2007

annual report & accounts

borders & southern petroleum plc

Contents

Highlights

- Completed the Falkland Islands 2D seismic interpretation and compiled first phase prospect inventory – numerous structural leads identified within a new fold belt play
- Awarded a 2 year extension to the first Exploration Term with an obligation to acquire a minimum of 750 sq km of 3D seismic data
- Raised £15 million through Placing of 50,000,000 Ordinary Shares
- Following a competitive public tender process, awarded 3D seismic acquisition contract to PGS
- Signed a Subscription Agreement with PGS raising $10 million
- 3D seismic acquisition was completed ahead of schedule and within budget
- Received 3D fast track processed data
- Cash balance as at 31 December 2007 was £19.6 million

Chairman's Statement

Since my last statement to shareholders the Company has made significant progress in realising its objective of building a successful exploration and production business. Having defined a very attractive lead inventory based on a coarse 2D seismic grid we made the decision to acquire new 3D seismic over part of our acreage in the Falkland Islands, with a particular focus on large, high impact structural targets.

The planning for the 3D commenced in January 2007 with the tendering process starting in June. One of the issues we faced was the scale of our lead inventory. Our objective was to cover as many high impact leads and different play types as we could. With the increased seismic acquisition costs due to high global demand we needed to raise additional funds in order to maximise the survey area. In September the Company completed the successful placing of 50,000,000 ordinary shares of 1p per share, raising £15 million.

Following a competitive tender, PGS were awarded both the seismic acquisition and processing contracts. During our discussions with PGS they expressed an interest in investing directly in the Company which resulted in their subscription for 16,656,670 new ordinary shares of 1p per share, raising $10 million. The placement and subscription agreements gave us a strong cash position which is reflected in our year end cash balance.

These funds allowed us to acquire nearly 1500 sq km of 3D seismic, far exceeding our work programme obligation of 750 sq km. This is a large survey for a Company of our size but we believe it gives us the best chance to deliver success.

In September the Company completed the successful placing of 50,000,000 ordinary shares of 1p per share, raising £15 million.

The seismic operations commenced in October 2007 and were completed in February 2008. The acquisition was finished ahead of schedule and within budget. Importantly the operations were conducted without any HSE incidents. We contracted marine mammal observers on the seismic vessel and their observations have provided an excellent insight into the wildlife in the area. This new data will be incorporated into the Environmental Impact Assessment (EIA) ahead of drilling.

As we look forward, our aim, from a technical perspective, is to work up drillable prospects by the end of the year. In parallel we hope to progress access to a suitable rig. In this regard we are working with other Falkland Islands operating companies to identify a suitable rig, but equally as we get nearer to finalising the technical evaluation we will be looking at all possible options for rig access.

The processing of the 3D seismic is well under way and we are just starting to receive some of the early processing results. The prospect generation will be undertaken using the final product but already the fast track data is giving us more confidence of the quality of our acreage and the prospect of delivering real value to our shareholders. As an untested frontier basin the South Falkland basin and particularly the fold belt trend looks a very exciting proposition.

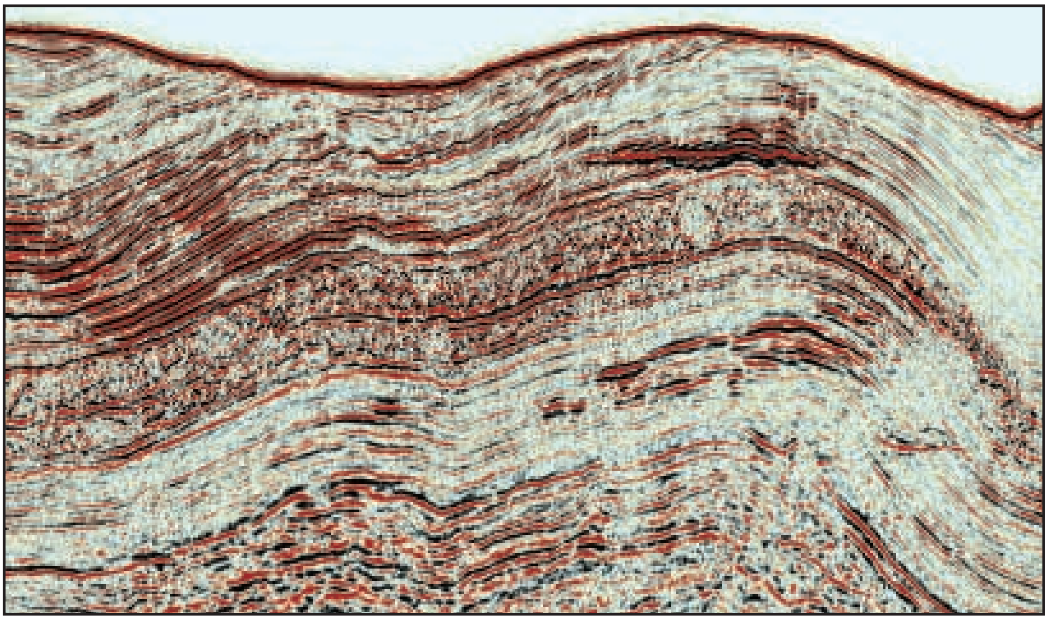
Chief Executive's Review

It was one hundred years this May since the first commercial oil was discovered in the Middle East. The discovery was located at Masjid-i-Suleiman in the Zagros foothills in Iran and occurred some 30 years prior to discoveries in Saudi Arabia and Kuwait. The Zagros fold belt has proven to be one of the world's most prolific hydrocarbon provinces and continues to be an important area for both exploration and production. In fact, it is so prolific that it is probably atypical of fold belts around the world. That said, commercial hydrocarbons have been discovered in nearly 50 fold belts, accounting for approximately 14% of the world's discovered reserves.

It is the chance to discover multi-billion barrel hydrocarbon provinces and the abundance of large simple structural traps that has attracted petroleum explorers to fold belts. Globally, 37 fold belts contain giant fields (>250 million barrels of oil equivalent), and 16 have total reserves of more than 3 billion barrels of oil equivalent. In 2000 the US Geological Survey's global assessment of resources concluded that fold belts contained some 15% of the global yet-to-find resources.

It is for these reasons that Borders & Southern was first drawn to unlocking the potential of a previously undefined fold belt play in the South Falkland Basin, approximately 150 km south of the Falkland Islands. Prior to our 2D seismic acquisition programme only limited data had existed, and it was far from certain whether a credible exploration play would materialise. However, on receipt of the processed data it became clear that we were fortunate to have defined a new fold belt play, the majority of which falls within our licensed acreage.

Whilst fold belts have always attracted explorers they have also frustrated explorers due to the structural complexity in the face of often poor quality seismic data. The reason for this is that the majority of fold belts occur on land within major mountain ranges. Seismic acquisition is difficult, expensive and commonly delivers results which can support differing structural interpretations. In contrast to many of these areas, the fold belt located offshore in the South Falkland Basin is very well imaged and, as previously reported, has allowed us to define numerous large (>50 sq km) anticlinal traps capable of containing giant accumulations.



Seismic section from the fast track 3D data. The bright horizontal amplitude anomaly near the crest of the anticline represents gas hydrates. Further amplitude anomalies appear in the core of the anticline.

With the completion of the 2D seismic interpretation technical risks were still perceived as too high to proceed directly with drilling in this untested frontier basin. This was primarily due to the coarse seismic grid which had a line spacing of approximately 5 km. The Board reviewed all possible options for risk reduction and concluded the best way forward was to acquire a 3D seismic survey over part of the play fairway. Following a competitive public tender the seismic acquisition and processing contracts were awarded to PGS.

Prior to tendering the seismic contracts we entered discussions with the Falkland Island Government about a possible extension to the initial exploration term. These discussions reached a successful conclusion with the award of a 2 year extension, representing a total of 5 years for the first exploration phase. The new expiry date is 1st November 2009. At that time Borders & Southern will have the option to further extend the initial exploration term in lieu of a one well obligation or enter the second 5 year exploration term which also has a one well work programme obligation. This means the Company has sufficient time to fully evaluate and test its exploration licences.

The extension was granted on the basis that Borders & Southern completed a minimum work programme obligation of 750 sq km of new 3D seismic data. This we have already achieved by the acquisition of 1492 sq km of full fold 3D data. The survey commenced at the end of October 2007 and was completed in February 2008, ahead of schedule and within budget.

The full processing will take 5 months but we have recently received a fast track product. Whilst we do not intend to interpret this data as it is primarily a data QC product, it has allowed us to make some initial observations. The data quality is very good, and particularly good for a fold belt. The seismic is giving us an order of magnitude more information than we previously held and we are confident that we now have the data to fully assess the prospectivity and the associated risks in our acreage.

The 3D fast track product has confirmed the structural robustness of the prospects that had previously been mapped. Clear four way dip closures can be seen on the seismic time slices. Additionally, new structures, albeit smaller, have been recognised. These structures had previously fallen between the coarse grid of 2D lines.

The data has also provided us with greater resolution deeper in the section. This will allow us to map previously undefined sub-thrust plays, older ramp anticlines and tilted fault blocks along with stratigraphic plays. As a consequence, we would anticipate a much expanded prospect inventory after the mapping.

The new data demonstrates to us that the gas hydrates are more widely distributed than previously thought. We are starting to see a systematic relationship between the presence of hydrates and the anticline crests and thrust faults. This will be investigated further on the final processed product.

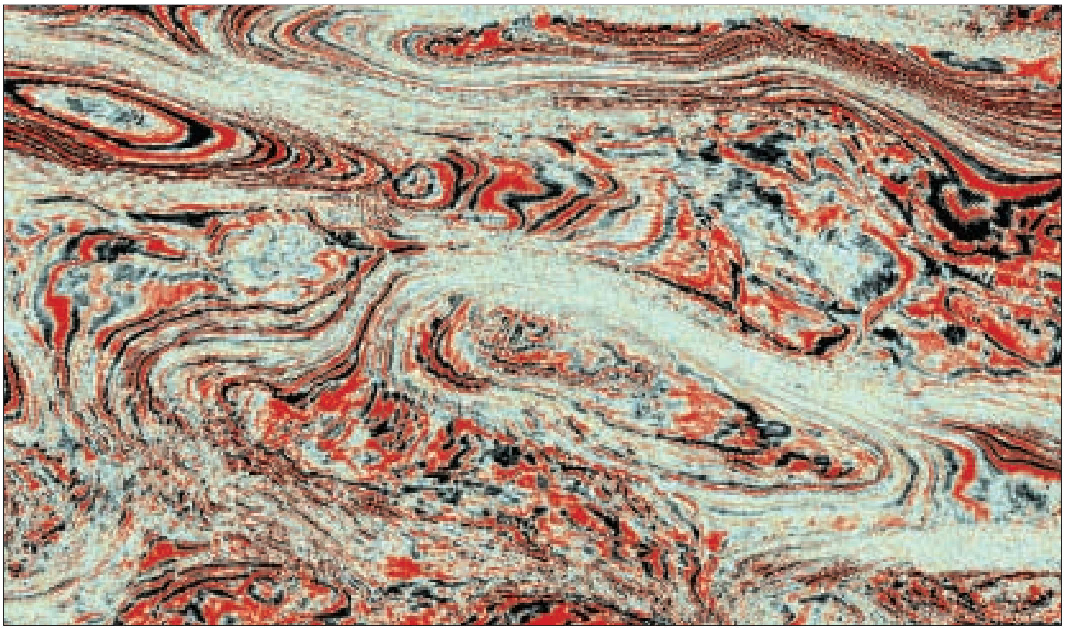
Other possible indirect evidence of hydrocarbons is seen. Amplitude anomalies, occurring in geologically sensible trapping configurations, have been noted. Certain stratigraphic intervals appear more prone to display amplitude anomalies over different structures and may therefore be providing us with information on reservoir distribution. It's encouraging news, but it is too early to say whether these are direct hydrocarbon indicators. AVO analysis on the final product should provide more answers.

We are delighted with the progress of the project to date and with these initial observations and look forward to receiving the final data so that the hard work can begin.

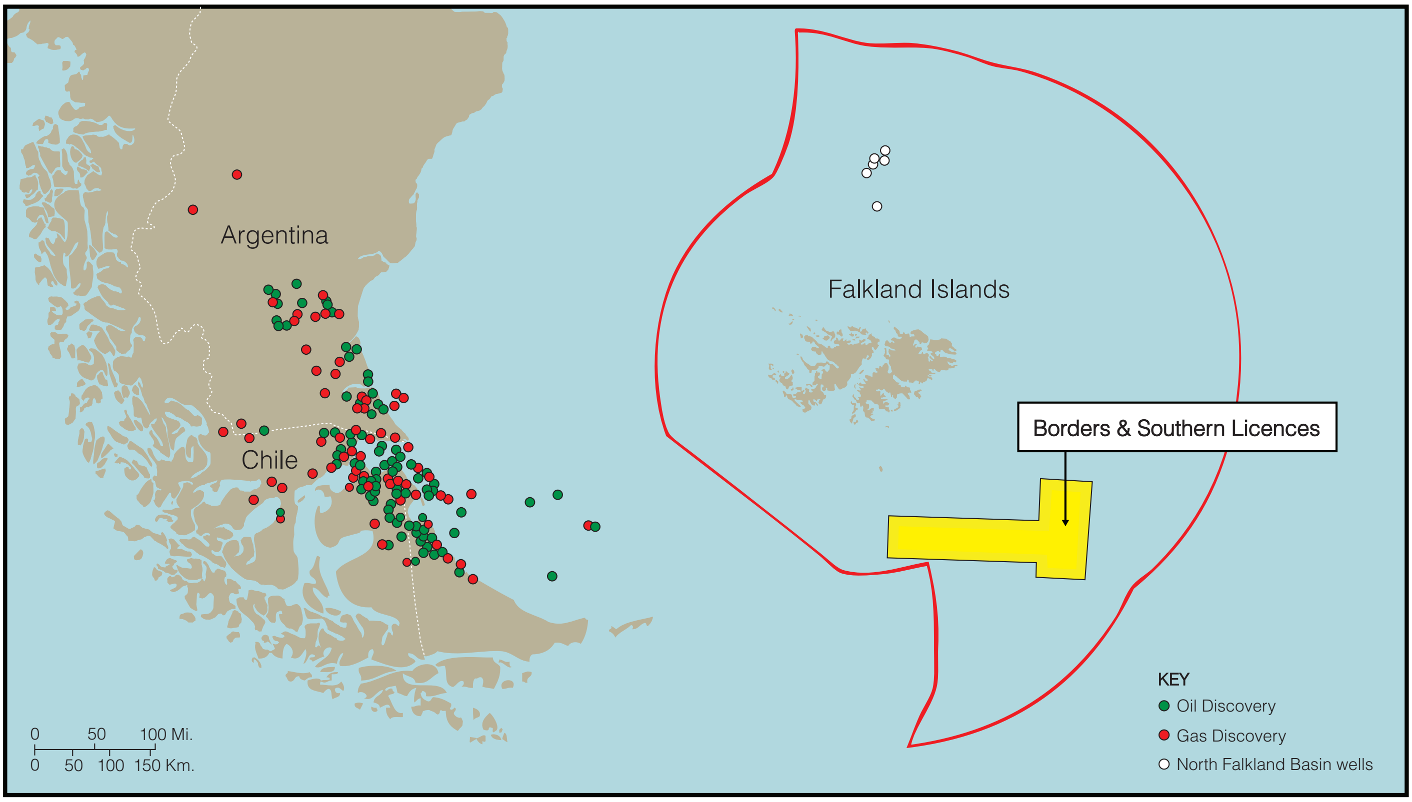
One additional benefit from acquiring a 3D survey is that we will not have to undertake site surveys prior to drilling. The vertical resolution and aerial coverage of 3D seismic data in deep water can be used to identify shallow geohazards and gauge seabed stability. Furthermore, the detailed imaging of the sea floor will assist the benthic sampling programme that will be undertaken as part of the EIA.

Strategically, we hope to have mature prospects with drilling locations in the fourth quarter of this year. Our aim is to align our technical work programme with the other Falkland operating companies so that we can take advantage of a shared drilling campaign. In that regard we are working together trying to source rigs. Rig supply shows no signs of easing at the moment, but our aim is to advance our technical work so that we can take advantage of any opportunity should it arise. In the meantime we intend to progress our EIA, a requirement ahead of drilling.

Prior to committing to a rig we will need to review our funding options. We currently have a very healthy cash balance, but unfortunately this is not enough to cover our drilling aspirations. At the appropriate time the Board will decide whether to initiate a farmout of the acreage or to seek additional funding (or a combination). We are very fortunate to have an extremely attractive frontier exploration project on our hands and we need to make sure we optimise value for the shareholders.

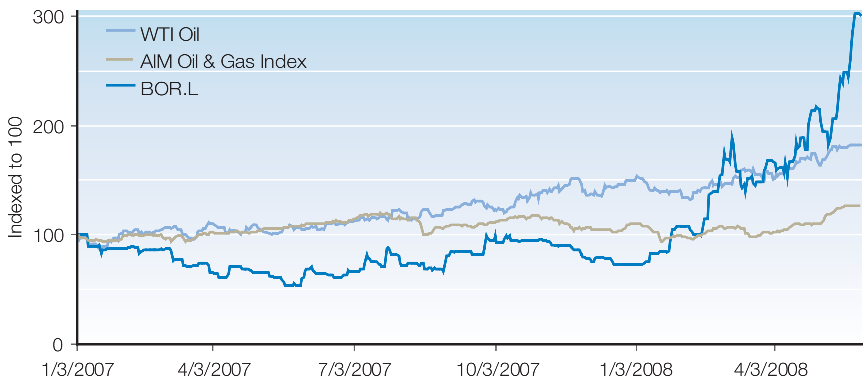


Seismic time slice from part of the fast track 3D data. Robust structural closures are clearly recognized - the oval shapes represent a horizontal section through the anticlines.



Location map showing the position of our acreage relative to the Falkland Islands and the South American continent. The highlighted oil and gas discoveries represent approximately 6 billion barrels of oil equivalent. The petroleum system responsible for these discoveries, based on a Late Jurassic / Early Cretaceous marine source rock, is the same petroleum system that we anticipate to be present south of the Falkland Islands and is completely independent from that of the North Falkland Graben.

Financial Review



During the year, the Company raised a total of £19.2 million post expenses from private placements to UK Institutions and to PGS, the seismic contractor.

At balance date, the Company had £19.6 million in cash or cash equivalent deposits. However, part of those funds were required to fund the balance of the 3D seismic survey with the remaining invoices paid by end May in accordance with the terms of the contract. With all these commitments paid for, the Company had a cash balance of approximately £12.7 million at end May 2008 which places it on a sound financial basis.

The cash deposits are held with a UK based Aaa rated bank in either US Dollars or Pounds Sterling treasury deposits and current accounts.

As you will have read in other parts of this report, the Company's objective is to drill exploration wells within the Falkland Island licenses at some point. The Company has a wide range of options for funding this expenditure including a farm-out and/or a capital raising. When the Company is in a position to assess a firm rig contract and the results of the recent 3D seismic survey, it will consider the best option for the shareholders to fund this capital expenditure. We believe that we are well placed financially to take advantage of either or a combination of these options.

As you can see from the graphs, the Company's shares have performed very well over the last year both in absolute terms and also relative to other AIM listed oil and gas companies.

Board of Directors

Number of Board Meetings	7
Attendance:	
Harry Dobson	5
Howard Obee	7
Peter Fleming	7
Stephen Posford	5
Nigel Hurst-Brown	7

Board of Directors

David Harry Williamson Dobson
(Non-Executive Chairman) age 60

Harry Dobson is a former investment banker and senior partner of Yorkton Securities. He currently engages in various merchant banking and venture capital activities in North America and Europe, and has acted as Chairman of a number of resource companies (including American Pacific Mining Company Inc. and Lytton Minerals Limited). He is currently the Chairman of Kirkland Lake Gold Inc. (a Toronto Stock Exchange and AIM quoted Company) and Rambler Metals and Mining plc (an AIM quoted Company). He is experienced in the organisation and funding of resource projects, including those located in inaccessible locations.

Howard Kevin Obee
(Chief Executive) age 48

Howard Obee was appointed Chief Executive when the Company was incorporated in June 2004. He has a PhD in structural geology from Imperial College, and has spent 20 years in the oil industry, initially with BP (1985-1992), and subsequently with BHP Billiton (1992-2004). He trained as an exploration geologist, but has been appointed to various technical and commercial roles, incorporating exploration, new ventures, strategic planning, and business development. His most recent roles for BHP Billiton were West Africa Asset Team Leader, and Exploration Manager, London. He has experience of executing seismic and drilling programmes in frontier basins, including those in deep water.

Peter William Fleming
(Finance Director) age 46

Peter Fleming has over 15 years of upstream oil and gas experience, the majority of which was gained at BHP Billiton both in London and Melbourne. Whilst at BHP Billiton, Peter held senior positions in exploration and business development, investment evaluation, acquisitions and disposals and strategic planning. Prior to joining BHP Billiton, he worked for Bridge Oil and Banque Indosuez. He holds Masters degrees in Business Administration and Finance.

Stephen James Douglas Posford
(Non-Executive Director) age 61

Stephen Posford was a partner of stockbrokers W.Greenwell and Co. In 1986, he became Managing Director of Greenwell Montagu Gilt Edged, and in 1989 moved to Salomon Brothers to head up their proprietary trading department in London. He then became Salomon Brothers European CEO before retiring in 1996.

Christopher Nigel Hurst-Brown
(Non-Executive Director) age 56

Since qualifying as a Chartered Accountant, Nigel Hurst-Brown has pursued a career in fund management. From 1986-1990 he was Chairman of Lloyd's Investment Managers. In 1990 he moved to Mercury Asset Management as a main board Director and following Mercury's acquisition by Merrill Lynch in 1997 became a Managing Director of Merrill Lynch Investment Managers. Currently he is Chief Executive of Hotchkis and Wiley (UK) Limited and a member of the Executive Committee of its US parent Hotchkis and Wiley Capital Management LLC.

Directors' Report for the Year Ended 31 December 2007

The directors present their report and the audited consolidated financial statements for the year ended 31 December 2007.

Domicile

The parent company of the group (which is also the ultimate parent), Borders & Southern Petroleum Plc, is a public limited company and is registered and domiciled in England.

Principal activity

The principal activity of the group is the exploration for oil and gas.

The comparative figures cover the 18 months ended 31 December 2006.

Results and dividends

The group income statement is set out on page 21 and shows the result for the year.

The directors do not recommend the payment of a dividend.

Review of business and future developments

A review on the operations of the group is contained in the Chief Executive's Review and Financial Review on pages 4 and 9.

Risks and uncertainties and financial risk management

Business risks and uncertainties

The Company is subject to risks inherent in oil and gas exploration. In addition, there are risks associated with the jurisdictions where the Group operates.

The Company has an experienced team of professionals who have considerable experience in the industry, which mitigates some of these risks. However, a number of risks are out of the control of the Company such as the cost of goods and services procured by the Company in the course of its business.

Financial risk management

The company's operations are such that it has a limited exposure to a variety of financial risks. These may, from time to time, include the effects of changes in price risk, liquidity risk and a foreign exchange risk. The company does not use derivative financial instruments to manage interest rate or currency risks and as such, no hedge accounting is applied.

Given the size of the company, the directors have not delegated the responsibility of monitoring financial risk management to a sub-committee of the board. The company's management implements the policies set by the board of directors.

Price risk

The company is exposed to price risk due to normal inflationary increases in the purchase price of goods and services. The company has no exposure to equity securities price risk, as it holds no listed or other equity investments.

Liquidity risk

The company has no long term commitments and is able to satisfy any current liability from cash reserves. The company's solvency is monitored and assured within the framework and regulations set out by the Financial Services Authority.

Foreign exchange risk

The company has potential exposure due to some of its purchases being invoiced in foreign currencies, mainly US dollars. To mitigate the risk, the company when it becomes aware of a liability in the foreign currency, seeks to minimise the risk by either immediately converting the required funds to the relevant currency or taking out a forward contract. Other than forward contracts, the company does not use any other type of currency hedging.

Key Performance Indicators

The Company's key financial performance indicators (discussed in the Chief Executive's Review and Finance Review on pages 4-9) are the management of its cash position and the fulfilment of the exploration program.

Post balance sheet events

No events have occurred since the year end which require reporting or disclosing in the financial statements.

Charitable and political donations

There were no political or charitable contributions made by the company or the group during the period.

Health, safety and environment

The group has an overriding commitment to health, safety and environmental responsibility. The group works closely with host governments and communities in the countries in which it operates, together with its contractors and partners, to ensure internationally recognised standards are implemented and maintained along with compliance to local legislation.

The group's exploration activities are subject to the relevant environmental protection acts. The group closely monitors its activities to ensure to the best of its knowledge there is no potential for the breach of such regulations. There have been no convictions in relation to breaches of these Acts recorded against the group during the reporting period.

Creditor payment policy

It is the group's policy to settle the terms of payment with suppliers when agreeing the terms of the transaction, to ensure that suppliers are aware of these terms and to abide by them.

The amounts owed to the company and group's trade creditors at the year end represented 39 days (2006: 23 days) as a proportion of the total amounts invoiced by suppliers during the year.

Financial instruments

Details of the use of financial instruments by the company and its subsidiary undertaking are contained in note 21 of the financial statements.

Directors and their interests

The beneficial and other interests of the directors and their families in the share capital at the beginning of the year or the date of their appointment to the board, whichever is later, and at 31 December 2007, were as follows:

	At 31 December 2007 Number	At 31 December 2006 Number
David Harry Williamson Dobson	26,670,000	25,000,000
Stephen James Douglas Posford	26,670,000	25,000,000
Howard Kevin Obee	10,000,000	10,000,000
Peter William Fleming	2,200,000	2,200,000
Christopher Nigel Hurst-Brown	1,330,000	1,000,000

The ordinary shares in which Mr D H W Dobson is interested are held by the Zila Corporation, a company owned by the Whitmill Trust Company Limited, as trustee of The Lotus Trust of which he is a beneficiary.

The group has provided the directors with qualifying third party indemnity insurance.

Share options

	Number of options held at the beginning and end of the year	Fair value of options	Exercise price	Vesting period
Howard Kevin Obee	50,000	21p	48p	3 years
Peter William Fleming	50,000	21p	48p	3 years

Substantial shareholders

At 30 May 2008 the following had notified the company of disclosable interests in 3% or more of the nominal value of the company's shares carrying voting rights:

	Number of ordinary shares	% of share capital
Landsdowne Partners Limited Partnership	27,125,000	13.96
Stephen James Douglas Posford	26,670,000	13.72
Zila Corporation	26,670,000	13.72
Allianz SE	20,890,577	10.75
Petroleum Geo-Services	16,656,670	8.57
Howard Kevin Obee	10,000,000	5.15

Directors' responsibilities

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company, for safeguarding the assets of the company, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a Directors' Report which complies with the requirements of the Companies Act 1985.

The directors are responsible for preparing the annual report and the financial statements in accordance with the Companies Act 1985. The directors are also required to prepare financial statements for the group in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs) and the rules of the London Stock Exchange for companies trading securities on the Alternative Investment Market. The directors have chosen to prepare financial statements for the company in accordance with IFRSs.

International Accounting Standard 1 requires that financial statements present fairly for each financial year the company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. A fair presentation also requires the directors to:

- consistently select and apply appropriate accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Financial statements are published on the group's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements, which may vary from legislation in other jurisdictions. The maintenance and integrity of the group's website is the responsibility of the directors. The directors' responsibility also extends to the ongoing integrity of the financial statements contained therein

Auditors

All of the current directors have taken all the steps that they ought to have taken to make themselves aware of any information needed by the company's auditors for the purposes of their audit and to establish that the auditors are aware of that information. The directors are not aware of any relevant audit information of which the auditors are unaware.

BDO Stoy Hayward LLP have expressed their willingness to continue in office and a resolution to reappoint them will be proposed at the Annual General Meeting.

By order of the board

William John Walton Slack
Company Secretary

Date: 3 June 2008

Audit Committee Report

The Board has established an Audit Committee comprising Mr Hurst-Brown (Chairman), Mr Dobson and Mr Posford, all independent, non-executive directors.

The Audit Committee meets at least biannually and is responsible for:

- The integrity of the financial statements and related disclosures, based on adequate books, records and internal controls and selection and consistent application of appropriate accounting policies;
- The appropriateness of the internal financial controls;
- The independent auditors' qualifications, independence, and performance; and
- The compliance with legal and regulatory requirements.

Remuneration Committee Report

The Board has established a Remuneration Committee comprising Mr Dobson (Chairman), Mr Hurst-Brown and Mr Posford, all independent non-executive Directors.

The Remuneration Committee meets at least annually and is responsible for:

- Reviewing the performance of the CEO and other executive directors and senior management of the company and determines their remuneration and the basis of their service agreements with due regard to the interests of shareholders;
- The payment of any bonuses to the CEO, other executive directors and senior management; and
- Making recommendations to the board with respect to equity-based incentive plans and to act as a preparatory body for the board of directors in the management of any company award and option plans

Directors' remuneration and service contracts

On 18 May 2005, all of the company's directors entered into a service agreement with the company.

The remuneration of the directors for the year ended 31 December 2007 was as follows:

	Basic salary £	Share based payment £
David Harry Williamson Dobson	-	-
Stephen James Douglas Posford	-	-
Howard Kevin Obee	87,084	3,515
Christopher Nigel Hurst-Brown	-	-
Peter William Fleming	23,050	3,515

Pensions

The group does not operate a pension scheme for its directors or employees.

Independent auditor's report to the shareholders of Borders and Southern Petroleum Plc

We have audited the group and parent company financial statements (the ''financial statements'') of Borders and Southern Petroleum plc for the year ended 31 December 2007 which comprise the Consolidated Income Statement, the Consolidated and Company Balance Sheets, the Consolidated and Company Cash Flow Statements, the Consolidated and Company Statements of Changes in Equity and the related Notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the statement of directors' responsibilities.

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

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

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises the Highlights, Chairman’s Statement, Directors’ report, the Chief Executive’s Review, the Financial Review, the Board of Directors, the Audit Committee Report and the Remuneration Committee Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Our report has been prepared pursuant to the requirements of the Companies Act 1985 and for no other purpose. No person is entitled to rely on this report unless such a person is a person entitled to rely upon this report by virtue of and for the purpose of the Companies Act 1985 or has been expressly authorised to do so by our prior written consent. Save as above, we do not accept responsibility for this report to any other person or for any other purpose and we hereby expressly disclaim any and all such liability.

Basis of audit opinion

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

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

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31 December 2007 and of its loss for the year then ended;
- the parent Company's financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31 December 2007;
- the financial statements have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the financial statements.

BDO Stoy Hayward LLP
Chartered Accountants & Registered Auditors

Date: 3 June 2008

Financial Statements

Consolidated Income Statement

for the year ended 31 December 2007

	Note	12 months ended 31 December 2007	18 months ended 31 December 2006
Continuing operations		£	£
Administrative expenses		(857,046)	(1,176,389)
Loss from operations	2	(857,046)	(1,176,389)
Finance income	8	689,323	649,365
Loss before tax		(167,723)	(527,024)
Income tax expense	9	–	–
Loss for the year		(167,723)	(527,024)
Loss per share - basic and diluted (see note 3)		(0.11p)	(0.41p)

The notes on pages 28 and 43 form part of these financial statements

Consolidated Balance Sheet

at 31 December 2007

	Note	31 December 2007 £	31 December 2007 £	31 December 2006 £	31 December 2006 £
Assets					
Non-current assets					
Property, plant and equipment	10		3,893		10,144
Intangible assets	11		11,632,574		1,637,066
Total non-current assets			11,636,467		1,647,210
Current assets					
Trade and other receivables	13	157,440		135,731	
Cash and cash equivalents		19,624,705		9,468,174	
Total current assets			19,782,145		9,603,905
Total assets			31,418,612		11,251,115
Liabilities					
Current liabilities	14		(1,160,324)		(65,804)
Trade and other payables					
Total net assets			30,258,288		11,185,311
Capital and reserves					
Share capital	15		1,943,442		1,276,875
Share premium reserve			29,096,644		10,561,393
Other reserves			54,195		15,313
Retained earnings			(835,993)		(668,270)
Total equity			30,258,288		11,185,311

The financial statements were approved by the board of directors and authorised for issue on 3 June 2008.

HOWARD KEVIN OBEE
Director

PETER WILLIAM FLEMING
Director

The notes on pages 28 and 43 form part of these financial statements

Consolidated Statement of Changes in Equity

for the year ended 31 December 2007

	Share capital £	Share premium reserve £	Other reserves £	Retained earnings £	Total £
Balance at 1 July 2005	1,276,875	10,561,393	–	(141,246)	11,697,022
Loss for the period and total recognised income and expense for the period	–	–	–	(527,024)	(527,024)
Recognition of share based payments	–	–	15,313	–	15,313
Balance at 31 December 2006 carried forward	1,276,875	10,561,393	15,313	(668,270)	11,185,311
Balance at 1 January 2007 brought forward	1,276,875	10,561,393	15,313	(668,270)	11,185,311
Loss for the year and total recognised income and expense for the year	–	–	–	(167,723)	(167,723)
Issue of share capital	666,567	18,535,251	–	–	19,201,818
Recognition of share based payments	–	–	38,882	–	38,882
Balance at 31 December 2007	1,943,442	29,096,644	54,195	(835,993)	30,258,288

The following describes the nature and purpose of each reserve within owners' equity:

Reserve	**Description and purpose**
Share capital	This represents the nominal value of shares issued.
Share premium reserve	Amount subscribed for share capital in excess of nominal value.
Other reserves	Fair value of options issued during the year.
Retained earnings	Cumulative net gains and losses recognised in the consolidated income statement.

The notes on pages 28 and 43 form part of these financial statements

Company Balance Sheet

as at 31 December 2007

	Note	31 December 2007 £	31 December 2007 £	31 December 2006 £	31 December 2006 £
Assets					
Non-current assets					
Property, plant and equipment	10		3,893		10,144
Intangible assets	11		–		1,637,066
Investment	12		1		1
			3,894		1,647,211
Current assets					
Trade and other receivables	13	11,830,277		156,758	
Cash and cash equivalents		19,624,705		9,468,174	
			31,454,982		9,624,932
Total assets			31,458,876		11,272,143
Liabilities					
Current liabilities	14		(1,154,555)		(60,804)
Trade and other payables					
Total net assets			30,304,321		11,211,339
Capital and reserves					
Called up share capital	15		1,943,442		1,276,875
Share premium reserve			29,096,644		10,561,393
Other reserves			54,195		15,313
Retained earnings			(789,960)		(642,242)
Total equity			30,304,321		11,211,339

The financial statements were approved by the board of directors and authorised for issue on 3 June 2008.

HOWARD KEVIN OBEE
Director

PETER WILLIAM FLEMING
Director

The notes on pages 28 and 43 form part of these financial statements

Company Statement of Changes in Equity

for the year ended 31 December 2007

	Share capital £	Share premium reserve £	Other reserves £	Retained earnings £	Total £
Balance at 1 July 2005	1,276,875	10,561,393	–	(141,246)	11,697,022
Loss for the period and total recognised income and expense for the period	–	–	–	(500,996)	(500,996)
Recognition of share based payments	–	–	15,313	–	15,313
Balance at 31 December 2006 carried forward	1,276,875	10,561,393	15,313	(642,242)	11,211,339
Balance at 1 January 2007 brought forward	1,276,875	10,561,393	15,313	(642,242)	11,211,339
Loss for the year and total recognised income and expense for the year	–	–	–	(147,718)	(147,718)
Issue of share capital	666,567	18,535,251	–	–	19,201,818
Recognition of share based payments		–	38,882	–	38,882
Balance at 31 December 2007	1,943,442	29,096,644	54,195	(789,960)	30,304,321

The following describes the nature and purpose of each reserve within owners' equity:

Reserve	Description and purpose
Share capital	This represents the nominal value of shares issued.
Share premium reserve	Amount subscribed for share capital in excess of nominal value.
Other reserves	Fair value of options issued during the year.
Retained earnings	Cumulative net gains and losses recognised in the income statement.

The notes on pages 28 and 43 form part of these financial statements

Consolidated Cash Flow

for the year ended 31 December 2007	31 December 2007		31 December 2006	
	£	£	£	£
Cash flow from operating activities				
Loss before tax		(167,723)		(527,024)
Adjustments for:				
Depreciation		8,031		10,653
Exploration and evaluation expenditure transferred to income statement		2,525		–
Foreign exchange losses		131,496		392,486
Share-based payment		38,882		15,313
Finance income		(689,323)		(649,365)
Cash flows from operating activities before changes in working capital		(676,112)		(757,937)
(Increase)/ decrease in trade and other receivables		(3,806)		2,203
Increase/(decrease) in trade and other payables		1,094,521		(265,742)
Decrease in provisions		–		(42,955)
Net cash inflow/ (outflow) from operating activities		414,603		(1,064,431)
Cash flows used in investing activities				
Interest received		671,419		654,221
Exploration and development expenditure		(9,998,033)		(139,398)
Purchase of property, plant and equipment		(1,780)		(5,832)
Net cash used in investing activities		(9,328,394)		508,991
Cash flows from financing activities				
Proceeds from issue of shares and share options (net of issue costs)		19,201,818		–
Net cash from financing activities		19,201,818		–
Net increase/(decrease) in cash and cash equivalents		10,288,027		(555,440)
Cash and cash equivalents at the beginning of the year		9,468,174		10,416,100
Exchange losses on cash and cash equivalents		(131,496)		(392,486)
Cash and cash equivalents at the end of the year		19,624,705		9,468,174

Group and company	31 December 2007	31 December 2006
	£	£
Cash available on demand	372,558	397,041
Cash on deposit	19,252,147	9,071,133
Total	19,624,705	9,468,174

Cash and cash equivalents consist of cash at bank on demand and balances on deposit with an original maturity of three months or less.

The notes on pages 28 and 43 form part of these financial statements

Company Cash Flow

for the year ended 31 December 2007	31 December 2007		31 December 2006	
	£	£	£	£
Cash flow from operating activities				
Loss before tax		(147,718)		(500,996)
Adjustments for:				
Depreciation		8,031		10,653
Foreign exchange losses		131,496		392,486
Share-based payment		38,882		15,313
Finance income		(689,323)		(649,365)
Cash flows from operating activities before changes in working capital		(658,632)		(731,909)
(Increase)/ decrease in trade and other receivables		(11,653,091)		(18,824)
Increase/(decrease) in trade and other payables		1,093,752		(270,743)
Decrease in intangibles		1,634,541		–
Decrease in provisions		–		(42,955)
Net cash inflow/ (outflow) from operating activities		(9,583,430)		1,064,431
Cash flows from investing activities				
Interest received		671,419		654,221
Purchase of intangible assets		–		(139,398)
Purchase of property, plant and equipment		(1,780)		(5,832)
Net cash from investing activities		669,639		508,991
Cash flows from financing activities				
Proceeds from issue of shares and share options (net of issue costs)		19,201,818		–
Net cash from financing activities		19,201,818		–
Net increase/(decrease) in cash and cash equivalents		10,288,027		(555,440)
Cash and cash equivalents at the beginning of the year		9,468,174		10,416,100
Exchange losses on cash and cash equivalents		(131,496)		(392,486)
Cash and cash equivalents at the end of the year		19,624,705		9,468,174

The notes on pages 28 and 43 form part of these financial statements

1. ACCOUNTING POLICIES

Basis of preparation

The principal accounting policies adopted in the preparation of the financial statements are set out below and have been consistently applied to all years presented.

From 1 January 2007 all companies listed on the Alternative Investment Market are required to prepare their consolidated financial statements in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) as adopted by the European Union and with those parts of the Companies Act 1985 applicable to companies preparing their accounts under IFRS. The parent company financial statements have also been prepared in accordance with International Financial Reporting Standards.

The group's functional currency is UK £ and it has adopted this as its presentational currency.

New and revised Standards effective for 31 December 2007 year ends and adopted by the group

Standards

IFRS 7 – Financial Instruments: Disclosures (effective for accounting periods commencing on or after 1 January 2007). There was no impact of the adoption of this interpretation on the results or net assets of the group.

Amendments

IAS 1 - Presentation of Financial Statements - Capital Disclosures (effective for accounting periods commencing on or after 1 January 2007). There was no impact of the adoption of this interpretation on the results or net assets of the group.

Interpretations

IFRIC 8 – Scope of IFRS 2 (effective for accounting periods beginning on or after 1 May 2006). There was no impact of the adoption of this interpretation on the results or net assets of the group.

IFRIC 10 – Interim Financial Reporting and Impairment (effective for accounting periods commencing on or after 1 November 2006). There was no impact of the adoption of this interpretation on the results or net assets of the group.

New and revised Standards effective for 31 December 2007 year ends but are not currently relevant to the group

Interpretations

IFRIC 7 - Applying the Restatement Approach under IAS29- Financial Reporting in Hyperinflationary Economies (effective for accounting periods commencing or after 1 March 2006).

IFRIC 9 – Reassessment of Embedded Derivatives (effective for accounting periods commencing on or after 1 May 2006).

New and revised Standards issued but not effective for 31 December 2007 year ends

New Standards

IFRS 8 – Operating segments (effective for accounting periods commencing on or after 1 January 2009). The group will apply this standard in the accounting period commencing 1 January 2009.

Amendments

IFRS3 – Business combinations (effective for accounting periods commencing on or after 1 July 2009). This is not considered relevant to the group's operations.

IFRS 2 – Share-based Payments – Vesting Conditions and Cancellations (effective for accounting periods commencing on or after 1 January 2009). The group will apply this amendment in the accounting period commencing 1 January 2009.

IAS 1 – Presentation of Financial Statements: A Revised Approach (effective for accounting periods commencing on or after 1 January 2009). The group will apply this amendment in the accounting period commencing 1 January 2009.

IAS 23 – Borrowing Costs (effective for accounting periods commencing on or after 1 January 2009). This is not considered relevant to the group's operations.

IAS 27 – Consolidated and Separate Financial Statements (effective for accounting periods commencing on or after 1 July 2009). The group will apply this amendment in the accounting period commencing 1 January 2010.

Interpretations

IFRIC 11 – IFRS 2 – Group and Treasury Share Transactions (effective for accounting periods commencing on or after 1 March 2007). This is not considered relevant to the group's operations

IFRIC 12 - Service Concession Arrangements (effective for accounting periods commencing on or after 1 January 2008). This is not considered relevant to the group's operations.

IFRIC 13 – Customer Loyalty Programmes (effective for accounting periods commencing on or after 1 July 2008). This is not considered relevant to the group's operations

IFRIC 14 – IAS 19: The Limit on a Defined Benefit Asset, Minimum funding Requirement and their Interaction (effective for accounting periods commencing on or after 1 January 2008). This is not considered relevant to the group's operations

Transitional arrangements

Previously the Group had reported under United Kingdom Generally Accepted Accounting Principles (UK GAAP). The transition from UK GAAP to IFRS has not impacted upon the group's previously reported equity or loss, and has only resulted in presentational changes to the financial statements. For this reason an opening balance sheet restated using IFRS accounting principles and a reconciliation for comparative periods between UK GAAP and IFRS has not been considered necessary. No transitional exemptions have been adopted.

Basis of consolidation

Where the company has the power, either directly or indirectly, to govern the financial and operating policies of another entity or business so as to obtain benefits from its activities, it is classified as a subsidiary. The consolidated financial statements present the results of the company and its subsidiaries ("the group") as if they formed a single entity. Intercompany transactions and balances between group companies are therefore eliminated in full.

Business combinations

The consolidated financial statements incorporate the results of business combinations using the purchase method. In the consolidated balance sheet, the acquiree's identifiable assets, liabilities and contingent liabilities are initially recognised at their fair values at the acquisition date. The results of acquired operations are included in the consolidated income statement from the date on which control is obtained.

Loss for the financial year

The company has taken advantage of the exemption allowed under section 230 of the Companies Act 1985 and has not presented its own income statement in these financial statements. The group loss for the year includes a loss after tax of £147,718 (2006 - £500,996) which is dealt with in the financial statements of the parent company.

The company's investments in subsidiaries

In the parent company's accounts subsidiaries are carried at cost less amounts provided for impairment

Critical accounting estimates and judgements and key sources of estimation uncertainty

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities, and the disclosure of contingent liabilities at the date of the financial statements. If in the future such estimates and assumptions, which are based on management's best judgement at the date of the financial statements, deviate from the actual circumstances, the original estimates and assumptions with be modified as appropriate in the year in which the circumstances change. Where necessary, the comparatives have been reclassified or extended from the previously reported results to take into accounts presentational changes.

Management has made the following judgements which have the most significant effects on the amounts recognised in the financial statements:

- Recoverability of exploration and evaluation costs

  The group uses the full cost method of accounting, whereby exploration and evaluation costs are capitalised as intangible assets if the associated project is commercially viable, and reviewed for impairment. This requires judgement assessments as to (a) the likely future commerciality of the asset, and (b) future revenues and costs relating to the project in order to determine the recoverable value of the asset.

The key sources of estimation uncertainty at the balance sheet date, which have significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are as follows:

- Share options

  The group's share based payments were recognised at fair value, as in the prior period, using a 50% volatility rate. This is set out in greater detail in note 7.

Income

At the end of the year the group had not commenced commercial production from its exploration sites and therefore has no revenue in the year.

Finance income

Finance income is measured and recognised using the effective rate of interest. The income consists of interest on cash deposits.

Segment reporting

A business segment is a distinguishable component of an enterprise that is engaged in providing an individual product or service or a group of related products or services and that is subject to risks and returns that are different from those of other business segments. The group has only one business segment, which is the exploration for oil and gas, and is its primary reporting segment.

A geographical segment is a distinguishable component of an enterprise that is engaged in providing products or services within a particular economic environment and that is subject to risks and returns that are different from those of components operating in other economic environments. The group's geographical segments are the United Kingdom, the Falkland Islands and other areas Worldwide, and make up the group's secondary reporting segment.

Impairment

Exploration and evaluation assets are assessed for impairment when facts and circumstances suggest that the carrying amount may exceed its recoverable amount. Such indicators include the point at which a determination is made as to whether or not commercial reserves exist. Where the E&E assets concerned fall within the scope of an established full cost pool, the E&E assets are tested for impairment together with all development and production assets associated with that cost pool, as a single cash generating unit. The aggregate carrying value is compared against the expected recoverable amount of the pool, generally by reference to the present value of the future net cash flows expected to be derived from production of commercial reserves. Where the E&E assets to be tested fall outside the scope of any established cost pool, there will generally be no commercial reserves and the E&E assets concerned will generally be written off in full. Any impairment loss is recognized in the income statement as additional depreciation and separately disclosed.

In assessing the value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the rises specific to the asset for which the estimates of future cash flows have not been adjusted. Exploration and evaluation assets have been assessed using a discount rate of 10% and future revaluations based on expected recovery of oil over life of the fields using oil prices per barrel based on prices of flat $25.

No impairment was considered necessary.

Property, plant and equipment

Office equipment is initially recorded at cost. Depreciation is provided on office equipment so as to write off the cost, less any estimated residual value, over their expected useful economic life as follows:

Office equipment	33 1/3%

Assets are depreciated from the date of acquisition, and on a straight line basis.

Exploration and evaluation expenditure

As permitted under IFRS 6, the group has accounted for exploration and evaluation expenditure using the full cost method, whereby all costs associated with oil exploration are capitalised as intangible assets on a project-by-project basis, pending determination of feasibility of the project. Costs incurred include appropriate technical and administrative expenses but not general overheads. If an exploration project is successful, the related expenditures will be transferred to tangible assets and amortised over the estimated life of the commercial reserves. Where a licence is relinquished, a project is abandoned, or is considered to be of no further value to the group the related costs are written off. All capitalised costs are reviewed annually against the underlying value of oil and gas reserves, unless the expenditure relates to an area where it is too early to make a decision about the value of the assets.

Impairment tests and provisions

The carrying amounts of the company's asset are reviewed at each balance sheet date and, if there is any indication that an asset may be impaired, its recoverable amount is estimated. The recoverable amount is the higher of its net selling price and its value in use.

Estimates on impairment are limited to an assessment by the Directors of any events or changes in circumstance that would indicate that the carrying value of the asset may not be recoverable.

Any impairment loss arising from the review is charged to the income statement whenever the carrying amount of the asset exceeds its recoverable amount.

Provisions

A provision is recognised in the balance sheet when the group has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

Foreign currencies

Transactions in foreign currencies are translated into sterling at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the closing rates at the balance sheet date and the exchange differences are included in the income statement. The functional and presentational currency of the parent and all group companies is sterling.

Operating leases

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

Share based payments

The fair value of employee share option plans is calculated using the Black-Scholes-Merton pricing model. In accordance with IFRS 2 'Share-based Payments' the resulting cost is charged to the income statement over the vesting period of the options. The value of the charge is adjusted to reflected expected and actual levels of options vesting.

Where equity settled share options are awarded to employees, the fair value of the options at the date of grant is charged to the income statement over the vesting period. Non-market vesting conditions are taken into account by adjusting the number of equity instruments expected to vest at each balance sheet date so that, ultimately, the cumulative amount recognised over the vesting period is based on the number of options that eventually vest. Market vesting conditions are factored into the fair value of the options granted. As long as all other vesting conditions are satisfied, a charge is made irrespective of whether the market vesting conditions are satisfied. The cumulative expense is not adjusted for failure to achieve a market vesting condition.

Where the terms and conditions of options are modified before they vest, the increase in the fair value of the options, measured immediately before and after the modification, is also charged to the consolidated income statement over the remaining vesting period.

Financial instruments

Financial instruments are initially recorded at fair value. Subsequent measurement depends on the designation of the instrument, as follows:-

- Trade and other receivables are initially recognised at fair value and subsequently at amortised cost using the effective rate of interest, net of allowances for impairment.
- Trade and other payables are initially recognised at fair value and subsequently at amortised cost using the effective rate of interest.
- The group does not hold or issue derivative financial instruments for trading purposes.
- Financial instruments issued by group companies are treated as equity only to the extent that they do not meet the definition of a financial liability. The group's and company's ordinary shares are all classified as equity instruments.
- Cash and cash equivalents consist of cash at bank on demand and balances on deposit with an original maturity of three months or less.

Taxes

The major components of income tax on the profit or loss include current and deferred tax.

Current tax is based upon the profit or loss for the year adjusted for items that are non-assessable or disallowed and is calculated using tax rates that have been enacted, or substantively enacted, by the balance sheet date.

Income tax is charged or credited to the income statement, except where the tax relates to items credited or charged directly to equity, in which case the tax is also dealt within equity.

Deferred tax assets and liabilities are recognised where the carrying amount of an asset or liability in the balance sheet differs to its tax base.

Recognition of deferred tax assets is restricted to those instances where it is probable that taxable profit will be available against which the difference can be utilised.

The amount of the asset or liability is determined using tax rates that have been enacted or substantively enacted by the balance sheet date and are expected to apply when deferred tax liabilities and assets are settled or recovered.

Losses

Losses from operations is stated after crediting all items of operating income and charging all operating expenses, but before crediting or charging any financial income or expenses.

2. EXPENSES BY NATURE

	12 months ended 31 December 2007 £	18 months ended 31 December 2006 £
Staff costs (note 5)	259,342	276,499
Exploration and evaluation expenditure	118,579	144,422
Services provided by the auditors:		
Audit fee	16,000	14,000
Other services:		
Auditing of the accounts of the associate of the company under legislation	4,000	–
Other taxation services	–	6,000
Exchange differences	131,496	392,486
Depreciation of office equipment	8,031	10,653
Operating lease expenses-property	113,545	102,284
Share-based payment- equity settled	38,882	15,313
Sundry items	167,171	214,732
	857,046	1,176,389

3. LOSS PER SHARE

The calculation of the basic earnings per share is based on the loss attributable to ordinary shareholders divided by the weighted average number of shares in issue during the year. The loss for the financial year for the group was £167,723 (2006 - £527,024) and the weighted average number of shares in issue for the year was 147,182,725 (2006 - 127,687,500).

Potentially Dilutive Share Options

Because the group is loss making, no diluted loss per share has been calculated. However, at 31 December 2007 there were options over 700,000 shares outstanding which are potentially dilutive (2006 - 500,000). These options are described in Note 7.

4. SEGMENT ANALYSIS

For the purpose of segmental information the operations of the group consist of one class of business, the exploration for hydrocarbon liquids and gas.

During the year the group's exploration and evaluation activities took place outside the UK, substantially in the Falkland Islands. These costs are capitalised, where appropriate, in accordance with the accounting policies as set out in note 1 above.

The operating loss of the group is analysed as follows:

	12 months ended 31 December 2007 £	18 months ended 31 December 2006 £
United Kingdom	738,467	1,031,967
Falkland Islands	30,307	21,028
Worldwide (excluding UK and Falkland Islands)	88,272	123,394
	857,046	1,176,389

Total assets are analysed as follows:

	Group		Company	
	31 December 2007 £	31 December 2006 £	31 December 2007 £	31 December 2006 £
United Kingdom	19,786,038	9,593,315	31,458,876	9,614,343
Falkland Islands	11,632,574	1,657,800	–	1,657,800
	31,418,612	11,251,115	31,458,876	11,272,143

The assets are held in either the United Kingdom or the Falkland Islands

Capital expenditure

	Group		Company	
	31 December 2007 £	31 December 2006 £	31 December 2007 £	31 December 2006 £
United Kingdom	1,780	145,230	1,780	145,230
Falkland Islands	9,998,033	–	–	–
	9,999,813	145,230	1,780	145,230

5. STAFF COSTS

Company and Group:

Staff costs (including directors) comprise:

	12 months ended 31 December 2007 £	18 months ended 31 December 2006 £
Wages and salaries	197,217	233,302
Employers national insurance contribution	23,243	27,884
Share based payment-equity settled	38,882	15,313
	259,342	276,499

The average number of employees (including directors) employed during the year by the company was 6 (2006 - 7) and for the group was 6 (2006 - 7). All employees and directors of the group and the company were involved in management.

In 2007 the group granted to staff of Borders and Southern Petroleum Plc, for nil consideration, share options with a total fair value of £22,565 (2006 - £105,457), of which £3,730 (2006 - £15,313) has been expensed during the year. In addition £35,152 has been expensed during the year in respect of share options granted in 2006.

6. DIRECTORS' EMOLUMENTS

The directors' emoluments for the period are as follows:

	12 months ended 31 December 2007 £	18 months ended 31 December 2006 £
Directors' fees	110,133	138,335
Share based payments – equity settled	7,030	3,063
	117,163	141,398

The fees and share-based payments made to each director are disclosed in the Remuneration Committee Report.

In 2006, the group granted to two directors of Borders and Southern Petroleum Plc, for nil consideration, 50,000 share options each, with a total fair value of £21,091. Of this amount £7,030 (2006 - £3,063) has been expensed during the year.

The directors are the key management personnel.

7. SHARE-BASED PAYMENT

On 3rd July 2007, the group granted 200,000 share options to an employee of Borders and Southern Petroleum Plc, for nil consideration. The options will be cancelled if the employee leaves the company.

	31 December 2007 Weighted average exercise price	31 December 2007 Number	31 December 2006 Weighted average exercise price	31 December 2006 Number
Outstanding at the beginning of the year	48p	500,000	–	–
Granted during the year	26p	200,000	48p	500,000
Outstanding at the end of the year		700,000		500,000

The exercise price of the options outstanding at the year end ranged between 26p and 48p and their weighted average contractual life was 4 years.

The fair value of each option granted during the year was 11p. The following information is relevant in the determination of the fair value of the options granted during the year under the equity-settled share based remuneration scheme operated by the company.

	31 December 2007	31 December 2006
Equity-settled scheme		
Option pricing model used	Black-Scholes	Black-Scholes
Weighted average share price at grant date	26p	48p
Exercise price	26p	48p
Weighted average contractual life (days)	1,460	1,460
Expected volatility	50%	50%
Expected dividend growth rate	0%	0%
Risk-free interest rate	4.10%	4.72%
Share-based remuneration expense for the year in respect of the equity-settled scheme for options granted during the year.	£3,730	–
Share-based remuneration expense for the year in respect of the equity-settled scheme for options granted during 2006.	£35,152	£15,313
Total share-based remuneration expense for the year	£38,882	£15,313

8. FINANCE INCOME

	12 months ended 31 December 2007 £	18 months ended 31 December 2006 £
Bank interest receivable	689,323	649,365

9. TAX EXPENSE

Current tax expense

	12 months ended 31 December 2007 £	18 months ended 31 December 2006 £
UK corporation tax on loss for the year	–	–

Factors affecting current period tax charge

The reasons for the difference between the actual tax charge for the year and the standard rate of corporation tax in the UK applied to losses for the year are as follows:

	12 months ended 31 December 2007 £	18 months ended 31 December 2006 £
Loss for the year/period	(167,723)	(527,024)
Standard rate corporation tax charge 30% (2006-30%)	(50,317)	(158,107)
Expenses not deductible for tax purposes	14,041	6,227
Depreciation in excess of capital allowances	1,608	1,320
Unutilised tax losses carried forward	34,668	150,560
Total current tax for the year	–	–

Factors that may affect future tax charges

The group has a deferred tax asset of £74,000 (2006 - £64,000) in respect of unrelieved tax losses of £265,000 at 31 December 2007 (2006 - £230,000), and a deferred tax asset of £1,236 in respect of accelerated capital allowances (2006- £371). The deferred tax asset has not been recognised in the financial statements as the timing of economic benefit is uncertain.

10. PROPERTY, PLANT AND EQUIPMENT

Group and company

	Office equipment £
Cost	
As at 1 July 2005	18,685
Additions	5,832
As at 31 December 2006	24,517
Depreciation	
As at 1 July 2005	3,720
Charge for the period	10,653
As at 31 December 2006	14,373
Net book value	
As at 31 December 2006	10,144
As at 30 June 2005	14,965
Cost	
As at 1 January 2007	24,517
Additions	1,780
As at 31 December 2007	26,297
Depreciation	
As at 1 January 2007	14,373
Charge for the year	8,031
As at 31 December 2007	22,404
Net book value	
As at 31 December 2007	3,893
As at 31 December 2006	10,144

11. INTANGIBLE ASSETS

Group and company

	Exploration and evaluation costs £
Cost	
As at 1 July 2005	1,497,668
Additions	139,398
As at 31 December 2006	1,637,066
Net book value	
As at 31 December 2006	1,637,066
As at 30 June 2005	1,497,668

11. INTANGIBLE ASSETS continued

Group

	Exploration and evaluation costs £
Cost	
As at 1 January 2007	1,637,066
Additions	9,998,033
Disposal to income statement	(2,525)
As at 31 December 2007	11,632,574
Net book value	
As at 31 December 2007	11,632,574
As at 31 December 2006	1,637,066

Company

	Exploration and evaluation costs £
Cost	
As at 1 January 2007	1,637,066
Transfer of costs to the subsidiary company	(1,637,066)
As at 31 December 2007	–
Net book value	
As at 31 December 2007	–
As at 31 December 2006	1,637,066

12. INVESTMENTS IN SUBSIDIARY

Company

	31 December 2007 £	31 December 2006 £
Cost		
As at 1 January 2007 and 31 December 2007	1	1
Net book value		
As at 31 December 2006 and 31 December 2007	1	1

The company owns the one ordinary £1 subscriber share, being 100% of the issued share capital, in Borders and Southern Falkland Islands Limited. The company was registered in England and its principal activity is oil and gas exploration.

13. TRADE AND OTHER RECEIVABLES

	Group		Company	
	31 December 2007 £	31 December 2006 £	31 December 2007 £	31 December 2006 £
Amounts owed by group undertakings	–	–	11,672,837	21,027
Other receivables	57,542	23,389	57,542	23,389
Prepayments and accrued income	99,898	112,342	99,898	112,342
	157,440	135,731	11,830,277	156,758

All amounts shown under receivables fall due for payment within one year.

14. TRADE AND OTHER PAYABLES

	Group		Company	
	31 December 2007 £	31 December 2006 £	31 December 2007 £	31 December 2006 £
Trade payables	1,112,169	28,436	1,112,169	28,436
Other taxes and social security costs	8,084	–	8,084	–
Other payables	1,051	1,367	1,051	1,367
Accruals and deferred income	39,020	36,001	33,251	31,001
	1,160,324	65,804	1,154,555	60,804

15. SHARE CAPITAL

	31 December 2007 £	31 December 2006 £
Authorised		
750,000,000 ordinary shares of 1 pence each	7,500,000	7,500,000
Allotted, called up and fully paid		
At 1 January 2007 and at 1 July 2005		
127,687,500 ordinary shares of 1 pence each	1,276,875	1,276,875
66,656,670 ordinary shares of 1 pence each issued during the year	666,567	–
At 31 December 2007 and at 31 December 2006		
194,344,170 ordinary shares of 1 pence each	1,943,442	1,276,875

During the year the company issued 66,656,670 ordinary 1 pence shares for £19,201,818 (net of £795,183 costs) to raise further working capital.

16. CONTROLLING ENTITY

Borders & Southern Petroleum Plc is the ultimate parent and ultimate controlling party of the group.

17. RELATED PARTY TRANSACTIONS

During the year Borders & Southern Petroleum Plc paid expenses of £10,014,745 (2006 - £21,027) on behalf of Borders & Southern Falkland Islands Limited. At the year end £10,035,771 (2006 - £21,027) was due from the subsidiary.

There have been no transactions with directors during the year. The remuneration paid to each director is disclosed in the Remuneration Committee Report.

18. OPERATING LEASES

As at 31 December 2007 the future aggregate minimum lease payments under non-cancellable operating leases are as follows:

	Land and Buildings	
	31 December 2007 £	31 December 2006 £
Within one year	63,030	57,300

19. CONTINGENT LIABILITIES

The group and company had no contingent liabilities at 31 December 2007.

20. CAPITAL COMMITMENTS

At the balance sheet date the company had a seismic contract with PGS. Work under this contract was completed post balance date and all payments due to PGS under this contract have been paid. Subsequent to the payment of all the amounts owed to PGS, the company had a cash balance of approximately £12.7 million.

21. FINANCIAL INSTRUMENTS

The main risks arising from the group's operations are interest rate risk and foreign currency translation risk. The group monitors risk on a regular basis and takes appropriate measures to ensure risks are managed in a controlled manner.

a) Interest rate risk

The group's financial assets and liabilities accrue interest at prevailing floating rates in the United Kingdom or at pre-arranged fixed rates, as described further below. The group does not currently use derivative instruments to manage its interest rate risk.

At 31 December 2007 the company held cash at bank and in deposits under its control of £19,624,705 (2006 - £9,468,174), which forms the majority of the group's working capital. Of this £372,558 (2006 - £397,041) relates to deposits placed with banking institutions that are available on demand which carry interest at prevailing United Kingdom deposit floating rates. The balance represents restricted deposits of £19,252,147 (2006 - £9,071,133) with weighted average fixed interest rate of 5% for three months.

b) Foreign currency translation risk

The operational currency of the oil and gas exploration and evaluation activities of the group is US $, services and treasury function is £ sterling. Balances are held in £ sterling and US $ are purchased when required and used to meet exploration and evaluation needs.

The interest rate risk and foreign currency profile of financial assets and liabilities of the group and the company are as follows:

	Group		Company	
Current financial assets	Loans and receivables 31 December 2007 £	Loans and receivables 31 December 2006 £	Loans and receivables 31 December 2007 £	Loans and receivables 31 December 2006 £
Held in UK £:				
Trade and other receivables	157,440	135,731	11,830,277	156,758
Cash and cash equivalents	8,966,225	6,111,427	8,966,225	6,111,427
Total current financial assets held in UK £	9,123,665	6,247,158	20,796,502	6,268,185
Held in US $:				
Cash and cash equivalents	10,658,480	3,356,747	10,658,480	3,356,747
Total financial assets	19,782,145	9,603,905	31,454,982	9,624,932

Foreign currency translation risk:

If there was a 10% change in the year end exchange rate there would be a movement in the UK £ equivalent of financial assets held in US $ of £1,065,848 for the group and the company (2006 - £335,674).

	Group		Company	
Current financial liabilities	Financial liabilities measured at amortised cost 2007 £	Financial liabilities measured at amortised cost 2006 £	Financial liabilities measured at amortised cost 2007 £	Financial liabilities measured at amortised cost 2006 £
Held in UK£:				
Trade and other payables	194,595	65,804	188,826	60,804
Held in US $:				
Trade and other payables	965,729	–	965,729	–
Total financial liabilities	1,160,324	65,804	1,154,555	60,804

Foreign currency translation risk:

If there was a 10% change in the year end exchange rate there would be a movement in the UK £ equivalent of financial liabilities held in US $ of £96,573 for the group and the company (2006 - £ nil).

c) Credit risk

The group has no customers so formal credit procedures are in the process of being established. Credit risk on cash balances is managed by only banking with reputable financial institutions with a high credit rating. The only significant concentration of credit risk is cash held at bank and the maximum credit risk exposure for the group and company is detailed in the table below:

	2007		2006	
	Carrying Value	Maximum exposure	Carrying Value	Maximum exposure
	£	£	£	£
Cash and cash equivalents	19,624,705	19,624,705	9,468,174	9,468,174
Maximum credit risk exposure	19,624,705	19,624,705	9,468,174	9,468,174

Fair values

The fair values of the group's financial assets and liabilities at 31 December 2007 and at 31 December 2006 are materially equivalent to their carrying value as disclosed in the balance sheet and related notes.

Capital

The objective of the directors is to maximise shareholder return and minimise risk by keeping a reasonable balance between debt and equity. To date the group has minimised risk by being purely equity financed.

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Christopher Nigel Hurst-Brown
Peter William Fleming

Secretary
William John Walton Slack

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