Unlocking the potential for major new resource discoveries

Borders & Southern Petroleum Plc

Annual Report and Accounts 2010

borders&southern
petroleum plc

Year highlights

- Signed rig contract
- Selected drilling locations on the Darwin and Stebbing prospects
- Initiated detailed well designs
- Procured long lead items
- Advanced logistical planning for operations
- Signed rig assignment agreement

Cash balance

$194m

Market capitalisation

$420m

Secured rig contract

In November 2010 the company signed a contract with Ocean Rig UDW Inc. for the provision of mobile drilling rig services. Drilling is anticipated to start in the fourth quarter of 2011, using Ocean Rig's vessel, the Leiv Eiriksson.

"We are delighted to have signed this contract. It represents a significant milestone for the company and is the culmination of an intense period of technical and contractual effort. The rig is of a high specification, ideally suited for our work programme in the South Atlantic."

Howard Obee
Chief Executive

See the Business Review on pages 6 and 7 for more details.

Borders & Southern Petroleum is focused on exploring frontier or emerging hydrocarbon systems, seeking to identify and test high value prospects.

The company's first drilling campaign will target an untested fold belt in the South Falkland Basin.

Our operations

Borders & Southern holds a 100% equity interest and operatorship in five Production Licences located to the south of the Falkland Islands. The acreage covers an area of nearly 20,000 sq km.

We have acquired and evaluated 2,862 km of 2D seismic data and 1,492 sq km of 3D seismic data and have compiled an extensive prospect inventory.

Logistical planning is well underway as we target the fourth quarter to spud our first exploration well.

For up-to-date information on our share price and all the latest news please visit our website www.bordersandsouthern.com

Contents

Borders & Southern at a glance

Our strategy:

Identify and access opportunities where:

- there is a high degree of confidence of a working source system;
- the play fairway contains multiple high impact prospects; and
- the company is able to secure a significant part of the play fairway.

What's next:

- Finalise the detailed well engineering of the prospects
- Gain regulatory approvals ahead of drilling
- Complete procurement and mobilisation of drilling equipment
- Prepare for the mobilisation of the Leiv Eiriksson in the fourth quarter of this year

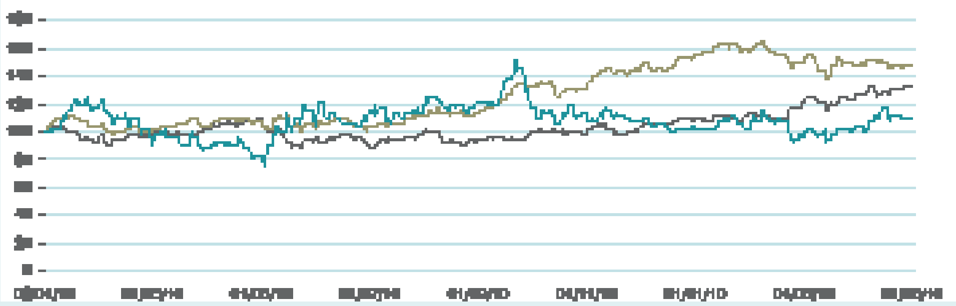
Shares and pricing

Pence/share

BOR.L

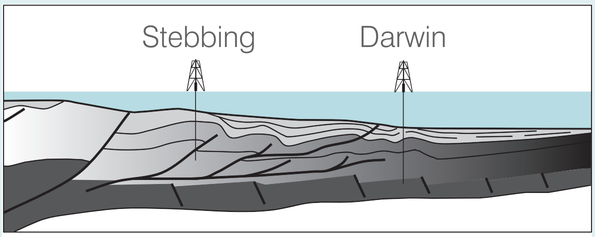
Index to 100

BOR.L
AIM Oil & Gas
WTI Oil



Borders & Southern's acreage comprises five Production Licences

Our two prospects



Stebbing is a robust simple fold with reservoir intervals in the Tertiary and Upper Cretaceous. P50 resource estimates for the combined reservoir intervals are 1,280 million barrels of recoverable oil.

Darwin is in a robust tilted fault block with a Lower Cretaceous aged reservoir interval. P50 resource estimates for the entire structure down to the mapped spill point are 760 million barrels of recoverable oil.

Falkland Islands
South Falkland Basin
100% (operator) interest

01 PL018 (Quad 61, blocks 16 to 30)
3,668 sq km

02 PL019 (Quad 62, blocks 16 to 30)
3,668 sq km

03 PL020 (Quad 63, blocks 16 to 30)
3,668 sq km

04 PL021 (Quad 64, blocks 1 to 30)
7,381 sq km

05 PL022 (Quad 73, blocks 1 to 5)
1,213 sq km

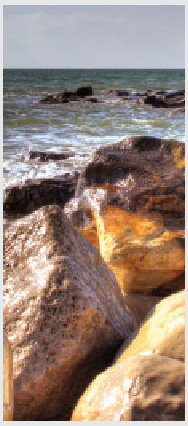
Chairman's statement

Harry Dobson
Non-executive
Chairman

At the time of writing, the commodity sector continues to be buoyant. Oil price has been above $70 per barrel for much of the last twelve months, peaking above $125 per barrel at the start of May. Exploration continues to be a key growth engine and frontier exploration has been delivering results in places such as East Africa and Gulf of Guinea, but also in the North Falkland Basin where the Sea Lion discovery is currently being appraised. Whilst the Sea Lion success has no impact on our own activities due to the different geology, we are delighted for the Falkland Islands. As drilling has progressed in the North Falklands, our own frontier exploration programme to the south of the Islands has gathered momentum with the signing of a rig contract and the building of the drilling team.

In brief

- **Our 2009 fund raising has given us a strong balance sheet – cash balance of $194 million**
- **We have built a high calibre drilling team and well planning is advanced**
- **Initial well results are anticipated in the first quarter of 2012**



"We are on track and the excitement is growing as we approach the spud of our first well."

In November 2009 we raised funds to enable us to drill our first two prospects in the Falkland Islands. In November 2010 we signed a contract with Ocean Rig UDW Inc. for the provision of mobile drilling rig services. The remote location and our relatively short programme made it challenging to secure a rig. However, we were delighted to finally reach an agreement with Ocean Rig for two firm wells and three options.

The rig is ideally suited to our operation. It is a fifth generation, harsh environment, dynamically positioned semi-submersible and will be mobilising to our location in the fourth quarter of this year. Whilst the precise start date for our programme is uncertain, we are very pleased to be commencing operations in the summer months of the southern hemisphere (although drilling throughout the year is possible).

The other area where we have made great progress is in the building of the drilling team. Our drilling manager, Jonathan Harris, together with our well management contractor, AGR Peak Well Management Ltd, has assembled a strong team, which is currently working on logistics and detailed well engineering.

The operation is complex and expensive due to the remote location. Most of the well services are sourced out of Europe, which means careful planning is essential. But we are on track and the excitement is growing as we approach the spud of the first well. We have worked up two excellent prospects with significant follow-up potential and look forward to seeing the well outcomes in the first quarter of 2012.

Harry Dobson
Non-executive Chairman

Our aims...

apply industry leading technology and petroleum systems analysis

Borders & Southern's objective is to test the hydrocarbon potential of the east-west trending fold belt, located approximately 150 km to the south of the Falkland Islands. This fold belt trend contains numerous large simple structures (up to 150 sq km in area), including thrust cored anticlines and tilted fault blocks. The clear definition of these structures has been achieved through the acquisition of 2,862 km of 2D seismic and 1,492 sq km of 3D seismic.

The geology and stratigraphy is anticipated to be similar to the adjacent Malvinas and Magallanes sub-basins where working petroleum systems are proven.

Business review

Howard Obee, Chief Executive (L) and Peter Fleming, Finance Director (R)

In brief

- **The Leiv Eiriksson has been contracted to drill the Darwin and Stebbing prospects**
- **Assigning the rig contract to FOGL will deliver significant cost savings**
- **The complex logistical challenge is well underway**

The past eighteen months have seen considerable drilling activity in the Falkland Islands. A large number of wells have been completed to the north of the Islands and one oil discovery reported. Most relevant to our exploration programme, the year also saw the first well drilled in the South Falkland Basin. BHP Billiton drilled the Toroa prospect, a stratigraphic trap located approximately 70 km north of our acreage. Although the outcome was disappointing, subsequent RNS statements suggest that there are a lot of positives that can be drawn from the results.

The Toroa well is reported to have found good quality sands in the Cretaceous, a thick, good quality source rock interval and good seals. This is consistent with our interpretation of our 3D seismic data, which we believe shows similar aged reservoirs and seals. The source rock was reported to be marginally mature at the Toroa well location. This same interval is buried deeper in our acreage and therefore is anticipated to have generated both oil and gas. The principal reason for failure of the Toroa well is considered to have been trap integrity, in particular, lateral seal failure in the stratigraphic trap. In contrast, our prospects are robust structural traps and are therefore expected to have greater trap integrity.

Rig contract won

Dynamically positioned, harsh environment semi-submersible will start to mobilise to the Falkland Islands in October 2011

"Technical work on our prospects is now complete. We are currently focused on the logistical challenge of a drilling campaign in a remote location."

Technical work on our Darwin and Stebbing prospects is complete. As reported previously they are large structures with good geophysical attributes and we are delighted to have them in our portfolio. Our recoverable resource estimate for Darwin is 300 million barrels (amplitude anomaly only) or 760 million barrels (down to the structural spill point). Our recoverable resource estimate for Stebbing is 710 million barrels in the Tertiary alone or 1,280 million barrels for combined Tertiary and Cretaceous reservoirs. We are hoping to spud the first well in December of this year, but before then we have a lot of work ahead of us.

In November 2010 we signed a contract with Ocean Rig UDW Inc. for the provision of mobile drilling rig services using their vessel the Eirik Raude. Recently, by mutual agreement, we have substituted its sister rig the Leiv Eiriksson. The substitution occurred as an opportunity arose to take a rig that had recently upgraded its Blowout Preventer to include casing shear rams and which had just completed its DNV 10 year special survey. The casing shear rams give superior capabilities in the event of a well control event or emergency disconnect. Further benefits of the rig substitution include an experienced crew and greater clarity on the arrival time. This could help save funds, as we will have greater certainty for the timing of third party services and equipment mobilisation.

The Leiv Eiriksson, completed in 2001, is a dynamically positioned semi-submersible with harsh environment capability. Its track record includes operations in West Africa, Atlantic West Ireland, Norwegian Sea, West of Shetlands and the Black Sea. Recently a Borders and Southern team comprising Howard Obee, Jonathan Harris and David Lord (AGR Peak Well Management) completed a successful rig inspection as it was mobilising from the Mediterranean towards its next assignment in Greenland.

Most recently we have announced that we have signed an Assignment Agreement with Falkland Oil & Gas whereby they will take two of the option slots under our rig contract. This is a very good result for both companies. Not only will we share mobilisation costs for the rig but also on third party services and equipment. Considerable cost savings will be made by working closely together on the combined programme.

Our short-term work focus is on the detailed well engineering, logistics planning and gaining the relevant government approvals ahead of drilling. We are also in the process of setting up a base and offices in the Falkland Islands.

Final cost estimates for the wells are not yet complete, but we believe we have sufficient funds with contingency to complete the programme. The current cash balance of $194 million reflects the costs already incurred on long lead items such as wellheads and casing. The company's cash reserves continue to be held in high quality banks, although interest yields are very low in line with the economic environment.

Howard Obee
Chief Executive

Peter Fleming
Finance Director

Borders & Southern has put pen to paper on a rig contract with Ocean Rig UDW Inc. for the provision of mobile drilling rig services using the Leiv Eiriksson drilling unit, a dynamically positioned, harsh environment semi-submersible.

On completion of its current contract in Greenland in October 2011, the rig will be mobilised to the Falklands to commence a two well drilling programme.

Darwin and Stebbing have been selected to drill first. They are completely independent prospects other than they require the same source rock to be present. This means they have different aged reservoirs and seals, different source kitchens and migration pathways and different structural styles.

The Darwin and Stebbing wells are currently estimated to take approximately 45 days each. Following these wells, two of the three option wells under the contract have been assigned to Falkland Oil & Gas.

Shallow hazard assessments and pore pressure prediction studies have been completed and detailed well engineering continues.

Corporate social responsibility


View looking towards Stanley, Falkland Islands

Responsible behaviour is fundamental to everything we do. We are a relatively small company within the exploration and production community, but have big ambitions for growth. If we are to be successful, deliver growth and produce value for all our stakeholders we must ensure that we operate to the highest of standards.

The board of directors has overall responsibility for the company's policies and business principles and the review of performance. The business principles are implemented by all directors, officers and employees of the company and are promoted to our contractors and partners.

Key areas of focus are:

- Health and safety
- Environmental impact
- Business ethics
- Community development
- Employee well-being

In brief

- **We work closely with the host governments and communities in the countries in which we operate to ensure internationally recognised standards are implemented and maintained along with compliance to local legislation**
- **The board of directors is responsible for setting objectives and targets, monitoring performance and providing the necessary resources to support its commitment**
- **All employees have responsibility for HSE awareness and the commitment to high standards**

The new rig deal...
what does it mean
for the future of
Borders & Southern?

Principal risks and uncertainties

"Based on current cost estimates, we believe we have sufficient funds to drill these two wells with contingency."

Risk management

The key risks and uncertainties facing the business and the processes in place to mitigate and manage those risks are described below:

Risk	Mitigation
Exploration	
All exploration wells carry sub-surface risk that could result in a negative outcome. This risk is considered higher in frontier areas where there is relatively little geological data available to constrain interpretations.	The company has made considered judgements on the type and quantity of data acquired in its licences, all aimed at reducing the pre-drill exploration risk. It has selected prospects, located on 3D seismic, that display strong geophysical attributes. The company believes it cannot reduce the risk further ahead of drilling.
Safety	
Working in the oil and gas industry carries inherent potential health and safety risks. Drilling wells in a remote, harsh environment can present real challenges.	The company has built a very experienced team, contracted a high quality rig with a good safety record and has put in place clear safety policies and procedures, supported by strong leadership and accountability throughout the company.
Environment	
Drilling activity within the oil and gas industry can impact the environment.	The company has submitted and gained approval for a detailed Environmental Impact Assessment addressing all environmental risks and outlining mitigation plans. The company is committed to meeting host government legislation and industry best practice.
Financial	
The company is exposed to a variety of financial risks that include price risk, liquidity risk and foreign exchange risk. Furthermore, the exact cost of the drilling programme is subject to factors beyond our control, such as weather.	The company has placed its cash deposits with high quality UK banks and seeks to match the currencies of the deposits with the currencies of the expected costs for the drilling campaign and other general administration costs. The well cost estimates are developed using probability based simulations that provide cost ranges. Based on the current estimates, we believe that we have sufficient funds, with reasonable contingencies to cover these ranges, to drill two wells.

- **Any discovery will transform the company in terms of its value and scale of operations**
- **In the success case, the depth of the prospect inventory would support substantial exploration activity and resource accretion**
- **Success would lead to further 3D seismic being acquired and a commitment to further exploration and appraisal drilling**

Board of directors

Harry Dobson
(Non-executive Chairman)

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.

Harry is Chairman of the Remuneration Committee and sits on the Audit Committee.

Howard Obee
(Chief Executive)

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 over 25 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 Fleming
(Finance Director)

Peter Fleming has over 19 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 Posford
(Non-executive Director)

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.

Stephen sits on the Audit and Remuneration Committees.

Nigel Hurst-Brown
(Non-executive Director)

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.

Nigel is Chairman of the Audit Committee and sits on the Remuneration Committee.

	Number of board meetings		
Attendance	Board	Remuneration Committee	Audit Committee
Harry Dobson	4	1	2
Howard Obee	4	—	2
Peter Fleming	4	—	2
Stephen Posford	4	1	2
Nigel Hurst-Brown	4	1	2

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Directors' report

for the year ended 31 December 2010

The directors present their report and the audited consolidated financial statements for the year ended 31 December 2010.

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.

Results and dividends

The group statement of comprehensive income is set out on page 18 and shows the result for the year.

The directors do not recommend the payment of a dividend (2009: $nil).

Review of business and future developments

A review on the operations of the group is contained in the Business Review on pages 6 and 7.

Principal risks and uncertainties and financial risk management

Exploration risk

The exploration for and development of hydrocarbons is speculative and involves a high degree of risk. These risks include the uncertainty that the group will discover sufficient oil or gas to exploit commercially.

Financial risk management

The company's operations are such that it has a limited exposure to a variety of financial risks, but may include the effects of changes in price risk, liquidity risk and a foreign exchange risk.

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 entered into a contract to drill two exploration wells during the year. Based on the current well cost estimates, the company believes it has sufficient cash reserves to meet its expected costs under this contract.

Foreign exchange risk

The company has potential exposure due to some of its purchases being invoiced in UK Sterling. To mitigate the risk, the company retains funds on UK Sterling bank accounts to settle these liabilities.

The company also has potential exposure to cash being raised in UK Sterling but planned future expenditure being in US Dollars. To mitigate against this risk the company may take out forward exchange contracts when considered necessary.

Safety

Working in the oil and gas industry carries inherent potential health and safety risks. Drilling wells in a remote, harsh environment can present real challenges.

Environment

Drilling activity within the oil and gas industry can impact the environment.

Directors' report continued

for the year ended 31 December 2010

Key performance indicators

The company's key performance indicators (discussed in the Business Review on pages 6 and 7 are on the management of its cash position ($194 million at year end; 2009: $206 million) and the fulfilment of the exploration programme.

Post reporting date events

All events that have occurred since the year end which require reporting have been disclosed in note 19.

Charitable and political donations

There were no political or charitable contributions made by the company or the group during the year (2009: $nil).

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 country 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 4 days (2009: 14 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 20 of the financial statements.

Directors' responsibilities

The directors are responsible for preparing the director's report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have prepared the group and company financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and elected to prepare the company financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the group and company and of the profit or loss of the group for that period. The directors are also required to prepare financial statements in accordance with the rules of the London Stock Exchange for companies trading securities on AIM.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRSs as adopted by the European Union, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the requirements of the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Directors and their interests

	At 31 December 2010 Number	At 31 December 2009 Number
David Harry Williamson Dobson	**26,670,000**	26,670,000
Stephen James Douglas Posford	**27,499,990**	27,500,000
Howard Kevin Obee	**10,000,000**	10,000,000
Christopher Nigel Hurst Brown	**1,530,000**	1,530,000
Peter William Fleming	**2,200,000**	2,200,000

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 of the year	Number of options held at the end of the year	Exercise price
Howard Kevin Obee	50,000	300,000	56p
Peter William Fleming	50,000	300,000	56p
Christopher Nigel Hurst Brown	—	250,000	58p

Substantial shareholders

At 19 May 2011 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	67,979,000	15.86%
Stephen James Douglas Posford	27,499,990	6.40%
Zila Corporation	26,670,000	6.22%
Blackrock Investment Management (UK) Limited	25,920,085	6.05%
Henderson Global Investors Ltd	22,248,512	5.19%
Allianz SE	18,460,000	4.30%

Website publication

The directors are responsible for ensuring the annual report and the financial statements are made available on a website. Financial statements are published on the company'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 company's website is the responsibility of the directors. The directors' responsibility also extends to the ongoing integrity of the financial statements contained therein.

Auditor

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 auditor for the purposes of its audit and to establish that the auditor is aware of that information. The directors are not aware of any relevant audit information of which the auditor is unaware.

BDO LLP has expressed its willingness to continue in office and a resolution to reappoint BDO LLP will be proposed at the Annual General Meeting.

By order of the board

William Slack
Company Secretary
19 May 2011

Audit committee report

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

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

- reviewing 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 auditor's 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 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 determining 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 2010 was as follows:

	Basic salary $	Share-based payment $	**Total 2010 $**	Total 2009 $
Harry Dobson	—	—	**—**	—
Stephen Posford	—	—	**—**	—
Howard Obee	200,347	41,033	**241,380**	159,793
Nigel Hurst-Brown	—	41,033	**41,033**	8,321
Peter Fleming	124,458	41,033	**165,491**	50,845
Total	324,805	123,099	**447,904**	218,959

Pensions

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

Independent auditor's report

to the members of Borders and Southern Petroleum Plc

We have audited the financial statements of Borders & Southern Petroleum Plc for the year ended 31 December 2010 which comprise the consolidated statement of comprehensive income, the consolidated statement of financial position, the consolidated statement of changes in equity, the company statement of financial position, the company statement of changes in equity, the consolidated statement of cash flows, the company statement of cash flows and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the statement of directors' responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/private.cfm.

Opinion on financial statements

In our opinion:

- the financial statements give a true and fair view of the state of the group's and the parent company's affairs as at 31 December 2010 and of the group's loss for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Anthony Perkins (Senior Statutory Auditor)
For and on behalf of BDO LLP, Statutory Auditor
London
United Kingdom
19 May 2011

BDO LLP is a limited liability partnership registered in England and Wales (with registered number OC305127).

Consolidated statement of comprehensive income

for the year ended 31 December 2010

	Note	2010 $	2009 $
Administrative expenses		**(1,504,467)**	(1,209,977)
Loss from operations	2	**(1,504,467)**	(1,209,977)
Finance income	8	**1,359,497**	4,587,604
Finance expense	8	**(20,313)**	(226,891)
(Loss)/profit before tax		**(165,283)**	3,150,736
Tax expense	9	**—**	—
(Loss)/profit for the year and total comprehensive (loss)/income for the year attributable to owners of the parent		**(165,283)**	3,150,736
Basic and basic (loss)/earnings per share (see note 3)		**(0.039) cents**	1.54 cents

The notes on pages 25 to 36 form part of the financial statements.

Consolidated statement of financial position

as at 31 December 2010

		2010		2009	
	Note	$	$	$	$
Assets					
Non-current assets					
Property, plant and equipment	10		**13,110**		19,516
Intangible assets	11		**37,730,165**		36,619,040
Total non-current assets			**37,743,275**		36,638,556
Current assets					
Other receivables	13	**11,315,514**		100,191	
Cash and cash equivalents	16	**194,130,019**		206,321,177	
Total current assets			**205,445,533**		206,421,368
Total assets			**243,188,808**		243,059,924
Liabilities					
Current liabilities					
Trade and other payables	14		**(271,471)**		(244,680)
Total net assets			**242,917,337**		242,815,244
Equity					
Share capital	15		**7,675,453**		7,675,453
Share premium			**238,034,095**		238,034,095
Other reserves			**620,662**		353,286
Retained deficit			**(3,396,477)**		(3,231,194)
Foreign currency reserve			**(16,396)**		(16,396)
Total equity			**242,917,337**		242,815,244

The notes on pages 25 to 36 form part of the financial statements.

The financial statements were approved by the board of directors and authorised for issue on 19 May 2011.

Howard Obee
Director

Peter Fleming
Director

Company number
5147938

Consolidated statement of changes in equity

for the year ended 31 December 2010

	Share capital $	Share premium $	Other reserves $	Retained deficit $	Foreign currency reserve $	Total $
Balance at 1 January 2009	3,867,741	57,906,686	209,409	(6,381,930)	(16,396)	55,585,510
Total comprehensive income for the year	—	—	—	3,150,736	—	3,150,736
Issue of share capital	3,807,712	180,127,409	—	—	—	183,935,121
Recognition of share-based payments	—	—	143,877	—	—	143,877
Balance at 31 December 2009	7,675,453	238,034,095	353,286	(3,231,194)	(16,396)	242,815,244
Total comprehensive loss for the year	—	—	—	(165,283)	—	(165,283)
Recognition of share-based payments	—	—	267,376	—	—	267,376
Balance at 31 December 2010	**7,675,453**	**238,034,095**	**620,662**	**(3,396,477)**	**(16,396)**	**242,917,337**

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	Amount subscribed for share capital in excess of nominal value.
Other reserves	Fair value of options issued.
Foreign currency reserve	Differences arising on change of presentation and functional currency to US Dollars.
Retained deficit	Cumulative net gains and losses recognised in the consolidated statement of comprehensive income.

The notes on pages 25 to 36 form part of the financial statements.

Company statement of financial position

as at 31 December 2010

	Note	2010 $	2010 $	2009 $	2009 $
Assets					
Non-current assets					
Property, plant and equipment	10		**13,110**		19,516
Investments	12		**2**		2
Total non-current assets			**13,112**		19,518
Current assets					
Other receivables	13	**49,209,046**		36,845,926	
Cash and cash equivalents	16	**194,130,019**		206,321,177	
Total current assets			**243,339,065**		243,167,103
Total assets			**243,352,177**		243,186,621
Liabilities					
Current liabilities					
Trade and other payables	14		**(264,290)**		(237,495)
Total net assets			**243,087,887**		242,949,126
Capital and reserves					
Called up share capital	15		**7,675,453**		7,675,453
Share premium			**238,034,095**		238,034,095
Other reserves			**620,662**		353,286
Retained deficit			**(3,223,638)**		(3,095,023)
Foreign currency reserve			**(18,685)**		(18,685)
Total equity			**243,087,887**		242,949,126

The notes on pages 25 to 36 form part of the financial statements.

The financial statements were approved by the board of directors and authorised for issue on 19 May 2011.

Howard Obee
Director

Peter Fleming
Director

Company number
5147938

Company statement of changes in equity

for the year ended 31 December 2010

	Share capital $	Share premium reserve $	Other reserves $	Retained deficit $	Foreign currency reserve $	Total $
Balance at 1 January 2009 brought forward	3,867,741	57,906,686	209,409	(6,276,415)	(18,685)	55,688,736
Total comprehensive income for the year	—	—	—	3,181,392	—	3,181,392
Issue of share capital	3,807,712	180,127,409	—	—	—	183,935,121
Recognition of share-based payments	—	—	143,877	—	—	143,877
Balance at 31 December 2009	7,675,453	238,034,095	353,286	(3,095,023)	(18,685)	242,949,126
Total comprehensive loss for the year	—	—	—	(128,615)	—	(128,615)
Recognition of share-based payments	—	—	267,376	—	—	267,376
Balance at 31 December 2010	**7,675,453**	**238,034,095**	**620,662**	**(3,223,638)**	**(18,685)**	**243,087,887**

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	Amount subscribed for share capital in excess of nominal value.
Other reserves	Fair value of options issued.
Foreign currency reserve	Differences arising on change of presentation and functional currency to US Dollars.
Retained deficit	Cumulative net gains and losses recognised in the consolidated statement of comprehensive income.

The notes on pages 25 to 36 form part of the financial statements.

Consolidated statement of cash flows

for the year ended 31 December 2010

	Note	2010 $	2010 $	2009 $	2009 $
Cash flow from operating activities					
(Loss)/profit before tax			**(149,818)**		3,150,736
Adjustments for:					
Depreciation			**9,930**		9,206
Share-based payment			**267,376**		143,877
Finance income			**(1,359,497)**		(4,587,604)
Foreign expense			**20,313**		226,891
Cash flows from operating activities before changes in working capital			**(1,211,696)**		(1,056,894)
(Increase)/decrease in other receivables			**(1,847,804)**		12,841
Increase in trade and other payables			**11,326**		49,910
Net cash outflow from operating activities			**(3,048,174)**		(994,143)
Cash flows used in investing activities					
Interest received		**520,830**		359,490	
Redemption of other financial assets		**—**		9,950,668	
Purchase of intangible assets		**(10,479,407)**		(578,180)	
Purchase of property, plant and equipment		**(3,524)**		(13,793)	
Net cash used in investing activities			**(9,962,101)**		9,718,185
			(13,010,275)		8,724,042
Cash flows from financing activities					
Gain on forward contract		**—**		4,366,870	
Interest paid		**(20,313)**		—	
Proceeds from issue of shares and share options (net of issue costs)		**—**		183,935,121	
Net cash from financing activities			**(20,313)**		188,301,991
Net (decrease)/ increase in cash and cash equivalents			**(13,030,588)**		197,026,033
Cash and cash equivalents at the beginning of the year			**206,321,177**		9,522,035
Exchange gain/(loss) on cash and cash equivalents			**839,430**		(226,891)
Cash and cash equivalents at the end of the year	16		**194,130,019**		206,321,177

Company statement of cash flows

for the year ended 31 December 2010

	Note	2010 $	2010 $	2009 $	2009 $
Cash flow from operating activities					
(Loss)/profit before tax			**(128,615)**		3,181,392
Adjustments for:					
Depreciation			**9,930**		9,206
Share-based payment			**267,376**		143,877
Finance income			**(1,359,497)**		(4,587,604)
Foreign expense			**20,313**		226,891
Cash flows from operating activities before changes in working capital			**(1,190,493)**		(1,026,238)
(Increase)/decrease in other receivables			**(1,847,804)**		12,840
Increase in trade and other payables			**26,795**		49,912
Net cash outflow from operating activities			**(3,011,502)**		(963,486)
Cash flows used in investing activities					
Interest received		**520,830**		359,491	
Interest paid		**(20,313)**		—	
Redemption of other financial assets		**—**		9,950,668	
Purchase of intangible assets		**(10,516,079)**		(608,838)	
Purchase of property, plant and equipment		**(3,524)**		(13,793)	
Net cash used in investing activities			**(10,019,086)**		9,687,528
			(13,030,588)		8,724,042
Cash flows from financing activities					
Gain on forward contract		**—**		4,366,870	
Proceeds from issue of shares and share options (net of issue costs)		**—**		183,935,121	
Net cash from financing activities			**—**		188,301,991
Net (decrease)/increase in cash and cash equivalents			**(13,030,588)**		197,026,033
Cash and cash equivalents at the beginning of the year			**206,321,177**		9,522,035
Exchange gain/(loss) on cash and cash equivalents			**839,430**		(226,891)
Cash and cash equivalents at the end of the year	16		**194,130,019**		206,321,177

Notes to the financial statements

for the year ended 31 December 2010

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.

These consolidated and parent financial statements have been prepared in accordance with International Financial Reporting Standards (IFRSs and IFRIC interpretations) issued by the International Accounting Standards Board (IASB) as adopted by the European Union and with those parts of the Companies Act 2006 applicable to companies preparing their accounts under IFRSs.

New and revised Standards effective for 31 December 2010 year end which are currently relevant to the group

The financial statements have been drawn up on the basis of accounting policies consistent with those applied in the financial statements for the year to 31 December 2009. Of the new and revised standards effective for the 31 December 2010 year end, the following standards, interpretations and amendments to existing standards are relevant to the group have been adopted for the first time in 2010:

Amendments

IAS 27 Consolidated and separate financial statements (effective for accounting periods commencing on or after 1 July 2009).

IAS 39 Reclassification of financial assets: effective date and transition (effective for accounting periods commencing on or after 1 July 2009).

Improvements to IFRSs (2010) Amendments to various standards Issued 16 April 2009 (effective for accounting periods commencing on or after 1 January 2010).

The adoption of these standards, interpretations and amendments did not affect the group results of operations or financial positions. The presentation of these financial statements incorporates changes arising from adoption of these standards, interpretations and amendments.

New and revised Standards issued but not effective for 31 December 2010 year end

The IASB and IFRIC have issued standards and interpretations which are effective for reporting periods beginning after the date of these financial statements, and which the group is not adopting early. Of these issued standards and interpretations, the following are considered relevant to the group:

IAS 24 (revised) Revised definition of related party (effective for accounting periods commencing on or after 1 January 2011). The group will apply this amendment in the accounting period commencing 1 January 2011.

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.

Notes to the financial statements continued

for the year ended 31 December 2010

1 Accounting policies continued

(Loss)/profit for the financial year

The company has taken advantage of the exemption allowed under Section 408 of the Companies Act 2006 and has not presented its own income statement in these financial statements. The group loss for the year includes a loss after tax of $113,150 (2009: profit after tax of $3,181,392) which is dealt with in the financial statements of the parent company.

The company's investments in subsidiaries

The parent company's subsidiaries are carried at cost less amounts provided for impairment.

Finance income

Finance income consists of interest on cash deposits and foreign exchange gains.

The treatment of foreign exchange gains on derivatives is discussed under financial instruments.

Segment reporting

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the board of directors.

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. 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.

Impairment

Exploration assets are reviewed regularly for indication of impairment, where circumstances indicate that the carrying value may not be recoverable. If an indication of impairment exists, the asset is tested for impairment in accordance with IAS 36: Impairment of assets.

The carrying value is compared against the expected recoverable amount, generally by reference to the present value of future net cash flows expected to be generated from the production of commercial reserves. The cash-generating unit (CGU) applied for impairment testing is usually the individual field, except that a number of fields may be grouped together to form a single CGU where the cash flows are interdependent.

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

Provisions

A provision is recognised in the statement of financial position 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 US Dollars at the exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into US Dollars at the closing rates at the reporting date and the exchange differences are included in the statement of comprehensive income. The functional and presentational currency of the parent and all group companies is the US Dollar.

1 Accounting policies continued

Operating leases

Rentals payable under operating leases are charged to the statement of comprehensive income 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 pricing model. Non-employee options granted as part of consideration for services rendered are valued at the fair value of those services. Where information on the fair value of services rendered is not readily available, the fair value is calculated using the Black-Scholes pricing model. In accordance with IFRS 2 Share-based payments the resulting cost is charged to the statement of comprehensive income over the vesting period of the options. The amount of charge is adjusted each year to reflect expected and actual levels of options vesting.

Where equity-settled share options are awarded, the fair value of the options at the date of grant is charged to the statement of comprehensive income over the vesting period. Non-market vesting conditions are taken into account by adjusting the number of equity instruments expected to vest at each reporting 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 statement of comprehensive income 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 may use derivative financial instruments such as currency forward contracts to manage the risks associated with foreign exchange. They are carried in the statement of financial position at fair value with changes in fair value recognised in the consolidated statement of comprehensive income in the finance income or expense line;
- 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; and
- 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 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 reporting date.

Tax is charged or credited to the statement of comprehensive income, 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 statement of financial position 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 reporting date and are expected to apply when deferred tax liabilities and assets are settled or recovered.

Notes to the financial statements continued

for the year ended 31 December 2010

1 Accounting policies continued

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 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 reporting 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 using a 50% volatility rate. See note 7.

2 Loss from operations

	2010 $	2009 $
Staff costs (note 5)	**533,910**	375,968
Share-based payment – equity-settled	**267,376**	143,877
Services provided by the auditor:		
Audit: fees payable to the company's auditor for the audit of the parent company and consolidated financial statements	**49,852**	32,146
Fees payable to the company's auditor:		
Tax services	**21,476**	4,442
Other services	**—**	6,902
Depreciation of office equipment	**9,930**	9,206
Operating lease expenses – property	**209,801**	185,200

3 Basic and dilutive (loss)/earnings per share

The calculation of the basic and dilutive loss 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 $165,283 (2009: profit $3,150,736) and the weighted average number of shares in issue for the year was 428,578,404 (2009: 204,611,972). During the year the potential ordinary shares are anti-dilutive and therefore diluted loss per share has not been calculated. At the statement of financial position date, there were 2,450,000 (2009: 2,250,000) potentially dilutive ordinary shares being the share options (note 7).

4 Segment analysis

The company operates in one operating segment (exploration for oil and gas) and in substantially one geographical market (the Falkland Islands), therefore no additional segmental information is presented.

Of the group's total non-current assets, the property, plant and equipment is based in the UK; all other non-current assets are located in the Falkland Islands.

5 Staff costs

Company and group

Staff costs (including directors) comprise:

	2010 $	2009 $
Wages and salaries	**476,165**	336,203
Employers national insurance contribution	**57,745**	39,765
	533,910	375,968
Share-based payment – equity-settled	**220,944**	134,996
	754,854	510,964

The average number of employees (including directors) employed during the year by the company was six (2009: six) and for the group was six (2009: six). All employees and directors of the group and the company are considered to be the key management personnel.

Of the $267,376 share-based payment charge included in the consolidated statement of comprehensive income, $220,944 (2009: $134,996) has been charged in respect of share options granted in prior years to staff (including directors). The remaining $46,432 (2009: $8,881) relates to share options granted to external parties; see note 7 for further details.

6 Directors' emoluments

The directors' emoluments for the year are as follows:

	2010 $	2009 $
Directors' fees	**324,805**	187,782
Share-based payments – equity-settled	**123,099**	31,176
	447,904	218,958

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

In 2009, the group granted to three directors of Borders & Southern Petroleum Plc, for nil consideration, 250,000 share options each, with a total fair value of $374,446. Of this amount $123,099 (2009: $24,963) has been expensed during the year. For further details, refer to the Remuneration Committee Report.

7 Share-based payment

On 7 June 2010, the group granted 200,000 share options to an external party. The options vest after three years and expire after ten years. Because of the difficulty in measuring the fair value of the services received, this has been determined by reference to the fair value of the options granted. A Black-Scholes model has been used to determine the fair value of options granted (see below).

	31 December 2010 Weighted average exercise price	31 December 2010 Number	31 December 2009 Weighted average exercise price	31 December 2009 Number
Outstanding at the beginning of the year	**53p**	**2,250,000**	50p	1,000,000
Granted during the year	**74p**	**200,000**	53p	1,250,000
Outstanding at the end of the year	**54p**	**2,450,000**	52p	2,250,000

The weighted average contractual life of the options outstanding at the year end was four years (2009: four years). The options are exercisable after three years.

Notes to the financial statements continued

for the year ended 31 December 2010

7 Share-based payment continued

The following information is relevant in the determination of the fair value of the options granted during the year under the scheme operated by the company.

Equity-settled scheme	31 December 2010	31 December 2009
Option pricing model used	**Black-Scholes**	Black-Scholes
Weighted average share price at grant date	**74p**	53p
Exercise price	**74p**	53p
Weighted average contractual life (days)	**1,460**	1,460
Expected volatility	**50%**	70%
Risk-free interest rate	**2.5%**	4%
Fair value of options	**31p**	30p

The expected volatility used to calculate the share-based remuneration expense was based on the standard deviation of the company's monthly close share prices since inception.

Share-based remuneration expense for the year in respect of the equity-settled scheme for options granted during the year	**$17,887**	—
Share-based remuneration expense for the year in respect of the equity-settled scheme for options granted during 2006	**—**	$31,066
Share-based remuneration expense for the year in respect of the equity-settled scheme for options granted during 2007	**$5,710**	$11,483
Share-based remuneration expense for the year in respect of the equity-settled scheme for options granted during 2008	**$54,028**	$54,781
Share-based remuneration expense for the year in respect of the equity-settled scheme for options granted during 2009	**$189,751**	$46,547
Total share-based remuneration expense for the year	**$267,376**	$143,877

8 Finance income and expense

Finance income

	2010 $	2009 $
Bank interest received	**520,067**	171,075
Treasury stock interest	**—**	49,659
Foreign exchange gain	**839,430**	4,366,870
	1,359,497	4,587,604

Finance expense

	2010 $	2009 $
Bank interest paid	**20,313**	—
Foreign exchange loss	**—**	226,891
	20,313	226,891

9 Tax expense

Current tax expense

	2010 $	2009 $
UK corporation tax on (loss)/profit for the year	**—**	—

Factors affecting current year 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)/profits for the year are as follows:

	2010 $	2009 $
(Loss)/profit before and after taxation	**(165,283)**	3,150,736
Standard rate corporation tax charge (28%)	**(46,279)**	882,206
Expenses not deductible for tax purposes	**195,747**	158,500
Capital allowances in excess of depreciation	**1,602**	(1,970)
Unutilised tax losses carried forward	**—**	8,585
Tax losses brought forward utilised	**(151,070)**	(1,047,321)
Total current and deferred tax for the year	**—**	—

Factors that may affect future tax charges

The group has a deferred tax asset of approximately $41,000 (2009: $192,000) in respect of unrelieved tax losses of approximately $146,000 at 31 December 2010 (2009: $686,000). The rate of tax used in the calculation of the deferred tax asset is 27% (2009: 28%).The deferred tax asset has not been recognised in the financial statements as the timing of the economic benefit is uncertain.

10 Property, plant and equipment

Group and company	Office equipment $
Cost	
As at 1 January 2009	69,464
Additions	13,793
As at 31 December 2009	83,257
Depreciation	
As at 1 January 2009	54,535
Charge for the year	9,206
As at 31 December 2009	63,741
Net book value	
As at 31 December 2009	19,516
As at 31 December 2008	14,929

Notes to the financial statements continued

for the year ended 31 December 2010

10 Property, plant and equipment continued

	Office equipment $
Cost	
As at 1 January 2010	83,257
Additions	3,524
As at 31 December 2010	**86,781**
Depreciation	
As at 1 January 2010	63,741
Charge for the year	9,930
As at 31 December 2010	**73,671**
Net book value	
As at 31 December 2010	**13,110**

11 Intangible assets

Group	Exploration and evaluation costs $
Cost	
As at 1 January 2009	36,040,860
Additions	578,180
As at 31 December 2009	36,619,040
Net book value	
As at 31 December 2009	36,619,040
As at 31 December 2008	36,040,860

Group	Exploration and evaluation costs $
Cost	
As at 1 January 2010	36,619,040
Additions	1,111,125
As at 31 December 2010	37,730,165
Net book value	
As at 31 December 2010	37,730,165

On 19 January 2010 it was confirmed by the Acting Governor of the Falkland Islands that it consented to extend the licences to 1 November 2012 with a commitment to drill one well prior to 1 November 2012.

12 Investments in subsidiary

Company	2010 $	2009 $
Cost		
As at 1 January and 31 December	**2**	2
Net book value		
As at 31 December	**2**	2

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 Other receivables

	Group		Company	
	2010 $	2009 $	**2010 $**	2009 $
Amounts owed by group undertakings	**—**	—	**47,261,814**	36,745,735
Other receivables	**1,883,812**	52,980	**1,883,812**	52,980
Prepayments and accrued income	**9,431,702**	47,211	**63,420**	47,211
	11,315,514	100,191	**49,209,046**	36,845,926

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

Amounts owed by group undertakings are not interest bearing and are payable on demand.

14 Trade and other payables

	Group		Company	
	2010 $	2009 $	**2010 $**	2009 $
Trade payables	**115,704**	47,566	**115,704**	47,566
Other taxes and social security costs	**24,216**	13,588	**24,216**	13,588
Other payables	**33,635**	23,396	**33,635**	23,396
Accruals and deferred income	**97,916**	160,130	**90,735**	152,945
	271,471	244,680	**264,290**	237,495

15 Share capital

	2010 $	2009 $
Authorised		
750,000,000 ordinary shares of 1 pence each (2009: 750,000,000)	**14,926,125**	14,926,125
Allotted, called up and fully paid		
428,578,404 ordinary shares of 1 pence each (2009: 428,578,404)	**7,675,453**	7,675,453

Notes to the financial statements continued

for the year ended 31 December 2010

16 Cash and cash equivalents

Group and company	2010 $	2009 $
Cash available on demand	**2,204,126**	950,774
Cash on deposit	**191,925,893**	205,370,403
Total	**194,130,019**	206,321,177

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

17 Related party transactions

Company

During the year Borders & Southern Petroleum Plc paid expenses of $10,516,079 (2009: $608,838) on behalf of Borders & Southern Falkland Islands Limited. At the year end $47,261,814 (2009: $36,745,735) was due from the subsidiary.

The employees and directors of the group and the company are considered to be the key management personnel, there were no transactions between the group, the company and the key management personnel during the year. The remuneration paid to the key management personnel is disclosed in note 6.

18 Commitments

The total future value of minimum lease payments on office property is due as follows:

	Land and buildings	
	2010 $	2009 $
Not later than one year	**109,066**	224,470
Later than one year but not later than five years	**56,312**	112,230
	165,378	336,700

On 6 December 2010 the company entered in to a contract with Ocean Rig UDW Inc. for the provision of mobile drilling rig services using the Eirik Raude drilling unit. Under the contract the company committed to drill two wells with options to drill a further three wells. The expected costs under this contract for drilling two wells, including mobilisation and de-mobilisation, are currently estimated to be $60 million and the company anticipates these costs will be incurred within 18 months from the statement of financial position date.

19 Events after the reporting period

On 5 May 2011, a new contract was entered into with Ocean Rig UDW Inc. to substitute the Leiv Eiriksson drilling unit for the Eirik Raude. There were no other material changes to the terms and conditions of the contract entered in to during the year.

Post reporting date the group made a cash deposit of $52.3 million as security for a letter of credit which will be treated as restricted cash.

On 18 May 2011, the company signed an agreement to assign two of its option wells to Falkland Oil & Gas Limited.

20 Financial instruments

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

Liquidity is not considered to be a risk due to the sufficient cash funds readily available by the group at the year end.

The group is exposed to risks that arise from its use of financial instruments. This note describes the group's objectives, policies and processes for managing those risks and the methods used to measure them. There have been no substantive changes in the group's exposure to financial instrument risks, its objectives, policies and processes for managing those risks or the methods used to measure them from previous periods unless otherwise stated in the note.

20 Financial instruments continued

Principal financial instruments

The principal financial instruments used by the group from which financial instrument risk arises, held by category, are as follows:

- other receivables;
- cash and cash equivalents; and
- trade and other payables.

The fair values of the group's financial assets and liabilities at 31 December 2010 and as at 31 December 2009 are materially equivalent to the carrying value as disclosed in the statement of financial position and related notes.

a) Cash flow interest rate risk

The group is exposed to cash flow interest rate risk from monies held at bank and on deposit at variable rates.

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 2010 the company held cash at bank and in deposits under its control of $194,130,019 (2009: $206,321,177). This forms the majority of the group's working capital. Of the cash at bank and in deposit, $2,204,126 (2009: $950,774) 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 $191,925,893 (2009: $205,370,403) with weighted average fixed interest rate of 0.2% (2009: 0.5%) for three months. If there was 1% change in interest rates the impact on the statement of comprehensive income would be $1,986,481 (2009: $441,500).

b) Foreign currency translation risk

The operational currency of the oil and gas exploration and evaluation activities of the group is US$ and the group's functional and presentational currency is US$. Foreign exchange risk arises because the group's services and treasury function is UK Sterling, which results in gains or losses on retranslation into US$. To minimise this foreign currency risk cash balances are held in both £ sterling and US$.

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

	Group		Company	
Current financial assets	**Financial assets measured at amortised cost 2010 $**	Financial assets measured at amortised cost 2009 $	**Financial assets measured at amortised cost 2010 $**	Financial assets measured a amortised cost 2009 $
Held in UK£:				
Other receivables	**9,514,835**	52,980	**146,553**	52,980
Cash and cash equivalents	**38,318,280**	17,297,060	**38,318,280**	17,297,060
Total current financial assets held in UK£	**47,833,115**	17,350,040	**38,464,833**	17,350,040
Held in US$:				
Trade and other receivables	**—**	—	**47,261,814**	36,745,735
Cash and cash equivalents	**155,811,739**	189,024,117	**155,811,739**	189,024,117
Total financial assets	**203,644,854**	206,374,157	**241,538,386**	243,119,892

If there was a 10% change in the year end exchange rate there would be a movement in the US$ equivalent of financial assets held in UK£ of $4,783,311 (2009: $1,735,004) for the group and company.

Notes to the financial statements continued

for the year ended 31 December 2010

20 Financial instruments continued

b) Foreign currency translation risk continued

	Group		Company	
	Financial liabilities measured at amortised cost 2010 $	Financial liabilities measured at amortised cost 2009 $	**Financial liabilities measured at amortised cost 2010 $**	Financial liabilities measured a amortised cost 2009 $
Held in UK£:				
Trade and other payables	**149,338**	231,092	**149,338**	223,907
Total financial liabilities	**149,338**	231,092	**149,338**	223,907

If there was a 10% change in the year end exchange rate there would be a movement in the US$ equivalent of financial liabilities held in the UK£ of $14,934 (2009: $7,096) for the group and company.

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:

	2010		2009	
	Carrying value $	**Maximum exposure $**	Carrying value $	Maximum exposure $
Cash and cash equivalents	**194,130,019**	**194,130,019**	206,321,177	206,321,177
Maximum credit risk exposure	**194,130,019**	**194,130,019**	206,321,177	206,321,177

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. The group considers its capital to comprise its ordinary share capital, share premium, accumulated retained deficit and other reserves.

Corporate directory

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Secretary	William Slack
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Joint broker	Ocean Equities Limited 3 Copthall Avenue London EC2R 7BH
Solicitors	SNR Denton UK LLP One Fleet Place London EC4M 7WS
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Bankers	Lloyds TSB Bank plc 19–21 The Quadrant Richmond Surrey PW9 1BP HSBC Bank plc 70 Pall Mall London SW1Y 5EZ
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