

Group Income Statements

Group Income Statement

Year ended 31 December 2007

	Notes	2007 £'000	2006 £'000
Sales revenue	2	639,203	578,847
Cost of sales		(353,695)	(261,268)
Gross profit		285,508	317,579
Administrative expenses		(31,628)	(22,490)
Disposal of subsidiaries		(597)	-
Exploration costs written off	9	(64,235)	(32,494)
Operating profit	3	189,048	262,595
(Loss)/gain on hedging instruments	17	(29,267)	15,701
Finance revenue	2	3,095	3,030
Finance costs	5	(48,673)	(17,994)
Profit from continuing activities before tax		114,203	263,332
Income tax expense	6	(61,609)	(105,894)
Profit for the year from continuing activities		52,594	157,438
Attributable to:			
Equity holders of the parent		50,887	157,438
Minority interest	24	1,707	-
		52,594	157,438
Earnings per ordinary share	8	Stg p	Stg p
Basic		7.10	24.23
Diluted		6.96	23.67

Group Statement of Recognised Income and Expense

Year ended 31 December 2007

	Notes	2007 £'000	2006 £'000
Profit for the financial year		52,594	157,438
Currency translation adjustments	23	(5,321)	(55,057)
Hedge movement	23	(79,780)	68,236
		(85,101)	13,179
Total recognised income and expense for the year		(32,507)	170,617
Attributable to:			
Equity holders of the parent		(34,214)	170,617
Minority interest		1,707	-
		(32,507)	170,617

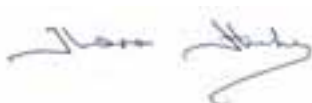
Group Balance Sheet
As at 31 December 2007

	Notes	2007 €'000	2006 €'000
ASSETS			
Non-current assets			
Intangible exploration and evaluation assets	9	956,580	820,437
Property, plant and equipment	10	832,111	934,368
Investments	11	447	496
		1,789,138	1,755,301
Current assets			
Inventories	12	24,897	13,735
Trade receivables		87,746	74,609
Other current assets	13	33,351	28,963
Cash and cash equivalents	14	82,224	99,478
Derivative financial instruments	17	–	16,065
Assets held for sale	18	73,846	–
		302,064	232,850
Total assets		2,091,202	1,988,151
LIABILITIES			
Current liabilities			
Trade and other payables	15	(177,397)	(161,797)
Hardman acquisition payable		–	(333,912)
Other financial liabilities	16	(9,793)	(7,516)
Current tax liabilities		(31,457)	(20,549)
Derivative financial instruments	17	(89,509)	–
Liabilities directly associated with assets classified as held for sale	18	(4,756)	–
		(312,912)	(523,774)
Non-current liabilities			
Trade and other payables	15	(15,586)	(17,137)
Other financial liabilities	16	(540,272)	(206,883)
Deferred tax liabilities	20	(307,615)	(311,925)
Provisions	20	(133,612)	(124,868)
Derivative financial instruments	17	(68,535)	(37,088)
		(1,065,620)	(697,901)
Total liabilities		(1,378,532)	(1,221,675)
Net assets		712,670	766,476
EQUITY			
Called up share capital	22	71,961	65,190
Share premium	22	128,465	126,075
Other reserves	23	210,089	69,791
Shares to be issued		–	235,621
Retained earnings	21	286,668	269,799
Equity attributable to equity holders of the parent		697,183	766,476
Minority interest	24	15,487	–
Total equity		712,670	766,476

Approved by the Board and authorised for issue on 11 March 2008



Aidan Heavey
Chief Executive Officer



Tom Hickey
Chief Financial Officer

Group Cashflow Statement

Year ended 31 December 2007

	Notes	2007 £'000	2006 £'000
Cashflows from operating activities			
Cash generated from operations	25	446,660	404,064
Income taxes paid		(30,030)	(61,868)
Net cash from operating activities		416,630	342,196
Cashflows from investing activities			
Acquisition of subsidiaries		(334,954)	21,336
Disposal of subsidiaries		(597)	-
Purchase of intangible exploration and evaluation assets		(165,726)	(67,976)
Purchase of property, plant and equipment		(198,355)	(243,087)
Finance revenue		3,206	3,030
Net cash used in investing activities		(696,426)	(286,697)
Cashflows from financing activities			
Net proceeds from issue of share capital		2,661	3,502
Proceeds from issue of subsidiary share capital to minority interest		1,244	-
Debt arrangement fees		(8,431)	(1,175)
Repayment of bank loans		(29,474)	(27,914)
Drawdown of bank loan		379,979	59,996
Finance costs		(40,782)	(16,997)
Dividends paid	7	(39,406)	(32,492)
Purchase of treasury shares		(3,722)	(3,977)
Net cash generated by/(used) in financing activities		262,069	(19,057)
Net (decrease)/increase in cash and cash equivalents		(17,727)	36,442
Cash and cash equivalents at beginning of year		99,478	65,386
Translation difference		473	(2,350)
Cash and cash equivalents at end of year	14	82,224	99,478

(a) General information

Tullow Oil Plc is a company incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office is given on page 122. The nature of the group's operations and its principal activities are set out in the operations and finance reviews on pages 12 to 43.

(b) Adoption of new and revised standards

In the current year, the Group has adopted IFRS 7 – Financial Instruments: Disclosures which is effective for annual reporting periods beginning on or after 1 January 2007, and the related amendment to IAS 1 – Presentation of Financial Statements. The impact of the adoption of IFRS 7 and the changes to IAS 1 has been to expand the disclosures provided in these financial statements regarding the Group's financial instruments and management of capital (see note 17). Four interpretations issued by the International Financial Reporting Interpretations Committee are effective for the current period. These are: IFRIC 7 – Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies; IFRIC 8 Scope of IFRS 2; IFRIC 9 Reassessment of Embedded Derivatives; and IFRIC 10 Interim Financial Reporting and Impairment. The adoption of these Interpretations has not led to any changes in the Group's accounting policies.

In addition, the Group has elected to adopt the following in advance of its effective date:

IAS 23 Borrowing Costs (revised 2007) (effective for accounting periods beginning on or after 1 January 2009)

The revisions made to IAS 23 have had no impact on the Group's accounting policies. The principal change to the Standard, which was to eliminate the previously available option to expense costs as incurred, has 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 these financial statements, the following Standards and Interpretations which have not been applied in these financial statements were in issue but not yet effective:

IFRS 2 Share-based payments (revised 2008)
IFRS 3 Business combinations (revised 2008)
IFRS 8 Operating segments
IAS 1 Presentation of financial statements (revised 2008)
IAS 27 Consolidated and separate financial statements (revised 2008)
IAS 32 Financial instruments: Presentation (revised 2008)
IFRIC 11 IFRS 2 – Group and Treasury Share Transactions
IFRIC 12 Service Concession Arrangements
IFRIC 13 Customer Loyalty Programmes
IFRIC 14 IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

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

(c) Basis of accounting

The financial statements have been prepared in accordance with International Financial Reporting Standards ('IFRS') adopted by the European Union and therefore the Group financial statements comply with Article 4 of the EU IAS Regulation.

The financial statements have been prepared on the historical cost basis, except for derivative financial instruments that have been measured at fair value. The principal accounting policies adopted by the Group are set out below.

(d) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) made up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

Minority interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Minority interests consist of the amount of those interests at the date of the original business combination (see below) and the minority's share of changes in equity since the date of the combination. Losses applicable to the minority in excess of the minority's interest in the subsidiary's equity are allocated against the interests of the Group except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses.

The results of subsidiaries acquired or disposed of during the year are included in the Group 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 used by the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3 are recognised at their fair value at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 non-current assets held for sale and discontinued operations, which are recognised and measured at fair value less costs to sell. Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest.

Accounting policies
continued**(d) Basis of consolidation (continued)**

in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in profit or loss.

Joint ventures

The Group is engaged in oil and gas exploration, development and production through unincorporated joint ventures. The Group accounts for its share of the results and net assets of these joint ventures as jointly controlled assets. In addition, where Tullow acts as operator to the joint venture, the gross liabilities and receivables (including amounts due to or from non-operating partners) of the joint venture are included in the Group Balance Sheet.

(e) Non-current assets held for sale

Non-current assets (or disposal groups) classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

(f) Revenue

Sales revenue represents the sales value, net of VAT and overriding royalties, of the Group's share of liftings in the year together with tariff income. Revenue is recognised when goods are delivered and title has passed.

Revenues received under take-or-pay sales contracts in respect of undelivered volumes are accounted for as deferred income.

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

(g) Over/underlift

Lifting or offtake arrangements for oil and gas produced in certain of the Group's jointly owned operations are such that each participant may not receive and sell its precise share of the overall production in each period. The resulting imbalance between cumulative entitlement and cumulative production less stock is 'underlift' or 'overlift'. Underlift and overlift are valued at market value and included within debtors and creditors respectively. Movements during an accounting period are adjusted through Cost of Sales such that Gross Profit is recognised on an entitlements basis. The Group's share of any physical stock, warehouse stock and materials are accounted for at the lower of cost and net realisable value.

(h) Foreign currencies

The Pound Sterling is the presentation currency of the Group. For the purpose of presenting consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period, unless exchange

rates fluctuate significantly during that period, in which case the exchange rates at the date of transactions are used. Currency translation adjustments arising on the restatement of opening net assets of foreign subsidiaries, together with differences between the subsidiaries' results translated at average rates versus closing rates, are taken directly to reserves. All resulting exchange differences are classified as equity until disposal of the subsidiary. On disposal the cumulative amounts of the exchange differences are recognised as income or expense.

Transactions in foreign currencies are recorded at the rates of exchange ruling at the transaction dates. Monetary assets and liabilities are translated into Sterling at the exchange rate ruling at the Balance Sheet date, with a corresponding charge or credit to the Income Statement. However, exchange gains and losses arising on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur, which form part of the net investment in a foreign operation, are recognised in the foreign currency translation reserve and recognised in profit or loss on disposal of the net investment. In addition, exchange gains and losses arising on long-term foreign currency borrowings which are a hedge against the Group's overseas investments, are dealt with in reserves.

(i) Exploration, evaluation and production assets

The Group adopts the successful efforts method of accounting for exploration and appraisal costs. All licence acquisition, exploration and evaluation costs are initially capitalised in cost centres by well, field or exploration area, as appropriate. Directly attributable administration costs and interest payable are capitalised insofar as they relate to specific development activities. Pre-licence costs are expensed in the period in which they are incurred.

These costs are then written off unless commercial reserves have been established or the determination process has not been completed and there are no indications of impairment.

All field development costs are capitalised as property, plant and equipment. Property, plant and equipment related to production activities are amortised in accordance with the Group's Depletion and Amortisation accounting policy.

(j) Commercial reserves

Commercial reserves are proven and probable oil and gas reserves, which are defined as the estimated quantities of crude oil, natural gas and natural gas liquids which geological, geophysical and engineering data demonstrate with a specified degree of certainty to be recoverable in future years from known reservoirs and which are considered commercially producible. There should be a 50 per cent statistical probability that the actual quantity of recoverable reserves will be more than the amount estimated as a proven and probable reserves and a 50 per cent statistical probability that it will be less.

(k) Depletion and amortisation – discovery fields

All expenditure carried within each field is amortised from the commencement of production on a unit of production basis, which is the ratio of oil and gas production in the period to the estimated quantities of commercial reserves at the end of the period plus the production in the period, generally on a field-by-field basis. Costs used in the unit of production calculation comprise the net book value of capitalised costs plus the estimated future field development costs. Changes in the

estimates of commercial reserves or future field development costs are dealt with prospectively.

Where there has been a change in economic conditions that indicates a possible impairment in a discovery field, the recoverability of the net book value relating to that field is assessed by comparison with the estimated discounted future cashflows based on management's expectations of future oil and gas prices and future costs.

Any impairment identified is charged to the Income Statement as additional depletion and amortisation. Where conditions giving rise to impairment subsequently reverse, the effect of the impairment charge is also reversed as a credit to the Income Statement, net of any depreciation that would have been charged since the impairment.

(l) Decommissioning

Provision for decommissioning is recognised in full when the related facilities are installed. 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 the estimated cost of decommissioning, discounted to its net present value, and 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 by recording an adjustment to the provision, and a corresponding adjustment to property, plant and equipment. The unwinding of the discount on the decommissioning provision is included as a finance cost.

(m) Property, plant and equipment

Property, plant and equipment is stated in the Balance Sheet at cost less accumulated depreciation and any recognised impairment loss. Depreciation on property, plant and equipment other than exploration and production assets, is provided at rates calculated to write off the cost less estimated residual value of each asset on a straight-line basis over its expected useful economic life of between three and five years.

(n) Finance costs and debt

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Finance costs of debt are allocated to periods over the term of the related debt at a constant rate on the carrying amount. Arrangement fees and issue costs are deducted from the debt proceeds on initial recognition of the liability and are amortised and charged to the Income Statement as finance costs over the term of the debt.

(o) Share issue expenses and share premium account

Costs of share issues are written off against the premium arising on the issues of share capital.

(p) Taxation

Current and deferred tax, including UK corporation tax and overseas corporation tax, are provided at amounts expected to be paid using the tax rates and laws that have been enacted or substantially enacted by the Balance Sheet date. Deferred corporation tax is recognised on all temporary differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation

to pay more, or right to pay less, tax in the future have occurred at balance sheet date. Deferred tax assets are recognised only to the extent that it is considered more likely than not that there will be suitable taxable profits from which the underlying temporary differences can be deducted. Deferred tax is measured on a non-discounted basis.

Deferred tax is provided on temporary differences arising on acquisitions that are categorised as Business Combinations. Deferred tax is recognised at acquisition as part of the assessment of the fair value of assets and liabilities acquired. Any deferred tax is charged or credited in the income statement as the underlying temporary difference is reversed.

Petroleum Revenue Tax (PRT) is treated as an income tax and deferred PRT is accounted for under the temporary difference method. Current UK PRT is charged as a tax expense on chargeable field profits included in the Income Statement and is deductible for UK corporation tax.

(q) Pensions

Contributions to the Group's defined contribution pension schemes are charged to operating profit on an accruals basis.

(r) Derivative financial instruments

The Group uses derivative financial instruments to manage its exposure to fluctuations in foreign exchange rates, interest rates and movements in oil and gas prices.

Derivative financial instruments are stated at fair value.

The purpose for which a derivative is used is established at inception. To qualify for hedge accounting, the derivative must be 'highly effective' in achieving its objective and this effectiveness must be documented at inception and throughout the period of the hedge relationship. The hedge must be assessed on an ongoing basis and determined to have been 'highly effective' throughout the financial reporting periods for which the hedge was designated.

For the purpose of hedge accounting, hedges are classified as either fair value hedges, when they hedge the exposure to changes in the fair value of a recognised asset or liability, or cashflow hedges, where they hedge exposure to variability in cashflows that is either attributable to a particular risk associated with a recognised asset or liability or forecasted transaction.

In relation to fair value hedges which meet the conditions for hedge accounting, any gain or loss from re-measuring the derivative and the hedged item at fair value is recognised immediately in the Income Statement. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the Income Statement.

For cashflow hedges, the portion of the gains and losses on the hedging instrument that is determined to be an effective hedge is taken to equity and the ineffective portion, as well as any change in time value, is recognised in the Income Statement. The gains and losses taken to equity are subsequently transferred to the Income Statement during the period in which the hedged transaction affects the Income Statement or if the hedge is subsequently deemed to be ineffective. A similar treatment applies to foreign currency loans which are hedges of the Group's net investment in the net assets of a foreign operation.

Accounting policies

continued

(r) Derivative financial instruments (continued)

Gains or losses on derivatives that do not qualify for hedge accounting treatment (either from inception or during the life of the instrument) are taken directly to the Income Statement in the period.

(s) Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases and are charged to the Income Statement on a straight-line basis over the term of the lease.

Assets held under finance leases are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included in the Balance Sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income, unless they are directly attributable to qualifying assets, in which case they are capitalised in accordance with the Group's policy on borrowing costs.

(t) Share based payments

The Group has applied the requirements of IFRS 2 Share Based Payments. In accordance with the transitional provisions of that standard, only those awards that were granted after 7 November 2002, and had not vested at 1 January 2005, are included.

All share based awards of the Company are equity settled as defined by IFRS 2. The fair value of these awards has been determined at the date of grant of the award allowing for the effect of any market-based performance conditions. This fair value, adjusted by the Group's estimate of the number of awards that will eventually vest as a result of non-market conditions, is expensed uniformly over the vesting period.

The fair values were calculated using a binomial option pricing model with suitable modifications to allow for employee turnover after vesting and early exercise. Where necessary this model was supplemented with a Monte Carlo model. The inputs to the models include: the share price at date of grant; exercise price; expected volatility; expected dividends; risk free rate of interest; and patterns of exercise of the plan participants.

(u) Critical accounting judgements and key sources of estimation uncertainty

Details of the Group's significant accounting judgements and critical accounting estimates are set out in these financial statements and include:

- Carrying value of intangible exploration and evaluation fixed assets (note 9);
- Carrying value of property, plant and equipment (note 10);
- Commercial reserves estimates (note 10);
- Derivative financial instruments (note 17);
- Decommissioning costs (note 20); and
- Acquisition of subsidiaries (note 26).

Note 1. Segmental reporting

In the opinion of the Directors the operations of the Group comprise one class of business, oil and gas exploration, development and production and the sale of hydrocarbons and related activities. The Group also operates within four geographical markets, Europe, Africa, South Asia and South America.

The following tables present revenue, profit and certain asset and liability information regarding the Group's business segments for the years ended 31 December 2007 and 2006.

	Europe £'000	Africa £'000	South Asia £'000	South America £'000	Unallocated £'000	Total £'000
2007						
Sales revenue by origin	258,838	371,883	8,482	-	-	639,203
Segment result	78,979	144,886	1,827	(4,419)	-	221,273
Disposal of subsidiaries						(597)
Unallocated corporate expenses						(31,628)
Operating profit						189,048
Loss on hedging instruments						(29,267)
Finance revenue						3,095
Finance costs						(48,673)
Profit before tax						114,203
Income tax expense						(61,609)
Profit after tax						52,594
Total assets	553,340	1,344,226	66,465	112,008	15,163	2,091,202
Total liabilities	(242,597)	(527,843)	(13,870)	(37,731)	(556,491)	(1,378,532)
Other segment information						
Capital expenditure:						
Property, plant and equipment	86,960	115,012	6,096	-	4,145	212,213
Intangible fixed assets	32,587	152,129	4,411	4,745	-	193,872
Depletion, depreciation and amortisation	(101,359)	(98,379)	(3,286)	-	(2,781)	(205,805)
Impairment losses recognised in income	-	(13,834)	-	-	-	(13,834)

Notes to the Group financial statements
continued

Note 1. Segmental reporting (continued)

	Europe €'000	Africa €'000	South Asia €'000	South America €'000	Unallocated €'000	Total €'000
2006						
Sales revenue by origin	307,007	268,302	3,538	–	–	578,847
Segment result	129,735	159,304	(3,954)	–	–	285,085
Unallocated corporate expenses						(22,490)
Operating profit						262,595
Gain on hedging instruments						15,701
Finance revenue						3,030
Finance costs						(17,994)
Profit before tax						263,332
Income tax expense						(105,894)
Profit after tax						157,438
Total assets	541,684	1,281,760	62,174	79,815	22,718	1,988,151
Total liabilities	(250,234)	(356,008)	(15,507)	(20,315)	(579,611)	(1,221,675)
Other segment information						
Capital expenditure:						
Property, plant and equipment	161,675	217,693	10,567	–	3,136	393,071
Intangible fixed assets	37,197	575,808	15,897	79,815	–	708,717
Depletion, depreciation and amortisation	(79,870)	(64,068)	(992)	–	(1,651)	(146,581)

Unallocated expenditure and net liabilities include amounts of a corporate nature and not specifically attributable to a geographic area, including tax balances and the Group debt.

Note 2. Total revenue

	2007 €'000	2006 €'000
Sales revenue		
Oil and gas revenue from the sale of goods	619,607	599,425
Profit/(loss) on realisation of cashflow hedges	2,058	[37,182]
	621,665	562,243
Tariff income	17,538	16,604
Total operating revenue	639,203	578,847
Finance revenue	3,095	3,030
Total revenue	642,298	581,877

Note 3. Operating profit

	2007 £'000	2006 £'000
Profit from operations is stated after charging		
Staff costs (see note 4 below)	33,632	20,637
Depletion and amortisation	203,024	144,930
Impairment of property, plant and equipment	13,834	-
Depreciation of other fixed assets	2,781	1,651
Operating lease rentals	4,798	1,852
Auditors' remuneration (see below)	767	550

	2007 £'000	2006 £'000
Audit services:		
Fees payable to the Company's auditors for the audit of the Company's annual accounts	168	130
Audit of the Company's subsidiaries pursuant to legislation	358	264
	526	394
Tax services:		
Compliance services	68	49
Advisory services	6	6
	74	55
Other non-audit services:		
Acquisition assistance	119	62
Other services not covered above	48	39
	167	101
Total	767	550

Other services not covered above includes £nil (2006: £5,000) payable to an associate of the Company's auditors.

Note 4. Staff costs

The average monthly number of employees (including Executive Directors) employed by the Group worldwide was:

	2007 Number	2006 Number
Administration	156	116
Technical	121	93
Total	277	209

Staff costs in respect of those employees was as follows:

	2007 £'000	2006 £'000
Salaries	30,442	18,376
Social security costs	1,750	1,150
Pension costs	1,440	1,111
	33,632	20,637

A proportion of the Group's staff costs shown above is recharged to the Group's joint venture partners and a proportion is capitalised into the cost of fixed assets under the Group's accounting policy for exploration, evaluation and production assets.

Included in salaries is a charge for share based payments of £5,388,000 (2006: £4,186,000).

Details of Directors' remuneration, Directors' transactions and Directors' interests are set out in the part of the Directors' Remuneration Report described as having been audited and form part of these financial statements.

Notes to the Group financial statements
continued**Note 5. Finance costs**

	2007 £'000	2006 £'000
Interest on bank overdrafts and loans	43,561	12,658
Interest on obligations under finance leases	288	374
Total borrowing costs	43,849	13,032
Less amounts included in the cost of qualifying assets	(7,431)	(7,490)
	36,418	5,542
Finance and arrangement fees	3,646	5,681
Unwinding of discount on decommissioning provision (note 20)	8,609	6,771
	48,673	17,994

Borrowing costs included in the cost of qualifying assets during the year arose on the general borrowing pool and are calculated by applying a capitalisation rate of 7.74% (2006: 6.78%) to cumulative expenditure on such assets.

Note 6. Taxation on profit on ordinary activities**(a) Analysis of charge in period**

The tax charge comprises:

	2007 £'000	2006 £'000
Current tax		
UK corporation tax	2,328	14,344
Foreign taxation	27,768	17,434
Total corporate tax	30,096	31,778
UK petroleum revenue tax	11,048	21,605
Total current tax	41,144	53,383
Deferred tax		
UK corporation tax	21,631	45,585
Foreign taxation	229	6,530
Total corporate tax	21,860	52,115
UK petroleum revenue tax	(1,395)	396
Total deferred tax (note 20)	20,465	52,511
Total tax expense	61,609	105,894

(b) Factors affecting tax charge for period

As the Group earns a significant portion of its profits in the UK, the tax rates applied to profit on ordinary activities in preparing the reconciliation below is the standard rate of UK corporation tax applicable to the Group's oil and gas activities plus the rate of Supplementary corporation tax (SCT).

The difference between the total current tax charge shown above and the amount calculated by applying the standard rate of UK corporation tax (30%) plus the rate of SCT in respect of UK upstream profits (20%) to the profit before tax is as follows:

	2007 £'000	2006 £'000
Group profit on ordinary activities before tax	114,203	263,332
Tax on group profit on ordinary activities at a combined standard UK corporation tax and SCT rate of 50% (2006: 50%)	57,102	131,666
Effects of:		
Expenses not deductible for tax purposes	12,056	7,264
Net losses not recognised	50,706	19,635
Petroleum revenue tax (PRT)	9,654	22,001
UK corporation tax deductions for current PRT	(4,827)	(11,001)
Adjustments relating to prior years	(5,613)	290
Income taxed at a different rate	(57,469)	(63,961)
Group total tax expense for the year	61,609	105,894

The Group's profit before taxation will continue to be subject to jurisdictions where the effective rate of taxation differs from that in the UK. Furthermore, unsuccessful exploration expenditure is often incurred in jurisdictions where the Group has no taxable profits, such that no related tax benefit arises. Accordingly the Group's tax charge will continue to depend on the jurisdictions in which pre-tax profits and exploration costs written off arise.

The Group has tax losses of £131 million (2006: £124 million) that are available indefinitely for offset against future taxable profits in the companies in which the losses arose. Deferred tax assets have not been recognised in respect of these losses as they may not be used to offset taxable profits elsewhere in the Group.

Note 7. Dividends

	2007 £'000	2006 £'000
Declared and paid during year		
Final dividend for 2006: Stg3.5p (2005: Stg3p) per ordinary share	25,051	19,505
Interim dividend for 2007: Stg2p (2006: Stg2p) per ordinary share	14,355	12,987
Dividends paid	39,406	32,492
Proposed for approval by shareholders at the AGM		
Final dividend for 2007: Stg4p (2006: Stg3.5p) per ordinary share	28,784	25,051

The proposed final dividend is subject to approval by shareholders at the Annual General Meeting and has not been included as a liability in these financial statements.

Notes to the Group financial statements

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Note 8. Earnings per ordinary share

Basic earnings per ordinary share amounts are calculated by dividing net profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per ordinary share amounts are calculated by dividing net profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued if employee and other share options were converted into ordinary shares.

	2007 £'000	2006 £'000
Earnings		
Net profit attributable to equity shareholders	50,887	157,438
Effect of dilutive potential ordinary shares	–	–
Diluted net profit attributable to equity shareholders	50,887	157,438
	2007	2006
Number of shares		
Basic weighted average number of shares	717,025,714	649,665,389
Dilutive potential ordinary shares	14,348,042	15,593,396
Diluted weighted average number of shares	731,373,756	665,258,785

Note 9. Intangible exploration and evaluation fixed assets

	2007 £'000	2006 £'000
At 1 January	820,437	160,543
Acquisition of subsidiaries (note 26)	48,959	623,542
Additions	193,872	85,175
Assets held for sale (note 18)	(11,398)	–
Amounts written off	(64,235)	(32,494)
Transfer (to)/from property, plant and equipment (note 10)	(15,442)	937
Currency translation adjustments	(15,613)	(17,266)
At 31 December	956,580	820,437

The amounts for Intangible Exploration and Evaluation assets represent active exploration projects. These amounts will be written off to the Income Statement as exploration costs 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 Exploration and Evaluation assets will ultimately be recovered, is inherently uncertain.

Note 10. Property, plant and equipment

	Oil and gas assets £'000	Other fixed assets £'000	Total £'000
Cost			
At 1 January 2006	1,035,035	7,274	1,042,309
Acquisition of subsidiaries (note 26)	86,931	–	86,931
Additions	303,004	3,136	306,140
Transfer to intangible exploration and evaluation fixed assets (note 9)	(937)	–	(937)
Currency translation adjustments	(66,741)	(414)	(67,155)
At 1 January 2007	1,357,292	9,996	1,367,288
Acquisition of subsidiaries (note 26)	(39,489)	–	(39,489)
Additions	208,068	4,145	212,213
Assets held for sale (note 18)	(88,676)	–	(88,676)
Transfer from intangible exploration and evaluation fixed assets (note 9)	15,442	–	15,442
Currency translation adjustments	(19,291)	273	(19,018)
At 31 December 2007	1,433,346	14,414	1,447,760
Depletion and amortisation			
At 1 January 2006	302,745	3,001	305,746
Charge for the year	144,930	1,651	146,581
Currency translation adjustments	(19,154)	(253)	(19,407)
At 1 January 2007	428,521	4,399	432,920
Charge for the year	203,024	2,781	205,805
Impairment loss	13,834	–	13,834
Assets held for sale	(30,371)	–	(30,371)
Currency translation adjustments	(6,769)	230	(6,539)
At 31 December 2007	608,239	7,410	615,649
Net book value			
At 31 December 2007	825,107	7,004	832,111
At 31 December 2006	928,771	5,597	934,368

Additions include capitalised interest of £7,431,000 (2006: £7,490,000).

The carrying amount of the Group's oil and gas assets includes an amount of £8,147,000 (2006: £10,381,000) in respect of assets held under finance leases.

Other fixed assets include leasehold improvements, motor vehicles and office equipment.

The impairment loss relates to the Chinguetti field in Mauritania.

Depletion and amortisation for 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 commercial reserves at the end of the period plus production in the period, generally on a field-by-field basis. Commercial reserves 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. Commercial reserves estimates are based on a Group reserves report produced by an independent engineer. 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.

Notes to the Group financial statements

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Note 11. Investments

	2007 €'000	2006 €'000
Unlisted investments	447	447
Government gilts	-	49
	447	496

The fair value of these investments is not materially different from their carrying value.

Principal subsidiary undertakings

At 31 December 2007 the Company's principal subsidiary undertakings, all of which are included in the consolidated Group financial statements, were:

Name	%	Country of operation	Country of registration
Directly held			
Tullow Oil UK Limited	100	United Kingdom	Scotland
Tullow Oil SK Limited	100	United Kingdom	England & Wales
Tullow Oil SPE Limited	100	United Kingdom	England & Wales
Tullow Group Services Limited	100	United Kingdom	England & Wales
Tullow Oil Limited	100	Ireland	Ireland
Tullow Overseas Holdings B.V.	100	Netherlands	Netherlands
Tullow Gabon Holdings Limited	50	Gabon	Isle of Man
Indirectly held			
Tullow (EA) Holdings Limited	100	Isle of Man	British Virgin Islands
Tullow Oil International Limited	100	Channel Islands	Jersey
Tullow Pakistan (Developments) Limited	100	Pakistan	Jersey
Tullow Bangladesh Limited	95	Bangladesh	Jersey
Tullow Côte d'Ivoire Limited	100	Côte d'Ivoire	Jersey
Tullow Côte d'Ivoire Exploration Limited	100	Côte d'Ivoire	Jersey
Tullow India Operations Limited	100	India	Jersey
Tullow Cameroon Limited	100	Cameroon	Jersey
Tullow Madagascar Limited	100	Madagascar	Jersey
Tullow Ghana Limited	100	Ghana	Jersey
Tullow Angola B.V.	100	Angola	Netherlands
Tullow Congo Limited	100	Congo	Isle of Man
Tullow Equatorial Guinea Limited	100	Equatorial Guinea	Isle of Man
Tullow Kudu Limited	100	Namibia	Isle of Man
Tullow Uganda Limited	100	Uganda	Isle of Man
Tullow Gabon Holdings Limited	50	Gabon	Isle of Man
Tullow Oil Gabon SA	100	Gabon	Gabon
Tulipe Oil SA	50	Gabon	Gabon
Hardman Chinguetti Production (Pty) Limited	100	Mauritania	Australia
Hardman Petroleum (Mauritania) (Pty) Limited	100	Mauritania	Australia
Planet Oil (Mauritania) Limited	100	Mauritania	Guernsey
Tullow Uganda Operations Limited	100	Uganda	Australia
Tullow Hardman Holdings B.V.	100	Netherlands	Netherlands
Tullow South Africa (Pty) Limited	100	South Africa	South Africa

The principal activity of all companies relates to oil and gas exploration, development and production.

Note 12. Inventories

	2007 £'000	2006 £'000
Warehouse stocks and materials	16,927	8,790
Oil stocks	7,970	4,945
	24,897	13,735

Note 13. Other current assets

	2007 £'000	2006 £'000
Other debtors	27,214	25,587
Prepayments	2,458	1,872
VAT recoverable	3,679	1,504
	33,351	28,963

Note 14. Cash and cash equivalents

	2007 £'000	2006 £'000
Cash at bank and in hand	69,357	42,628
Short-term deposits	12,867	56,850
	82,224	99,478

Cash and cash equivalents includes an amount of £8,254,000 (2006: £7,995,000) which is a reserve held on fixed term deposit in support of a Letter of Credit facility which relates to the Group's share of certain decommissioning and FPSO costs.

Note 15. Trade and other payables**Current liabilities**

	2007 £'000	2006 £'000
Trade payables	62,693	20,162
Other payables	9,174	37,462
Deferred income (take or pay)	722	1,372
Accruals	86,032	88,566
PAYE and social security	6,649	124
VAT and other similar taxes	10,064	12,067
Current portion of finance lease (note 19)	2,063	2,044
	177,397	161,797

Non-current liabilities

	2007 £'000	2006 £'000
Other payables	9,051	8,372
Non-current portion of finance lease (note 19)	6,535	8,765
	15,586	17,137
	14,872	16,570
– After one year but within five years	714	567
	15,586	17,137

Notes to the Group financial statements
continued

Note 16. Financial liabilities

	2007 £'000	2006 £'000
Current		
Short-term borrowings	9,793	7,516
Non-current		
Term loans repayable		
– After one year but within two years	282,275	1,135
– After two years but within five years	257,997	175,496
– After five years	–	30,252
	540,272	206,883

Group bank loans are stated net of unamortised arrangement fees of £11,635,000 (2006: £7,174,000).

Short-term borrowings, term loans and guarantees are secured by fixed and floating charges over the oil and gas assets (note 10) of the Group.

Interest rate risk

The interest rate profile of the Group's financial assets and liabilities at 31 December 2007 was as follows:

	Stg £'000	Euro £'000	US\$ £'000	Other £'000	Total £'000
Cash at bank at floating interest rate	37,004	390	39,328	472	77,194
Cash at bank on which no interest is received	713	–	2,529	1,788	5,030
Fixed rate debt	(25,000)	–	(75,101)	–	(100,101)
Floating rate debt	(40,000)	–	(421,599)	–	(461,599)
Net (debt)/cash	(27,283)	390	(454,843)	2,260	(479,476)

The profile at 31 December 2006 for comparison purposes was as follows:

	Stg £'000	Euro £'000	US\$ £'000	Other £'000	Total £'000
Cash at bank at floating interest rate	38,256	130	53,763	6,619	98,768
Cash at bank on which no interest is received	133	–	577	–	710
Fixed rate debt	(30,000)	–	(63,805)	–	(93,805)
Floating rate debt	(40,000)	–	(87,768)	–	(127,768)
Net (debt)/cash	(31,611)	130	(97,233)	6,619	(122,095)

Cash at bank at floating interest rate consisted of deposits which earn interest at rates set in advance for periods ranging from overnight to one month by reference to Sterling or US Dollar LIBOR.

Floating rate debt comprises bank borrowings at interest rates fixed in advance from overnight to three months at rates determined by US Dollar LIBOR and Sterling LIBOR. Fixed rate debt comprises bank borrowings at interest rates fixed in advance for periods greater than three months or bank borrowings where the interest rate has been fixed through interest rate hedging.

The Borrowing Base Facility incurs interest on outstanding debt at Sterling or US Dollar LIBOR plus a margin ranging from 100 basis points to 240 basis points depending on utilisation and concentration of non-OECD assets. The outstanding debt is repayable in variable amounts (determined semi-annually) over the period to 31 August 2012, or such time as is determined by reference to the remaining reserves of the assets, whichever is earlier. There is no requirement under the Borrowing Base Facility to hedge interest rate exposure to Sterling LIBOR and US Dollar LIBOR. The Borrowing Base Facility states that consideration should be given to hedging at least 30% of the interest rate exposure to fluctuations in LIBOR for Sterling and US Dollars in respect of loans under the facility, net of relevant cash balances.

The Hardman Bridge Facility is a US\$550 million (£275.4 million) facility which is currently repayable in full on 31 January 2009. Tranche A of the facility is a US\$150 million (£75.1 million) revolving tranche which incurs interest on outstanding debt at US Dollar LIBOR plus a margin ranging from 250 basis points to 350 basis points. The margin on Tranche A increases in quarterly 25 basis point increments and is also dependent on whether certain assets are included in the security package. Tranche B of the facility is a US\$400 million (£200.3 million) non-revolving tranche which incurs interest on outstanding debt at US Dollar LIBOR plus a margin of 300 basis points to 325 basis points, depending on whether certain assets are included in the security package. There is no requirement under the Hardman Bridge Facility to hedge interest rate exposure to US Dollar LIBOR. The Hardman Bridge Facility states that consideration should be given to hedging at least 30% of the interest rate exposure to fluctuations in LIBOR for US Dollars in respect of loans under the facility, net of relevant cash balances.

At the end of December 2007, the headroom under the facilities amounted to US\$457 million (£228.8 million); US\$307 million (£153.7 million) under the Borrowing Base and US\$150 million (£75.1 million) under the Hardman Bridge Facility. At the end of December 2006, the headroom under the two facilities was US\$1.4 billion (£714.6 million); US\$416 million (£212.3 million) under the Borrowing Base and US\$1 billion (£502.3 million) under the Hardman Bridge Facility which was not drawn down until January 2007.

In the table for 2007, £100.1 million of the gross debt has been shown as fixed rate debt as the particular bank borrowings were fixed in November 2007 for a six-month duration.

The Group is exposed to floating rate interest rate risk as entities in the Group borrow funds at floating interest rates. The Group hedges its floating rate interest rate exposure on an ongoing basis through the use of interest rate derivatives, namely interest rate swaps, interest rate caps and interest rate zero cost collars. All interest rate derivatives currently in place were put in place for a three-year period in late 2005 and expire in November 2008. The effect of the interest rate cap currently in place limits the exposure to US Dollar LIBOR at 5.8% for a current notional principal of US\$35 million (£17.5 million). The interest rate swap currently in place has a swap rate of 4.75% for a current notional principal of US\$35 million (£17.5 million). The zero cost collar currently in place has a floor of 3.475% and a cap of 5.8% for a notional principal of US\$35 million (£17.5 million). The combined mark to market position as at the 2007 year end was £104,000 (2006: £156,000). As the interest rate swaps do not give rise to material differences between book and fair values, the hedged amounts are included in floating rate debt in the 2007 and 2006 table.

Foreign currency risk

Wherever possible, the Group conducts and manages its business in Sterling (UK) and US Dollars (all other countries), the functional currencies of the industry in the areas in which it operates. A natural hedge exists in the majority of the Group's oil and gas income and expenditure, which are denominated in US Dollars and Sterling respectively. The Group's borrowing facilities are also denominated in Sterling and US Dollars, which further assists in foreign currency risk management. From time to time the Group undertakes certain transactions denominated in foreign currencies. These exposures are managed by executing foreign currency financial derivatives, typically to manage exposures arising on corporate transactions such as acquisitions and disposals. There were no foreign currency financial derivatives in place at the 2007 year end. Cash balances are held in other currencies to meet immediate operating and administrative expenses or to comply with local currency regulations.

As at 31 December 2007 the only material monetary assets or liabilities of the Group that were not denominated in the functional currency of the respective subsidiaries involved were US\$570 million (£285.4 million) cash drawings under the US\$1,350 million (£675.9 million) Borrowing Base Facility and US\$400 million (£200.3 million) cash drawings under the US\$550 million (£275.4 million) Hardman Bridge Facility. As at 31 December 2006 the only material assets or liabilities that were not denominated in the functional currency of the respective subsidiaries involved were US\$280 million (£142.9 million) cash drawings under the US\$850 million (£425.6 million) Borrowing Base facility. These US Dollar cash drawings at 31 December 2007 continue to be held as a hedge against US Dollar denominated net assets in subsidiaries.

The carrying amounts of the Group's foreign currency denominated monetary assets and monetary liabilities at the reporting date are £452.2 million (2006: £90.5 million).

Foreign currency sensitivity analysis

The Group is mainly exposed to fluctuation in the US dollar. The Group measures its market risk exposure by running various sensitivity analyses including 10% favourable and adverse changes in the key variables. The sensitivity analyses include only outstanding foreign currency denominated monetary items and adjusts their translation at the period end for a 10% change in foreign currency rates.

Notes to the Group financial statements continued

Note 16. Financial liabilities (continued)

As at 31 December 2007 a 10% increase in Sterling against the US Dollar would have resulted in a decrease in foreign currency denominated liabilities and equity of £49.4 million (2006: £13.8 million) and a 10% decrease in Sterling against US Dollar would have resulted in an increase in foreign currency denominated liabilities and equity of £60.3 million (2006: £16.8 million).

Liquidity risk

The Group manages the liquidity requirements by the use of both short and long-term cashflow projections, supplemented by maintaining debt financing plans and active portfolio management. Ultimate responsibility for liquidity risk management rests with the Board of Directors, which has built an appropriate liquidity risk management framework for the management of the Group's short, medium and long-term funding and liquidity management requirements.

Note 17. Financial instruments

Financial risk management objectives

The Group holds a portfolio of commodity derivative contracts, with various counterparties, covering both its underlying oil and gas businesses. In addition the Group holds a small portfolio of interest rate and foreign exchange derivatives. The use of financial derivatives is governed by the Group's policies approved by the Board of Directors. Compliance with policies and exposure limits is reviewed by the internal auditors on a regular basis. The Group does not enter into or trade financial instruments, including derivative financial instruments, for speculative purposes.

Fair values of financial assets and liabilities

The Group considers the carrying value of all the financial assets and liabilities to be materially the same as the fair value.

Fair values of derivative instruments

Under IAS 39 all derivatives must be recognised at fair value on the Balance Sheet with changes in such fair value between accounting periods being recognised immediately in the Income Statement, unless the derivatives have been designated as cashflow or fair value hedges. The fair value is the amount for which the asset or liability could be exchanged in an arm's length transaction at the relevant date. Fair values are determined using quoted market prices (marked-to-market values) where available. To the extent that market prices are not available, fair values are estimated by reference to market-based transactions, or using standard valuation techniques for the applicable instruments and commodities involved.

The Group's derivative instrument book and fair values were as follows:

Assets/(liabilities):	Less than one year £'000	One to three years £'000	Total 2007 £'000	Less than one year £'000	One to three years £'000	Total 2006 £'000
Cashflow hedges						
Gas derivatives	(7,573)	(13,489)	(21,062)	33,397	12,217	45,614
Oil derivatives	(81,832)	(55,046)	(136,878)	(23,309)	(49,373)	(72,682)
Interest rate derivatives	(104)	–	(104)	88	68	156
	(89,509)	(68,535)	(158,044)	10,176	(37,088)	(26,912)
Fair value through profit and loss						
Exchange rate derivatives	–	–	–	5,889	–	5,889
	(89,509)	(68,535)	(158,044)	16,065	(37,088)	(21,023)

Market risk

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

Oil and gas prices

The Group uses a number of derivative instruments to mitigate the commodity price risk associated with its underlying oil and gas revenues. Such commodity derivatives will tend to be priced using pricing benchmarks, such as Brent Dated and D-1 Heren, which correlate as far as possible to the underlying oil and gas revenues respectively. The Group hedges its estimated oil and gas revenues on a portfolio basis, aggregating its oil revenues from substantially all of its African oil interests and its gas revenues from substantially all of its UK gas interests.

At 31 December 2007 the Group's oil hedge position was summarised as follows:

Oil hedges	H1 2008	H2 2008	2009	2010	2011
Volume – bopd	20,600	18,000	11,000	2,000	–
Average Price* – \$/bbl	70.60	70.30	62.43	83.40	–

* Average hedge prices are based on market prices as at 31 December 2007 and represent the current value of hedged volumes at that date.

At 31 December 2007 the Group's gas hedge position was summarised as follows:

Gas hedges	H1 2008	H2 2008	2009	2010	2011
Volume – mmscfd	95.4	54.1	74.6	33.8	11.0
Average Price* – p/therm	52.14	47.83	50.56	48.53	52.08

* Average hedge prices are based on market prices as at 31 December 2007 and represent the current value of hedged volumes at that date.

As at 31 December 2007 all of the Group's oil and gas derivatives have been designated as cash flow hedges. The Group's oil and gas hedges have been assessed to be 'highly effective' within the range prescribed under IAS 39 using regression analysis on oil and ratio analysis on gas. There is, however, a degree of ineffectiveness inherent in the Group's oil hedges arising from, among other factors, the discount on the Group's underlying African crude relative to Brent and the timing of oil liftings relative to the hedges. There is also a degree of ineffectiveness inherent in the Group's gas hedges which arise from, among other factors, field production performance on any day.

Income statement hedge summary

The changes in the fair value of hedges which are required to be recognised immediately in the Income Statement for the year, were as follows:

	2007 £'000	2006 £'000
(Loss)/gain on hedging instruments:		
Cash flow hedges		
Gas derivatives		
Ineffectiveness	(533)	422
Time Value	(9,989)	(809)
	(10,522)	(387)
Oil derivatives		
Ineffectiveness	(2,380)	8,308
Time Value	(10,476)	1,891
	(12,856)	10,199
Fair value through profit and loss		
Foreign exchange derivatives	(5,889)	5,889
Total net (loss)/gain for the year in Income Statement	(29,267)	15,701

The following table summarises the deferred gains/(losses) on derivative instruments, net of tax effects, recorded in hedge reserve (note 23) for the year:

	2007 £'000	2006 £'000
Deferred amounts in hedge reserve		
At 1 January	(52,213)	(120,449)
Amounts recognised in profit for the year	23,917	(13,255)
Deferred (losses)/gains before tax arising during the year	(133,615)	122,625
Deferred tax movement taken directly to equity	29,918	(41,134)
	(79,780)	68,236
At 31 December	(131,993)	(52,213)

Notes to the Group financial statements
continued

Note 17. Financial instruments (continued)

Deferred amounts in hedge reserve net of tax effects	2007	2006
	£'000	£'000
Cash flow hedges		
Gas derivatives	(7,191)	21,556
Oil derivatives	(124,706)	(73,878)
Interest rate derivatives	(96)	109
	(131,993)	(52,213)

Financial derivatives

The Group internally measures its market risk exposure by running various sensitivity analyses, including utilizing 10% favourable and adverse changes in the key variables.

Oil and gas sensitivity analysis

The following analysis, required by IFRS 7, is intended to illustrate the sensitivity to changes in market variables, being Dated Brent oil prices and UK D-1 Heren natural gas prices. The sensitivity analysis, which is used internally by management to monitor financial derivatives, has been prepared using the following assumptions:

- the pricing adjustments relate only to the point forward mark to market (MTM) evaluations;
- the price sensitivities assume there is no ineffectiveness related to the oil and gas hedges; and
- the sensitivities have been run only on the intrinsic element of the hedge as management consider this to be the material component of the MTM oil and gas hedges.

As at 31 December 2007 a 10% increase in the dated Brent oil price curve would have decreased equity by approximately £49 million (2006: £15 million), a 10% decrease would have increased equity by approximately £43 million (2006: £17 million).

As at 31 December 2007 a 10% increase in the UK, D-1 Heren natural gas price curve would have decreased equity by approximately £14 million (2006: £9 million), a 10% decrease would have increased equity by approximately £12 million (2006: £11 million).

Interest rate sensitivity analysis

As at 31 December 2007, the interest rate derivative position was out-of-the-money to an amount of £104,000 (2006: £156,000) and due to immateriality no sensitivity analysis has been performed on the position.

FX sensitivity analysis

As at 31 December 2007, there were no foreign exchange derivatives outstanding. As at 31 December 2006, a 10% weakening of the AUD to the USD would have reduced equity and profit for the year by approximately £15 million and 10% strengthening of the AUD to the USD would have increased equity and profit for the year by approximately £17 million.

Interest rate sensitivity

A 10% relative change in LIBOR would have impacted equity and profit for the year by +/-£3.0 million (2006: +/-£1.2 million).

Credit risk

Credit risk refers to the risk that the counterparty will fail to perform or fail to pay amounts due, resulting in financial loss to the Group. The primary activities of the Group are oil and gas exploration and production. The Group has a credit policy that governs the management of credit risk, including the establishment of counterparty credit limits and specific transaction approvals. The Group limits credit risk by assessing creditworthiness of potential counterparties before entering into transactions with them and continuing to evaluate their credit worthiness after transactions have been initiated. The Group attempts to mitigate credit risk by entering into contracts that permit netting and allow for termination of the contract upon the occurrence of certain events of default. The Group's exposure and the credit ratings of its counterparties are continuously monitored and the aggregate value of transactions concluded is spread amongst approved counterparties.

The Group does not have any significant credit risk exposure to any single counterparty or any group of counterparties having similar characteristics, as at present the majority of the oil and gas derivative positions of the group are out-of-the-money. The credit risk on derivative financial instruments is limited because the counterparties are banks with high credit-ratings assigned by international credit-rating agencies.

Note 18. Assets held for sale

On 31 January 2008 and 5 November 2007, the Group entered into sale agreements to dispose of Tullow Congo Ltd and its 40% interest in the Ngosso Permit in Cameroon respectively. The disposals were part of the Group's active asset management programme, and provide financial flexibility for its development programmes.

These transactions are subject to final completion and both are expected to be completed within 12 months. The related net assets have been classified as assets held for sale and presented separately in the balance sheet.

During the year, these assets contributed £37 million (2006: £30 million) to the group's net operating cash flows and paid £17 million (2006: £14 million) in respect of investing activities.

The major classes of assets and liabilities comprising the operations classified as held for sale are as follows:

	2007 £'000	2006 £'000
Property, plant and equipment	58,305	–
Intangible exploration and evaluation assets	11,398	–
Trade and other receivables	4,143	–
Total assets classified as held for sale	73,846	–
Trade and other payables	(3,229)	–
Decommissioning provisions	(1,527)	–
Total liabilities directly associated with assets classified as held for sale	(4,756)	–
Net assets of disposal group	69,090	–

Note 19. Obligations under finance leases

	2007 £'000	2006 £'000
Amounts payable under finance leases:		
– Within one year	2,294	2,339
– Within two to five years	6,882	9,354
	9,176	11,693
Less future finance charges	(578)	(884)
Present value of lease obligations	8,598	10,809
Amount due for settlement within 12 months (note 15)	2,063	2,044
Amount due for settlement after 12 months (note 15)	6,535	8,765

The fair value of the Group's lease obligations approximates the carrying amount. The remaining lease term is four years (2006: five years). For the year ended 31 December 2007 the effective borrowing rate was 2.8 % (2006: 2.8%).

Notes to the Group financial statements
continued**Note 20. Provisions****(i) Decommissioning costs**

	2007 £'000	2006 £'000
At 1 January	124,868	91,139
Acquisition of subsidiary (note 26)	–	5,463
New provisions and changes in estimates	7,252	24,199
Assets held for sale (note 18)	(1,527)	–
Decommissioning payments	(5,065)	(257)
Unwinding of discount (note 5)	8,609	6,771
Currency translation adjustment	(525)	(2,447)
At 31 December	133,612	124,868

The decommissioning provision represents the present value of decommissioning costs relating to the UK, African and Asian oil and gas interests, which are expected to be incurred up to 2025. These provisions have been created based on Tullow's internal estimates and, where available, operator's estimates. Assumptions, based on the current economic environment, have been made which management believe are a reasonable basis upon which to estimate the future liability. These estimates are reviewed regularly to take into account any material changes to the assumptions. However, actual decommissioning costs will ultimately depend upon future market prices for the necessary decommissioning works 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.

(ii) Deferred taxation

	PRT £'000	UK and overseas corporate taxation £'000	Total £'000
At 1 January 2006	2,355	49,118	51,473
Charged to income statement	396	52,115	52,511
Acquisition of subsidiary (note 26)	–	158,842	158,842
Hedge movement directly to equity (note 17)	–	41,134	41,134
Currency translation adjustment	–	7,965	7,965
At 1 January 2007	2,751	309,174	311,925
Charged to income statement	(1,395)	21,860	20,465
Acquisition of subsidiary (note 26)	–	9,020	9,020
Hedge movement directly to equity (note 17)	–	(29,918)	(29,918)
Currency translation adjustment	–	(3,877)	(3,877)
At 31 December 2007	1,356	306,259	307,615

Deferred UK and overseas corporation tax is provided as follows:

	2007 £'000	2006 £'000
Accelerated capital allowances	175,549	155,863
Decommissioning charges	(40,223)	(31,356)
Other temporary differences	174,810	176,702
Currency translation adjustment	(3,877)	7,965
Provision	306,259	309,174

No deferred tax has been provided on unremitted earnings of overseas subsidiaries, as the Group has no plans to remit these to the UK in the foreseeable future.

Note 21. Reconciliation of changes in equity

	Share capital £'000	Share premium £'000	Other reserves (note 23) £'000	Shares to be issued (note 26) £'000	Retained earnings £'000	Total £'000	Minority interest £'000	Total equity £'000
At 1 January 2006	64,744	123,019	60,589	-	140,667	389,019	-	389,019
Total recognised income and expense for the year	-	-	13,179	-	157,438	170,617	-	170,617
Purchase of treasury shares	-	-	(3,977)	-	-	(3,977)	-	(3,977)
Shares to be issued in respect of Hardman acquisition	-	-	-	235,621	-	235,621	-	235,621
New shares issued in respect of employee share options	446	3,056	-	-	-	3,502	-	3,502
Share based payments charges	-	-	-	-	4,186	4,186	-	4,186
Dividends paid (note 7)	-	-	-	-	(32,492)	(32,492)	-	(32,492)
At 1 January 2007	65,190	126,075	69,791	235,621	269,799	766,476	-	766,476
Total recognised income and expense for the year	-	-	(85,101)	-	50,887	(34,214)	1,707	(32,507)
Acquisition	-	-	-	-	-	-	13,780	13,780
Purchase of treasury shares	-	-	(3,722)	-	-	(3,722)	-	(3,722)
Shares to be issued in respect of Hardman acquisition (note 26)	6,500	-	229,121	(235,621)	-	-	-	-
New shares issued in respect of employee share options	271	2,390	-	-	-	2,661	-	2,661
Share based payments charges	-	-	-	-	5,388	5,388	-	5,388
Dividends paid (note 7)	-	-	-	-	(39,406)	(39,406)	-	(39,406)
At 31 December 2007	71,961	128,465	210,089	-	286,668	697,183	15,487	712,670

Note 22. Called up equity share capital and share premium account

	2007 £'000		2006 £'000
(a) Authorised			
1,000,000,000 Ordinary shares of Stg10p each	100,000		100,000
(b) Allotted equity share capital and share premium			
	Equity share capital allotted and fully paid Number	£'000	Share premium £'000
Ordinary shares of Stg10p each			
At 1 January 2006	647,437,723	64,744	123,019
Issues during the year			
- Exercise of share options	4,462,575	446	3,056
At 1 January 2007	651,900,298	65,190	126,075
Issues during the year			
- Exercise of share options	2,711,407	271	2,390
- Hardman acquisition	64,998,817	6,500	-
At 31 December 2007	719,610,522	71,961	128,465

Notes to the Group financial statements
continued

Note 23. Other reserves

	Merger reserve £'000	Foreign currency translation reserve £'000	Hedge reserve £'000	Treasury shares £'000	Total £'000
At 1 January 2006	178,953	2,085	(120,449)	–	60,589
Hedge movement	–	–	68,236	–	68,236
Currency translation adjustment	–	(55,057)	–	–	(55,057)
Purchase of treasury shares	–	–	–	(3,977)	(3,977)
At 1 January 2007	178,953	(52,972)	(52,213)	(3,977)	69,791
Hedge movement (note 17)	–	–	(79,780)	–	(79,780)
Currency translation adjustment	–	(5,321)	–	–	(5,321)
Purchase of treasury shares	–	–	–	(3,722)	(3,722)
Merger reserve movement	229,121	–	–	–	229,121
At 31 December 2007	408,074	(58,293)	(131,993)	(7,699)	210,089

During the year the Group issued 64,998,817 ordinary shares relating to the acquisition of Hardman Resources. In accordance with the merger provisions of Section 131 of the Companies Act 1985, the Group has transferred the premium on the shares issued of £229.1 million, using the market value at the date of acquisition, to the Merger reserve.

The treasury shares reserve represents the cost of shares in Tullow Oil plc purchased in the market and held by the Tullow Oil Employee Trust to satisfy options held under the Group's share incentive plans (see note 27).

Note 24. Minority interest

	2007 £'000	2006 £'000
At 1 January	–	–
Additions	13,780	–
Share of profit for the year	1,707	–
At 31 December	15,487	–

The minority interest relates to Tulipe Oil SA, where the Group has acquired a 50% controlling shareholding during the year.

Note 25. Cashflows from operating activities

	2007 £'000	2006 £'000
Profit before taxation	114,203	263,332
Adjustments for:		
Depletion, depreciation and amortisation	205,805	146,581
Impairment loss	13,834	–
Net foreign exchange losses	–	840
Exploration costs written off	64,235	32,494
Disposal of subsidiaries	597	–
Decommissioning expenditure	(5,065)	–
Share based payment charge	5,388	4,186
Loss/(gain) on hedging instruments	29,267	(15,701)
Finance revenue	(3,095)	(2,451)
Finance costs	48,673	17,415
Operating cashflow before working capital movements	473,842	446,696
(Increase)/decrease in trade and other receivables	(20,472)	509
Increase in inventories	(11,162)	(4,729)
Increase/(decrease) in trade payables	4,452	(38,412)
Cash generated from operations	446,660	404,064

Note 26. Acquisition of subsidiaries

The Group acquired Hardman Resources Limited with effect from 20 December 2006, and completed the acquisition on 10 January 2007. The fair values of the identifiable assets and liabilities have been reassessed during the current year, to reflect additional information which has become available concerning conditions that existed at the date of acquisition, in accordance with the provisions of IFRS 3 – Business Combinations. The resulting changes are set out in the following table:

	Fair value as previously reported £'000	2007 fair value adjustment £'000	Fair value as restated £'000
Intangible exploration and evaluation assets	623,542	48,959	672,501
Property, plant and equipment	86,931	(39,489)	47,442
Inventories	3,866	–	3,866
Other current assets	10,790	–	10,790
Cash and cash equivalents	46,540	–	46,540
Trade and other payables	(11,480)	–	(11,480)
Derivative financial instruments	(1,147)	–	(1,147)
Deferred tax liabilities	(158,842)	(9,020)	(167,862)
Provisions	(5,463)	–	(5,463)
Total cost of acquisition	594,737	450	595,187
Satisfied by:			
Cash			359,566
Shares issued			235,621
			595,187

The principal fair value adjustments are in respect of property, plant and equipment, where Chinguetti commercial reserves have been downgraded by 50%, intangible exploration and evaluation assets where additional fair value has been ascribed to the African and South American assets, and the deferred tax effect of these adjustments.

Due to the inherently uncertain nature of the oil and gas industry and intangible exploration evaluation assets in particular, the assumptions underlying the final assigned values are highly judgemental in nature. The purchase consideration equals the aggregate of the fair value of the identifiable assets and liabilities of Hardman, and therefore no goodwill has been recorded on the acquisition. Deferred tax has been recognised in respect of the fair value adjustments as applicable.

Notes to the Group financial statements
continued**Note 27. Share based payments****2005 Performance Share Plan (PSP)**

Under the PSP, senior executives can receive conditional awards of rights over whole shares worth up to 150% of salary p.a. (200% in exceptional circumstances). Awards vest under the PSP subject to a Total Shareholder Return (TSR) based performance condition under which the Company's TSR performance is measured over a fixed three-year period against both the constituents of the FTSE 250 index (excluding investment trusts) (the 'Index') and a comparator group of oil and gas companies. Half of an award is tested against the Index and the other half against the comparator group. The test is over a three year period starting on 1 January prior to grant, and an individual must normally remain in employment for three-years from the date of grant for the shares to vest. No dividends are paid to participants over the vesting period. Further details in relation to the PSP award measurements are provided in the Directors' Remuneration Report.

The shares outstanding under the PSP are as follows:

	2007 PSP shares	2007 Average weighted share price at grant p	2006 PSP shares	2006 Average weighted share price at grant p
Outstanding at 1 January	2,903,082	251.66	1,784,417	187.50
Granted	1,548,392	371.24	1,118,665	354.01
Outstanding at 31 December	4,451,474	293.25	2,903,082	251.66
The inputs of the option valuation model were:				
Risk free interest rate		5.3% pa		4.5%-4.7% pa
Expected volatility		33%		32%
Dividend yield		1.5% pa		1.0-1.1% pa

The expected life is the period from the date of grant to the vesting date. Expected volatility was determined by calculating the historical volatility of the Company's share price over a period commensurate with the expected lifetime of the awards. The weighted average fair value of the awards granted in 2007 was 181.57p per award (2006: 264.96p).

The Group recognised a total expense of £2,233,000 (2006: £1,392,000) in respect of the PSP.

2005 Deferred Share Bonus Plan (DSBP)

Under the DSBP, the portion of any annual bonus entitlement above 60% of the base salary of a senior executive nominated by the Remuneration Committee is required to be deferred into shares. Shares awarded under the DSBP will normally vest following the end of the period of three financial years commencing with that in which the award is granted.

The shares outstanding under the DSBP are as follows:

	2007 DSBP shares	2007 Share price at grant	2006 DSBP shares	2006 Share price at grant
Outstanding at 1 January	79,787	348.5p	-	-
Granted	104,467	396.0p	79,787	384.5p
Outstanding at 31 December	184,254	375.4p	79,787	348.5p
The inputs of the option valuation model were:				
Dividend Yield		1.3% pa		1.1% pa

The expected life is the period from the date of grant to the vesting date. The fair value of the awards granted in 2007 was 381.23p per award (2006: 337.2p).

The Group recognised a total expense of £226,000 (2006: £74,000) in respect of the DSBP.

2000 Executive Share Option Scheme (ESOS)

The only share option scheme operated by the Company during the year was the 2000 ESOS. Options granted under the 2000 ESOS normally only become exercisable following the third anniversary of the date of the grant if the performance condition has been met. The awards are tested against the Index and 100% of awards will vest if the Company's TSR is above the median of the Index over the three-year period following grant. Options awarded under the 2000 ESOS before 24 May 2005 are subject to monthly re-testing on a rolling three-year basis if the TSR performance criterion is not met. Options granted on or after 24 May 2005 are not subject to monthly re-testing.

Options have previously been granted under the 1988 ESOS and the 1998 ESOS. Options granted under the 1988 ESOS and the 1998 ESOS are not subject to performance conditions. All awards under the 1988 ESOS and the 1998 ESOS were made prior to 7 November 2002 and therefore, under the IFRS transitional provisions, they have not been accounted for in accordance with IFRS 2 – Share Based Payments.

The following table illustrates the number and weighted average exercise prices (WAEP) of, and movements in, share options under the 1988 ESOS, the 1998 ESOS and the 2000 ESOS during the year.

	2007 Number	2007 WAEP p	2006 Number	2006 WAEP p
Outstanding as at 1 January	19,637,480	129.39	21,989,560	96.65
Granted during the year	2,358,408	396.46	2,311,045	346.02
Exercised during the year	(2,711,407)	98.31	(4,462,575)	78.54
Expired during the year	(67,797)	317.85	(200,550)	164.35
Outstanding at 31 December	19,216,684	166.04	19,637,480	129.39
Exercisable at 31 December	11,410,205	83.83	10,694,335	73.86

The weighted average share price at exercise for options exercised in 2007 was 439.32p (2006: 78.54p).

Options outstanding at 31 December 2007 had exercise prices of 57.3p to 539.5p and remaining contractual lives of 1 to 10 years.

The principal inputs to the options valuation model were:

Risk free interest rate	5.2-5.3% pa
Expected volatility	33-35%
Dividend yield	1.0-1.5% pa
Employee turnover	From 0% – 10% pa depending on seniority
Early exercise	At rates dependent upon seniority and potential gain from exercise

Expected volatility was determined by calculating the historical volatility of the Company's share price over a period commensurate with the expected lifetime of the awards.

The fair values and expected lives of the options valued in accordance with IFRS 2 were:

Award date	Weighted average exercise price p	Weighted average fair value p	Weighted average expected life from grant date years
Jan – Dec 2005	169.3	53.0	4.8
Jan – Dec 2006	347.7	109.7	4.4
Jan – Dec 2007	396.9	123.4	4.8

The Group recognised a total expense of £2,794,000 (2006: £2,658,000) in respect of the ESOS.

UK & Irish Share Incentive Plans (SIPs)

The SIPs were launched at the beginning of 2004. These are all employee plans, which have been set up in both the UK and Ireland, that enable employees to make contributions out of salary up to prescribed limits each month, which are used by the Plan trustees to acquire Tullow shares ('Partnership Shares'). The Company makes a matching contribution to the trustees to acquire a matching number of Tullow shares ('Matching Shares') on a one-for-one basis. The SIPs have a three month accumulation period.

The fair value of a Matching Share is the market value at grant adjusted for any options included. For this purpose, the grant date is the start of the accumulation period.

For the UK plan, Partnership Shares are purchased at the lower of the market values at the start of the Accumulation Period and the purchase date. For the Irish plan, shares are bought at the market price at the purchase date.

Matching shares vest three years after grant and dividends are paid to the employee during this period.

The Group recognised a total expense of £126,000 (2006: £55,000) for the matching shares and £9,000 (2006: £7,000) for the partnership shares.

Notes to the Group financial statements

continued

Note 28. Operating lease arrangements

	2007 £'000	2006 £'000
Minimum lease payments under operating leases recognised in income for the year	4,798	1,852

At the Balance Sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows:

	2007 £'000	2006 £'000
Minimum lease payments under operating leases		
Due within one year	5,098	7,087
After one year but within two years	5,229	7,011
After two years but within five years	15,522	20,503
Due after five years	3,236	12,362
	29,085	46,963

Operating lease payments represent rentals payable by the Group for certain of its office properties and a lease for an FPSO vessel for use on the Chinguetti field in Mauritania. Leases on office properties are negotiated for an average of six years and rentals are fixed for an average of six years. The FPSO lease runs for a minimum period of seven years from February 2006 and the contract provides for an option to extend the lease for a further three years at a slightly reduced rate.

Note 29. Capital commitments

The Directors have committed to a budget for capital expenditure for exploration and development of £445.6 million (2006: £362.7 million).

Note 30. Contingent liabilities

At 31 December 2007 there existed contingent liabilities amounting to £14.1 million (2006: £4.7 million) in respect of performance guarantees for committed work programmes.

Note 31. Related party transactions

Transactions with the Directors of Tullow Oil plc are disclosed in the Remuneration Report on pages 57 to 66. Directors are considered to be the only key management personnel as defined by IAS 24 – Related Party Disclosures.

There are no other related party transactions.

Note 32. Subsequent events

Since the Balance Sheet date Tullow has continued to progress its exploration, development and business growth strategies.

In January 2008 the Group announced the sale of its 11% interest in the M'Boundi field for a total cash consideration of US\$435 million (£218 million). The transaction is expected to complete in 2008.

Note 33. Pension schemes

The Group operates defined contribution pension schemes for staff and Executive Directors. The contributions are payable to external funds which are administered by independent trustees. Contributions during the year amounted to £1,440,000 (2006: £1,111,000). At 31 December 2007, there was a liability of £51,000 (2006: £67,000) for contributions payable included in creditors.