INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS OF GULFSANDS PETROLEUM PLC

We have audited the Group and Parent Company financial statements of Gulfsands Petroleum plc for the year ended 31 December 2006 which comprise the Consolidated Profit and Loss Account, the Consolidated and Company Balance Sheets, the Consolidated Cash Flow Statement, and related Notes. These 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, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Responsibilities of Those Charged with Governance.

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

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion, the information given in the Directors' Report is consistent with the financial statements. In addition, we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and transactions with the Company is not disclosed.

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

Basis of audit opinion

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

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

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Group's and the Parent Company's affairs as at 31 December 2006 and of the Group's profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Director's Report is consistent with the financial statements.

UHY Hacker Young

UHY Hacker Young
Chartered Accountants
Registered Auditors
30 April 2007

St Alphage House
2 Fore Street
London EC2Y 5DH

CONSOLIDATED PROFIT AND LOSS ACCOUNT
FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	Year ended 31 December 2006 $'000	Year ended 31 December 2005 Continuing group share $'000	Year ended 31 December 2005 Minority share $'000	Year ended 31 December 2005 Total operations $'000
Turnover	2	**29,750**	24,926	20,086	45,012
Cost of sales		**(18,740)**	(13,866)	(12,047)	(25,913)
Gross profit		**11,010**	11,060	8,039	19,099
Administrative expenses before exceptional items		**(4,455)**	(4,923)	(1,330)	(6,253)
Share based payments	19	**(851)**	—	—	—
Hurricane repairs	26	**(2,573)**	—	—	—
Total administrative expenses		**(7,879)**	(4,923)	(1,330)	(6,253)
Operating profit	3	**3,131**	6,137	6,709	12,846
Loss on disposal of subsidiary	4	—	(6,080)	—	(6,080)
Profit on ordinary activities before interest		**3,131**	57	6,709	6,766
Unwinding of discount on decommissioning	17	**(2,223)**	(1,370)	(1,234)	(2,604)
Interest receivable		**1,193**	1,413	205	1,618
Interest payable	5	—	(2,510)	(1,822)	(4,332)
Profit/(loss) on ordinary activities before taxation		**2,101**	(2,410)	3,858	1,448
Tax on profit/(loss) on ordinary activities	6	**(1,537)**	(1,551)	—	(1,551)
Profit/(loss) on ordinary activities after taxation		**564**	(3,961)	3,858	(103)
Minority interests	7	—	13	(3,858)	(3,845)
PROFIT/(LOSS) FOR THE YEAR		**564**	(3,948)	—	(3,948)
Earnings/(Loss) per share (cents):					
Basic	8	**0.59**	(4.62)	—	(4.62)
Diluted	8	**0.58**	(4.62)	—	(4.62)

The 2005 profit and loss account "Continuing group share" consists of Gulfsands Petroleum plc's 52.6% of Northstar Gulfsands LLC ("NSGS") and other activities, while the "Minority share" column is the NSGS 47.4% partner share (note 4)

There are no recognised gains and losses other than those passing through the consolidated profit and loss account and the results for 2006 relate entirely to continuing operations.

CONSOLIDATED BALANCE SHEET
AT 31 DECEMBER 2006

	Notes	2006 $'000	2005 $'000
Fixed assets			
Tangible fixed assets	11	**49,164**	33,545
Intangible fixed assets	12	**15,097**	5,726
		64,261	39,271
Current assets			
Debtors	14	**9,629**	4,983
Cash at bank and in hand		**26,724**	36,561
		36,353	41,544
Creditors: amounts falling due within one year	15	**(16,036)**	(3,436)
Net current assets		**20,317**	38,108
Total assets less current liabilities		**84,578**	77,379
Deferred tax liabilities	16	**(824)**	(173)
Provision for decommissioning	17	**(8,420)**	(6,958)
Equity minority interests		**—**	(260)
NET ASSETS		**75,334**	69,988
Capital and Reserves			
Share capital	18	**11,047**	9,971
Share premium account	20	**56,506**	53,651
Other reserves	20	**12,560**	11,709
Profit and loss account	20	**(4,779)**	(5,343)
SHAREHOLDERS' FUNDS	21	**75,334**	69,988

These financial statements were approved by the Board of Directors on 30 April 2007 and signed on its behalf by:

John P Dorrier
Chief Executive Officer

David F DeCort
Chief Financial Officer

COMPANY BALANCE SHEET
AT 31 DECEMBER 2006

	Notes	*2006 $'000*	*2005 $'000*
Fixed assets			
Office furniture and equipment		**23**	6
Investments	13	**57,846**	46,382
		57,869	46,388
Current assets			
Debtors	14	**3,477**	15
Cash at bank and in hand		**9,828**	18,374
		13,305	18,389
Creditors: amounts falling due within one year	15	**(885)**	(380)
Net current assets		**12,420**	18,009
Total assets less current liabilities		**70,289**	64,397
NET ASSETS		**70,289**	64,397
Capital and Reserves			
Share capital	18	**11,047**	9,971
Share premium account	20	**56,507**	53,651
Other reserve	20	**851**	—
Profit and loss account	20	**1,884**	775
SHAREHOLDERS' FUNDS		**70,289**	64,397

These financial statements were approved by the Board of Directors on 30 April 2007 and signed on its behalf by:

John P Dorrier
Chief Executive Officer

David F DeCort
Chief Financial Officer

CONSOLIDATED CASH FLOW STATEMENT
FOR THE YEAR ENDED 31 DECEMBER 2006

		Year ended 31 December 2006	*Year ended 31 December 2005*		
	Notes	*$'000*	*Continuing group share $'000*	*Minority share $'000*	*Total 2005 operations $'000*
Net cash inflow from operating activities	22	**15,999**	3,232	6,272	9,504
Returns on investments and servicing of finance					
Interest received		**1,193**	1,619	—	1,619
Interest paid		—	(1,732)	(1,560)	(3,292)
Net cash inflow/(outflow) from returns on investments and servicing of finance		**1,193**	(113)	(1,560)	(1,673)
Taxation paid		**(1,111)**	—	—	—
Capital expenditure		**(29,572)**	(11,301)	(5,024)	(16,325)
Acquisitions and disposals					
Purchase of Minority Interest		**(277)**	—	—	—
Net cash outflow from acquisitions and disposals		**(277)**	—	—	—
Financing					
Cash proceeds from issue of shares		**3,931**	56,651	—	56,651
Contributions to subsidiary undertaking		—	101	—	101
Warrants exercised for cash		—	1,689	—	1689
Issue costs of share capital		—	(464)	—	(464)
Receipts from new loans		—	1,474	1,329	2,803
Repayment of loans		—	(10,820)	(9,751)	(20,571)
Payments in respect of warrants — restructuring costs		—	(3,550)	—	(3,550)
Minority share — payment as a result of disposal of a subsidiary undertaking		—	(11,183)	—	(11,183)
Net cash inflow from financing		**3,931**	33,898	(8,422)	25,476
(Decrease)/increase in cash	23	**(9,837)**	25,716	(8,734)	16,982
Cash at bank and in hand at beginning of year		**36,561**	10,845	8,734	19,579
Cash at bank and in hand at end of year		**26,724**	36,561	—	36,561

NOTES TO THE CONSOLIDATED ACCOUNTS

FOR THE YEAR ENDED 31 DECEMBER 2006

1. Accounting policies

1.1 Basis of preparation

The Group has adopted the accounting policies set out below in preparation of the financial statements. All of these policies have been applied consistently throughout the year unless otherwise stated.

The consolidated accounts have been prepared in accordance with applicable accounting standards in the United Kingdom and under the historical cost convention. In addition, these accounts have been prepared in accordance with the provisions of the Statement of Recommended Practice (SORP) "Accounting for Oil and Gas Exploration, Development, Production and Decommissioning Activities", issued by the UK Oil Industry Accounting Committee.

1.2 Basis of consolidation

These financial statements consolidate the accounts of Gulfsands Petroleum plc and all its subsidiary undertakings (the "Group"), drawn up to 31 December each year.

In the Group financial statements, merged subsidiary undertakings are treated as if they had always been a member of the Group. The results of such subsidiaries are included for the whole year in the year they join the Group.

Intra-group sales, profits and balances are eliminated fully on consolidation.

The results of subsidiaries acquired or sold are consolidated for the years from or to the date control passed. Acquisitions are accounted for under the acquisition method, under which purchase consideration is allocated to the assets and liabilities on the basis of fair value at the date of acquisition.

The Company's consolidated financial statements include the accounts of undertakings when the Company has the power to exercise, or actually exercises, dominant influence or control over the undertaking.

No individual profit and loss account is presented in respect of the Company as permitted by section 230 of the Companies Act 1985. The Company's profit for the year was $1,109,555 (2005 — $774,263).

1.3 Reporting currency

These accounts are presented in U.S. dollars. The Company's operations and the majority of all costs associated with foreign operations are paid in U.S. dollars and not the local currency of the operations. Therefore, the reporting and functional currency is the U.S. dollar. Gains and losses from foreign currency transactions, if any, are recognised in profit or loss for the year.

1.4 Oil and gas properties

The Group follows the full cost method of accounting for oil and gas properties under which expenditure on pre-license, license acquisition, exploration, appraisal and development activities is capitalised. All capitalised exploration and development expenditures are recorded within an appropriate cost pool within tangible fixed assets, except that certain exploration and appraisal costs may be held outside a cost pool pending determination of commercial reserves, within intangible fixed assets. The Group has two cost pools: USA and Syria.

Pre-license acquisition, exploration and appraisal costs of individual license interests held outside a cost pool remain un-depreciated pending determination but subject to there being no evidence of impairment. When a decision to develop an oil and gas property has been taken, the costs are transferred to the appropriate cost pool within tangible fixed assets.

1. Accounting policies (continued)

1.5 Oil and gas reserves

The Group's definition of commercial reserves is proven and probable reserves. Proven and probable oil and gas reserves are estimated quantities of commercially producible petroleum which the existing geological, geophysical and engineering data show to be recoverable in future years. The proven reserves included herein conform to the definition approved by the Society of Petroleum Engineers ("SPE") and the World Petroleum Congress ("WPC"). The probable reserves included herein conform to definition of probable reserves approved by the SPE/WPC using the deterministic methodology.

1.6 Production assets

Impairment and ceiling test

When events or changes in circumstances indicate that the carrying amount of expenditure within a cost pool may not be recoverable from future net revenues from oil and gas reserves attributable to that pool, a comparison between the net book value of the cost pool and the discounted future cash flows from that cost pool is undertaken. To the extent that the carrying amount exceeds the recoverable amount, the pool is written down to its recoverable amount and the write off is an impairment charge. Accumulated costs in relation to an abandoned area are written off in full against profit in the year in which the decision to abandon the area is made.

Depreciation, depletion and amortisation

Costs carried within each pool are depreciated on a unit of production basis using the ratio of oil and gas production in the year to the estimated quantity of commercial reserves at the end of the year plus production in the year. Changes in estimates of commercial reserves or future development costs are dealt with prospectively.

Decommissioning costs

Where a material liability for the removal of production facilities and site restoration at the end of the production life of a field exists, a provision for decommissioning is recognised. The amount recognised is the present value of estimated future expenditure determined in accordance with local conditions and requirements. Accretion expense is recognised to represent the unwinding of the discount of the present value of the provision for decommissioning. A corresponding tangible fixed asset of an amount equivalent to the provision for decommissioning is also created and depreciated on a unit of production basis. Changes in estimates are recognised prospectively, with corresponding adjustments to the provision and the associated fixed asset.

1.7 Other tangible fixed assets

Other tangible fixed assets are stated at cost less depreciation and any provision for impairment. Depreciation is provided at rates calculated to write off the cost, less estimated residual value, of assets on a straight-line basis over their estimated useful lives, generally 3 years.

The carrying values of other tangible fixed assets are reviewed for impairment when events or changes in circumstances indicate the carrying values may not be recoverable.

1.8 Revenue recognition

Oil sales revenue represents amounts invoiced (exclusive of sales related taxes) for the Group's share of oil and gas sales in the year, in addition to realised gains and losses from hedging activities.

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective rate applicable.

1.9 Operating leases

Rentals payable under operating leases are charged to the profit and loss account on a straight line basis over the lease term.

1. Accounting policies (continued)

1.10 Taxation
Current tax, including UK corporation tax and overseas tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

The liability method is used in accounting for deferred income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. The recoverability of deferred tax assets are evaluated annually and a valuation allowance is provided if it is more likely than not that the deferred tax asset will not give rise to future benefits in the Group's tax returns.

1.11 Derivative financial instruments
The Group used forward crude oil and gas sales contracts and swaps to reduce exposure to fluctuations in the price of crude oil and natural gas in order to reduce the volatility of the cash flows of the Group. Contracts were only entered into to hedge physical positions related to the Group's crude oil and natural gas production and are, accordingly, accounted for as hedge transactions. The gain or loss arising on these instruments is deferred and recognised only when the hedged transaction occurs. The Group does not hold or issue derivative financial instruments for speculative purposes. The Group does not intend to use these instruments in the future.

1.12 Share based compensation
The Company made share-based payments to certain employees and directors by way of issues of share options. The fair value of these payments is calculated by the Company using the Black Scholes option pricing model. The expense is recognised on a straight line basis over the period from the date of award to the date of vesting, based on the Company's best estimate of shares that will eventually vest.

1.13 Cash at bank and in hand
Cash at bank and in hand includes cash in hand and deposits repayable on demand, less overdrafts payable on demand.

1.14 Foreign currency
Foreign currency transactions of individual companies within the Group are translated to the functional and reporting currency of US dollars at the rates when the transactions occurred. Monetary assets and liabilities denominated in foreign currencies are translated at the rate of exchange at the balance sheet date. All differences are taken to the profit and loss account.

1.15 Investments
Investments in subsidiary companies are included in the Company balance sheet at cost, less provision for any impairment.

1.16 Trade debtors
Trade debtors are carried at original invoice amounts less any provision made for impartment of receivables. A provision for impairment of trade debtors is made when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the debtor.

2. Segmental information

The Group operates a single class of business being oil and gas exploration and production. All turnover in 2006 relates to income from the Group's oil and gas assets, and arose in USA.

The Group profit before interest for the year is analysed by geographical area as follows:

	Years ended 31 December	
	2006 $'000	*2005 $'000*
USA	**6,117**	8,878
Syria	**(643)**	(548)
Iraq	**(497)**	(1,505)
Colombia	**(15)**	—
Common costs	**(1,831)**	(59)
Group's profit before interest	**3,131**	6,766
Net interest	**(1,030)**	(5,318)
Tax	**(1,537)**	(1,551)
Minority interests	**—**	(3,845)
Profit/(loss) for the year	**564**	(3,948)

Common costs have not been apportioned to geographical areas.

3. Operating profit

The Group's operating profit is stated after charging/(crediting):

	Years ended 31 December	
	2006 $'000	*2005 $'000*
Foreign Exchange Gain	**(139)**	(412)
Auditors' remuneration:		
— Audit services	**208**	36
— Non-audit services	**88**	58
Share-based payment charge (note 19)	**851**	—
Hurricane repairs	**2,573**	—
Depreciation of oil and gas properties (note 11)	**4,201**	6,139
Depreciation of other fixed assets (note 11)	**59**	18
Staff costs (excluding share-based payments)	**1,994**	1,251
Operating lease rentals:		
— buildings	**378**	245
— vehicles and equipment	**40**	35

4. Loss on disposal of subsidiary

In 2005, one of the subsidiaries of the Company, Gulfsands Petroleum USA Inc. ("GP USA") redeemed its membership interest (52.6%) in Northstar Gulfsands LLC (a limited liability company registered in Texas) ("NSGS") in return for the partition of certain assets in NSGS. This was accomplished by a conveyance of a certain undivided interest in its oil and gas properties to GP USA and the retention of the remaining interest therein to NSGS together with certain other assets. As a result of this partition and redemption agreement, NSGS ceased to be a subsidiary of GP USA. However, the Group continued to earn its share of turnover from certain oil and gas properties owned and managed by NSGS. Therefore, in accordance with Financial Reporting Standard 3 ("Reporting Financial Performance"), the Directors did not consider this change in arrangement as a discontinued operation as the disposal of NSGS did not have a material effect on the nature and focus of the Group's operations.

As a result of this change in arrangement, in 2005 the Company recognized a loss on the disposal of $1,243,583, wrote off the unamortised goodwill of $1,285,714, and incurred restructuring costs of $3,550,000. The restructuring cost of $3,550,000 represents payment made in respect of 52.6% of the outstanding warrants in NSGS as at the time of the partition.

5. Interest payable and similar charges

	2006 $'000	*2005 $'000*
Debt amortisation	—	1,040
Other loans	—	3,292
	—	4,332

6. Tax on profit/(loss) on ordinary activities

	2006 $'000	*2005 $'000*
Corporation tax:		
UK Corporation tax	**885**	340
US Corporation tax	—	—
Deferred tax:		
Net operating loss and capital loss carry forwards	**6,992**	1,659
Basis differences in oil and gas properties and other fixed assets	**(6,340)**	(448)
	1,537	1,551

The Group's effective tax rate differs from the UK statutory rate of 30% as a result of the differences shown below:

Profit before tax	**2,101**	1,448
Corporation tax calculated at 30%	**630**	434
Effects of:		
Expenses not deductible for tax purposes	**260**	72
Depreciation in excess of allowances	**(94)**	209
Tax losses and other items	**89**	(375)
	885	340

7. Minority interests

In September 2006, Gulfsands Petroleum USA ("GP USA"), a subsidiary of the Company purchased the remaining 16.93% equity minority interest in Darcy Energy, LLC, another subsidiary of the Company from Bazmo Exploration, LLC. The amount paid was $277,347 which included the repayment from Bazmo of two loans and accrued interest owed to GP USA totalling $49,000. An amount of approximately $17,000 representing goodwill on this acquisition was written off to the profit and loss account. Following this purchase, all subsidiaries are now wholly owned.

8. Earnings/(loss) per share

	Years ended 31 December	
	2006 $'000 except per share amounts	*2005 $'000 except per share amounts*
Profit/(loss)	**564**	(3,948)
Basic earnings/(loss) (cents per share)	**0.59**	(4.62)
Diluted earnings/(loss) (cents per share)	**0.58**	(4.62)

Weighted average number of shares:	*2006 Number*	*2005 Number*
For basic earnings per share	**95,565,086**	85,442,295
Options outstanding	**930,600**	904,290
For diluted earnings per share	**96,495,686**	86,346,585

The basic and diluted earnings/(loss) per share have been calculated using the profit for the year ended 31 December 2006 of $564,000 (2005 — $3,948,000 loss). The basic earnings per share was calculated using a weighted average number of shares in issue of 95,565,086 (2005 — 85,442,295). The diluted loss per share for 2005 has been kept the same as the basic loss per share for 2005 as the conversion of share options decreases the 2005 basic loss per share, thus being anti-dilutive.

9. Directors' remuneration and share options

The Directors' remuneration in respect of the Group were as follows:

	Year ended 31 December 2006				*Year ended 31 December 2005*
	Salaries/Fees $'000	*Bonuses $'000*	*Benefits in kind $'000*	*Total $'000*	*Total $'000*
Executive Directors					
John Dorrier	263	50	240*	553	380
David DeCort	225	40	209*	474	338
Mahdi Sajjad**	204	50	5	259	228
Non-executive Directors					
Malcolm Butler	6	—	—	6	21
Charles Stonehill	4	—	—	4	19
John Bolsover	29	—	—	29	40
Andrew West	71	—	231	302	—
Kenneth Judge	32	—	260	292	—
David Cowan	37	—	159	196	
	871	140	1,104	2,115	1,026

* Included within the Benefits in kind are US Medicare taxes associated with the exercise of stock options by the Directors in 2006.

** Mahdi Sajjad's total salary was $297,000 but only $204,000 was paid by the Group with the remaining salary of $93,000 paid by the Company's joint venture partner in Syria.

9. Directors' remuneration and share options (continued)

Directors' remuneration comprises fees, salaries, and emoluments paid to Directors. Benefits in kind represent share based payments in respect of share options granted to Directors and other benefits paid to them. John Dorrier in his capacity as the Chief Executive Officer is the highest paid director.

Share options

The market price of the Company's shares on 31 December 2006 was £1.02 and the share price range during the year was £0.845 to £1.96.

The share options held by Directors are exercisable from 18 February 2005 to the following dates (excluding item (f)):

(a) 25 November 2008 (b) 2 August 2006 (c) 1 January 2008 (d) 17 October 2008 (e) May 2005 (f) between 5 April 2005 and 5 April 2010 (g) 13 February 2011 (h) 25 July 2011 (i) 18 October 2011

	Exercise price	*At 1/1/2006*	*Exercised in 2006*	*Granted during the year ending 31-Dec-06*	***Outstanding at 31-Dec-06***
John Dorrier	(a) US $0.11	1,487,500	(1,487,500)	—	—
	(b) US $0.23	1,487,500	(1,487,500)	—	—
	(c) US $0.43	700,000	(700,000)	—	—
	(d) US $0.57	1,137,500	(1,137,500)	—	—
	(f) GB £1.30	500,000	—	—	**500,000**
		5,312,500	(4,812,500)	—	**500,000**
David DeCort	(a) US $0.11	875,000	(875,000)	—	—
	(b) US $0.23	875,000	(875,000)	—	—
	(c) US $0.43	568,750	(568,750)	—	—
	(d) US $0.57	875,000	(875,000)	—	—
	(f) GB £1.30	450,000	—	—	**450,000**
		3,643,750	(3,193,750)	—	**450,000**
David Cowan	(b) US $0.23	218,750	(218,750)	—	—
	(d) US $0.57	175,000	—	—	**175,000**
	(g) GB £1.445	—	—	125,000	**125,000**
		393,750	(218,750)	125,000	**300,000**
Andrew West	(g) GB £1.445	—	—	125,000	**125,000**
	(h) GB £1.04	—	—	75,000	**75,000**
		—	—	200,000	**200,000**
Charles Stonehill	(f) GB £1.30	125,000	(125,000)	—	—
Malcolm Butler	(f) GB £1.30	125,000	(125,000)	—	—
John Bolsover	(f) GB £1.30	200,000	(200,000)	—	—
Kenneth Judge	(i) GB £0.96	0	0	400,000	**400,000**
		9,800,000	(8,675,000)	725,000	**1,850,000**
Nordman Continental S.A.*	(b) US $0.23	1,312,500	(1,312,500)	—	—
	(c) US $0.43	568,750	—	—	**568,750**
	(d) US $0.57	875,000	—	—	**875,000**
	(f) GB £1.30	450,000	—	—	**450,000**
		3,206,250	(1,312,500)	—	**1,893,750**

* Nordman is owned by the IT — 5483 Trust, Grand Cayman, which is a discretionary trust, the trustees of which are Shelter Trust Anstalt Liechtenstein. Mr. Mahdi Sajjad's children are potential beneficiaries under the Trust.

9. Directors' remuneration and share options (continued)

The share options exercised by the Directors during 2006 resulted in personal taxable gains to them as follows. For both John Dorrier and David DeCort the share options were considered income in the US when exercised even if those shares were not sold. Only a portion of the share options that were exercised were sold by John Dorrier and David DeCort and the shares that were sold were done so to cover US taxes and the cost of exercising the stock options.

	$'000
John Dorrier	6,846
David DeCort	4,462
Nordman Continental	2,285
David Cowan	381
Malcolm Butler	58
Charles Stonehill	87
John Bolsover	145
	14,264

10. Staff costs

The aggregate payroll costs of staff and Directors were as follows:

	Years ended 31 December	
	2006 $'000	*2005 $'000*
Wages and salaries	**1,683**	1,144
Payroll taxes	**311**	107
Share-based payments	**787**	—
	2,781	1,251

The average monthly number of persons employed by the Group, including Directors was as follows:

	2006 Number	*2005 Number*
Finance, technical and administration	**23**	26

11. Tangible fixed assets

Group

	Oil and gas properties-USA $'000	*Other fixed assets $'000*	*Total $'000*
Cost:			
At 1 January 2006	41,372	50	41,422
Additions	19,656	223	19,879
At 31 December 2006	61,028	273	61,301
Accumulated depreciation:			
At 1 January 2006	(7,856)	(21)	(7,877)
Charge for the period	(4,201)	(59)	(4,260)
At 31 December 2006	(12,057)	(80)	(12,137)
Net book value at 31 December 2006	**48,971**	**193**	**49,164**
Net book value at 31 December 2005	33,516	29	33,545

Depreciation and amortization of oil and gas properties is calculated on a unit-of-production basis, using the ratio of oil and gas production in the period to the estimated quantities of proved and probable reserves at the end of the period plus production in the period, on a field-by field basis. Proved and probable reserve estimates are based on a number of underlying assumptions including oil and gas prices, future costs, oil and gas in place and reservoir performance, which are inherently uncertain. Management uses established industry techniques to generate its estimates and regularly references its estimates against those of external consultants. However, the amount of reserves that will ultimately be recovered from any field cannot be known with certainty until the end of the field's life.

Included in oil and gas properties above are capitalized decommissioning costs with a net book value of $9,127,940 as at 31 December 2006.

The Directors have assessed the carrying value of the oil and gas properties and in their opinion, no impairment provision is considered necessary.

12. Intangible fixed assets

Group

	Exploration and evaluation assets - Syria $'000	*Computer software $'000*	*Total $'000*
Cost:			
At 1 January 2006	5,691	38	5,729
Additions	9,375	11	9,386
At 31 December 2006	15,066	49	15,115
Accumulated depreciation:			
At 1 January 2006	—	(3)	(3)
Charge for the period	—	(15)	(15)
At 31 December 2006	—	(18)	(18)
Net book value at 31 December 2006	**15,066**	**31**	**15,097**
Net book value at 31 December 2005	5,691	35	5,726

12. Intangible fixed assets (continued)

The amounts for intangible exploration and evaluation ("E&E") assets represent active exploration projects. These amounts will be written off to the profit and loss account as exploration expense unless commercial reserves are established or the determination process is not completed and there are no indications of impairment. The outcome of ongoing exploration, and therefore whether the carrying value of E&E assets will ultimately be recovered, is inherently uncertain. The Directors have reviewed the oil and gas E&E costs for possible impairment. No provision for impairment is considered necessary against E&E cost incurred in the oil and gas field under exploration as at 31 December 2006.

13. Fixed asset investments

Company	*2006 $'000*	*2005 $'000*
Cost of shares in Gulfsands Petroleum Ltd.	**7,306**	7,306
Loans to Subsidiaries	**50,540**	39,076
At 31 December 2006	**57,846**	46,382

The Company's fixed asset investment of $7,306,000 represents the Company's acquisition of the entire share capital of Gulfsands Petroleum Ltd. by means of a share for share exchange in 2005.

Loans to subsidiary undertakings include a revolving loan from the Company to Gulfsands Petroleum USA, Inc. for $34,320,000. The loan agreement stipulates that accrued interest at 8.5% will be paid on 31 March 2007 for accrued interest from the beginning of the loan, or July 2005, to date and subsequently paid at 31 December annually. The principal balance may be paid in part or in full at anytime with no penalty. On 1 January 2011, the loan converts to a term loan and the payments will be made in 4 installments over the next 4 years.

The Company's investments in subsidiary undertakings are shown below. All investments are in ordinary shares and are indirectly owned by the Company unless otherwise stated:

Name of company	*Proportion of voting shares at 31 December 2006*	*Nature of business*	*Country of Incorporation*
Directly held by the Company:			
Gulfsands Petroleum Ltd.	100%	Holding company	Cayman Islands
Indirectly held by the Company:			
Gulfsands Petroleum Holdings Ltd.	100%	Holding company	Cayman Islands
Gulfsands Petroleum Colombia Ltd.	100%	Oil & gas exploration	Cayman Islands
Gulfsands Petroleum Syria Ltd.	100%	Oil & gas exploration	Cayman Islands
Gulfsands Petroleum Iraq Ltd.	100%	Oil & gas exploration	Cayman Islands
Gulfsands Petroleum USA, Inc.	100%	Oil & gas exploration	US
Darcy Energy LLC	100%	Oil & gas exploration	US

14. Debtors

	Group At 31 December		Company At 31 December	
	2006 $'000	2005 $'000	2006 $'000	2005 $'000
Trade debtors	**5,340**	3,549	**—**	—
Other debtors	**243**	182	**—**	—
Underlift (see note below)	**919**	919	**—**	—
Corporation tax recoverable	**740**	—	**—**	—
Prepayments and accrued income	**2,387**	333	**68**	15
Amounts due from subsidiaries	**—**	—	**3,409**	—
	9,629	4,983	**3,477**	15

Underlift at 31 December 2006 represents underlift acquired as a result of the acquisition of oil and gas properties in May 2004. In accordance with FRS 5, underlift represents a right to future economic benefit (through entitlement to receive equivalent future production), which constitutes an asset. This amount is due after more than one year.

15. Creditors: amounts falling due within one year

	Group At 31 December		Company At 31 December	
	2006 $'000	2005 $'000	2006 $'000	2005 $'000
Trade creditors	**10,987**	236	**13**	40
Other creditors	**875**	—	**17**	—
Provision for decommissioning (note 17)	**3,319**	2,860	**—**	—
UK Corporation tax payable	**855**	340	**855**	340
	16,036	3,436	**885**	380

16. Deferred tax liabilities

Group

	2006 $'000	2005 $'000
Deferred tax liability — accelerated oil and gas depreciation allowance	**(6,120)**	221
Deferred tax asset — net operating losses	**6,944**	(48)
At 31 December	**824**	173

17. Provision for decommissioning

The provision for decommissioning relates to the expected present value of costs of plugging and abandoning the oil and gas properties held by Gulfsands Petroleum USA, Inc and Darcy Energy LLC. The provision for decommissioning is estimated after taking account of inflation, years to abandonment, and borrowing rates. At 31 December 2006, the oil and gas properties have estimated plugging and abandonment dates between 2007 and 2032.

An adjustment in the estimate was made in 2006 because of the increase in costs in the Gulf of Mexico following Hurricanes Katrina and Rita and the subsequent increase in the bonds on certain properties, required by the Minerals Management Service (MMS), the US Federal Agency that manages the natural gas, oil and other mineral resources in the Gulf of Mexico.

The portion of the provision for decommissioning expected to be settled in 2007 totalling approximately \$3.3 million is included in creditors: amounts falling due within one year (see note 15) and the remainder totalling approximately \$8.42 million is included in provision for decommissioning in the consolidated balance sheet at 31 December 2006.

Actual decommissioning costs will ultimately depend upon future market prices for the necessary decommissioning work required, which will reflect market conditions at the relevant time. Furthermore, the timing of decommissioning is likely to depend on when the fields cease to produce at economically viable rates. This in turn will depend upon future oil and gas prices, which are inherently uncertain.

The movement in the provision for decommissioning was as follows:

	2006 $'000
At 1 January 2006	**9,818**
Liabilities settled during the period	**(2,062)**
Additions	**131**
Change in estimates	**1,629**
Unwinding of discount on decommissioning provision	**2,223**
At 31 December 2006 (secured — see note — 29)	**11,739**
Less: current portion (Creditors: amounts falling due within one year — Note 15)	**(3,319)**
	8,420

18. Share capital

	2006 Number	*2005 Number*
Authorised:		
Ordinary Shares (par value 5.714 pence per share)	**175,000,000**	175,000,000
	175,000,000	175,000,000

	2006 $'000	*2005 $'000*
Allotted, called up and fully paid:		
103,018,750 (2005 — 93,031,250) ordinary shares of 5.714 pence each	**11,047**	9,971

18. Share capital (continued)

The movements in share capital and options are summarised below:

	Number of ordinary shares	*Number of share options*
At 1 January 2006	93,031,250	13,796,250
Share options exercised for cash	9,987,500	(9,987,500)
Share options issued	—	1,025,000
Share options lapsed	—	(100,000)
At 31 December 2006	103,018,750	4,733,750

The detail of the share options outstanding at 31 December 2006 are as follows:

Number of options	*Option Price*	*Exercisable between*
568,750	$ 0.43	1 January 2003 — 1 January 2008
1,050,000	$ 0.57	17 October 2003 — 17 October 2008
2,190,000	£1.30	5 April 2005 — 5 April 2010
50,000	£1.00	15 January 2006 — 15 January 2011
20,000	£1.33	30 January 2005 — 30 January 2011
380,000	£1.45	13 February 2006 — 13 February 2011
75,000	£1.04	25 July 2006 — 25 July 2011
400,000	£0.96	18 October 2006 — 18 October 2011
4,733,750*		

* Of this number of options, the options granted to the Directors were 3,743,750 and those granted to other staff were 990,000.

The average share price during 2006 was £1.18.

19. Share based payments

The Group recognised a charge of $851,474 in the profit and loss account in respect of its share based payment plans. This charge was based on the requirements of FRS 20 on share based payments. For this purpose, the weighted average estimated fair value of the share options granted was calculated using a Black-Scholes option pricing model in respect of options. The volatility measured at the standard deviation of expected share price return is based on statistical analysis of the past 5 years of data from companies included in the FTSE Small Oil and Gas Producers Index which resulted in a volatility of 51.895%. FRS 20 allows a newly listed entity that does not have sufficient history to cover the term of the share options to use the volatility of similar size companies in the same industry. In this case, Gulfsands has been listed for less than two years and the share options terms are 5 years.

As risk free rate of 4.58% has been used. The details which have been processed into the model are as follows:

Number of options	*Grant Date*	*Option Price*	*Fair Value calculated by the model*	*Expected exercise date*
50,000	1/15/2006	£1.00	$0.75	1/15/2011
20,000	1/30/2006	£1.33	$1.18	1/30/2011
380,000	2/13/2006	£1.45	$1.27	2/13/2011
75,000	7/25/2006	£1.04	$0.97	7/25/2011
400,000	10/18/2006	£0.96	$0.90	10/18/2011

20. Capital and reserves

Group

	Share capital $'000	*Share premium account $'000*	*Other reserves $'000*	*Profit and loss account $'000*	*Total $'000*
At 1 January 2006	9,971	53,651	11,709	(5,343)	69,988
Options exercised	1,076	2,855	—	—	3,931
Share based payment charge (note 19)	—	—	851	—	851
Retained profit for the year	—	—	—	564	564
At 31 December 2006	11,047	56,506	12,560	(4,779)	75,334

The other reserve of $11,709,000 as at 1 January 2006 represents share premium of Gulfsands Petroleum Ltd. of $19,008,000 less merger reserve of $7,299,000. The share-based payment charge of $851,474 (see note 19) has been credited to other reserves in 2006 in accordance with FRS 20.

Company

	Share capital $'000	*Share premium account $'000*	*Other reserves $'000*	*Profit and loss account $'000*	*Total $'000*
At 1 January 2006	9,971	53,651	—	775	64,397
Options exercised	1,076	2,855	—	—	3,931
Share based payment charge (note 19)	—	—	851	—	851
Retained profit for the year	—	—	—	1,110	1,110
At 31 December 2006	11,047	56,506	851	1,885	70,289

21. Reconciliation of movements in shareholders' funds

	2006 $'000	*2005 $'000*
Profit/(loss) for the year	**564**	(3,948)
Share options and warrants exercised	**3,931**	1,689
Cost of share based payments	**851**	—
Shares issued on placement	**—**	56,651
Share issue costs	**—**	(464)
Net additions to shareholders' funds	**5,346**	53,928
Opening shareholders' funds	**69,988**	16,060
Closing shareholders' funds	**75,334**	69,988

22. Reconciliation of operating profit to net cash inflow from operating activities

	Years ended 31 December 2006 $'000	2005 $'000
Operating profit	**3,131**	12,846
Depreciation	**4,275**	6,157
Share based payment charge	**851**	—
Gain on disposal of assets	**—**	(3)
(Decrease)/increase in debtors, excluding deferred tax assets	**(3,885)**	4,726
Increase/(decrease) in creditors, excluding provision for liabilities and charges	**11,627**	(14,222)
Net cash inflow from operating activities	**15,999**	9,504

23. Analysis of change in net funds

	At 1 January 2006 $'000	Net cash flows $'000	At 31 December 2006 $'000
Cash at bank and in hand	36,561	(9,837)	26,724
Overdrafts	—	—	—
Net funds	36,561	(9,837)	26,724

24. Reconciliation of net cash flow to movements in net funds

	Years ended 31 December 2006 $'000	2005 $'000
Decrease in cash in the year	**(9,837)**	16,982
Cash inflow from increase in debt	**—**	17,769
Change in net funds resulting from cash flows	**(9,837)**	34,751
Amortisation expense	**—**	(1,109)
Minority share	**—**	18,537
Movement in net debt	**(9,837)**	52,179
Opening net funds/(debt)	**36,561**	(15,618)
Closing net funds	**26,724**	36,561

25. Commitments

Operating leases
Annual commitments under operating leases are as follows:

	2006		2005	
	Land & buildings $'000	Other $'000	Land & buildings $'000	Other $'000
Leases expiring within one year	**306**	**24**	185	—
Leases expiring within two years	**62**	**3**	71	58
Leases expiring three years and beyond	**110**	**6**	577	9
	478	**33**	833	67

26. Exceptional Items

In 2005, Hurricanes Katrina and Rita hit the Gulf Coast and several of the Group's offshore oil and gas properties were damaged. Many of the repairs were not performed until 2006. The charge to the profit and loss account for these hurricane repairs was $2,573,000 for 2006.

27. Capital commitments

There are no obligations or contracts outstanding in relation to ongoing projects not provided for in the Accounts at 31 December 2006.

28. Contingent liabilities

Due to the nature of the Group's business, some contamination of the real estate property owned or leased by the Group is possible. Environmental site assessments of the property would be necessary to adequately determine remediation costs, if any. Management of the Group does not consider the amounts that would result from any environmental site assessments to be significant to the financial position or results of operations of the Group. Accordingly, except for the provision made against decommissioning costs (note 17), no further provision for potential remediation costs is reflected in the accompanying Accounts.

29. Financial instruments and derivatives

Risk assessment
The Group's oil and gas activities are subject to a range of financial and operational risks, as described below which can significantly impact its performance.

Liquidity rate risk
The overriding financial risk to the Group during 2006 was not that of liquidity. During 2006, the Group had considerable funds to progress its expanding exploration portfolio. At the end of the year the Group had cash in hand of $27 million.

Cash forecasts identifying the liquidity requirements of the Group are produced frequently. These are reviewed regularly by management and the board to ensure that sufficient financial headroom exists for at least 12 months. With the Group's Syria drilling programme scheduled and the Gulf of Mexico activities, the Board is also keen to ensure that sufficient cash reserves for expansion exists.

The current strategy of no debt will continually be reviewed in the light of developments with existing projects and new project opportunities as they arise.

Currency risk
The Group has minimal currency exposure arising from transactions, as most of its transactions were in its functional currency, US dollars.

Operational risk
Operational risks include equipment failure, well blowouts, pollution, fire and the consequences of bad weather. Where the Group is a project operator of either a producing field or an exploration drilling programme, it takes increased responsibility for ensuring that all relevant legislation is met, and that all partners have appropriate insurance cover in place. The Group's insurance policies contain overall limits and deductibles, which are reviewed each year prior to policy renewal.

29. Financial instruments and derivatives (continued)

Financial assets

The Group's financial assets consist of cash at bank and debtors. The interest rate profile at 31 December for these assets at US dollar equivalents was as follows:

	Financial assets on which floating rate interest is earned $'000	*Financial assets on which no interest is earned $'000*	*Total $'000*
2006			
US Dollar	23,042	12,164	35,206
UK Sterling	1,111	35	1,146
Syrian Pound	—	1	1
	24,153	12,200	36,353
2005			
US Dollar	31,926	8,592	40,518
UK Sterling	934	82	1,016
Syrian Pound	—	10	10
	32,860	8,684	41,544

The UK sterling assets comprise cash on call accounts. The US dollar assets represent cash on call accounts, money market accounts, and short term debtors. The Group earned interest on its interest bearing financial assets at rates between 1.35% and 4.76%. All financial assets on which no interest is earned are considered immediately available to turn into cash on demand.

The Company has classified as cash at bank and in hand certain deposits that are not available for use in its operations. At 31 December 2006 the Company had a commitment as part of an escrow agreement to escrow funds for its future decommissioning provision associated with its oil and gas properties at an estimated undiscounted cost of $12.5 million. At 31 December 2006, the Company had escrowed approximately $11.4 million of cash for use in the settlement of its decommissioning provision (see note 17).

Financial liabilities

The Group's financial liabilities consist of short term creditors and decommissioning liabilities. That interest rate profile at 31 December of these liabilities is shown below:

	Financial liabilities on which no interest paid $'000
2006	
US Dollar	(24,195)
UK Sterling	(885)
Syrian Pound	(200)
	(25,280)
2005	
US Dollar	(10,014)
UK Sterling	(380)
	(10,394)

29. Financial instruments and derivatives (continued)

The Group's short term creditors are considered payable on demand. The Group's decommissioning liabilities that are due within one year amounted to $3.3 million and the balance of $8.4 million is due after more than one year. Further details of the decommissioning liabilities are set out in notes 15 and 17.

Derivatives
The Group has exposure to changes in oil and gas prices. The Group utilises derivative financial instruments to reduce exposure to market risks resulting from fluctuations in oil and gas prices in order to reduce the volatility of the cash flows of the Group.

The Group has entered into forward swap contracts as of 31 December 2006 and 2005. The counter-parties to the contracts are non-related third parties. The contracts settle monthly and are scheduled to coincide with either oil production equivalent to barrels ("bbl") per month or gas production equivalent to volumes in millions of British thermal units ("MMbtu") per month. The contracts represent agreements between the Group and the counter-parties to exchange cash based on a designated price. Prices are referenced to oil or natural gas futures contracts traded on either the Houston Ship Channel/Beaumont, Texas index or on the New York Mercantile Exchange ("NYMEX") index. Cash settlement occurs monthly based on the floating price. The Group accounts for any realised gains and losses from the contracts as adjustments to turnover in the year of the settlement.

The remainder of all of the forward swap contracts expire in May 2007 and the Directors do not intend to renew these contracts.

	$'000
Unrecognised losses at 1 January 2005	2,719
Losses arising in previous years that were recognised in 2005	(2,719)
Losses arising in the period that were not recognised in 2005	5,676
Unrecognised losses at 31 December 2005	5,676
Unrecognised losses at 1 January 2006	5,676
Losses arising in previous years that were recognised in 2006	(5,676)
Losses arising in the period that were not recognised in 2006	1,810
Unrecognised losses at 31 December 2006	1,810

Fair values
At 31 December 2006 and 2005, the fair value and book value of the Group's financial assets and liabilities were materially the same, except for the derivatives instruments referred to above which have not been recognised in these financial statements.

30. Related party transactions

There were no related party transactions during the year ended 31 December 2006.

31. Ultimate controlling party

Ultimate control is exercised by the shareholders of Gulfsands Petroleum plc.

32. Events after the balance sheet date

Increased ownership in onshore property
On 8 March 2007, Darcy Energy LLC a subsidiary of GP USA, Inc. purchased for $500,000 an additional 62.625% of the onshore oil and gas leases in the Emily Hawes Field, Matagorda Island, Texas. Darcy previously owned 35.875% in this property and after this purchase owns 98.5% of the property.