	75	(66 )	9	(12 )	(3 )
Assumptions (%)					
Accrued Benefit Obligation at December 31					
Discount Rate	5.25	5.25		5.25	
Long-Term Rate of Employee Compensation Increase	4.00	4.00		4.45	
Benefit Cost for Year Ended December 31					
Discount Rate	6.00	6.00		6.00	
Long-Term Rate of Employee Compensation Increase	4.00	4.00		4.45	
Long-Term Annual Rate of Return on Plan Assets	7.00	–		7.50	
			2009		
	Registered	Nexen		Syncrude	Total
	(Funded)	Supplemental	Total		
	(Funded)	(Unfunded)			
Change in Projected Benefit Obligation (PBO)					
Beginning of Year	203	62	265	107	372
Service Cost	14	4	18	5	23
Interest Cost	14	4	18	7	25
Plan Participants' Contributions	6	–	6	1	7
Actuarial Loss/(Gain)	16	8	24	10	34
Benefits Paid	(10 )	(2 )	(12 )	(5 )	(17 )
End of Year1, 2	243	76	319	125	444



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	Registered (Funded)	Nexen Supplemental <sup>1</sup> (Unfunded)	2009 Total	Syncrude	Total
Change in Fair Value of Plan Assets					
Beginning of Year	153	–	153	57	210
Actual Return on Plan Assets	40	–	40	9	49
Employer's Contribution	75	2	77	7	84
Plan Participants' Contributions	6	–	6	1	7
Benefits Paid	(10 )	(2 )	(12 )	(5 )	(17 )
End of Year	264	–	264	69	333
Reconciliation of Funded Status					
Funded Status <sup>1</sup>	21	(76 )	(55 )	(56 )	(111 )
Items Not Yet Recognized in Earnings					
Unamortized Prior Service Costs	2	(1 )	1	–	1
Unamortized Net Actuarial Loss	37	18	55	39	94
Net Recognized Pension Asset (Liability)	60	(59 )	1	(17 )	(16 )
Accounts Recorded in the Consolidated Balance Sheet					
Deferred Charges and Other Assets (Note 5)	60	–	60	–	60
Accounts Payable and Accrued Liabilities	–	(2 )	(2 )	–	(2 )
Deferred Credits and Other Liabilities (Note 12)	–	(57 )	(57 )	(17 )	(74 )
Net Recognized Pension Asset (Liability)	60	(59 )	1	(17 )	(16 )
Assumptions (%)					
Accrued Benefit Obligation at December 31					
Discount Rate	6.00	6.00		6.00	
Long-Term Rate of Employee Compensation Increase	4.00	4.00		5.00	
Benefit Cost for Year Ended December 31					
Discount Rate	6.50	6.50		6.50	
Long-Term Rate of Employee Compensation Increase	4.00	4.00		5.00	
Long-Term Annual Rate of Return on Plan Assets	7.00	–		8.50	

<sup>1</sup>Includes self-funded obligations for supplemental benefits to the extent that the benefit is limited by statutory guidelines. The self-funded obligations for supplemental benefits are backed by an irrevocable letter of credit.

<sup>2</sup>The accumulated benefit obligations (the projected benefit obligation excluding future salary increases) of the Nexen plan was \$256 million at December 31, 2010, (2009 – \$211 million). Nexen's supplemental pension plan's accumulated benefit obligation was \$78 million at December 31, 2010 (2009 – \$65 million). Nexen's share of Syncrude's employee pension plan's accumulated benefit obligation was \$120 million at December 31, 2010 (2009 – \$96 million).





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## Net Pension Expense Recognized Under Our Defined Benefit Pension Plans

	2010	2009	2008
Nexen			
Cost of Benefits Earned by Employees	21	18	23
Interest Cost on Benefits Earned	20	18	17
Actual (Return) Loss on Plan Assets	(28 )	(40 )	54
Actuarial (Gains)/Losses	41	24	(39 )
Pension Expense Before Adjustments for the Long-Term Nature of Employee Future Benefit Costs	54	20	55
Difference Between Actual and Expected Return on Plan Assets	8	26	(71 )
Difference Between Actual and Recognized Actuarial Losses	(38 )	(21 )	41
Difference Between Actual and Recognized Past Service Costs	1	–	1
Net Pension Expense	25	25	26
Syncrude <sup>1</sup>			
Cost of Benefits Earned by Employees	5	5	4
Interest Cost on Benefits Earned	7	7	7
Actual (Return) Loss on Plan Assets	(8 )	(9 )	19
Actuarial (Gains)/Losses	19	10	(25 )
Pension Expense Before Adjustments for the Long-Term Nature of Employee Future Benefit Costs	23	13	5
Difference Between Actual and Expected Return on Plan Assets	2	4	(26 )
Difference Between Actual and Recognized Actuarial Losses	(16 )	(8 )	27
Net Pension Expense	9	9	6
Total Net Pension Expense <sup>2</sup>	34	34	32

<sup>1</sup>Nexen's share of Syncrude's plan.

<sup>2</sup>Pension expense is reported principally within operating expense and general and administrative expense in the Consolidated Statement of Income.

## (B) PLAN ASSET ALLOCATION AT DECEMBER 31

Our investment goal for the assets in our defined benefit pension plans is to preserve capital and earn a long-term rate of return on assets, net of all management expenses, in excess of the inflation rate. Investment funds are managed by external fund managers based on policies approved by the Board of Directors and Pension Committee of Nexen. Nexen's investment strategy is to diversify plan assets between debt and equity securities of Canadian and non-Canadian corporations that are traded on recognized stock exchanges. Allowable and prohibited investment types are also prescribed in Nexen's investment policies.

Nexen's investment strategy is to ensure appropriate diversification between and within asset classes in order to optimize the return/risk trade-off. Nexen's policy allows investment in equities, fixed income, cash and real estate assets. Derivative instruments can be utilized as deemed appropriate by the Pension



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Committee. Nexen's expected long-term annual rate of return on plan assets assumption is based on a mix of historical market returns for debt and equity securities. The returns that are used as the basis for future expectations are derived from the major asset categories in which Nexen is currently invested.

The target allocations for plan assets are identified in the table below. Equity securities primarily include investments in large-cap companies, both Canadian and foreign, and debt securities primarily include corporate bonds of companies from diversified industries and Canadian Treasury issuances. The Canadian fixed income pooled funds invest in low-cost fixed income index funds that track the DEX Universe Bond Index. The Canadian equity pooled funds invest in low-cost equity index funds that track the S&P/TSX Composite Index. The foreign equity pooled funds invest in low-cost equity index funds that track the S&P 500 and the MSCI EAFE Indexes.

Nexen also has an unregistered self-funded supplemental benefits pension plan that covers obligations that are limited by statutory guidelines. These benefits are backed by an irrevocable letter of credit and payments are made from Nexen's general operating revenues.

Syncrude's pension plans are governed and administered separately from Nexen's. Syncrude's investment assets are subject to similar investment goals, policies and strategies.

Plan Asset Allocation (%)	Expected 2011	2010	2009
Nexen			
Equity Securities	65	65	62
Debt Securities	35	35	38
Total	100	100	100
Syncrude			
Equity Securities	60	60	71
Debt Securities	40	40	29
Total	100	100	100

The fair values of Nexen's defined benefit pension plan assets at December 31, 2010 by asset category are as follows:

Asset Category	Fair Value Measurements at December 31, 2010			Total
	Quoted Prices in Active Markets			
	for Identical Assets			
	Significant Observable Inputs	Significant Unobservable Inputs		
	(Level 1)	(Level 2)	(Level 3)	
Cash	3	–	–	3
Pooled Funds				
Canadian Fixed Income	–	105	–	105
Canadian Equity	–	78	–	78

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Foreign Equity	–	126	–	126
Total	3	309	–	312

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The fair values of Nexen's defined benefit pension plan assets at December 31, 2009 by asset category are as follows:

## Fair Value Measurements at December 31, 2009

Asset Category	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Cash	9	–	–	9
Equity Securities				
Canadian Equity	36	–	–	36
Pooled Funds				
Canadian Fixed Income	–	90	–	90
Canadian Equity	–	30	–	30
Foreign Equity	–	99	–	99
Total	45	219	–	264

The fair values of Syncrude's defined benefit pension plan assets at December 31, 2010 by asset category are as follows:

## Fair Value Measurements at December 31, 2010

Asset Category	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
Cash	1	–	–	1
Pooled Funds				
Canadian Fixed Income	–	32	–	32
Canadian Equity	–	22	–	22
Foreign Equity	–	31	–	31
Other Types of Investment				
Other	–	–	1	1
Total	1	85	1	87



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The fair values of Syncrude's defined benefit pension plan assets at December 31, 2009 by asset category are as follows:

Asset Category	Fair Value Measurements at December 31, 2009			Total
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
Cash	1	–	–	1
Pooled Funds				
Canadian Fixed Income	–	17	–	17
Canadian Equity	–	19	–	19
Foreign Equity	–	30	–	30
Other Types of Investment				
Other	–	–	2	2
Total	1	66	2	69

## (C) DEFINED CONTRIBUTION PENSION PLANS

Under these plans, pension benefits are based on plan contributions. During 2011, Canadian pension expense for these plans was \$7 million (2009-\$8 million; 2008-\$6 million). During 2010, US pension expense for these plans was \$6 million (2009-\$7 million; 2008-\$4 million) and UK pension expense for these plans was \$6 million (2009 - \$6 million; 2008 - \$6 million).

## (D) POST-RETIREMENT BENEFITS

Nexen provides certain post-retirement benefits, including group life and supplemental health insurance, to eligible employees and their dependents. The present value of Nexen employees' future post-retirement benefits at December 31, 2010 was \$15 million (2009-\$14 million).

## (E) EMPLOYER FUNDING CONTRIBUTIONS AND BENEFIT PAYMENTS

Canadian regulators have prescribed funding requirements for our defined benefit plans. Funding contributions over the last three years have met these requirements and also included additional discretionary contributions permitted by law to ensure the plans are adequately funded in light of expected future changes in assumptions. For our defined contribution pension plans, we make contributions on behalf of our employees and no further obligation exists. Funding contributions related to our defined benefit plans are:

Expected



	2011	2010	2009
Nexen	11	33	77
Syncrude	14	14	7
Total Defined Benefit Contribution	25	47	84

Our most recent funding valuation was prepared as of June 30, 2010. Our next funding valuation is required by June 30, 2013. Syncrude's most recent funding valuation was prepared as of December 31, 2009. The next funding valuation is required as at December 31, 2012.

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Our total benefit payments in 2010 were \$19 million for Nexen (2009-\$12 million). Our share of Syncrude's total benefit payments in 2010 was \$6 million (2009-\$5 million). Our estimated future payments are as follows:

	Defined Benefit		Other	
	Nexen	Syncrude	Nexen	Syncrude
2011	12	6	3	–
2012	12	6	4	–
2013	13	6	4	–
2014	14	7	4	–
2015	14	7	5	–
2016-2020	84	45	28	2

## 14. EQUITY

## (A) AUTHORIZED CAPITAL

Authorized share capital consists of an unlimited number of common shares of no par value and an unlimited number of Class A preferred shares of no par value, issuable in series.

## (B) ISSUED COMMON SHARES AND DIVIDENDS

(thousands of shares)	2010	2009	2008
Issued Common Shares, Beginning of Year	522,916	519,449	528,305
Issue of Common Shares for Cash			
Exercise of Tandem Options	527	1,146	1,911
Dividend Reinvestment Plan	1,654	1,328	871
Employee Flow-through Shares	609	993	499
Repurchased under Normal Course Issuer Bid	–	–	(12,137 )
End of Year	525,706	522,916	519,449
Dividends Declared per Common Share (\$/share)	0.20	0.20	0.18
Cash Consideration (Cdn\$ millions)			
Exercise of Tandem Options	5	12	23
Dividend Reinvestment Plan	35	29	25
Employee Flow-through Shares	15	16	16
Total	55	57	64

During the year 1,654,173 common shares were issued under the Dividend Reinvestment Plan, leaving a balance of 621,171 common shares (2009 – 2,275,344; 2008 – 3,603,841) reserved for issuance at December 31, 2010. In 2011, we plan to request board approval to increase the number of common shares reserved for issuance under the Dividend Reinvestment Plan. Dividends paid to holders of common shares have been designated as “eligible dividends” for Canadian tax purposes.

During 2008, we received approval from the Toronto Stock Exchange (TSX) for a Normal Course Issuer Bid to repurchase up to a maximum of 52,914,046 common shares between August 6, 2008 and August 5, 2009. Under this

authorization, we repurchased and cancelled 12,136,900 common shares acquired on the open market through the TSX in 2008 at an average price of \$27.85 per common share, totalling \$338 million. Of the amount paid, \$22 million reduced the book value of our common shares and the excess of \$316 million reduced retained earnings. We did not repurchase any common shares in 2010 or 2009.

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## (C) TANDEM OPTIONS

In 2010, our board of directors approved amendments to our tandem option plans to allow for performance vesting of certain grants. Performance tandems vest over three years if our annual total shareholder return (stock price appreciation and cumulative dividends on a reinvested basis) falls within certain percentile ranks relative to our industry peer group. The ultimate number of performance tandems that vest will depend upon our performance measured over three calendar years. If our performance is below the specified level compared with our industry peer group, the performance tandems awarded will be forfeited. If our performance is at or above the specified level, the number of performance tandems exercisable shall be determined by our relative ranking. Stock compensation expense related to the performance tandems is accrued based on the price of our common shares at the end of the period and the anticipated performance factor. The expense is recognized over a three-year graded vesting period similar to the existing tandems plan.

We grant tandem and performance tandem options to purchase common shares to officers and employees. Performance tandems are awarded to officers and senior employees. Each option permits the right to either purchase one Nexen common share at the exercise price or receive a cash payment equal to the excess of market price over the exercise price. There were no performance tandems exercised during the year ended December 31, 2010. The following tandem options have been granted:

	2010		2009		2008	
	Options		Options		Options	
(thousands of shares)	(thousands)	Weighted Average Exercise Price (\$/option)	(thousands)	Weighted Average Exercise Price (\$/option)	(thousands)	Weighted Average Exercise Price (\$/option)
Outstanding Tandem Options, Beginning of Year	23,130	25	24,622	22	27,403	20
Granted	4,615	1 22	4,350	24	3,534	19
Exercised for Stock	(527 )	9	(1,146 )	10	(1,911 )	13
Surrendered for Cash	(2,191 )	11	(4,116 )	12	(3,839 )	13
Cancelled	(2,704 )	28	(560 )	28	(552 )	30
Expired	(3,888 )	27	(20 )	12	(13 )	11
End of Year	18,435	25	23,130	25	24,622	22
Tandem Options Exercisable at End of Year	9,949	27	15,282	25	17,087	21
Common Shares Reserved for Issuance Under the Tandem Option Plan	25,301		26,283		27,429	

1 Approximately 29% of options granted in 2010 contain performance vesting conditions.

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The range of exercise prices of tandem and performance tandem options outstanding and exercisable at December 31, 2010 is as follows:

	Outstanding Tandem and Performance Tandem Options			Exercisable Tandem and Performance Tandem Options	
	Number of Options (thousands)	Weighted Average Exercise Price (\$/option)	Weighted Average Years to Expiry (years)	Number of Options (thousands)	Weighted Average Exercise Price (\$/option)
\$15.00 to \$19.99	3,027	19	3	1,924	19
\$20.00 to \$24.99	8,613	23	4	1,427	25
\$25.00 to \$29.99	3,620	28	2	3,428	28
\$30.00 to \$34.99	3,150	32	1	3,147	32
\$35.00 to \$39.99	20	36	1	20	36
\$40.00 to \$44.99	5	40	2	3	40
Total	18,435			9,949	

## (D) STOCK APPRECIATION RIGHTS

In 2010, our board of directors approved amendments to our STARs plans to allow for performance vesting of certain grants. Performance STARs vest over three years if our annual total shareholder return (stock price appreciation and cumulative dividends on a reinvested basis) falls within certain percentile ranks relative to our industry peer group. The ultimate number of performance STARs that vest will depend upon our performance measured over three calendar years. If our performance is below the specified level compared with our industry peer group, the performance STARs awarded will be forfeited. If our performance is at or above the specified level, the number of performance STARs exercisable shall be determined by our relative ranking. Stock compensation expense related to the performance STARs is accrued based on the price of our common shares at the end of the period and the anticipated performance factor. The expense is recognized over a three-year graded vesting period similar to the existing STARs plan.

Our STARs and performance STARs plans entitle employees to cash payments equal to the excess of the market price of the common shares over the exercise price of the right. Performance STARs are awarded to senior employees. There were no performance STARs exercised during the year ended December 31, 2010. The following stock appreciation and performance stock appreciation rights have been granted:

2010		2009		2008	
	Weighted		Weighted		Weighted