Gulf Keystone Petroleum Ltd.
Annual Report and Accounts

09

Strengthening our position

GULF KEYSTONE PETROLEUM LTD.

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

Highlights

Highlights

- First exploration well in Kurdistan, Shaikan-1, announced as a major discovery
- Diversified the asset base in Kurdistan with the addition of two new Production Sharing Contracts ("PSCs"), Sheikh Adi and Ber Bahr
- Second exploration well in Kurdistan, Bijell-1, spudded on 11 December 2009
- Strategic decision to exit Algeria through the sale of assets leading to eventual country exit anticipated to occur in 2010
- Issue of 121.9 million shares to raise $35.7 million of new funds during 2009

Recent/Upcoming Events

- Independent report assesses oil in place resources on Shaikan in the 1.9 (P90) billion barrels to 7.4 (P10) billion barrels range with further significant upside
- Bijell-1 well announced as a discovery with 3,200 barrels of oil per day produced on test and with operations still ongoing as of June 2010
- Reorganisation of assets in Kurdistan leading to an enhanced position in the Company's existing PSCs, subject to final documentation
- Issue of 182.2 million shares to raise approximately $200 million of new funds including a recent placing with institutions raising $165 million
- Major Kurdistan work programme which includes three appraisal wells on Shaikan and the first exploration well on Sheikh Adi
- $15.6 million bank guarantee exercised in favour of Sonatrach in May 2010
- Cash balance as at 1 June 2010 of approximately $156.4 million
- Further funding requirement anticipated to come from planned commencement of test production in late summer 2010

Executive Chairman and Chief Executive Officer's Statement

In 2009, after two years of planning, we repositioned Gulf Keystone Petroleum to focus on exploration in the Kurdistan Region of Iraq, potentially one of the most abundant hydrocarbon basins in the world.

Todd Francis Kozel
Executive Chairman and Chief Executive Officer

As an oil and gas explorer seeking major discoveries, the frontier is the place to be. Kurdistan, one of the few places on earth where you can see oil at the surface, is such a frontier. Consequently, in 2009 after two years of planning, we repositioned Gulf Keystone Petroleum to focus on exploration in the Kurdistan Region of Iraq, potentially one of the most abundant hydrocarbon basins in the world.

By contrast, Algeria, for years the backbone of Gulf Keystone, has latterly offered diminishing opportunities for an entrepreneurial explorer. Development projects require large front end investments over a number of years to achieve modest rates of return, a business environment suiting large organisations with deep pockets. The decision to exit Algeria and focus on the Kurdistan Region of Iraq was a carefully considered decision and it took courage from the Board and faith from our shareholders. This decision ultimately led to a large impairment charge of $73.9 million in relation to the Company's activities in Algeria and is a dominant feature of the 2009 loss after tax of $96.3 million.

With the discoveries on Shaikan in August, October and November last year, our courage and hope has been handsomely rewarded. I would argue that of any public listed company active in Kurdistan, Gulf Keystone has made one of the largest discoveries, holds one of the largest licence positions and has amongst the best pre-drill upside in its acreage.

In establishing the scale of that upside, we've only just begun. Gulf Keystone may still be a relatively small-cap independent, but we have commenced a major drilling campaign extending over the next 12 to 18 months. Significant appraisal drilling along with a firm plan of development is required to move the Company's already substantial contingent oil in place resources to reserves. During the remainder of 2010, we aim to drill the three appraisal wells on Shaikan and the first exploration well on the Sheikh Adi structure. We expect to see our first production before year end – although this will be modest and is only expected to provide for basic operating and capital needs. This work programme is designed to both increase and provide greater resource certainty and the information obtained from production will provide further evidence to support potential recovery rates from Shaikan.

Without doubt the real value to be captured for our shareholders remains in the upside potential of our acreage positions which will be tested on both Shaikan and Sheikh Adi this year. We are already reviewing with MOL the progress made in exploring Akri-Bijeel, and identifying the next steps. Genel's plan to drill the first exploration well on Ber Bahr is also eagerly awaited.

This campaign has required an extraordinary degree of preparatory work, and for a company of our size, I cannot overstate this achievement. In a matter of months, the operational team has planned and commenced, with the requisite engineering capabilities, a three rig programme. The team is also advanced in establishing production facilities with potential processing capacity of up to 18,000 bopd.

On behalf of the Company, I should like to thank all our staff for their enthusiastic response to the challenge of moving into an intensive appraisal programme and their flexibility in conforming to the associated plan for human resources and technical skills, during this period. Our technical team, in particular, deserve considerable praise. I am confident that the Kurdistan Region of Iraq will no doubt prove to have abundant hydrocarbons, but it is not a highly developed basin and the earth does not easily give up its secrets. I am proud of the Gulf Keystone team of professionals who have successfully chosen world class assets, successfully explored the first half of the portfolio and have continued to work to put together an exciting exploration, appraisal and production plan for 2010 and 2011.

In conclusion, it is important for me also to give our thanks to our host, the Kurdistan Regional Government, with whom we have developed an excellent working relationship. As a result of the announcement made on 10 March 2010 which reorganised Gulf Keystone's interests in its existing acreage in Kurdistan, which is still subject to final documentation and approval, they have become our new strategic partner and it has been their determination to carry forward hydrocarbon exploration which has allowed Gulf Keystone to create so much value this year for its shareholders and the people of Iraq.

Finally, in view of their sustained faith and support, I should like to thank our shareholders. The success of our fund-raising exercise, post year-end, has shown that there remain a vital group of shareholders, both institutional and retail, with the appetite and determination to support the management team, the high quality asset portfolio and the Kurdistan Region of Iraq. Gulf Keystone can now look forward with confidence, with the necessary resources for the work programme largely in place, and any further funding requirement is anticipated to come from the planned commencement of test production in late summer 2010.

TF Kozel
Executive Chairman and
Chief Executive Officer

Strengthening our position

A focused portfolio

Chief Operating Officer's Review

2009 was a transformational year for Gulf Keystone. A year that saw Gulf Keystone transition from a company that was operator of a very small oil field and a non-operating partner in a small-to-medium size gas project in Algeria to the operator of a very substantial oil field discovery in Kurdistan.

John Gerstenlauer
Chief Operating Officer

Kurdistan

For Gulf Keystone, 2009 will always be dominated by the results of drilling operations on the Shaikan-1 exploration well. However, the Company's activities included a number of additional highlights.

In July of 2009, Gulf Keystone concluded a partnership arrangement with Etamic that saw the Company's holdings in Kurdistan increase to four blocks with the addition of interests in the highly prospective Sheikh Adi and Ber Bahr Blocks.

Late in 2009, Gulf Keystone's partner and operator of the Akri-Bijeel Block, spudded its first exploration well, the Bijell-1 well.

Shaikan

In early 2009, Weatherford began the mobilisation of their newly constructed Rig 842 from Houston, Texas to the Mersin seaport on the Mediterranean coast of Turkey, for eventual overland transportation to Gulf Keystone's Shaikan Block. In late April, Rig 842 began drilling the first Gulf Keystone exploration well in Kurdistan, the Shaikan-1 well, designed to reach a total depth ("TD") of approximately 3,500 metres +/– 200 metres, depending on drilling results at TD. The only offset well available in this very much under explored area was a dry hole over 26 kilometres away and on another structure. Thus Shaikan-1 was, in every sense of the word, a rank wildcat.

Early drilling challenges such as unanticipated shallow faults and severe lost drilling circulation resulted in many hole stability problems and slowed the progress of drilling such that the first potentially prospective zones were not encountered until late July.

During the last week in July, Rig 842 drilled into the Sargelu formation at a depth of about 1,325 metres and began to receive oil shows in the drilling mud returns. On 3 August 2009, the Sargelu formation was tested at an initial rate of just over 5,000 barrels of oil per day ("bopd") and ultimate rates of almost 7,500 bopd with a gas oil ratio ("GOR") of 120 cubic feet of gas per barrel of oil and an oil gravity of 21 to 22 degrees, API. At this point, the Shaikan-1 exploration well and indeed the Shaikan Block itself, based on the robust nature of the initial test, became a success story. This success story would only become more impressive as further drilling demonstrated the overall potential of the 150 square kilometre Shaikan structure.

Subsequent discoveries in the Jurassic age Alan, Mus and Butmah formations indicated very high permeability reservoirs but very little reservoir energy due to the gas caps having escaped through breaches in the upper seals. Thus, the Mus tested at an actual rate of 128 bopd and the Butmah at a calculated rate (due to mechanical problems with the test string) of 5,000 bopd with a gravity of 18 degrees, API. Testing as part of the 2010 work programme using an electric submersible pump ("ESP") should demonstrate the actual production capabilities of these two zones.

As drilling continued into the Triassic age rocks additional discoveries were also made in the Upper Kurre Chine A, which tested at 1,700 bbls/day of 43 degree API gravity oil and GORs of approximately 1,000 and later in the Upper Kurre Chine B which flowed 8,000 bbls/day of 53 degree API gravity oil and 20 million standard cubic feet of gas.

Thus after testing less than a third of the potentially productive intervals in the Shaikan-1 well, Gulf Keystone had demonstrated an aggregate test rate of over 20,000 bopd with oil gravities ranging from 18 to 53 degrees API. Subsequent analysis and calculations by both Gulf Keystone and by Dynamic Global Advisors ("DGA"), an independent Houston-based consultancy, resulted in a P90 to P10 gross oil in place range of 1.9 to 7.4 billion barrels. Gulf Keystone believes that industry average recovery factors of 30% to 35% might be achievable.

Later, while still drilling in portions of the upper Triassic, in fact while still in additional layers of the Kurre Chine formation, an anhydrite seal layer was

The Shaikan-1 exploration well and indeed the Shaikan Block itself, based on the robust nature of the initial test, became a success story.

penetrated and an unexpected high pressure reservoir was encountered at 2,947 metres. Multiple, strong gas and oil inflows were encountered from 2,947 metres to 2,950 metres. At a depth of 2,950 metres, it became clear that the casing programme and wellhead pressure ratings were not strong enough to handle the bottom hole pressures being encountered. The well, based on the data available at the time had been designed for a lower pressure regime, i.e. a more-or-less hydrostatic pressure gradient from surface to final TD. The pressures in the zone that were encountered starting at 2,947 metres were approximately 50% higher than a normal, hydrostatic pressure gradient.

These types of pressures, given a revised, much more robust casing design and a higher pressure rated wellhead, do not represent a serious impediment to future drilling. Quite the contrary, the significant inflows of large quantities of oil and gas from this zone make future drilling of the remainder of the Triassic and at least the top portions of the underlying Permian age layers very prospective and promising from the standpoint of discovering even more hydrocarbons within the Shaikan structure. A future appraisal well will be redesigned to go to depths in excess of 5,000 metres and drill into the Permian formation. This appraisal well, in the form of Shaikan-2 will be drilled in 2010. In addition Shaikan-1 will be tested in the Mus and Butmah using an ESP in an effort to prove the potentially high productivity of those zones. Following the testing of the Mus and Butmah, the Sargelu formation will be put on long-term test though temporary production facilities. It is intended that the long-term test will continue for a period of at least 18 to 24 months and the resulting 8,000 to 10,000 bopd will be sold into the Kurdistan domestic market.

The Shaikan-1 well has already demonstrated oil in place numbers with a P90 to P10 range of 1.9 to 7.4 billion barrels, and there is still significant upside potential. In further reference to the third party analysis completed by DGA, they quote potential (P1) upside in the Jurassic and upper Triassic intervals already drilled of up to 13 billion barrels of oil in place. In addition they also refer to further potential of 1 to 5 billion barrels of oil in place in the middle to lower Triassic layers which was partially encountered at 2,947 metres to 2,950 metres before drilling ceased. Whilst this demonstrates the potential of Shaikan there does remain significant appraisal drilling leading to a firm plan of development to move the Company's already substantial contingent oil in place resources to reserves.

Algeria

2009 was also a watershed year for Gulf Keystone as the Company's projects in Algeria required significant investment for modest returns, a relatively small resource base and little prospect of first revenues until 2014. Given this backdrop and the substantial sums required to develop the Ferkane Perimeter Block 126a GKN and GKS oil fields along with the HBH Permit, HBH and RM gas fields, combined with the lack of prospectivity on its exploration area – Ben Guecha Permit Block 108 and 128b – where the cost of drilling would have significantly exceeded the $15.6 million bank guarantee – the Company decided to focus financial resources on where it saw the best risk/return for its shareholders. Kurdistan had billions of barrels of oil potential and the Company took the strategic decision to undertake an orderly exit from Algeria in order to focus on Kurdistan. Consequently the financial results for 2009 contain an impairment charge for the past investment in Algeria.

Summary

2009 was a transformational year for Gulf Keystone. A year that saw Gulf Keystone transition from a company that was operator of a very small oil field and a non-operating partner in a small-to-medium size gas project in Algeria to the operator of a very substantial oil field discovery in Kurdistan. At the end of 2009, Gulf Keystone was in possession of interests in four extremely prospective Blocks in the Northern area of the Kurdistan Region of Iraq. As announced

The Shaikan-1 well has already demonstrated oil-in-place numbers with a P90 to P10 range of 1.9 to 7.4 billion barrels.

on 10 March 2010 these assets are subject to a reorganisation of the Company's interests in Kurdistan which await final documentation and approval. Upon completion, the net result is to increase Gulf Keystone's interest in its existing assets in Kurdistan.

The Shaikan Block, where a massive discovery of 1.9 to 7.4 (P90 to P10) billion barrels of oil in place has already been made, contains the upside potential for billions of additional barrels from future appraisal and exploration work.

The MOL-operated Akri-Bijeel Block, has seen the first exploration well spudded on the smallest of three drilling prospects on the Block.

The Sheikh Adi Block, due to the lack of a structural closure on the Western end of Shaikan, contains a drilling prospect which has now been de-risked and is likely to be full of significant volumes of oil and gas.

Finally there is the Genel-operated Ber Bahr Block containing what is perhaps the largest structure in any of the four Blocks where the Company holds an interest which has now also been significantly de-risked by the sizeable oil and gas discoveries at Shaikan-1.

JB Gerstenlauer
Chief Operating Officer

Kurdistan Region of Iraq

By 2009 Gulf Keystone had secured interests in four 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

Location of assets

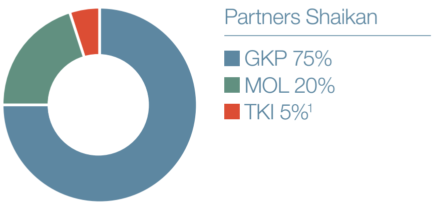
- Kurdistan covers approximately 40,000 square kilometres and is situated in the North Eastern corner of Iraq
- Gulf Keystone's Blocks are adjacent to each other and are located approximately 85 kilometres from Erbil and 50 kilometres from the Turkish border
- Erbil is located 320 kilometres North North-West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

Shaikan-1 (SH-1)

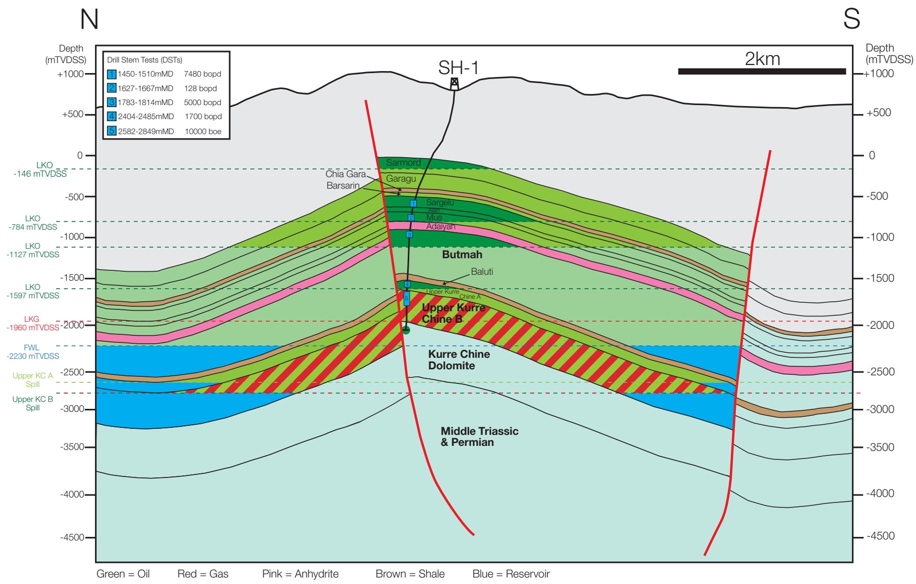
GKP Operator 75%, MOL 20%, TKI 5%[1]

Drill site location

- Large anticlinal structure covering over 150 square kilometres
- Well site located on top of structure
- Drilled to a total depth of 2,950 metres
- Multiple target horizons



1 Held in trust



Schematic cross section of reservoirs and fluid contacts at Shaikan-1

Shaikan-1 Discovery Report

Final Evaluation by Dynamic Global Advisors ("DGA")

- Significant discovery at Shaikan
- Oil in the Cretaceous, Jurassic and Triassic formations
- 1.9 to 7.4 billion barrels of oil in place

On 14 January 2010, Gulf Keystone published the Final Evaluation Report by DGA on the Shaikan-1 discovery well. A copy of this report is available on Gulf Keystone's website: www.gulfkeystone.com

Oil in place summary

Discovered oil in place	P90	Mean	P10
Shaikan-1 (to 2,950m) (million barrels)	1.891	4.184	7.422

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 PLC ("MOL") and Texas Keystone Inc. ("TKI") 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 exploration phase of two years with further work commitments. During 2008, 171 kilometres of 2D seismic was acquired and the Shaikan-1 well, which discovered substantial quantities of hydrocarbons during 2009, completes the work commitments for the first phase of the contract.

Under the terms of the PSC, following a discovery, an appraisal work programme can be agreed with the Kurdistan Regional Government. Following the successful appraisal of a discovery, a development plan can be prepared for submission and approval by the authorities.

The work programme for Shaikan during 2010 and 2011 will combine appraisal drilling of the Shaikan structure along with 3D seismic acquisition and processing. The original discovery well, SH-1, is to be tested further during the Summer of 2010 to evaluate well productivity in the Jurassic reservoir. Following this testing SH-1 will be put into first production by August 2010.

The Kurdistan Regional Government has an option to nominate a third party interest of up to 15% in the Shaikan PSC and a further option to nominate a government interest of up to 20% following a commercial discovery.

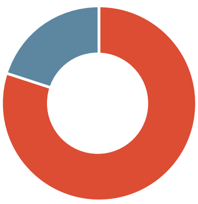
Akri-Bijeel

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 Bijell-1 well was spudded in late 2009 and announced as a discovery in March 2010.

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

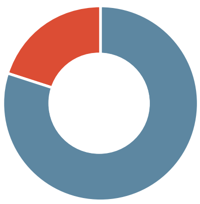


Sheikh Adi

GKP Operator 80%, KRG 20%

The Sheikh Adi Block is situated North East of Dihok and lies to the West and on trend with the Shaikan structure. The Block covers an area of 251 square kilometres. Gulf Keystone will operate, and has an 80% interest in, the Sheikh Adi PSC, which has an initial three year exploration phase commencing in July 2009. The Company believes that the Block has hydrocarbon potential at multiple levels from Cretaceous, Jurassic, Triassic and Permian. Sheikh Adi has a mapped undrilled surface anticline covering approximately 35 square kilometres covered by modern seismic data. During the initial exploration phase there is a commitment to shoot 100 kilometres of 2D seismic and drill an exploration well.

The KRG has a 20% carried interest.



Ber Bahr

Genel Operator 40%, GKP 40%, KRG 20%

The Ber Bahr Block covers an area of 208 square kilometres and lies to the North of Dihok and on trend with the Shaikan and Sheikh Adi Blocks. The Ber Bahr PSC is operated by Genel Energy International Limited (40%) and has an initial two year exploration phase which commenced in March 2009. Gulf Keystone has a 40% interest in the Ber Bahr PSC. The Company believes that the Block has hydrocarbon potential at multiple levels from Cretaceous, Jurassic, Triassic and Permian. The Block has a mapped undrilled surface anticline covering an area of approximately 100 square kilometres and covered by a modern 2D seismic grid. During the initial exploration phase there is a commitment to drill one exploration well.

The KRG has a 20% carried interest.

Algeria

In 2009 the Company decided to undertake a strategic exit from Algeria

Blocks 108 and 128b
Ben Guecha Permit

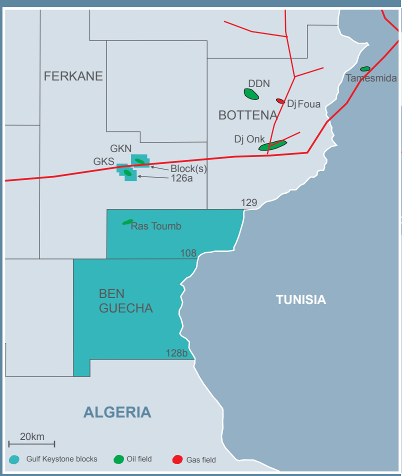
- Relinquished in early 2010
- Guarantee of $15.6 million exercised by Sonatrach in May 2010

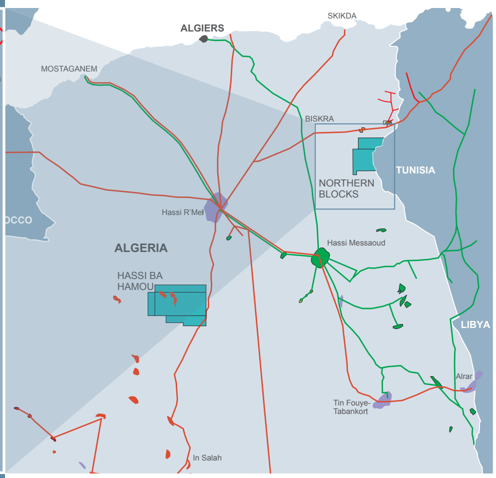
Block 126a
GKN and GKS oil fields

- Options currently being evaluated

HBH
Hassi Ba Hamou Permit

- Settlement agreement for the transfer of Gulf Keystone's interests to British Gas for $10.0 million signed in 2010





Gulf Keystone decided in 2009 to undertake a strategic exit from Algeria.

Ben Guecha Permit
The Ben Guecha Permit Blocks 108 and 128b were relinquished in early 2010. Since the exploration work programme of seismic and two exploration wells was not undertaken, Sonatrach, Algeria's national oil company, exercised a $15.6 million guarantee during May 2010.

Ferkane Permit
Options for Block 126a, containing the GKN and GKS oil field are currently being evaluated.

Hassi Ba Hamou ("HBH") Permit
In February 2010, a settlement agreement was announced which provided for the transfer of the Company's interest in HBH to the operator, BG Group PLC, for $10.0 million, subject to Sonatrach and Algerian government approval.

Financial Review

Following the successful equity fundraising of $165 million in May 2010, Gulf Keystone is well placed to deliver its stated exploration and appraisal programme through to the second quarter of 2011.

Ewen Ainsworth
Finance Director

Results for the year

Oil production in Algeria ceased in June 2008 and has not subsequently recommenced, and as such there was no revenue (2008: $1.0 million) or cost of sales (2008: $2.0 million) from the sale of oil in Algeria during 2009.

An impairment charge to non-current assets of $69.6 million (2008: $37.2 million) was incurred in relation to the Hassi Ba Hamou ("HBH") Permit and the GKN and GKS oil fields in Algeria. The impairment charge reflects the Company's strategic decision to cease further investment in Algeria and because the sale of the assets was deemed unlikely. The Company retains $10 million in non-current assets on its balance sheet in relation to the HBH Permit being proceeds due from BG North Sea Holdings Ltd ("BG") under a Settlement Agreement announced on 18 February 2010.

Inventory in relation to various items for oil and gas activities in Algeria was also impaired by $4.3 million (2008: $nil).

General & administrative expenses were $21.2 million (2008: $16.4 million). The current year general and administrative costs include $3.9 million relating to the Algerian oil field. Taking this in to account and also adjusting for $0.3 million foreign exchange gains in 2009, $3.1 million foreign exchange loss in 2008 and $6.4 million share-based payments expense (2008: $0.9 million) underlying general and administrative costs were 9% lower during the year.

Interest revenue of $0.3 million (2008: $1.9 million) declined during 2009 due to reduced cash balances and lower rates of interest.

Other losses of $0.4 million (2008: $nil) are for the change in the fair value of the Standby Equity Distribution Agreement ("SEDA") with YA Global Master SPV Ltd which has been treated as a derivative financial instrument. Finance costs of $1.0 million (2008: $0.1 million) relate to the interest charge on the decommissioning provision and bank guarantee.

Taxation

The tax expense of $0.03 million (2008: $0.2 million benefit) is related to UK activities.

Profit after tax

The results for 2009 show a loss after tax of $96.3 million (2008: $59.0 million) largely a result of the impairment charge in relation to the Group's exit from Algeria of $73.9 million (2008: $37.2 million).

Issue of equity

On 6 May 2009 the Company secured £30 million by way of a 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.

Between May and December 2009, 27,501,033 million new common shares were issued under the SEDA at a weighted average price of £0.47 per share for a total value of $21.1 million.

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 $3.2 million.

On 20 May 2009 the Company placed 1,000,000 new common shares of $0.01 each at a price of £0.1539 each, raising gross proceeds of $0.2 million.

On 3 August 2009 the Company placed 75,600,000 new common shares of $0.01 each at a price of £0.09 each, raising gross proceeds of $11.2 million.

Cash Flow

Net cash outflow from oil and gas operations after general and administrative expenses was $1.7 million (2008: $12.5 million). The significant decrease relates mainly to funds received in 2009 for the sale of oil in Algeria relating to 2008 and

Gross proceeds raised in May 2010

$165.0m

Capital expenditure during 2009

$49.2m

GKP Share Price Movement January 2009 – May 2010

an increase in current liabilities. Interest received of $0.3 million (2008: $1.6 million) was due to reduced cash balances and lower rates of interest. Tax refunded was $0.1 million (2008: tax paid of $0.1 million). Net cash used in operating activities was $1.3 million (2008: $11.0 million).

Capital expenditure of $49.2 million (2008: $87.1 million) relates mainly to exploration activities in the Kurdistan Region of Iraq and Algeria.

Issue of new common shares during the year raised $35.7 million (2008: $46.8 million).

Taking into account the net cash used in operations, capital expenditure and proceeds from the issue of shares, the net cash outflow during the year was $14.9 million (2008: $51.3 million).

Cash and cash equivalents at the end of the year were $19.2 million (2008: $33.6 million).

Recent Events

Between January and May 2010, 8,179,645 new common shares were issued under the SEDA at a weighted average price of £0.84 per share for a total value of $10.9 million.

On 10 March 2010 the Company announced a reorganisation of its assets in Kurdistan the details of which are in the Directors' Report. In order to meet the anticipated $52 million payment associated with the Sheikh Adi and Ber Bahr PSC acquisitions and to fully fund the envisaged work programme during the remainder of 2010 and into the second quarter of 2011 the Company issued shares to existing and new institutional shareholders; on 25 May 2010 the Company placed 152,300,000 new common shares of $0.01 each at a price of £0.75 each, raising gross proceeds of $165.0 million.

On 15 March 2010 the Company placed 20,915,034 new common shares of $0.01 each at a price of £0.765 each, raising gross proceeds of $24 million.

During May 2010 Sonatrach exercised a guarantee of $15.6 million in relation to the Ben Guecha Permit Blocks 108 and 128b in Algeria as the exploration commitments were not satisfied. This guarantee had been provided for from existing cash resources prior to the $165.0 million share placing.

Gulf Keystone announced in February of this year an agreement with BG for the proposed withdrawal and transfer of the Company's interests in the Hassi Ba Hamou ("HBH") Permit for a net cash payment from BG of $10.0 million. The agreement is subject to the conclusion of separate transfer documentation which will require the approval of Sonatrach and any necessary Algerian governmental authorities.

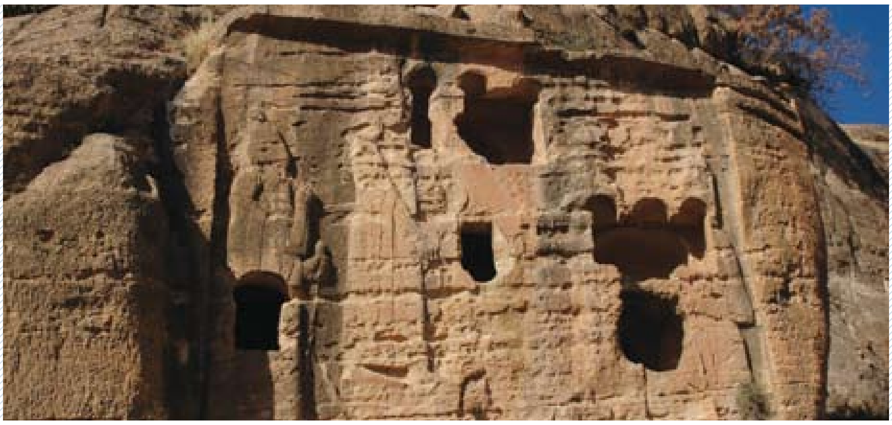
Outlook

Following the successful equity fundraising of $165 million in May 2010, Gulf Keystone is well placed to deliver its stated exploration and appraisal programme through to the second quarter of 2011. First oil production, and the associated revenues from the Shaikan-1 well anticipated in autumn 2010, will further bolster the Company's finances such that additional funding required to complete the Group's work programme would be modest, if any. The Board awaits the results of Gulf Keystone's ambitious current drilling programme which offers the potential for significant further value creation.

KE Ainsworth
Finance Director

Making a positive contribution

Corporate and Social Responsibility



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

The Board of Directors

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

Occupational health and safety

We recognise the inherent potential risks associated with exploration and production of hydrocarbons and our responsibility to protect our employees and contractors from all work-related injuries and illnesses.

During 2009, the Company's main activity was the exploration drilling of Shaikan-1 of which over half a million man-hours were recorded.

Corporate responsibility

Despite significant effort invested in Health and Safety Management, site supervision, safety training and providing protective equipment, regrettably there was one lost time injury ("LTI") among our drilling contractors.

All incidents were fully investigated and recommendations to minimize the chance of a re-occurrence implemented.

GKPI's 2009 Recordable Incident Rate of 0.8 per total man hours worked and Lost Time Incident Rate of 0.4 per total man hours worked were in line with the Company's targets for 2009 and the Company intends to work extensively with contractors to continue to address health and safety issues in 2010.

This will be carried out with systematic audits, health and safety training and continuous improvement of its management systems. Driving safety remains a high priority with GKP operations.

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.

John B Gerstenlauer
Chief Operating Officer

Mr Gerstenlauer joined 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.

Ewen Ainsworth
Finance Director

Mr Ainsworth was appointed as Finance Director of Gulf Keystone in January 2008. Mr Ainsworth has over 21 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.

Lord Peter Truscott
Non-Executive Director

Lord Truscott of St James's is an independent Member of the House of Lords, and a Director and consultant with a number of publicly listed and private companies, mainly in the energy and mining sectors. He joined Gulf Keystone as a Non Executive Director in May 2008. Lord Truscott was appointed as a Member of the House of Lords in 2004. Between 2006 and 2007, he was the UK's Energy Minister and 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. He represented Hertfordshire in the European Parliament between 1994 and 1999, and was the Government's Foreign Affairs and Defence Spokesman and Vice-President of the Parliament's Security Committee. He has been a member of the Lords European Union Select Committee, Sub-Committee C (Foreign Affairs, Defence and Development). An expert on Russia, he has written a biography of President Putin amongst other books and many articles on the former Soviet Union. He was Visiting Research Fellow with the Institute for Public Policy Research, and has written reports on European Defence (IPPR), on political risk management in the energy and defence sectors (RUSI), and European Energy Security (RUSI). He has

a doctorate in modern history from Oxford University , is a Fellow of the Industry and Parliament Trust and is currently an Associate Fellow with Royal United Services Institute for defence and security studies.

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, and was also a Board member of Kuwait Gulf Oil Company and the United Oil Projects and as a member of several Steering Committees.

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. 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 Advisor to the Board of Directors of Una Oil, a private international oil services company based in Monaco. 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.

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 47 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.

Mohamed Messaoudi
Country Manager – Algeria

Mr Messaoudi, a petroleum geologist, has over 30 years' experience in the oil and gas industry in Algeria. Mr Messaoudi joined Sonatrach, the Algerian National Oil Enterprise in 1979, becoming Chief Geologist for the Hassi Messaoud Basin in 1996 and then the Regional Exploration Manager of the North Algeria Area/Onshore and Offshore Basins. Prior to Mr Messaoudi's retirement from Sonatrach, he held the position of Regional Exploration Manager for the South East Algeria Region. The South East 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 2007 as the Country Manager of Algeria.

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 31 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.

Tony Peart
Legal and Commercial Director

Mr Peart joined Gulf Keystone in 2008 and has over 30 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 and 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.

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 2009.

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

Principal Activities

The principal activity of the Group during the year was that of oil and gas exploration and production operating in the Kurdistan Region of Northern Iraq and the Republic of Algeria. During 2009 a strategic decision was made to suspend investment in its Algerian projects and undertake an exit from Algeria.

The subsidiaries principally affecting the profits or net assets of the Group in the year are listed in Note 11 to the consolidated financial statements.

Results and dividends

The Group's net loss after tax for the year was $96.3 million (2008: net loss of $59.0 million). The Directors do not recommend a dividend for the year (2008: $ 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 16.

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 20.

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 2 to 13 of this document.

Post balance sheet events

There have been three draw downs from the Standby Equity Distribution Agreement ("SEDA") subsequent to balance sheet date raising $10.9 million (£6.9 million) and resulting in the issue of 8.18 million new common shares of $0.01 each to YA Global Master SPV Ltd. For further details on the SEDA refer to Note 16. On 18 February 2010, the Company announced that it had negotiated an agreement with BG North Sea Holdings Limited ("BG") that settled, on confidential terms, the claims and counterclaims between the parties. The agreement provides for the immediate stay of the arbitration and the proposed withdrawal of the Company from the Hassi Ba Hamou ("HBH") Permit for a net cash payment from BG of $10.0 million to GKP. The agreement is subject to the conclusion of separate transfer documentation which will require the approval of Sonatrach and any necessary Algerian governmental authorities. Whilst the Company is confident that the necessary approvals will be forthcoming, there is no guarantee this will be the case.

On 10 March 2010, the Company announced it had negotiated with the Kurdistan Regional Government ("KRG") to reorganise the Company's interest in Gulf Keystone Petroleum International Limited ("GKPI") following a material default by Etamic and non-completion of the transaction as originally negotiated. The reorganisation and transactions detailed are subject to KRG approval and signature and therefore the terms may change. Discussions regarding the proposed reorganisation remain ongoing. The main components of the proposed reorganisation and transaction as they currently stand are:

- GKPI will continue to be a 100% subsidiary of GKP as opposed to Etamic gaining a 50% shareholding in this Company.
- Following the default and non-completion of the transaction by Etamic, GKPI will pay $40 million to the KRG which is an Infrastructure Support Payment due and owing by Etamic in return for GKPI maintaining its 80% interest in Sheikh Adi and 40% interest in Ber Bahr.
- GKP will make a termination payment of $12 million to Etamic in full and final settlement of all of their rights.
- The KRG shall also be entitled to receive an additional Infrastructure Support Payment to be allocated to social programmes, amounting to 40% of GKPI's entitlement to Profit Petroleum derived from GKPI's share of profits in all four production sharing contracts ("PSCs").

The Company expects to make payment of the $52 million to the KRG ($40 million) and Etamic ($12 million) by mid-August 2010.

The net effect of the total expenditure of $52 million is that GKP's net share in each of the four PSCs will be as follows:

PSC	GKP's interest %	Fully diluted %[3]
Shaikan	75.0	51.0[1]
Sheikh Adi	80.0	80.0
Ber Bahr	40.0	40.0
Akri-Bijeel	20.0	12.8[2]

1 Minimum GKPI holding subject to Government back-in right of 20% and Third Party back-in right of 15% if exercised in full.
2 Minimum GKPI holding subject to Government back-in right of 20% and Third Party back-in right of 20% if exercised in full.
3 Subject to KRG 40% share of GKPI's profit petroleum.

Directors' Report continued

The reorganisation and transactions detailed above are subject to KRG approval and signature and therefore the terms may change.

On 15 March 2010, the Company announced it had completed a fully subscribed placing of 20,915,034 new common shares of $0.01 (the "Placing Shares") at a placing price of £0.765 per share, raising gross proceeds of approximately $24 million (£16 million).

On 11 May 2010, the $15.6 million bank guarantee was exercised in favour of Sonatrach.

On 25 May 2010, the Company announced it had completed a fully subscribed placing of 152,301,835 new common shares of $0.01 (the "Placing Shares") at a placing price of £0.75 per share, raising gross proceeds of approximately $165.0 million (£114.2 million).

On 7 June 2010, the Company announced that it has executed the Gulf Keystone Employee Benefit Trust (the "Trust") and settled an initial cash contribution on the independent trustee (the "Trustee"). Future funding is anticipated to be made by way of loan from the Company. The Trustee may acquire common shares in the Company, by subscription or by purchase, and, at the discretion of the Trustee, make available interests in those common shares for the benefit of Directors and employees under the Company's Share Option Plan and Executive Bonus Scheme (the "Plans").

The Company is often, due to the nature of its operations, in a close period as defined in the AIM Rules for Companies and the Directors are often not permitted to deal in the Company's shares. Accordingly, it is intended that the Company will recommend to the Trustee that the following awards and option grants are made following publication of the Annual Results and when the Company is not in a close period:

Executive Bonus Scheme for 2009

It is recommended that the Trustee make discretionary awards for 2009 on the same terms as the Company's Executive Bonus Scheme ("Executive Bonus Scheme"), such that no more than one third of the maximum number of common shares set out below will be considered for award in each year. The maximum number of common shares available under the Executive Bonus Scheme for 2009 for the Directors are set out below:

Todd Kozel	5,000,000 common shares
Ewen Ainsworth	1,000,000 common shares
John Gerstenlauer	1,000,000 common shares
Ali Al-Qabandi	1,000,000 common shares
Mehdi Varzi	100,000 common shares
Lord Peter Truscott	100,000 common shares

In total, it is recommended that the Trustee award 11,519,000 common shares for 2009 under the Executive Bonus Scheme to Directors and employees. These awards have been accounted for at 31 December 2009 based on an estimated share price of £0.75 per share. The awards to Directors have also been included in the Directors Emoluments for the year ended 31 December 2009.

Share Option Plan with Long-Term Incentive Performance Conditions

The Remuneration Committee of the Company, following extensive review by external advisors, has proposed structured option grants under the existing Share Option Plan with stretching performance criteria known as the Long Term Incentive Performance Conditions. It will be recommended that the Trustee grant the following Directors share options ("LTIP Share Options") over the number of common shares shown below, at a price to be determined but not substantially less than the market price of the shares at the time of grant:

Todd Kozel	9,766,473 common shares
John Gerstenlauer	1,953,295 common shares
Ewen Ainsworth	1,953,295 common shares

The LTIP Share Options will be available for exercise in equal tranches over three financial years and be subject to the following performance conditions:

i) One third of the LTIP Share Options will be subject to operational performance conditions as follows:

- 50% of the one third tranche of LTIP Share Options will vest only on the achievement of sustained production of at least 8,000 barrels of oil per day resulting in sustained oil sales and revenue flow;
- 30% of the one third tranche of LTIP Share Options will vest only on successful resource addition through a combination of appraisal and production testing resulting in a significant movement of P10 hydrocarbon in place resources to P90 hydrocarbon in place resources; and
- 20% of the one third tranche of LTIP Share Options will vest only in the event of a significant new discovery.

ii) One third of the LTIP Share Options will vest on the share price reaching 150 pence.

iii) One third of the LTIP Share Options will vest on the share price reaching 200 pence.

A total of 22.5 million common shares may be the subject of LTIP Share Options for Directors and employees.

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[1]
J Asher – Non-Executive Director[1] (resigned 1 April 2010)
P Truscott – Non-Executive Director[1]
JB Gerstenlauer – Chief Operating Officer
KE Ainsworth – Finance Director

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 2009 Number of common shares	At 1 January 2009 Number of common shares
TF Kozel	3,917,781	23,751,114
AA Al Qabandi	5,150,000	5,000,000
M Varzi	180,000	180,000
J Asher	14,000,000	6,675,000
KE Ainsworth	449,400	142,857
P Truscott	1,000,000	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.

On 29 March 2010 the Board approved an award of 166,667 common shares for Mr Kozel under the Company's Executive Bonus Scheme. Mr Kozel holds an interest in 4,084,448 Gulf Keystone shares at the date of this report, representing approximately 0.61% of the Company's issued share capital.

On 29 March 2010 the Board approved an award of 150,000 common shares for Mr Al Qabandi under the Company's Executive Bonus Scheme. Mr Al Qabandi holds an interest in 5.3 million Gulf Keystone shares at the date of this report, representing approximately 0.79% of the Company's issued share capital.

On 29 March 2010 the Board approved an award of 89,014 common shares for Mr Ainsworth under the Company's Executive Bonus Scheme. Mr Ainsworth holds an interest in 538,414 Gulf Keystone shares at the date of this report, representing approximately 0.08% of the Company's issued share capital.

On 1 April 2010, Lord Truscott and his wife sold 500,000 common shares at an average price of £0.85 per share. Following this sale Lord and Lady Truscott hold 500,000 common shares, representing approximately 0.07% of the common shares in issue.

Directors' interests in share options of the Company, including family interests, as at 31 December are disclosed on Page 26.

Substantial shareholdings

Other than the Directors' interests shown above, the Company has been notified of the following substantial interests as at 17 May 2010:

	Number of common shares	Percentage of issued share capital
Gulf Keystone Petroleum LLC	40,000,000	7.69%
TD Waterhouse	38,365,308	7.38%
Capital Research & Management Co	37,087,632	7.13%
Barclay's Personal Investment Management	34,015,083	6.54%
Halifax Share Dealing	32,177,792	6.19%
Gokana Trust (formerly referred to as Emerald Trust)	30,365,000	5.84%
Blakeney Management	29,171,400	5.61%
Selftrade	21,704,131	4.17%

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 Report and Chief Operating Officer's Operating Review. The financial position of the Group, its cash flows, and an available funding facility are described in the Financial Review. In addition Note 22 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 approximately $156.4 million of cash and cash equivalents at 1 June 2010 and the SEDA facility (see Note 16) to satisfy its obligations and finance its exploration and evaluation programme in 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, being at least the next twelve months. However, due to high levels of planned expenditure as a result of the significant drilling campaign over the next 12 months following the Group's recent exploration success in Kurdistan, together with the anticipated cash outflows of $52 million associated with the Sheikh Adi and Ber Bahr PSC acquisitions (see Note 23), the Group may require additional finance through production revenue streams, fund raisings, or other methods of finance. In this regard the Company

Directors' Report continued

is currently on track to commence first production in late summer 2010 targeting up to 10,000 bopd, and has a number of financing possibilities which it believes it would be able to pursue, if and when required. Nevertheless, the possibility remains that the Group's operations, and the availability of additional finance, could be significantly affected by adverse exploration and appraisal results, geopolitical events in the region, macroeconomic conditions or other risks.

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 has 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.

Auditors

Each of the persons who is a Director at the date of approval of this Annual Report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditors are unaware; and
- the Director has taken all the steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Annual General Meeting 2010

The resolutions to be proposed at the Annual General Meeting ("AGM") to be held on 3 August 2010 are set out in the Notice of the AGM.

By order of the Board

TF Kozel
Executive Chairman & Chief Executive Officer
5 June 2010

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 which, during the year, comprised 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 Remunerations and Appointments Committee.

The Board is responsible to shareholders for the proper management of the Group. A statement of Directors' responsibilities in respect of the financial statements is set out on Page 28. The Non-Executive Directors have a particular responsibility to ensure that the strategies proposed by the Executive Directors are fully considered.

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

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

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

During 2009, 14 scheduled Board meetings were held. Nine meetings took place in Europe – none of which were in the UK, five of which were in countries outside of the EU; and five meetings were held in North America.

Board Committees

The following committees, which have written terms of reference, deal with specific aspects of the Group's affairs:

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 25 to 27.

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, focusing in particular on accounting policies and areas of management judgement and estimation. The Committee is responsible for monitoring the controls which are in force to ensure the integrity of the information reported to the shareholders. The Committee acts as a forum for discussion of internal control issues and contributes to the Board's review of the effectiveness of the Group's internal control and risk management systems and processes. It advises the Board on the appointment of external auditors and on their remuneration for both audit and non-audit work, and discusses the nature and scope of the audit with the external auditors. The Committee assesses the performance of the external auditors as well as their independence and objectivity.

The Audit Committee is responsible for the development, implementation and monitoring of the Group's policy on external audit. To fulfil its responsibility regarding the independence of the external auditors, the Audit Committee reviewed:

- the external auditors' plan for the current year, noting the role of the audit partner, who signs the audit report and who, in accordance with professional rules, has not held office for more than five years, and any changes in the key audit staff;
- the overall extent of non-audit services provided by the external auditors, in addition to its case-by-case approval of the provision of non-audit services by the external auditors; and
- the past service of the auditors who were first appointed in 2006.

The Committee has considered the likelihood of a withdrawal of the auditor from the market and noted that there are no contractual obligations to restrict the choice of external auditors.

To assess the effectiveness of the external auditors, the Audit Committee reviewed:

- the arrangements for ensuring the external auditors' independence and objectivity;
- the external auditors' fulfilment of the agreed audit plan and any variations from the plan; and
- the robustness and perceptiveness of the auditors in their handling of the key accounting and audit judgements.

Following the above, the Audit Committee has recommended to the Board that Deloitte LLP is re-appointed.

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

Corporate Governance Statement continued

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. The Audit Committee will continue to review this decision annually particularly in light of the Group's expansion.

Relations with Shareholders

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

This year's AGM will be held on 3 August 2010.

Report of the Remuneration and Appointments Committee

Remuneration and Appointments Committee

The Remuneration and Appointments Committee comprised Mehdi Varzi, Jeremy Asher and Lord Truscott in 2009.

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 in 2008. Opus has not provided services to the Group during 2009.

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 $	Fees $	Bonus $	2009 Total $	2008 Total $
TF Kozel	675,000	–	1,938,272	2,613,272	687,438
AA Al Qabandi	270,000	–	519,533	789,533	281,194
JB Gerstenlauer	594,000	–	387,838	981,838	204,960
KE Ainsworth	234,848	–	519,533	754,381	276,802
M Varzi	–	80,000	38,784	118,784	85,918
J Asher	–	80,000		80,000	85,918
P Truscott	–	117,576	38,784	156,360	83,670
JR Cooper	–	–	–	–	23,169
	1,773,848	277,576	3,442,744	5,494,168	1,729,069

Report of the Remuneration and Appointments Committee continued

Directors' interests in options

Directors' interests in share options of the Company, including family interests, as at 31 December 2009 and for the comparative period, were as follows:

	Date of grant	Number of options over common shares	Exercise price	Option exercise period
2009				
TF Kozel	17 Mar 09	3,000,000	£0.30	01/01/2012–31/12/2018
AA Al Qabandi	17 Mar 09	1,000,000	£0.30	01/01/2012–31/12/2018
JB Gerstenlauer	25 Sep 08	2,000,000	£0.30	25/09/2011–24/09/2018
KE Ainsworth	14 Feb 08	1,000,000	£0.30	13/02/2011–12/02/2018
M Varzi	14 Feb 08	100,000	£0.30	13/02/2011–12/02/2018
J Asher	14 Feb 08	100,000	£0.30	13/02/2011–12/02/2018
P Truscott	25 Sep 08	100,000	£0.30	23/05/2011–22/05/2018
2008				
TF Kozel	20 Aug 05	2,650,000	£0.48	20/08/2005–19/08/2014
AA Al Qabandi	20 Aug 05	500,000	£0.48	20/08/2005–19/08/2014
JB Gerstenlauer	25 Sep 08	2,000,000	£0.30	25/09/2011–24/09/2018
KE Ainsworth	14 Feb 08	1,000,000	£0.30	13/02/2011–12/02/2018
M Varzi	14 Feb 08	100,000	£0.30	13/02/2011–12/02/2018
J Asher	14 Feb 08	100,000	£0.30	13/02/2011–12/02/2018
P Truscott	25 Sep 08	100,000	£0.30	23/05/2011–22/05/2018

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 £0.40.

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 million and 1 million options respectively at an exercise price of £0.30 under the Company's Unapproved Share Option Plan. These options replace the options held by Messrs Kozel and Al Qabandi in 2008. The new options will vest and become exercisable in full on 1 January 2012 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 £0.40

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

Bonus shares

The Group granted bonus share payments to certain employees pursuant to the Group's Executive Bonus Scheme, subject to continuing employment. These bonus shares are awarded over a period of three years. The number and value of shares granted are as follows:

Directors' bonuses

	2009 Number of shares	2009 Total $	2008 Number of shares	2008 Total $
TF Kozel	1,833,334	1,938,272	166,667	12,438
AA Al Qabandi	483,333	519,533	150,000	11,194
JB Gerstenlauer	333,333	387,838	–	–
KE Ainsworth	483,333	519,533	150,000	11,194
M Varzi	33,333	38,784	–	–
P Truscott	33,333	38,784	–	–
	3,199,999	3,442,744	466,667	34,826

The awards are included in the Directors' emoluments on Page 25.

The market price of the shares at 31 December 2009 and 31 December 2008 was £0.90 and £0.17 respectively and the range during 2009 was £0.05 to £1.23.

Approved by the Board

TF Kozel
Executive Chairman & Chief Executive Officer
5 June 2010

Directors' Responsibilities in the Preparation of the 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;
- 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; and
- make an assessment of the Company's ability to continue as a going concern.

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 2009 which comprise the Consolidated Income Statement, Consolidated Statement of Comprehensive Income, Consolidated Balance Sheet, Consolidated Statement of Changes in Equity, Consolidated Cash Flow Statement, Summary of Significant Accounting Policies and the related Notes 1 to 23. These Group financial statements have been prepared under the 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 auditors' 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 Group 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 the 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 2009 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.

Independent Auditors' Report to the Members of Gulf Keystone Petroleum Limited continued

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. Note 1 explains that whilst the Group's existing financial resources include approximately $156.4 million of cash and cash equivalents at 1 June 2010 and the Standby Equity Distribution Agreement facility, due to high levels of planned expenditure as a result of the significant drilling campaign over the next 12 months following the Group's recent exploration success in Kurdistan, together with the anticipated cash outflows of $52 million associated with the Sheikh Adi and Ber Bahr PSC acquisitions, the Group may require the injection of additional finance through production revenue streams, fund raisings, or other methods of finance. 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 Group'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
5 June 2010

Consolidated Income Statement
for the year ended 31 December 2009

	Notes	2009 $'000	2008 $'000
Continuing operations			
Revenue	5	–	999
Cost of sales	5	–	(2,013)
Gross loss		–	(1,014)
Other operating expenses			
Impairment of intangible exploration assets	9	(57,418)	(29,350)
Impairment of tangible oil and gas properties	10	(12,182)	(7,860)
Impairment of inventories	3,12	(4,343)	–
Loss on change in fair value of financial asset	13	–	(6,455)
General and administrative expenses		(21,180)	(16,417)
Loss from operations	3	(95,123)	(61,096)
Other gains and losses	6	(442)	–
Interest revenue	5	318	1,932
Finance costs	15	(1,027)	(105)
Loss before tax		(96,274)	(59,269)
Tax benefit	7	(28)	231
Loss after tax for the year		(96,302)	(59,038)
Loss per share (cents)			
Basic	8	(22.80)	(18.61)
Diluted	8	(22.80)	(18.61)

Consolidated Statement of Comprehensive Income

for the year ended 31 December 2009

	2009 $'000	2008 $'000
Loss for the period	(96,302)	(59,038)
Foreign currency translation differences	27	(211)
Total comprehensive loss for the period	(96,275)	(59,249)

Consolidated Balance Sheet
as at 31 December 2009

	Notes	2009 $'000	2008 $'000
Non–current assets			
Intangible assets	9	90,482	95,520
Property, plant and equipment	10	3,433	15,713
Deferred tax asset	7	960	
		94,875	111,233
Current assets			
Inventories	12	574	5,922
Trade and other receivables	13	2,214	7,857
Cash and cash equivalents	13	19,156	33,606
Derivative financial instruments		574	–
		22,518	47,385
Total assets		117,393	158,618
Current liabilities			
Trade and other payables	14	44,117	18,515
Current tax liabilities	7	524	–
		44,641	18,515
Non-current liabilities			
Trade and other payables	14	113	14,857
Provisions	15	3,545	2,846
		3,658	17,703
Total liabilities		48,299	36,218
Net assets		69,094	122,400
Equity			
Share capital	16	3,985	2,765
Share premium account	16	239,813	204,919
Share option reserve		11,745	4,890
Exchange translation reserve		(157)	(184)
Accumulated losses		(186,292)	(89,990)
Total equity		69,094	122,400

The financial statements were approved by the Board of Directors and authorised for issue on 5 June 2010 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 2009

	Notes	Share capital $'000	Share premium account $'000	Share option reserve $'000	Exchange translation reserve	Accumulated losses $'000	Total equity $'000
		Attributable to equity holders of the Group					
Balance as at 1 January 2008		1,866	159,063	3,988	27	(30,952)	133,992
Share-based payment expense		–	–	902	–	–	902
Share issue		899	45,856	–	–	–	46,755
Foreign currency translation differences		–	–	–	(211)	–	(211)
Net loss for the year		–	–	–	–	(59,038)	(59,038)
Balance at 1 January 2009		2,765	204,919	4,890	(184)	(89,990)	122,400
Share-based payment expense	20	–	–	6,361	–	–	6,361
Deferred tax on share-based payment transactions	7	–	–	494	–	–	494
Share issue	16	1,220	34,894	–	–	–	36,114
Foreign currency translation differences		–	–	–	27	–	27
Net loss for the year		–	–	–	–	(96,302)	(96,302)
Balance at 31 December 2009		3,985	239,813	11,745	(157)	(186,292)	69,094

Consolidated Cash Flow Statement

for the year ended 31 December 2009

	Notes	2009 $'000	2008 $'000
Operating activities			
Cash used in operations	17	(1,663)	(12,516)
Tax refunded/(paid)		56	(145)
Interest received		318	1,632
Net cash used in operating activities		(1,289)	(11,029)
Investing activities			
Proceeds on sale of property, plant and equipment		37	–
Purchase of intangible assets		(48,984)	(85,331)
Purchase of property, plant and equipment		(279)	(1,734)
Net cash used in investing activities		(49,226)	(87,065)
Financing activities			
Proceeds on issue of share capital		35,657	46,755
Net cash generated by financing activities		35,657	46,755
Net decrease in cash and cash equivalents		(14,858)	(51,339)
Cash and cash equivalents at beginning of year		33,606	88,286
Effect of foreign exchange rate changes		408	(3,341)
Cash and cash equivalents at end of the year being bank balances and cash on hand	13	19,156	33,606

Consolidated Financial Statements

for the year ended 31 December 2009

Summary of Significant Accounting Policies

General information

The Company is incorporated in Bermuda and it is quoted on the Alternative Investment Market of the London Stock Exchange (registered address: Milner House, 18 Parliament Street, Hamilton, Bermuda). 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, the following new and revised Standards and Interpretations have been adopted and have affected the amounts reported in these financial statements.

Standards affecting presentation and disclosure

IAS 1 (revised 2007) *Presentation of Financial Statements*	IAS 1 (2007) has introduced a number of changes in the format and content of the financial statements.
IFRS 8 *Operating Segments*	IFRS 8 is a disclosure standard that has resulted in additional disclosures relating to geographical information (see Note 2).
Improving Disclosures about Financial Instruments (Amendments to IFRS 7 Financial Instruments: Disclosures)	The amendments to IFRS 7 expand the disclosures required in respect of fair value measurements and liquidity risk.

Standards not affecting the reported results or the financial position

The following new and revised Standards and Interpretations have been adopted in the current year. Their adoption has not had any impact on the amounts reported in these financial statements but may impact the accounting for future transactions.

Amendment to IFRS 2 Share-based Payments – *Vesting Conditions and Cancellations*	The amendments clarify the definition of vesting conditions for the purposes of IFRS 2, introduce the concept of "non-vesting" conditions and clarify the accounting treatment for cancellations. The amendment has been applied retrospectively in accordance with the relevant transitional provisions.
IAS 23 (revised 2007) *Borrowing Costs*	The principal change to the Standard was to eliminate the option to expense all borrowing costs when incurred. This change has had no impact on these financial statements because it has always been the Group's accounting policy to capitalise borrowing costs incurred on qualifying assets.

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

IFRS 1 (amended)/IAS 27 (amended)	*Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate*
IFRS 1 (amended)	*Additional Exemptions for First-time Adopters*
IFRS 2 (amended)	*Group Cash-settled Share-based Payment Transactions*
IFRS 3 (revised 2008)	*Business Combinations*
IFRS 9	*Financial Instruments*
IAS 24 (revised 2009)	*Related Party Disclosures*
IAS 27 (revised 2008)	*Consolidated and Separate Financial Statements*
IAS 28 (revised 2008)	*Investment in Associates*
IAS 32 (amended)	*Classification of Rights Issues*
IFRIC 14 (amended)	*Prepayment of a Minimum Funding Requirement*
IFRIC 17	*Distributions of Non-cash Assets to Owners*
IFRIC 18	*Transfers of Assets from Customers*
IFRIC 19	*Extinguishing Financial Liabilities with Equity Instruments*
Improvements to IFRSs (2009)*	

* Improvements with effective date of 1 January 2010

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.

Basis of accounting

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

The financial statements have been prepared under the historical cost basis, except for certain financial instruments, 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 recognised in other comprehensive income and 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.

Consolidated Financial Statements continued
for the year ended 31 December 2009
Summary of Significant Accounting Policies

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 assets to be recovered.

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

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

Fixtures and equipment – 20% straight-line

Intangible assets other than oil and gas
Intangible assets, other than oil and gas assets, have finite useful lives and are measured at cost and amortised over their expected useful economic lives as follows:

Computer software – 33% straight-line

Intangible and tangible non-current assets – oil and gas interests
The Group adopts the full cost method of accounting for its oil and gas interests 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 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 of 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 assets, 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.

Consolidated Financial Statements continued

for the year ended 31 December 2009

Summary of Significant Accounting Policies

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 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 assets at fair value through profit and loss

Financial assets are held at fair value through profit and loss ("FVTPL") when the financial asset is either held for trading or it is designated as at FVTPL.

A financial asset other than a financial asset held for trading may be designated as FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis in accordance with the Group's documented risk management or investment strategy and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives and IAS 39 *Financial Instruments: Recognition and Measurement* permits the entire combined contract (asset or liability) to be designated as at FVTPL.

Financial assets are stated at fair value, with any gains or losses arising on remeasurement recognised in profit or loss. The net gain or loss recognised in profit or loss incorporates any dividend or interest earned on the financial asset and is included in the other gains and losses line in the income statement.

The Standby Equity Distribution Agreement ("SEDA") has been designated as a financial asset at FVTPL upon initial recognition and the fair value has been estimated with reference to the fees payable for the SEDA and the percentage of the SEDA drawn down at balance sheet date.

Financial liabilities and equity

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

Borrowings

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

Trade payables

Trade payables are not interest-bearing and are stated at amortised cost. The average maturity for trade and other payables is one to three months.

Cash and cash equivalents

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

Equity instruments

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

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

Decommissioning provision
The decommissioning provision represents management's best estimate of the Group's liability for restoring the sites of drilled wells to their original status, discounted where the effect is material. 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 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 Group 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. When an asset is expected to be disposed of or abandoned, the recoverable amount reflects the expected net disposal consideration, together with the value of any liabilities avoided or transferred.

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 15.

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. Reserves estimates principally affect the depreciation, depletion and amortisation charges.

Consolidated Financial Statements continued

for the year ended 31 December 2009

Summary of Significant Accounting Policies

Inventory impairment

During the year, management reconsidered the recoverability of the Algerian inventory balance. The decision was made to write the inventory balance down to the net recoverable value as a result of management's intention to exit Algeria and restrictions imposed on the resale of inventory in Algeria.

Standby Equity Distribution Agreement

In May 2009 the Group secured £30 million by way of a SEDA. The Company entered into the £30 million SEDA with YA Global Master SPV Ltd, an investment fund managed by Yorkville Advisors, LLC. The SEDA has been treated as a derivative financial instrument and its fair value is being determined with reference to the fees payable for the SEDA and the percentage of the SEDA drawn down at balance sheet date.

Notes to the Consolidated Financial Statements
for the year ended 31 December 2009

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 Report and Chief Operating Officer's Operating Review. The financial position of the Group, its cash flows, and an available funding facility are described in the Financial Review. In addition Note 22 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 approximately $156.4 million of cash and cash equivalents at 1 June 2010 and the Standby Equity Distribution Agreement ("SEDA") facility (see Note 16) to satisfy its obligations and finance its exploration and evaluation programme in 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, being at least the next 12 months. However, due to high levels of planned expenditure as a result of the significant drilling campaign over the next 12 months following the Group's recent exploration success in Kurdistan, together with the anticipated cash outflows of $52 million associated with the Sheikh Adi and Ber Bahr production sharing contract ("PSC") acquisitions (see Note 23), the Group may require additional finance through production revenue streams, fund raisings, or other methods of finance. In this regard the Company is currently on track to commence first production in late Summer 2010 targeting up to 10,000 bopd, and has a number of financing possibilities which it believes it would be able pursue, if and when required. Nevertheless, the possibility remains that the Group's operations, and the availability of additional finance, could be significantly affected by adverse exploration and appraisal results, geopolitical events in the region, macroeconomic conditions or other risks.

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 has 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. Segment information
The Group has adopted IFRS 8 *Operating Segments* with effect from 1 January 2009. IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the Group that are regularly reviewed by the Chief Executive Officer to allocate resources to the segments and to assess their performance. In contrast, the predecessor Standard (IAS 14 *Segment Reporting*) required the Group to identify two sets of segments (business and geographical), using a risk and returns approach, with the Group's system of internal financial reporting to key management personnel serving only as the starting point for the identification of such segments.

For management purposes, the Group is organised into three business segments which are based on their geography. The chief operating decision maker is the Executive Chairman and Chief Executive Officer. He is assisted by the Chief Operating Officer, the Finance Director and the Vice President of Operations as well as the Country Managers in Kurdistan and Algeria.

The accounting policies of the reportable segments are consistent with the Group's accounting policies.

Each segment is described in more detail below:

- Algeria: the Algerian segment consists of the Algiers office and the Group's operations in Algeria. During 2009 the remaining Algerian assets, being Block 126a, which includes the GKN and GKS oil fields and the Hassi Ba Hamou ("HBH") gas field, were impaired.
- Kurdistan: the Kurdistan segment consists of the Shaikan, Akri-Bijeel, Sheikh Adi and Ber Bahr Blocks and the Erbil office which provides support to the operations in Kurdistan.
- United Kingdom: the UK segment provides geological, geophysical and engineering services to the Gulf Keystone Group.

Corporate manages activities that serve more than one segment. It represents all overhead and administration costs incurred that cannot be directly linked to one of the above segments.

Notes to the Consolidated Financial Statements continued

for the year ended 31 December 2009

2. Segment information continued

31 December 2009	Algeria $'000	Kurdistan $'000	United Kingdom $'000	Corporate $'000	Elimination $'000	Total $'000
Revenue						
Inter-segment sales	–	–	3,991	–	(3,991)	–
Total revenue	–	–	3,991	–	(3,991)	–
Impairment of intangible assets	(57,418)	–	–	–	–	(57,418)
Impairment of tangible oil and gas properties	(12,182)	–	–	–	–	(12,182)
Impairment of inventories	(4,343)	–	–	–	–	(4,343)
Allocated general and administrative expenses	(6,667)	(2,126)	(3,622)	(11,791)	3,409	(20,797)
Depreciation and amortisation expense	(88)	(122)	(171)	(2)	–	(383)
(Loss)/profit from operations	(80,698)	(2,248)	198	(11,793)	(582)	(95,123)
Other gains and losses	–	–	–	(442)	–	(442)
Interest revenue	–	4	96	218	–	318
Finance costs	(1,027)	–	–	–	–	(1,027)
(Loss)/profit before tax	(81,725)	(2,244)	294	(12,017)	(582)	(96,274)
Tax expense	–	–	(28)	–	–	(28)
(Loss)/profit after tax	(81,725)	(2,244)	266	(12,017)	(582)	(96,302)
Capital expenditure	8,537	44,139	3	–	–	52,679
Total assets	13,591	82,769	4,813	227,393	(211,173)	117,393

31 December 2008	Algeria $'000	Kurdistan $'000	United Kingdom $'000	Corporate $'000	Elimination $'000	Total $'000
Revenue						
Oil sales	999	–	–	–	–	999
Inter-segment sales	–	–	2,864	–	(2,864)	–
Total revenue	999	–	2,864	–	(2,864)	999
Production costs	(125)	–	–	–	–	(125)
Oil and gas properties depreciation expense	(1,888)	–	–	–	–	(1,888)
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)
Allocated general and administrative expenses	(3,218)	(1,045)	(3,378)	(10,655)	2,259	(16,037)
Depreciation and amortisation expense	(132)	(66)	(182)	–	–	(380)
Loss from operations	(48,029)	(1,111)	(696)	(10,655)	(605)	(61,096)
Interest revenue	–	27	14	1,891	–	1,932
Finance costs	(105)	–	–	–	–	(105)
Loss before tax	(48,134)	(1,084)	(682)	(8,764)	(605)	(59,269)
Tax benefit	–	–	231	–	–	231
Loss after tax	(48,134)	(1,084)	(451)	(8,764)	(605)	(59,038)
Capital expenditure	73,677	11,019	1	6	–	84,703
Total assets	84,700	43,071	1,879	144,485	(115,517)	158,618

External revenues for 2008 of $999,000 relate to the Algerian operating segment; are from the Group's largest customer, Sonatrach; and originated in Algeria.

Geographical information

The Group's information about its segment assets (non-current assets excluding investments in associates, deferred tax assets and other financial assets) by geographical location are detailed below:

	2009 $'000	2008 $'000
Algeria	13,272	74,087
Kurdistan	80,555	36,922
Bermuda	5	10
Other	83	214
	93,915	111,233

Notes to the Consolidated Financial Statements continued
for the year ended 31 December 2009

3. Loss from operations

	2009 $'000	2008 $'000
Loss from operations has been arrived at after charging:		
Depreciation of property, plant and equipment	363	2,176
Amortisation of intangible assets	20	92
Impairment of intangible exploration assets	57,418	29,350
Impairment of tangible oil and gas properties	12,182	7,860
Impairment of inventories	4,343	–
Loss on change in fair value of financial asset	–	6,455
Staff costs (see Note 4)	10,711	5,161
Auditors' remuneration for audit services (see below)	113	65
Operating lease rentals (see Note 19)	371	418
Exchange (gain)/loss	(336)	3,099

	2009 $'000	2008 $'000
Fees payable to the Company's auditors for the audit of the Company's annual accounts	93	54
Fees payable to the Company's auditors for other services to the Group		
– The audit of the Company's subsidiaries pursuant to legislation and other	20	11
Total audit fees	113	65
Tax services	13	30
Total fees	126	95

4. Staff costs

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

	2009 Number	2008 Number
Office and management	14	12
Exploration staff	53	42
	67	54

Their aggregate remuneration comprised:

	2009 $'000	2008 $'000
Wages and salaries	3,474	3,011
Social security costs	876	1,248
Share-based payment (see Note 20)	6,361	902
	10,711	5,161

5. Revenue

	2009 $'000	2008 $'000
Sale of goods	–	999
Interest revenue		
– Interest on bank deposits	318	1,632
– Unwinding of discount on non-current financial asset	–	300
	318	1,932

The sale of goods for the year ended 31 December 2008 included 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 included 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.

6. Other gains and (losses)

	2009 $'000	2008 $'000
Change in the fair value of derivative financial instruments relating to the SEDA held at year end (see Note 16)	(442)	–

7. Tax (benefit)/expense

	2009 $'000	2008 $'000
Provision for current UK corporation tax	509	(170)
Provision for deferred UK corporation tax	(481)	(61)
Tax attributable to the Company and its subsidiaries	28	(231)

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

Any corporate tax liability in Algeria is settled out of Sonatrach's share of oil under the terms of the Production Sharing Contracts and is therefore not reflected in the tax charge for the year.

In Kurdistan, the Group is subject to corporate income tax on its income from petroleum operations. The rate of corporate income tax is currently 40% for all taxable profits in excess of nine million Iraqi Dinars (equivalent to $7,934 at the 31 December 2009 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% (2008: 28%) 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:

	2009 $'000	2008 $'000
Loss before tax	(96,274)	(59,269)
Tax at the Bermudan tax rate of 0% (2008: 0%)	–	–
Effect of different tax rates of subsidiaries operating in other jurisdictions	(28)	231
Tax benefit/(expense) for the year	(28)	231

In addition to the amount charged to the income statement, $494,000 relating to estimated excess tax deductions related to share-based payments has been recognised directly in equity.

8. Loss per share

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

	2009 $'000	2008 $'000
Loss		
Loss for the purposes of basic and diluted loss per share	(96,302)	(59,038)

Notes to the Consolidated Financial Statements continued
for the year ended 31 December 2009

8. Loss per share continued

	2009 Number	2008 Number
Number of shares		
Weighted average number of common shares for the purposes of basic loss per share	422,471,016	317,323,197
Adjustments for:		
– bonus shares	n/a	n/a
– share options	n/a	n/a
Weighted average number of common shares for the purposes of diluted loss per share	422,471,016	317,323,197

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.

As at 31 December 2009, 11 million share options and 12,952,333 un-issued bonus shares were excluded from the loss per share calculation as they were anti-dilutive.

9. Intangible assets

	Exploration and evaluation costs $'000	Computer software $'000	Total $'000
At 1 January 2008			
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

	Exploration and evaluation costs $'000	Computer software $'000	Total $'000
At 31 December 2008			
Cost	95,483	284	95,767
Accumulated amortisation	–	(247)	(247)
Net book value	95,483	37	95,520
Year ended 31 December 2009			
Opening net book value	95,483	37	95,520
Additions	52,398	2	52,400
Impairment write off	(57,418)	–	(57,418)
Amortisation charge	–	(20)	(20)
Closing net book value	90,463	19	90,482
At 31 December 2009			
Cost	90,463	286	90,749
Accumulated amortisation	–	(267)	(267)
Net book value	90,463	19	90,482

The net book value at 31 December 2009 includes intangible assets relating to HBH $10.5 million (2008: $59.5 million); Shaikan $59.5 million (2008: $28.7 million); Ber Bahr $10.0 million (2008: nil) and Akri-Bijeel $10.5 million (2008: $7.3 million).

During the year, the Group recognised an impairment loss in respect of the Algerian Northern Blocks cost pool and the HBH cost pool due to management's decision to withdraw from Algeria. This impairment loss comprises of a charge to the exploration and evaluation costs of $57.4 million relating to the impairment of the HBH project and a charge to the oil and gas properties of $12.2 million (see Note 10).

The Northern Blocks have a nil carrying value at 31 December 2009 and the HBH project has been written down to $10.0 million being the net cash payment due from BG for the transfer of GKP's interest in HBH which also settles the claims and counterclaims between the two parties over unpaid cash calls (see Note 23).

The additions to oil and gas exploration and evaluation costs in the year include the drilling of the Shaikan-1 exploration well; the preparation for the Bijell-1 exploration well; 2D seismic acquired on HBH; drilling of the RM-2 appraisal well on the HBH project; and the completion and testing of the RM-1 exploration well on the HBH project.

The amortisation charge of $20,000 (2008: $92,000) for computer software has been included in general and administrative expenses.

10. Property, plant and equipment

	Oil and gas properties $'000	Fixtures and equipment $'000	Total $'000
At 1 January 2008			
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 9)	(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

	Oil and gas properties $'000	Fixtures and equipment $'000	Total $'000
At 31 December 2008			
Cost	19,064	1,783	20,847
Accumulated depreciation	(4,192)	(942)	(5,134)
Net book value	14,872	841	15,713
Year ended 31 December 2009			
Opening net book value	14,872	841	15,713
Additions	–	279	279
Impairment write off (Note 9)	(12,182)	–	(12,182)
Disposals	–	(51)	(51)
Depreciation charge	–	(363)	(363)
Foreign currency translation differences	–	37	37
Closing net book value	2,690	743	3,433
At 31 December 2009			
Cost	2,690	2,048	4,738
Accumulated depreciation	–	(1,305)	(1,305)
Net book value	2,690	743	3,433

Notes to the Consolidated Financial Statements continued
for the year ended 31 December 2009

10. Property, plant and equipment continued
The depreciation charge of $0.4 million on fixtures and equipment (2008: $0.3 million) has been included in general and administrative expenses.

11. Subsidiary
Details of the Company's subsidiaries at 31 December 2009 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
Gulf Keystone Petroleum HBH Limited	Bermuda	100%	100%	Exploration and evaluation activities
Shaikan Petroleum Limited	Bermuda	100%	100%	Exploration and evaluation activities

12. Inventories

	2009 $'000	2008 $'000
Exploration materials	574	5,922

During 2009, the Algerian assets were written down to their net realisable value, being nil, due to the Group's intention to exit Algeria. The impairment expense relating to the write down of inventory in 2009 was $4.3 million.

13. 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 North Sea Holdings Limited ("BG"). Under the agreement, BG are required to pay Gulf Keystone a bonus payment if gas reserves reach a minimum of 900bcf. The value of the financial asset was written down to $nil in 2008. The financial asset was extinguished in 2010 under the settlement agreement with BG (see Note 23).

Trade and other receivables

	2009 $'000	2008 $'000
Trade receivables	–	6,413
Other receivables	1,507	625
Prepayments	707	819
	2,214	7,857

Included within prepayments is an amount of $0.4 million (2008: $0.4 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 18.

14. 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.

	2009 $'000	2008 $'000
Current		
Trade payables	8,282	420
Accrued expenses	35,835	18,095
	44,117	18,515
Non-current		
Accrued expenses	113	14,857

The non-current accrued expenses in 2008 relate to the discounted value of the cash guarantee on Blocks 108/128b which was repaid to Sonatrach in May 2010. At 31 December 2009 this payable was included in current accrued expenses.

15. Provisions

Decommissioning provision	$'000
At 1 January 2009	2,846
Additional provision in the year	414
Unwinding of discount	285
At 31 December 2009	3,545

The Group has estimated that decommissioning costs for the Algerian wells will be approximately $0.85 million per well based on recent experience and that for the Kurdistan wells will be $0.4 million. 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 in Algeria and Shaikan-1 and Bijell-1 wells in Kurdistan. 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 2009 at net present value is $3.5 million (2008: $2.8 million). Of this provision for well abandonment for nine wells and production facilities, the expenditure is expected to be incurred over the next five to 21 years. Refer to Note 23 for details of the settlement agreement reached with BG over the HBH asset.

16. Share capital

	2009 $'000	2008 $'000
Authorised		
Common shares of $0.01 each	7,500	5,000
Non-voting shares $0.01 each	500	500
Series A preferred shares of $1,000 each	60,000	60,000
	68,000	65,500

The authorised common share capital was increased from $5.0 million to $7.5 million at the 2009 Annual General Meeting.

Notes to the Consolidated Financial Statements continued

for the year ended 31 December 2009

16. Share capital continued

	Common shares			
	Shares No	Amount $'000	Share capital $'000	Share premium $'000
Issued and fully paid				
Balance at 1 January 2008	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
Bonus scheme shares March 2009	1,119,419	11	11	–
Shares issued under the SEDA	27,501,033	21,099	275	20,824
Private placement	91,260,000	14,807	913	13,894
Issue costs	n/a	(259)	–	(259)
SEDA costs	2,087,740	456	21	435
Balance 31 December 2009	489,976,407	243,798	3,985	239,813

In March and August 2009, a total of 1,119,419 new common shares were issued as part of the Company's bonus share scheme (2008: 418,171 new shares).

In May and August 2009, 91.26 million new common shares were placed at an average price of £0.10 per share to finance continuing exploration and development activities.

On 6 May 2009 the Company secured £30 million by way of a 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 drawdown 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.

Between May and December 2009, 29.59 million new common shares were issued under the SEDA at a weighted average price of £0.45 per share for a total value of $21.56 million, including 2,087,740 new common shares of $0.01 each which were issued in lieu of cash payments for fees due.

Subsequent to year end, a further 814,036 new common shares were issued under the Company's bonus share scheme.

There have been three drawdowns from the SEDA subsequent to balance sheet date raising £6.9 million and resulting in the issue of 8.18 million new common shares of $0.01 each.

On 15 March 2010, the Company completed a fully subscribed placing (the "Placing") of 20,915,034 new common shares of $0.01 (the "Placing Shares") at a placing price of £0.77 per share (the "Placing Price") raising gross proceeds of approximately £16 million ($24 million).

On 25 May 2010, the Company announced it had completed a fully subscribed placing of 152,301,835 new common shares of $0.01 (the "Placing Shares") at a placing price of £0.75 per share, raising gross proceeds of approximately $165 million (£114.2 million).

Rights attached to share capital

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

(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.

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

	2009 $'000	2008 $'000
Loss from operations	(95,123)	(61,096)
Adjustments for:		
Depreciation of property, plant and equipment	363	2,176
Amortisation of intangible assets	20	92
Impairment of intangible exploration assets	57,418	29,350
Impairment of tangible oil and gas properties	12,182	7,860
Loss on disposal of property, plant and equipment	14	–
Loss on change in fair value of financial asset	–	6,455
Impairment of inventories	4,343	4
Foreign exchange (gain)/loss	(336)	3,099
Share-based payment expense	6,361	902
Decrease/(increase) in inventories	1,005	(400)
Decrease/(increase) in receivables	5,643	(1,519)
Increase/(decrease) in payables	6,447	561
Net cash used in operating activities	(1,663)	(12,516)

18. Guarantees

Cash backed guarantees

As part of the contractual terms of the Algerian production sharing contracts, the Group has given bank guarantees to Sonatrach of $15.6 million. Included within the cash balance at 31 December 2009 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 Permit ("Blocks 108/128b") exploration and evaluation work programme stipulated in the contract and is reduced as the work programme is completed. This guarantee was forfeited in favour of Sonatrach in May 2010 as the exploration commitments for these blocks were not satisfied before the expiration of the exploration phase of the contract in January 2010 (refer to Note 14).

19. Commitments

Operating lease commitments – the Group as a lessee

	2009 $'000	2008 $'000
Minimum lease payments under operating leases recognised as expense for the year	371	418

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

	2009 $'000	2008 $'000
Within one year	377	371
In the second to fifth years inclusive	1,540	55
After five years	64	–
	1,981	426

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 5 which was January 2010. A new lease was signed in February 2010 for five years to February 2015. The office equipment lease is for five years and commenced in 2009.

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.

Notes to the Consolidated Financial Statements continued
for the year ended 31 December 2009

19. Commitments continued
Expenditure commitments on current permits for the Group could 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 2010 for the Group is approximately $109.8 million (2009: $53.5 million) of which the majority is contracted. This includes the minimum amounts required to retain the relevant licences but is in addition to the amounts of $40 million and $12 million disclosed in Note 23.

20. Share-based payments

	2009 $'000	2008 $'000
Bonus shares charge	6,340	1,204
Share options (credit)/charge	21	(302)
	6,361	902

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 three years for all options. 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 three years (2008: seven years).

	2009		2008	
	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	9,491	39.5p	8,991	50.3p
Granted during the year	6,650	33.9p	4,050	30.0p
Cancelled during the year	(3,550)	46.2p	–	–
Forfeited during the year	(1,591)	47.3p	(3,550)	55.9p
Outstanding at 31 December	11,000	32.8p	9,491	39.5p
Exercisable at 31 December	–	–	1,464	49.2

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

	2009	2008
Weighted average share price on date of grant (in pence)	11.5p	25.1p
Weighted average exercise price of options granted in the year (in pence)	33.9p	30.0p

The expected volatility was calculated as 57.9%, 68.3% and 86.7% for the March 2009, July 2009 and March 2010 awards respectively (2008: 54.0% and 52.8% for the February and September 2008 awards respectively) and has been based on the Company's share price averaged for the three years prior to grant date.

The expected term of the 2009 awards is three years (2008: three to seven years).

The risk free rate was 5% for the March and July 2009 awards and 4.5% for the March 2010 award (2008: 4.3% and 4.5% for the February and September 2008 awards respectively).

In March 2009 3.55 million options that were issued under the Company's Unapproved Share Option Plan prior to December 2007 were replaced with the same number of new options, which were granted with an exercise price of £0.30 per share and an expiry date of 31 December 2018. The fair value of the modified options has been calculated using the same assumptions as those stated above for the March 2009 grants and has resulted in an immaterial incremental value.

The weighted average fair value of the options granted in 2009 was £0.045 (2008: £0.108).

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:

Expiry date	Exercise price (pence)	Options ('000) 2009	2008
19 August 2014	48.00	–	4,250
29 September 2015	85.00	–	141
16 September 2017	31.00	–	350
10 October 2017	39.50	400	450
4 December 2017	33.00	250	250
13 February 2018	30.00	1,550	1,900
24 September 2018	30.00	2,150	2,150
31 December 2018	30.00	4,400	–
15 March 2019	30.00	250	–
30 July 2019	30.00	1,650	–
18 October 2019	80.75	100	–
7 December 2019	80.75	250	–
		11,000	9,491

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) 2009	2008
Balance at 1 January	1,854	1,371
Granted during the year	11,519	2,300
Forfeited during the year	(160)	(630)
Issued during the year	(4,816)	(1,187)
Balance at 31 December	8,397	1,854

The weighted average fair value of the bonus shares granted in 2009 was £0.75 (2008: £0.0599).

21. 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:

	2009 $'000	2008 $'000
Purchases of services in year	2,621	2,864
Amounts owed to related parties at year end	200	–

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

Texas Keystone Inc.

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

On 21 December 2007, Gulf Keystone Petroleum International ("GKPI") entered into a Production Sharing Contract ("PSC") 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, GKPI was liable to pay for TKI's share of the costs of the Exploration Work Programme and all costs ancillary to the Joint Operations up until the drilling of the first exploration well. TKI elected not to participate in the drilling of the Shaikan-1 well and by failing to exercise this election agreed to assign its interest under the contract to GKPI.

Notes to the Consolidated Financial Statements continued

for the year ended 31 December 2009

21. Related party transactions continued

Consequently TKI holds its interest in trust for GKPI pending transfer of its interest which is subject to the approval of the Kurdistan Regional Government.

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

Opus Executive Partners

Opus Executive Partners ("Opus"), a specialist recruitment company, is a related party of the Group because Lord Peter Truscott, a Director of the Company, is an Associate Partner of Opus. No services were used in 2009, however Opus have provided the Remuneration and Appointments Committee with information with regard to structuring Directors' remuneration packages and searching for suitable candidates in prior years and similarly in the early part of 2010. Opus did not provide any other services to the Group.

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 and Chief Executive Officer
AA Al Qabandi – Business Development Director
JB Gerstenlauer – Chief Operating Officer
KE Ainsworth – Finance Director
M Varzi – Non-Executive Director
J Asher – Non-Executive Director (resigned 1 April 2010)
P Truscott – Non-Executive Director
AA Samarrai – Kurdistan Country Manager
M Messaoudi – Algeria Country Manager
IA Al Khaldi – Vice President Middle East North Africa Region (resigned 3 September 2009)
CH Garrett – Vice President Operations
AR Peart – Legal and Commercial Director

Further information about the remuneration of individual Directors is provided in the Report of the Remuneration and Appointments Committee on Pages 25 to 27.

	2009 $'000	2008 $'000
Short-term employee benefits	3,123	2,561
Share-based payment – options	14	231
Share-based payment – bonus shares	6,172	939
	9,309	3,731

22. Financial instruments

	2009 $'000	2008 $'000
Financial assets		
Cash and cash equivalents	19,156	33,606
Loans and receivables	1,507	7,038
Derivative asset	574	–
	21,237	40,644
Financial liabilities		
Loans and payables	44,230	33,372

The majority of the financial liabilities are due to be settled within one year and are classified as current liabilities ($44,117,000 current).

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 Note 16, the Consolidated Statement of Comprehensive Income and the Consolidated Statement of Changes in Equity.

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 2009.

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.

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 these 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.

The Group is also party to a SEDA (see Note 16) which represents a derivative over the Company's equity. The fair value of the SEDA reflects the liquidity in the market for the Company's shares at the prevailing share price but since the shares are valued under the SEDA at prices based on the market price, the fair value of the SEDA is not material. Changes in the fair value of the SEDA are recognised in the income statement (see Note 6).

Foreign currency risk management

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

The carrying amounts of the Group's significant foreign currency denominated monetary assets and monetary liabilities at the reporting date were not material to the Group. A 10% change would not have a material effect.

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

Based on the exposure to the interest rates for cash and cash equivalents at the balance sheet date, a 0.5% increase or decrease would not have a material impact on the Group's profit for the year. A rate of 0.5% is used as it represents management's assessment of the reasonably possible changes in interest rates.

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 does not have any significant trade and other receivables outstanding from any one creditor at balance sheet date (2008: $6.4 million receivable from Sonatrach).

Notes to the Consolidated Financial Statements continued
for the year ended 31 December 2009

22. Financial instruments continued
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.

The maturity profile of the Group's financial liabilities are indicated by their classification in the balance sheet as "current" or "non-current", and further information relevant to the Group's liquidity position is disclosed in Note 19 and Note 1 under "Going Concern".

23. Subsequent events
There have been three draw downs from the SEDA subsequent to balance sheet date raising $10.9 million (£6.9 million) and resulting in the issue of 8.18 million new common shares of $0.01 each to YA Global Master SPV Ltd. For further details on the SEDA refer to Note 16.

On 18 February 2010, the Company announced that it had negotiated an agreement with BG that settled, on confidential terms, the claims and counterclaims between the parties. The agreement provides for the immediate stay of the arbitration and the proposed withdrawal of the Company from the HBH Permit for a net cash payment from BG of $10.0 million to GKP. The agreement is subject to the conclusion of separate transfer documentation which will require the approval of Sonatrach and any necessary Algerian governmental authorities. Whilst the Company is confident that the necessary approvals will be forthcoming, there is no guarantee this will be the case.

On 10 March 2010, the Company announced it had negotiated with the Kurdistan Regional Government ("KRG") to reorganise the Company's interest in GKPI following a material default by Etamic and non-completion of the transaction as originally negotiated. The reorganisation and transactions detailed are subject to KRG approval and signature and therefore the terms may change. Discussions regarding the proposed reorganisation remain ongoing. The main components of the proposed reorganisation and transaction as they currently stand are:

- GKPI will continue to be a 100% subsidiary of GKP as opposed to Etamic gaining a 50% shareholding in this Company.
- Following the default and non-completion of the transaction by Etamic, GKPI will pay $40 million to the KRG which is an Infrastructure Support Payment due and owing by Etamic in return for GKPI maintaining its 80% interest in Sheikh Adi and 40% interest in Ber Bahr.
- GKP will make a termination payment of $12 million to Etamic in full and final settlement of all of their rights.
- The KRG shall also be entitled to receive an additional Infrastructure Support Payment to be allocated to social programmes, amounting to 40% of GKPI's entitlement to Profit Petroleum derived from GKPI's share of profits in all four PSCs.

The Company expects to make payment of the $52 million to the KRG ($40 million) and Etamic ($12 million) by mid-August 2010.

The net effect of the total expenditure of $52 million is that GKP's net share in each of the four PSCs will be as follows:

PSC	GKP's interest %	Fully diluted %[3]
Shaikan	75.0	51.0[1]
Sheikh Adi	80.0	80.0
Ber Bahr	40.0	40.0
Akri-Bijeel	20.0	12.8[2]

1 Minimum GKPI holding subject to Government back-in right of 20% and Third Party back-in right of 15% if exercised in full.
2 Minimum GKPI holding subject to Government back-in right of 20% and Third Party back-in right of 20% if exercised in full.
3 Subject to KRG 40% share of GKPI's profit petroleum.

The reorganisation and transactions detailed above are subject to KRG approval and signature and therefore the terms may change.

On 15 March 2010, the Company announced it had completed a fully subscribed placing of 20,915,034 new common shares of $0.01 (the "Placing Shares") at a placing price of £0.765 per share, raising gross proceeds of approximately $24 million (£16 million).

On 11 May 2010, the $15.6 million bank guarantee was exercised in favour of Sonatrach.

On 25 May 2010, the Company announced it had completed a fully subscribed placing of 152,301,835 new common shares of $0.01 (the "Placing Shares") at a placing price of £0.75 per share, raising gross proceeds of approximately $165.0 million (£114.2 million).

On 7 June 2010, the Company announced that it has executed the Gulf Keystone Employee Benefit Trust (the "Trust") and settled an initial cash contribution on the independent trustee (the "Trustee"). Future funding is anticipated to be made by way of loan from the Company. The Trustee may acquire common shares in the Company, by subscription or by purchase, and, at the discretion of the Trustee, make available interests in those common shares for the benefit of Directors and employees under the Company's Share Option Plan and Executive Bonus Scheme (the "Plans").

The Company is often, due to its operations, in a close period, as defined in the AIM Rules for Companies and the Directors often not permitted to deal in the Company's shares. Accordingly, the Company will recommend to the Trustee that the following awards and option grants are made when the Company is not in a close period:

Executive Bonus Scheme for 2009

It is recommended that the Trustee make discretionary awards for 2009 on the same terms as the Company's Executive Bonus Scheme ("Executive Bonus Scheme"), such that no more than one third of the maximum number of common shares set out below will be considered for award in each year. The maximum number of common shares available under the Executive Bonus Scheme for 2009 for the Directors are set out below:

Todd Kozel	5,000,000 common shares
Ewen Ainsworth	1,000,000 common shares
John Gerstenlauer	1,000,000 common shares
Ali Al-Qabandi	1,000,000 common shares
Mehdi Varzi	100,000 common shares
Lord Peter Truscott	100,000 common shares

In total, it is recommended that the Trustee award 11,519,000 common shares for 2009 under the Executive Bonus Scheme to Directors and employees. These awards have been accounted for at 31 December 2009 based on an estimated share price of £0.75 per share. The awards to Directors have also been included in the Directors Emoluments for the year ended 31 December 2009.

Share Option Plan with Long-Term Incentive Performance Conditions

The Remuneration Committee of the Company, following extensive review by external advisors, has proposed structured option grants under the existing Share Option Plan with stretching performance criteria known as the Long-Term Incentive Performance Conditions. It will be recommended that the Trustee grant the following Directors share options ("LTIP Share Options") over the number of common shares shown below, at a price to be determined but not substantially less than the market price of the shares at the time of the grant:

Todd Kozel	9,766,473 common shares
John Gerstenlauer	1,953,295 common shares
Ewen Ainsworth	1,953,295 common shares

The LTIP Share Options will be available for exercise in equal tranches over three financial years, and be subject to the following performance conditions:

i) One third of the LTIP Share Options will be subject to operational performance conditions as follows:

- 50% of the one third tranche of LTIP Share Options will vest only on the achievement of sustained production of at least 8,000 barrels of oil per day resulting in sustained oil sales and revenue flow;
- 30% of the one third tranche of LTIP Share Options will vest only on successful resource addition through a combination of appraisal and production testing resulting in a significant movement of P10 hydrocarbon in place resources to P90 hydrocarbon in place resources; and
- 20% of the one third tranche of LTIP Share Options will vest only in the event of a significant new discovery.

ii) One third of the LTIP Share Options will vest on the share price reaching 150 pence.

iii) One third of the LTIP Share Options will vest on the share price reaching 200 pence.

A total of 22.5 million common shares may be the subject of LTIP Share Options for Directors and employees.

Directors and Advisors

Directors

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

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