TIDELANDS OIL & GAS CORP/WA
Form 10KSB/A
June 16, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-KSB/A
Amendment No. 1

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the year ended December 31, 2005
Commission File Number 0-29613

TIDELANDS OIL & GAS CORPORATION
(Name of small business issuer in its charter)

Nevada	66-0549380
(State or other jurisdiction of incorporation or organization)	(I. R. S. Employer Identification No.)

1862 West Bitters Rd., San Antonio, TX 78248
(Address of principal executive office)

(210) 764-8642
(Issuer's Telephone Number)

Securities Registered Pursuant of Section 12(b) of the Act: None

Securities Registered Pursuant of Section 12(g) of the Act:
Common Stock, $0.001 Par Value

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment of this Form 10-KSB. [ ]

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2of the Exchange Act. Yes ___ No X___

The issuer had operating revenues of $1,725,756 for the year ended December 31, 2005.

This report contains a total of 31 pages. The Exhibit Index appears on page 33.

As of June 15, 2006, there were 80,525,815 shares of the issuer's common stock outstanding.

The aggregate market value of the issuer's voting stock held by non-affiliates was $58,827,842 based on the low bid price on that date as reported by the NASD

OTC Electronic Bulletin Board April 14, 2006. The sum excludes the shares held by officers, directors, and stockholders whose ownership exceeded 10% of the outstanding shares at December 31, 2005, in that such persons may be deemed affiliates of the Company. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

EXPLANATORY NOTE:

We have amended our Annual Report on Form 10-KSB for the year ended December 31, 2005, filed on April 17, 2006. This amendment replaces the Company's "Report of Independent Registered Public Accounting Firm" (the Audit Report) contained in the original filing with a revised Audit Report. The revised Audit Report includes disclosure in the Notes to the Financial Statements regarding the Company's revenue recognition policy as well as separately disclosing impairment charges associated with long-lived assets and goodwill. Additionally, we have revised Item 12 titled, "Certain Relationships and Related Transactions" correcting stock issuance dates.

TIDELANDS OIL & GAS CORPORATION
FORM 10-KSB/A

December 31, 2005

Page

ITEM 7. FINANCIAL STATEMENTS

TIDELANDS OIL & GAS CORPORATION
CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 2005 AND 2004

TABLE OF CONTENTS

BAUM & COMPANY, P.A.
1515 UNIVERSITY DRIVE, SUITE 209
CORAL SPRINGS, FLORIDA 33071

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors
Tidelands Oil & Gas Corporation
San Antonio, Texas

We have audited the accompanying consolidated balance sheets of Tidelands Oil & Gas Corporation as of December 31, 2005 and 2004, and the related statements of consolidated stockholders' equity, operations, and cash flows for the years ended December 31, 2005 and 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Tidelands Oil & Gas Corporation as of December 31, 2005 and 2004, and the results of their consolidated operations and their consolidated cash flows for the years ended December 31, 2005 and 2004 in conformity with accounting principles generally accepted in the United States of America.

As more fully described in Note 2 to the financial statements, the accompanying consolidated balance sheets and related statements of consolidated shareholders' equity, operations and cash flows have been restated to reflect the proper accounting for certain transactions which occurred during the year ended December 31, 2004. In our original report dated April 13, 2005, we expressed an unqualified opinion on the consolidated financial statements, and our opinion on the revised statements, as expressed herein, remains unqualified.

Baum & Company, P.A.
Coral Springs, Florida
April 14, 2006

TIDELANDS OIL & GAS CORPORATION
CONSOLIDATED BALANCE SHEETS
YEARS ENDED

ASSETS

	December 31, 2005	December 31, 2004 (Restated)
Current Assets:		
Cash	$ 1,113,911	$ 5,459,054
Accounts and Loans Receivable	468,458	516,387
Inventory	142,204	82,523
Prepaid Expenses	183,938	487,488
Total Current Assets	1,908,511	6,545,452

Property Plant and Equipment, Net	10,042,088	9,086,313
Other Assets:		
Deposits	14,004	4,108
Cash Restricted	76,803	25,000
Deferred Charges	0	116,250
Note Receivable	288,506	286,606
Goodwill	1,158,937	6,358,937
Total Other Assets	1,538,250	6,790,901
Total Assets	$ 13,488,849	$ 22,422,666

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:		
Current Maturities - Note Payable	$ 225,000	$ 0
Accounts Payable and Accrued Expenses	1,225,554	574,224
Total Current Liabilities	1,450,554	574,224
Long-Term Debt	4,271,768	11,731,883
Total Liabilities	5,722,322	12,306,107
Commitments and Contingencies		
Derivative Liability	0	5,168,000
Stockholders' Equity:		
Common Stock, $.001 Par Value per Share, 100,000,000 Shares Authorized, 78,495,815 and 61,603,359 Shares Issued and Outstanding at 2005 and 2004 Respectively	78,497	61,604
Additional Paid-in Capital	40,818,174	30,354,195
Subscriptions Receivable	(550,000)	(550,000)
Minority Interest	--	--
Accumulated (Deficit)	(32,580,144)	(24,917,240)
Total Stockholders' Equity	7,766,527	4,948,559
Total Liabilities and Stockholders' Equity	$ 13,488,849	$ 22,422,666

See Accompanying Notes to Consolidated Financial Statements

TIDELANDS OIL AND GAS CORPORATION
STATEMENTS OF CONSOLIDATED STOCKHOLDERS' EQUITY
YEARS ENDED DECEMBER 31, 2005 AND 2004 (RESTATED)

	Common Shares	Stock Amount	Stock Additional Paid-In Capital	Subscription Receivable	Acc (D
Balance December 1, 2003	44,825,302	$ 44,826	$ 11,072,987	$ (18,000)	$(10
Common Stock Issued for Cash	6,725,545	6,725	6,081,592	--	
Common Stock Issued for Services Regarding $4,083,335 Sale of Stock	300,000	300	449,700	--	
Fee for Services Regarding Sale of Common Stock	--	--	(450,000)	--	
Issuance of Common Stock for Services	6,602,800	6,603	9,321,213	--	
Issuance of Common Stock for Subscription	2,500,000	2,500	547,500	(550,000)	
Issuance of Common Stock for Conversion of Note Payable and Accrued Interest	75,000	75	113,236	--	
Beneficial Conversion Feature - Convertible Debentures	--	--	3,092,105	--	
Write Off Stock Subscription Receivable	--	--	--	18,000	
Issuance of Common Stock to Acquire 50% of Sonterra Energy Corp.	574,712	575	125,862	--	
Net Loss	--	--	--	--	(14
Balance December 31, 2004	61,603,359	$ 61,604	$ 30,354,195	$ (550,000)	$(24
Issuance of Common Stock for Services	2,970,000	2,971	4,019,554	--	
Issuance of Common Stock for Conversion of Convertible Debentures	6,707,456	6,707	4,993,293	--	

Beneficial Conversion Feature -Convertible Debentures	--	--	(756,328)	--	
Cancellation of Stock Previously Issued for Services per Litigation Settlement	(285,000)	(285)	(297,540)	--	
Exercise of Stock Purchase Warrants	7,500,000	7,500	2,505,000	--	
Net Loss	--	--	--	--	(7
Balance December 31, 2005	78,495,815	$ 78,497	$ 40,818,174	$ (550,000)	$(32

See Accompanying Notes to Consolidated Financial Statements

TIDELANDS OIL & GAS CORPORATION
STATEMENTS OF CONSOLIDATED OPERATIONS
YEARS ENDED

	December 31, 2005 (Restated)	December 31, 2004 (Restated)
Revenues:		
Gas Sales and Pipeline Fees	$ 1,725,756	$ 1,800,863
Construction Service	135,567	82,975
Other	0	0
Total Revenues	1,861,323	1,883,838
Expenses:		
Cost of Sales	1,003,386	1,508,891
Operating Expenses	202,766	99,665
Depreciation	485,481	244,889
Interest	611,363	300,566
Beneficial Conversion Feature Interest	(756,329)	3,092,105
Sales, General and Administrative	8,033,249	11,022,019
Impairment Losses - Long-Lived Assets	392,000	0
Impairment Losses - Goodwill	5,200,000	15,358,000
Total Expenses	15,171,916	31,626,135
(Loss) from Operations	(13,310,593)	(29,742,297)
Gain on Reduction of Derivative Liability	5,168,000	15,390,000

Loss on Equipment Sale	(3,167)	0
Other Income	61,956	0
Interest and Dividend Income	123,075	50,260
Minority Interest	--	--
Litigation Settlement	297,825	0
Net (Loss)	$ (7,662,904)	$(14,302,037)
Net (Loss) Per Common Share:		
Basic and Diluted	$ (0.11)	$ (0.27)
Weighted Average Number of Common Shares Outstanding - Basic and Diluted	70,049,587	53,214,230

See Accompanying Notes to Consolidated Financial Statements

TIDELANDS OIL & GAS CORPORATION
STATEMENTS OF CONSOLIDATED CASH FLOWS
YEARS ENDED

	December 31, 2005	December 31, 2004 (Restated)
Cash Flows Provided (Required) By Operating Activities:		
Net (Loss)	$ (7,662,904)	$(14,302,037)
Adjustments to Reconcile Net (Loss) To Net Cash Provided (Required) By Operating Activities:		
Depreciation	485,481	244,889
Goodwill	0	(5,200,000)
Impairment Losses	5,592,000	15,358,000
Change in Derivative Instrument	(5,168,000)	(10,222,000)
Loss on Disposal of Equipment	3,167	0
Issuance of Common Stock:		
For Services Provided	4,022,525	9,327,816
Beneficial Conversion Feature - Interest	(756,329)	3,092,105
Return of Issued Stock		
Litigation Settlement	(297,825)	0
Changes In:		
Accounts Receivable	47,929	(516,159)
Inventory	(59,681)	(82,523)
Prepaid Expenses	303,550	(465,279)
Deferred Charges	116,250	(116,250)

Deposits	(61,699)	(25,308)
Accounts Payable and Accrued Expenses	651,330	(201,370)
Net Cash (Required) By Operating Activities	(2,784,206)	(3,108,116)
Cash Flows Provided (Required) By Investing Activities:		
(Increase) In Investments	0	(901,871)
Acquisitions of Property, Plant & Equipment	(1,837,222)	(8,727,010)
Disposals of Equipment	800	0
Net Cash (Required) By Investing Activities	(1,836,422)	(9,628,881)

See Accompanying Notes to Consolidated Financial Statements

TIDELANDS OIL & GAS CORPORATION
STATEMENTS OF CONSOLIDATED CASH FLOWS
(CONTINUED)
YEARS ENDED

	December 31, 2005	December 31, 2004 (Restated)
Cash Flows Provided (Required) By Financing Activities:		
Proceeds from Issuance of Common Stock	0	6,088,317
Proceeds from Long-Term Loans	277,385	6,731,883
Proceeds from Issuance Of Convertible Debentures	0	5,000,000
Repayment of Short-Term Loans	0	(250,000)
Reduction of Stock Subscription Receivable	0	18,000
Loan to Related Party	(1,900)	(286,606)
Net Cash Provided By Financing Activities	275,485	17,301,594
Net Increase (Decrease) in Cash	(4,345,143)	4,564,597
Cash at Beginning of Period	5,459,054	894,457
Cash at End of Period	$ 1,113,911	$ 5,459,054
Supplemental Disclosures of Cash Flow Information:		
Cash Payments for Interest	$ 356,504	$ 38,320

Cash Payments For Income Taxes	$ 0	$ 0
Non-Cash Financing Activities:		
Return of Issued Stock For		
Beneficial Conversion Feature - Interest	$ (756,329)	$ 3,092,105
Litigation Settlements	(297,825)	0
Increase of Stock Subscription Receivable	--	550,000
Issuance of Common Stock:	0	0
Operating Activities	4,022,525	9,327,816
Repayment of Notes	2,512,500	75,000
Conversion of Debentures	5,000,000	0
Payment of Accounts Payable	0	38,311
Acquisition Cost	0	126,437
Total Non-Cash Financing Activities	$ 10,480,871	$ 13,209,669

See Accompanying Notes to Consolidated Financial Statements

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

This summary of significant accounting policies is presented to assist in understanding these consolidated financial statements. The consolidated financial statements and notes are representations of management who is responsible for their integrity and objectivity. The accounting policies used conform to accounting principles generally accepted in the United States of America and have been consistently applied in the preparation of these consolidated financial statements.

Organization

Tidelands Oil and Gas Corporation (the Company and formerly C2 Technologies, Inc.), was incorporated in the state of Nevada on February 25, 1997. On December 1, 2000, the Company completed its acquisition of Rio Bravo Energy, LLC, and their related entities thereby making Rio Bravo Energy, LLC, a wholly-owned subsidiary of the Company. During 2004, the Company acquired all of the stock of Sonterra Energy Corporation (Sonterra) and through this wholly-owned subsidiary, the Company purchased all of the assets of a gas distribution organization (see Note 15-Acquisitions). The Company also, during 2004, increased its ownership interest from 25% to 98% in Reef Ventures, LP, and their wholly-owned subsidiaries (Reef International, LLC and Reef Marketing, LLC) (see Note 15-Acquisitions).

Nature of Operations

The Company currently operates a natural gas pipeline between Eagle Pass, Texas and Piedras Negras, Mexico and a propane distribution system serving residential customers in the Austin, Texas area. In addition, the company is engaged in the development of natural gas storage facilities in Mexico and other natural gas pipelines between the United States and Mexico.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company accounts and transactions have been eliminated.

Fair Value of Financial Instruments

Statement of Financial Accounting Standards No. 107 "Disclosure About Fair Value of Financial Instruments," requires the disclosure of the fair value of off-and-on balance sheet financial instruments. Unless otherwise indicated, the fair values of all reported consolidated assets and consolidated liabilities, which represent financial instruments (none of which are held for trading purposes), approximate the carrying values of such amounts.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Use of Estimates

The preparation of consolidated financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Property, Plant and Equipment

Property, plant and equipment are recorded at historical cost. Depreciation of property, plant and equipment is provided on the straight-line method over the estimated useful lives of the related assets. Maintenance and repairs are charged to operations. Additions and betterments, which extend the useful lives of the assets, are capitalized. Upon retirement or disposal of the property, plant and equipment, the cost and accumulated depreciation are eliminated from the accounts, and the resulting gain or loss is reflected in operations.

Long-Lived Assets

Statement of Financial Accounting Standards 144 (SFAS 144) "Accounting for the Impairment or Disposal of Long-Lived Assets" requires that long-lived assets to be held and used by the Company be reviewed for impairment whenever events or changes in circumstances indicate that the related carrying amount may not be recoverable. When required, impairment losses on assets to be held and used are recognized based on the fair value of the asset, and long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less cost to sell.

The requirements of SFAS 144 and the evaluation by the Company resulted in impairment losses of $392,000, all of which is attributable to the Rio Bravo Energy, LLC, Consolidated Group.

Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards 109 (SFAS 109) "Accounting for Income Taxes," which requires the establishment of a deferred tax asset or liability for the recognition of future deductions of taxable amounts and operating loss carry forwards, deferred tax expense or benefit is recognized as a result of the change in the deferred asset or liability during the year. If necessary, the Company will establish a valuation allowance to reduce any deferred tax asset to an amount which will, more likely than not, be realized.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Net (Loss) Per Common Share

The Company accounts for net (loss) per share in accordance with Statement of Financial Accounting Standard 128 (SFAS 128) "Earnings Per Share". Basic (loss) per share is based upon the net (loss) applicable to the weighted average number of common shares outstanding during the period. Diluted (loss) per share reflects the effect of the assumed conversions of convertible securities and exercise of stock options only in the periods in which such affect would have been dilutive.

Goodwill

Goodwill represents the excess of purchase price and related costs over the value assigned to the net tangible and identifiable assets of businesses acquired. Statement of Financial Accounting Standards No. 142 (SFAS 142), "Goodwill and Other Intangible Assets" requires goodwill to be tested for impairment on an annual basis and between annual tests in certain circumstances, and written down when impaired, rather than being amortized as previous accounting standards required. Furthermore, SFAS 142 requires purchased intangible assets other than goodwill to be amortized over their useful lives unless these lives are determined to be indefinite. As the result of an acquisition during the second quarter of 2004, the Company recorded goodwill in the amount of $20,561,800. The Company evaluates the carrying value of goodwill on a quarterly basis. As part of the evaluation, the company compares the carrying value of the intangible asset with its fair value to determine whether there has been impairment. As a result of management's impairment review of goodwill during 2004 and 2005, the Company recognized impairment losses of $15,358,000 and $5,200,000 in 2004 and 2005 respectively.

Revenue Recognition

The Company's revenues for 2005 were derived principally (80%) from the sale of propane gas to residential customers, as well as charges generated from transportation fees (13%). During 2004, the Company's main source of revenue (71%) was derived from the sale of natural gas to commercial accounts, as well as the sale of propane gas to residential customers (21%) and the charging of transportation fees (4%). Additional revenues, 7% and 4% in 2005 and 2004 respectively, were the result of construction services performed in the various subdivisions which were the recipients of the propane gas hook-ups.

Revenues are recognized at the time of monthly billings based on meter readings provided by independent contractors.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

New Accounting Standards

In June 2001, Statement of Financial Accounting Standards 143, "Accounting for Asset Retirement Obligations", (SFAS 143) was issued and is effective for fiscal years beginning after June 15, 2002. SFAS 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The adoption of SFAS 143 does not have a material effect on our consolidated financial statements.

In July 2002, Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities", (SFAS 146) was issued and is effective for periods beginning after December 31, 2002. SFAS 146 requires, among other things, that costs associated with an exit activity (including restructuring and employee and contract termination costs) or with a disposal of long-lived assets be recognized when the liability has been incurred and can be measured at fair value. Companies must record in earnings from continuing operations costs associated with an exit or disposal activity that does not involve a discontinued operation. Costs associated with an activity that involves a discontinued operation would be included in the results of discontinued operations. The implementation of the provisions of SFAS No. 146 does not have a material effect on the consolidated financial statements.

In December 2002, Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation", (SFAS No. 148) was issued and is effective for fiscal years beginning after December 15, 2002. SFAS No. 148 amends the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation", (SFAS No. 123) to require prominent disclosures in both interim and annual financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. SFAS No. 148 also amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. The Company had decided not to voluntarily adopt the SFAS No. 123 fair value method of accounting for stock-based employee compensation. Therefore, the new transition alternatives allowed in SFAS No. 148 will not affect the consolidated financial statements.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

New Accounting Standards (Continued)

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 On Derivative Instruments And Hedging Activities". SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. SFAS No. 149 is generally effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. In May 2003, the FASB issued SFAS No. 150, "Accounting For Certain Financial Instruments With Characteristics Of Both Liabilities And Equity". SFAS No. 150 improves the accounting for certain financial instruments that previously might have been accounted for as equity. SFAS No. 150 required that those instruments be classified as liabilities in statements of financial position. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003. The Company adopted both SFAS 149 and SFAS 150 in 2003. The adoption of these standards have resulted in beneficial conversion feature charges (credits) of $3,092,105 and ($756,329) in 2004 and 2005 respectively.

NOTE 2 - SUMMARY OF RESTATED CONSOLIDATED FINANCIAL STATEMENTS

During the fourth quarter of 2005, management reevaluated its accounting treatment for several complex transactions which occurred during the year ended December 31, 2004. After considerable review and outside consultation, management determined that their interpretation of the accounting guidelines for these involved issues was not correct and thereby their recording of the initial transaction needed to be restated. Accordingly, management has chosen to restate in this note the consolidated financial statements for the year ended December 31, 2004, as well as the interim reports for the quarters ended March 31, June 30, and September 30, 2005. Following are the transactions which precipitated the restatements:

(A) Goodwill associated with the acquisition of Reef Ventures, LP, (May 2004), and the related derivative liability for warrants issued as part of the purchase price. Management, after their review of EITF 00-19 "Accounting For Derivative Financial Instruments Indexed To, and Potentially Settled In, A Company's Own Stock", has concluded that it is necessary to account for goodwill and the related derivative liability associated with the May 2004 acquisition (see Note 15). At December 31, 2004, the net effect of this adjustment results in an increase in goodwill of $5,200,000, an increase in the derivative liability of $5,168,000, a gain on reduction of the derivative liability of $15,390,000 and a goodwill impairment loss of $15,358,000.

NOTE 2 - SUMMARY OF RESTATED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

(B) Issuance of convertible debentures with freestanding warrants and embedded beneficial conversion features. Management, after reviewing SFAS 133 and EITF 00-19, has determined that the convertible debentures issued in November, 2004, contain an embedded beneficial conversion feature. Accordingly, at December 31, 2004, this charge to the statement of operations amounted to $3,092,105.

(C) Valuation of stock issued for services and financing costs. Management reviewed all stock issued for services and financing costs in 2004, and in accordance with the provisions outlined in EITF 96-18 and SFAS 123, management increased the charges associated with these stock issuances by $4,724,750 at December 31, 2004.

All of the transactions referred to above relate to non-cash charges and do not affect the Company's revenues, cash flows from operations or liquidity.

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004

NOTE 2 - SUMMARY OF RESTATED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

SUMMARY OF RESTATED FINANCIAL STATEMENTS
DECEMBER 31, 2004

	Previously Reported		Restatement Adjustment	Restated Total
Consolidated Balance Sheets:				
Total Assets	$ 17,222,666	(1)	$ 5,200,000	$ 22,422,666
Total Liabilities	12,306,107	(2)	5,168,000	17,474,107
Stockholders' Equity	$ 4,916,559		$ 32,000	$ 4,948,559
Consolidated Results of Operations:				
Revenues	1,883,838		0	1,883,838
Expenses	8,451,280	(3,4)	23,174,855	31,626,135
Net (Loss) from Operations	(6,567,442)		(23,174,855)	(29,742,297)
Derivative Gain	0	(5)	15,390,000	15,390,000
Other Income	50,260		0	50,260
Net (Loss)	$ (6,517,182)		$ (7,784,855)	$(14,302,037)

Net (Loss) per Common Share:		
Basic and Diluted	$ (0.12)	$ (0.27)
Weighted Average Number of Common Shares Outstanding:		
Basic and Diluted	53,214,230	53,214,230

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004

NOTE 2 - SUMMARY OF RESTATED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

SUMMARY OF RESTATED INTERIM REPORTS - 2005

	MARCH 31, 2005			JUNE 30, 2005	
	Previously Reported	Restatement Adjustment	Restated Total	Previously Reported	Restatement Adjustment
ASSETS					
Current Assets:					
Cash and Cash Equivalents	$ 4,623,198	--	$ 4,623,198	$ 3,468,839	--
Accounts and Loans Receivable	404,488	--	404,488	309,323	--
Inventory	60,159	--	60,159	75,573	--
Prepaid Expenses	418,362	--	418,362	302,531	--
Total Current Assets	5,506,207	--	5,506,207	4,156,266	--
Property, Plant and Equipment, Net	9,245,326	--	9,245,326	9,630,591	--
Other Assets:					
Deposits	6,608	--	6,608	6,608	--
Deferred Charges	38,750	--	38,750	0	--
Restricted Cash	75,000	--	75,000	75,846	--
Note Receivable	287,170	--	287,170	286,114	--
Goodwill	1,158,937	(1) 5,200,000	6,358,937	1,158,937	--
Total Other Assets	1,566,465	5,200,000	6,766,465	1,527,505	--

Total Assets	$ 16,317,998	$ 5,200,000	$ 21,517,998	$ 15,314,362	$ 0
LIABILITIES AND STOCKHOLDERS' EQUITY					
Current Liabilities:					
Current Maturities of Note Payable	$ 225,000	$ --	$ 225,000	$ 112,500	$ --
Convertible Debenture Payable	5,000,000	--	5,000,000	2,480,000	--
Accounts Payable and Accrued Expenses	438,830	--	438,830	656,302	--
Derivative Liability	0	(2) 8,062,500	8,062,500	0	--
Total Current Liabilities	5,663,830	8,062,500	13,726,330	3,248,802	--
Long-Term Debt:					
Note Payable, less Current Maturities	6,592,301	--	6,592,301	4,255,990	--
Total Liabilities	12,256,131	8,062,500	20,318,631	7,504,792	--
Stockholders' Equity:					
Common Stock	62,364	62,364	74,281	74,281	77,157
Additional Paid-in Capital	22,918,580	13,151,198	36,069,778	28,655,789	9,531,144
Subscriptions Receivable	(550,000)	(550,000)	(550,000)	(550,000)	(550,000
Minority Interest	--	--	--	--	--
Accumulated Deficit	(18,369,077)	(16,013,698)	(34,382,775)	(20,370,500)	(9,531,144
Total Stockholders' Equity	4,061,867	(2,862,500)	1,199,367	7,809,570	--
Total Liabilities and Stockholders' Equity	$ 16,317,998	$ 5,200,000	$ 21,517,998	$ 15,314,362	$ 0

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004

NOTE 2 - SUMMARY OF RESTATED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

SUMMARY OF RESTATED INTERIM REPORTS - 2005

SEPTEMBER 30, 2005

	Previously Reported	Restatement Adjustment	Total
ASSETS			
Current Assets:			
Cash and Cash Equivalents	$ 2,336,430	--	$ 2,336,430
Accounts and Loans Receivable	208,668	--	208,668
Inventory	90,332	--	90,332
Prepaid Expenses	208,879	--	208,879
Total Current Assets	2,844,309	--	2,844,309
Property, Plant and Equipment, Net	10,097,779	--	10,097,779
Other Assets:			
Deposits	6,708	--	6,708
Deferred Charges	0	--	0
Restricted Cash	101,471	--	101,471
Note Receivable	284,944	--	284,944
Goodwill	1,158,937	--	1,158,937
Total Other Assets	1,552,060	--	1,552,060
Total Assets	$ 14,494,148	$ 0	$ 14,494,148
LIABILITIES AND STOCKHOLDERS' EQUITY			
Current Liabilities:			
Current Maturities of Note Payable	$ 168,750	$ --	$ 168,750
Convertible Debenture Payable	980,000	--	980,000
Accounts Payable and Accrued Expenses	642,457	--	642,457
Derivative Liability	0	--	0
Total Current Liabilities	1,791,207	--	1,791,207
Long-Term Debt:			
Note Payable, less Current Maturities	4,252,304	--	4,252,304
Total Liabilities	6,043,511	--	6,043,511
Stockholders' Equity:			
Common Stock			
Additional Paid-in Capital	30,369,493	9,682,940	40,052,433
Subscriptions Receivable			

Minority Interest Accumulated Deficit	(21,446,013)	(9,682,940)	(31,128,953
Total Stockholders' Equity	8,450,637	--	8,450,637
Total Liabilities and Stockholders' Equity	$ 14,494,148	$ 0	$ 14,494,148

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004

NOTE 2 - SUMMARY OF RESTATED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

SUMMARY OF RESTATED INTERIM REPORTS - 2005 (CONTINUED)

	Three Months Ended March 31, 2005			Six Months En	
	Previously Reported	Restatement	Restated Total	Previously Reported	Rest
Revenues:					
Gas Sales and Pipeline Fees	$ 586,949	$ --	$ 586,949	$ 849,490	$
Construction Services	41,126	--	41,126	119,121	
Total Revenues	628,075	--	628,075	968,611	
Expenses:					
Cost of Sales	284,679	--	284,679	415,248	
Operating Expenses	66,774	--	66,774	129,137	
Depreciation	115,441	--	115,441	236,395	
Interest	209,787	--	209,787	393,860	
Beneficial Conversion Feature Interest	0	(3) 4,736,843	4,736,843	0	(3)
Sales, General and Administrative	1,220,911	(4) 597,500	1,818,411	3,098,570	(4) 1,
Impairment Losses	0	0	0	0	(1) 5,
Total Expenses	1,897,592	5,334,343	7,231,935	4,273,210	6,
(Loss) from Operations	(1,269,517)	(5,334,343)	(6,603,860)	(3,304,599)	(6,
Derivative Gain (Loss)	--	(5) (2,894,500)	(2,894,500)	--	(5) 5,

Gain (Loss) on Equipment Sale	(3,167)	--	(3,167)	(3,167)	
Interest and Dividend Income	35,992	--	35,992	69,651	
Minority Interest	--	--	--	--	
Litigation Settlement	0	--	0	0	
Net (Loss)	$ (1,236,692)	$ (8,228,843)	$ (9,465,535)	$(3,238,11)	$ (1,
Net (Loss) Per Common Share, Basic and Diluted:	$ (0.02)	$ --	$ (0.15)	$ (0.05)	$
Weighted Average Number of Common Shares Outstanding: Basic and Diluted	61,893,359	--	61,893,359	67,941,251	

-18-

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004

NOTE 2 - SUMMARY OF RESTATED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

SUMMARY OF RESTATED INTERIM REPORTS - 2005 (CONTINUED)

	Nine Months Ended September 30, 2005			
	Previously Reported		Restatement	Total
Revenues:				
Gas Sales and Pipeline Fees	$ 1,097,505		$ --	$ 1,097,505
Construction Services	119,121		--	119,121
Total Revenues	1,216,626		--	1,216,626
Expenses:				
Cost of Sales	635,113		--	635,113
Operating Expenses	210,545		--	210,545
Depreciation	360,817		--	360,817
Interest	503,950		--	503,950
Beneficial Conversion Feature Interest	0	(3)	(501,659)	(501,659)
Sales, General and Administrative	4,022,271	(4)	2,556,200	6,578,471
Impairment Losses	0	(1)	5,200,000	5,200,000
Total Expenses	5,732,696		7,254,541	12,987,237

(Loss) from Operations	(4,516,070)	(7,254,541)	(11,770,611)
Derivative Gain (Loss)	--	(5) 5,168,000	5,168,000
Gain (Loss) on Equipment Sale	(3,167)	--	(3,167)
Interest and Dividend Income	96,240	--	96,240
Minority Interest			
Litigation Settlement	109,369	(4) 188,456	297,825
Net (Loss)	$ (4,313,62)	$ (1,898,085)	$ (6,211,713)
Net (Loss) Per Common Share, Basic and Diluted:	$ (0.06)	$ --	$ (0.09)
Weighted Average Number of Common Shares Outstanding: Basic and Diluted	69,378,850	--	69,378,850

(1) Adjust goodwill to period ending balances.

(2) Adjust to recognize fair value of derivative financial instruments as liabilities at December 31, 2004 ($5,168,000) and first quarter adjustment ($2,894,500) necessitated by marking to market the fair value of the derivative.

(3) Adjustments associated with the issuance of convertible debentures.

(4) Adjustments to recognize the fair value of services and related expenses paid for by the issuance of stock.

(5) Adjustments to recognize the gain / (loss) on changes in the derivative liability when the conversion price became variable.

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004

NOTE 3 - PREPAID EXPENSES

A summary of prepaid expenses at December 31, 2005 and December 31, 2004 is as follows:

	December 31, 2005	December 31, 2004

Prepaid Expenses-Other	$ 2,741	$ 4,802
Prepaid Insurance	88,340	82,318
Prepaid License Fee	84,270	79,500
Prepaid Financing	0	310,000
Prepaid Rent	7,500	8,301
Prepaid Interest	1,087	2,567
	$ 183,938	$ 487,488

NOTE 4 - PROPERTY, PLANT AND EQUIPMENT

A summary of property, plant and equipment at December 31, 2005 and December 31, 2004 is as follows:

	December 31, 2005	December 31, 2004	Estimated Economic Life
Pre-Construction Costs:			
International Crossings to Mexico	$ 540,880	$ 27,601	N/A
Mexican Gas Storage Facility and Related Pipelines	1,926,616	928,232	N/A
Domestic LNG System	18,319	0	
Propane Distribution Systems	0	207,415	N/A
Total	2,485,815	1,163,248	
Office Furniture, Equipment and Leasehold Improvements	174,412	46,141	5 Years
Pipelines - Domestic	0	431,560	15 Years
Pipeline - Eagle Pass, TX to Piedras Negras, Mexico	6,106,255	6,106,255	20 Years
Gas Processing Plant	0	186,410	15 Years
Tanks & Lines - Propane Distribution System	1,895,494	1,596,439	5 Years
Machinery and Equipment	66,493	57,180	5 Years
Trucks, Autos and Trailers	136,940	63,175	5 Years
Total	10,865,409	9,650,408	
Less: Accumulated Depreciation	823,321	564,095	
Net Property, Plant and Equipment	$ 10,042,088	$ 9,086,313	

Depreciation expense for the years ended December 31, 2005 and December 31, 2004 was $485,581 and $244,889 respectively.

NOTE 5 - RESTRICTED CASH

Restricted cash consists of certificates of deposit to secure letters of credit issued to the Railroad Commission of Texas.

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004

NOTE 6 - LONG-TERM DEBT

A summary of long-term debt at December 31, 2005 and December 31, 2004 is as follows:

	December 31, 2005	December 31, 2004
Note Payable, Secured, Interest Bearing at 2% Over Prime Rate, Maturing May 25, 2008	4,496,468	6,731,883
Convertible Debentures, Unsecured, 7% Interest Bearing, Maturing May 18, 2006	0	5,000,000
	4,496,468	11,731,883
Less: Current Maturities	225,000	0
Total Long-Term Debt	$ 4,271,468	$ 11,731,883

NOTE 7 - INCOME TAXES

The Company files a consolidated federal income tax return. At December 31, 2005, the Company had a net operating loss carry forward of approximately $24,200,000 available to offset future federal taxable income through 2025.

The components of the deferred tax assets and liabilities accounts at December 31, 2005 are as follows:

Total Deferred Tax Assets	$ 8,470,000
Less: Valuation Allowance	8,470,000
Deferred Tax Asset (Liability)	$ 0

NOTE 8 - COMMON STOCK TRANSACTIONS

On January 3, 2005, the company issued 200,000 shares of its common stock for 2005 legal fees valued at $100,000 under the 2004 Stock Grant and Option Plan.

On February 1, 2005, the company issued 500,000 shares of its restricted common stock valued at $797,500 to Impact International, LLC pursuant to the terms of the purchase of Reef Ventures, L.P.

On February 25, 2005, the Company approved the issuance of 60,000 shares of its restricted common stock valued at $82,000 for investor public relations services.

On May 1, 2005, the Company issued 500,000 shares of its restricted common stock valued at $900,000 to Impact International, LLC pursuant to the terms of the purchase of Reef Ventures, L.P.

NOTE 8 - COMMON STOCK TRANSACTIONS (CONTINUED)

On June 23, 2005, the Company issued Impact International, LLC Seven Million Five Hundred Thousand (7,500,000) common shares in response to Impact's exercise of their common stock purchase warrants. Impact tendered payment in the form of a promissory note in the amount of $2,512,500. The note will reduce and offset the principal balance owed by the Company under the Purchase and Sale Agreement dated May 25, 2004 whereby it acquired the Eagle Pass pipeline by purchasing an additional 73% of Reef Ventures, LP.

On June 27, 2005, the Company authorized the issuance of 150,000 shares of its restricted common stock valued at $199,500 to each of the three members of the Board of Directors, Michael R. Ward, Ahmed Karim and Carl Hessel.

On June 27, 2005, the Company authorized the issuance of 150,000 shares of common stock under a 2004 non-qualified stock grant and option plan which was registered on Form S-8, November 5, 2004. The shares were valued at $199,125 and were issued to James B. Smith, the Company's Senior Vice President, CFO and newly appointed member of the Board of Directors.

On July 1, 2005, the company issued 1,000,000 shares of its restricted common stock valued at $1,230,000 pursuant to an employment contract with an officer of the Company.

On July 1, 2005, the Company issued 50,000 shares of its restricted common stock valued at $61,500 pursuant to an employment contract with an officer of the Company.

On July 1, 2005, the Company issued 10,000 shares of its restricted common stock valued at $12,150 to an employee of the Company.

On August 18, 2005, Tidelands settled the legal dispute with L. L. Capital Group, LLC whereby L. L. Capital Group, LLC canceled 285,000 shares of the 1,000,000 shares of the Company's restricted common stock which it had received for a one year consulting contract executed August 4, 2004. The 285,000 shares canceled were valued at $297,825.

On December 20, 2005, the Company issued 10,000 shares of its common stock valued at $8,350 under the 2004 Stock Grant and Option Plan pursuant to an employment contract with an officer of the Company.

On December 20, 2005, the Company issued 40,000 shares of its restricted common stock valued at 33,400 pursuant to an employment contract with an officer of the Company.

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004

NOTE 8 - COMMON STOCK TRANSACTIONS (CONTINUED)

On June 14, 2005, June 27, 2005, July 5, 2005, September 19, 2005, September 29, 2005 and November 2, 2005, Mercator Momentum Fund III, L.P., Monarch Pointe Fund, Ltd (the "Funds") and Robinson Reed, Inc. (a managed account of the "Funds") notified the Company of their intent to convert portions of their remaining 7% convertible debentures into common stock which were converted as follows:

Entity	Amount	Price Per Share	Number of Shares
June 14, 2005			
Mercator Momentum Fund, III, L.P.	$ 273,600	$0.76	360,000
Mercator Momentum Fund, L.P.	380,000	0.76	500,000
Monarch Pointe Fund, Ltd	866,400	0.76	1,140,000
June 27, 2005			
Mercator Momentum Fund, III, L.P.	175,000	0.76	230,263
Mercator Momentum Fund, L.P.	250,000	0.76	328,947
Monarch Pointe Fund, Ltd	575,000	0.76	756,579
July 5, 2005			
Robinson Reed, Inc.	200,000	0.76	263,158
September 19, 2005			
Mercator Momentum Fund, L.P.	92,000	0.70	131,429
Mercator Momentum Fund III, L.P.	60,000	0.70	85,714
Monarch Pointe Fund, Ltd.	196,000	0.70	280,000
Robinson Reed, Inc.	52,000	0.70	74,286
September 29, 2005			
Mercator Momentum Fund, L.P.	207,000	0.71	291,549
Mercator Momentum Fund, III, L.P.	144,000	0.71	202,817
Mercator Momentum Fund, Ltd.	459,000	0.71	646,479
Robinson Reed, Inc.	90,000	0.71	126,761
November 2, 2005			
Mercator Momentum Fund, L.P.	$ 214,000	0.76	261,579
Mercator Momentum Fund, III, L.P.	134,900	0.76	177,500
Monarch Pointe Fund, LTD	473,100	0.76	622,500
Robinson Reed, Inc.	158,000	0.76	217,895
	$5,000,000		6,687,456

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The "Funds" shares and the "Impact" shares issued were all included in the Company's registration statement filed on Form SB-2 which was declared effective by the Securities & Exchange Commission on May 27, 2005.

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004

NOTE 9 - STOCK OPTIONS, STOCK WARRANTS AND SHARES RESERVED FOR CONVERTIBLE DEBENTURES

The following table presents the activity for options, warrants and shares reserved for issuance upon conversion of outstanding convertible debentures for the year ending December 31, 2005 and 2004:

	Stock Options	Stock Warrants	Shares Reserved for Convertible Debentures	Weighted Average Exercise Price
Outstanding - December 31, 2003	2,500,000	8,516,807	0	$0.31
Granted / Issued	250,000	10,562,141	11,111,111	0.69
Exercised	(2,500,000)	(1,500,000)	0	0.14
Outstanding - December 31, 2004	250,000	17,578,948	11,111,111	$0.50
Granted / Issued	0	0	0	-
Exercised / Converted	0	(8,500,000)	(6,687,456)	0.49
Expired	0	0	0	-
Cancelled	0	(50,000)	(4,423,655)	0
Outstanding - December 31, 2005	250,000	9,028,948	0	$1.01

The 2004 Non-Qualified Stock Grant and Option Plan has 4,350,872 shares remaining available for future issuance.

On November 18, 2004, the Company entered into a Securities Purchase Agreement with Mercator Momentum Fund, LP, Mercator Momentum Fund III, LP, Monarch Pointe Fund, LP, (collectively, "the Funds") and M.A.G. Capital, LLC ("M.A.G.") (formerly Mercator Advisory Group, LLC). In exchange for $5,000,000 the Company issued to the Funds, 7% convertible debentures with a maturity date of May 18, 2006. As of November 2, 2005, the $5,000,000 of convertible debentures was converted for 6,587,456 shares of the Company's common stock.

In connection with this financing the Company issued 6,578,948 common stock warrants which expire November 18, 2007. The warrants are exercisable at prices ranging from $0.80 to $0.87. The Company granted the Funds and M.A.G. registration rights on both groups of securities; such registration was declared effective May 27, 2005.

Accounting for Stock-Based Compensation

As allowed by Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, the Company has elected to apply the intrinsic-value-based method of accounting. Under this method, the Company measures stock-based compensation for option grants to employees assuming that options granted at market price at the date of grant have no intrinsic value. Restricted stock awards were valued based on the market price of a share of non-restricted stock on the date earned. No compensation expense has been recognized for stock-based incentive compensation plans other than for restricted stock awards pursuant to executive employment agreements.

NOTE 10 - COMMITMENT FOR SUITE LICENSE AGREEMENT

On June 4, 2004, the Company entered into a Suite License Agreement with the San Antonio Spurs, L.C.C. commencing July 1, 2004 for a period of five years. The annual license fee for the first year is $159,000 and is subject to a 6% per annum price escalation thereafter. The annual fee is payable in installments as indicated in the agreement.

The future annual license fee commitments are as follows:

2005	$168,540
2006	178,652
2007	189,371
2008	200,733
	$737,296

NOTE 11 - RELATED PARTY TRANSACTION

The Company executed an agreement in January 2004 with a related party to provide charter air transportation for its employees, customers and contractors to job sites and other business related destinations. A $300,000 5% interest bearing loan due in January 2007 was made by the Company regarding the transaction. The loan balance is credited by airtime charges at standard industry rates offset by interest charges computed on the average monthly balance. At December 31, 2005, the loan balance was $288,506.

NOTE 12 - LEASES

The Company entered into an operating lease on August 1, 2003 for the rental of its executive office at a monthly rent of $3,400, which expired November 30, 2005.

The Company retained tenancy in the building under the month-to-month clause until February 1, 2006. On February 1, 2006, the Company renewed the lease until December 31, 2007 at the same $3,400 per month rental.

The Company's wholly-owned subsidiary, Sonterra Energy Corporation, entered into a sublease agreement for its executive officers in an adjacent building for $2,500 per month until its renewal in October 2005 at which time the monthly rent increased to $3,000 per month through March 31, 2006. However, on February 1, 2006, Sonterra Energy Corporation entered into a direct operating lease with the building owner at a monthly rental of $3,300 for a term ending December 31, 2007.

NOTE 12 - LEASES (CONTINUED)

Sonterra Energy Corporation previously had entered into an operating lease beginning October 1, 2004 for a propane tank site at an annual rent of $10,000 expiring September 30, 2019.

Future commitments under the operating leases are as follows:

Year Ending	Total
2006	$ 83,400
2007	90,400
2008 - 2009	107,500
Total Minimum Lease Payments	$ 281,300

Rent expense for the years ended December 31, 2005 and 2004 was $82,300 and $43,300, respectively.

NOTE 13 - COMMITMENTS AND CONTINGENCIES

The Company is subject to the laws and regulations relating to the protection of the environment. The Company's policy is to accrue environmental and related cleanup costs of a non-capital nature when it is both probable that a liability has been incurred and when the amount can be reasonably estimated. Although it is not possible to quantify with any degree of certainty the financial impact of the Company's continuing compliance efforts, management believes any future remediation or other compliance related costs will not have a material adverse effect on the consolidated financial condition or reported results of consolidated operations of the Company.

NOTE 14 - LITIGATION

On January 6, 2003, we were served as a third party defendant in a lawsuit titled Northern Natural Gas Company vs. Betty Lou Sheerin vs. Tidelands Oil & Gas Corporation, ZG Gathering, Ltd. and Ken Lay, in the 150th Judicial District Court, Bexar County, Texas, Cause Number 2002-C1-16421. The lawsuit was initiated by Northern Natural Gas when it sued Betty Lou Sheerin for her failure to make payments on a note she executed payable to Northern in the original principal amount of $1,950,000. Northern's suit was filed on November 13, 2002. Sheerin answered Northern's lawsuit on January 6, 2003. Sheerin's answer generally denied Northern's claims and raised the affirmative defenses of fraudulent inducement by Northern, estoppel, waiver and the further claim that the note does not comport with the legal requirements of a

NOTE 14 - LITIGATION (CONTINUED)

negotiable instrument. Sheerin seeks a judicial ruling that Northern be denied any recovery on the note. Sheerin's answer included a counterclaim against Northern, ZG Gathering, and Ken Lay generally alFleging, among other things, that Northern, ZG Gathering, Ltd. and Ken Lay, fraudulently induced her execution of the note. Northern has filed a general denial of Sheerin's counterclaims. Sheerin's answer included a third party cross claim against Tidelands. She alleges that Tidelands entered into an agreement to purchase the Zavala Gathering System from ZG Gathering Ltd. and that, as a part of the agreement, Tidelands agreed to satisfy all of the obligations due and owing to Northern, thereby relieving Sheerin of all obligations she had to Northern on the $1,950,000 promissory note in question. Tidelands and Sheerin agreed to delay the Tideland's answer date in order to allow time for mediation of the case. Tidelands participated in a mediation on March 11, 2003. The case was not settled at that time. Tideland's answered the Sheerin suit on March 26, 2003. Tideland's answer denies all of Sheerin's allegations.

On May 24 and June 16, 2004 respectively, Betty Lou Sheerin filed her first and second amended original answer, affirmative defenses, special exceptions and second amended original counterclaim, second amended original third party cross-actions and requests for disclosure. In these amended pleadings, she sued Michael Ward, Royis Ward, James B. Smith, Carl Hessel and Ahmed Karim in their individual capacities. Her claims against these individuals are for fraud, breach of contract, breach of the Uniform Commercial Code, breach of duty of good faith and fair dealing and conversion. Sheerin has now non-suited her claims against Michael Ward, Royis Ward, and James B. Smith.

In September 2002, as a pre-closing deposit to the purchase of the ZG pipelines, the Company executed a $300,000 promissory note to Betty L. Sheerin, a partner of ZG Gathering, Ltd. In addition, the Company issued 1,000,000 shares of its common stock to various partners of ZG Gathering, Ltd. On December 3, 2003, Sheerin filed a separate lawsuit against Tidelands in the 150th District Court of Bexar County, Texas on this promissory note seeking a judgment against Tidelands for the principle amount of the note, plus interest. On December 29th, 2003, Tidelands answered this lawsuit denying liability on the note. On April 1, 2004, Tidelands filed a plea in abatement asking the court to dismiss or abate Sheerin's lawsuit on the $300,000 promissory note as it was related to and its outcome was dependent on the outcome of the Sheerin third party cross action against Tidelands in Cause Number 2002-C1-16421. The Company believes that the promissory note and shares of common stock should be cancelled based upon the outcome of the litigation described above. Accordingly, our financial statements reflect this belief.

NOTE 14 - LITIGATION (CONTINUED)

On September 15, 2004 and again on October 15, 2004 respectively, Sheerin amended her pleadings to include a third and fourth amended third party cross action against Tidelands adding a claim for the $300,000 promissory note. In these amended pleadings, Sheerin also deleted her claims against Carl Hessel and Ahmed Karim. After adding the claim on the $300,000 promissory note to the third party claims of Sheerin against Tidelands in Cause No. 2002-C1-16421, Sheerin dismissed Cause Number 2002-C1-16421.

Tidelands won a partial summary judgment against Sheerin as to all of her tort claims pled against Tidelands, save and except only her claim for conversion of 500,000 shares of Tidelands stock.

Sheerin seeks damages against Tidelands for indemnity for any sums found to be due from her to Northern Natural Gas Company, unspecified amounts of actual damages, statutory damages, unspecified amounts of exemplary damages, attorneys fees, costs of suit, and prejudgment and post judgment interest.

On August 5, 2005, Northern Natural Gas Company filed its Fourth Amended Original Petition which, for the first time, named Tidelands as a defendant to Northern. Northern seeks to impose liability on Tidelands for $1,950,000 promissory note signed by McDay Energy Partners, Ltd. (the predecessor to ZG Gathering, Ltd.) and Sheerin and the $1,700,000 promissory note signed by McDay only. Northern contends that Tidelands is alternatively liable to Northern for payment of both such promissory notes totaling $3,709,914 plus interest because Northern is a third-party beneficiary under a December 3, 2001 purchase and sale agreement between ZG and Tidelands claiming that in such agreement Tidelands agreed to assume and satisfy all indebtedness due and owing Northern by Sheerin and ZG. Northern also claims that it is entitled to foreclosure of a lien on the gas gathering system and pipeline that was the subject of the promissory notes in question.

On March 6, 2006, Tidelands won a summary judgment motion it filed against Northern and the court has now dismissed Northern's claims against Tidelands.

On November 28, 2005, ZG Gathering, Ltd. and ZG Pipeline Management ("ZG") filed its answer to Northern's Fifth Amended Petition, its counter-claim against Northern, and its answer and cross claim against Tidelands. ZG contends that the promissory notes given by ZG and Sheerin to Northern were procured by Northern's fraudulent misrepresentations and it claims unspecified amounts of damages against Northern. ZG's cross action against Tidelands claims Tidelands entered into an agreement to purchase the Zavala Gathering System from ZG and that, as part of that agreement, Tidelands agreed to satisfy the $3,700,914 Northern indebtedness of ZG, and to defend, indemnify, and hold ZG and Sheerin harmless from such indebtedness to pay off a Sheerin loan of $300,000, and to issue 1 million shares of Tidelands stock, of which 500,000 was to be free-trading shares. ZG claims that Tidelands breached this agreement by failing to satisfy the Northern

NOTE 14 - LITIGATION (CONTINUED)

indebtedness, failing to defend and indemnify it from such debt, failing to pay off the $300,000 note, failing to issue the free-trading shares in Tidelands, and by placing a stop transfer order on the restricted stock that was issued by Tidelands. ZG seeks specific performance of the agreement, recovery of an unspecified amount of damages, and its attorney's fees.

Much of the discovery has been completed at this time. Based on investigation, and discovery to date, Tidelands appears to have a number of potential defenses to the claims of Sheerin and Northern. Tidelands intends to aggressively defend these lawsuits. The complexity of the issues in this case and the inherent uncertainties in litigation of this kind prevent a more definitive evaluation of the extent of Tidelands' liability exposure.

During April and May, 2005, three separate legal actions were initiated against Sonterra Energy Corporation (Sonterra), a wholly-owned subsidiary of the Company. Two of the actions concern claims made by developers against Sonterra for their failure to pay rent and easement use fees as a result of their asset purchase from Oneok Propane Distribution Company on November 1, 2004. The third action involves a claim made by a builder that Sonterra does not have a proper easement for the current use of certain property. The Company believes that the three actions filed are without merit and intend to vigorously defend itself. Litigation regarding these three actions are still in their early stages, therefore, potential financial impacts, if any, cannot be determined at this time.

In accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies," management has reached the conclusion that there is a remote possibility that any or all of the aforementioned claims would be upheld at trial and has also determined that the amount of the claims cannot be reasonably estimated. Accordingly, the Company's financial statements reflect no accrual of a loss contingency with response to the above legal matters.

NOTE 15 - ACQUISITIONS

REEF VENTURES, L.P. TRANSACTION

On May 25, 2004, the Company entered into a Purchase and Sale Agreement for Reef Ventures, L.P. by and between Impact International, LLC ("Impact") and Coahuila Pipeline, LLC. ("Coahuila"), (jointly "Seller") and Tidelands Oil & Gas Corporation ("Tidelands") and Arrecefe Management, LLC ("Arrecefe"), (jointly "Buyer"). The transaction closed on June 18, 2004.

NOTE 15 - ACQUISITIONS (CONTINUED)

Purchase and Sale Agreement - Background

Reef Ventures, L.P. was formed in Texas on April 16, 2003. Coahuila owned one percent (1%) of Reef Ventures, L.P. Impact was a limited partner of Reef Ventures and owned seventy-two percent (72%) of Reef Ventures, L.P. Tidelands formed Arrecefe Management, L.L.C., a Texas limited liability company, to act as the general partner for Reef Ventures, L.P. Tidelands had already owned twenty-five percent (25%) of Reef Ventures, L.P.

Summary of Purchase and Sale Agreement

The Company and Arrecefe purchased Impact's and Coahuila's units of interest in Reef Ventures, L.P., respectively. Impact financed the sale of the Reef interests by taking back a promissory note (the "Tidelands Note") in the amount of $6,523,773 payable as follows:

(a) The "Tidelands Note" bears interest at prime plus two (2%) percent. The note calls for quarterly interest payments during the first fifteen (15) months, and thereafter, principal and interest would be due quarterly amortized over twenty (20) years, but not to exceed an amount equal to One Hundred (100%) percent of Reef's net cash flow. All quarterly interest payments due which are limited by the amounts of Reef's net cash flow have been and will be added to the note balance if applicable. The unpaid balance of the note would be due at the end of the fourth year.

(b) The Tidelands' note is secured by (i) a deed of trust (the "Deed of Trust") from the Partnership to Impact, covering the pipeline and related facilities, easements, rights-of-way and the Gas Contracts which comprise the project, being that 12-inch pipeline Project for transporting natural gas from Eagle Pass Texas to Piedras Negras, Mexico, defined in the Partnership Agreement. The Deed of Trust would include a present assignment of Reef's rights to receive cash flow from the Gas Project which would be exercisable by Impact only upon default under the Tidelands' Note, Reef guarantee, or Reef Deed of Trust. (ii) a guaranty of payment and performance from the Partnership (the "Partnership Guaranty"), and (iii) a pledge agreement whereby the Partnership pledges to Impact its 98% membership interest in Reef.

Minority Interest

The remaining two percent (2%) of Reef Ventures, LP, is owned by an unaffiliated third party. No value or allocation of net income or loss will be attributed until the total investment by existing ownership has been recovered.

TIDELANDS OIL & GAS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004

NOTE 16 - SUBSEQUENT EVENTS

During January, 2006, the Company completed a private placement of $6,569,750 of securities with several institutional investors led by Palisades Master Fund, L.P. The private placement consists of Original Issue Discount Convertible Debentures, convertible into common stock of the Company at a conversion price of $0.87 per share. The investors will also receive three-year warrants to purchase, in the aggregate, 2,491,975 shares of common stock of the Company at a conversion price of $0.935 per share. Additional 13 month callable warrants to purchase, in the aggregate, 7,551,432 were issued to the investors with an exercise price of $1,275 which warrants include a forced exercise provision by the Company if certain price and equity conditions are met. The Company will receive net proceeds of $4,964,410 from the transactions.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

On December 20, 2005, the Company issued 10,000 common shares valued at $8,350 and 40,000 shares of valued at $33,400, to Robert Dowies, a company vice president under the terms of his employment agreement.

On September 14, 2005, Michael Ward, James B. Smith and Ahmed Karim, executed amended promissory notes to the Company bearing interest at a rate of 5% annually and payable in full on, or before September 14, 2006. The notes were originally executed on September 14, 2004 in connection with the exercise of common stock options. The shares of stock issued previously to these individuals remained subject to security agreements. Prior to December 31, 2005, each of the above individuals paid $5,500 in interest accrued and owing to the Company on the original promissory note maturity date of September 14, 2005.

On July 1, 2005, the company issued 1,000,000 shares of its restricted common stock valued at $1,230,000 pursuant to the employment contract with Michael Ward, company president and CEO.

On July 1, 2005, the Company issued 50,000 shares of its restricted common stock valued at $61,500 pursuant to an employment contract with Robert Dowies, a company vice president under the terms of his employment agreement.

On July 1, 2005, the Company issued 10,000 shares of its restricted common stock valued at $12,150 Jason Jones, a Sonterra employee.

On June 27, 2005, the Company authorized the issuance of 150,000 shares of its restricted common stock valued at $199,500 to each of the three members of the Board of Directors, Michael R. Ward, Ahmed Karim and Carl Hessel.

On June 27, 2005, the Company authorized the issuance of 150,000 shares of common stock to James B. Smith, the Company's Senior Vice President, CFO and newly appointed member of the Board of Directors. The transaction was valued at $199,125.

On November 1, 2004, we issued 500,000 common shares to James B. Smith which represents the annual stock grant under the terms of his employment agreement valued at $435,000.

One November 3, 2004, the Company issued 500,000 common shares to Michael Ward under the terms of his employment contract. The shares were valued at $417,000.

On October 18, 2004 we entered into an employment agreement with Robert Dowies. Mr. Dowies became a Company Vice President. His annual salary is $ 100,000 including an annual stock grant of 100,000 shares.

On October 13, 2004, we sold Four Million (4,000,000) Tidelands Oil & Gas common shares to ACH Securities, S.A., a company domiciled in Geneva, Switzerland, for Two Million ($2,000,000) Dollars. On October 14, 2004, in connection with the ACH Securities transaction, we issued Margaux Investment Group, S.A. common stock warrants to purchase One Million (1,000,000) Tidelands Oil & Gas common shares for Fifty ($0.50) Cents per share and One Million (1,000,000) shares for $2.50 per share. Mr. Carl Hessel, a company director, is a partner in Margaux Investment Management Group, S.A. and, as such he has an indirect financial interest in the common stock warrants.

On September 14, 2004, we issued 500,000 shares of common stock to Michael Ward under the terms of his employment agreement. The shares were valued at $427,500.

On September 14, 2004, the following individuals exercised common stock options:

On September 14, 2004, Michael Ward, the Company's President and Director, exercised his common stock option to purchase 500,000 common shares for $110,000 payable on a promissory note bearing interest at the rate of 5% payable in full on, or before September 14, 2005. The shares are subject to a security agreement.

On September 14, 2004 Ahmed Karim, the Company's Vice President and Director, exercised his common stock option to purchase 500,000 common shares for $110,000 payable on a promissory note bearing interest at the rate of 5% payable in full on, or before September 14, 2005. The shares are subject to a security agreement.

On September 14, 2005, James Smith, the Company's Chief Financial Officer, exercised his common stock option to purchase 500,000 common shares for $110,000 payable on a promissory note bearing interest at the rate of 5% payable in full on, or before September 14, 2005. The shares are subject to a security agreement.

On April 15, 2004, we issued 3,322 common shares to Carl Hessel for $ 4,983. Carl Hessel was a member of our board of directors at the time of issuance.

The Company executed an agreement in January 2004 with a related party to provide charter air transportation for its employees, customers and contractors to job sites and other business related destinations. A $300,000 5% interest bearing loan due in January 2007 was made by the Company regarding the transaction. The loan balance is credited by airtime charges at standard industry rates offset by interest charges computed on the average monthly balance. At December 31, 2005, the loan balance was $288,506.

On January 8, 2004, we authorized the issuance of 300,000 common shares to Carl Hessel for services valued at $450,000. These shares were issued before Mr. Hessel joined our Board of Directors.

During 2004, the Company had four executive officers, Michael Ward, James B. Smith, Robert Dowies and Ahmed Karim. Michael Ward's annual salary is $252,000. James B. Smith's annual salary was $168,000. Mr. Dowies annual salary is $100,000.

On February 5, 2003, we granted Michael Ward, Royis Ward and Ahmed Karim common stock options to purchase 500,000 shares each at $0.22 per share. On August 16, 2003, we granted James B. Smith common stock options to purchase 500,000 shares at $0.22 per share. The options were exercised on September 14, 2004.

ITEM 13. EXHIBITS

Exhibit	Description	Location o
31.1	Chief Executive Officer-Section 302 Certification pursuant to Sarbanes- Oxley Act.	
31.2	Chief Financial Officer- Section 302 Certification pursuant to Sarbanes-Oxley Act.	
32.1	Chief Executive Officer-Section 906 Certification pursuant to Sarbanes-Oxley Act.	
32.2	Chief Financial Officer- Section 906 Certification pursuant to Sarbanes-Oxley Act.	

-33-

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) to the Securities Exchange Act of 1934, the Company has duly caused this Form 10-KSB Report for the period ending December 31, 2005 to be signed on its behalf by the undersigned, thereunto duly authorized on this 16th day of June, 2006.

TIDELANDS OIL & GAS CORPORATION

BY: /s/ Michael Ward

Michael Ward, President, CEO

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the dates indicated.

Date: June 16, 2006

/s/ Michael Ward

Michael Ward, President, Director

/s/ James B. Smith

James B. Smith, Senior Vice President, CFO

/s/ Ahmed Karim

Ahmed Karim
Vice President, Director

-34-