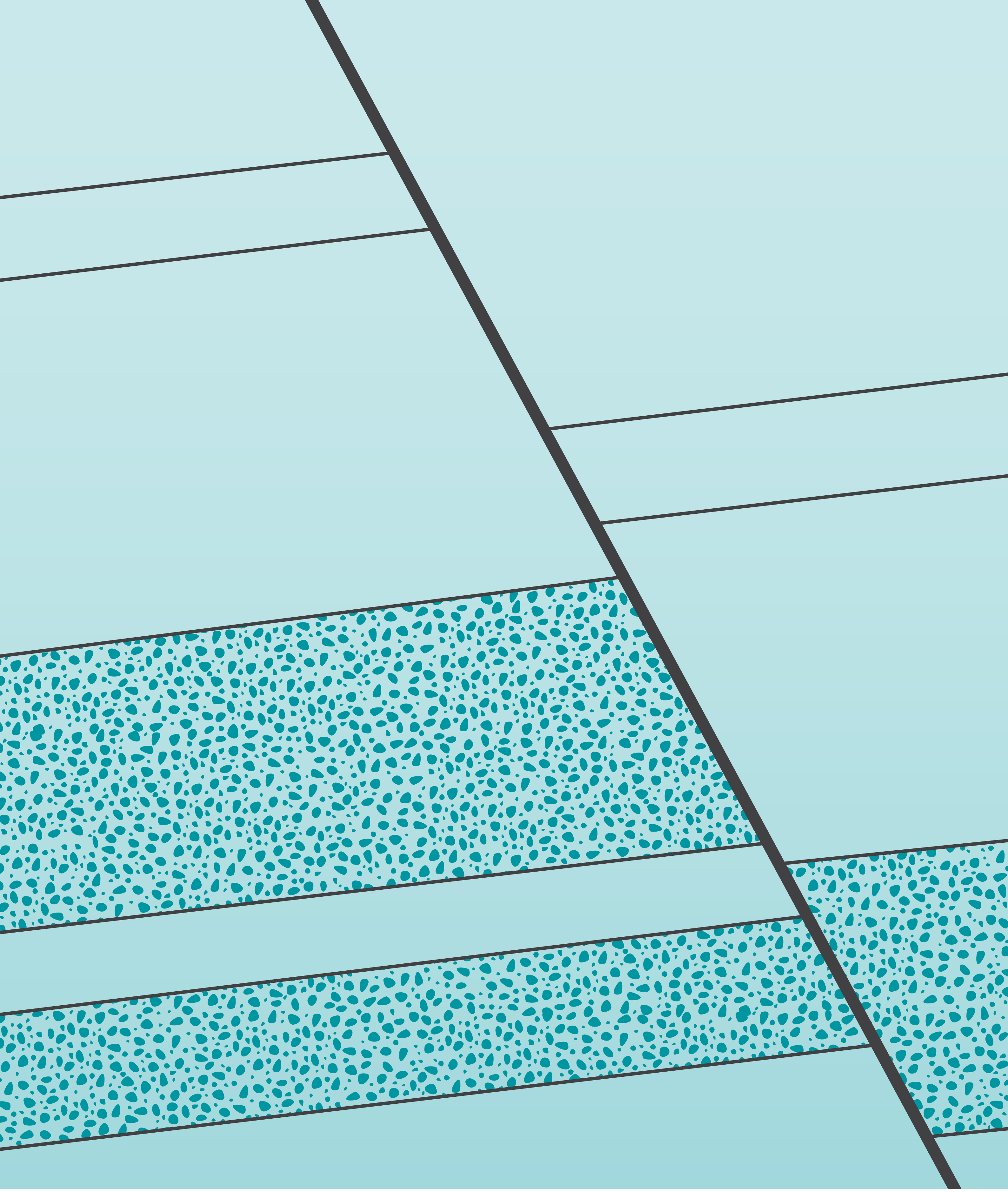


borders & southern petroleum plc

Annual report and accounts 2012

Borders & Southern (AIM: BOR) is an independent oil and gas exploration company. Headquartered in London, the Company's principal area of activity is in the Falkland Islands.

The Company retains a 100% interest and operatorship in three Production licences covering an area of nearly 10,000 square kilometres.

In 2012 Borders & Southern made a significant gas condensate discovery with its first exploration well. The company is now working towards the appraisal of this discovery along with further exploration of the surrounding area.

Our history

The Company was awarded its first exploration licence in 2004

In April 2012 the Company made its first discovery.

Our progress to date page 07

Our expertise

We are led by an experienced management team

Commercial decisions are underpinned by disciplined, high quality technical work.

Board of Directors page 12

Our future

Our business continues to present an extremely positive outlook

We have a rich inventory of low to moderate risk prospects.

Future exploration targets page 04

Overview

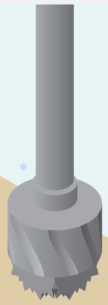
Business review

Corporate governance

Financial statements

Our year at a glance

January: Spud



Borders & Southern spuds its first exploration well

April: Discovery

Announced a significant gas condensate discovery (Darwin)

Completed capital raising: $75m (pre-expenses)

Spudded Stebbing well

July

Completed drilling operations

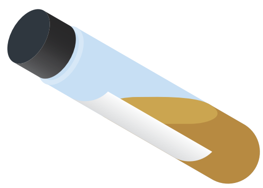
August

Fluid analysis results

Initial condensate yield: 123 to 140 stb/MMscf

46° to 49°

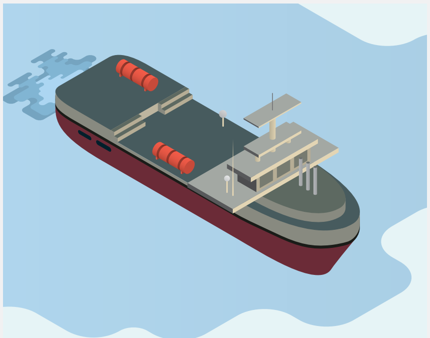
condensate API



October

Signed 3D seismic contract with PGS

1,025 square kilometres



November

Entered the second phase of the exploration licences

For up-to-date share price information and the latest news, visit our website:

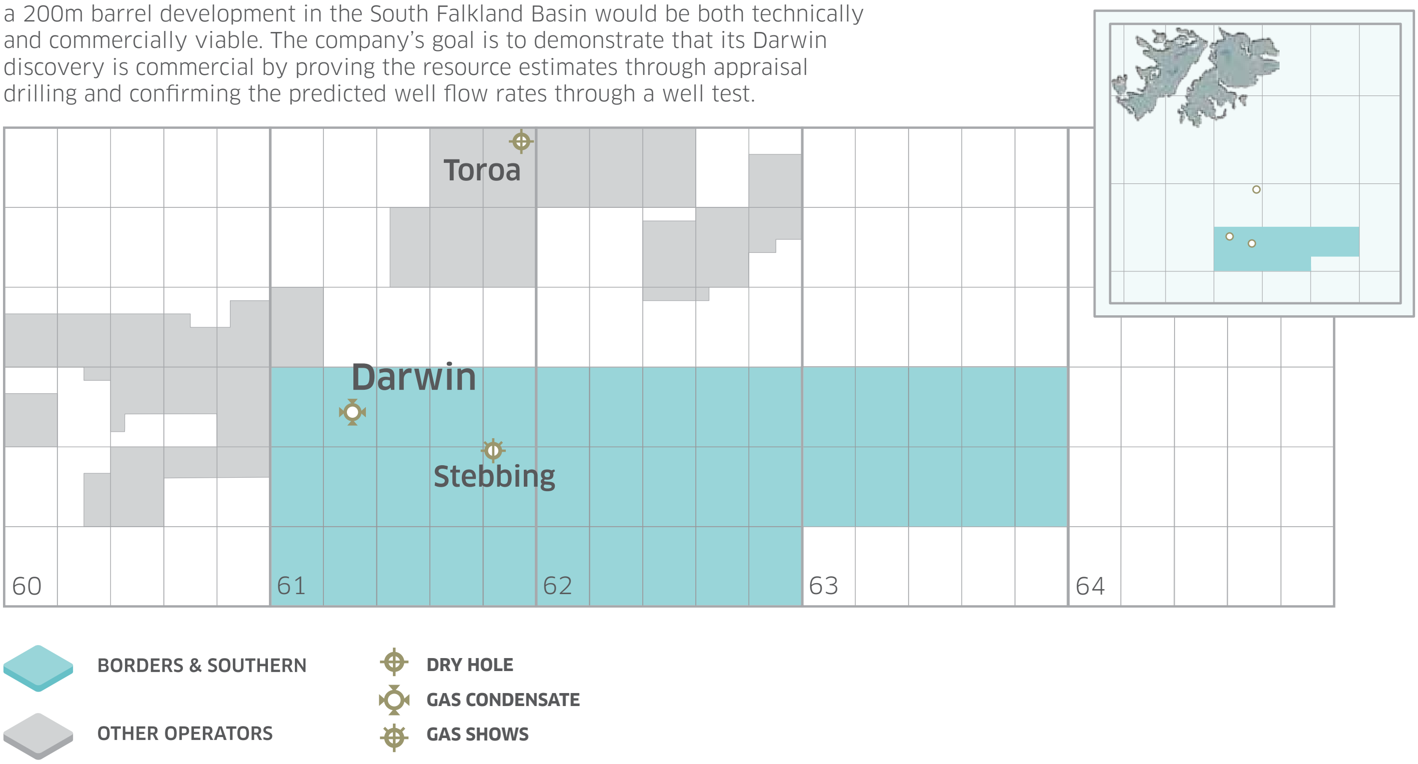
www.bordersandsouthern.com

Darwin discovery

Our key asset in the Falklands

Our first exploration well resulted in a gas condensate discovery.

Engineering and commercial studies undertaken by the company have shown that a 200m barrel development in the South Falkland Basin would be both technically and commercially viable. The company's goal is to demonstrate that its Darwin discovery is commercial by proving the resource estimates through appraisal drilling and confirming the predicted well flow rates through a well test.



Darwin comprises two adjacent tilted fault blocks, named Darwin East and Darwin West. The discovery well (61/17-1) was located on Darwin East. The structures are clearly defined on high quality 3D seismic. The reservoir and fluid content are marked by a flat spot and amplitude conformance to structure. The clarity of the amplitude anomalies will provide confidence in the siting of appraisal wells.

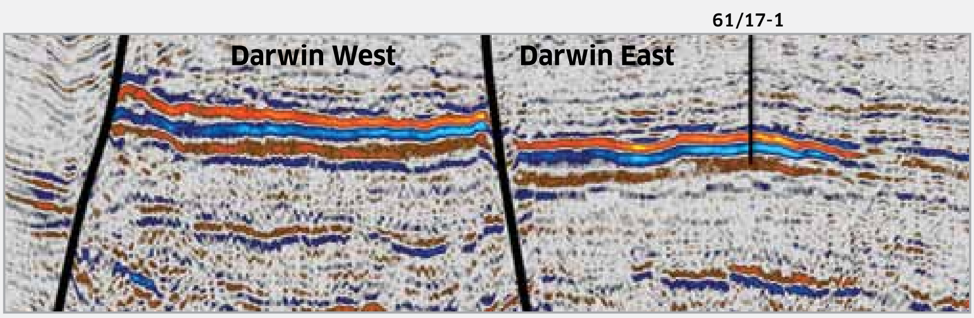
The discovery is a gas condensate. The reservoir is located approximately 2.8 km below the seabed. At surface conditions the fluid separates into a gas and liquid phase. The liquid has the properties of a light crude oil, 46 to 49 API. Initial studies suggest the liquid could be marketed at a slight discount to Brent crude pricing.

Based on preliminary mapping the combined Darwin East and Darwin West fault blocks are assessed to contain a recoverable resource of 130 to 250m barrels. Our current view of the mid case is 200m barrels. Recent geophysical analysis suggests that appraisal drilling on Darwin West could lead to the upward revision of these numbers.

The reservoir consists of good quality shallow marine sandstone. Reservoir engineering studies indicate that sustained individual well flow rates of 70 MMscf/d (gas) and 9,500 stb/d (condensate) could be achieved. Modelling suggests that Darwin East and Darwin West could be developed using a total of six production wells and four gas re-injection wells.

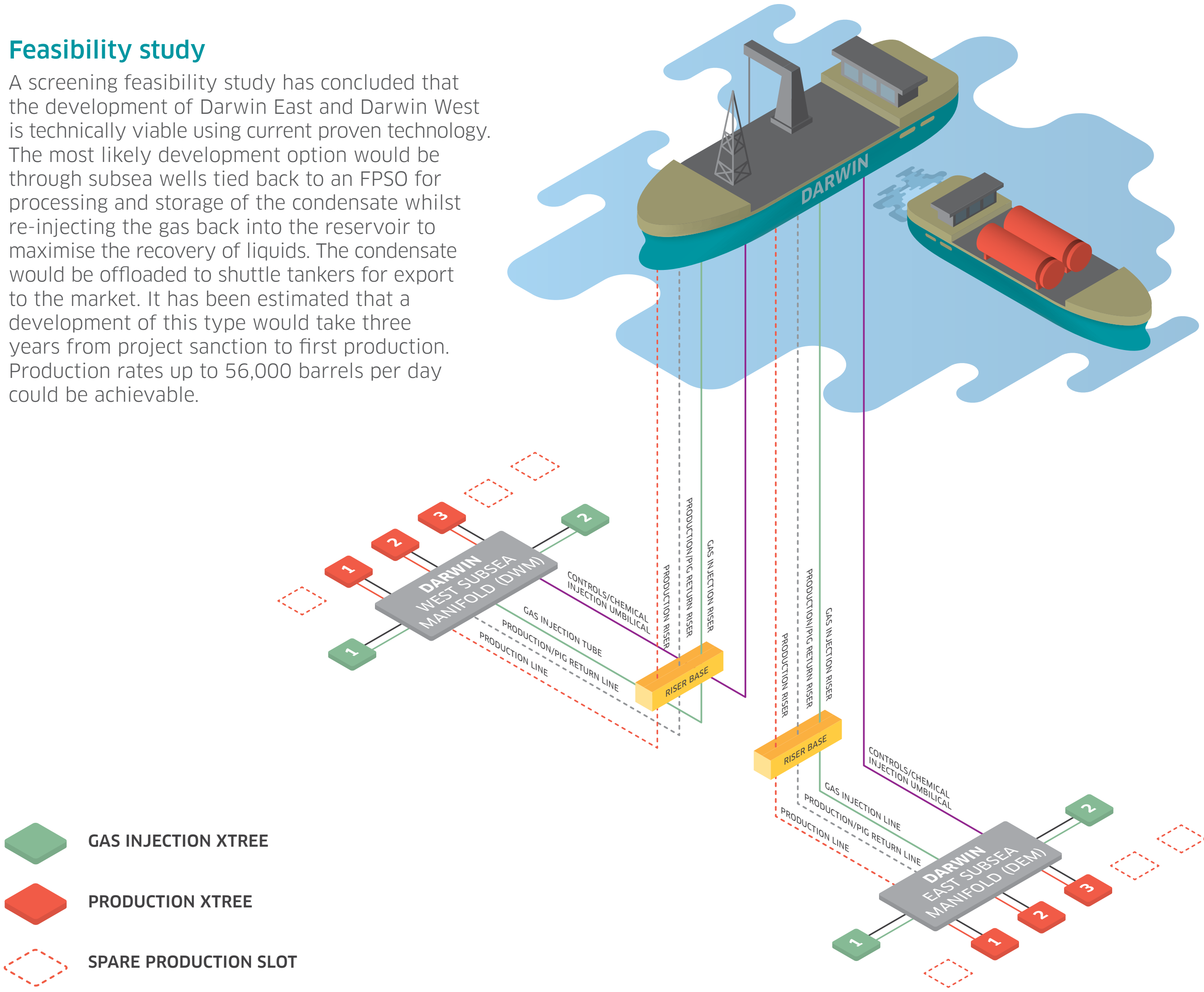
Darwin reservoir

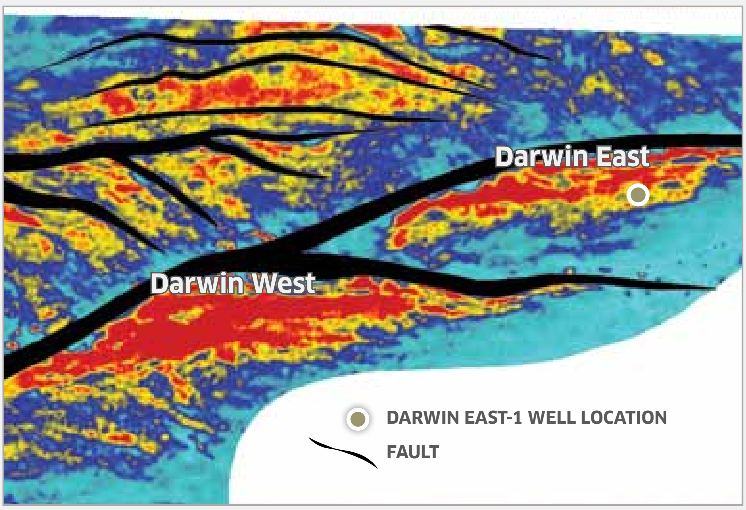
An arbitrary seismic line through the reservoir section of Darwin East and Darwin West. Discovery well 61/17-1 is marked.



Feasibility study

A screening feasibility study has concluded that the development of Darwin East and Darwin West is technically viable using current proven technology. The most likely development option would be through subsea wells tied back to an FPSO for processing and storage of the condensate whilst re-injecting the gas back into the reservoir to maximise the recovery of liquids. The condensate would be offloaded to shuttle tankers for export to the market. It has been estimated that a development of this type would take three years from project sanction to first production. Production rates up to 56,000 barrels per day could be achievable.





Darwin reservoir and fluid properties

Gross interval thickness:	84.5m
Net pay:	67.8m
Average hydrocarbon saturation:	71.5%
Average porosity:	22%
Average permeability:	337 mD
Condensate API:	46° to 49°
Initial condensate yield:	123–140 stb/MMscf

Seismic amplitude map illustrating reservoir pay and the main bounding faults. Discovery well 61/17-1 is marked.

Prospects

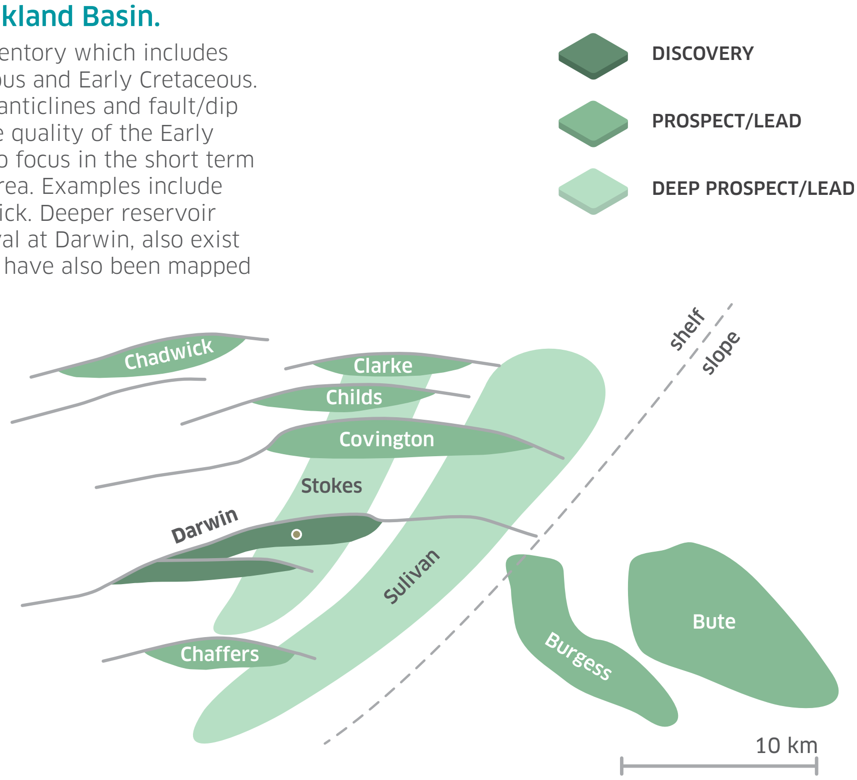
Our short-term exploration focus

Darwin has proved that there is a working hydrocarbon system in the South Falkland Basin.

The company holds an extensive prospect inventory which includes reservoir targets in the Tertiary, Late Cretaceous and Early Cretaceous. It contains both structural traps (thrust cored anticlines and fault/dip closures) and stratigraphic traps. However, the quality of the Early Cretaceous reservoir at Darwin is leading us to focus in the short term on similar prospects within the surrounding area. Examples include Covington, Chaffers, Childs, Clarke and Chadwick. Deeper reservoir targets, below the hydrocarbon bearing interval at Darwin, also exist (Sulivan and Stokes). Large stratigraphic traps have also been mapped (Bute and Burgess).

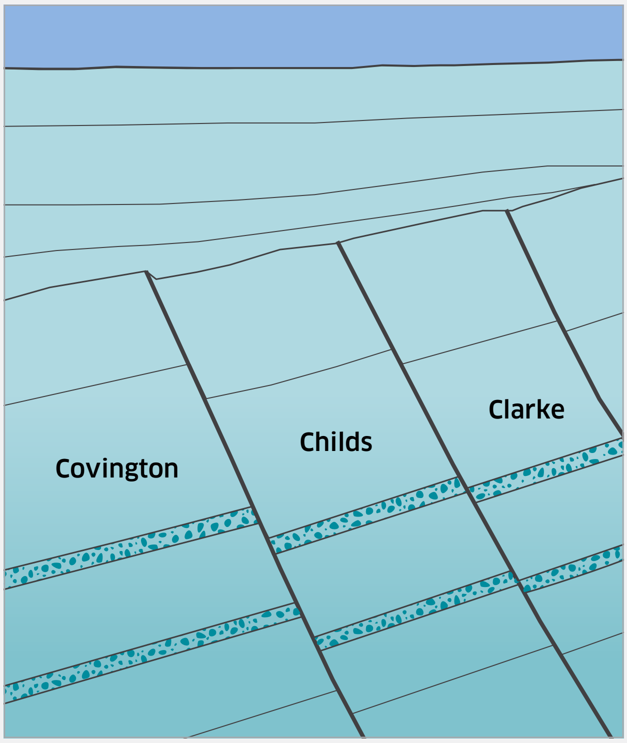
The prospect inventory contains nine prospects within the Early Cretaceous play fairway, with prospect sizes in the range 120 to 720m barrels recoverable. Numerous other leads also exist. We assess these Early Cretaceous prospects to be low to medium risk. The structural traps have the lowest technical risk.

In order to fully evaluate these prospects the company recently completed the acquisition of 1,025 square kilometres of new 3D seismic. This survey is contiguous with the earlier survey, acquired in 2007/2008, which will be reprocessed and merged with the new data to provide one large consistent data set.



PGS Ramform Challenger

PGS seismic vessel Ramform Challenger equipped with GeoStreamer technology acquired 1,025 square kilometres of new 3D seismic data.



Corporate responsibility

Conducting our operations safely

Borders & Southern completed its 2012 drilling campaign safely and with limited impact on the environment.

The operation involved a large number of personnel rotating in and out of the Falkland Islands along with the transportation of considerable supplies from Europe. Borders & Southern ensured that its drilling policies and management systems were carefully followed. Detailed planning, risk identification and mitigation, training where necessary and familiarisation exercises were undertaken in advance and during the campaign. Close cooperation with the Falkland Islands Government and the UK HSE was maintained throughout the operation on safety and well integrity matters.

Limiting our environmental impact

The company's objective was to minimise its footprint throughout the operation. We used water based drilling mud and the most environmentally friendly chemicals whenever possible for mud and cement formulations (following UK DECC guidelines and chemical classification). Our waste management plan ensured that hazardous waste was removed from the Islands and recycling occurred wherever possible so as to minimise the waste going to landfill. Oil spill contingency plans were put in place that included training for onshore rig and support vessel personnel and oil spill drills at the start of the campaign.

All drilling campaign objectives were achieved in 2012.

Focus areas during 2012

Environmental impact	The company continued to develop and implement policies and procedures designed to identify and mitigate risks associated with a drilling campaign in a remote location with a relatively complex logistics supply chain.
Health and safety	Full risk assessments were undertaken prior to and during the drilling campaign. Mitigation plans and monitoring processes were put in place. Close cooperation with the authorities occurred throughout.
Business ethics	The company had significant expenditures and worked with numerous contractors during the drilling programme. Compliance with the Bribery Act and the company's standards was sought from the company's main suppliers supporting our operations.
Corporate governance	The company reviewed and maintained its procedures and reporting practices. The structure of the board and committees remained unchanged.
Community support	Wherever possible, the company used local suppliers of goods and services and employed local people during the Falkland Islands operations.

Chairman's statement

Harry Dobson Non-executive Chairman

"Last year Borders & Southern enjoyed its first taste of exploration success. In April 2012 the company announced a gas condensate discovery with its first exploration well."

Subsequent post-well technical studies have endorsed our initial opinion that Darwin has the potential to develop into a significant field. Furthermore, the discovery well (61/17-1) has opened up a new hydrocarbon basin, proved an Early Cretaceous play fairway and significantly reduced the risk profile of the company's prospect inventory.

Building on this success, the company has defined an ambitious work programme for the next two years. This includes further technical evaluation, 3D seismic acquisition and processing, reprocessing of existing 3D seismic, securing a partner and a rig contract, well planning and finally the drilling of both appraisal and exploration wells. At the conclusion of this programme, the company hopes to have established a core area comprising an appraised discovery that can be taken forward for project sanction and significant growth options.

2012 will be seen as a breakthrough year for the company. With a successful drilling campaign behind us, we now have an important discovery (Darwin) to underpin the company's future.

Furthermore, the discovery has profound implications on the quality of nearby prospects and B&S is starting to realise its ambition and vision of building a successful exploration company, delivering growth and value through discovery and appraisal. We have increasing confidence of further discoveries and believe our acreage position could develop into a core area.

The accomplishments of last year were due to the hard work of a small, dedicated and professional team that made excellent commercial and technical judgements. This team is supported by a number of contractors with whom we have developed good working relationships over a number of years. Without their help, the achievements would not have been possible and our thanks go to all those involved.

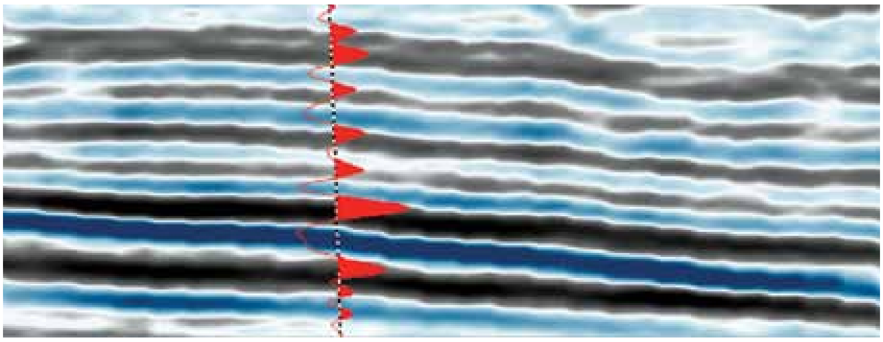
With a drilling programme involving a large number of personnel and operating in an environmentally sensitive area, the board maintained a strong focus on high standards of health, safety and environmental management during the year. I am pleased to report that the operation was conducted safely and without major incident and it is a credit to the drilling team that they performed to such standards in a remote location where logistical challenges can be significant.

The technical evaluation of the Darwin gas condensate discovery is progressing well. Our initial estimate of the recoverable liquids from the discovery was in the range of 130 to 250m barrels. Comprehensive post-well studies, a re-evaluation of the seismic data and the development of new reservoir models suggest that this might be conservative. As we have already reported, a screening feasibility study and independent project economics both indicate that if our current resource estimates alone are substantiated through appraisal drilling, a development of the discovery is both technically and commercially viable using existing technology. Demonstrating further resource additions will clearly enhance any development.

The next couple of years will be an exciting period for the company. We have defined a comprehensive work plan and we are totally focused on building and demonstrating the value of the company's assets.

Harry Dobson
Non-executive Chairman

Leveraging our strengths
Looking forward



A solid business model delivering on our promises

Our forward strategy

- Focus on Darwin and its surrounding area
- Continue to enhance our understanding of Early Cretaceous reservoirs
- Secure a partner to help fund the next drilling campaign

+

A focus on our strengths

- **Technical rigor** developing our experienced team
- **Commercial discipline** identifying and mitigating critical risks
- **Corporate responsibility** to ensure the safety of our people, minimise our environmental impact and to maintain stakeholder relationships

Our progress to date

- Safely operated two deep water wells in the Falkland Islands
- Made the first hydrocarbon discovery in the South Falkland Basin
- Proved an Early Cretaceous play fairway
- Compiled an extensive inventory of relatively low risk follow up prospects

What's next?

- Complete the processing of the newly acquired 3D seismic
- Reprocess the existing 3D seismic data and merge with the new data
- Complete the seismic remapping of existing prospects and hopefully identify additional new prospects
- Commence the planning of future appraisal and exploration wells
- Form a joint venture partnership
- Secure a deep water, harsh environment rig for the next drilling programme

Operations review

Howard Obee Chief Executive
Peter Fleming Finance Director

"The company acquired its acreage to the south of the Falkland Islands in 2004 with the specific objective of evaluating an untested fold belt."

Chief Executive's statement

Recognising that there was a high probability that a regional Late Jurassic to Early Cretaceous source rock would be present and working in the area, we were looking for robust simple structures characteristic of fold belts. Acquisition of 2D seismic confirmed the presence of large anticlines and tilted fault blocks. Encouraged by the confirmation of closed structures, our initial attention focused on the folds due to their size and simplicity. However, our perception of sub-surface risk became more balanced following the acquisition of 3D seismic, which revealed particularly interesting geophysical attributes associated with the tilted fault blocks.

The drilling programme was therefore designed to test both structural play types, targeting different aged reservoirs: Early Cretaceous shallow marine sand reservoirs in tilted fault blocks and Tertiary/Late Cretaceous deep-water turbidite reservoirs in folds. Whilst the drilling results proved the fault blocks as a valid play, it left questions unanswered about the folds. Our second well (61/25-1), drilled on the Stebbing prospect, encountered very strong hydrocarbon shows in poor quality Tertiary reservoir, but failed to reach the deeper Late Cretaceous targets due to high pressures. Therefore part of the regional geology remains unevaluated and the folds continue to be legitimate targets within our exploration portfolio.

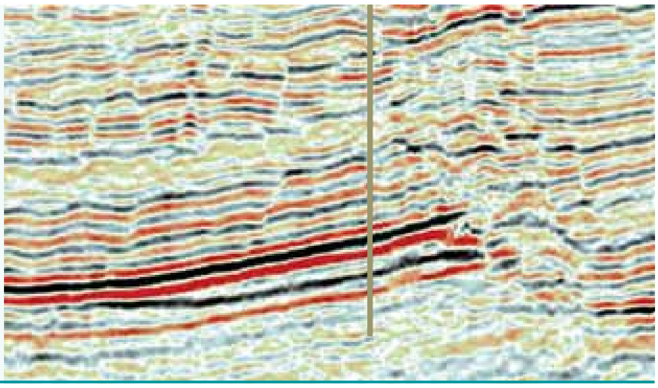
However, short-term focus has to be placed on the Early Cretaceous high quality reservoir, both appraising the Darwin discovery and exploring nearby prospects. This is partly due to its ability to be clearly imaged on 3D seismic data. Our understanding of this reservoir interval is improving all the time. The Darwin exploration well was sited on the easternmost of two adjacent tilted fault blocks as it was anticipated that it would encounter the thickest, high quality reservoir. The well came in very close to prognosis, but now through integrating the well data with the seismic we are able to extract more information from our seismic volume. This has led to alternative reservoir models and may indicate that the reservoir unit is actually thicker on Darwin West.

A new 3D survey commenced in late February 2013. The key objective is to reduce the technical risks on those prospects currently only mapped on 2D data. Additionally, the survey will provide new information on regional reservoir development and potentially identify new prospects. An initial processed product will be received approximately three months after acquisition has been completed. At that stage we would hope to get first insights into the geophysical attributes of key prospects. The final depth processed data will not be received for approximately nine months. Well planning can proceed using the fast track data, but ultimate well locations will be selected using the final product.

The 2012 drilling campaign not only improved our understanding of the sub-surface, it also provided valuable insights into the operating environment. We learnt that we could safely drill deep-water wells with little impact from adverse weather conditions. Securing a harsh environment dynamically positioned

Darwin discovery

Licence	PL018
B&S interest	100%
Structure	Tilted fault block
Reservoir	Lower Cretaceous shallow marine sands



semi-submersible meant that we lost very little time due to weather. We also learnt that we could operate year round. The biggest challenge came from logistics, but with careful planning and taking enough contingency supplies we were able to minimise the impact of the long supply route between Europe and the Falkland Islands.

One important licence milestone occurred in November of last year, as we entered the second exploration term. By doing so, we committed to drill one exploration well and had to relinquish 50% of our acreage. Defining the area of relinquishment was not difficult and the impact on our exploration portfolio was minimal. Part of the area relinquished was structurally very complex, the other part very deep water. Additionally our palaeogeographic models predicted that the area would have limited reservoir development. Following relinquishment, we still retain nearly 10,000 square kilometres and hold a very extensive prospect inventory.

As previously announced, in order to help fund the next appraisal and exploration programme, we intend to bring partners into the licences. This process is underway and our aim is to conclude it as soon as possible. At the same time, we are actively monitoring the rig market, with a view to mobilising a rig in late 2014 or early 2015.

In summary, the entire team is extremely optimistic about our discovery, the quality of the surrounding prospects and the potential growth options for the company. Our immediate priority is to demonstrate a clear path to the next drilling campaign.

Financial review

The company reported a loss for the year of $1.3m compared to $1.7m for 2011. The reduction in losses was mainly due to unrealised gains on exchange rates from deposits held in Sterling. Administrative expenses were $3.1m for the year compared to $2.1m in 2011 due to higher staff related costs in 2012.

We commenced the drilling campaign in 2012 with the view that we had sufficient funds, with contingency, to drill both wells. The rig equipment problems during the drilling of the Darwin well resulted in significant increases to the budgeted well cost and we considered it prudent to raise additional capital of $74m (pre expenses) in late April to ensure that we continued to have sufficient funds, with contingency, to drill Stebbing. This prudent approach to capital management has proven to be correct. After spending around $192m in 2012, the company ended the year with around $56m in cash deposits. This is sufficient to fund the small amounts still owing from the drilling campaign, the existing 3D seismic acquisition and ongoing overhead costs for the foreseeable future. Due to the increased levels of expenditure during 2012 and 2013 considerable effort is expended on cost-tracking and oversight to ensure that capital is allocated efficiently.

Howard Obee
Chief Executive

Peter Fleming
Finance Director

Risk management
Principal risks and uncertainties

Risk	Nature of risk	Mitigation
Exploration	Oil and gas exploration is an inherently risky business. Exploration and appraisal wells can result in positive, negative or inconclusive outcomes.	Borders & Southern has an experienced technical and management team that makes considered technical and commercial judgements. It takes care to acquire the right type of data, applies rigorous petroleum systems analysis and fully evaluates the sub-surface risks prior to financial commitment.
Health, Safety, Security & Environment (HSSE) incidents	Operational activity in a remote, environmentally sensitive, deep water area provides exposure to various risks to personnel and the environment.	The company produces project-specific Safety Management documents that establish safety standards, roles and responsibilities, procedures, reporting lines and emergency actions. All incidents are thoroughly investigated to establish causes and ensure appropriate corrective actions are taken. Management are continuously involved in the management of HSSE.
Financial risk	Exposure to a variety of financial risks that include liquidity and foreign exchange risk.	The company holds its cash in relatively short-term treasury deposits with high quality UK banks. It holds both Dollar and Sterling accounts to match its expenditure profile. Refer to note 20 for more details.
Fiscal risk	The Falkland Islands are responsible for their own tax royalty system. Like all administrations, they can change the terms at any time which might have impact on project returns.	The Falkland Islands Government has historically set fiscal terms to attract foreign investment.
Oil price	One of the main impacts on the commerciality of any discovery is the oil price. Fluctuations in commodity prices occur on a daily basis.	The current price of Brent Crude is around \$100 per barrel. The company runs its project economics at \$85 and \$65 per barrel in order to assess commerciality.
Funding risk	Inability to fund future work programme due to low cash deposits.	Borders & Southern is presently looking to attract partners to help fund the next stage of the appraisal and exploration drilling programme.
Sovereignty risk	There is an ongoing dispute over the sovereign status of the Falkland Islands. The Falkland Islands are a self-governing overseas territory of the United Kingdom. Argentina continues to claim sovereignty.	The British Government strongly supports the Falkland Islanders' rights for self-determination. A recent referendum recorded an overwhelming majority to continue as a UK overseas territory.

Introduction to governance

> **"Whilst the company is listed on AIM and is not subject to the Corporate Code on corporate governance, the board regularly reviews its procedures to ensure good practice relative to its peer companies."**

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 do so. The board regularly reviews its procedures and board committees and their composition and makes changes to ensure they are consistent with good practice for companies of similar size and complexity.

The board considers 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. 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.

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 for 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

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.

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 28 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.

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.

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.

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.

REMUNERATION COMMITTEE

AUDIT COMMITTEE

Directors' report

for the year ended 31 December 2012

The directors present their report and the audited consolidated financial statements for the year ended 31 December 2012.

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 2012, were as follows:

	At 31 December 2012 Number	At 31 December 2011 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	1,300,000	1,300,000	24–30 pence	51–56 pence	three years
Peter Fleming	1,300,000	1,300,000	24–30 pence	51–56 pence	three years
Nigel Hurst-Brown	250,000	250,000	32 pence	58 pence	three years

Substantial shareholders

At May 2013 the following held 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	63,063,235	13.03%
Ignis Investment Services Limited	33,685,117	6.96%
Stephen Posford	27,500,000	5.68%
The Capital Group Companies Inc.	27,293,100	5.63%
Zila Corporation	26,670,000	5.51%

Domicile

The parent company of the group, 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 19 and shows the result for the year.

The directors do not recommend the payment of a dividend (2011: $nil).

Review of business and future developments

A review on the operations of the group is contained in the Chief Executive's Review and Financial Review on pages 8 to 9.

Directors' report continued

for the year ended 31 December 2012

Principal risks and uncertainties and financial risk management

The Group's risks and uncertainties are outlined on page 10.

Key performance indicators

The company's key performance indicators were focused on the safe fulfilment of the exploration programme and finding commercial hydrocarbons.

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 (2011: $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 (2011: 2 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 elected to prepare the group and company financial statements in accordance with International Financial Reporting Standards (IFRS) 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.

Number of board meetings during the year

Attendance	Board	Remuneration Committee	Audit Committee
Harry Dobson	9	1	2
Howard Obee	9		
Peter Fleming	9		
NIgel Hurst-Brown	9	1	2
Stephen Posford	9	1	2

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
17 May 2013

Remuneration Committee report

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 2012 was as follows:

	Basic salary $	Bonus $	Share-based payment $	**Total 2012 $**	Total 2011 $
Harry Dobson	–	–	–	**–**	–
Howard Obee	299,587	80,765	164,975	**545,327**	373,229
Peter Fleming	249,315	80,765	164,975	**495,055**	355,921
Nigel Hurst-Brown	16,153	–	34,333	**50,486**	42,612
Stephen Posford	12,115	–	–	**12,115**	–
	577,170	161,530	364,283	**1,102,983**	771,762

The share-based payments relate to the expensing of the fair value of options issued in 2009 and 2011. See note 7 for further details.

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 2012 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 Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

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 2012 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
17 May 2013

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 2012

	Note	2012 $	2011 $
Administrative expenses		**(3,125,685)**	(2,081,967)
Loss from operations	2	**(3,125,685)**	(2,081,967)
Finance income	8	**2,023,224**	360,037
Finance expense	8	**–**	(13,465)
Loss before tax		**(1,102,461)**	(1,735,395)
Tax expense	9	**(178,043)**	(5,506)
Loss for the year and total comprehensive loss for the year attributable to owners of the parent		**(1,280,504)**	(1,740,901)
Basic loss per share (see note 3)		**(0.3) cents**	(0.4) cents

The notes on pages 26 to 36 form part of the financial statements.

Consolidated statement of financial position

as at 31 December 2012

	Note	2012 $	2012 $	2011 $	2011 $
Assets					
Non-current assets					
Property, plant and equipment	10		**20,773**		20,629
Intangible assets	11		**258,011,250**		64,643,520
Total non-current assets			**258,032,023**		64,664,149
Current assets					
Other receivables	13	**1,544,557**		1,544,103	
Cash and cash equivalents		**44,715,158**		95,776,313	
Restricted use cash		**11,719,899**		80,947,886	
Total current assets			**57,979,614**		178,268,302
Total assets			**316,011,637**		242,932,451
Liabilities					
Current liabilities					
Tax payables	9		**(178,043)**		–
Trade and other payables	14		**(3,527,721)**		(1,330,112)
Total net assets			**312,305,873**		241,602,339
Equity					
Share capital	15		**8,530,461**		7,675,453
Share premium			**308,602,131**		238,034,095
Other reserves			**1,607,559**		1,046,565
Retained deficit			**(6,417,882)**		(5,137,378)
Foreign currency reserve			**(16,396)**		(16,396)
Total equity			**312,305,873**		241,602,339

The notes on pages 26 to 36 form part of the financial statements.

The financial statements were approved by the board of directors and authorised for issue on 17 May 2013.

Howard Obee
Director

Peter Fleming
Director

Company Number:
5147938

Consolidated statement of changes in equity

for the year ended 31 December 2012

	Share capital $	Share premium $	Other reserves $	Retained deficit $	Foreign currency reserve $	Total $
Balance at 1 January 2011	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
Total comprehensive loss for the year	–	–	–	(1,280,504)	–	(1,280,504)
Issue of shares	855,008	73,158,509	–	–	–	74,013,517
Share issue costs	–	(2,590,473)	–	–	–	(2,590,473)
Recognition of share-based payments	–	–	560,994	–	–	560,994
Balance at 31 December 2012	**8,530,461**	**308,602,131**	**1,607,559**	**(6,417,882)**	**(16,396)**	**312,305,873**

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.
Retained deficit	Cumulative net gains and losses recognised in the consolidated statement of comprehensive income.
Foreign currency reserves	Differences arising on change of presentation and functional currency to US Dollars.

The notes on pages 26 to 36 form part of the financial statements.

Company statement of financial position

as at 31 December 2012

	Note	2012 $	2012 $	2011 $	2011 $
Assets					
Non-current assets					
Property, plant and equipment	10		**20,773**		20,629
Investments	12		**2**		2
Total non-current assets			**20,775**		20,631
Current assets					
Other receivables	13	**259,731,149**		65,274,488	
Cash and cash equivalents		**44,715,158**		95,776,313	
Restricted use cash		**11,719,899**		80,947,886	
Total current assets			**316,166,206**		241,998,687
Total assets			**316,186,981**		242,019,318
Liabilities					
Current liabilities					
Tax payables	9		**(178,043)**		–
Trade and other payables	14		**(3,527,721)**		(241,635)
Total net assets			**312,481,217**		241,777,683
Equity					
Called up share capital	15		**8,530,461**		7,675,453
Share premium			**308,602,131**		238,034,095
Other reserves			**1,607,559**		1,046,565
Retained deficit			**(6,240,249)**		(4,959,745)
Foreign currency reserve			**(18,685)**		(18,685)
Total equity			**312,481,217**		241,777,683

The notes on pages 26 to 36 form part of the financial statements.

The financial statements were approved by the board of directors and authorised for issue on 17 May 2013.

Howard Obee
Director

Peter Fleming
Director

Company Number:
5147938

Company statement of changes in equity

for the year ended 31 December 2012

	Share capital $	Share premium reserve $	Other reserves $	Retained deficit $	Foreign currency reserve $	Total $
Balance at 1 January 2011	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
Total comprehensive loss for the year	–	–	–	(1,280,504)	–	(1,280,504)
Issue of shares	855,008	73,158,509	–	–	–	74,013,517
Share issue costs	–	(2,590,473)	–	–	–	(2,590,473)
Recognition of share-based payments	–	–	560,994	–	–	560,994
Balance at 31 December 2012	**8,530,461**	**308,602,131**	**1,607,559**	**(6,240,249)**	**(18,685)**	**312,481,217**

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 26 to 36 form part of the financial statements.

Consolidated statement of cash flows

for the year ended 31 December 2012

	Note	2012 $	2012 $	2011 $	2011 $
Cash flow from operating activities					
Loss before tax			**(1,102,461)**		(1,735,395)
Adjustments for:					
Depreciation			**4,000**		13,606
Share-based payment			**560,994**		425,903
Finance income			**(2,023,224)**		(360,037)
Finance expenses			**–**		13,465
Realised foreign exchange gains/(losses)			**532,591**		(254)
Cash flows from operating activities before changes in working capital			**(2,028,100)**		(1,642,712)
(Increase)/decrease in other receivables			**(454)**		402,423
Increase in trade and other payables			**11,248**		1,058,641
Tax paid			**–**		(5,506)
Net cash outflow from operating activities			**(2,017,306)**		(187,154)
Cash flows used in investing activities					
Interest received		**225,545**		360,743	
Purchase of intangible assets		**(191,181,369)**		(17,545,073)	
Purchase of property, plant and equipment		**(4,144)**		(21,125)	
Net cash used in investing activities			**(190,959,968)**		(17,205,455)
Cash flows from financing					
Proceeds from issue of shares (net of issue costs)		**71,423,044**		–	
Net cash flows from financing activities			**71,423,044**		–
Net decrease in cash and cash equivalents			**(121,554,230)**		(17,392,609)
Cash and cash equivalents at the beginning of the year			**176,724,199**		194,130,019
Exchange gain/(loss) on cash and cash equivalents			**1,265,088**		(13,211)
Cash and cash equivalents and cash held in escrow at the end of the year	16		**56,435,057**		176,724,199
Cash and cash equivalents			**44,715,158**		95,776,313
Restricted use cash			**11,719,899**		80,947,886

Company statement of cash flows

for the year ended 31 December 2012

	Note	2012 $	2012 $	2011 $	2011 $
Cash flow from operating activities					
Loss before tax			**(1,102,461)**		(1,730,601)
Adjustments for:					
Depreciation			**4,000**		13,606
Share-based payment			**560,994**		425,903
Finance income			**(2,023,224)**		(360,037)
Finance expense			**–**		13,465
Realised foreign exchange gains/(losses)			**532,591**		–
Cash flows from operating activities before changes in working capital			**(2,028,100)**		(1,637,664)
(Increase)/decrease in other receivables			**(1,239,136)**		1,641,817
Decrease in trade and other payables			**(122,232)**		(22,655)
Tax paid			**–**		(5,506)
Net cash outflow from operating activities			**(3,389,468)**		(24,008)
Cash flows from investing activities					
Interest received		**225,545**		360,037	
Interest paid		**–**		(254)	
Increase in amounts due from group undertaking		**(189,809,207)**		(17,707,259)	
Purchase of property, plant and equipment		**(4,144)**		(21,125)	
Net cash from investing activities			**(189,587,806)**		(17,368,601)
Cash flows from financing					
Proceeds from issue of shares (net of issue costs)		**71,423,044**		–	
Net cash flows from financing activities			**71,423,044**		–
Net decrease in cash and cash equivalents			**(121,554,230)**		(17,392,609)
Cash and cash equivalents at the beginning of the year			**176,724,199**		194,130,019
Exchange gain/(loss) on cash and cash equivalents			**1,265,088**		(13,211)
Cash and cash equivalents and cash held in escrow at the end of the year	16		**56,435,057**		176,724,199
Cash and cash equivalents			**44,715,158**		95,776,313
Restricted use cash			**11,719,899**		80,947,886

Notes to the financial statements
for the year ended 31 December 2012

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 (IFRS 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 IFRS.

The consolidated financial statements have been prepared under the historical cost convention.

New and revised standards effective for 31 December 2012 year end
There were no new standards issued in respect of the year ended 31 December 2012 that were relevant for adoption by the group.

New and revised standards issued but not effective for 31 December 2012 year end
There were no new standards issued but not effective for the year ended 31 December 2012 that would be relevant for adoption by the group.

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 subsidiary ("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 $1,280,501 (2011: loss after tax of $1,740,901) 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.

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 of exploration and evaluation expenditure
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.

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.

Notes to the financial statements continued
for the year ended 31 December 2012

1 Accounting policies continued

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;
- 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. Some of these funds are held in restricted deposits or escrow accounts as security for suppliers to the company.

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.

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 will be modified as appropriate in the year in which the circumstances change. Where necessary, the comparatives will be 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 on a project by project basis pending determination of feasibility of the project 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. Following a review of the carrying value of the capitalised exploration and evaluation costs as at 31 December 2012, the board concluded that no impairment was necessary at that time.

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 75% volatility rate based on the standard deviation of the company's share price since inception and a 1% risk-free rate based on current UK Government bond yields. See note 7.

2 Loss from operations

	2012 $	2011 $
Staff costs (note 5)	**1,305,596**	789,931
Share-based payment – equity-settled	**560,994**	425,903
Services provided by the auditors:		
Remuneration receivable by the company's auditor or an associate of the company's auditor for the auditing of the accounts	**24,000**	21,015
Fees payable to the company's auditor and its associates for other services:		
Tax services – compliance	**14,000**	9,131
Depreciation of office equipment	**4,000**	13,606
Operating lease expenses-property	**284,338**	274,493
Foreign exchange (gain)/loss	**(1,797,679)**	13,211

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 $1,280,504 (2011: loss $1,740,901) and the weighted average number of shares in issue for the year was 463,145,812 (2011: 428,578,404). 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 266,752 (2011: 621,906) 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 and all other non-current assets are located in the Falkland Islands.

Notes to the financial statements continued

for the year ended 31 December 2012

5 Staff costs

Company and group

Staff costs (including directors) comprise:

	2012 $	2011 $
Wages and salaries	**1,152,106**	699,657
Employers' national insurance contribution	**153,490**	90,274
	1,305,596	789,931
Share-based payment – equity-settled	**446,899**	349,218
	1,752,495	1,139,149

The average number of employees (including directors) employed during the year by the company was six (2011: six) and for the group was six (2011: six). All employees and directors of the group and the company are considered to be the key management personnel.

Of the $560,994 share-based payment charge included in the consolidated statement of comprehensive income, $446,899 (2011: $349,218) has been charged in respect of share options granted to staff (including directors) in the current and prior years. The remaining $114,095 (2011: $76,685) relates to share options granted to external parties.

6 Directors' emoluments

The directors' emoluments for the year are as follows:

	2012 $	2011 $
Directors' fees	**738,700**	511,720
Share-based payments – equity-settled	**364,283**	260,042
	1,102,983	771,762

The fees and share-based payments made to each director are disclosed in the Remuneration Committee Report. During the year, the highest paid director received total remuneration of $380,352 (2011: $264,514).

In 2009, the group granted to three directors of Borders and Southern Petroleum Plc, for nil consideration, 250,000 share options each, with a total fair value of $374,446. Of this amount $103,000 (2011: $127,838) has been expensed during the year.

In 2011, the group granted to two directors of Borders and Southern Petroleum Plc, for nil consideration, 1,000,000 share options each, with a total fair value of $774,447. Of this amount $261,283 (2011: $132,204 has been expensed during the year.

7 Share-based payment

In September 2012, the group granted 400,000 share options to an employee of the group. The options vest after three years and expire after ten years. A Black-Scholes model has been used to determine the fair value of options granted (see below).

	31 December 2012 Weighted average exercise price	31 December 2012 Number	31 December 2011 Weighted average exercise price	31 December 2011 Number
Outstanding at the beginning of the year	**52p**	**5,350,000**	54p	2,450,000
Granted during the year	**24p**	**400,000**	50p	2,900,000
Outstanding at the end of the year	**50p**	**5,750,000**	52p	5,350,000
Exercisable at the end of the year	**60p**	**2,050,000**	50p	1,000,000

The weighted average contractual life of the options outstanding at the year end was eight years (2011: seven years).

The range of exercise prices of share options outstanding at the end of the year is 24 pence: 74 pence (2011: 42 pence: 74 pence).

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 2012	31 December 2011
Option pricing model used	**Black-Scholes**	Black-Scholes
Weighted average share price at grant date	**24p**	50p
Exercise price	**24p**	50p
Weighted average contractual life (days)	**1,460**	1,460
Expected volatility	**75%**	60%
Risk-free interest rate	**1.0%**	2.0%
Fair value of options	**13p**	23p

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.

	2012 $	2011 $
Share-based remuneration expense for the year in respect of the equity-settled scheme for options granted during 2008	**–**	30,590
Share-based remuneration expense for the year in respect of the equity-settled scheme for options granted during 2009	**150,446**	197,055
Share-based remuneration expense for the year in respect of the equity-settled scheme for options granted during 2010	**32,988**	32,754
Share-based remuneration expense for the year in respect of the equity-settled scheme for options granted during 2011	**370,004**	165,504
Share-based remuneration expense for the year in respect of the equity-settled scheme for options granted during the year	**7,556**	–
Total share-based remuneration expense for the year	**560,994**	425,903

8 Finance income and expense

Finance income

	2012 $	2011 $
Bank interest received	**225,545**	360,037
Foreign exchange gain	**1,797,679**	–
	2,023,224	360,037

Finance expense

	2012 $	2011 $
Bank interest paid	**–**	254
Foreign exchange loss	**–**	13,211
	–	13,465

Notes to the financial statements continued

for the year ended 31 December 2012

9 Tax expense

Current tax expense

	2012 $	2011 $
UK corporation tax on loss for the year at 24.5% (2011: 26.5%)	**178,043**	–
Adjustments recognised in the current year in relation to the current tax of prior years	**–**	5,506
Total current and deferred tax for the year	**178,043**	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:

	2012 $	2011 $
Loss before taxation	**(1,102,461)**	(1,735,395)
Standard rate corporation tax charge at 24.5% (2011: 26.5%)	**(270,103)**	(459,880)
Expenses not deductible for tax purposes	**520,000**	273,982
Capital allowances in excess of depreciation	**(521)**	(2,342)
Unutilised tax losses carried forward	**–**	188,240
Adjustments recognised in the current year in relation to the current tax of prior years	**–**	5,506
Tax losses brought forward utilised	**(53,571)**	–
Small companies relief	**(17,762)**	–
Total current and deferred tax for the year	**178,043**	5,506

Factors that may affect future tax charges

The group has a deferred tax asset of approximately $nil (2011: $178,000) in respect of unrelieved tax losses of approximately $nil at 31 December 2012 (2011: $710,000). The rate of tax used in the calculation of the deferred tax asset is 24.5% (2011: 26.5%). 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 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
As at 31 December 2010	13,110

10 Property, plant and equipment continued

	Office equipment $
Cost	
As at 1 January 2012	107,906
Additions	4,144
As at 31 December 2012	**112,050**
Depreciation	
As at 1 January 2012	87,277
Charge for the year	4,000
As at 31 December 2012	**91,277**
Net book value	
As at 31 December 2012	**20,773**

11 Intangible assets

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
As at 31 December 2010	37,730,165

Group	Exploration and evaluation costs $
Cost	
As at 1 January 2012	64,643,520
Additions	193,367,730
As at 31 December 2012	**258,011,250**
Net book value	
As at 31 December 2012	**258,011,250**

On 8 November 2012 the company received approval from The Falkland Islands Government to proceed into the Second Term for Production Licences PL018, PL019 and part of PL020. The other part of PL020, Licence PL021 and PL022 were relinquished. The second term of the Licences expires on 1 November 2017.

12 Investments in subsidiary

Company	2012 $	2011 $
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.

Notes to the financial statements continued

for the year ended 31 December 2012

13 Other receivables

	Group		Company	
	2012 $	2011 $	**2012 $**	2011 $
Amounts owed by group undertakings	**–**	–	**258,186,598**	64,969,073
Other receivables	**1,481,056**	239,235	**1,481,056**	239,325
Prepayments and accrued income	**63,501**	1,304,778	**63,495**	66,090
	1,544,557	1,544,103	**259,731,149**	65,274,488

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	
	2012 $	2011 $	**2012 $**	2011 $
Trade payables	**2,013,333**	138,650	**2,013,333**	138,650
Other taxes and social security costs	**47,706**	26,257	**47,706**	26,257
Other payables	**–**	42,228	**–**	42,228
Accruals and deferred income	**1,466,682**	1,122,977	**1,466,682**	34,500
	3,527,721	1,330,112	**3,527,721**	241,635

15 Share capital

	2012 $	2011 $
Authorised		
750,000,000 ordinary shares of 1 pence each (2011: 750,000,000)	**14,926,125**	14,926,125
Allotted, called up and fully paid		
484,098,484 ordinary shares of 1 pence each (2011: 428,578,404)	**8,530,461**	7,675,453
Share capital		
Brought forward	**7,675,453**	7,675,453
Shares issued in year	**855,008**	–
Carried forward	**8,530,461**	7,645,453
Share premium		
Brought forward	**238,034,095**	238,034,095
Shares issued in year	**70,568,036**	–
Carried forward	**308,602,131**	238,034,095

16 Cash and cash equivalents and restricted use cash

Group and company	2012 $	2011 $
Cash available on demand	**4,296,872**	2,589,436
Cash on deposit	**40,418,286**	93,186,877
Restricted use cash	**11,719,899**	80,947,886
Total	**56,435,057**	176,724,199

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 $193,217,525 (2011: $17,702,259) on behalf of Borders & Southern Falkland Islands Limited. At the year end $258,186,598 (2011: $64,969,073) 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	
	2012 $	2011 $
Not later than one year	**148,430**	135,255

During 2012, the company entered into an agreement with PGS Geophysical AS for the acquisition of 3D seismic. This seismic will be acquired during 2013 and the estimated cost is $22 million.

The group licence commitment is to drill one exploration well before 1 November 2017.

19 Events after the reporting period

In February 2013, the company commenced the acquisition of 3D seismic within the licences. On the 9 April, it was announced that the acquisition had been completed.

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 2012 and as at 31 December 2011 are materially equivalent to the carrying value as disclosed in the statement of financial position and related notes.

20 Financial instruments continued

a) 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 2012 the company held cash at bank and in deposits under its control of $56,435,057 (2011: $176,724,199), which forms the majority of the group's working capital. Of the cash at bank and in deposit, $4,296,872 (2011: $2,589,436) 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 $40,418,286 (2011: $93,186,877) with a weighted average fixed interest rate of 0.2% (2011: 0.2%) for three months. The company also held cash in escrow accounts of $11,719,899 (2011: $80,947,886). If there was 1% change in interest rates the impact on the statement of comprehensive income would be $564,351 (2011: $1,767,242).

b) Foreign currency risk

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

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 2012 $**	Other receivables measured at amortised cost 2011 $	**Other receivables measured at amortised cost 2012 $**	Other receivables measured at amortised cost 2011 $
Held in UK£:				
Other receivables	**801,484**	247,468	**801,484**	247,468
Cash and cash equivalents and cash held in escrow	**41,576,326**	41,023,045	**41,576,326**	41,023,045
Total current financial assets held in UK£	**377,810**	41,270,513	**377,810**	41,270,513
Held in US$:				
Trade and other receivables	**729,034**	–	**258,915,627**	64,969,073
Cash and cash equivalents	**14,858,731**	135,701,154	**14,858,731**	135,701,154
Total financial assets	**57,965,575**	176,971,667	**316,152,168**	241,940,740

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 Sterling of $4,157,633 (2011: $4,113,128) for the group and company.

	Group		Company	
	Financial liabilities measured at amortised cost 2012 $	Financial liabilities measured at amortised cost 2011 $	**Financial liabilities measured at amortised cost 2012 $**	Financial liabilities measured at amortised cost 2011 $
Held in UK£:				
Trade and other payables	**3,527,721**	1,330,112	**3,527,721**	241,635
Total financial liabilities	**3,527,721**	1,330,112	**3,527,721**	241,635

If there was a 10% change in the year-end exchange rate there would be a movement in the US Dollar equivalent of financial liabilities held in the UK Sterling of $352,772 (2011: $18,088) for the group and company.

20 Financial instruments continued

c) Credit risk

Neither the group nor the company have customers so formal credit procedures are in the process of being established. During drilling operations, the group incurred 100% of costs that were shared with other companies and these were invoiced to these companies with all amounts due for these shared costs paid to the group during the year. 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 on an ongoing basis is cash held at bank and the maximum credit risk exposure for the group and company is detailed in the table below:

	2012 Group and Company		2011 Group and Company	
	Carrying value $	**Maximum exposure $**	Carrying value $	Maximum exposure $
Cash and cash equivalents and cash held in escrow	**56,435,057**	**56,435,057**	176,724,199	176,724,199
Maximum credit risk exposure	**56,435,057**	**56,435,057**	176,724,199	176,724,199

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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