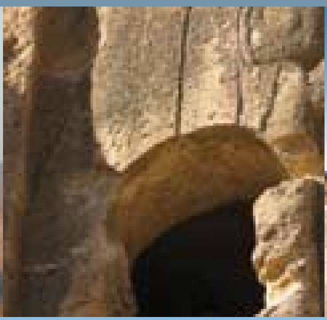
GULF KEYSTONE PETROLEUM LTD.

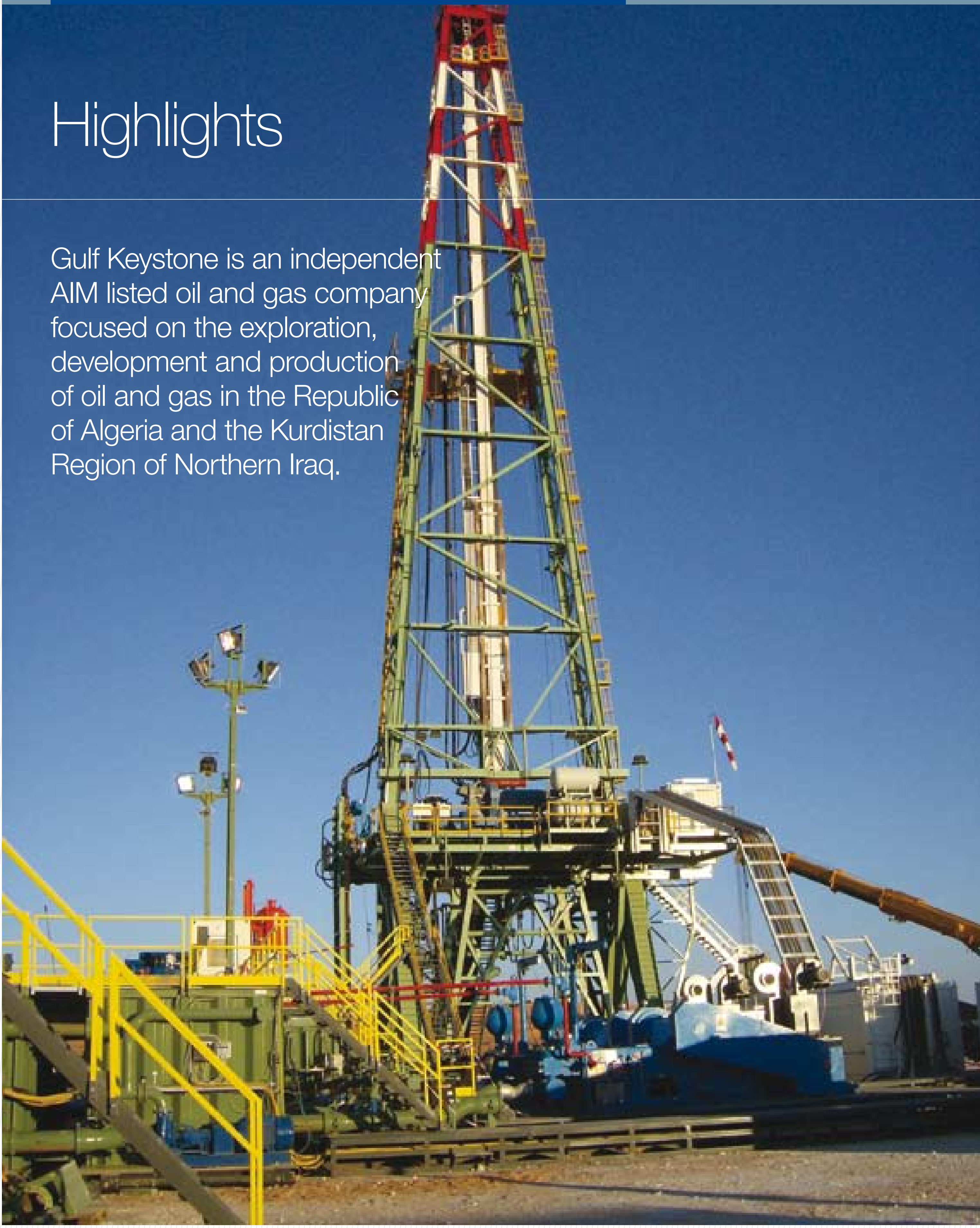
Annual Report and Accounts 2007




A year of diversification

Highlights

Gulf Keystone is an independent AIM listed oil and gas company focused on the exploration, development and production of oil and gas in the Republic of Algeria and the Kurdistan Region of Northern Iraq.



غلف كيستون هي شركة بترول مستقلة ومسجلة في السوق الموازيه
بسوق لندن المالي وتعمل في مجال استكشاف وتطوير وإنتاج النفط الخام
والغاز في الجمهورية الجزائرية الديمقراطية وفي إقليم كردستان في
العراق.

In January 2007, BG farmed into the HBH licence in Algeria

In 2007 Gulf Keystone acquired 2,047 kilometres of 2D seismic and 533 square kilometres of 3D seismic on the HBH licence area. In 2008, GKP and its partners will drill six wells on the HBH licence in Algeria.

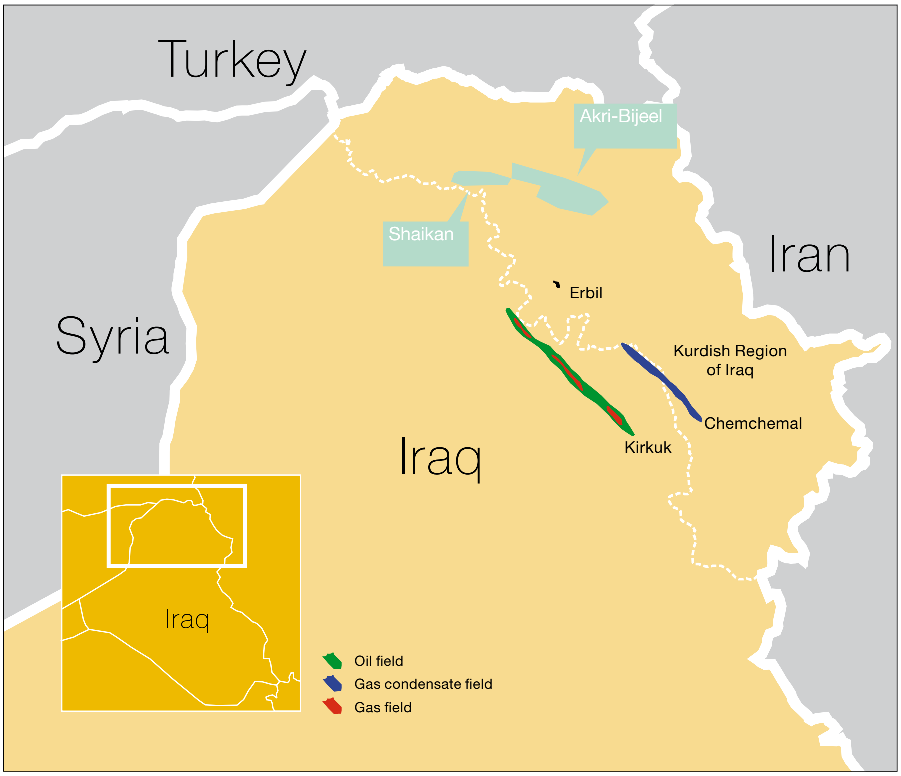
In November 2007, Gulf Keystone entered into two production sharing contracts in the Kurdistan Region of Northern Iraq

In 2008, Gulf Keystone acquired 170 kilometres of 2D seismic in Kurdistan

In January 2008 ALNAFT (the Hydrocarbon National Agency in Algeria) approved the proposed Development Plan for the GKN & GKS oil fields following the Declaration of Commerciality in June 2007

Gulf Keystone at a glance

In 2007, Gulf Keystone diversified out of its 100% Algeria focused position and secured interests in two blocks in Kurdistan. The Kurdish Region of Northern Iraq has the potential to be a world class hydrocarbon province and Gulf Keystone believes it is well positioned to seek out further growth opportunities.



Shaikan and Akri-Bijeel key deliverables:

- Acquisition of 171 kilometres of 2D seismic completed on the Shaikan block.
- Drilling of one exploration well planned on the Shaikan block
- Approximately 400 kilometres of 2D seismic started on the Akri-Bijeel block
- Optional exploration well on the Akri-Bijeel block

A Unique Investment Opportunity

- Two Kurdistan PSC's signed in partnership with MOL
- Country manager appointed and Erbil office established
- Fast track seismic and exploratory drilling
- Area of 1,172 square kilometres
- Large untested surface structures
- Oil seeps discovered

Shaikan – GKP Operator 80%

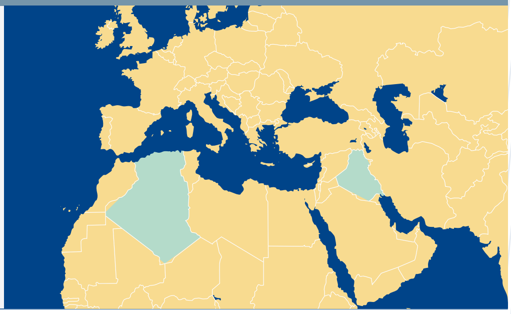
- Three year initial exploration phase
- Commitment of 150 kilometre 2D seismic
- Commitment for one exploration well
- 25 year Production Sharing Contract

Akri-Bijeel – 20%

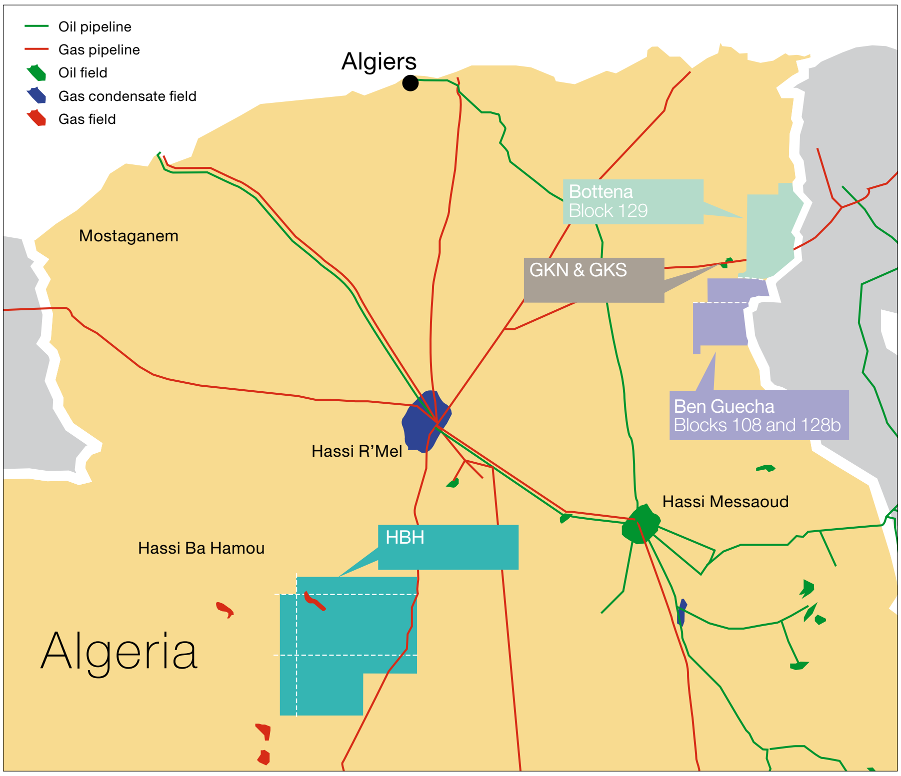
- Three year initial exploration phase
- Commitment of 200 kilometre 2D seismic
- One optional exploration well
- 25 year Production Sharing Contract

Location of assets

- GKP have signed one block as operator and entered as a partner into a second block with MOL – the two blocks are adjacent
- GKP interest blocks are c. 90 km NW Erbil and c. 50-80 km from the Turkish border
- Erbil is 320 km NNW of Baghdad



The Company currently has exploration and appraisal rights over eight blocks and two producing fields in the Republic of Algeria. Gulf Keystone has operated in Algeria since 2001 and has in depth knowledge of the country's local culture, political and operating environments.



The next phase – 2008 key deliverables:

- GKN/GKS development plan:
  - To build a pipeline to connect GKS-2 to the existing evacuation pipeline so that this well can begin production
  - Upgrade the facilities and jointly develop the block with our partner Sontrach
- HBH:
  - one exploration well and one appraisal well have been drilled in early 2008
  - The plan is for a further two appraisal wells on the HBH field and to further explore the block with a further two exploration wells

Hassi Ba Hamou Perimeter Blocks 317b1, 322b3, 347b, 348, 349b Partners shares: GKP 38.25%; BG (operator) 36.75%; Sonatrach 25%

The Hassi Ba Hamou Perimeter covers an area of 18,380 square kilometres and is located in the Timimoun Basin/Allal High area in central Algeria. Gulf Keystone was awarded the contract which covers five Blocks (317b1, 322b3, 347b, 348, 349b) during Algeria's 6th International Bid Round in April 2005.

GKN and GKS Field

Located in North Algeria, South East Constantine basin, Block 126a, the GKN and GKS oil fields received Development Plan approval (60% Working Interest) in January 2008.

Bottena Perimeter – Block 129

Block 129 is located in the Bottena Perimeter which covers an area of 4,368 square kilometres within the South Constantine Basin, to the east of Block 126a.

Ben Guecha Permit – Blocks 108 and 128b

The permit covers an area of 4,641 square kilometres and is located in the South Constantine basin, adjacent to Block 108. The contract for Blocks 108 and 128b, which established a joint venture between SONATRACH and Gulf Keystone, resulted from direct negotiations which took place in April 2005 outside of Algeria's International Bid Rounds.

A year of diversification

2007 was a year of significant challenges for Gulf Keystone Petroleum from which i believe the Company has emerged both operationally and strategically stronger.

Todd Francis Kozel
Executive Chairman &
Chief Executive Officer

The entitlement to a share of production revenues from the GKN and GKS fields are a first for Gulf Keystone marking our evolution into an exploration and production company.

Overview

The year began well with approval by the Algerian Council of Ministers for the introduction of BG Group into the Hassi Ba Hamou ("HBH") Contract in the Timimoun Basin/Allal High area in central Algeria, with its formal ratification by an announcement in the Official Journal of Algeria. This was, for Gulf Keystone, a strategically important transaction which significantly enhanced our financial position and brought in a strong partner as operator.

The Declaration of Commerciality by the Joint SONATRACH/Gulf Keystone Management Committee in June 2007 for the GKN and GKS oil fields, located in Block 126a, South East Constantine Basin, North Algeria, was followed by confirmation in January 2008 of approval by ALNAFT (the Hydrocarbon National Agency) of the Field Development Plan. This triggered an entitlement to a share of production revenues from the GKN and GKS fields effective from 10 October 2007, which are a first for Gulf Keystone marking our evolution into an exploration and production company.

In November 2007, we were delighted, in partnership with MOL Hungarian Oil & Gas Public Company Limited ("MOL"), to be awarded interests in two blocks in Kurdistan. This was an important first step in the diversification of Gulf Keystone's asset portfolio and extended our relationships with major international energy companies.

We have made a good start to the current year. Two wells have been completed and preparations are advanced for the commencement of a third well of a six well campaign to be drilled by our operating partner BG Group on the HBH Permit, Algeria. 2D seismic on the Shaikan Block, Kurdistan, has been completed and seismic on the Akri-Bijeel Block, Kurdistan, has begun.

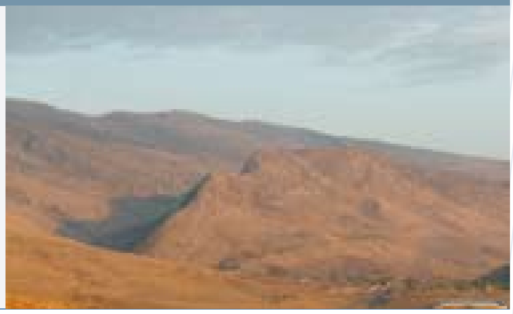
I would like to thank all of the Company's employees who have contributed enormously to the strong position that we now enjoy.

Management

A number of directors decided to leave the Company after termination of the RAK Petroleum proposal and the Company then embarked on a major restructuring initiative.

I assumed the role of Chairman and Chief Executive and co-founder Mr Ali Al-Qabandi assumed one of the vacant Director positions.

In January 2008, I was delighted to welcome Mr Jeremy Asher and Mr Mehdi Varzi as Non-Executive Directors of the Company. Jeremy Asher has considerable oil and gas and business management experience and Mehdi Varzi, a joint Iranian and British national, has considerable experience in the international oil and gas industry. Both have significantly strengthened our Board.



I was also delighted to welcome Mr Ewen Ainsworth who joined the Board in January 2008, as Finance Director. Ewen Ainsworth has over 20 years experience of finance roles within the oil and gas industry, including as Finance Director of a publicly listed oil and gas company.

Operating Review

Algeria

Hassi Ba Hamou ("HBH") Permit

The HBH Permit, awarded to Gulf Keystone in May 2005, comprises five blocks within an area of 18,380 square kilometres in the Timimoun Basin/Allal High area in central Algeria. The HBH Permit contains the significant HBH gas field that was discovered by SONATRACH in 1965.

Following approval by the Algerian Council of Ministers, the introduction of BG Group ("BG") into the HBH Contract was formally ratified in January 2007 by an announcement in the Official Journal of Algeria. This completed the transaction between Gulf Keystone and BG, first announced in August 2006, in which BG acquired a 36.75% interest in the HBH Concession, with Gulf Keystone retaining a 38.25% interest and SONATRACH a 25% interest.

The 3D seismic programme shot over 533 square kilometres of the HBH gas field, which began in July 2007, has been completed on plan and the results have been evaluated giving the partners a greater understanding of the gas discovery.

The HBH Permit wide 2D seismic programme was completed on 4 December 2007 with 2,047 kilometres of seismic having been acquired to fulfil the 2,000 kilometres commitment. Early indications from the data interpretation are that promising leads and prospects have been identified over the HBH Permit, three of which the partners agreed to prioritise as drill targets in the six well campaign currently underway. The six well drilling programme planned for the HBH Licence Area consists of three exploration wells and three development wells which will satisfy the contractual commitment for Period 1 of the Exploration Licence.

Spudded on 16 December 2007, HBH-4, an appraisal well on the HBH gas field, the first of the six well campaign, was successfully drilled to a total depth of 1,011 metres and tested. A production test, completed on reservoirs of Devonian age, achieved a stabilised flow rate of 12,800 cubic metres per hour (10.8 mmscfg per day) through an 88/64-inch choke.

The drill rig then moved to well HBHN-1, an exploration well to the north of the HBH gas field, which was spudded on 21 February 2008. The well completed drilling in April 2008 but failed to find commercial quantities of hydrocarbons and it was abandoned.

The rig has now moved to prepare for drilling of the third well of the six well commitment, exploration well RM-1.

Blocks 108 and 128a

Formal ratification in the Official Journal of Algeria of The Council of Ministers of the award of the Ben Guecha Blocks (108 and 128a), which Gulf Keystone signed in April 2005, occurred in January 2007, marking the start of the first three year period of exploration on the contract.

Gulf Keystone immediately commenced exploration and appraisal activities on the Blocks. On Block 108, we completed the processing and preliminary interpretation of 156 square kilometres of 3D seismic acquired over the producing Ras Toumb field. The inventory of potential prospects has been reviewed and the risks and rewards are currently being assessed.

The remaining work commitment covering the blocks includes the drilling of one appraisal well on the Ras Toumb field and the drilling of one exploration well.

Block 126

SONATRACH and Gulf Keystone reached final agreement on all aspects of the field development plans for the GKS and GKN oil fields, located in Block 126a, South East Constantine Basin, North Algeria on 25 June 2007, the joint Management Committee for the 126a Block unanimously approved the declaration of commerciality for both fields.

The Development Plan was then submitted to ALNAFT (the Hydrocarbon National Agency) for approval which was received in January 2008. Approval conferred on Gulf Keystone entitlement to its first producing revenues effective from 10 October 2007.

The GKN-1 well is currently producing at approximately 1,000 bopd gross and the Development Plan envisages bringing the GKS-2 well on stream as soon as practicable. SONATRACH and Gulf Keystone intend to build a pipeline to connect GKS-2 to the existing evacuation pipeline so that this well can begin production. The GKS-2 well produced at a rate equivalent to 4,586 bopd and 4.61 mmcfgd when it was tested in 2005.

The two fields will then be developed in a staged process through the acquisition of a 3D seismic survey and a development drilling programme jointly conducted by SONATRACH and Gulf Keystone. In addition, it is intended that the existing facilities will be upgraded to handle c3,000 bopd (gross).

Block 129

Early in 2007, the environmental impact assessment was completed and the work programme and budget finalised to include the testing of one of the two discovery wells Hassi El Kerma-1 ("HEK-1") and Hassi El Kerma-3 ("HEK-3"), the acquisition of additional 2D seismic and the processing of 412 square kilometres of 3D seismic acquired over the DDN discovery.

In April 2007, Gulf Keystone commenced workover operations on well HEK-3, an oil and gas discovery well drilled by SONATRACH in 2004. At that time, the well was tested over the Cretaceous, Coniacian limestone interval and achieved, post acidisation, a flow rate of 184 barrels of oil over a four hour period, prior to the well being suspended. Gulf Keystone re-entered the well and tested the same zone, over the measured interval 2,439 to 2,446 metres, employing an acid fracturing technique to improve connectivity between the reservoir and the wellbore. After cleaning up the well, a stabilised flow rate of 1,040 barrels per day of 31 degrees API oil was achieved through a 32/64 inch choke. The well was flowed through a separator for a total of 4.5 days and over 3,500 barrels of oil were produced during this period. The crude contained little entrained gas and has an estimated gas/oil ratio of 93 standard cubic feet per barrel. The well is presently suspended.

A large amount of good quality engineering data was collected during the test programme which, combined with the produced volume of oil and the long flow and shut in periods, is providing valuable data for reservoir evaluation and field development study purposes. SONATRACH and Gulf Keystone are evaluating the potential for the commercial development of the HEK discovery.

Kurdistan

Gulf Keystone was delighted in November 2007 to be awarded interests in two Production Sharing Contracts ("PSCs") covering the Shaikan Block and the Akri-Bijeel Block and also to be in partnership in these PSCs with MOL, through its subsidiary Kalegran, and Texas Keystone Inc. ("Texas Keystone").

Shaikan Block

The Shaikan Block is situated approximately 90 kilometres North-West of Erbil and covers an area of 283 square kilometres. The interests under the PSC are Gulf Keystone 75% (operators), Kalegran 20% and Texas Keystone 5%. Gulf Keystone will carry Texas Keystone's 5% share of initial costs and expenses prior to drilling the first well.

Acquisition of 2D seismic on the Shaikan Block began on 2 March 2008 and was completed on 19 April 2008. A total of 171 kilometres was acquired utilising both vibrator and dynamite sources. The 2D seismic is now being processed.

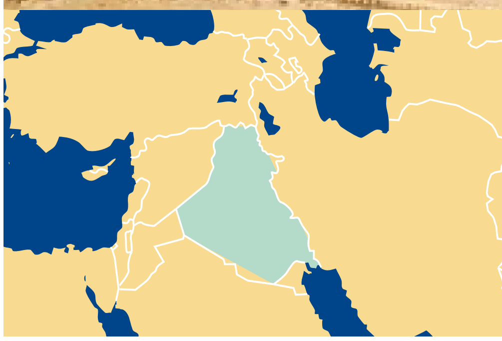
Akri-Bijeel Block

In consideration for introducing Kalegran into the Shaikan partnership, Gulf Keystone received a 20% interest, on a ground floor basis, in the Kalegran operated PSC covering the Akri-Bijeel Block. The Akri-Bijeel Block is adjacent to the Shaikan Block. The interests in this PSC are Kalegran 80% (operator) and Gulf Keystone 20%.

The partners expect to begin an extensive 2D seismic programme on the Akri-Bijeel Block in the second quarter of 2008 to assess the exploration potential of the Block.

The commercial terms of the PSC are in line with the terms and conditions published by the Kurdistan Regional Government ("KRG") on its website. Both the PSCs are of a 25 year duration with an initial three year exploration phase. Gulf Keystone's expected total expenditure for these two blocks over the next three years, given its current interests, is approximately US$53 million, the majority of which is expected to have been incurred during the initial six month period.

Kurdistan in Context



Financial Review

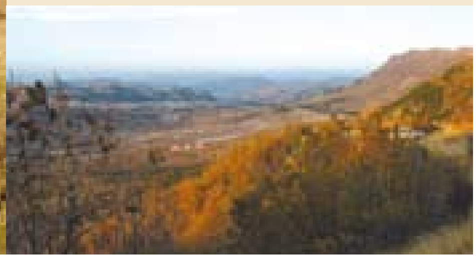
The Company reports a loss after taxation of US$30.0 million (2006: profit US$46.3 million) for the year ended 31 December 2007. This loss is after a charge of US$20.6 million as a result of an impairment test on Block 126a following the failure to find commercial levels of hydrocarbons in GRJ.

Net cash generated for the period of $28.9 million (2006: $7.9 million), reflected the collection of $55 million from the partial disposal of HBH in the prior year, which added significantly to the Group's cash reserve. Net cash used in operating activities for the period was $11.4 million (2006: $11.3 million).

In common with many exploration companies, the Group raises finance for its exploration and appraisal activities in

The Kurdistan Region is an autonomous, federally recognised political, ethnic and economic region covering approximately 40,000 kilometres in the North Eastern corner of Iraq. With a population of approximately 4 million, the Kurdistan region has a more developed economy in comparison to other parts of Iraq due to the relative peace of the region.

Over the past 30 years, there has been limited oil and gas activity and the region is perhaps the last significant, accessible, onshore hydrocarbon province in the world that is yet to be properly explored.



discrete tranches to finance its activities for specific periods. The directors actively monitor the cash requirements of the business, and further funding is raised as and when required. The Group's existing cash reserves, which stood at $88.3 million at 31 December 2007 (2006: $59.3 million), along with the expected production revenue from the GKN and GKS fields, are considered to be sufficient to cover known work commitments on existing projects. A successful outcome from these work commitments will require additional financing for these projects as they move into appraisal and/or development.

Outlook

The shape of Gulf Keystone, and as such our future prospects, has improved considerably over the past year.

Gulf Keystone is now entitled to its first production revenues from Block 126 and it is anticipated that this will allow the development of these fields to be self financing. The Gulf Keystone/SONATRACH Joint Venture is focused on increased production from the GKN and GKS fields and the prudent future development of these fields.

The work programme on the HBH Permit is progressing at a steady pace. Operator, BG North Sea Holdings, is currently preparing to drill the third well of a six well programme while the partners, SONATRACH/Gulf Keystone/BG, continue to evaluate the economic potential of the HBH discovery and further exploration upside.

Our 2D seismic survey on the Shaikan Block in the Kurdish Region of Iraq has been completed and it is intended to drill an exploration well on the Shaikan structure as soon as a drilling rig and services can be contracted. Our partner, MOL, has brought forward their planned 400 kilometre 2D seismic programme on the Akri-Bijeel Block in Kurdistan, its process to acquire seismic began in April 2008. The results of that survey will be used to plan an exploration drilling programme on the Block. The progress being made on both blocks in Kurdistan is outstanding.

I am confident that 2008 will prove to be a year of historically unparalleled activity and potential for Gulf Keystone.

TF Kozel
Executive Chairman & Chief Executive Officer

Making a positive contribution

Our goal is to be a partner of choice, a competent and responsible operator, a Company known for making a positive contribution to those with whom we interact.

The Board of Gulf Keystone bases its actions on the principles of openness, integrity and accountability. Gulf Keystone respects countries' traditions and cultures.

Economic dealings

The Company strives to conduct business to high ethical standards, and is committed to conducting its business in an open and honest manner. Gulf Keystone seeks to be fair in our relationships and dealings with our counterparties. Gulf Keystone strives to build strong relationships with our business partners, host governments, and within the local communities in which we operate.

Social responsibility

We are sensitive to the diverse cultures with whom we interact and we aim to make a positive contribution to the communities in which we operate.

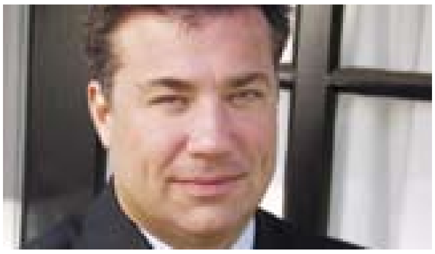
Gulf Keystone values its diverse workforce, and is committed to providing a workplace free of discrimination where all employees are afforded opportunities and are rewarded upon merit and ability.

Gulf Keystone is committed to protecting the health and safety of our employees and our contractors. The safety of the Company's employees, contractors and those in the local communities where we operate is of paramount importance.

Environmental performance

Gulf Keystone is focused on minimising the environmental impact of its operations. Gulf Keystone is committed to meeting the legal and regulatory requirements governing environmental practices within all countries in which it operates.

A year of new opportunities



Todd Kozel
Executive Chairman &
Chief Executive Officer

Mr Kozel co-founded Gulf Keystone where he serves as the Executive Chairman and Chief Executive Officer. In 1988 Mr Kozel founded Texas Keystone Inc., an independent oil and gas exploration, development and production company, headquartered in Pittsburgh, USA. Mr Kozel served as Texas Keystone's President from 1995 to 2004 and has served as a director since 1988. Mr Kozel also co-founded Falcon Drilling Company LLC, an American independent drilling and oilfield services company, in 2001 and serves on its Board of Directors.

Ali Al-Qabandi (CPA, ICPA)
Executive Vice President

Mr Al-Qabandi co-founded Gulf Keystone where he has served as a director since 23 July 2007. Prior to his appointment as the Executive Vice President, Mr Al-Qabandi had been serving the Company in the capacity of Business Development Officer. He has held numerous executive positions and committee chairmanships for the Kuwait Oil Company which he joined in 1979. Most recently, Mr Al-Qabandi served as the Executive Assistant Managing Director of Planning and Finance for the Kuwait Oil Company ("KOC") and a director of the Kuwait National Petroleum Company.
Mr Al-Qabandi also served as Chairman of the Corporate Information Implementation Project, a board member of Kuwait Gulf Oil Company, a board member of United Oil Projects, Chairman of the KOC Profit Centre Committee and was a member of the Strategic Planning Steering Committee, the Review of KOC Organisation Committee, the Cost Optimisation Steering Committee and Field Development Steering Committee.

Mehdi Varzi
Non-Executive Director

Mr Varzi was appointed as a Non-Executive Director of Gulf Keystone in January 2008. He graduated from the London School of Economics & Political Science with a Bachelor of Economics and holds an MA from the School of Oriental and African Studies, London University. Mr Varzi began his career with the National Iranian Oil Company before joining the Iranian Ministry of Foreign Affairs. In 1982 Mr Varzi joined stockbrokers Grieveson Grant & Co. Over his time with Grieveson Grant & Co, which subsequently became Dresdner Kleinwort Wasserstein, Mr Varzi held a number of positions, culminating in the position of Managing Director, Oil & Gas Research.
In 2001, Mr Varzi established an independent global energy consultancy, Varzi Energy, which advises a number of leading international financial institutions on global oil and gas developments. Over the past 10 years, Mr Varzi has served as a Member of the International Advisory Panel of Nippon Oil, Non Executive Director of Sonoran Energy, Director of Global Macro Energy Research and Middle Eastern Affairs at Trinity Funds and adviser to the chairman of Turcas Petrol. He is also a regular speaker at international energy conferences.

Jeremy Asher
Non-Executive Director

Mr Asher was appointed as a Non-Executive Director of Gulf Keystone in January 2008. Mr Asher graduated from the London School of Economics & Political Science in 1979 and was awarded an MBA with high distinction from the Harvard University Graduate School of Business Administration. Following several years consulting with what is now Oliver Wyman, he became co-head of the global oil products trading business at what is now Glencore AG, and left in 1989 to acquire and develop the Beta oil refinery at Wilhelmshaven in Germany. Between 1998 and 2001, Mr Asher held the position of CEO of PA Consulting Group, where he oversaw PA's globalisation and growth and negotiated and managed the integration of PA's acquisition of Hagler Bailly Inc. Since then, he has been involved in financing a variety of investments in the energy sector, directly and more recently through his investment company Agile Energy Ltd. Mr Asher serves as a Non Executive Director of Tower Resources plc. He is also a member of the investment advisory group at Imperial Innovations Ltd, the technology ventures company controlled by Imperial College and as a member of the UK Regional Advisory Board of the London Business School.

Kristian 'Ewen' Ainsworth
Finance Director

Mr Ainsworth was appointed as Finance Director of Gulf Keystone in January 2008. Mr Ainsworth has over 20 years experience of finance roles within the oil and gas industry. Prior to joining Gulf Keystone, Mr Ainsworth was Finance Director of London AIM listed Europa Oil & Gas (Holdings) plc. Mr Ainsworth has held increasingly senior finance positions within a number of oil and gas companies including Conoco (U.K.) Ltd (London), Murco Petroleum Ltd (London), Texaco Ltd (London and Aberdeen) and CIECO Exploration & Production (UK) Ltd where he was responsible for all aspects of North Sea accounting and providing financial support for the Algeria and Azerbaijan operations. He joined Europa Oil & Gas (Holdings) plc in September 2004 where Mr Ainsworth provided support to the business across a wide brief, including, preparation and submission of a successful licence application in Egypt, business development, compliance, legal and HR issues. A qualified accountant, Mr Ainsworth gained ACMA accreditation in 1993. He has strong technical skills in managing public company finances and regulatory obligations as well as international transaction and funding experience.

Ibrahim Al-Khaldi
Chief Operating Officer

Mr Al-Khaldi co-founded Gulf Keystone where he serves as the Chief Operating Officer. Prior to joining Gulf Keystone, Mr Al-Khaldi served as Business Development Manager for the Middle East and North Africa for Baker Atlas, a subsidiary of Baker Hughes Inc, one of the world's largest oil services companies.

Prior to joining Baker Atlas, Mr Al-Khaldi served as a general field engineer for Western Atlas International Inc, and oil services company and predecessor to Baker Atlas, and was responsible for assignments to Europe, Africa, the Middle East, the Far East, South America and North America.

Directors and senior management team

Chris Garrett
Vice President Operations

Mr Garrett joined Gulf Keystone in 2004 as Managing Director of the UK entity and Operations Manager for Algeria. Mr Garrett's background is in geology and geophysics and he spent 12 years overseas working in the USA and Middle East. He brings to Gulf Keystone over 29 years of oilfield experience gained with Core Laboratories and Western Geophysical and latterly with Baker Hughes and Randall & Dewey. Previously he worked for Randall & Dewey and Baker Hughes in a number of roles ranging from international exploration and operations management through to property and prospect evaluation.

Adnan Samarrai
Country Manager – Kurdistan

Mr Samarrai holds a B.Sc degree in geology and has been an active member of the American Association of Petroleum Geologists since 1972. He has over 45 years experience in the oil and gas industry in Iraq including wide experience in petroleum geology and drilling technology. He joined the Iraq Petroleum Co. (IPC) in the early sixties before joining the Iraq National Oil Company ("INOC") in 1972 where he held the position of Chief Exploration Geologist until his resignation in 1998. Since his resignation from INOC Mr Samarrai has worked as Consulting Geologist to both BG International and Exploration Consultant Ltd (ECL) before joining Gulf Keystone firstly as a consultant and subsequently as the Country Manager for Kurdistan in November 2006.

Mohamed Messaoudi
Country Manager – Algeria

Mr Messaoudi is a petroleum geologist with 27 years experience in the oil and gas industry in Algeria. Mr Messaoudi jointed SONATRACH, the Algerian National Oil Enterprise in 1979, becoming Chief Geologist for the Hassi Messaoud Basin in 1996 and then the Regional Exploration Manager of the North Algeria Area/Onshore and Offshore Basins. Prior to Mr Messaoudi's retirement from SONATRACH, he held the position of Regional Exploration Manager for the South East Algeria Region. The South East Region is Algeria's most important hydrocarbon area and contains the Hassi Messaoud, Berkine, Illizi and Oued Mya basins.

Directors' Report

The Directors present their annual report and the consolidated financial statements of Gulf Keystone Petroleum Limited (the "Group") for the year ended 31 December 2007.

Gulf Keystone Petroleum Limited is a public company, incorporated in Bermuda, and quoted on the Alternative Investment Market of the London Stock Exchange.

Principal activities

The principal activity of the Group during the year was that of oil and gas exploration and production operating in the Republic of Algeria and the Kurdistan Region of Northern Iraq.

Results and dividends

The Group's net loss after tax for the year was $30.0 million (2006: net profit of $46.3 million). The Directors do not recommend a dividend for the year (2006: $nil).

Capital structure

Details of the authorised and issued share capital, together with movements in the Company's issued share capital during the year are shown in Note 15.

There are no specific restrictions on the size of a holding nor on the transfer of shares, which are both governed by the general provisions of the Company's bye-laws and prevailing legislation. The Directors are not aware of any agreements between holders of the Company's shares that may result in restrictions on the transfer of securities or on voting rights.

Details of the employee share scheme are set out in Note 21.

No person has any special rights of control over the Company's share capital and all issued shares are fully paid.

With regard to the appointment and replacement of directors, the Company is governed by its bye-laws, the Companies Act (Bermuda) and related legislation.

Review of the business and future developments

A review of the business is given on pages 4 to 7 of this document.

Post balance sheet events

On 10 January 2008, ALNAFT (the Hydrocarbon National Agency in Algeria) approved the proposed Development Plan for the GKN and GKS oil fields located in Northern Algeria. The Field Development Plan envisages producing oil from the GKN-1 well (currently producing at approximately 1,000 bopd gross) and bringing the GKS-2 well on stream as soon as practicable.

Under the terms of the Development Plan, the Group is entitled to an approximate 30% to 49% share of production from the GKN-1 well effective from 10 October 2007. As a result, oil production revenue of $5.4 million and cost of sales of $3.3 million has been recorded for the year ended 31 December 2007.

Directors

The following Directors have held office during the year.

TF Kozel – Executive Chairman & Chief Executive Officer[2]
JW Guest – President (resigned 23 July 2007)
RW Parsons – Chairman (resigned 23 July 2007)[1]
Sheikh Sultan Bin Saqr Al-Qassimi – Non-Executive Director (resigned 23 July 2007)[1]
AA Al-Qabandi – Executive Vice President (appointed 23 July 2007)[2]
JR Cooper – Finance Director (resigned 23 January 2008)
M Varzi – Non-Executive Director (appointed 7 January 2008)[3]
J Asher – Non-Executive Director (appointed 21 January 2008)[3]
KE Ainsworth – Finance Director (appointed 24 January 2008)

1 Members of the Audit Committee, Remuneration and Appointments Committee and Directors' Remuneration Committee up to 23 July 2007.
2 Members of the Audit Committee, Remuneration and Appointments Committee and Directors' Remuneration Committee from 23 July 2007 to 21 January 2008.
3 Members of the Audit Committee, Remuneration and Appointments Committee and Directors' Remuneration Committee from 22 January 2008.

Directors' Report continued

Directors' interests in shares and options

Directors' interests in the shares of the Company, including family interests, were as follows:

	At 31 December 2007 Number of common shares	At 1 January 2007 Number of common shares
TF Kozel	20,050,000	20,050,000
RW Parsons	n/a	300,000
JW Guest	n/a	698,614
JR Cooper	n/a	126,533
AA Al-Qabandi	5,500,000	5,500,000

In addition to the above interests, TF Kozel and AA Al-Qabandi are shareholders in Gulf Keystone Petroleum Company LLC which owns 40,000,000 Common Shares.

On 15 February 2008, Agile Energy purchased 250,000 ordinary shares in the Company at a price of 31.50p. Agile Energy is a Channel Islands company owned by the Asher Family Trust, of which J Asher is the settlor and sole beneficiary.

Directors' interests in share options of the Company, including family interests, as at 31 December are disclosed on Page 18.

Substantial shareholdings

Other than the Directors' interests shown above, the Company has been notified of the following substantial interests as at 14 April 2008:

	Number of common shares	Percentage of issued share capital
Chase Nominees Ltd	37,999,296	13.64%
Credit Suisse Client Nominees (UK) Ltd	20,984,862	7.54%
Gibca Ltd	20,000,000	7.18%
Appollo Nominees Ltd	19,530,605	7.01%
Credit Suisse Securities (Europe) Ltd	16,850,920	6.05%
HSBC Global Custody Nominee (UK) Ltd	10,553,000	3.79%
Evolution Securities Nominees Ltd	10,436,000	3.75%

Going concern

The Directors have considered the factors relevant to support a statement on going concern. They have a reasonable expectation that the Group will continue in operational existence for the foreseeable future and have therefore used the going concern basis in preparing the financial statements.

In common with many exploration companies, the Group raises finance for its exploration and appraisal activities in discrete tranches to finance its activities for specific periods. The directors actively monitor the cash requirements of the business, and further funding is raised as and when required. The Group's existing cash reserves, which stood at $88.3m at 31 December 2007 (2006: $59.3m), along with the expected production revenue from the GKN and GKS fields, are considered to be sufficient to cover known work commitments on existing projects. A successful outcome from these work commitments will require additional financing for these projects as they move into appraisal and/or development.

Annual General Meeting 2008

The resolutions to be proposed at the Annual General Meeting ("AGM") to be held on 10 June 2008 are set out in the Notice of the AGM.

By order of the Board

TF Kozel
Executive Chairman & Chief Executive Officer
7 May 2008

Corporate Governance Statement

Principles of Corporate Governance

Although not required to, the policy of the Board is to manage the affairs of the Group in accordance with the principles underlying the Combined Code on Corporate Governance insofar as is appropriate given the circumstances of the Group.

The Board

The Group is led and controlled by a Board comprising the Executive Chairman and Chief Executive Officer, two Non-Executive Directors and two Executive Directors.

There are no matters specifically reserved to the Board for its decision, although board meetings are held on a regular basis, outside of the UK, and effectively no decision of any consequence is made other than by the Directors. All Directors participate in the key areas of decision-making, including the appointment of new Directors, through the Remunerations and Appointments Committee.

The Board is responsible to shareholders for the proper management of the Group. A statement of Directors' responsibilities in respect of the financial statements is set out on Page 20. The Non-Executive Directors have a particular responsibility to ensure that the strategies proposed by the Executive Directors are fully considered.

To enable the Board to discharge its duties, all Directors have full and timely access to all relevant information.

There is no agreed formal procedure for the Directors to take independent professional advice at the Group's expense, however, independent professional advice is made available where considered appropriate.

All Directors submit themselves for re-election at the Annual General Meeting at regular intervals. There are no specific terms of appointment for Non-Executive Directors.

During 2007, 13 scheduled board meetings were held. Eight meetings took place in continental Europe, five of which were in countries outside of the EU; four in North America and one in the Middle East.

Board Committees

The following committees, which have written terms of reference, deal with specific aspects of the Group's affairs. As a result of Board changes during 2007, Todd Kozel and Ali Al-Qabandi were required to sit on several committees as an interim measure until two non-executive directors were appointed. Whilst this is not considered to be best practice, the Company made every effort to appoint several non-executive directors to rectify this situation and on 22 January 2008, Mehdi Varzi and Jeremy Asher were appointed as members of the Remuneration and Appointments Committee and the Audit Committee.

The Remuneration and Appointments Committee

The Remuneration and Appointments Committee is responsible for making recommendations to the Board on the Company's framework of Executive remuneration and its cost. The Committee determines the contract terms, remuneration and other benefits for each of the Executive Directors and for other senior members of management and is advised, as necessary, by a leading firm of recruitment consultants. The Committee comprised Roger Parsons and Sheikh Sultan Bin Saqr Al-Qassimi up to their resignation on 23 July 2007, Todd Kozel and Ali Al-Qabandi to 21 January 2008 and has comprised Mehdi Varzi and Jeremy Asher since that date. Details of the Directors' remuneration are set out on Pages 17 to 19.

Corporate Governance Statement continued

The Audit Committee

The Audit Committee comprised Roger Parsons and Sheikh Sultan Bin Saqr Al-Qassimi up to their resignation on 23 July 2007, Todd Kozel and Ali Al-Qabandi up to 21 January 2008 and has comprised Mehdi Varzi and Jeremy Asher since that date. Its primary tasks are to review the half-yearly and annual accounts before they are presented to the Board, focusing in particular on accounting policies and areas of management judgement and estimation. The Committee is responsible for monitoring the controls which are in force to ensure the integrity of the information reported to the shareholders. The Committee acts as a forum for discussion of internal control issues and contributes to the Board's review of the effectiveness of the Group's internal control and risk management systems and processes. It advises the Board on the appointment of external auditors and on their remuneration for both audit and non-audit work, and discusses the nature and scope of the audit with the external auditors. The Committee assesses the performance of the external auditors as well as their independence and objectivity.

The external auditors confirm their independence each year in writing to the Committee.

The Committee, which meets at least three times per year, provides a forum for reporting by the Group's external auditors. Meetings are also attended, by invitation, by the Finance Director and CEO.

Internal control

The Board acknowledges its responsibility for establishing and monitoring the Group's systems of internal control. Although no system of internal control can provide absolute assurance against material misstatement or loss, the Group's systems are designed to provide the Directors with reasonable assurance that problems are identified on a timely basis and dealt with appropriately.

The key procedures that have been established and which are designed to provide effective control are as follows:

- Management Structure: The Board meets regularly to discuss all issues affecting the Group; and
- Investment Appraisal: The Group has a clearly defined framework for investment appraisal and approval is required by the Board where appropriate.

The Board regularly reviews the effectiveness of the systems of internal control and considers the major business risks and the control environment. No significant control deficiencies have come to light during the year and no weakness in internal financial control has resulted in any material losses, contingencies or uncertainties which would require disclosure as recommended by the guidance for directors on reporting on internal financial control.

The Board considers that in light of the control environment described above, there is no current requirement for a separate internal audit function.

Relations with shareholders

The Executive Chairman and Chief Executive Officer and Finance Director are the Company's principal spokespeople with investors, fund managers, the press and other interested parties. Each of the Non-Executive Directors are available to attend meetings with major shareholders (without the Executive Directors present), if requested by such major shareholders. At the Annual General Meeting, private investors are given the opportunity to question the Board.

This year's AGM will be held on 10 June 2008.

Report of the Remuneration and Appointments Committee

Remuneration and Appointments Committee

The Remuneration and Appointments Committee comprised Roger Parsons and Sheikh Sultan Bin Saqr Al-Qassimi up to their resignation on 23 July 2007, Todd Kozel and Ali Al-Qabandi up to 21 January 2008 and has comprised Mehdi Varzi and Jeremy Asher since that date.

The Committee was provided with information supplied by Opus Executive Partners ("Opus"), a specialist recruitment Company, with regard to structuring Directors' remuneration packages and searching for suitable candidates. Opus did not provide any other services to the Group.

Details of the remuneration of each director are set out below.

Remuneration policy

The policy of the Committee is to reward Executive Directors in line with the current remuneration of Directors in comparable businesses, taking into consideration the advice of independent benefit consultants in order to recruit, motivate and retain high quality executives within a competitive market place.

There are two main elements of the remuneration packages for Executive Directors and Senior Management:
- basic annual salary (including Directors' fees) and benefits; and
- share option and bonus share incentives.

There are no pension arrangements in the Group.

The Directors have share options granted to them under the terms of the Share Option Scheme which is open to other qualifying employees. The exercise of options under the Scheme is based upon the satisfaction of conditions relating to the share price and length of employment. The conditions vary from grant to grant.

Directors' Contracts

It is the Company's policy that Executive Directors should have contracts with an indefinite term providing for a maximum of one year's notice. In the event of early termination, the Directors' contracts provide for compensation up to a maximum of basic salary for the notice period.

Todd Kozel, Ali Al-Qabandi and Ewen Ainsworth have service contracts with the Company. These can be terminated by either side on twelve months' notice for Todd Kozel, six months for Ewen Ainsworth and one week for Ali Al-Qabandi.

Non-Executive Directors

The fees of Non-Executive Directors are determined by the Board as a whole having regard to the commitment of time required and the level of fees in similar companies.

Report of the Remuneration and Appointments Committee continued

Directors' emoluments

	Salary $	Bonus shares $	Fees $	2007 Total $	2006 Total $
TF Kozel	675,000	–	–	675,000	675,000
RW Parsons	–	–	47,379	47,379	141,000
JW Guest	330,808	416,634	–	747,442	1,316,406
Sheikh Sultan Bin Saqr Al-Qassimi	–	–	26,322	26,322	45,000
JR Cooper	360,662	164,322	–	524,984	434,584
CA Brown	–	–	–	–	220,062
AA Al-Qabandi	119,096	–	–	119,096	–
	1,485,566	580,956	73,701	2,140,223	2,832,052

Directors' interests in options

Directors' interests in share options of the Company, including family interests, as at 31 December 2007 and for the comparative period, were as follows:

	Date of grant	Number of options over common shares	Exercise Price (Great British Pence)	Option exercise period
2007				
TF Kozel	20 Aug 05	2,650,000	48.00p	20 Aug 05 – 19 Aug 14
AA Al-Qabandi	20 Aug 05	500,000	48.00p	20 Aug 05 – 19 Aug 14
2006				
TF Kozel	20 Aug 05	2,650,000	48.00p	20 Aug 05 – 19 Aug 14
AA Al-Qabandi	20 Aug 05	500,000	48.00p	20 Aug 05 – 19 Aug 14
RW Parsons	20 Aug 05	50,000	48.00p	20 Aug 05 – 19 Aug 14
JW Guest	20 Aug 05	50,000	48.00p	20 Aug 05 – 19 Aug 14
JW Guest	5 Jan 06	2,100,000	66.00p	5 Jan 06 – 30 Dec 15
Sheikh Sultan Bin Saqr Al-Qassimi	20 Aug 05	500,000	48.00p	20 Aug 05 – 19 Aug 14
JR Cooper	29 Sep 06	1,200,000	59.75p	29 Sep 06 – 28 Sep 09
CA Brown	11 May 06	400,000	60.50p	14 May 06 – 5 Oct 07

For the above Directors, the exercise of an option is subject to the following vesting conditions being satisfied:
(a) on or after the share price of Common Shares reaches 96p, an option shall be exercisable in respect of one-third of total shares under option;
(b) on or after the price of the Common Shares reaches 144p, an option shall be exercisable in respect of a further third of total shares under option; and
(c) on or after the price of the Common Shares reaches 192p, an option shall be exercisable in respect of 100 per cent of the shares under option.

There were no share options exercised during the year.

On 15 February 2008, KE Ainsworth was granted 1,000,000 options over common shares and M Varzi and J Asher were each granted 100,000 options over common shares with an exercise price of 30p. The options will become exercisable in full after a period of three years from the date of grant provided the Company's closing share price on any day after the Date of Grant is at a level which is no less than 133% of the option price that is 39.9p.

Upon a change of control the above conditions fall away for all options and all options become exercisable.

There have been no other changes in Directors' interests in share options in the year other than the lapse of CA Brown, JW Guest, RW Parsons, Sheikh Sultan Al-Qassimi and JR Cooper's options.

Bonus shares

The Group granted bonus share payments to certain employees pursuant to Gulf Keystone's Executive Bonus Scheme, subject to continuing employment. These bonus shares are awarded over a period of three years but measured at fair value at the date of grant. JW Guest was the one exception to this as in 2006 his grant was awarded over a two year period. The number and value of shares granted are as follows:

Directors' bonuses

	2007 Number of shares	2007 Total $	2006 Number of shares	2006 Total $
JW Guest	684,019	416,634	678,614	806,221
JR Cooper	253,065	164,322	126,533	150,326
	937,084	580,956	805,147	956,547

The awards are included in the Directors' emoluments on Page 18.

JW Guest's award includes entitlement for both 2006 and 2007 and certain other contractual rights, including a percentage of salary to be taken in shares instead of cash.

The market price of the shares at 31 December 2007 and 31 December 2006 was 32.3p and 70p respectively and the range during 2007 was 25.5p to 72.5p.

Approved

TF Kozel
Executive Chairman & Chief Executive Officer

7 May 2008

Directors' Responsibilities in the Preparation of Financial Statements

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

The Directors have elected to prepare the group financial statements under International Financial Reporting Standards ("IFRSs").

International Accounting Standard 1 requires that financial statements present fairly for each financial year the Company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's "Framework for the Preparation and Presentation of Financial Statements". In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. Directors are also required to:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company, for safeguarding assets and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website.

Legislation in Bermuda governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent Auditors' Report to the members of Gulf Keystone Petroleum Limited

We have audited the Group financial statements of Gulf Keystone Petroleum Limited for the year ended 31 December 2007 which comprise the Consolidated Income Statement, Consolidated Balance Sheet, Statement of Changes in Equity, Consolidated Cash Flow Statement, Summary of Significant Accounting Policies and the related notes 1 to 25.

This report is made solely to the Company's members, as a body. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the accounting policies as set out in the Summary of Significant Accounting Policies.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records or if we have not received all the information and explanations we require for our audit.

We read other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Directors' Report, the Report of the Remuneration and Appointments Committee, the Chairman's and the Chief Executive Officer's Statement and the Corporate Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs, of the state of the Group's affairs as at 31 December 2007 and of its loss for the year then ended;
- the financial statements have been properly prepared in accordance with the accounting policies set out in the Summary of Significant Accounting Policies; and
- the information given in the Directors' Report is consistent with the financial statements.

Deloitte and Touche LLP
Chartered Accountants and Registered Auditors
London, United Kingdom
7 May 2008

Consolidated Income Statement
for the year ended 31 December 2007

	Notes	2007 $'000	2006 $'000
Continuing operations			
Revenue	5	5,414	–
Cost of sales		(3,257)	–
Gross profit		2,157	–
Other income/(expense)			
Gain on sale of assets	24	–	61,103
Impairment of intangible exploration assets	9	(20,585)	–
General and administrative expenses		(16,172)	(16,589)
(Loss)/profit from operations	3	(34,600)	44,514
Interest revenue	5	5,183	2,160
Finance costs		(101)	(229)
(Loss)/profit before tax		(29,518)	46,445
Tax expense	6	(377)	(136)
(Loss)/profit after tax for the year		(29,895)	46,309
(Loss)/profit per share (cents)			
Basic	7	(10.79)	17.69
Diluted	7	(10.79)	16.74

Consolidated Balance Sheet
as at 31 December 2007

	Notes	2007 $'000	2006 $'000
Non-current assets			
Property, plant and equipment	8	24,097	26,782
Intangible assets	9	41,996	19,955
Financial asset	12	6,155	5,597
		72,248	52,334
Current assets			
Inventories	11	5,526	4,711
Trade and other receivables	12	6,047	59,999
Cash and cash equivalents	12	88,286	59,328
		99,859	124,038
Total assets		172,107	176,372
Current liabilities			
Trade and other payables	13	36,684	10,835
Tax liabilities	6	377	136
Provisions	14	1,054	2,050
Total liabilities		38,115	13,021
Net assets		133,992	163,351
Equity			
Share capital	15	1,853	1,853
Share premium account	15	159,076	159,063
Share option reserve	16	3,988	3,535
Exchange translation reserve	16	27	(43)
Accumulated losses	17	(30,952)	(1,057)
Total equity		133,992	163,351

The financial statements were approved by the Board of Directors and authorised for issue on 7 May 2008 and are signed on its behalf by:

TF Kozel
Executive Chairman & Chief Executive Officer

KE Ainsworth
Finance Director

Consolidated Statement of Changes in Equity
for the year ended 31 December 2007

	Attributable to equity holders of the Group					
	Share capital $'000	Share premium account $'000	Share option reserve $'000	Accumulated losses $'000	Exchange translation reserve $'000	Total equity $'000
Balance as at 1 January 2006	1,638	135,349	502	(47,366)	(57)	90,066
Share-based payment expense	–	–	3,033	–	–	3,033
Exchange differences arising on translation of overseas operations	–	–	–	–	14	14
Share conversion and issue	215	23,714	–	–	–	23,929
Net profit for the year	–	–	–	46,309	–	46,309
Balance at 1 January 2007	1,853	159,063	3,535	(1,057)	(43)	163,351
Share-based payment expense	–	–	453	–	–	453
Exchange differences arising on translation of overseas operations	–	–	–	–	70	70
Share conversion and issue	–	13	–	–	–	13
Net loss for the year	–	–	–	(29,895)	–	(29,895)
Balance at 31 December 2007	1,853	159,076	3,988	(30,952)	27	133,992

Consolidated Cash Flow Statement
for the year ended 31 December 2007

	Notes	2007 $'000	2006 $'000
Operating activities			
Cash used in operations	18	(15,916)	(13,418)
Tax expense		(136)	–
Interest received		4,625	2,160
Net cash used in operating activities		(11,427)	(11,258)
Investing activities			
Proceeds from prior year sale of assets		55,000	–
Purchase of intangible assets		(9,184)	(3,166)
Purchase of property, plant and equipment		(455)	(1,401)
Net cash generated by/(used in) investing activities		45,361	(4,567)
Financing activities			
Interest paid		–	(229)
Repayment of loan		(5,000)	–
Proceeds on issue of share capital		13	23,929
Net cash (used in)/generated by financing activities		(4,987)	23,700
Net increase in cash and cash equivalents		28,947	7,875
Cash and cash equivalents at beginning of year		59,328	51,439
Effect of foreign exchange rate changes		11	14
Cash and cash equivalents at end of the year being bank balances and cash	12	88,286	59,328

Consolidated Financial Statements
Summary of Significant Accounting Policies

General information
The Company is incorporated in Bermuda and it is quoted on the Alternative Investment Market of the London Stock Exchange. The Company serves as the holding Company for the Group, which is engaged in oil and gas exploration and production, operating in the Republic of Algeria and the Kurdistan Region of Northern Iraq.

Adoption of new and revised accounting standards
In the current year the Group has adopted IFRS 7 Financial Instruments: Disclosures which is effective for annual reporting periods beginning on or after 1 January 2007 and the related amendment to IAS 1 Presentation of Financial Statements. The impact of the adoption of IFRS 7 and the changes to IAS 1 has been to expand the disclosures provided in these financial statements regarding the Group's financial instruments and management of capital (see note 23).

Four Interpretations issued by the International Financial Reporting Interpretations Committee became effective for the current period. These are: IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies; IFRIC 8 Scope of IFRS 2; IFRIC 9 Reassessment of Embedded Derivatives; and IFRIC 10 Interim Financial Reporting and Impairment. The adoption of these Interpretations has not led to any changes in the Group's accounting policies.

At the date of authorisation of these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective:

IAS 23 (revised)	Borrowing Costs
IAS 27 (revised)	Consolidated and Separate Financial Statements
IFRS 3 (revised)	Business Combinations
IFRS 8	Operating Segments
IFRIC 11	IFRS 2 Group and Treasury Share Transactions
IFRIC 12	Service Concession Arrangements
IFRIC 13	Customer Loyalty Programmes
IFRIC 14	IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

The Directors anticipate that the adoption of these Standards and Interpretations in future periods will have no material impact on the financial statements of the Group except for revised segment disclosures when IFRS 8 comes into effect for periods commencing on or after 1 January 2009.

Basis of accounting
The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs").

The financial statements have been prepared under the historical cost basis, except for the valuation of share options and contingent deferred consideration, and on a going concern basis. The principal accounting policies adopted are set out below.

Basis of consolidation
The consolidated financial statements incorporate the financial statements of the Company and enterprises controlled by the Company (its subsidiaries) made up to 31 December each year. The Group uses the purchase method of accounting for the acquisition of subsidiaries.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those of the Group.

All intra-group transactions, balances and unrealised gains on transactions between Group companies are eliminated on consolidation. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Revenue

Revenue is recognised to the extent that it is probable that economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of consideration received or receivable and reflects actual sales value in respect of petroleum production in the normal course of business, net of sales related taxes. Petroleum sales are recorded when goods are delivered and title has passed.

Interest income is accrued on a time basis, with reference to the principal outstanding and at the effective rate of interest applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

Leasing

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease.

Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the shorter of the period to the next rent review date and the lease term.

Foreign currencies

The functional and presentation currency of the Company, and the presentation currency of the Group, is US dollars.

Transactions in currencies other than US dollars are recorded at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing on the balance sheet date. Non-monetary assets and liabilities carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Gains and losses arising on retranslation are included in the income statement for the year.

On consolidation, the assets and liabilities of the Group's operations which use functional currencies other than the US Dollar are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for each month in the year. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed of.

Taxation

The tax expense represents the sum of tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year earned in the United Kingdom by the Group's subsidiary. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated by using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or from the initial recognition of other assets and liabilities in a transaction that affects neither the tax profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Consolidated Financial Statements continued
Summary of Significant Accounting Policies

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that is no longer probable that sufficient taxable profits will be available to allow all or part assets to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or the asset is realised using rates that have been enacted or substantially enacted by the balance sheet date. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Property, plant and equipment other than oil and gas interests
Property, plant and equipment are stated at cost less accumulated depreciation and any accumulated impairment losses. Depreciation is provided at rates calculated to write each asset down to its estimated residual value evenly over its expected useful life as follows:
Fixtures and equipment – 20% straight-line

Intangible assets other than oil and gas
Intangible assets, other than oil and gas assets, have finite useful lives and are measured at cost and amortised over their expected useful economic lives as follows:
Computer software – 33% straight-line

Intangible and tangible non-current assets – oil and gas interests
The Group adopts the full cost method of accounting for its oil and gas interests. Under the full cost method of accounting all costs relating to the exploration for and development of oil and gas exploration and evaluation interests, whether productive or not, are accumulated and capitalised as non-current assets within geographic cost pools. Exploration and evaluation costs are generally classified as intangible non-current assets during the exploration and evaluation phase and are carried forward where activities in an area have not yet reached a stage which permits reasonable assessment of the existence of economically recoverable reserves, and subject to there being no impairment.

Costs dealt with in this way include seismic data, licence acquisition costs, technical work, exploration and appraisal drilling, general technical support and directly attributable administrative and overhead costs.

Exploration and evaluation costs are transferred to property, plant and equipment upon declaration of commerciality and amortised, together with development costs and decommissioning costs capitalised, over the life of the area, generally the field.

Upon cessation of exploration on each licence, or otherwise when an impairment of an exploration and evaluation asset arises, an impairment test is performed for the pool and any balance of unsuccessful exploration and evaluation costs carried forward in the pool is amortised over the life of the pool.

Depreciation, depletion and amortisation is provided under the unit of production method which uses the estimated remaining commercial reserves and the net book value and any further anticipated costs to develop such reserves.

Impairment of tangible and intangible non-current assets
At each balance sheet date, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset, or group of assets, is estimated in order to determine the extent of the impairment loss (if any). For exploration and evaluation assets, the group of assets considered is the pool. For other assets where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs, generally the field.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have been adjusted.

If the recoverable amount is estimated to be less than its carrying amount, the carrying amount is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

Disposals of oil and gas interests

The difference between the fair value of the consideration receivable and the carrying value of the relevant proportion of the oil and gas asset disposed of is first applied to reduce any unsuccessful exploration and evaluation cost carried in the pool, with any excess gain recognised in the income statement.

Carry of expenditures and farm-in arrangements

Where the Group enters into a commercial agreement which includes carry of expenditures or a farm-in, the arrangement is accounted for according to its commercial substance. Generally, in the case of a farm-in, the substance is that the counterparty has acquired a share, or a greater share, of the underlying oil and gas reserves and the arrangement is treated as a partial disposal. Where the substance is that the counterparty has acquired a right, or a conditional right to be reimbursed by the Group out of future production, a liability is recognised at the time the obligation arises. In the case of a carry, a liability is recognised when the obligation is probable and is no longer conditional upon factors under the Group's control.

Inventories

Inventories relate to materials acquired for use in exploration activities. These are valued at the lower of cost and net realisable value.

Capitalisation of interest

Any interest payable on funds borrowed for the purpose of obtaining a qualifying asset will be capitalised as a cost of that asset. However, any associated interest charge from funds borrowed principally to address a short-term cash flow shortfall during the suspension of development activities shall be expensed in the year.

Financial instruments

The Group's financial instruments comprise of cash and borrowings together with various items such as other receivables and trade payables, which arise directly from its operations. The main purpose of these financial instruments is to provide working capital.

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group has become a party to the contractual provisions of the instrument.

Impairment of financial assets

Financial assets, other than those valued at fair value through the profit and loss, are assessed for indicators of impairment at each balance sheet date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been impacted.

Objective evidence of impairment could include:

- significant financial difficulty of the issuer or counterparty; or
- default or delinquency in interest or principal payments; or
- it becoming probable that the borrower will enter bankruptcy or financial reorganisation.

For certain categories of financial asset, such as trade receivables, assets that are assessed not to be impaired individually are subsequently assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period, as well as observable changes in local or national economic conditions that correlate with default on receivables.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets. If in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Consolidated Financial Statements continued
Summary of Significant Accounting Policies

Trade receivables
Trade receivables do not carry any interest and are stated at their nominal value as reduced by appropriate allowances for estimated irrecoverable amounts.

Contingent deferred consideration
Contingent deferred consideration embedded in certain asset sale contracts is treated as a financial instrument and recognised immediately at its fair value and then reviewed on a periodic basis until the contractual rights to the cash flows from the financial asset expire. Movements in the fair value are taken to the income statement.

Financial liabilities and equity
Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

Borrowings
Interest-bearing loans and overdrafts are recorded at the proceeds received, net of direct issue costs. Finance charges, including premiums payable on settlement or redemption, are accounted for on an accrual basis and are added to the carrying amount of the instrument to the extent that they are not settled in the year in which they arise.

Trade payables
Trade payables are not interest bearing and are stated at their nominal value.

Cash and cash equivalents
Cash and cash equivalents comprise of cash on hand and demand deposits and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Equity instruments
Equity instruments issued by the Company are recorded at the proceeds received, net of direct issue costs.

Provisions
Provisions are recognised when the Group has a present obligation as a result of a past event which it is probable will result in an outflow of economic benefits that can be reliably estimated.

Decommissioning provision
The decommissioning provision represents management's best estimate of the Group's liability for restoring the sites of drilled wells to their original status, discounted where the effect is material.

Share-based payments
The Group has applied the requirements of IFRS 2 to bonus shares and share option schemes allowing certain employees within the Group to acquire or receive shares of the Company. For all grants of bonus shares and share options, the fair value as at the date of grant is calculated using an appropriate option pricing model and the corresponding cost is recognised over the expected life of the option. The fair value of the bonuses granted is recognised as an employee expense with a corresponding increase in equity to the extent that company performance conditions are expected to be met. The fair value of the bonuses granted is measured using the standard methodology applied by the Company taking into account the terms and conditions upon which the bonuses were granted. To the extent that previous estimates relating to the satisfaction of performance conditions change, a corresponding adjustment is recognised in the income statement.

Critical accounting estimates and judgements

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

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

Impairment review of GKN and GKS

An impairment test of the Group's producing pools requires a comparison of the carrying value of the assets of the pool with the estimated discounted net cash flows from future production to measure any impairment charge. The future net cash flows from production reflect estimates of reserves, productive rates, future oil and gas prices and costs, all of which are inherently uncertain, together with the application of an appropriate discount rate. Management uses a set of assumptions as at the date of the test which it considers to be collectively reasonable in its judgement, and employs an economist to assist in performing the tests. However, because of these uncertainties the actual future cash flows could materially differ from those estimated.

Contingent deferred consideration from HBH sale

As part of the HBH agreement with the BG group ("BG"), if gas reserves of the HBH field are agreed (in accordance with the agreement) to be greater than 800 bcf BG will pay the Group an additional $4 million for every 100 bcf over 800 bcf from a minimum of 900 bcf up to a maximum of 1,300 bcf. The Group estimates, based on a previous independent review of potential reserves that the Group will receive $8 million contingent deferred income, which discounted to money of the day at 10% per annum results in an estimated receivable contingent deferred income of $6.2 million at 31 December 2007 (2006: $5.6 million).

Carrying value of intangible exploration and evaluation assets

The outcome of ongoing exploration, and therefore whether the carrying value of intangible exploration and evaluation assets will ultimately be recovered, is inherently uncertain. Management makes the judgements necessary to implement the Group's policy with respect to exploration and evaluation assets and considers these assets for impairment at least annually with reference to indicators in IFRS 6.

Decommissioning costs

The Group has estimated that decommissioning costs for wells will be approximately $850,000 per well based on recent experience. It has provided for its share of this amount for GKN-1, GKS-2 and GKS-3. The total amount provided in the balance sheet as at 31 December 2007 at net present value is $1.1 million.

Estimating revenue recognised

The production revenue recognised by the Group is calculated using the monthly average Sahara Blend oil price between 10 October and 31 December 2007 as the final sales price at which the revenue will be calculated had not been agreed with SONATRACH at the date of signing this report. The average Sahara Blend oil price for this period totalled $89.46 per barrel.

Notes to the Consolidated Financial Statements
For the year ended 31 December 2007

1. Presentation of financial statements
The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs").

These financial statements are presented in US dollars since that is the currency in which the majority of the Group's transactions are denominated.

2. Business and geographical segments
Business and geographical segments
For management purposes, the Group is currently organised into three legal entities – Gulf Keystone Petroleum Limited and its subsidiaries Gulf Keystone Petroleum International Limited and Gulf Keystone Petroleum (UK) Limited.

Geographical segments
For the purposes of segmental reporting, the primary segment reporting format is determined to be geographical segments. The Group's main exploration and production activities take place in Algeria and the Kurdistan region of Northern Iraq with corporate support functions in Bermuda and the United Kingdom.

Business segments
The secondary segment reporting format is business segments of which the Group has one segment being the exploration and production of oil and gas.

Segment information for each geographical location is presented below:

2007	Algeria 2007 $'000	Kurdistan 2007 $'000	United Kingdom 2007 $'000	Bermuda 2007 $'000	Eliminations 2007 $'000	Total 2007 $'000
Revenue	5,414	–	–	–	–	5,414
Inter-segment sales	–	–	6,639	–	(6,639)	–
Total revenue	5,414	–	6,639	–	(6,639)	5,414
Cost of sales						
Production costs	(3,257)	–	–	–	–	(3,257)
Gross profit	2,157	–	6,639	–	(6,639)	2,157
Impairment of intangible exploration assets	(20,585)	–	–	–	–	(20,585)
General and administration expenses	(1,902)	(1,289)	(7,423)	(11,647)	6,089	(16,172)
Segment result	(20,330)	(1,289)	(784)	(11,647)	(550)	(34,600)
Interest revenue						5,183
Finance costs						(101)
Loss before tax						(29,518)
Tax						(377)
Loss after tax						(29,895)

2. Business and geographical segments (continued)

2007	Algeria 2007 $'000	Kurdistan 2007 $'000	United Kingdom 2007 $'000	Bermuda 2007 $'000	Eliminations 2007 $'000	Total 2007 $'000
OTHER INFORMATION						
Capital additions	16,605	25,836	57	–	–	42,498
Depreciation and amortisation	2,487	3	183	–	(41)	2,632
Impairment losses recognised	20,585	–	–	–	–	20,585
BALANCE SHEET						
Assets						
Segment assets	71,179	31,633	3,611	144,947	(79,263)	172,107
Liabilities						
Segment liabilities	(73,845)	(32,916)	(1,522)	(5,347)	75,515	(38,115)

2006	Algeria 2006 $'000	Kurdistan 2006 $'000	United Kingdom 2006 $'000	Bermuda 2006 $'000	Eliminations 2006 $'000	Total 2006 $'000
Revenue	–	–	–	–	–	–
Inter-segment sales	–	–	4,276	–	(4,276)	–
Total revenue	–	–	4,276	–	(4,276)	–
Cost of sales						
Production costs	–	–	–	–	–	–
Gross profit	–	–	4,276	–	(4,276)	–
Gain on sale of assets	61,103	–	–	–	–	61,103
Impairment of intangible exploration assets	–	–	–	–	–	–
General and administration expenses	(5,517)	–	(4,024)	(11,412)	4,364	(16,589)
Result						
Segment result	55,586	–	252	(11,412)	88	44,514
Interest revenue						2,160
Finance costs						(229)
Profit before tax						46,445
Tax						(136)
Profit after tax						46,309

Notes to the Consolidated Financial Statements continued

For the year ended 31 December 2007

2. Business and geographical segments (continued)

2006	Algeria 2006 $'000	Kurdistan 2006 $'000	United Kingdom 2006 $'000	Bermuda 2006 $'000	Eliminations 2006 $'000	Total 2006 $'000
OTHER INFORMATION						
Capital additions	4,726	–	65	–	–	4,791
Depreciation and amortisation	106	–	170	–	–	276
BALANCE SHEET						
Assets						
Segment assets	61,225	–	1,459	173,441	(59,753)	176,372
Liabilities						
Segment liabilities	(66,742)	–	(873)	(2,258)	56,852	(13,021)

3. Profit/(loss) from operations

	2007 $'000	2006 $'000
Profit/(loss) from operations has been arrived at after charging:		
Depreciation of property, plant and equipment – owned assets	2,568	212
Amortisation of intangible assets	64	64
Impairment of intangible exploration assets	20,585	–
Staff costs (see note 4)	7,539	8,160
Auditors' remuneration for audit services (see below)	120	105
Operating lease rentals (see note 20)	413	610
Exchange loss	229	157

Amounts payable to Deloitte & Touche LLP, and the previous auditors, in respect of both audit and non-audit services were:

	2007		2006	
	$'000	%	$'000	%
Audit services				
– Annual statutory audit of the Group	106	63%	94	53%
– Annual statutory audit of UK subsidiary	14	8%	11	6%
	120	71%	105	59%
Other services pursuant to legislation				
– Interims	32	19%	24	13%
Tax services				
– Compliance services	16	10%	49	28%
	168	100%	178	100%

Our assurance services payable in respect of the interims for 2006 were to Baker Tilly.

4. Staff costs

The average monthly number of employees (including executive directors) for the year was as follows:

	2007 Number	2006 Number
Office and management	14	14
Exploration staff	40	35
	54	49

Their aggregate remuneration comprised:

	2007 $'000	2006 $'000
Wages and salaries	3,628	3,823
Social security costs	3,458	1,304
Share based payment (see note 21)	453	3,033
	7,539	8,160

5. Revenue

	2007 $'000	2006 $'000
Sale of goods	5,414	–
Interest revenue		
Interest on bank deposits	4,625	2,160
Unwinding of discount on contingent income	558	–
	5,183	2,160

6. Tax expense

	2007 $'000	2006 $'000
Provision for current UK corporation tax	313	60
Provision for deferred UK corporation tax	64	76
Tax attributable to the Company and its subsidiaries	377	136

Under current Bermuda laws, the Group is not required to pay taxes in Bermuda on either income or capital gains. The Group has received an undertaking from the Minister of Finance in Bermuda exempting it from any such taxes at least until the year 2016.

Any corporate tax liability in Algeria is settled out of SONATRACH's share of oil under the terms of the Production Sharing Contracts and is therefore not reflected in the tax charge for the year. In December 2006 the Algerian Government announced the introduction of a windfall tax. The tax applies to all foreign operators in Algeria producing hydrocarbons (gas or liquids) in association with SONATRACH. The tax is only applied to any profits generated when the average price of a barrel of oil is greater than $30 in the month concerned. In GKP's forecast production range the windfall tax will only be applied at 5% of GKP's share of production from Algeria.

In Kurdistan, the Group is subject to corporate income tax on its income from petroleum operations. The rate of corporate income tax is currently 40% for all taxable profits in excess of nine million Iraqi dinar (equivalent to $7,359 at the 31 December 2007 exchange rate). However, any corporate income tax arising from petroleum operations will be paid from the Kurdistan Regional Government of Iraq's share of petroleum profits.

Notes to the Consolidated Financial Statements continued

For the year ended 31 December 2007

6. Tax expense (continued)

The tax currently payable is based on taxable profit for the year earned in the United Kingdom by the Group's subsidiary. UK corporation tax is calculated at 30% of the estimated assessable profit for the year of the UK subsidiary.

Deferred tax is provided for due to the temporary differences which give rise to such a balance in jurisdictions subject to income tax. During the current period, no taxable profits were made in respect of the Group's Kurdistan PSC's. As a result, no corporate income tax has been provided in the period.

The charge for the year can be reconciled to the profit/(loss) per the income statement as follows:

	2007 $'000	2006 $'000
Profit/(loss) before tax	(29,518)	46,445
Tax at the Bermudan tax rate 0% (2006: 0%)	–	–
Effect of different tax rates of subsidiaries operating in other jurisdictions	(377)	(136)
Tax expense for the year	(377)	(136)

7. Earnings/(Loss) per share

The calculation of the basic and diluted earnings/(loss) per share is based on the following data:

Earnings/(Loss)

	2007 $'000	2006 $'000
(Loss)/profit for the purposes of basic and diluted loss per share	(29,895)	46,309

Number of shares

	2007 Number	2006 Number
Weighted average number of ordinary shares for the purposes of basic earnings/(loss) per share	276,963,270	261,769,050
Adjustments for:		
– bonus shares	n/a	1,669,707
– share options	n/a	13,240,500
Weighted average number of ordinary shares for the purposes of diluted earnings/(loss) per share	276,963,270	276,679,257

8. Property, plant and equipment

	Oil and gas properties $'000	Fixtures and equipment $'000	Total $'000
At 1 January 2006			
Cost	24,849	923	25,772
Accumulated depreciation	–	(178)	(178)
Net book value	24,849	745	25,594
Year ended 31 December 2006			
Opening net book value	24,849	745	25,594
Additions	1,233	167	1,400
Depreciation charge	–	(212)	(212)
Closing net book value	26,082	700	26,782
At 31 December 2006			
Cost	26,082	1,090	27,172
Accumulated depreciation	–	(390)	(390)
Net book value	26,082	700	26,782
Year ended 31 December 2007			
Opening net book value	26,082	700	26,782
Additions	460	255	715
Adjustment to prior year transfer	(904)	–	(904)
Depreciation charge	(2,304)	(264)	(2,568)
Foreign currency translation differences	–	72	72
Closing net book value	23,334	763	24,097
At 31 December 2007			
Cost	25,638	1,417	27,055
Accumulated depreciation	(2,304)	(654)	(2,958)
Net book value	23,334	763	24,097

The depreciation charge of $2,304,000 on oil and gas properties (2006: $nil) has been included in cost of sales and the depreciation charge of $264,000 on fixtures and equipment (2006: $212,000) has been included in general and administrative expenses.

The adjustment to prior year transfer relates to a transfer between intangible assets and property, plant and equipment (see Note 9).

Notes to the Consolidated Financial Statements continued

For the year ended 31 December 2007

9. Intangible assets

	Exploration and evaluation costs $'000	Computer software $'000	Total $'000
At 1 January 2006			
Cost	16,722	156	16,878
Accumulated amortisation	–	(27)	(27)
Net book value	16,722	129	16,851
Year ended 31 December 2006			
Opening net book value	16,722	129	16,851
Additions	3,330	61	3,391
Disposal of HBH	(223)	–	(223)
Amortisation charge	–	(64)	(64)
Closing net book value	19,829	126	19,955
At 31 December 2006			
Cost	19,829	217	20,046
Accumulated amortisation	–	(91)	(91)
Net book value	19,829	126	19,955
Year ended 31 December 2007			
Opening net book value	19,829	126	19,955
Additions	41,738	45	41,783
Adjustment to prior year transfer (see Note 8)	904	–	904
Impairment write off	(20,585)	–	(20,585)
Amortisation charge	–	(64)	(64)
Foreign currency translation differences	–	3	3
Closing net book value	41,886	110	41,996
At 31 December 2007			
Cost	41,886	265	42,151
Accumulated amortisation	–	(155)	(155)
Net book value	41,886	110	41,996

The net book value at 31 December 2007 is made up of intangible assets relating to HBH $7.5m; Block 108 $3.2m; Block 129 $5.6m; and Kurdistan $25.7m.

During 2007, an impairment loss was recognised in respect of intangible exploration assets relating to Block 126a following the failure to find commercial levels of hydrocarbons in GRJ.

The additions to oil and gas exploration and evaluation costs in the year relate to the simulation and testing of GRJ-2, which has been subsequently written off in the year; drilling of the HBH-4 appraisal well and the acquisition of HBH 2D and 3D seismic.

The amortisation charge of $64,075 (2006: $64,452) has been included in general and administrative expenses.

10. Subsidiary

Details of the Company's subsidiaries at 31 December 2007 are as follows:

Name of subsidiary	Place of incorporation	Proportion of ownership interest %	Proportion of voting power held %	Principal activity
Gulf Keystone Petroleum (UK) Limited	Great Britain	100	100	Geological, geophysical and engineering services
Gulf Keystone Petroleum International Limited	Bermuda	100	100	Exploration and evaluation activities in Kurdistan

11. Inventories

	2007 $'000	2006 $'000
Exploration materials	5,526	4,711

12. Financial assets

Non-current financial asset

This balance represents $6.2 million (2006: $5.6 million) of contingent deferred consideration from the HBH agreement with BG that is required to be recorded at fair value in accordance with IAS 39. This amount is recorded as a financial asset and represents the estimated fair value of potential future "bonus" payments in respect of the approved commercial reserves attributable to the HBH field upon development. The timing of payment of this amount is uncertain but it has been included in non-current assets.

Trade and other receivables

	2007 $'000	2006 $'000
Disposal of HBH	–	55,000
Recoverable from BG	–	2,014
Trade receivables	4,269	–
Prepayments for inventories	–	1,175
Other receivables and prepayments	1,778	1,810
	6,047	59,999

The $4.3 million trade receivable owing from SONATRACH relates to production revenue from the GKN-1 well for the period from 10 October to 31 December 2007.

Included within other receivables and prepayments is an amount of $458,000 (2006: $458,000) being the deposit for the UK office which is receivable after more than one year.

The Directors consider that the carrying amount of trade and other receivables approximates to their fair value and no amounts are provided against them.

Cash and cash equivalents

Cash and cash equivalents comprise of cash and short-term deposits held by the Group. The carrying amount of these assets approximates to their fair value. Certain restrictions relating to cash balances are explained in note 19.

Notes to the Consolidated Financial Statements continued

For the year ended 31 December 2007

13. Trade and other payables

Trade and other payables principally comprise amounts outstanding for trade purchases and ongoing costs.

The Directors consider that the carrying amount of trade payables approximates to their fair value.

	2007 $'000	2006 $'000
Due within one year:		
Trade payables	226	1,483
Amounts owed to related parties	–	5,050
Accrued expenses	36,458	4,302
	36,684	10,835

14. Provisions

	Decommissioning provision $'000
At 1 January 2007	2,050
Decrease due to revision of estimate	(687)
Utilisation of provision	(410)
Unwinding of discount	101
At 31 December 2007	1,054

Of this provision for well abandonment for three wells, the expenditure is expected to be incurred over the next five to 10 years.

15. Share capital

	2007 $'000	2006 $'000
Authorised		
500,000,000 Common shares of $0.01 each	5,000	5,000
50,000,000 Non-voting shares $0.01 each	500	500
60,000 Series A Preferred shares of $1,000 each	60,000	60,000
	65,500	65,500

	Common shares Shares Number	Common shares Amount $'000	Share capital $'000	Share premium $'000
Issued and fully paid				
Balance 1 January 2006	253,732,140	136,987	1,638	135,349
Share issue August 2006	21,600,000	23,929	215	23,714
Bonus scheme shares October 2006	148,000	–	–	–
Bonus scheme shares December 2006	1,274,968	–	–	–
Balance 31 December 2006	276,755,108	160,916	1,853	159,063
Retention scheme shares October 2007	652,832	6	–	6
Retention scheme shares November 2007	71,098	1	–	1
Bonus scheme shares December 2007	561,518	6	–	6
Balance 31 December 2007	278,040,556	160,929	1,853	159,076

In October and November 2007, 723,930 new shares were issued as part of a one-off retention scheme.

In December 2007, 561,518 new shares were issued as part of the Company's bonus share scheme (2006: 1,422,968 new shares).

In August 2006, 21.6 million new common shares were placed at £0.62 per common share to finance continuing exploration and development activities.

Rights attached to share capital

The holders of the common shares have the following rights:

The holders of the common shares (subject to the other provisions of the bye-laws) are:

(i) entitled to one vote per share;
(ii) entitled to receive notice of, and attend and vote at, general meetings of the Company;
(iii) entitled to dividends or other distributions; and
(iv) in the event of a winding-up or dissolution of the Company, whether voluntary or involuntary or for a reorganisation or otherwise or upon a distribution of capital, entitled to receive the amount of capital paid up on their Common Shares and to participate further in the surplus assets of the Company only after payment of the Series A Liquidation Value (as defined in the Bye-laws) on the Series A Preferred Shares.

Notes to the Consolidated Financial Statements continued

For the year ended 31 December 2007

16. Other reserves

	Share option reserve $'000	Exchange translation reserve $'000
Balance at 1 January 2006	502	(57)
Currency exchange difference	–	14
Employee share bonus and share options charge	3,033	–
Balance at 31 December 2006	3,535	(43)
Currency exchange difference	–	70
Employee share bonus and share options charge	453	–
Balance at 31 December 2007	3,988	27

17. Accumulated losses

	$'000
Balance at 1 January 2006	(47,366)
Net profit for the year	46,309
Balance at 31 December 2006	(1,057)
Net loss for the year	(29,895)
Balance at 31 December 2007	(32,221)

18. Reconciliation of profit/(loss) from operations to net cash used in operating activities

	2007 $'000	2006 $'000
(Loss)/profit from operations	(34,598)	44,514
Adjustments for:		
Depreciation of property, plant and equipment	2,568	212
Amortisation of intangible assets	64	64
Impairment of intangible exploration assets	20,585	–
Stock written off	249	–
Foreign exchange loss	229	–
Share-based payment expense	453	3,033
(Increase) in inventories	(1,064)	(1,239)
Decrease in provisions	(996)	–
Decrease/(increase) in receivables	(1,050)	(56,613)
(Increase) in non-current financial assets	–	(5,597)
(Decrease)/increase in payables	(2,356)	2,208
Net cash used in operating activities	(15,916)	(13,418)

19. Guarantees

Cash backed guarantees

As part of the contractual terms of the Algerian contracts, the Group has given bank guarantees to SONATRACH of $21.6 million. These are cash backed guarantees which effectively reduce the free cash available that the Group has on its balance sheet. The $21.6 million total is comprised of $6 million for the Bottena ("129 Contract") work programme and $15.6 million for the Ben Guecha ("108/128b Contract") work programme. These guarantees are for the exploration and evaluation work programmes stipulated in the contracts and are reduced as the work programmes are completed.

Other guarantees

The Group has provided a guarantee of $3.75 million to the Federal Government of the Republic of Iraq to state it will meet the minimum financial commitment and / or the minimum exploration obligations as required under the terms of the PSC. The guarantee is reduced as the work programme is completed.

20. Operating lease arrangements

The Group as a lessee

	2007 $'000	2006 $'000
Minimum lease payments under operating leases recognised as expense for the year	413	610

At the balance sheet date, the Group had outstanding total commitments under non-cancellable operating leases, which fall due as follows:

	2007 $'000	2006 $'000
Within one year	418	531
In the second to fifth years inclusive	46	805
	464	1,336

Operating lease payments represent rentals payable by the Group for certain of its office properties in the UK and Algeria and residential properties in Algeria. The UK lease is for ten years from February 2005 with a break clause at year five which is January 2010. The Algerian properties are leased for two years or less.

21. Share-based payments

	2007 $'000	2006 $'000
Bonus shares (credit)/charge	(57)	2,184
Share options charge	510	849
	453	3,033

Equity settled share option plan

The Group plan provides for a grant price equal to the closing market price of the Group shares on the date of grant. The vesting period is generally 10 years for options granted before August 2006 and three years for options granted after that. If options remain unexercised after a period of 10 years from the date of grant, the options expire. Furthermore, options are forfeited if the employee leaves the Group before the options vest.

The weighted average contractual life relating to the share options outstanding at the year end was seven years (2006: seven years).

	2007		2006	
	Options ('000)	Weighted average exercise price (in pence)	Options ('000)	Weighted average exercise price (in pence)
Outstanding at 1 January	13,241	57.2p	6,992	53.8p
Granted during the year	1,850	33.8p	7,249	61.5p
Forfeited during the year	(6,100)	60.3p	(1,000)	65.6p
Outstanding at 31 December	8,991	50.3p	13,241	57.2p
Exercisable at 31 December	1,581	51.9p	1,997	51.9p

Notes to the Consolidated Financial Statements continued

For the year ended 31 December 2007

21. Share-based payments (continued)

The inputs into the stochastic (Monte-Carlo) valuation model are as follows:

	2007	2006
Weighted average share price on date of grant (in pence)	33.8p	61.5p
Weighted average exercise price of options granted in the year (in pence)	33.8p	61.5p

Expected volatility was determined by using the average of a peer group of similar oil and gas companies over a seven year period for grants before 2006 and over a five year period after that. This was thought more instructive given the limited nature of the Company's history.

The expected volatility was calculated as 43.5%/43.1% for September 2006 and October 2006 and 36.0% for all grants in 2007.

The expected term of the September 2006 and October 2006 grants were five to nine years. The 2007 grants have been calculated using an expected term of four to five years.

The risk free rate was 4.2% and 4.3% for the September 2006 and October 2006 grants respectively and 4.9%, 5.0% and 4.5% for the September, October and December 2007 grants.

The Company has made no dividend payments to date and as there is no expectation of making payments in the immediate future, therefore the dividend yield variable has been set at zero for all grants.

Share options outstanding at the end of the year have the following expiry date and exercise prices:

Expiry date	Exercise price (pence)	Options ('000) 2007	2006
19 August 2014	48.0	4,250	5,100
05 October 2007	60.5	–	400
29 September 2015	85.0	492	492
30 December 2015	66.0	–	2,100
29 September 2009	59.8	2,049	4,799
18 October 2009	59.0	350	350
17 September 2010	31.0	1,050	–
11 October 2010	39.5	550	–
05 December 2010	33.0	250	–
		8,991	13,421

Bonus shares

The Group issues bonus shares to certain employees for a nominal consideration. Bonuses are generally granted over three years and are vested in three equal tranches during those years subject to continued employment. These share-based payments are measured at fair value at the date of grant. The fair value of the shares granted is recognised as an employee expense with a corresponding increase in equity. The fair value of the shares granted is the market price on the date of the award and is charged to the income statement over the vesting period taking into account the terms and conditions upon which the shares were granted.

	Bonus shares ('000) 2007	2006
As at 1 January	3,093	–
Issued during the year	783	3,093
Lapsed during the year	(38)	–
Sold during the year	(1,153)	–
As at 31 December	2,685	3,093

22. Related party transactions

Transactions with related parties

Transactions between the Company and its subsidiaries are disclosed below.

During the year the parent Company entered into the following transactions with its subsidiary, Gulf Keystone Petroleum (UK) Ltd:

	2007 $'000	2006 $'000
Purchases of services in year	6,639	4,276
Amounts owed to related parties at year end	597	–

These amounts relate to the provision of geological, geophysical and engineering services by Gulf Keystone Petroleum (UK) Limited.

On 9 June 2006 the Group signed loan agreements with GIBCA Limited and Falcon Partners Trust, both related parties, to provide an unsecured debt facility drawn down in aggregate by US$5 million at an interest rate of 7% and for a term of 12 months. Sheikh Sultan Al-Qassimi is a shareholder in GIBCA Limited and Mr Todd Kozel has a relationship with Falcon Partners Trust. On 13 January 2007 the Group repaid in full these loans on the completion of the BG deal. The interest expense paid and accrued for in the year was nil (2006: $228,693).

Texas Keystone Inc.

Texas Keystone Inc is a related party of the Group because Mr Todd Kozel, a director of the Company, is also a director of Texas Keystone, Inc. ("TKI").

On 21 December 2007, the Company entered into a Joint Operating Agreement ("the Agreement") for the Shaikan Block in Kurdistan in which TKI holds a 5% participating interest. TKI initially led the pursuit of opportunities in the Kurdistan region and participated in the successful signature of the Production Sharing Contract for the Shaikan Block. In return for this and TKI's continuing participation, Gulf Keystone Petroleum International Limited will be liable and pay for TKI's share of the costs of the Exploration Work Programme and all costs ancillary to the Joint Operations.

No guarantees have been given or received. No provisions have been made for doubtful debts in respect of the amounts owed by related parties.

Remuneration of key management personnel

The remuneration of the directors and officers, the key management personnel of the Group, is set out below in aggregate for each of the categories specified in IAS 24 Related Party Disclosures.

The names and positions held by those directors and employees identified as key management personnel are as follows:

TF Kozel – Executive Chairman & Chief Executive Officer
JW Guest – President (resigned 23 July 2007)
RW Parsons – Chairman (resigned 23 July 2007)
Sheikh Sultan Bin Saqr Al-Qassimi – Non-Executive Director (resigned 23 July 2007)
AA Al-Qabandi – Executive Vice President (appointed 23 July 2007)
JR Cooper – Finance Director (resigned 23 January 2008)
I Patrick – Director of Commercial & Legal Affairs (Gulf Keystone Petroleum (UK) Ltd)
IA Al-Khaldi – Chief Operating Officer
C Garrett – Vice President Operations
D Mackertich – Executive Vice President Exploration & Technical

Notes to the Consolidated Financial Statements continued

For the year ended 31 December 2007

22. Related party transactions (continued)

Further information about the remuneration of individual directors is provided in the Report of the Remuneration and Appointments Committee on pages 17 to 19.

	2007 $'000	2006 $'000
Short-term employee benefits	3,206	3,462
Share-based payment – options	510	849
Share-based payment – bonus shares	(57)	2,184
	3,659	6,495

23. Financial instruments

Capital risk management

The Group manages its capital to ensure that the entities within the Group will be able to continue as going concerns while maximising the return to stakeholders through the optimisation of the debt and equity balance. The Group is not subject to externally imposed capital requirements. The capital structure of the Group consists of cash and cash equivalents and equity attributable to equity holders of the parent, comprising issued capital, reserves and accumulated losses as disclosed in notes 15, 16 and 17.

Gearing ratio

The Group's Board of Directors reviews the capital structure on a regular basis. As part of this review, the Board considers the cost of capital and the risks associated with each class of capital.

Given the current stage of development of the Group's assets, it is the Group's policy to finance its business by means of internally generated funds and external share capital. As a result, there was no debt at 31 December 2007.

Significant accounting policies

Details of the significant accounting policies and methods adopted, including the criteria for recognition, the basis of measurement and the basis on which income and expenses are recognised, in respect of each class of financial asset, financial liability and equity instrument are disclosed in the Summary of Significant Accounting Policies.

Categories of financial instruments

	Carrying value 2007 $'000	2006 $'000
Financial assets		
Fair value through profit and loss (designated at recognition)	6,155	5,597
Loans and receivables (including cash and cash equivalents)	94,333	119,327
Financial liabilities		
Amortised cost	36,684	10,835

Financial risk management objectives

The Group's management monitors and manages the financial risks relating to the operations of the Group. These financial risks include market risk (including currency and fair value interest rate risk), credit risk, liquidity risk and cash flow interest rate risk.

The Group does not presently hedge against these risks as the benefits of entering into such agreements is not considered to be significant enough as to outweigh the significant cost and administrative burden associated with such hedging contracts.

The risks are closely reviewed by the Board on a regular basis and steps are taken where necessary to ensure these risks are minimised.

23. Financial instruments (continued)

Market risk

The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates and changes in interest rates in relation to the Group's cash balances.

The operating currencies of the Group are Great British pounds (GBP), US dollars (USD), Algerian dinars (DZD) and Iraqi dinars (IQD). The Group does not hedge against the effects of movement in exchange rates. The risks are monitored by the Board on a regular basis.

During the financial year the Group diversified its operations into Kurdistan in Northern Iraq, exposing the Group to an additional foreign currency risk arising from the use of Iraqi dinars. This additional exposure is being managed in the same manner as the Group's other foreign currency risks.

There have been no other changes to the Group's exposure to market risks or the manner in which it manages and measures the risk.

Foreign currency risk management

The Group undertakes certain transactions denominated in foreign currencies, being any currency other than the functional currency of the Group subsidiary concerned, hence, exposures to exchange rate fluctuations arise.

The carrying amounts of the Group's significant foreign currency denominated monetary assets and monetary liabilities at the reporting date are as follows:

	Assets		Liabilities	
	2007 $'000	2006 $'000	2007 $'000	2006 $'000
Great British pounds	1,160	998	(43)	(342)
Algerian dinars	397	(454)	(300)	(573)

Foreign currency sensitivity analysis

The Group is mainly exposed to the currency of the United Kingdom (Great British pounds), Algeria (Algerian dinars) and Iraq (Iraqi dinars).

The following table details the Group's sensitivity to a 10% increase and decrease in the US dollar against the relevant foreign currencies. 10% is the sensitivity rate that represents management's assessment of the reasonably possible change in foreign exchange rates.

The sensitivity analysis includes only outstanding foreign currency denominated monetary items as at the balance sheet date, and adjusts their translation at the year end for a 10% change in foreign currency rates. The sensitivity analysis includes external loans as well as loans to foreign operations within the Group where the denomination of the loan is in a currency other than the currency of the lender or the borrower.

A positive number below indicates an increase in profit and net assets where the dollar weakens 10% against the relevant currency. For a 10% strengthening of the dollar against the relevant currency, there would be an equal and opposite impact on the profit and other equity, and the balances below would be negative.

	GBP Currency Impact		DZD Currency Impact		IQD Currency Impact	
	2007 $'000	2006 $'000	2007 $'000	2006 $'000	2007 $'000	2006 $'000
Profit or loss	116	100	40	41	–	–

The Group's sensitivity to foreign currency has decreased during the current year, particularly in relation to GBP denominated monetary assets, as there has been a decrease in the value of GBP bank balances and GBP accounts receivable in 2007.

Notes to the Consolidated Financial Statements continued

For the year ended 31 December 2007

23. Financial instruments (continued)

Interest rate risk management

The Group's policy on interest rate management is agreed at Board level and is reviewed on an ongoing basis. The current policy is to maintain a certain amount of funds in the form of cash for short-term liabilities and have the rest on relatively short term deposits, usually one month notice to maximise returns and accessibility.

Interest rate sensitivity analysis

The sensitivity analysis below has been determined based on the exposure to the interest rates for cash and cash equivalents at the balance sheet date. A 0.5% increase or decrease is used as it represents management's assessment of the reasonably possible changes in interest rates.

If interest rates increased by 0.5% and all other variables were held constant, the Group's profit for the year ended 31 December 2007 would increase by $441,430 per annum (2006: increase by $296,640).

If interest rates decreased by 0.5% and all other variables were held constant, the Group's profit for the year ended 31 December 2007 would decrease by $441,430 per annum (2006: decrease by $296,640).

The Group's sensitivity to interest rates has remained relatively constant during the current period due to the fairly constant cash balance for the majority of the current financial year.

Credit risk management

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group has a non-current financial asset totalling $6.2 million (2006: $5.6 million) which represents the estimated fair value of potential future "bonus" payments payable by BG to the Group in respect of the size of the ultimately approved commercial reserves attributable to the HBH field upon development.

In addition to this non current financial asset, trade and other receivables outstanding from the BG Group at balance date totalled $462,810 (2006: $57.0 million). The credit risk in relation to the BG receivables is considered to be minimal.

The Group also had a trade receivable outstanding from SONATRACH, Algeria's national oil development enterprise, totalling $4.3 million at 31 December 2007.

The Group has no other major counterparties.

Liquidity risk management

Ultimate responsibility for liquidity risk management rests with the Board of Directors. It is the Group's policy to finance its business by means of internally generated funds and external share capital. In common with many exploration companies, the Group raises finance for its exploration and appraisal activities in discrete tranches to finance its activities for limited periods. Further funding is raised as and when required. When any of the Group's projects move to the development stage, specific financing, including debt, may be required to enable development to take place.

23. Financial instruments (continued)

Liquidity and interest risk tables

The following tables detail the Group's remaining contractual maturity for its non-derivative financial liabilities. The tables have been drawn up based on the undiscounted cash flows of financial liabilities based on the earliest date on which the Group can be required to pay.

	Weighted average effective interest rate %	Less than 1 month $'000	1 to 3 months $'000	Total $'000
2007				
Non-interest bearing	n/a	25,200	11,484	36,684
2006				
Non-interest bearing	n/a	10,835	–	10,835

The following table details the Group's expected maturity for its non-derivative financial assets.

	Weighted average effective interest rate %	Less than 1 month $'000	1 to 3 months $'000	1 to 5 years $'000	Total $'000
2007					
Non-interest bearing	n/a	–	6,047	6,155	12,202
Variable interest rate instruments	5.25%	88,286	–	–	88,286
2006					
Non-interest bearing	n/a	55,000	4,999	5,597	65,596
Variable interest rate instruments	3.64%	59,328	–	–	59,328

The undiscounted value of those non-interest bearing assets with cash flows expected in the one to five year bracket is $8 million (2006: $8 million). For all other financial assets the book value equals the undiscounted value of the asset.

24. Gain on sale of assets

The gain on sale of assets recorded in 2006 was principally comprised of funds received from the farm in deal with BG for a 36.75% interest in the HBH block of $55 million. Against that consideration the cost of sales (the amount previously invested by Gulf Keystone on HBH) were calculated as $657,583 (the carrying value of that interest in the Group's balance sheet, of $222,899 and costs incurred of $434,683).

Additionally, Gulf Keystone recorded a contingent deferred consideration of $5.6 million in 2006 which due to the unwinding of the discount rate, has increased to $6.2 million in 2007 (refer to Note 12). The remainder of the gain recorded in 2006 was for the sale of surplus stock ($163,735) and the temporary loan to a third party of a drilling rig under contract to Gulf Keystone ($1 million).

25. Subsequent events

On 10 January 2008, ALNAFT (the Hydrocarbon National Agency in Algeria) approved the proposed Development Plan for the GKN and GKS oil fields located in Northern Algeria. The field Development Plan envisages producing oil from the GKN-1 well (currently producing at approximately 1,000 bopd gross) and bringing the GKS-2 well on stream as soon as practicable.

Under the terms of the Development Plan, the Group is entitled to a 30% to 49% share of production from the GKN-1 well effective from 10 October 2007. As a result, oil production revenue of $5.4 million and cost of sales of $3.3 million has been recorded for the year ended 31 December 2007.

Directors and Advisers

Directors

Todd Kozel	Executive Chairman & Chief Executive Officer
Ali Al-Qabandi	Executive Vice President
Mehdi Varzi	Non-Executive Director
Jeremy Asher	Non-Executive Director
Kristian Ewen Ainsworth	Finance Director

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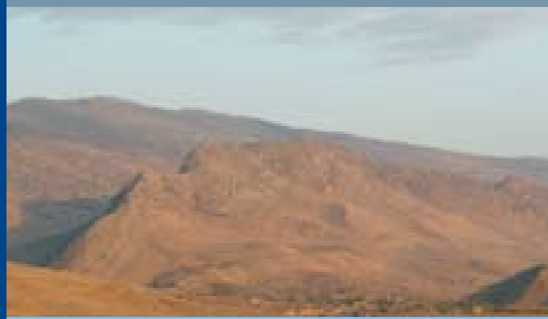

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