Annual Report and Accounts 2008

GULF KEYSTONE PETROLEUM LTD.

A year of accomplishment

Gulf Keystone is an independent oil and gas company, listed on the Alternative Investment Market ("AIM") of the London Stock Exchange (stock quote GKP).

Contents

Highlights

171 kilometres of 2D seismic acquired on the Shaikan Block in 2008

442 kilometres of 2D seismic acquired on the Akri-Bijeel Block in 2008

Three exploration and three appraisal wells drilled on the HBH Perimeter in 2008

Phase 2 of the HBH exploration contract entered requiring a further three wells to be drilled and 1,300 kilometres of 2D seismic to be shot

Successful fund raising in July 2008 totalling $46.8 million resulting in the issue of 89.5 million new shares

Recent/Upcoming Events

Shaikan-1 well spudded on 27 April 2009

First Akri-Bijeel exploration well planned for Q3 2009

£30 million Standby Equity Distribution Agreement signed in May 2009

Kurdistan Region of Iraq

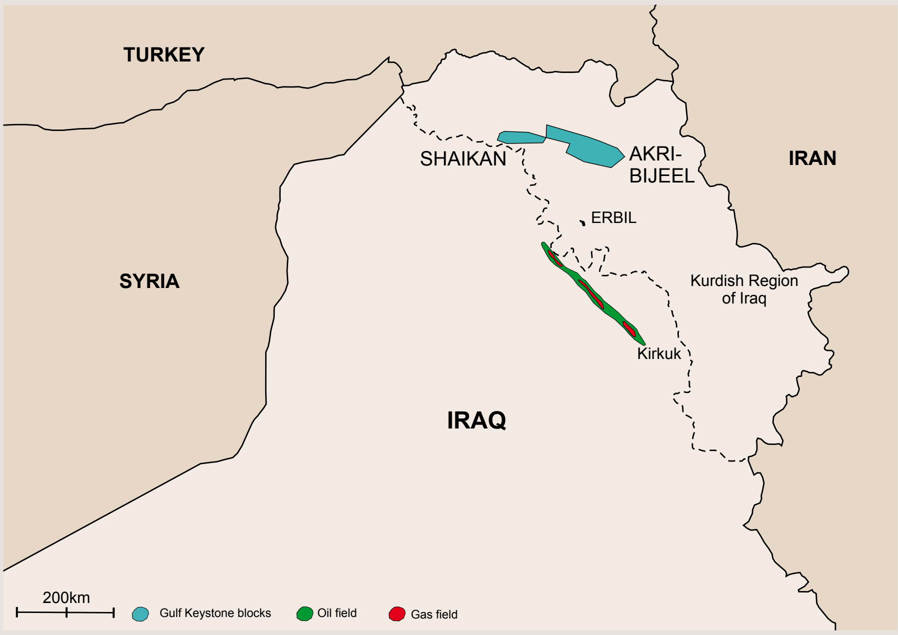
In 2007 Gulf Keystone secured interests in two blocks in Kurdistan, Northern Iraq – an area with the potential to become a world class hydrocarbon province.

A unique investment opportunity

- Limited Exploration and Production ("E&P") activity in the past
- Many undrilled surface structures
- Major discoveries are currently being made such as Heritage's Miran West-1 well

Location of assets

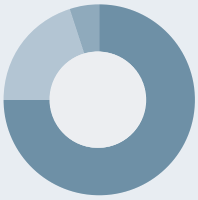
- Kurdistan covers approximately 40,000 square kilometres and is situated in the North Eastern corner of Iraq
- Gulf Keystone's blocks are adjacent to each other and are located approximately 85 kilometres from Erbil and 50 kilometres from the Turkish border
- Erbil is located 320 kilometres North North-West of Baghdad

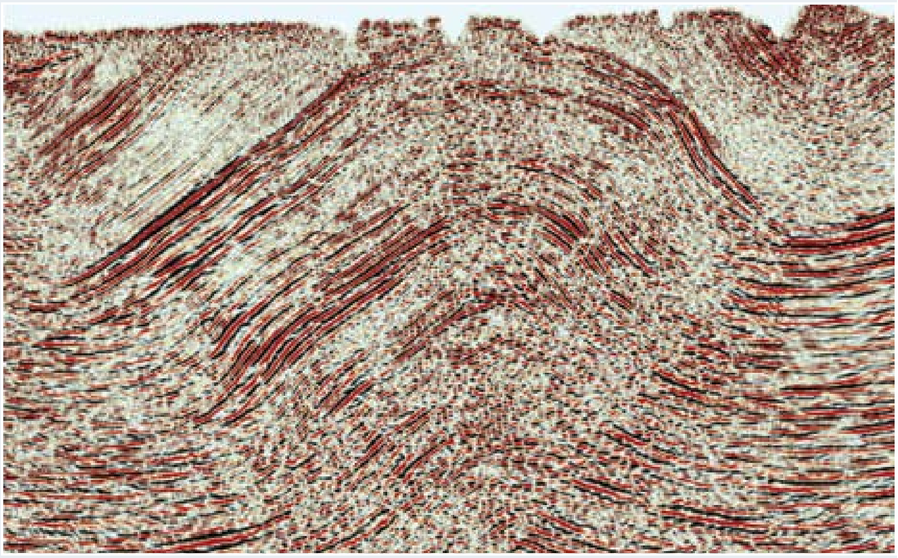


Shaikan

GKP Operator 75%, MOL 20%, TKI 5%

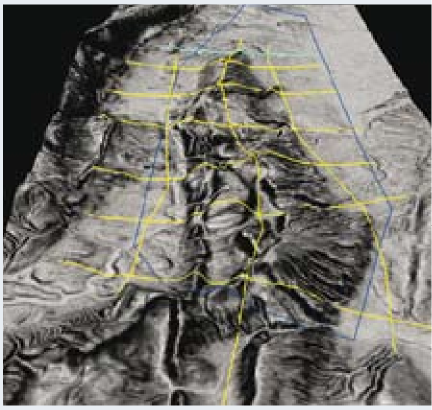
Drill site location:
> Large anticlinal structure covering over 100 square kilometres
> Well site located on top of structure
> Planned total depth of 3,000–3,500 metres
> Multiple target horizons



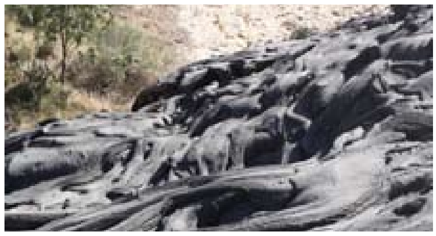


The Shaikan production sharing contract ("PSC") was awarded to operator Gulf Keystone (75%) and Kalegran Limited (20%) a subsidiary of MOL Hungarian Oil and Gas Public Limited Company ("MOL") and Texas Keystone Inc. (5%) in November 2007. The Shaikan Block is situated near the city of Dihok, approximately 85 kilometres North West of Erbil and covers an area of 283 square kilometres.

The first phase of the contract is for three years with a commitment to shoot 100 kilometres of 2D seismic and drill one exploration well. The partners can elect to enter an optional second phase of two years with further work commitments. During 2008 171 kilometres of 2D seismic was acquired and the Shaikan-1 well spudded on 27 April 2009 and is expected to take up to four months to complete.



Seismic lines draped on topographic image.



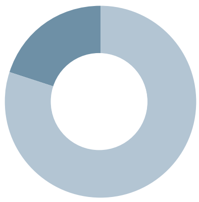
Akri-Bijeel

MOL Operator 80%, GKP 20%

The Akri-Bijeel PSC was awarded to operator Kalegran Limited (80%) in November 2007 along with Gulf Keystone (20%). The Akri-Bijeel Block is adjacent to the Shaikan Block and covers an area of 889 square kilometres.

The first phase of the contract is for three years with a commitment to shoot 200 kilometres of 2D seismic and drill one optional exploration well. The partners can elect to enter an optional second phase of two years with further work commitments. During 2008, 442 kilometres of 2D seismic was acquired and the Akri-Bijeel-1 well is expected to be spudded in the second half of 2009.

The Kurdistan Regional Government ("KRG") has an option to nominate a third party interest of up to 15% in the Shaikan PSC and up to 20% in the Akri-Bijeel PSC. On both Shaikan and Akri-Bijeel the KRG has a further option to nominate a government interest of up to 20% on each PSC following a commercial discovery.



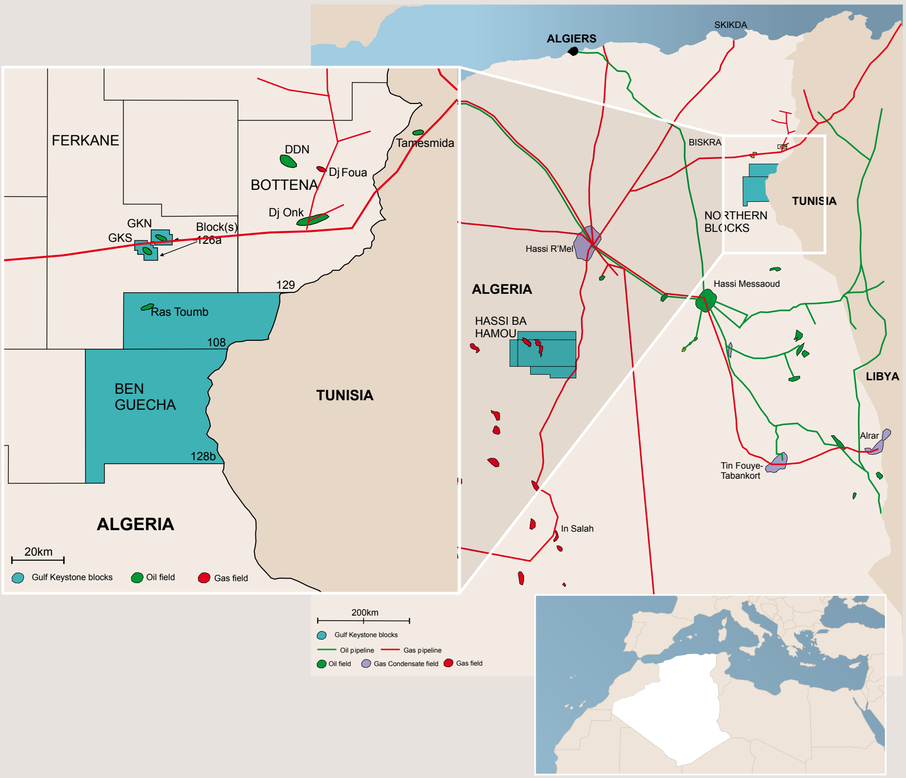
Algeria

The Company currently has exploration and appraisal rights over six 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 Hassi Ba Hamou ("HBH") Permit was awarded in April 2005 to Gulf Keystone during Algeria's 6th International Bid Round. The HBH Permit initially covered an area of 18,830 square kilometres located in the Timimoun Basin/Allal High area of central Algeria which covered five blocks (317b1, 322b3, 347b, 348 and 349b) and contained the HBH gas field.

In August 2006, BG Group plc agreed to acquire 36.75% of the HBH Permit and assume the role of operator. Gulf Keystone's interest then became 38.25%. Sonatrach, Algeria's national oil company maintained a 25% interest.

In consideration, Gulf Keystone received $55 million in cash and a $30 million carry. A contingent deferred consideration of up to $20 million is also payable, dependent on the gas reserves at the time of the HBH gas field development approval. The $30 million carry on the work programme was used to fund the acquisition of 2,047 kilometres of 2D seismic and 533 square kilometres of 3D seismic, all of which was undertaken during 2007.



HBH profile

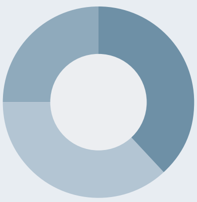
> Phase 2 of the exploration contract entered in 2008
> Commitment for three additional wells
> Commitment for 1,300 kilometres of 2D seismic to be completed by September 2010

A six well programme to appraise the HBH gas field (wells HBH-4, HBH-5 and HBH-6) and explore the HBH Permit (wells HBHN-1, RM-1 and FEG-1) commenced in December 2007 and was completed in January 2009. The drilling results are discussed more fully in the Executive Chairman & Chief Executive Officer's Statement.

The completion of the seismic acquisition and well programme detailed above completed the Phase 1 work commitments. Following the success of exploration well RM-1 in June 2008, both Gulf Keystone and BG Group elected to enter Phase 2 of the HBH Permit. Entering Phase 2 required a 30% reduction in the HBH Permit area to 12,833 square kilometres covering four blocks (317b1, part 347b, 348 and 349b) along with a work commitment of 500 square kilometres of 3D seismic, one exploration well and two appraisal wells. Phase 2 work commitments are required to be completed by September 2010.

With the success of appraisal drilling during 2008, planning for the development and commercialisation of the HBH gas field has now begun. Project approval and sanction is currently anticipated during 2010 and first gas in 2014.

Plans for the development of the more recent RM discovery is dependent upon the results of further work during Phase 2 of the HBH Permit.



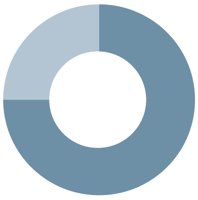
Partners HBH

- GKP 38.25%
- BG 36.75%
- Sonatrach 25%

Blocks 108 and 128b

Ben Guecha Permit

> GKP awarded permit in April 2005
> Seismic and two exploration wells to be completed by January 2010



Partners 108 and 128b

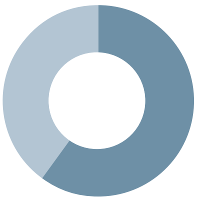
- GKP 75%
- Sonatrach 25%

The Ben Guecha Permit Blocks 108 and 128b, located in North Africa, South East Constantine Basin, were awarded in April 2005 and cover an area of 4,641 square kilometres. The permit is in close proximity to the GKN and GKS oil fields and contains the Ras Toumb oil storage facility and part of the 30 kilometre local pipeline which transports oil from the GKN-1 well.

Block 126a

GKN and GKS oil fields

> GKP awarded a 60% interest in 2001
> Development plan approved by ALNAFT in 2008
> GKP's entitlement to production effective from 10 October 2007



Partners 126a

- GKP 60%
- Sonatrach 40%

The award of a 60% interest in the Ferkane Perimeter Block 126 in 2001 (Sonatrach 40% interest) marked Gulf Keystone's first entry into Algeria. The Ferkane Perimeter is located in North Algeria, South East Constantine Basin. After completing the work programme under the Ferkane Perimeter contract in 2005 Gulf Keystone retained a sub area 126a (with the remaining area of 126 being relinquished) containing the GKN and GKS oil fields. Gulf Keystone subsequently submitted a development plan in 2007 for the GKN and GKS oil fields which was approved by ALNAFT (the Hydrocarbon National Agency) in January 2008.

This approval conferred on Gulf Keystone entitlement to production from the GKN and GKS oil fields from 10 October 2007 for a period of 20 years.

The development plan envisages an initial production target of 3,000 barrels of oil per day ("bopd") (net 882 bopd on an entitlement basis to Gulf Keystone) from two wells, GKN-1 and GKS-2. In order to achieve this target a facilities upgrade is required to handle the increased throughput and a workover of the GKN-1 well. Also required is the construction of a spur line to connect the GKS-2 well to an existing local 30 kilometre pipeline which already transports oil from the GKN-1 well to the storage facility at Ras Toumb. Oil is then trucked from the Ras Toumb facility to Biskra where the oil enters the main export line to Skikda on the Mediterranean coast where it can be loaded on to tankers for international shipment. A further phase of the development requires a 3D seismic programme and the drilling of development wells.

A year of accomplishment

I believe we are a much stronger company operationally and strategically than a year ago and I do believe the outlook has never been more exciting for Gulf Keystone.

Todd Francis Kozel
Executive Chairman & Chief Executive Officer

Overview

I am pleased to report another year of good progress by Gulf Keystone Petroleum Limited ("Gulf Keystone"). I believe we are a much stronger company operationally and strategically than a year ago. This can be witnessed in the skills and enthusiasm of our people, the success of our drilling campaign and our prospects for the current year. Financially, realising the funding necessary to secure the Company's future remains a priority, but a number of alternatives are being pursued, and some good progress has already been made.

Management

In my 2007 Annual Report to shareholders, I described the background to a major restructuring of the Company's management team which included a number of executive and non-executive appointments that significantly strengthened the Board. We have since further strengthened the Board with the appointment of Lord Truscott of St. James's as a Non-Executive Director and Mr John Berndt Gerstenlauer as Chief Operating Officer.

Lord Truscott, a member of the House of Lords and former Labour Government Energy Minister, has brought to the Board an assured and widely acknowledged expertise in international affairs, and political and commercial risk management, essential to a growing resources company. The depth of his knowledge and relationships in the Former Soviet Union ("FSU") are of particular value as we examine opportunities in this region for potential diversification.

John Gerstenlauer joined Gulf Keystone from BASF's Wintershall Nederland Group, where he was Managing Director and responsible for a business producing over 100,000 bopd, of which more than 80% was operated. He brings proven technical expertise, international project development experience and exceptional operating skills, all of which will be crucial as we continue our rapid progress in both Algeria and Kurdistan.

In addition, the corporate technical team was further strengthened with the appointment of Mr John Stafford as the Manager of Geology and Geophysics. John has been providing support to our decentralised technical teams and assessing business development opportunities.

In early 2008, we took an extremely important step forward and decentralised the Company's technical capabilities to our countries of operation, each under the leadership of a Country Manager with renowned local knowledge, contacts and expertise. The purpose of this policy was to place the Company's significant technical capability at the points of operation where its skills and expertise would be of the greatest value to those responsible for implementing our exploration, development and production strategy. I am pleased to report that this initiative has been a notable success, being a significant factor in the good progress that has been made over the past year in both Algeria and Kurdistan. I would like to commend Mr Mohamed Messaoudi, Country Manager for Algeria, and Mr Adnan Samarrai, Country Manager for Kurdistan, and their teams for their efforts.

Operating review

Algeria

Progress in Algeria has been dominated by the successful drilling campaign on the Hassi Ba Hamou ("HBH") Permit. This success prompted Gulf Keystone and its partners to elect to commit to Phase 2 of the project, ahead of completion of its Phase 1 commitments.

The HBH Permit contains the HBH gas field, which comprises four blocks within a revised concession area of 12,833 square kilometres in the Bechar Basin, in Algeria's Western Desert.

The HBH Permit drilling programme consisted of a series of six wells, three appraisal and three exploration. We were delighted that four of those six wells were successful, including one new discovery.

The first well in the programme, the HBH-4 appraisal well, spudded in December 2007 and was completed in January 2008 on schedule and to budget. A production test yielded a stabilised flow rate in line with expectations of 12,800 cubic metres per hour (10.8 mmscf per day) and provided us with valuable information on the resource potential of the permit.

In June 2008, the RM-1 exploration well was successfully drilled on a separate prospect some 50 kilometres to the South East of the HBH gas field and became our first discovery on the HBH Permit. Gas shows during drilling and logging results indicated a 61 metre gas column in sands of Siegenian age. During a production test, the well flowed gas at a stabilised flow rate of 10,266 cubic metres per hour (8.7 mmscf per day).

The HBH-5 appraisal well was successfully completed in November 2008. The well penetrated the Devonian age gas reservoir as predicted by the Gulf Keystone technical team and proved the extension of the HBH gas field to the South East. During a production test a stabilised flow rate of 11,366 cubic metres per hour (9.5 mmscf per day) was achieved.

The HBH-6 appraisal well, the sixth and final well of the first prospecting period on the HBH Permit, was completed in January 2009. The well penetrated the Devonian age gas reservoir as predicted by the Gulf Keystone technical team and during a production test a stabilised flow rate of 15,345 cubic metres per hour (12.97 mmscf per day) was achieved. HBH-6 completed the work commitments during this first phase.

HBHN-1, the first exploration well, completed in April 2008, was drilled on an untested structure to the North of the HBH gas discovery. The FEG-1 exploration well, completed in September 2008, was drilled on an untested trap to the South West of the HBH gas discovery. Neither encountered commercial gas volumes and were plugged and abandoned.

Following the success of the RM-1 exploration well in June 2008, Gulf Keystone and its partners agreed to go into the second prospecting period of the HBH Permit. This involves a work programme obligation of 500 square kilometres of 3D seismic (or equivalent of 2D), one exploration well and two appraisal wells.

Commencement of Phase 2 work commitments has already begun with the drilling of the RM-2 appraisal well in the first quarter of 2009 and the acquisition of additional 2D seismic which will contribute to our understanding of the RM discovery. RM-2 was drilled to the North of the RM-1 discovery to a depth of 919 metres on a separate Lower Devonian structure but the reservoir was shown to be water bearing. The well has been plugged and abandoned.

At the start of 2008, the Hydrocarbon National Agency in Algeria ("ALNAFT") approved the proposed Development Plan for the GKN and GKS oil fields (Gulf Keystone: 60% Working Interest, 30% Net Revenue Entitlement) located in North Algeria, South East Constantine Basin, Block 126a. This followed the Declaration of Commerciality by Sonatrach in June 2007. These were significant milestones for Gulf Keystone as the Company became entitled to a share of production revenues from these fields, complementing its exploration prospects.

As part of the development plan, 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 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 line with the Development Plan, the GKN-1 well was shut-in early in June 2008 in order to facilitate maintenance, repair, and a spur line extension to the main oil transportation line, a workover of the GKN-1 well, and an upgrade of the facilities to handle the expected increase in production when the GKS-2 well is brought on-stream. Currently this work is pending agreement with Sonatrach and approval from authorities in Algeria.

We anticipate that the restart of production from GKN-1 and the commencement of production from GKS-2 will contribute a combined 3,000 bopd (gross), 882 bopd (net).

During 2008 Sonatrach entered into a one year agreement, with an extension option, to purchase Gulf Keystone's share of production from the GKN and GKS fields. This agreement covered production from 10 October 2007. The first invoicing of crude to Sonatrach took place in November 2008. The full payment was received by February 2009, with settlement in accordance with a formula reflecting the prevailing crude price in the month of invoicing.

No activity took place on Block 108/128b during 2008.

The licence for Block 129 expired in September 2008 and the Block was relinquished.

Kurdistan

Since the award of an interest in the Shaikan and Akri-Bijeel Production Sharing Contracts ("PSCs") in November 2007, Gulf Keystone and its partners have made rapid progress in becoming established in Kurdistan and executing our planned work programme.

We and our partners have been especially delighted with the strength of our relationship with the Kurdistan Regional Government ("KRG") and the support we have received. Indeed, we were pleased to jointly host with the KRG a very successful visit by investors, media and "City" analysts to the country in June 2008. This included warm and positive meetings with senior KRG ministers and a tour of the Gulf Keystone facilities, including the blocks where numerous examples of oil seeps proved a particular attraction.

Shaikan

The Shaikan Block is situated approximately 85 kilometres North West of Erbil and covers an area of 283 square kilometres. The Shaikan Block is operated by Gulf Keystone with a participating interest of 75% in partnership with MOL Hungarian Oil and Gas Public Limited Company (20%) and Texas Keystone Inc. (5%).

The acquisition of 171 kilometres of 2D seismic data using a combination of vibrator and dynamite sources was completed in April 2008, which was ahead of schedule and under budget. This satisfies the seismic acquisition obligation under the exploration phase of the PSC.

Analysis of that seismic data has already resulted in a first, ready-to-drill prospect. An interpretation of the data by the Company's internal technical team has confirmed the existence in the subsurface, at the depth of prospective reservoir zones, of the large anticline, which is visible at the surface outcrop, and which, at the surface, is some 26 kilometres in length and five kilometres in width.

Based on this seismic data and analogues[1] in the region, and should a discovery well be drilled, potential un-risked in place contingent volumes in this prospect are up to two billion reservoir barrels of oil[2] as estimated by the Gulf Keystone technical team.

In August 2008, Gulf Keystone and its partners announced that Weatherford Drilling International (BVI) Ltd ("WDI"), had been contracted to supply a drilling rig for a minimum two well programme in Kurdistan and a further three optional wells.

With our partners, a stock and pipe yard has since been established near Maraiba in the Shaikan Block to serve both the Shaikan and Akri-Bijeel operations. The acquisition of a wellhead and casing is complete with long lead items now in stock at the pipe yard.

The WDI new build NOV IDEAL 1500HP rig arrived in Kurdistan in February 2009. The first exploration well, Shaikan-1, spudded on 27 April 2009 and is expected to be drilled to a depth of 3,500 metres. The well will target reservoir zones which include zones where oil has been discovered elsewhere in Kurdistan and Northern Iraq, namely the Qamchuqa, Sekhaniyan and Kurra Chine. Given the widely acknowledged prospectivity of Shaikan and the good seismic indications, we are looking forward to the results of the first well with increasing excitement.

As part of Gulf Keystone's established portfolio management strategy, management is reviewing a number of options including a possible farm-out and sale of some of the Company's 75% interest in the Shaikan Block.

Akri-Bijeel Block

The Akri-Bijeel Block, in which Gulf Keystone has a 20% interest, is adjacent to the Shaikan Block, and covers an area of 889 square kilometres and is operated by our partner.

The acquisition of 442 kilometres of 2D seismic was completed in August 2008 and the processing and interpretation of the seismic data is for the most part complete.

A well location has been selected and it is intended to drill the first Akri-Bijeel well following completion of Shaikan-1 using the same NOV IDEAL 1500HP rig.

American Depositary Receipt Programme
On 5 December 2008, Gulf Keystone established a sponsored Level 1 American Depositary Receipt ("ADR") programme, trading under the ticker symbol GFKSY in the US over-the-counter ("OTC") market with Pink OTC Markets Inc. (www.pinksheets.com). Each ADR represents 20 common shares in the Company.

These ADRs will give Gulf Keystone access to the US markets, which have shown an increasing appetite for foreign equities, and also provides the Company's shares with greater liquidity.

Strategy
Gulf Keystone's strategy is to build a diverse international portfolio of highly prospective hydrocarbon assets. Our focus is in the Middle East and North Africa ("MENA") and FSU regions, especially those provinces without direct competition from major oil companies and where the Company's relationships, skills and expertise can be effectively applied to deliver superior returns to shareholders.

Management's long-term strategy is also to balance carefully the significant upside potential of these assets and shareholder risk, ensuring that shareholders earn the best return consistent with an acceptable degree of risk. The Company is well advanced in this respect, although in the near term there remains more to be done to balance the imminent expenditure commitments associated with the Company's retained asset interests with its available funding.

People
We have a first class management team in place and a skilled and committed workforce. On behalf of shareholders, I thank all of them for their efforts in 2008 and congratulate them on their achievements.

Outlook
I do believe the outlook has never been more exciting for Gulf Keystone.

The spudding of our first exploration well in Kurdistan, on the highly prospective Shaikan Block, was perhaps one of the most significant milestones in the Company's history to date and we eagerly await the results of the drilling. This will be quickly followed by an exploration well on the similarly prospective Akri-Bijeel Block. A discovery success on either of these wells could materially change the value of Gulf Keystone.

Realising the funding to deliver the opportunities within the Company's portfolio remains a priority and a range of realistic funding solutions are being pursued.

I look forward to reporting back to shareholders as we progress through the 2009 drilling programme.

TF Kozel
Executive Chairman
& Chief Executive Officer

1 Where relevant analogue data was not available the reservoir parameters used are "best estimates" made by Gulf Keystone personnel based on their current understanding of the regional geology.
2 Potential oil in place volumes are quoted in reservoir barrels as there is insufficient data to allow estimation of an oil shrinkage factor and a recovery factor.

Results for the year

The Company is actively assessing the wider portfolio, strategy and opportunities with a view to farm-outs, sale or strategic partnerships and acquisitions.

Ewen Ainsworth
Finance Director

Algerian oil production is sold at discount to Saharan Blend and during the year revenue was $1 million (2007: $5.4 million).

During the second half of 2008 Gulf Keystone entered into a one year evergreen agreement for the purchase of its oil production in Algeria. This agreement covers the purchase of production from October 2007 onwards. Subsequently, in accordance with the terms of the oil sales agreement, 2007 oil sales were settled at a price relating to the month of November 2008. The underlying oil sales for 2008 were $3.5 million however a negative adjustment of $2.5 million was applied to reflect a lower realised oil price on the 2007 sales compared to the estimate used in the 2007 accounts.

Cost of sales of $2.0 million (2007: $3.3 million) comprises $0.1 million (2007: $1.0 million) of current expenditure and $1.9 million (2007: $2.3 million) of depreciation. Cost of sales for the year ended 31 December 2008 includes a $0.7 million downward adjustment to the estimated cost of sales for the year ended 31 December 2007.

An impairment charge of $37.2 million (2007: $20.6 million) was incurred in relation to Algerian Blocks 129, 108/128b and GKN and GKS. The impairment charge was a result of the expiration of the exploration licence on Block 129, the lack of intention to perform further drilling on Block 108/128b and lower future cash flows in respect of GKN and GKS.

A change in the fair value of the financial asset in respect of the contingent consideration from the HBH agreement with BG Group of $6.5 million was recognised due to the uncertainty as to whether it will become payable.

General and administrative expenses were $16.4 million (2007: $16.2 million) and after adjusting for foreign exchange losses of $3.1 million (2007: $0.2 million) were 18% lower during the year.

Interest revenue of $1.9 million (2007: $5.2 million) declined during 2008 primarily due to lower amounts of interest earned on cash balances. Finance costs of $0.1 million (2007: $0.1 million) were unchanged.

Taxation
The tax benefit of $0.2 million (2007: charge of $0.4 million) is related to UK activities.

Profit after tax
The results for 2008 show a loss after tax from continuing operations of $59.0 million (2007: $29.9 million).

Placing of shares
On 25 July 2008, the Company announced a fully subscribed placing of 89,509,488 new common shares at a placing price of £0.28 per share, raising net proceeds of $46.8 million after fees and expenses.

These shares were placed by the Company's brokers, Tristone Capital Limited and RBC Capital Markets, with institutional clients and certain of the Company's Directors, management and associates.

Directors and management participated in the placing for $5.6 million.

Cash flow
Net cash outflow from oil and gas production operations after general and administrative expenses was $12.5 million (2007: $15.9 million). Despite the lower receipt of interest income of $1.6 million (2007: $4.6 million) this was more than offset by lower cash costs of operations. Tax paid was unchanged at $0.1 million (2007: $0.1million). Consequently, net cash used in operating activities was $11.0 million (2007: $11.4 million).

Capital expenditure of $87.1 million (2007: $9.6 million) relates mainly to exploration activities in Algeria and the Kurdistan Region of Iraq.

Issue of new common shares during the year raised $46.8 million after fees and expenses (2007: $nil).

Taking into account the net cash used in operating activities, capital expenditure and proceeds from the issue of shares the net cash outflow during the year was $51.3 million (2007: inflow of $28.9 million).

Cash and cash equivalents at the end of the year were $33.6 million (2007: $88.3 million).

Issue of equity post-balance date
On 6 May 2009 the Company secured £30 million by way of a Standby Equity Distribution Agreement ("SEDA") with YA Global Master SPV Ltd, an investment fund managed by Yorkville Advisors, LLC. The SEDA enables Gulf Keystone, entirely at its own discretion for up to 36 months, to draw down funds in tranches in exchange for the issue of new equity on terms related to the prevailing market price at the time of each drawdown. To date, £2.4 million ($3.6 million) has been drawn down from the facility and 16,149,465 new shares have been issued. A further 2,087,740 new common shares of $0.01 each will be issued in lieu of cash payments for fees due. The unused facility at the date of this report amounts to £27.6 million.

Also on 6 May 2009 the Company placed 14,660,000 new common shares of $0.01 each at a price of £0.145 each, raising gross proceeds of approximately £2.1 million ($3.2 million).

On 20 May 2009 the Company issued 1 million new common shares of $0.01 each at a price of £0.1539 each, raising gross proceeds of £0.15 million ($0.24 million).

Outlook
The majority of the Company's assets are firmly in the investment stage of the oil and gas exploration and production cycle and have been financed principally from discrete tranches of equity for activities over specific periods. The Company's portfolio of assets have expenditure commitments which significantly exceed the Company's present financial resources, and therefore raising further funding remains a priority. In 2009 and beyond, the Company anticipates that internal cash generation is likely to become a more important tool in managing capital commitments and discretionary expenditure than has previously been the case. Gulf Keystone will therefore place greater emphasis on its asset base as a source of finance with valuable producing and development properties in Algeria and real company-making exploration potential in the Kurdistan Region of Iraq. With this in mind the Company is actively assessing the wider portfolio, strategy and opportunities with a view to farm-outs, sale or strategic partnerships and acquisitions in order to provide the further funding necessary to progress the asset interests it retains as its portfolio.

KE Ainsworth
Finance Director

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.

Gulf Keystone Petroleum's technical team (l-r) John Gerstenlauer, Chris Garrett, Jonathan Pitts, Mohamed Messaoudi and Adnan Samarrai.

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

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 focussed 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.

Opening of the Magara School, Kurdistan, where the Kurdistan Regional Government and Gulf Keystone constructed and renovated classrooms and supplied the school with computers.

A year of opportunity

Todd F Kozel
Executive Chairman & Chief Executive Officer

Mr Kozel co-founded the Company 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
Business Development Director

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

John B Gerstenlauer
Chief Operating Officer

Mr Gerstenlauer joins Gulf Keystone from BASF's Wintershall Nederland Group where he was Managing Director. He holds Bachelor of Science degrees in Marine Biology, Civil Engineering and a Master of Science degree in Ocean Engineering and has written numerous technical papers on petrophysical topics and drilling techniques. Mr Gerstenlauer's oil and gas industry career began when he joined Shell Coastal Division, New Orleans, as a petrophysical engineer in 1979. Over subsequent years, he assumed increasingly senior production engineering, drilling engineering and management roles within the Shell Group, Canadian Occidental Yemen and UMC Petroleum. In 1998, Mr Gerstenlauer joined Wintershall AG, Kassel, Germany as Project Manager then Consultant before becoming Managing Director of Wintershall Nederland Group, The Hague in 2003.

Mehdi Varzi
Non-Executive Director

Mr Varzi is President of Varzi Energy, an independent international energy consultancy set up in June 2001 in London, UK, after a 20-year career in the City of London. Mr Varzi retired in 2001 as the Managing Director of Global Energy Research at Dresdner Kleinwort Wasserstein (now Dresdner Kleinwort). Varzi Energy's various activities currently include advising a select group of major international financial institutions and companies on global macro energy issues; advising private and public sector energy companies on international strategy; identifying potential partners for domestic and international projects, both upstream and downstream; and assisting in the process of securing the most appropriate access to international financial markets for financing energy projects. Outside Varzi Energy, Mr Varzi is a Non-Executive Board Member of RAK Real Estate (an offshore real estate company listed on the PLUS market). Previously, Mr Varzi was a Diplomat in the Iranian Ministry of Foreign Affairs and a Senior Analyst at the National Iranian Oil Company based in Tehran. Mr Varzi also participates regularly as a speaker in major regional and international conferences and comments on global energy matters both on the radio and television.

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 in 1981. 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. Since then, he has been involved in financing a variety of investments in the energy sector. Mr Asher serves as a Non-Executive Director of Tower Resources plc and as a Director of Better Place LLC.

Lord Peter Truscott
Non-Executive Director

Lord Truscott of St James's was appointed as a Non-Executive Director of Gulf Keystone in May 2008. Lord Truscott was appointed as a member of the House of Lords in 2004. Between 2006 and 2007, he was Parliamentary Under-Secretary of State for Energy at the Department of Trade and Industry ("DTI") and the DTI Government Spokesperson in the House of Lords. Lord Truscott is currently Parliamentary British Council Ambassador, Russian Federation and Republics of the Former Soviet Union. He was until recently a member of the House of Lords European Union Select Committee, Sub-committee C (Foreign Affairs, Defence and Development Policy). Following his doctorate from Oxford University, he has written extensively on foreign, energy and security policy. He is currently an Associate Fellow of the Royal United Services Institute for Defence and Security Studies.

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 ("Europa").

Mr Ainsworth has held increasingly senior finance positions within a number of oil and gas companies including Conoco (UK) Ltd, Murco Petroleum Ltd, Texaco Ltd and CIECO Exploration & Production (UK) Ltd. He joined Europa in September 2004 where he provided support to the business across a wide brief, including 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.

Chris Garrett
Vice President Operations

Mr Garrett joined Gulf Keystone in 2004 as Managing Director of Gulf Keystone Petroleum (UK) Limited and as the Vice President of Operations. 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 30 years of oil field 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.

Ibrahim Al Khaldi
Vice President – MENA Region

Mr Al Khaldi co-founded Gulf Keystone where he serves as the Vice President of the Middle East and North Africa ("MENA") Region. Prior to joining Gulf Keystone, Mr Al Khaldi served as the Business Development Manager for the MENA Region 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, an 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.

Adnan Samarrai
Country Manager – Kurdistan

Mr Samarrai holds a Bachelor of Science degree in geology and has been an active member of the American Association of Petroleum Geologists since 1972. He has over 46 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. 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 retirement in 1998. Since his retirement from INOC Mr Samarrai has worked as Consulting Geologist to both BG International and Exploration Consultant Ltd before joining Gulf Keystone firstly as a consultant and subsequently as the Country Manager for Kurdistan in November 2006.

Tony Peart
Legal Advisor

Mr Peart is an independent advisor with over 29 years of legal, commercial and management experience in the oil and gas industry. From 2006 to 2008 he was Legal and Commercial Director of African Arabian Petroleum Limited, an Emirati-owned oil company holding exploration and production interests in North and West Africa. From 2000 to 2005 he was Senior Vice President, General Counsel and Corporate Secretary of Petrokazakhstan Inc. which was acquired by the Chinese National Petroleum Corporation. He was previously Managing Director of Bula Resources plc and MMS Petroleum plc and he has held senior management positions at Lasmo plc, Ultramar Exploration Limited and Veba Oil and Gas Limited. He is an Attorney and holds a Masters in General Management from the Vlerick Leuven Gent Management School and he has completed the Programme for Management Development at the Harvard Business School.

Mohamed Messaoudi
Country Manager – Algeria

Mr Messaoudi, a petroleum geologist, has over 29 years' experience in the oil and gas industry in Algeria. Mr Messaoudi joined Sonatrach, the Algerian National Oil Enterprise in 1979. He was involved in several exploration projects and discoveries in different Algerian basins, 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 Algeria Region is Algeria's most important hydrocarbon area and contains the Hassi Messaoud, Berkine, Illizi and Oued Mya basins. Mr Messaoudi joined Gulf Keystone in February 2007 as the Country Manager of Algeria.

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 2008.

Gulf Keystone Petroleum Limited is a public company, incorporated in Bermuda, and quoted on the Alternative Investment Market ("AIM") 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. This is expected to continue in the foreseeable future.

The subsidiaries principally affecting the profits or net assets of the Group in the year are listed in Note 10 to the consolidated financial statements.

Results and dividends

The Group's net loss after tax for the year was $59.0 million (2007: net loss of $29.9 million). The Directors do not recommend a dividend for the year (2007: $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 6 to 11 of this document.

Post-balance sheet events

On 6 May 2009 the Company secured £30 million by way of a Standby Equity Distribution Agreement ("SEDA") with YA Global Master SPV Ltd, an investment fund managed by Yorkville Advisors, LLC. The SEDA enables Gulf Keystone, entirely at its own discretion for up to 36 months, to draw down funds in tranches in exchange for the issue of new equity on terms related to the prevailing market price at the time of each drawdown. To date, £2.4 million ($3.6 million) has been drawn down from the facility and 16,149,465 new shares have been issued. A further 2,087,740 new common shares of $0.01 each will be issued in lieu of cash payments for fees due. The unused facility at the date of this report amounts to £27.6 million.

Also on 6 May 2009 the Company placed 14,660,000 new common shares of $0.01 each at a price of £0.145 each, raising gross proceeds of approximately £2.1 million ($3.2 million).

On 20 May 2009 the Company issued one million new common shares of $0.01 each at a price of £0.1539 each raising gross proceeds of £0.15 million ($0.24 million).

Directors' Report continued

Directors

The following Directors have held office during the year:

TF Kozel – Executive Chairman & Chief Executive Officer
AA Al Qabandi – Business Development Director
M Varzi – Non-Executive Director (appointed 7 January 2008)[1]
J Asher – Non-Executive Director (appointed 21 January 2008)[1]
P Truscott – Non-Executive Director (appointed 23 May 2008)[1]
JB Gerstenlauer – Chief Operating Officer (appointed 1 October 2008)
KE Ainsworth – Finance Director (appointed 24 January 2008)
JR Cooper – Finance Director (resigned 23 January 2008)

1 Member of the Audit Committee and Remuneration and Appointments Committee.

Directors' interests in shares and options

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

	At 31 December 2008 Number of common shares	At 1 January 2008 Number of common shares
TF Kozel	23,751,114	20,050,000
AA Al Qabandi	5,500,000	5,500,000
M Varzi	180,000	–
J Asher	6,675,000	–
KE Ainsworth	142,857	–
P Truscott	1,000,000	–

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.

In March 2009, Agile Energy, a Channel Islands company owned by the Asher Family Trust of which J Asher is the settlor and sole beneficiary, purchased a total of 5,325,000 ordinary shares in the Company at an average price of £0.065 per share. Following the purchase, Agile Energy has a beneficial interest in 12 million Gulf Keystone shares, representing approximately 3.0% of the Company's issued share capital.

On 13 March 2009, KE Ainsworth purchased 156,543 ordinary shares in the Company at an average price of £0.064 per share. On 16 March 2009 the Board approved an award of 95,767 ordinary shares for Mr Ainsworth under the Company's Executive Bonus Scheme. Mr Ainsworth holds an interest in 395,167 Gulf Keystone shares at the date of this report, representing approximately 0.1% of the Company's issued share capital.

On 16 March 2009 the Board approved an award of 166,667 ordinary shares for TF Kozel under the Company's Executive Bonus Scheme. On 15 April 2009, Mr Kozel transferred, by way of gift, 20,000,000 ordinary shares in the Company to Emerald Trust Limited as part of advised estate planning. Mr Kozel holds an interest in 3,917,781 Gulf Keystone shares at the date of this report, representing approximately 1.0% of the Company's issued share capital.

On 16 March 2009 the Board approved an award of 150,000 ordinary shares for Mr Al Qabandi under the Company's Executive Bonus Scheme. Mr Al Qabandi holds an interest in 5,650,000 Gulf Keystone shares at the date of this report, representing approximately 1.5% of the Company's issued share capital.

Directors' interests in share options of the Company, including family interests, as at 31 December are disclosed on page 23.

Substantial shareholdings

Other than the Directors' interests shown above, the Company has been notified of the following substantial interests as at 12 June 2009:

	Number of Common Shares	Percentage of issued share capital
Blakeney Management	32,561,898	8.08%
Capital Research & Management Co	23,700,000	5.88%
Gibca Ltd	20,000,000	4.96%
Gartmore Investment Managers	14,418,696	3.58%
RAB Capital	14,339,383	3.56%

Going Concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Executive Chairman and Chief Executive Officer's Statement on pages 6 to 9. The financial position of the Group, its cash flows, and available facility are described in the Financial Review on pages 10 to 11. In addition Note 23 to the consolidated financial statements includes the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; and its exposures to credit risk and liquidity risk.

In the absence of current production revenues, the Group is currently dependent upon its existing financial resources which include cash and cash equivalents and the Standby Equity Distribution Agreement facility (see Note 24) to satisfy its obligations and fully finance its exploration and evaluation programme in Algeria and Kurdistan. Failure to meet these exploration and evaluation commitments could put the related licence interests at risk of forfeiture.

The Directors believe that based on the forecasts and projections they have prepared, the resources available will be sufficient for the Company and its subsidiaries to continue as a going concern for the foreseeable future but only when taking into account proceeds anticipated to be generated from asset sale, farm-out of its oil and gas interests and/or equity placing. Whilst progress is being made on a number of potential transactions, further progress needs to be made to balance the expenditure commitments on the asset interests the Group retains with its available funding in order to secure the Group's future.

The Directors have concluded that the combination of these circumstances represent a material uncertainty that casts significant doubt upon the Group's ability to continue as a going concern and therefore it may be unable to realise its assets and discharge its liabilities in the normal course of business. Nevertheless after making enquiries, and considering the uncertainties described above, the Directors have a reasonable expectation that the Group have adequate resources to continue in operational existence for the foreseeable future. For these reasons, they continue to adopt the going concern basis in preparing the annual report and accounts.

Annual General Meeting 2009

The resolutions to be proposed at the Annual General Meeting ("AGM") to be held on 14 August 2009 are set out in the Notice of the AGM.

By order of the Board

TF Kozel
Executive Chairman & Chief Executive Officer
16 June 2009

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, three further Executive Directors and three Non-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 Remuneration 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 25. 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 AGM at regular intervals. There are no specific terms of appointment for Non-Executive Directors.

During 2008, 12 scheduled Board meetings were held. Eight meetings took place in Europe, five of which were in countries outside of the EU, three 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. Mehdi Varzi and Jeremy Asher were appointed to the Remuneration and Appointments Committee and the Audit Committee with effect from 22 January 2008, replacing Todd Kozel and Ali Al Qabandi in these roles. Lord Truscott joined both the Remuneration and Appointments and Audit Committee on 23 May 2008.

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. Details of the Directors' remuneration are set out on pages 22 to 24.

The Audit Committee

The Audit Committee's primary tasks are to review the half-yearly and annual accounts before they are presented to the Board, focussing 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 Chief Executive Officer.

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 AGM, private investors are given the opportunity to question the Board.

This year's AGM will be held on 14 August 2009.

Report of the Remuneration and Appointments Committee

Remuneration and Appointments Committee

The Remuneration and Appointments Committee comprised Todd Kozel and Ali Al Qabandi up to 21 January 2008 and has comprised Mehdi Varzi and Jeremy Asher since that date. Lord Truscott joined the Committee on 23 May 2008.

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 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, John Gerstenlauer and Ewen Ainsworth have service contracts with the Company. These can be terminated by either side on 12 months' notice for Todd Kozel, six months for John Gerstenlauer and 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.

Directors' emoluments

	Salary $	Bonus shares $	Fees $	2008 Total $	2007 Total $
TF Kozel	675,000	12,438	–	687,438	675,000
AA Al Qabandi	270,000	11,194	–	281,194	119,096
JB Gerstenlauer	204,960	–	–	204,960	–
KE Ainsworth	265,608	11,194	–	276,802	–
M Varzi	–	–	85,918	85,918	–
J Asher	–	–	85,918	85,918	–
P Truscott	–	–	83,670	83,670	–
JR Cooper	23,169	–	–	23,169	524,984
RW Parsons	–	–	–	–	47,379
JW Guest	–	–	–	–	747,442
Sheikh Sultan Bin Saqr Al-Qassimi	–	–	–	–	26,322
	1,438,737	34,826	255,506	1,729,069	2,140,223

Directors' interests in options

Directors' interests in share options of the Company, including family interests, as at 31 December 2008 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
2008				
TF Kozel	20 Aug 05	2,650,000	48p	20 Aug 05–19 Aug 14
AA Al Qabandi	20 Aug 05	500,000	48p	20 Aug 05–19 Aug 14
JB Gerstenlauer	25 Sep 08	2,000,000	30p	1 Oct 11–30 Sep 18
KE Ainsworth	14 Feb 08	1,000,000	30p	24 Jan 11–23 Jan 18
M Varzi	14 Feb 08	100,000	30p	7 Jan 11–6 Jan 18
J Asher	14 Feb 08	100,000	30p	21 Jan 11–20 Jan 18
P Truscott	25 Sep 08	100,000	30p	23 May 11–22 May 18
2007				
TF Kozel	20 Aug 05	2,650,000	48p	20 Aug 05–19 Aug 14
AA Al Qabandi	20 Aug 05	500,000	48p	20 Aug 05–19 Aug 14

The exercise of those options held by TF Kozel or AA Al Qabandi are 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% of the shares under option.

For all other Directors, 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.

There were no share options exercised during the year.

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

On 17 March 2009, TF Kozel and AA Al Qabandi were granted 3,000,000 and 1,000,000 options respectively at an exercise price of 30p under the Company's Unapproved Share Option Plan. These options replace the options held by Messrs Kozel and Al Qabandi disclosed in the table above. The new 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.

There have been no other changes in Directors' interests in share options in the year.

Report of the Remuneration and Appointments Committee continued

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. The number and value of shares granted are as follows:

Directors' bonuses

	2008 Number of shares	2008 Total $	2007 Number of shares	2007 Total $
TF Kozel	166,667	12,438	–	–
AA Al Qabandi	150,000	11,194	–	–
KE Ainsworth	150,000	11,194	–	–
JW Guest	–	–	684,019	416,634
JR Cooper	–	–	253,065	164,322
	466,667	34,826	937,084	580,956

The awards are included in the Directors' emoluments on page 22.

JW Guest's 2007 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 2008 and 31 December 2007 was 16.8p and 32.3p respectively and the range during 2008 was 12.0p to 37.0p.

Approved

TF Kozel
Executive Chairman & Chief Executive Officer
16 June 2009

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. However, 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 2008 which comprise the Consolidated Income Statement, Consolidated Balance Sheet, Consolidated Statement of Changes in Equity, Consolidated Cash Flow Statement, Summary of Significant Accounting Policies and the related Notes 1 to 24. These Group financial statements have been prepared under accounting policies set out therein.

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 Group 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, in accordance with IFRSs, and whether the Group financial statements have been properly prepared in accordance with the accounting policies set out in the Summary of Significant Accounting Policies and whether the information given in the Directors' Report is consistent with the Group financial statements.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit.

We read other information contained in the Annual Report as set out in the contents page and consider whether it is consistent with the audited Group financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group 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 Group financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Group 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 Group 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 Group financial statements.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs, of the state of the Group's affairs as at 31 December 2008 and of its loss for the year then ended;
- the Group 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 Group financial statements.

Emphasis of a matter - going concern

In forming our opinion on the financial statements, which is not qualified, we have considered the adequacy of the disclosure made in note 1 of the Group financial statements concerning the Group's ability to continue as a going concern. The Group is currently dependent upon its ability to raise funds via asset sale, farm outs and/or an equity placing to satisfy its obligations and fully finance its exploration programme. These conditions, along with other matters as set forth in note 1 of the Group financial statements, indicate the existence of a material uncertainty which may cast significant doubt about the company's ability to continue as a going concern. The financial statements do not include any adjustments that would result if the Group was unable to continue as a going concern.

Deloitte LLP
Chartered Accountants
London, United Kingdom
16 June 2009

Consolidated Income Statement
for the year ended 31 December 2008

	Notes	2008 $'000	2007 $'000
Continuing operations			
Revenue	5	999	5,414
Cost of sales	5	(2,013)	(3,257)
Gross (loss)/profit		(1,014)	2,157
Other operating expenses			
Impairment of intangible exploration assets	8	(29,350)	(20,585)
Impairment of tangible oil and gas properties	9	(7,860)	–
Loss on change in fair value of financial asset	12	(6,455)	–
General and administrative expenses		(16,417)	(16,172)
Loss from operations	3	(61,096)	(34,600)
Interest revenue	5	1,932	5,183
Finance costs	14	(105)	(101)
Loss before tax		(59,269)	(29,518)
Tax benefit/(expense)	6	231	(377)
Loss after tax for the year		(59,038)	(29,895)
Loss per share (cents)			
Basic	7	(18.61)	(10.79)
Diluted	7	(18.61)	(10.79)

Consolidated Balance Sheet
as at 31 December 2008

	Notes	2008 $'000	2007 $'000
Non-current assets			
Intangible assets	8	95,520	41,996
Property, plant and equipment	9	15,713	24,097
Financial asset	12	–	6,155
		111,233	72,248
Current assets			
Inventories	11	5,922	5,526
Trade and other receivables	12	7,857	6,047
Cash and cash equivalents	12	33,606	88,286
		47,385	99,859
Total assets		158,618	172,107
Current liabilities			
Trade and other payables	13	18,515	36,684
Tax liabilities	6	–	377
		18,515	37,061
Non-current liabilities			
Trade and other payables	13	14,857	–
Provisions	14	2,846	1,054
		17,703	1,054
Total liabilities		36,218	38,115
Net assets		122,400	133,992
Equity			
Share capital	15	2,765	1,866
Share premium account	15	204,919	159,063
Share option reserve	16	4,890	3,988
Exchange translation reserve	16	(184)	27
Accumulated losses	17	(89,990)	(30,952)
Total equity		122,400	133,992

The financial statements were approved by the Board of Directors and authorised for issue on 16 June 2009 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 2008

	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 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 1 January 2008	1,866	159,063	3,988	(30,952)	27	133,992
Share-based payment expense	–	–	902	–	–	902
Exchange differences arising on translation of overseas operations	–	–	–	–	(211)	(211)
Share issue	899	45,856	–	–	–	46,755
Net loss for the year	–	–	–	(59,038)	–	(59,038)
Balance at 31 December 2008	2,765	204,919	4,890	(89,990)	(184)	122,400

Consolidated Cash Flow Statement
for the year ended 31 December 2008

	Notes	2008 $'000	2007 $'000
Operating activities			
Cash used in operations	18	(12,516)	(15,916)
Tax paid		(145)	(136)
Interest received		1,632	4,625
Net cash used in operating activities		(11,029)	(11,427)
Investing activities			
Proceeds from prior year sale of assets		–	55,000
Purchase of intangible assets		(85,331)	(9,184)
Purchase of property, plant and equipment		(1,734)	(455)
Net cash (used in)/generated by investing activities		(87,065)	45,361
Financing activities			
Repayment of loan		–	(5,000)
Proceeds on issue of share capital		46,755	13
Net cash generated by/(used in) financing activities		46,755	(4,987)
Net (decrease)/increase in cash and cash equivalents		(51,339)	28,947
Cash and cash equivalents at beginning of year		88,286	59,328
Effect of foreign exchange rate changes		(3,341)	11
Cash and cash equivalents at end of the year being bank balances and cash on hand	12	33,606	88,286

Consolidated Financial Statements
for the year ended 31 December 2008
Summary of Significant Accounting Policies

General information
The Company is incorporated in Bermuda and it is quoted on the Alternative Investment Market ("AIM") of the London Stock Exchange. In 2008 the Company established a Level 1 American Depositary Receipt programme in conjunction with the Bank of New York Mellon which has been appointed as the depositary bank. 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, two interpretations issued by the International Financial Reporting Interpretations Committee are effective for the current period. These are: IFRIC 11/IFRS 2 – Group and Treasury Share Transactions and IFRIC 14/IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. 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:

IFRS 1 (amended)/IAS 27 (amended)	Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate
IFRS 2 (amended)	Share-based Payment – Vesting Conditions and Cancellations
IFRS 3 (revised 2008)	Business Combinations
IFRS 8	Operating Segments
IAS 1 (revised 2007)	Presentation of Financial Statements
IAS 23 (revised 2007)	Borrowing Costs
IAS 27 (revised 2008)	Consolidated and Separate Financial Statements
IAS 32 (amended)/IAS 1 (amended)	Puttable Financial Instruments and Obligations Arising on Liquidation
IAS 39 (amended)	Eligible Hedged Items
IFRIC 12	Service Concession Arrangements
IFRIC 15	Agreements for the Construction of Real Estate
IFRIC 16	Hedges of a Net Investment in a Foreign Operation
IFRIC 17	Distributions of Non-cash Assets to Owners
IFRIC 18	Transfers of Assets from Customers
Improvements to IFRSs (May 2008)	

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.

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 as discussed in the Directors' Report and in Note 1 below. 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.

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

Consolidated Financial Statements
for the year ended 31 December 2008
Summary of Significant Accounting Policies continued

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 having regard to the requirements of IFRS 6 Exploration for and Evaluation of Mineral Resources. 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, on a unit of production basis as discussed below.

Depreciation, depletion and amortisation is provided under the unit of production method which uses the estimated remaining commercial reserves and the net book value of the cost pool, including any unsuccessful exploration and evaluation costs, 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, on a pool-by-pool basis, 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). Where the assets fall into an area that does not have an established pool or if there are no producing assets to cover the unsuccessful exploration and evaluation costs, those assets would fail the impairment test and be written off to the income statement in full.

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.

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

Carry of expenditures and farm-in arrangements (continued)

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 and those overheads that have been incurred in bringing the inventories to their present location and condition. 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 cash and borrowings together with various items such as trade and 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 the income statement 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.

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.

Consolidated Financial Statements
for the year ended 31 December 2008
Summary of Significant Accounting Policies continued

Financial instruments (continued)

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 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. A corresponding amount equivalent to the provision is also recognised as part of the cost of the related property, plant and equipment. The amount recognised is reassessed each year in accordance with local conditions and requirements. Changes in the estimated timing of decommissioning or decommissioning cost estimates are dealt with prospectively. The unwinding of the discount on the decommissioning provision is included as a finance cost.

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

An impairment test of the Group's cost pool requires a comparison of the carrying value of the assets of the pool with its recoverable amount, that is, the higher of fair value less costs to sell and value in use. Value in use is usually determined on the basis of discounted estimated future net cash flows from future production. 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.

Critical accounting estimates and judgements (continued)

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 accounting policy for decommissioning provision is discussed above. The cost of decommissioning is estimated by reference to the Group's experience. Further details are provided in Note 14.

Estimating revenue and costs recognised

The production revenue recognised by the Group for the year ended 31 December 2007 was 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 was calculated had not been agreed with Sonatrach. The average Sahara Blend oil price for this period totalled $89.46 per barrel.

The related costs recognised by the Group for the year ended 31 December 2007 were calculated based on the estimated variable and fixed costs of the operation as documented in the ALNAFT-approved Final Discovery Report.

The difference between the estimated revenues and costs recognised by the Group for the year ended 31 December 2007 and actual revenues and costs as agreed with Sonatrach subsequently is disclosed in Note 5.

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 $4m for every 100 bcf over 800 bcf from a minimum of 900 bcf up to a maximum of 1,300 bcf. This has been recognised as a financial asset at fair value through profit or loss. The change in the estimated level of reserves during the year that impact the fair value of the Group's financial asset is described in Note 12.

Reserves

Commercial reserves are determined using estimates of oil in place, recovery factors and future oil prices. Future development costs are estimated using assumptions as to numbers of wells required to produce the commercial reserves, the cost of such wells and associated production facilities, and other capital and operating costs. Reserve estimates principally affect the depreciation, depletion and amortisation charges.

Notes to the Consolidated Financial Statements
for the year ended 31 December 2008

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.

Going concern

The Group's business activities, together with the factors likely to affect its future development, performance and position are set out in the Executive Chairman and Chief Executive Officer's Statement on pages 6 to 9. The financial position of the Group, its cash flows, and available facility are described in the Financial Review on pages 10 to 11. In addition Note 23 to the consolidated financial statements includes the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; and its exposures to credit risk and liquidity risk.

In the absence of current production revenues, the Group is currently dependent upon its existing resources which include cash and cash equivalents and the Standby Equity Distribution Agreement facility (see Note 24) to satisfy its obligations and fully finance its exploration and evaluation programme in Algeria and Kurdistan. Failure to meet these exploration and evaluation commitments could put the related licence interests at risk of forfeiture.

The Directors believe that based on the forecasts and projections they have prepared, the resources available will be sufficient for the Company and its subsidiaries to continue as a going concern for the foreseeable future but only when taking into account proceeds anticipated to be generated from asset sale, farm-out of its oil and gas interests and/or equity placing. Whilst progress is being made on a number of potential transactions, further progress needs to be made to balance the expenditure commitments on the asset interests the Group retains with its available funding in order to secure the Group's future.

The Directors have concluded that the combination of these circumstances represent a material uncertainty that casts significant doubt upon the Group's ability to continue as a going concern and therefore it may be unable to realise its assets and discharge its liabilities in the normal course of business. Nevertheless after making enquiries, and considering the uncertainties described above, the Directors have a reasonable expectation that the Group have adequate resources to continue in operational existence for the foreseeable future. For these reasons, they continue to adopt the going concern basis in preparing the annual report and accounts.

2. Business and geographical segments

Business and geographical segments

For management purposes, the Group is currently organised into four legal entities – Gulf Keystone Petroleum Limited and its subsidiaries Gulf Keystone Petroleum International Limited, Gulf Keystone Petroleum (UK) Limited and Gulf Keystone Petroleum Numidia 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.

2. Business and geographical segments (continued)

Segment information for each geographical location is presented below:

	Algeria 2008 $'000	Kurdistan 2008 $'000	United Kingdom 2008 $'000	Bermuda 2008 $'000	Eliminations 2008 $'000	Total 2008 $'000
Revenue	999	–	–	–	–	999
Inter-segment sales	–	–	2,864	–	(2,864)	–
Total revenue	999	–	2,864	–	(2,864)	999
Cost of sales	(2,013)	–	–	–	–	(2,013)
Gross profit/(loss)	(1,014)	–	2,864	–	(2,864)	(1,014)
Impairment of intangible exploration assets	(29,350)	–	–	–	–	(29,350)
Impairment of tangible oil and gas properties	(7,860)	–	–	–	–	(7,860)
Loss on change in fair value of financial asset	(6,455)	–	–	–	–	(6,455)
General and administrative expenses	(3,350)	(1,111)	(3,560)	(10,655)	2,259	(16,417)
Segment result	(48,029)	(1,111)	(696)	(10,655)	(605)	(61,096)
Interest revenue						1,932
Finance costs						(105)
Loss before tax						(59,269)
Tax benefit						231
Loss after tax						(59,038)

	Algeria 2008 $'000	Kurdistan 2008 $'000	United Kingdom 2008 $'000	Bermuda 2008 $'000	Eliminations 2008 $'000	Total 2008 $'000
OTHER INFORMATION						
Capital additions	73,677	11,019	1	6	–	84,703
Depreciation and amortisation	2,020	66	182	–	–	2,268
Share-based payments expense	–	–	–	902	–	902
BALANCE SHEET						
Assets						
Segment assets	84,700	43,071	1,879	144,485	(115,517)	158,618
Liabilities						
Segment liabilities	(105,344)	(42,078)	(615)	(282)	112,101	(36,218)

Notes to the Consolidated Financial Statements continued

for the year ended 31 December 2008

2. Business and geographical segments (continued)

	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	(3,257)	–	–	–	–	(3,257)
Gross profit/(loss)	2,157	–	6,639	–	(6,639)	2,157
Impairment of intangible exploration assets	(20,585)	–	–	–	–	(20,585)
General and administrative 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 expense						(377)
Loss after tax						(29,895)
OTHER INFORMATION						
Capital additions	16,605	25,836	57	–	–	42,498
Depreciation and amortisation	2,487	3	183	–	(41)	2,632
Share-based payments expense	–	–	–	453	–	453
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)

3. Loss from operations

	2008 $'000	2007 $'000
Loss from operations has been arrived at after charging:		
Depreciation of property, plant and equipment – owned assets	2,176	2,568
Amortisation of intangible assets	92	64
Impairment of intangible exploration assets	29,350	20,585
Impairment of tangible oil and gas properties	7,860	–
Loss on change in fair value of financial asset	6,455	–
Staff costs (see Note 4)	5,161	7,539
Auditors' remuneration (see below)	95	168
Operating lease rentals (see Note 20)	418	413
Exchange loss	3,099	229

Amounts payable to Deloitte LLP in respect of both audit and non-audit services were:

	2008		2007	
	$'000	%	$'000	%
Audit services				
– Annual statutory audit of the Group	54	57	106	63
– Annual statutory audit of the UK subsidiary	11	11	14	8
	65	68	120	71
Other services pursuant to legislation				
– Interims	–	–	32	19
Tax services				
– Compliance services	30	32	16	10
	95	100	168	100

4. Staff costs

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

	2008 Number	2007 Number
Office and management	12	14
Exploration staff	42	40
	54	54

Their aggregate remuneration comprised:

	2008 $'000	2007 $'000
Wages and salaries	3,011	3,628
Social security costs	1,248	3,458
Share-based payment (see Note 21)	902	453
	5,161	7,539

5. Revenue

	2008 $'000	2007 $'000
Sale of goods	999	5,414
Interest revenue		
– Interest on bank deposits	1,632	4,625
– Unwinding of discount on non-current financial asset	300	558
	1,932	5,183

Notes to the Consolidated Financial Statements continued

for the year ended 31 December 2008

5. Revenue (continued)

The sale of goods for the year ended 31 December 2008 includes a $2.5 million downward adjustment to the provisional price estimates for the year ended 31 December 2007 following the actual invoicing to Sonatrach in December 2008.

The related cost of sales for the year ended 31 December 2008 also includes a $0.7 million downward adjustment to the estimated cost of sale of goods for the year ended 31 December 2007 following agreement with Sonatrach in April 2009.

The basis for estimating the sale of goods and the related cost for the year ended 31 December 2007 are disclosed under the Critical Accounting Estimates and Judgements in the Summary of Accounting Policies.

6. Tax (benefit)/expense

	2008 $'000	2007 $'000
Provision for current UK corporation tax	(170)	313
Provision for deferred UK corporation tax	(61)	64
Tax attributable to the Company and its subsidiaries	(231)	377

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 ("PSCs") 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 applied at a rate of 5% of GKP's share of production revenue and is paid from GKP's share of production. It is only applied to any profits generated when the average price of a barrel of oil is greater than $30 in the month concerned. The tax is treated as a sales related tax, accounted for as a reduction in revenue.

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 9 million Iraqi Dinars (equivalent to $7,798 at the 31 December 2008 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.

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 28% (2007: 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 PSCs, nor were there any temporary differences on which deferred tax is required to be provided. As a result, no corporate income tax has been provided in the period.

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

	2008 $'000	2007 $'000
Loss before tax	(59,269)	(29,518)
Tax at the Bermudan tax rate of 0% (2007: 0%)	–	–
Effect of different tax rates of subsidiaries operating in other jurisdictions	231	(377)
Tax benefit/(expense) for the year	231	(377)

7. Loss per share

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

	2008 $'000	2007 $'000
Loss		
Loss for the purposes of basic and diluted loss per share	(59,038)	(29,895)

7. Loss per share (continued)

	2008 Number	2007 Number
Number of shares		
Weighted average number of ordinary shares for the purposes of basic loss per share	317,323,197	277,003,270
Adjustments for:		
– bonus shares	n/a	n/a
– share options	n/a	n/a
Weighted average number of ordinary shares for the purposes of diluted loss per share	317,323,197	277,003,270

There is no difference between basic and diluted earnings per share as the Group was loss making in each year and hence the effect of bonus shares and share options is anti-dilutive.

8. Intangible assets

	Exploration and evaluation costs $'000	Computer software $'000	Total $'000
At 1 January 2007			
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	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
Year ended 31 December 2008			
Opening net book value	41,886	110	41,996
Additions	82,947	21	82,968
Impairment write off	(29,350)	–	(29,350)
Amortisation charge	–	(92)	(92)
Foreign currency translation differences	–	(2)	(2)
Closing net book value	95,483	37	95,520
At 31 December 2008			
Cost	95,483	284	95,767
Accumulated amortisation	–	(247)	(247)
Net book value	95,483	37	95,520

The net book value at 31 December 2008 is made up of intangible assets relating to HBH $59.5 million (2007: $7.5 million); Shaikan $28.7 million (2007: $20.7 million); Akri-Bijeel $7.3 million (2007: $5.0 million); and others $nil (2007: $8.8 million).

Notes to the Consolidated Financial Statements continued

for the year ended 31 December 2008

8. Intangible assets (continued)

During the year, the Group recognised an impairment loss in respect of the Algerian Northern Blocks cost pool due to management's decision not to pursue further drilling on Block 108/128b, production interruptions on the GKN/GKS field and the expiration of the licence on Block 129. This impairment loss comprises a charge to the exploration and evaluation costs of $29.4 million and a charge to the oil and gas properties of $7.9 million (see Note 9).

In assessing whether the assets have been impaired, the carrying amount of the Algerian Northern Blocks cost pool was compared with the recoverable amount of the producing GKN/GKS field. The Group calculates the recoverable amount with reference to the value in use of the GKN/GKS field using a discount rate of 15% which reflects the risks inherent in the forecast cash flows and oil price assumptions based on forward prices ranging from $64 per barrel in 2010 to $73 per barrel in 2016.

The additions to oil and gas exploration and evaluation costs in the year include the drilling of HBH-4, HBH-5 and HBH-6 appraisal wells and the drilling of FEG-1, HBHN-1 & RM-1 exploration wells; the acquisition of 2D seismic for HBH; and 2D seismic acquisition and costs associated with the preparation for the drilling of the Shaikan-1 exploration well.

The amortisation charge of $92,000 (2007: $64,000) for computer software has been included in general and administrative expenses.

9. Property, plant and equipment

	Oil and gas properties $'000	Fixtures and equipment $'000	Total $'000
At 1 January 2007			
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
Year ended 31 December 2008			
Opening net book value	23,334	763	24,097
Additions	1,286	449	1,735
Impairment write off (Note 8)	(7,860)	–	(7,860)
Depreciation charge	(1,888)	(288)	(2,176)
Foreign currency translation differences	–	(83)	(83)
Closing net book value	14,872	841	15,713
At 31 December 2008			
Cost	26,924	1,783	28,707
Accumulated depreciation	(12,052)	(942)	(12,994)
Net book value	14,872	841	15,713

9. Property, plant and equipment (continued)

The depreciation charge of $1.9 million on oil and gas properties (2007: $2.3 million) has been included in cost of sales and the depreciation charge of $0.3 million on fixtures and equipment (2007: $0.3 million) has been included in general and administrative expenses.

The adjustment to prior year transfer in 2007 relates to a transfer between intangible assets and property, plant and equipment (see Note 8).

10. Subsidiary

Details of the Company's subsidiaries at 31 December 2008 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 and administration
Gulf Keystone Petroleum International Limited	Bermuda	100	100	Exploration and evaluation activities
Gulf Keystone Petroleum Numidia Limited	Bermuda	100	100	Exploration and evaluation activities

11. Inventories

	2008 $'000	2007 $'000
Exploration materials	5,922	5,526

12. Financial assets

Non-current financial asset

During 2008 a loss of $6.5 million was recognised in respect of the contingent deferred consideration from the HBH agreement with BG. Under the agreement, BG are required to pay Gulf Keystone a bonus payment if gas reserves reach a minimum of 900 bcf. At this time it is uncertain as to whether the contingent consideration will become payable and therefore the value of the financial asset has been written down to $nil.

Trade and other receivables

	2008 $'000	2007 $'000
Trade receivables	6,413	4,269
Other receivables and prepayments	1,444	1,778
	7,857	6,047

The $6.4 million trade receivable owing from Sonatrach relates to production revenue from the GKN-1 well for the period from 10 October 2007 to 2 June 2008. These funds were subsequently received in the first quarter of 2009.

Included within other receivables and prepayments is an amount of $0.4 million (2007: $0.5 million) 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 2008

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.

	2008 $'000	2007 $'000
Current		
Trade payables	420	226
Accrued expenses	18,095	36,458
	18,515	36,684
Non-current		
Accrued expenses	14,857	–

The non-current accrued expenses relate to the discounted value of the cash guarantee on Blocks 108/128b which is expected to be repayable to Sonatrach in January 2010 if the exploration commitments for these blocks are not satisfied before the expiration of the licence (Note 19).

14. Provisions

Decommissioning provision

	$'000
At 1 January 2008	1,054
Additional provision in the year	1,687
Unwinding of discount	105
At 31 December 2008	2,846

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, GKS-3, RM-1, HBH-4, HBH-5 and HBH-6. The Group estimated that decommissioning of production facilities at GKN/GKS will be approximately $3 million. The total amount provided in the balance sheet as at 31 December 2008 at net present value is $2.8 million (2007: $1.1 million). Of this provision for well abandonment for seven wells and production facilities, the expenditure is expected to be incurred over the next five to 21 years.

15. Share capital

	2008 $'000	2007 $'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

15. Share capital (continued)

	Common shares			
	Share number	Amount $'000	Share capital $'000	Share premium $'000
Issued and fully paid				
Balance at 1 January 2007	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	1,866	159,063
Bonus scheme shares February 2008	410,304	4	4	–
Share issue March 2008	40,000	–	–	–
Private placement July 2008	89,509,488	49,265	895	48,370
Bonus scheme shares September 2008	7,867	–	–	–
Issue costs of July 2008 private placement	n/a	(2,514)	–	(2,514)
Balance 31 December 2008	368,008,215	207,684	2,765	204,919

In February and September 2008, 418,171 new shares were issued as part of the Company's bonus share scheme (2007: 561,518 new shares).

In February 2007 the Company was notified that a subscriber had applied and paid for 40 Series A Preferred Shares in 2003 prior to the Company's placing and admission to AIM for which no shares were issued. At the time of the Company's placing and admission to AIM in 2004 each Series A Preferred Share converted to 1,000 ordinary shares. Following an exhaustive investigation it was confirmed that the proceeds had been received but no shares had been issued in exchange and in March 2008, 40,000 ordinary shares were issued to the subscriber to rectify the situation.

In July 2008, 89.5 million new ordinary shares were placed at a price of £0.28 per share to finance continuing exploration and development activities.

In October and November 2007, 723,930 new shares were issued as part of a one-off retention scheme. No such shares were issued in 2008.

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

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16. Other reserves

	Share option reserve $'000	Exchange translation reserve $'000
Balance at 1 January 2007	3,535	(43)
Currency exchange difference	–	70
Employee share bonus and share options charge	453	–
Balance at 31 December 2007	3,988	27
Currency exchange difference	–	(211)
Employee share bonus and share options charge	902	–
Balance at 31 December 2008	4,890	(184)

17. Accumulated losses

	$'000
Balance at 1 January 2007	(1,057)
Net loss for the year	(29,895)
Balance at 31 December 2007	(30,952)
Net loss for the year	(59,038)
Balance at 31 December 2008	(89,990)

18. Reconciliation of loss from operations to net cash used in operating activities

	2008 $'000	2007 $'000
Loss from operations	(61,096)	(34,598)
Adjustments for:		
Depreciation of property, plant and equipment	2,176	2,568
Amortisation of intangible assets	92	64
Impairment of intangible exploration assets	29,350	20,585
Impairment of tangible oil and gas properties	7,860	–
Loss on change in fair value of financial asset	6,455	–
Stock written off	4	249
Foreign exchange loss	3,099	229
Share-based payment expense	902	453
(Increase) in inventories	(400)	(1,064)
Decrease in provisions	–	(996)
Increase in receivables	(1,519)	(1,050)
Increase/(decrease) in payables	561	(2,356)
Net cash used in operating activities	(12,516)	(15,916)

19. Guarantees

Cash backed guarantees

As part of the contractual terms of the Algerian contracts, the Group has given bank guarantees to Sonatrach of $15.6 million. Included within the cash balance at 31 December 2008 are cash backed guarantees which effectively reduce the free cash available that the Group has on its balance sheet. The Company is required to keep a minimum cash balance sufficient to cover the bank guarantees at all times. The guarantee relates to the Ben Guecha ("108/128b Contract") exploration and evaluation work programme stipulated in the contract and is reduced as the work programme is completed. As discussed in Note 13, this guarantee is expected to be forfeited in favour of Sonatrach if the exploration commitments for these blocks are not satisfied before the expiration of the licence in January 2010.

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 Shaikan PSC. The guarantee is reduced as the work programme is completed.

20. Commitments

Operating lease commitments – the Group as a lessee

	2008 $'000	2007 $'000
Minimum lease payments under operating leases recognised as expense for the year	418	413

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

	2008 $'000	2007 $'000
Within one year	371	418
In the second to fifth years inclusive	55	46
	426	464

Operating lease payments represent rentals payable by the Group for certain of its office properties in the United Kingdom. The UK office lease is for 10 years from February 2005 with a break clause at Year Five which is January 2010. The office equipment lease is for five years and commenced in 2006.

Exploration commitments

Due to the nature of the Group's operations in exploring and evaluating areas of interest, it is difficult to accurately forecast the nature or amount of future expenditure, although it will be necessary to incur expenditure in order to retain present exploration and appraisal rights. Expenditure commitments on current permits for the Group can be reduced by selective relinquishment of exploration tenure or by the renegotiation of expenditure commitments. The approximate level of exploration expenditure expected in the year ending 31 December 2009 for the Group is approximately $53.5 million. This includes the minimum amounts required to retain the relevant licences.

21. Share-based payments

	2008 $'000	2007 $'000
Bonus shares (credit)/charge	1,204	(57)
Share options (credit)/charge	(302)	510
	902	453

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 (2007: seven years).

	2008		2007	
	Number of share options '000	Weighted average exercise price (in pence)	Number of share options '000	Weighted average exercise price (in pence)
Outstanding at 1 January	8,991	50.3p	13,241	57.2p
Granted during the year	4,050	30.0p	1,850	33.8p
Forfeited during the year	(3,550)	55.9p	(6,100)	60.3p
Outstanding at 31 December	9,491	39.5p	8,991	50.3p
Exercisable at 31 December	1,464	49.2p	1,581	51.9p

Notes to the Consolidated Financial Statements continued

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21. Share-based payments (continued)

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

	2008	2007
Weighted average share price on date of grant (in pence)	25.1p	33.8p
Weighted average exercise price of options granted in the year (in pence)	30.0p	33.8p

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 54.0% and 52.8% for the February and September 2008 awards respectively and 36.0% for all grants in 2007.

The expected term of the 2008 awards is three to seven years. The 2007 awards have been calculated using an expected term of four to five years.

The risk free rate was 4.3% and 4.5% for the February and September 2008 awards respectively and 4.9%, 5.0% and 4.5% for the September, October and December 2007 awards.

The Company has made no dividend payments to date and as there is no expectation of making payments in the immediate future. 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:

	Exercise price	Options ('000)	
Expiry date	(pence)	2008	2007
19 August 2014	48.0	4,250	4,250
29 September 2015	85.0	141	492
29 September 2009	59.8	–	2,049
18 October 2009	59.0	–	350
17 September 2010	31.0	350	1,050
11 October 2010	39.5	450	550
5 December 2010	33.0	250	250
14 February 2011	30.0	1,900	–
25 September 2011	30.0	2,150	–
		9,491	8,991

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)	
	2008	2007
Balance at 1 January	1,371	1,670
Granted during the year	2,300	1,778
Forfeited during the year	(630)	(20)
Issued during the year	(1,187)	(2,057)
Balance at 31 December	1,854	1,371

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) Limited:

	2008 $'000	2007 $'000
Purchases of services in year	2,864	6,639
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.

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 PSC for the Shaikan Block. In return for this and TKI's continuing participation, Gulf Keystone Petroleum International Limited was liable to 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
AA Al Qabandi – Business Development Director
JB Gerstenlauer – Chief Operating Officer (appointed 1 October 2008)
KE Ainsworth – Finance Director (appointed 24 January 2008)
M Varzi – Non-Executive Director (appointed 7 January 2008)
J Asher – Non-Executive Director (appointed 21 January 2008)
P Truscott – Non-Executive Director (appointed 23 May 2008)
AA Samarrai – Kurdistan Country Manager
M Messaoudi – Algeria Country Manager
IA Al Khaldi – Vice President Middle East North Africa Region
CH Garrett – Vice President Operations
JR Cooper – Finance Director (resigned 23 January 2008)
D Mackertich – Executive Vice President Exploration & Technical (resigned 30 April 2008)

Further information about the remuneration of individual Directors is provided in the Report of the Remuneration and Appointments Committee on pages 22 to 24.

	2008 $'000	2007 $'000
Short-term employee benefits	2,561	3,206
Share-based payment – options	231	510
Share-based payment – bonus shares	939	(57)
	3,731	3,659

Notes to the Consolidated Financial Statements continued

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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 2008.

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	
	2008 $'000	2007 $'000
Financial assets		
Fair value through profit and loss (designated at recognition)	–	6,155
Loans and receivables (including cash and cash equivalents)	40,644	94,333
Financial liabilities		
Amortised cost	33,372	36,684

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 commodity price, 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.

Market risk

The Group's activities expose it primarily to the financial risks of changes in foreign currency exchange rates, oil prices 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).

There have been no changes to the Group's exposure to market risks or the manner in which it manages and measures the risk. The Group does not hedge against the effects of movement in exchange rates, oil prices or interest rates. The risks are monitored by the Board on a regular basis.

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.

23. Financial instruments (continued)

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	
	2008 $'000	2007 $'000	2008 $'000	2007 $'000
Great British Pounds	117	1,160	(126)	(43)
Algerian Dinars	280	397	(18)	(300)

Foreign currency sensitivity analysis

The Group is mainly exposed to the currency of the United Kingdom (GBP), Algeria (DZD) and Iraq (IQD).

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	
	2008 $'000	2007 $'000	2008 $'000	2007 $'000	2008 $'000	2007 $'000
Profit or loss	12	116	28	40	–	–

The Group's sensitivity to foreign currency has decreased during the current year as there has been a decrease in the value of both GBP and DZD bank balances and accounts receivable in 2008.

Interest rate risk management

The Group's policy on interest rate management is agreed at the 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 2008 would increase by $304,723 per annum (2007: increase by $441,430).

If interest rates decreased by 0.5% and all other variables were held constant, the Group's profit for the year ended 31 December 2008 would decrease by $304,723 per annum (2007: decrease by $441,430).

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.

Notes to the Consolidated Financial Statements continued
for the year ended 31 December 2008

23. Financial instruments (continued)

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 trade and other receivables outstanding from the BG Group at balance date totalling $nil (2007: $0.5 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 $6.4 million at 31 December 2008 (2007: $4.3 million) which has been settled in full subsequent to year end.

The credit risk on liquid funds is limited because the counterparties for a significant portion of the cash and cash equivalents at the balance sheet date are banks with good credit ratings assigned by international credit-rating agencies.

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. The Group seeks to raise further funding 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.

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	1 to 5 years $'000	Total $'000
2008					
Non-interest bearing	n/a	9,475	9,040	–	18,515
Variable interest rate instruments	5.00%	–	–	15,600	15,600
2007					
Non-interest bearing	n/a	25,200	11,484	–	36,684

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
2008					
Non-interest bearing	n/a	–	7,038	–	7,038
Variable interest rate instruments	4.86%	18,006	–	15,600	33,606
2007					
Non-interest bearing	n/a	–	6,047	–	6,047
Variable interest rate instruments	5.56%	88,286	–	8,000	96,286

For all financial assets the book value equals the undiscounted value of the asset with the exception of the 2007 interest bearing financial asset falling in the one to five year bracket, the undiscounted value of which is $8 million.

24. Subsequent events

On 6 May 2009 the Company secured £30 million by way of a Standby Equity Distribution Agreement ("SEDA") with YA Global Master SPV Ltd, an investment fund managed by Yorkville Advisors, LLC. The SEDA enables Gulf Keystone, entirely at its own discretion for up to 36 months, to draw down funds in tranches in exchange for the issue of new equity on terms related to the prevailing market price at the time of each drawdown. To date, £2.4 million ($3.6million) has been drawn down from the facility and 16,149,465 new shares have been issued. A further 2,087,740 new common shares of $0.01 each will be issued in lieu of cash payments for fees due. The unused facility at the date of this report amounts to £27.6 million.

Also on 6 May 2009 the Company placed 14,660,000 new common shares of $0.01 each at a price of £0.145 each, raising gross proceeds of approximately £2.1 million ($3.2 million).

On 20 May 2009 the Company issued 1 million new common shares of $0.01 each at a price of £0.1539 each raising gross proceeds of £0.15 million ($0.24 million).

Directors, Advisors and Officers

Directors

Todd Kozel	Executive Chairman & Chief Executive Officer
Ali Al Qabandi	Business Development Director
Mehdi Varzi	Non-Executive Director
Jeremy Asher	Non-Executive Director
Peter Truscott	Non-Executive Director
John Gerstenlauer	Chief Operating Officer
Kristian Ewen Ainsworth	Finance Director

Secretary
Theresa Grant
Coson Corporate Services Limited
Milner House
18 Parliament Street
Hamilton HMFX
Bermuda

Registered Office
Milner House
18 Parliament Street
Hamilton HMFX
Bermuda

UK Solicitor
Memery Crystal LLP
44 Southampton Buildings
London
WC2A 1AP

Algerian Solicitor
Thompson & Knight LLP
Residence PTT
Villa 45 A
Hydra
Algiers 16035
Algeria

Auditors
Deloitte LLP
2 New Street Square
London
EC4A 3BZ

Registrar
Computershare Investor Services plc
PO Box 82, The Pavilions
Bridgwater Road
Bristol
BS99 7NH

Nominated Advisor and Joint Broker
RBC Capital Markets
71 Queen Victoria Street
London
EC4V 4DE

Joint Broker
Tristone Capital
77 Grosvenor Street
London
W1K 3JR

Bankers
The Bank of NT Butterfield & Son Limited
65 Front Street
PO Box HM 195
Hamilton HMAX
Bermuda

Credit Agricole (Suisse) S.A.
Lintheschergasse 15
8001 Zürich

HSBC
79 Piccadilly
London
W1J 8EU

Designed and produced by **Emperor Design Consultants Ltd**
Telephone **+44 (0)20 7729 9090 www.emperordesign.co.uk**

Algeria
Gulf Keystone Petroleum Ltd.
Villa 42B
Cité Des PTT Hydra
Algiers
Algeria

Bermuda
Gulf Keystone Petroleum Ltd.
Milner House
18 Parliament Street
PO Box 1561
Hamilton HMFX
Bermuda

Iraq
Gulf Keystone Petroleum International Ltd.
240/9/436
Ainkawa
Erbil
Iraq

UK
Gulf Keystone Petroleum (UK) Ltd.
16 Berkeley Street
Mayfair
London WIJ 8DZ
United Kingdom

GULF KEYSTONE PETROLEUM LTD.