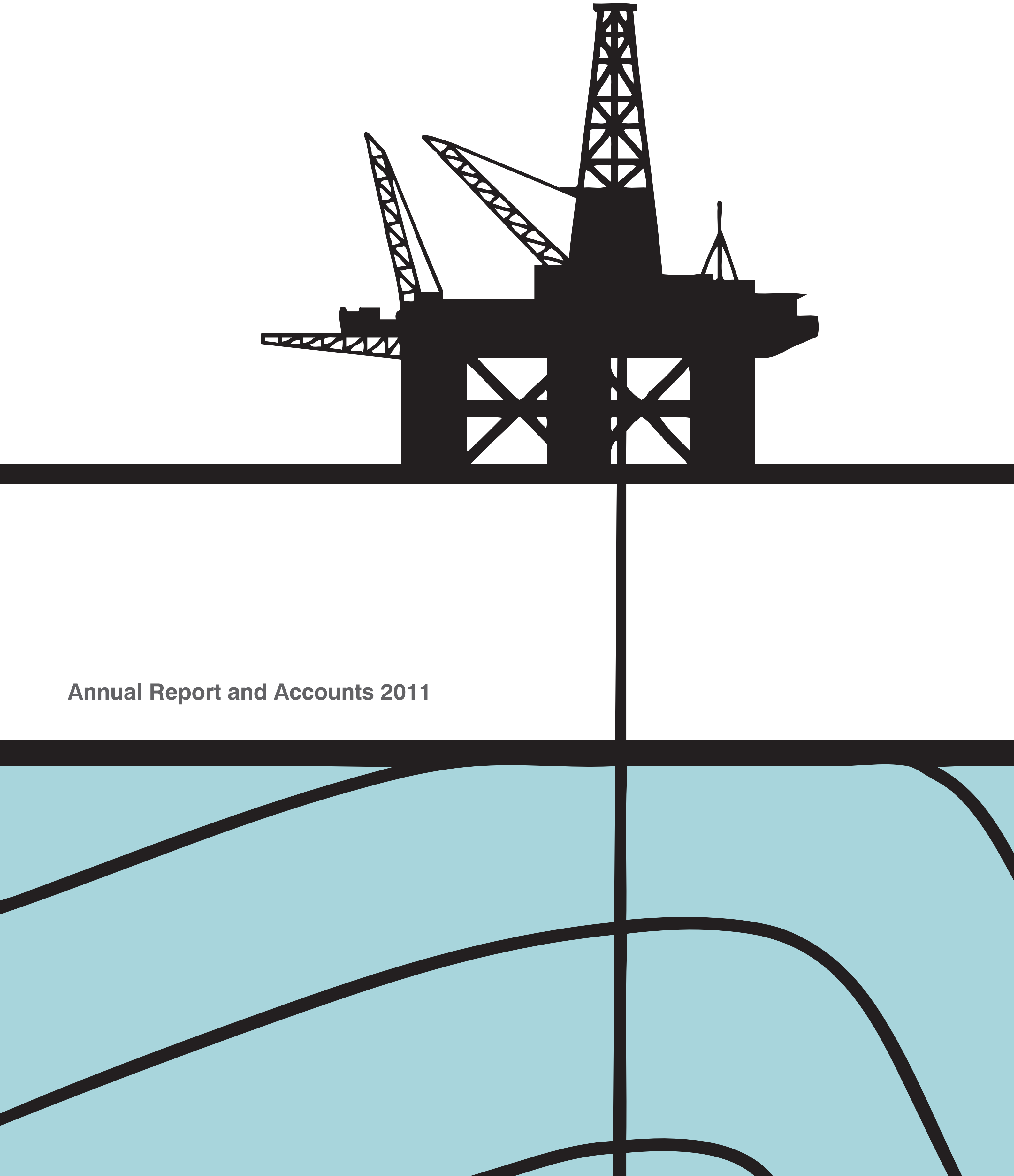
borders & southern
petroleum plc



Annual Report and Accounts 2011

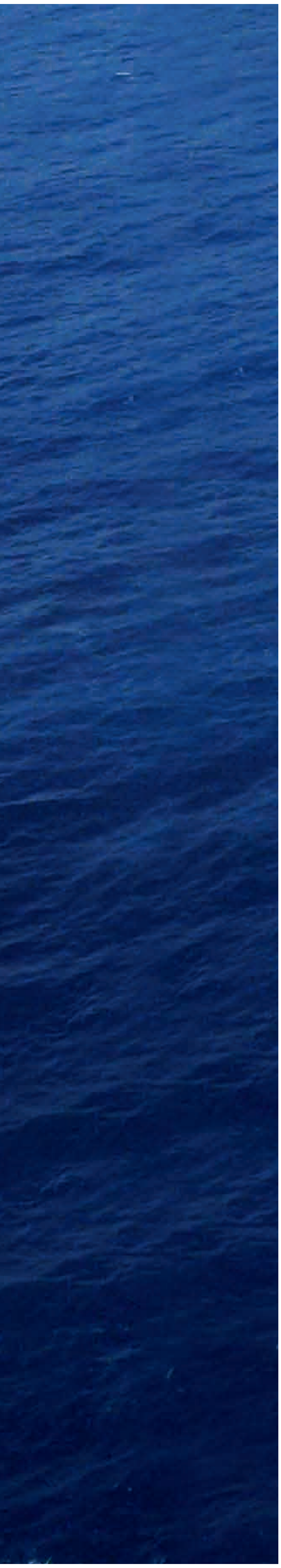
The Leiv Eiriksson drilling rig

Borders & Southern Petroleum Plc is an oil & gas exploration company focused on frontier and emerging basins.

Based in London and listed on the London Stock Exchange (AIM), the company operates five Production licences (100% interest) covering an area of nearly 20,000 sq km in the Falkland Islands.

We have acquired and evaluated 2,862 km of 2D and 1,492 sq km of 3D seismic data. Our first drilling programme is underway, where we have targeted two large structures located to the south of the Falklands. The first well has resulted in a gas condensate discovery and news from the second well is anticipated around the middle of the year.

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



Highlights

- Established an office and supply base in the Falkland Islands
- Finalised well engineering for the Darwin East and Stebbing wells
- Mobilised the Leiv Eiriksson drilling rig from Greenland to the Falkland Islands
- Drilled Darwin prospect, resulting in a gas condensate discovery
- Cash balance (including restricted use cash) as of 31 December 2011, $176.7m

Contents

A focused strategy

Our aim

To create value for our shareholders through exploration-led growth

Our strategy

- Focus on frontier or emerging basins
- Gain early project access
- Hold high equity positions
- Target play fairways containing multiple high impact prospects

Technical rigor

- Build and develop an experienced team
- Apply leading-edge technology
- Perform rigorous petroleum systems analysis

Commercial discipline

- Identify and mitigate critical risks
- Deliver strict financial control
- Negotiate robust contracts

Corporate responsibility

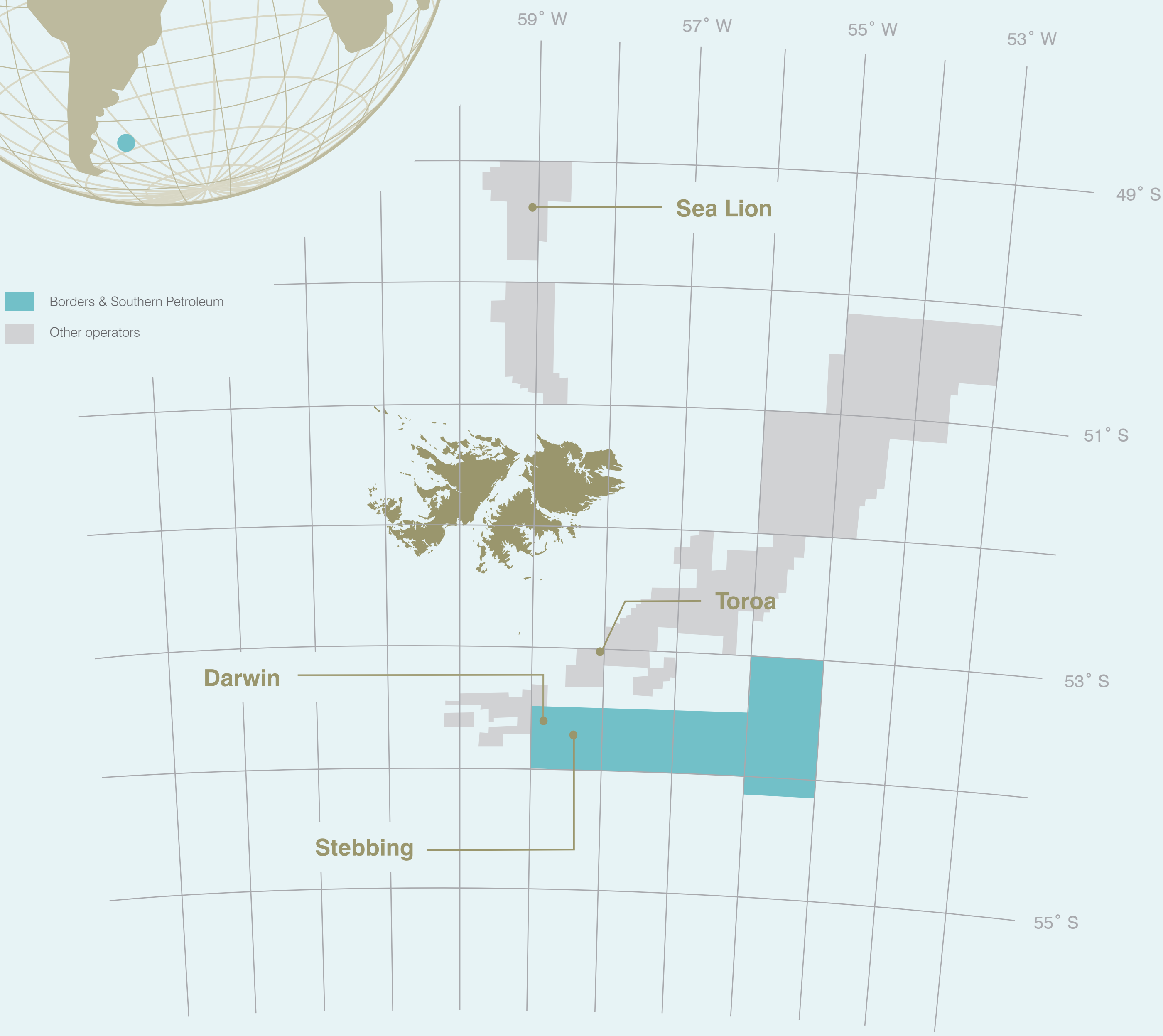
- Ensure the safety of our people
- Minimise our impact on the environment
- Maintain strong relationships with all our stakeholders

Progress

- Established an office and supply base in the Falkland Islands
- Mobilised the Leiv Eiriksson drilling rig from Greenland to the Falkland Islands
- Spudded the company's first exploration well
- Made the company's first discovery – Darwin
- Opened up a new hydrocarbon basin

What's next

- Complete the current drilling campaign by spudding the Stebbing well
- Integrate all the new well data into our existing regional and license evaluations
- Revise the company's prospect inventory
- Plan a new 3D seismic acquisition programme
- Interrogate the rig market for the next phase of exploration and appraisal



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

"I would like to extend my thanks to all the people who have been involved with this project and who have helped make it a success."

Recently we announced that the company's first exploration well drilled in the Falkland Islands had resulted in a gas condensate discovery. This was a tremendous outcome and represents the culmination of seven years' hard work since our listing on AIM in May 2005.

We had acquired our acreage in late 2004 with the specific purpose of testing our ideas that a fold belt trend located to the south of the Falklands could contain hydrocarbons. At the time, the acreage was unlicensed, had not been promoted and had very little seismic data over it. No exploration wells had been drilled in the basin at that stage and so the acreage was considered relatively high risk. However, over the seven years we acquired a comprehensive database, firstly by acquiring 2D seismic and later 3D seismic. At each stage, our understanding of the basin increased and, in our opinion, the risks decreased, so that when we finally compiled our prospect inventory we had a very attractive list of prospects.

Darwin was selected as our first test of the acreage. On paper it had many interesting geophysical characteristics. The prospect was large, structurally robust and viewed by the company as relatively low risk.

Drilling operations commenced in January of this year and although we had some initial problems with rig equipment that caused delays we reached our target depth during April. It was only when we had run the wireline logs that we appreciated that we had discovered gas condensate in a good quality reservoir. It's too early to talk about the size of the resource as there is still plenty of work to be done but we are delighted with the result and are very excited about the future of the company.

Drilling two deep water wells in a relatively remote location can provide many challenges, particularly from a logistical point of view. Our company has a small in-house team and so relies on many different contractor groups to provide expertise in different disciplines. I would like to extend my thanks to all the people who have been involved with this project and who have helped make it a success.

Our attention now turns to Stebbing, a completely independent prospect other than it requires the same regional source rock as Darwin (now proven). Again, it is a large structure with interesting geophysical attributes, so we look forward with great excitement.

Harry Dobson
Non-executive Chairman

Operations review

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Howard Obee
Chief Executive

Peter Fleming
Finance Director

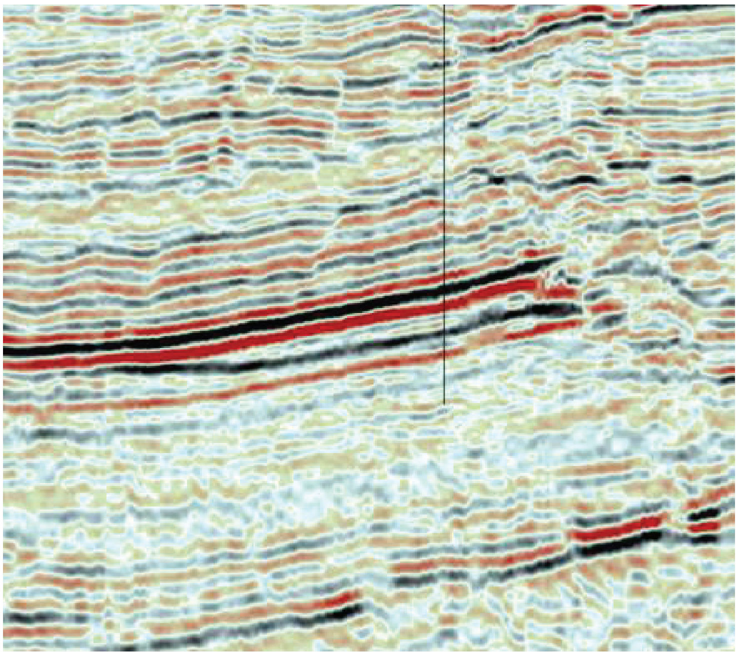
"Not only has it opened up a new hydrocarbon basin and confirmed our current technical understanding, it unlocks an exciting prospect inventory."

We spent much of 2011 preparing for our two well drilling campaign in the Falkland Islands, where the operational logistics provide their own unique challenges. The majority of the supplies and services were sourced out of Europe so careful planning was essential. We set up an office and supply base with the help of local businesses and managed to have the bulk of the supplies in place before the end of the year. AGR, who now have considerable experience of conducting drilling operations in the Falklands following their work in the North Falkland Basin, managed the operation on our behalf.

The well engineering was completed towards the end of the year and the well programmes were submitted to the Authorities in order to gain approval for drilling. In early December the Leiv Eiriksson was mobilised from Greenland, stopping briefly en route in Cape Verde. The rig arrived in the Falklands in January and after loading the riser, which had been transported down separately, moved to the first location and spudded on the 31 January. Well 61/17–1 was designed to test the Darwin prospect.

Well 61/17–1 was the first deep water well and only the second well to be drilled in the South Falkland Basin. It was selected as the first test as it was considered relatively low risk. The prospect had been mapped on 2D data but it was the acquisition of 3D that had really reduced the risk profile. The geophysical attributes included an AVO anomaly, amplitude conformance to structure and a flat spot.

Darwin Discovery



Licence:	**PL018**
B&S interest:	**100%**
Structure:	**Tilted fault block**
Reservoir:	**Lower Cretaceous shallow marine sands**
Seal:	**Lower Cretaceous marine shales**
Water depth:	**2011 m**
Total depth:	**4876 m**
Gross interval:	**84.5 m**
Net pay:	**67.8 m**
Average porosity:	**22%**
Maximum porosity:	**30%**
Hydrocarbon phase:	**Gas condensate**

The large, clearly defined structure was located at a focus for hydrocarbon migration. Our pre-drill prognosis anticipated that we would encounter a relatively massive, laterally continuous, shallow marine Lower Cretaceous sandstone with good porosity.

The well operations initially experienced some delays due to technical problems with the rig. These issues were overcome and good progress was made. Further delays were caused by the geology. Slow rates of penetration were experienced at times and an additional string of casing had to be run for well stability reasons. As the company carried substantial contingency funds going into the programme, the additional costs of the time delays were able to be absorbed. On a positive note, the rig performed extremely well in the environment and no time was wasted due to adverse weather.

The well reached its total depth of 4,876m in mid April and came in very close to prognosis. The top massive sandstone reservoir unit, identified on seismic, was 1m higher than anticipated. It was slightly thicker than expected and porosities slightly higher. Net pay encountered was 67.8m, average porosity 22%, with maximum values reaching 30%.

Although good hydrocarbon shows were encountered whilst drilling, it was the TD wireline log data that confirmed to us that we had penetrated a good quality reservoir containing gas condensate. (A gas condensate is a low density mixture of hydrocarbon liquids dissolved in saturated natural gas that come out of solution when the pressure drops below the dewpoint.) Critical to the successful commercialisation and development concept of such a discovery is the gas:liquids ratio. Condensate is a valuable product and can sell at a premium to Brent.

Extensive sampling of the reservoir fluid was undertaken. These samples will be shipped back to the UK for detailed laboratory analysis. Once understood, we will be able to comment on the scale of the discovery and its commerciality. Additional studies to be performed on the well samples collected whilst drilling include geochemistry, biostratigraphy, sedimentology and petrophysical analysis.

The outcome of this first exploration well was really pleasing. It proved a working source rock, a good quality reservoir and a thick seal. Not only has it opened up a new hydrocarbon basin and confirmed our current technical understanding, it unlocks an exciting prospect inventory. There is a considerable amount of work ahead of us to refine these prospects now that we have well calibration for our seismic. Future technical work is likely to include the reprocessing of our existing 3D data along with the acquisition of a new 3D seismic survey.

We will report later on the updated prospect inventory but the success of Darwin immediately highlights two other nearby tilted fault blocks, Covington and Chaffers, thought to contain similar aged shallow marine sandstone reservoirs. Furthermore, a submarine fan play fairway, containing stratigraphically trapped prospects Burgess and Bute, are thought to have a similar aged reservoir to Darwin. Additional 3D may reveal further examples of these Lower Cretaceous plays. So already we are starting to see a cluster of interesting prospects to build on the success of Darwin.

From a financial point of view we started the year with funds of \$194m. At that time we had ordered and paid for some of the long lead items for the drilling campaign. During 2012 the capital spending has increased as the rig and all the support equipment and people were moved to the Falkland Islands. As we have advised, the Darwin well was over budget for a variety of reasons, all of which were beyond the company's control. As a result of these delays and to provide funds for the acquisition of some additional 3D seismic, the company raised a further \$75m in April 2012, part of which is subject to approval at an EGM.

Howard Obee
Chief Executive

Peter Fleming
Finance Director


36 inch drill bit, used to drill conductor hole from seabed at the Darwin and Stebbing wells


Stanley Bulk Plant for storage of bulk materials (cement, barite and bentonite) prior to shipment to the rig

Limiting our environmental impact


King Penguins at Volunteer Point, Falkland Islands

In brief

- **We have been working closely with the Falkland Islands Government to ensure that we are both compliant with local regulations and standards and with international standards and regulations**
- **All employees and contractors on the rig, the support vessels and on land are made aware of the HSE policies and standards**
- **The company undertook risk assessments during 2011 in readiness of drilling operations**

The company has always viewed its responsibility for safe operations and limiting its environmental impact as integral to everything it does. All people involved in these operations, whether they are employees, directors, partners or contractors are made aware of the company's policies and procedures. In advance of drilling operations during 2012, all of its procedures and policies were reviewed and revised where appropriate.

Key areas of focus during 2011 were:

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

Focus areas during 2011

Environmental impact	During 2011 the company updated or developed and implemented policies and procedures designed to mitigate risks associated with the 2012 drilling campaign and future activities.
Health and safety	Risk assessments were undertaken during 2011 to ensure that all risks were mitigated and appropriate monitoring processes were in place. The company also works with the HSE.
Business ethics	Following the introduction of the Bribery Act, the company completed a risk assessment. This risk assessment was reviewed by a third party and compliance with the Act was sought from the company's main suppliers.
Corporate governance	During 2011 the board reviewed its compliance with the UK Corporate Governance code, notwithstanding that it does not apply to AIM companies. As a result of this review some changes were made to company procedures and reporting. No board changes were proposed at this stage of the company's development.
Community support	The company has, where possible, used local suppliers of goods and services and employed local people in the Falkland Island operations. This has led to a material boost to the local economy.


Surf Bay, Falkland Islands

Risk management

Principal risks and uncertainties

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 risk Oil & Gas exploration is a risk business. All exploration and appraisal wells carry technical risk. Results can be positive, negative or inconclusive. The risks are higher where there is limited well data to calibrate seismic data and geological models.	B & S has made considered judgments on the appropriate data required to minimise the technical risks. Rigorous petroleum systems analysis and geophysical attribute analysis based on high quality 3D seismic has been undertaken prior to prospect selection and well location.
Major incidents The company is exposed to operational risks before, during and after the 2012 exploration programme.	Major incident risks are continuously assessed and project-specific mitigations are developed. Management Systems and Safety Management Systems are in place and are regularly reviewed and updated. Safety critical equipment is inspected and function tested on a regular basis. Emergency equipment and procedures are tested regularly. Well designs and well operations are subjected to continuous independent scrutiny. Industry networks are used to disseminate lessons from major incidents worldwide.
Health, Safety, Security and Environment (HSSE) incidents All exploration activity involves health, safety, security and environmental risks. This is particularly the case in harsh deep water environments.	Project-specific Safety Management documents are developed to establish safety standards, roles and responsibilities, procedures, reporting lines and emergency actions. Risk assessments are conducted at key phases of each project and appropriate mitigation measures are then implemented. All incidents are thoroughly investigated to establish causes and ensure appropriate corrective actions are taken. Management are continuously involved in the management of HSSE. Regular auditing is conducted to verify compliance.
Financial risk The company is exposed to a variety of financial risks that include price risk, liquidity risk and foreign exchange risk.	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 company has contingent funds to provide for cost overruns.
Failure to secure materials, services or resources The company's operations are in a remote location and mainly sourced from Europe.	The company has retained AGR Well Management to manage its drilling operations including logistics. AGR has significant experience in sourcing materials and services for remote drilling operations. We have constructed a supply base in Stanley to hold stocks of critical items.
Bribery and corruption risk Inadequate systems to prevent bribery and corruption.	Anti-bribery and corruption processes were introduced during 2011 in line with the requirements of the UK Bribery Act.
Funding risk Inability to fund the exploration work programme due to cost overruns.	A prudent approach is applied in budgeting and business planning to ensure sufficient equity capital is available to meet commitments on exploration drilling. 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.

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The company is committed to complying with the majority of the principles and provisions of the UK Corporate Governance Code notwithstanding that AIM companies are not required to. During 2011 the board reviewed its procedures and board committees and their composition and made some changes to move closer to compliance with the UK Corporate Governance Code. These will be regularly reviewed to ensure that they are consistent with good practice for companies of similar size and complexity.

In reviewing the board composition, it considered the independence of the Non-executive Directors. The board considered the independence of the Non-executive Directors by applying the following criteria:

- the director provides an objective and robust challenge to the views and assumptions of the senior management;
- acts at all times in the best interest of the company and its shareholders; and
- has relevant experience and expertise.

Having reviewed the independence of each of the Non-executive Directors, the board concluded that they met the above criteria.

The company has regular board meetings. The frequency of the board meetings has recently increased in line with the start of exploration operations to update the board on the operations and the financial position of the company. Any director who is unable to physically attend a board meeting is given the opportunity to be consulted and comment before the meeting and the opportunity to participate via teleconference.

Communication with shareholders is considered important by the board. The CEO is primarily responsible for these communications in conjunction with the company's brokers and investor relations company.

Board committees

The board has established an Audit Committee and a Remuneration Committee; the terms of reference and composition are outlined below:

"Whilst the company is listed on AIM and is not subject to the Corporate Code on corporate governance, the board undertook a review of the Code during 2011 and implemented some changes to bring it more in line with the code."

Group structure

The board

Remuneration Committee

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.

As and when the Remuneration Committee deems appropriate, it takes external advice on comparable remuneration levels within the AIM oil and gas exploration company sector.

Remuneration consists of basic salary, bonus and a Long Term Incentive Plan in the form of options. The group does not operate a pension scheme for its directors or employees.

Members

Mr Harry Dobson (Chairman)
Mr Nigel Hurst-Brown (Non-executive Director)
Mr Stephen Posford (Non-executive Director)

Audit Committee

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.

Members

Mr Nigel Hurst-Brown (Chairman)
Mr Harry Dobson (Non-executive Director)
Mr Stephen Posford (Non-executive Director)

Board of directors

1. Harry Dobson
(Non-executive Chairman)

Harry Dobson is a former investment banker and senior partner of Yorkton Securities. He currently engages in various venture capital activities in North America and Europe and has acted as Chairman of a number of resource companies. 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 in inaccessible locations.

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

2. 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 25 years in the oil industry, initially with BP (1985–1992) and subsequently with BHP Billiton (1992–2004). He trained as an exploration geologist and has been appointed to various technical and commercial roles. He is experienced in the management of exploration projects, including those in frontier basins.

3. 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. He is also Chairman of Central Asia Metals plc.

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

4. Peter Fleming
(Finance Director)

Peter Fleming has over 20 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. He holds Masters degrees in Business Administration and Finance.

5. 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.

Number of board meetings during the year:

Attendance	Board	Remuneration Committee	Audit Committee
Harry Dobson	5	1	2
Howard Obee	5		
Peter Fleming	5		
Stephen Posford	4	1	2
Nigel Hurst-Brown	5	1	2

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 2011, were as follows:

	At 31 December 2011 Number	At 31 December 2010 Number
Harry Dobson	**26,670,000**	26,670,000
Stephen Posford	**27,500,000**	27,500,000
Howard Obee	**10,000,000**	10,000,000
Peter Fleming	**2,200,000**	2,200,000
Nigel Hurst-Brown	**1,530,000**	1,530,000

The ordinary shares in which Mr Harry 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	Fair value of options	Exercise price	Vesting period
Howard Obee	300,000	1,300,000	24–30 pence	51–56 pence	three years
Peter Fleming	300,000	1,300,000	24–30 pence	51–56 pence	three years
Nigel Hurst-Brown	250,000	250,000	32 pence	58 pence	three years

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 2011 was as follows:

	Basic salary $	Bonus $	Share-based payment $	**Total 2011 $**	Total 2010 $
Harry Dobson	—	—	—	**—**	—
Stephen Posford	—	—	—	**—**	—
Howard Obee	264,514	—	108,715	**373,229**	241,380
Peter Fleming	215,136	32,070	108,715	**355,921**	165,491
Nigel Hurst-Brown	—	—	42,612	**42,612**	41,033
Total	479,650	32,070	260,042	**771,762**	447,904

The share-based payments represent the fair value of options issued to the directors (note 7).

Substantial shareholders

At May 2012 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	50,598,883	11.81%
HSBC Client Holdings	40,122,587	9.36%
Capital Research and Management Company	27,780,000	6.49%
Stephen Posford	27,500,000	6.40%
Zila Corporation	26,670,000	6.22%
BlackRock Inc.	21,414,903	4.99%
Ignis Investment Services Limited	16,355,635	3.81%

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 20 and shows the result for the year.

The directors do not recommend the payment of a dividend (2010: $nil).

Review of business and future developments
A review on the operations and KPIs of the group is contained in the Chairman's Statement and Operations Review on pages 4 to 7. The directors consider the KPIs to be the management of cash and capital expenditure, all of which are discussed in the Chairman's Statement and Operations Review.

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 (2010: $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 two days (2010: four 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' report (continued)

for the year ended 31 December 2011

Directors' responsibilities

The directors are responsible for preparing the Directors' 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 financial statements in accordance with International Financial Reporting Standards (IFRS) 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 the Alternative Investment Market.

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 IFRS 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.

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 their 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 have expressed their willingness to continue in office and a Resolution to re-appoint them will be proposed at the annual general meeting.

By order of the board

William Slack
Company Secretary
21 May 2012

Independent auditor's report

to the members of Borders & Southern Petroleum Plc

We have audited the financial statements of Borders & Southern Petroleum Plc for the year ended 31 December 2011 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 auditors

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 2011 and of the group's loss for the year then ended;
- the group financial statements have been properly prepared in accordance with IFRS as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRS 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
21 May 2012

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 2011

	Note	2011 $	2010 $
Administrative expenses		**(2,081,967)**	(1,504,467)
Loss from operations	2	**(2,081,967)**	(1,504,467)
Finance income	8	**360,037**	1,359,497
Finance expense	8	**(13,465)**	(20,313)
Loss before tax		**(1,735,395)**	(165,283)
Tax expense	9	**(5,506)**	—
Loss for the year and total comprehensive loss for the year attributable to owners of the parent		**(1,740,901)**	(165,283)
Basic and diluted loss per share (see note 3)		**(0.4) cents**	(0.039) cents

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

Consolidated statement of financial position

as at 31 December 2011

		2011		2010	
	Note	$	$	$	$
Assets					
Non-current assets					
Property, plant and equipment	10		**20,629**		13,110
Intangible assets	11		**64,643,520**		37,730,165
Total non-current assets			**64,664,149**		37,743,275
Current assets					
Other receivables	13	**1,544,103**		11,315,514	
Cash and cash equivalents	16	**95,776,313**		194,130,019	
Restricted use cash	16	**80,947,886**		—	
Total current assets			**178,268,302**		205,445,533
Total assets			**242,932,451**		243,188,808
Liabilities					
Current liabilities					
Trade and other payables	14		**(1,330,112)**		(271,471)
Total net assets			**241,602,339**		242,917,337
Equity					
Share capital	15		**7,675,453**		7,675,453
Share premium			**238,034,095**		238,034,095
Other reserves			**1,046,565**		620,662
Retained deficit			**(5,137,378)**		(3,396,477)
Foreign currency reserve			**(16,396)**		(16,396)
Total equity			**241,602,339**		242,917,337

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 21 May 2012.

Howard Obee
Director

Peter Fleming
Director

Company number
5147938

Consolidated statement of changes in equity

for the year ended 31 December 2011

	Share capital $	Share premium $	Other reserves $	Retained deficit $	Foreign currency reserve $	Total $
Balance at 1 January 2010	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
Total comprehensive loss for the year	—	—	—	(1,740,901)	—	(1,740,901)
Recognition of share-based payments	—	—	425,903	—	—	425,903
Balance at 31 December 2011	**7,675,453**	**238,034,095**	**1,046,565**	**(5,137,378)**	**(16,396)**	**241,602,339**

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 2011

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	Note	2011 $	2011 $	2010 $	2010 $
Assets					
Non-current assets					
Property, plant and equipment	10		**20,629**		13,110
Investments	12		**2**		2
Total non-current assets			**20,631**		13,112
Current assets					
Other receivables	13	**65,274,488**		49,209,046	
Cash and cash equivalents	16	**95,776,313**		194,130,019	
Restricted use cash	16	**80,947,886**		—	
Total current assets			**241,998,687**		243,339,065
Total assets			**242,019,318**		243,352,177
Liabilities					
Current liabilities					
Trade and other payables	14		**(241,635)**		(264,290)
Total net assets			**241,777,683**		243,087,887
Equity					
Called up share capital	15		**7,675,453**		7,675,453
Share premium			**238,034,095**		238,034,095
Other reserves			**1,046,565**		620,662
Retained deficit			**(4,959,745)**		(3,223,638)
Foreign currency reserve			**(18,685)**		(18,685)
Total equity			**241,777,683**		243,087,887

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 21 May 2012.

Howard Obee
Director

Peter Fleming
Director

Company number
5147938

Company statement of changes in equity

for the year ended 31 December 2011

	Share capital $	Share premium reserve $	Other reserves $	Retained deficit $	Foreign currency reserve $	Total $
Balance at 1 January 2010	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
Total comprehensive loss for the year	—	—	—	(1,736,107)	—	(1,736,107)
Recognition of share-based payments	—	—	425,903	—	—	425,903
Balance at 31 December 2011	**7,675,453**	**238,034,095**	**1,046,565**	**(4,959,745)**	**(18,685)**	**241,777,683**

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 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 2011

	Note	2011 $	2011 $	2010 $	2010 $
Cash flow from operating activities					
Loss before tax			**(1,735,395)**		(165,283)
Adjustments for:					
Depreciation	10		**13,606**		9,930
Share-based payment	7		**425,903**		267,376
Finance income	8		**(360,037)**		(1,359,497)
Finance expenses	8		**13,465**		20,313
Cash flows from operating activities before changes in working capital			**(1,642,458)**		(1,227,161)
Decrease/(increase) in other receivables	13		**402,423**		(1,847,804)
Increase in trade and other payables	14		**1,058,641**		26,791
Tax paid			**(5,506)**		—
Net cash outflow from operating activities			**(186,900)**		(3,048,174)
Cash flows used in investing activities					
Interest received		**360,743**		520,830	
Interest paid		**(254)**		(20,313)	
Purchase of intangible assets	11	**(17,545,073)**		(10,479,407)	
Purchase of property, plant and equipment	10	**(21,125)**		(3,524)	
Net cash used in investing activities			**(17,205,709)**		(9,982,414)
Net decrease in cash and cash equivalents			**(17,392,609)**		(13,030,588)
Cash and cash equivalents at the beginning of the year			**194,130,019**		206,321,177
Exchange (loss)/gain on cash and cash equivalents	16		**(13,211)**		839,430
Cash and cash equivalents and cash held in escrow at the end of the year	16		**176,724,199**		194,130,019
Cash and cash equivalents			**95,776,313**		194,130,019
Restricted use cash			**80,947,886**		—
Cash and cash equivalents and restricted use cash at the end of the year			**176,724,199**		194,130,019

Company statement of cash flows

for the year ended 31 December 2011

	Note	2011 $	2011 $	2010 $	2010 $
Cash flow from operating activities					
Loss before tax			**(1,730,601)**		(128,615)
Adjustments for:					
Depreciation	10		**13,606**		9,930
Share-based payment	7		**425,903**		267,376
Finance income	8		**(360,037)**		(1,359,497)
Finance interest	8		**254**		20,313
Foreign exchange loss	8		**12,782**		—
Cash flows from operating activities before changes in working capital			**(1,638,093)**		(1,190,493)
Decrease/(increase) in other receivables	13		**1,641,817**		(1,847,804)
(Decrease)/increase in trade and other payables	14		**(22,655)**		26,795
Tax paid			**(5,506)**		—
Net cash outflow from operating activities			**(24,437)**		(3,011,502)
Cash flows from investing activities					
Interest received		**360,037**		520,830	
Interest paid		**(254)**		(20,313)	
Increase in amounts due from group undertaking	11	**(17,707,259)**		(10,516,079)	
Purchase of tangible assets	10	**(21,125)**		(3,524)	
Net cash from investing activities			**(17,368,601)**		(10,019,086)
Net decrease in cash and cash equivalents			**(17,393,038)**		(13,030,588)
Cash and cash equivalents at the beginning of the year	16		**194,130,019**		206,321,177
Exchange (loss)/gain on cash and cash equivalents			**(12,782)**		839,430
Cash and cash equivalents and cash held in escrow at the end of the year	16		**176,724,199**		194,130,019
Cash and cash equivalents			**95,776,313**		194,130,019
Restricted use cash			**80,947,886**		—
Cash and cash equivalents and restricted use cash at the end of the year			**176,724,199**		194,130,019

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 IFRS and with those parts of the Companies Act 2006 applicable to companies preparing their accounts under IFRS.

New and revised Standards effective for 31 December 2011 year end but are not currently relevant to the group

New Standards

IFRS 1 – Additional exemptions for first-time adopters (effective for accounting periods commencing on or after 1 February 2010).

Amendments

IAS 32 – Classification of Rights Issues (effective for accounting periods commencing on or after 1 February 2010).

IAS 19 and IFRIC 14 – Limit of a defined benefit asset, minimum funding requirements and their interaction (effective for accounting periods commencing on or after 1 January 2011).

Interpretations

IFRIC 19 – Extinguishing Financial Liabilities with Equity Instruments (effective for accounting periods commencing on or after 1 July 2010).

New and revised Standards effective for 31 December 2011 year end which are currently relevant to the group

The IFRS financial information has been drawn up on the basis of accounting policies consistent with those applied in the financial statements for the year to 31 December 2010. The following standards, interpretations and amendments to existing standards have been adopted for the first time in 2011:

Amendments

IAS 24 (revised) – Revised definition of related party (effective for accounting periods commencing on or after 1 January 2011).

The adoption of this amendment did not affect the Group results of operations or financial positions. The presentation of these financial statements incorporates changes arising from adoption of this amendment.

New and revised Standards issued but not effective for 31 December 2011 year end

The IASB and IFRIC have issued the following 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:

New Standards

IFRS 1* – Amendment – Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (effective for accounting periods commencing on or after 1 July 2011). This is not considered relevant to the group's operations.

IFRS 7* – Amendment – Transfer of financial assets (effective for accounting periods commencing on or after 1 July 2011). This is not considered relevant to the group's operations.

IFRS 9* – New standard replacing IAS 39 (effective for accounting periods commencing on or after 1 January 2013). This is not considered relevant to the group's operations.

IFRS 10* – Consolidated Financial Statements (effective for accounting periods commencing on or after 1 January 2013). The group will apply this amendment in the accounting period commencing 1 January 2013.

IFRS 11* – Joint Arrangements (effective for accounting periods commencing on or after 1 January 2013). This is not considered relevant to the group's operations.

IFRS 12* – Disclosure of Interests in Other Entities (effective for accounting periods commencing on or after 1 January 2013). This is not considered relevant to the group's operations.

IFRS 13* – Disclosure of Interests in Other Entities (effective for accounting periods commencing on or after 1 January 2013). This is not considered relevant to the group's operations.

1 Accounting policies continued

New and revised Standards issued but not effective for 31 December 2011 year end continued

Amendments

IAS 1* – Presentation of Items of Other Comprehensive Income (effective for accounting periods commencing on or after 1 July 2012). The group will apply this amendment in the accounting period commencing 1 January 2012.

IAS 12* – Deferred Tax: Recovery of Underlying Assets (effective for accounting periods commencing on or after 1 January 2012). This is not considered relevant to the group's operations.

IAS 19* – Employee Benefits (effective for accounting periods commencing on or after 1 January 2013). This is not considered relevant to the group's operations.

IAS 27* – Separate Financial Statements (effective for accounting periods commencing on or after 1 January 2013). The group will apply this amendment in the accounting period commencing 1 January 2013.

IAS 28* – Investments in Associates and Joint Ventures (effective for accounting periods commencing on or after 1 January 2013). This is not considered relevant to the group's operations.

* These have not been endorsed by the EU.

The Group is evaluating the impact of the above pronouncements but they are not expected to be material to the Group's earnings or to shareholders' funds.

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.

Loss 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 $1,740,901 (2010: loss after tax of $165,283) 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.

1 Accounting policies continued

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 IFRS 6 and IAS 36.

The carrying value is compared to the underlying value of oil and gas or 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.

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 would be 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.

The group has no financial assets categorised as fair value through profit or loss, held to maturity or available for sale. It has no financial liabilities categorised as fair value through profit or loss.

1 Accounting policies continued

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.

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 will 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 judgemental 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 may cause a material adjustment to the carrying amounts of assets and liabilities within the next financial year, is as follows:

- share options

The group's share-based payments were recognised at fair value using a 60% volatility rate. See note 7.

2 Loss from operations

	2011 $	2010 $
Staff costs (note 5)	**789,931**	533,910
Share-based payment – equity-settled	**425,903**	267,376
Services provided by the auditor:	**21,015**	49,852
Audit: fees payable to the company's auditor for the audit of the parent company and consolidated financial statements		
Fees payable to the company's auditor/or:		
– tax services	**9,080**	21,476
– other services	**9,131**	—
Depreciation of office equipment	**13,606**	9,930
Operating lease expenses – property	**274,493**	209,801

3 Basic and dilutive loss 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 $1,740,901 (2010: loss $165,283) and the weighted average number of shares in issue for the year was 428,578,404 (2010: 428,578,404). Due to the loss in the year the diluted loss per share has not been calculated. At the reporting date, there were 5,350,000 (2010: 2,450,000) 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:

	2011 $	2010 $
Wages and salaries	**699,657**	476,165
Employers national insurance contribution	**90,274**	57,745
	789,931	533,910
Share-based payment – equity-settled	**349,218**	220,944
	1,139,149	754,854

The average number of employees (including directors) employed during the year by the company was six (2010: six) and for the group was six (2010: six). All employees and directors of the group and the company are considered to be the key management personnel.

Of the $425,903 (2010: $267,376) share-based payment charge included in the consolidated statement of comprehensive income, $349,218 (2010: $220,944) has been charged in respect of share options granted to staff (including directors) in the current and prior years. The remaining $76,685 (2010: $46,432) 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:

	2011 $	2010 $
Directors' fees	**511,720**	324,805
Share-based payments – equity-settled	**260,042**	123,099
	771,762	447,904

The fees and share-based payments made to each director are disclosed in the Directors' 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 $127,838 (2010: $123,099) has been expensed during the year.

In 2011, the group granted to two directors of Borders & Southern Petroleum Plc, for nil consideration, 1,000,000 share options each, with a total fair value of $774,447. Of this amount $132,204 has been expensed during the year.

7 Share-based payment

In June, September and October 2011, the group granted 2,900,000 share options to two directors, an employee of the group and to external parties. 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 2011 Weighted average exercise price	31 December 2011 Number	31 December 2010 Weighted average exercise price	31 December 2010 Number
Outstanding at the beginning of the year	**54p**	**2,450,000**	53p	2,250,000
Granted during the year	**50p**	**2,900,000**	74p	200,000
Outstanding at the end of the year	**52p**	**5,350,000**	54p	2,450,000

The weighted average contractual life of the options outstanding at the year end was seven years (2010: four years).

At 31 December 2011, there were 1,000,000 options exercisable at a weighted average exercise price of 50 pence (2010: 700,000 at 42 pence).

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 2011	31 December 2010
Option pricing model used	**Black-Scholes**	Black-Scholes
Weighted average share price at grant date	**50p**	74p
Exercise price	**50p**	74p
Weighted average contractual life (days)	**1,460**	1,460
Expected volatility	**60%**	50%
Risk-free interest rate	**2.0%**	2.5%
Fair value of options	**23p**	31p

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

Share-based payment expense for the year in respect of the equity-settled scheme for options granted during the year	$165,504	—
Share-based payment expense for the year in respect of the equity-settled scheme for options granted during 2007	—	$5,710
Share-based payment expense for the year in respect of the equity-settled scheme for options granted during 2008	$30,590	$54,028
Share-based payment expense for the year in respect of the equity-settled scheme for options granted during 2009	$197,055	$189,751
Share-based payment expense for the year in respect of the equity-settled scheme for options granted during 2010	$32,754	$17,887
Total share-based remuneration expense for the year	$425,903	$267,376

8 Finance income and expense

Finance income

	2011 $	2010 $
Bank interest received	**360,037**	520,067
Foreign exchange gain	**—**	839,430
	360,037	1,359,497

Finance expense

	2011 $	2010 $
Bank interest paid	**254**	20,313
Foreign exchange loss	**13,211**	—
	13,465	20,313

9 Tax expense

Current tax expense

	2011 $	2010 $
UK corporation tax on loss for the year	**—**	—
Adjustments recognised in the current year in relation to the current taxation of prior years	**5,506**	—
Total current and deferred tax for the year	**5,506**	—

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 for the year are as follows:

	2011 $	2010 $
Loss before taxation	**(1,735,395)**	(165,283)
Standard rate corporation tax charge (26.5%)	**(459,880)**	(44,626)
Expenses not deductible for tax purposes	**273,982**	188,756
Capital allowances in excess of depreciation	**(2,342)**	1,545
Unutilised tax losses carried forward	**188,240**	—
Adjustments recognised in the current year in relation to the taxation of prior years	**5,506**	—
Tax losses brought forward utilised	**—**	(145,675)
Total current and deferred tax for the year	**5,506**	—

Factors that may affect future tax charges

The group has a deferred tax asset of approximately $178,000 (2010: $41,000) in respect of unrelieved tax losses of approximately $710,000 at 31 December 2011 (2010: $146,000). The rate of tax used in the calculation of the deferred tax asset is 25% (2010: 27%). 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 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
As at 31 December 2009	19,516

	$
Cost	
As at 1 January 2011	86,781
Additions	21,125
As at 31 December 2011	**107,906**
Depreciation	
As at 1 January 2011	73,671
Charge for the year	13,606
As at 31 December 2011	**87,277**
Net book value	
As at 31 December 2011	**20,629**

11 Intangible assets

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
As at 31 December 2009	36,619,040

11 Intangible assets continued

Group	Exploration and evaluation costs $
Cost	
As at 1 January 2011	**37,730,165**
Additions	26,913,355
As at 31 December 2011	**64,643,520**
Net book value	
As at 31 December 2011	**64,643,520**

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

All capitalised costs are reviewed annually against underlying value of oil and gas reserves, the directors consider that no impairment triggers exist and therefore accordingly no impairments are required.

12 Investments in subsidiary

Company	2011 $	2010 $
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	
	2011 $	2010 $	**2011 $**	2010 $
Amounts owed by group undertakings	**—**	—	**64,969,073**	47,261,814
Other receivables	**239,325**	1,883,812	**239,325**	1,883,812
Prepayments and accrued income	**1,304,778**	9,431,702	**66,090**	63,420
	1,544,103	11,315,514	**65,274,488**	49,209,046

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	
	2011 $	2010 $	**2011 $**	2010 $
Trade payables	**138,650**	115,704	**138,650**	115,704
Other taxes and social security costs	**26,257**	24,216	**26,257**	24,216
Other payables	**42,228**	33,635	**42,228**	33,635
Accruals and deferred income	**1,122,977**	97,916	**34,500**	90,735
	1,330,112	271,471	**241,635**	264,290

15 Share capital

	2011 $	2010 $
Authorised		
750,000,000 ordinary shares of 1 pence each (2010: 750,000,000)	**14,926,125**	14,926,125
Allotted, called up and fully paid		
428,578,404 ordinary shares of 1 pence each (2010: 428,578,404)	**7,675,453**	7,675,453

16 Cash and cash equivalents

Group and company	2011 $	2010 $
Cash available on demand	**2,589,436**	2,204,126
Cash on deposit	**93,186,877**	191,925,893
Restricted use cash	**80,947,886**	—
Total	**176,724,199**	194,130,019

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

Restricted use cash is made up of deposits used as security for a letter of credit and funds held in an escrow account in both cases to provide suppliers with security of payment.

17 Related party transactions

Company

During the year Borders & Southern Petroleum Plc paid expenses of $17,702,259 (2010: $10,516,079) on behalf of Borders & Southern Falkland Islands Limited. At the year end $64,969,073 (2010: $47,261,814) 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 5.

18 Commitments

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

	Land and buildings	
	2011 $	2010 $
Not later than one year	**135,255**	109,066
Later than one year but not later than five years	**—**	56,312
	135,255	165,378

On 5 May 2011 the company entered into a contract with Ocean Rig UDW Inc. for the provision of mobile drilling rig services using the Leiv Eiriksson drilling unit. Under the contract the company committed to drill two wells with options to drill a further three wells. On 18 May 2011, the company signed an agreement to assign 2 of its option wells to Falkland Islands Oil and Gas Limited.

18 Commitments continued

The company's committed costs for drilling two wells, including mobilisation and de-mobilisation, are currently estimated to be $76m and the company anticipates these costs will be incurred within twelve months from the statement of financial position date.

The group licence commitment is to drill one well by 1 November 2012.

19 Events after the reporting period

On 31 January 2012 the company commenced drilling operations on the first well within its Falkland Islands licences. On 26 April 2012 the company announced it had raised $75m before costs through a placement of shares. In April 2012 the company announced that a gas condensate discovery was made with the Darwin well. The Stebbing well was shortly after spudded.

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.

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 2011 and as at 31 December 2010 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 2011 the company held cash at bank and in deposits under its control of $176,724,199 (2010: $194,130,019), which forms the majority of the group's working capital. Of the cash at bank and in deposit, $2,589,436 (2010: $2,204,126) 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 $80,947,886 (2010: nil) and cash on deposit of $93,186,877(2010: $191,925,893) with weighted average interest rate of 0.2% (2010: 0.2%) for three months. If there was a 1% change in interest rates the impact on the statement of comprehensive income would be $1,767,242 (2010: $1,986,481).

b) Foreign currency translation risk

The functional 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$. Foreign exchange risk arises because some of the group's services and cash is in UK Sterling, which results in gains or losses on retranslation into US$. To minimise this foreign currency risk cash balances are held in both £ Sterling and US$.

20 Financial instruments continued

b) Foreign currency translation risk continued

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

	Group		Company	
Current financial assets	**Other receivables measured at amortised cost 2011 $**	Other receivables measured at amortised cost 2010 $	**Other receivables measured at amortised cost 2011 $**	Other receivables measured at amortised cost 2010 $
Held in UK£:				
Other receivables	**247,468**	1,883,812	**247,468**	1,883,812
Cash and cash equivalents and cash held in escrow	**41,023,045**	38,318,280	**41,023,045**	38,318,280
Total current financial assets held in UK£	**41,270,513**	40,202,092	**41,270,513**	40,202,092
Held in US$:				
Trade and other receivables	**—**	—	**64,969,073**	47,261,814
Cash and cash equivalents	**135,701,154**	155,811,739	**135,701,154**	155,811,739
Total financial assets	**176,971,667**	196,013,831	**241,940,740**	243,275,645

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 $4,113,128 (2010: $4,783,311) for the group and company.

	Group		Company	
	Financial liabilities measured at amortised cost 2011 $	Financial liabilities measured at amortised cost 2010 $	**Financial liabilities measured at amortised cost 2011 $**	Financial liabilities measured at amortised cost 2010 $
Held in UK£:				
Trade and other payables	**1,330,112**	271,471	**241,635**	264,290
Total financial liabilities	**1,330,112**	271,471	**241,635**	264,290

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 $18,088 (2010: $14,934) 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 high credit ratings. 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:

	2011		2010	
	Carrying value $	**Maximum exposure $**	Carrying value $	Maximum exposure $
Cash and cash equivalents and cash held in escrow	**176,724,199**	**176,724,199**	194,130,019	194,130,019
Maximum credit risk exposure	**176,724,199**	**176,724,199**	194,130,019	194,130,019

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.

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