TEXON PETROLEUM LTD

FINANCIAL REPORT

31 DECEMBER 2011

ABN 24 119 737 772

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GLOSSARY OF TERMS

bbl:	barrels
mbbl:	thousand barrels
bcf:	billion cubic feet
bcfe:	billion cubic feet equivalent
boe:	barrels of oil equivalent (including gas converted to oil equiv barrels on basis of 6mcf to 1 barrel of oil equiv)
bopd:	barrels of oil per day
boepd:	barrels of oil equivalent per day (including gas converted to oil equiv barrels on basis of 6mcf to 1 barrel of oil equiv)
EFS:	Eagle Ford Shale
ft:	feet
IFR:	initial flow rate
IPO:	initial public offering
m:	metres
mcf:	thousand cubic feet
mcfgpd:	thousand cubic feet of gas per day
mmbtu:	million British thermal units
mmcf:	million cubic feet
mmcfegpd:	million cubic feet equivalent of gas per day
mmcfgpd:	million cubic feet of gas per day
mboe:	thousand barrels of oil equivalent (including gas converted to oil equiv barrels on basis of 6mcf to 1 barrel of oil equiv)
mmboe:	million barrels of oil equivalent (including gas converted to oil equiv barrels on basis of 6mcf to 1 barrel of oil equiv)
NGL:	natural gas liquids
NRI:	nett revenue interest
WI:	working interest
WTI Crude:	West Texas Intermediate crude oil
YE:	Year End

DIRECTORS' REPORT

FOR THE YEAR ENDED 31 DECEMBER 2011

The directors present their report together with the financial report of Texon Petroleum Ltd ("the Company" or "Texon Petroleum") and of the Group, being the Company and its subsidiaries, for the financial year ended 31 December 2011 and the auditor's report thereon.

1 Directors

The Directors of Texon Petroleum Ltd at any time during or since the end of the financial year are:

Dr John Armstrong PhD, BSc (1st Hons) Geo.
Age – 67
Executive Chairman
Dr Armstrong was appointed a Director and Chairman of the Company on 17 May 2006. He has had a 40 year career in the upstream oil and gas industry including 9 years with UNOCAL in South East Asia and over 20 years in senior management roles at Santos.

Dr Armstrong was executive Chairman of Global Petroleum Limited – an ASX and AIM listed company from 2002 to early 2007, and he formed and was foundation Chairman, and then a Director, of Falkland Oil and Gas Limited, an AIM listed company, from October 2004 to May 2007. Dr Armstrong joined the Board of Mosaic Oil NL from September 2009 until February 2010 when he resigned.

Prior to becoming Chairman of Global Petroleum Limited, Dr Armstrong was a General Manager at Santos and played an important role in growing Santos from a small local gas company to a company which in 2001 had a market capitalisation of some A$3.5 billion and annual oil and gas revenue of over A$1 billion a year from its South Australia, Queensland, Western Australia, Northern Territory, Victoria, Papua New Guinea and United States of America areas of operation. He retired from Santos at the end of 2001.

Throughout his career, Dr Armstrong has worked closely with host country governments, government petroleum companies, the Federal Government and various State Governments in Australia, various regulators, customers, contractors, consultants and joint venture companies as operator and non-operator.

David Mason B App Sc
Age – 51
Non-Executive Director
David Mason was appointed a Director of the Company on 17 May 2006.

Mr Mason retired as President and Chief Executive Officer of Texon Petroleum Ltd and its USA subsidiaries on 30 November 2011 and remains on the Board as a non-executive Director. He holds a Bachelor of Applied Science Degree (Geophysics) from the Western Australian Institute of Technology.

Mr Mason founded, and is the principal shareholder of, Wandoo Energy LLC ("Wandoo") in the USA in July 2005. Wandoo has contracted with a data company in the USA to provide seismic surveys to Wandoo which, under an agreement with the Group, then provides it with certain oil and gas prospects from which the Group may ultimately drill for oil and gas. See also under 'Code of Conduct' on page 13 for a discussion on any potential conflict of interest.

Before his involvement with Wandoo and Texon, Mr Mason worked for 25 years in the oil and gas industry with three multinational companies namely, BHP Petroleum (1982-1986), Petrofina (1987-1996) and Woodside Energy (1996-2005). During this time, he gained experience in petroleum ventures in Australia, South East Asia, North Africa and the USA.

He has held positions in exploration management and as acting General Manager both in Petrofina and Woodside Energy. Throughout his career he has been directly involved in large commercially successful discoveries including Jabiru, Skua, Legendre, Mutineer/Bounty in Australia, three Vietnam fields and the Neptune and Midway fields in the Gulf of Mexico.

Mr Mason opened Woodside's first international exploration office in the USA. As business development team leader he was instrumental in building Woodside's acreage position in the Gulf of Mexico (GOM) to over 250 leases through lease rounds, participation in three joint ventures, and acquiring a 20% ownership of the deepwater GOM Neptune field prior to the drilling of the delineation wells that proved commercial volumes.

DIRECTORS' REPORT (continued)

1 Directors (continued)

He has built and managed exploration teams in three countries, worked closely with consultants, service companies, joint ventures as operator and non-operator, and governments and government petroleum companies under production sharing contracts.

Bernard Rowley
Age – 66
Independent Director
Bernard Rowley was appointed a Director of the Company on 31 January 2007.

Bernard Rowley was formerly Chairman of Enertrade. The gas assets of Enertrade were sold by the Queensland Government in 2007 and the remaining assets were merged into other Queensland Government owned corporations. Enertrade was a wholesale energy provider owned by the Queensland Government which built, owned and operated the North Queensland Gas Pipeline and its gas compression facility near Moranbah.

Mr Rowley was Chief Executive Officer of Suncorp for 10 years. Prior to that appointment he was general manager for the insurance operations and had previously served in various actuarial and information technology roles.

Mr Rowley is a Director of Australia & International Holdings Limited and was a Director of River City Motorway Limited until 25 February 2011 when an Administrator was appointed.

2 Chief Executive Officer

The Board appointed Mr Clifford S. Foss Jr as President and Chief Executive Officer of the Company effective 1 December 2011.

During 2006 to 2008 Mr Foss was senior Vice President of Exploration for Petrohawk Energy and for the eight years prior to that he held the same position with KCS Resources. Mr Foss brings to Texon some 40 years of successful exploratory and production experience in the Texas Gulf Coast area where he has a wide knowledge of the history of the industry, the ingredients for success, the active companies as well as an extensive range of industry contacts.

3 Company Secretary

Mr Des Olling, Dip Comm Law, FCIS was appointed Company Secretary of the Company on 17 May 2006. Mr Olling has over 38 years' experience as a Company Secretary including over 18 years with listed public companies in the oil and gas industry.

4 Directors' meetings

The number of Directors' meetings held during the year ended 31 December 2011 and the number of meetings attended by each Director are set out in the table below. An audit committee was established and its charter adopted by the Board on 15 May 2007. Mr Bernard Rowley is Chairman and sole member of the committee.

	Board Meetings			Audit Committee Meetings	
Director	**A**	**B**		**A**	**B**
John Armstrong	10	10			
David Mason	10	10			
Bernard Rowley	10	10		3	3

A = number of meetings attended by each Director
B = number of meetings held during the time the Director held office during the period

DIRECTORS' REPORT (continued)

5 Corporate Governance Statement

This statement outlines the main corporate governance practices in place throughout the financial year, which comply with the ASX Corporate Governance Council (CGC) recommendations, unless otherwise stated.

5.1 Board of Directors

Role of the Board

The Board's role, as set out in the Company's Board Charter is to be accountable to shareholders for the guiding and monitoring of the business affairs of the Company.

It fulfils this role by:

> ensuring that the Company's strategic objectives are met;
> delegating responsibility for the day to day management of the Company to the Chief Executive Officer;
> because of the Company's size, assisting the Chief Executive Officer in certain operational and management decisions;
> approving and monitoring capital expenditure;
> monitoring the cash resources of the Company on a regular basis; and
> reviewing the performance of the Chief Executive Officer and management on a regular basis.

The Board's Charter which provides details of the Board's role is available on the Company's website at www.texonpetroleum.com.au

Board processes

The Board has established an audit committee which assists the Board in carrying out its responsibilities but has not established a nomination or remuneration committee as recommended by the ASX Corporate Governance Council (CGC). The Board considers that, because of the Company's size, the establishment of other committees would not be cost nor time effective and because the role of these committees is carried out by the Board itself. Recommendations from the Board are carried out by management through the Chief Executive Officer. Further details regarding this committee are provided elsewhere in the Directors' Report.

The Board has adopted a Board Charter and Code of Conduct, as well as establishing policies in respect of Risk Management, Continuous Disclosure and Share Trading for Directors and officers. Details of these policies are outlined later in this report and the full documents can be found on the Company's website.

With the Company's assets and business operations located in Texas, USA, and the head office in Brisbane, a system of internal control has been established. This system provides a level of assurance to the Board that business transactions undertaken within the Company are subject to certain checks and balances.

The Board does not conduct formal reviews of its Directors or its procedures and governance performance. The small Board of three and the Company's size would make such formal reviews an inappropriate use of the Board's time and the Company's money. The Board does, however review the performance of the Chief Executive Officer on a regular basis. The Board will review its position as the Company continues to grow and may increase its number in future years.

The Board reviews the performance of senior executives against the Company's financial and operational performance on a quarterly, half-yearly and annual basis and by presentations to the Board by the Chief Executive Officer at various other times throughout the year. A more formal process for performance reviews of key executives may be considered appropriate in the future.

Formal Board meetings are held on a regular basis during the year and Directors also hold informal discussions with each other between Board meetings as required. During the year 10 Board meetings were held. The agenda for these meetings is prepared by the Chief Executive Officer and the Company Secretary, and Directors may also request items be placed on the agenda. Standing items include reports on corporate matters, cash resources and projections, actual performance compared with budgets and a review of the operational status of each prospect.

DIRECTORS' REPORT (continued)

5 Corporate Governance Statement (continued)

5.1 Board of Directors (continued)

Board processes (continued)

Should a new Director be appointed, the Company will ensure that a process of induction is implemented which includes information on the nature of the Company's business, current industry issues, the Board's strategy and expectations concerning the performance of Directors. Directors are also given access to continuing education programs to enhance their skills and knowledge. Newly appointed senior executives will also be provided with an induction process similar to Directors.

Independent professional advice and access to company information

Each Director has the right of access to all relevant Company information and to the Company's executives and, subject to prior consultation with the Chairman, may also seek independent professional advice from an advisor suitably qualified in the relevant field at the Group's expense. The Director must consult with such an adviser and obtain the prior approval of the Chairman of the fee payable for the advice before proceeding with the consultation. A copy of the advice received by the Director will be made available to all members of the Board.

Composition of the Board

The names of the Directors of the Company in office at the date of this report are set out on pages 1 and 2. The Board currently comprises one executive Director, one non-executive Director and one independent Director. The Company's Constitution will be amended at the Company's AGM in May 2012 to reduce the maximum number of Directors from ten (10) to five (5) with a minimum of three (3).

Each of the current Directors must be subject to re-election by shareholders at the annual general meeting every three years.

The ASX CGC recommends that a majority of the Board be independent Directors. With only three Directors and the Company at its present size the Board does not consider it appropriate to have a majority of independent Directors and would not be an efficient use of resources-relevant expertise. Dr Armstrong as Chairman and Mr Mason both have strong resource industry experience and expertise which the Board considers more appropriate to the requirements of the Company at this stage of its development.

The background of each Director can be found at the commencement of this report. The definition of "independent" has been taken from the ASX "Guidance Note 9" of the Listing Rules and the Board will keep this issue under review.

With respect to the ASX CGC recommendation that the Chairman should be an independent Director, the Board believes, again because of the size of the Company that the experience and background of the current executive Chairman is of more value to the Company than an independent Director who may not possess the same experience and background.

The Company has no policy regarding the minimum number of hours that Directors are required to commit to the Company's business nor any restriction on the number of other Boards that non-executive Directors may serve on.

5.2 Remuneration Report – audited

5.2.1 Principles of compensation – audited

Remuneration is referred to as compensation throughout this report.

Key management personnel have the authority and responsibility for planning, directing and controlling the activities of the Company and the Group, including Directors of the Company. Dr Armstrong, who was acting in an executive role for the whole of the year, Mr Mason, Chief Executive Officer during the year up to 30 November when he retired from this role and Mr Foss, Chief Executive Officer from 1 December, are the only highly remunerated S300A executives for the Company and the Group. Key management personnel include Directors and the five most highly remunerated company executives in the financial report.

DIRECTORS' REPORT (continued)

5 Corporate Governance Statement (continued)

5.2 Remuneration Report – audited (continued)

5.2.1 Principles of compensation – audited (continued)

As discussed above the Board has not formed a remuneration committee and sets compensation levels itself. In this regard it may obtain independent advice with regard to compensation packages required for appropriately qualified and experienced Directors and senior executives of the Company and the Group.

The compensation components explained below have been structured to attract and retain suitably qualified candidates to achieve the strategic and operational objectives of the Company and its shareholders. The compensation structures take into account the capability and experience of key management personnel and their ability to meet the Company's objectives. Compensation packages may include a mix of fixed compensation and equity-based compensation.

The Group also provides non-cash benefits and contributes to superannuation funds, where appropriate, for the above named personnel which are in addition to the compensation received.

Fixed compensation

Fixed compensation consists of base compensation (which is calculated on a total cost basis and includes any fringe benefits tax charges related to employee benefits), as well as employer contributions to superannuation funds.

In the absence of a remuneration committee, the Board reviews compensation levels compared with individual, segment and overall performance of the Group. External consultants will also be engaged when considered necessary.

Performance-linked compensation

The Board granted unlisted incentive options on 20 December 2011 to newly appointed CEO Mr Clifford Foss and Company Secretary Mr Des Olling. Mr Foss was granted 7,000,000 options in two tranches: tranche one was granted for 1,000,000 options and tranche two was granted for 6,000,000 options for a term of five (5) years expiring 30 November 2016. Mr Olling was granted 600,000 options for a term of four (4) years expiring 31 December 2015. The options for both Mr Foss and Mr Olling have an exercise price of 70 cents but are only exercisable if the volume weighted average price of the Company's shares over 20 consecutive days equals or exceeds 150% of the exercise price or 105 cents.

The Board approved the grant of unlisted incentive options during the year to Dr Armstrong (6,000,000 options) and Mr Rowley (600,000 options), subject to shareholder approval at a general meeting. The grants are on substantially the same terms as the tranche two option terms for Mr Foss above, except that there is no termination of employment clause in the terms of Dr Armstrong's and Mr Rowley's options, and should the issue of options be approved by shareholders the options will expire four years after such approval.

No cash amount is payable for any of the options. Further details of the option terms and conditions are set out in Note 20 to the consolidated financial statements.

Previously issued unlisted incentive options which expired 8 May 2011 were exercised or allowed to lapse (see details Note 20).

Long term options were granted as an incentive to ensure that the Company continues on its strategic path and achieves its goals. The Board, in the absence of a remuneration committee, believes that such incentives are reasonable for a Company of its current size and stage of development.

DIRECTORS' REPORT (continued)

5 Corporate Governance Statement (continued)

5.2 Remuneration Report – audited (continued)

5.2.1 Principles of compensation – audited (continued)

Short-term incentive

The Company does not have any short-term incentive programs.

Long-term incentive

Options granted to Directors and management are exercisable upon certain conditions and until their respective expiry dates. The Board believes that the performance hurdle where it applies, that options cannot be exercised unless the VWAP of the Company's share price is at least 150% of the exercise price over a period of at least 20 days, will provide the appropriate long term incentive for option holders over the term of the options.

Short-term and long-term incentive structure

The Company's incentive program is designed to provide incentive over the longer term. The Board believes that the long-term incentive program through the issue of options to Directors and management since IPO in May 2007 has assisted in achieving the intended purpose of incentivising the option holders and increasing the value of the Company and shareholders' wealth over that time.

Consequences of performance on shareholders' wealth

In considering the Company's performance and shareholders' wealth, Directors regard the following indices to be relevant:

	YE 2011	YE 2010	YE 2009	YE 2008	YE 2007*
Production (nett NRI boepd)	808	398	355	258	196**
Revenue (A$)	$20.87m	$7.91m	$5.75m	$5.59m	$0.51m
Net profit / (loss) (A$) ***	$2.0m	$6.0m	($2.2m)	($5.5m)	($4.3m)
Exploration & Evaluation & Development Expenditure(A$)	$48.9m	$23.0m	$9.2m	$11.0m	$7.0m
Cash (A$)	$13.37m	$13.66m	$6.63m	$4.83m	$12.13m
Net assets (A$)	$77.8m	$32.5m	$16.9m	$13.1m	$16.6m
Market capitalisation (A$) ****	$135.8m	$118.2m	$42.4m	$21.6m	$50.4m
Reserves 2P mmboe (nett to NRI)	6.36	3.87	2.25	0.70	0.12

* From IPO May 2007.
** Based on production for 52 days commencing in November 2007.
*** 2011 result includes a non-cash share-based payment expense of $2.1m. 2010 result includes profit on sale of 20% of Leighton Olmos and Frio wells of $6.0m.
**** As at 31 December.

DIRECTORS' REPORT (continued)

5 Corporate Governance Statement (continued)

5.2 Remuneration Report – audited (continued)

5.2.1 Principles of compensation – audited (continued)

Consequences of performance on shareholders' wealth (continued)

Each of the above indices is a measure of the Company's progress and the improvement in shareholders wealth since IPO.

Eight wells were drilled during the year including two Eagle Ford wells, four Olmos wells, one Yegua well and the Company's first Wilcox well. Production (nett to NRI) has increased from an average rate of 398 boepd in 2010 to 808 boepd in 2011. Average market oil prices increased from $79/bbl in 2010 to $95/bbl in 2011 whilst average gas prices have fallen slightly from $4.39/mmbtu in 2010 to $4.00/mmbtu in 2011.

No dividend was declared or paid to shareholders.

Other benefits

Mr Mason and Mr Foss are entitled to non-cash benefits of USA health insurance benefits up to US$15,000 per annum under their service contracts.

Service agreements

The Company has entered into letters of appointment with each Director and the Company Secretary which set out the fees payable and that all reasonable expenses properly incurred will be reimbursed.

Dr Armstrong was appointed Chairman of the Company for a minimum period of three years from 15 May 2007 unless the reason for him ceasing to be Chairman is that he is not re-elected at the Company's AGM or is otherwise removed by a shareholder vote. Subject to the provisions of the Corporations Act, the Company's constitution and the ASX listing rules, the Company is required to give 12 months' notice (or payment in lieu of such notice) if it no longer requires the services of Dr Armstrong as a Director.

Mr Mason was employed as CEO under a five year executive service agreement from July 2006 which contained early termination provisions. During the year the Board extended Mr Mason's contract until 31 December 2011 however Mr Mason retired from that position on 30 November 2011.

Mr Foss was appointed CEO from 1 December 2011 and is employed under a three year contract which will continue until either party gives notice or terminates the contract. The contract may be terminated by the Company immediately for breach and at any time with one month's notice. Mr Foss may terminate the contract if the Company makes certain changes to his duties and obligations without his consent.

Mr Rowley was appointed Director from 31 January 2007. The appointment has no fixed duration. Subject to the provisions of the Corporations Act, the Company's constitution and the ASX listing rules, the Company is required to give 12 months' notice (or payment in lieu of such notice) if it no longer requires the services of Mr Rowley as a Director.

Mr Olling was appointed Company Secretary from 15 May 2007. The appointment has no fixed duration. Fees payable are subject to a minimum increase of 5% per annum. Subject to the provisions of the Corporations Act, the Company's constitution and the ASX listing rules, the Company is required to give 12 months' notice (or payment in lieu of such notice) if it no longer requires the services of Mr Olling as Company Secretary.

Refer to Note 22 to the consolidated financial statements for details on the financial impact in future periods resulting from commitments arising from non-cancellable contracts for services with key management personnel.

DIRECTORS' REPORT (continued)

5 Corporate Governance Statement (continued)

5.2 Remuneration Report – audited (continued)

5.2.1 Principles of compensation – audited (continued)

Non-executive Directors

Mr Rowley was the only non-executive Director for the full year. Mr Mason became a non-executive Director from 1 December 2011 following his retirement as Chief Executive Officer of the Company. Directors' fees for non-executive Directors were increased from $45,000 to $55,000 each per annum plus superannuation during the year and out of pocket expenses incurred as a result of their Directorships. An additional $10,000 per annum is paid to Mr Rowley who served as the sole Board representative and Chairman of the audit committee.

Executive Director

Dr Armstrong undertook an executive role during the whole of the year to allow the Chief Executive Officer Mr Mason to focus on operational issues. In addition to his fee of $100,000 plus superannuation Directors agreed that Dr Armstrong receive a further $100,000 making a total of $200,000 plus superannuation for the year.

The former Chief Executive Officer Mr Mason was employed under a contract which provided that he receive a total remuneration package of US$250,000 per annum inclusive of Directors' fees plus superannuation, health insurance benefits to a maximum of US$15,000, and other statutory entitlements. Mr Mason's salary was reviewed by Directors in early 2011 and increased to US$300,000 from 1 January 2011. Other benefits as above remained unchanged.

5.2.2 Directors' and executive officers' remuneration – audited

Details of the nature and amount of each major element of remuneration of each Director of the Company and the two named Company and Group executives who received the highest remuneration and who are key management personnel are:

DIRECTORS' REPORT (continued)

5 Corporate Governance Statement (continued)

5.2 Remuneration Report – audited (continued)

5.2.2 Directors' and executive officers' remuneration – audited (continued)

		Short-term [1]			Post-employment		Shared-based payments	
		Salary & fees	Non-monetary benefits	Total	Superannuation benefits	Termination	Options [2]	Total
Directors		**$**	**$**	**$**	**$**	**$**	**$**	**$**
Non-executive								
Dr J Armstrong [3] [5]	2011	-	-	-	-	-	-	-
	2010	92,500	6,017	98,517	41,500	-	-	140,017
Mr B Rowley [3] [4]	2011	43,333	-	43,333	27,517	-	138,120	208,970
	2010	55,000	-	55,000	4,950	-	2,153	62,103
Executive								
Dr J Armstrong [3] [4] [5]	2011	166,000	6,239	172,239	49,487	-	1,381,200	1,602,926
	2010	-	-	-	-	-	-	-
Mr D Mason [3] (CEO to 30 Nov 2011)	2011	321,332	15,114	336,446	26,112	-	-	362,558
	2010	283,148	-	283,148	24,457	-	-	307,605
Total all directors	**2011**	**530,665**	**21,353**	**552,018**	**103,116**	**-**	**1,519,320**	**2,174,454**
	2010	**430,648**	**6,017**	**436,665**	**70,907**	**-**	**2,153**	**509,725**
Executives								
Mr C Foss [3] [4] (CEO from 1 Dec 2011)	2011	29,014	-	29,014	-	-	385,569	414,583
	2010	-	-	-	-	-	-	-
Mr D Olling [3] [4] (Company Secretary)	2011	148,464	-	148,464	-	-	138,600	287,064
	2010	102,449	-	102,449	-	-	700	103,149
Total all executives	**2011**	**177,478**	**-**	**177,478**	**-**	**-**	**524,169**	**701,647**
	2010	**102,449**	**-**	**102,449**	**-**	**-**	**700**	**103,149**
Total compensation	**2011** **2010 (Consolidated)**	**708,143** **533,097**	**21,353** **6,017**	**729,496** **539,114**	**103,116** **70,907**	**-** **-**	**2,043,489** **2,853**	**2,876,101** **612,874**

DIRECTORS' REPORT (continued)

5 Corporate Governance Statement (continued)

5.2 Remuneration Report – audited (continued)
5.2.2 Directors' and executive officers' remuneration – audited (continued)

Notes in relation to the table of Directors' and executive officers' remuneration – audited

(1) There was no short term cash bonus paid or earned during the year.

(2) The fair value of options is calculated at the date of grant using Monte Carlo sampling (2011) or the Black-Scholes pricing model (2010) and allocated to each reporting period on a pro rata basis over the period from grant date to vesting date. The value disclosed is the portion of the fair value of the options recognised in this reporting period. Market conditions have been taken into account within the valuation model. The fair value of services received in return for share options issued is based on the following inputs. Expected volatility was estimated by considering historic average share price volatility. Dr Armstrong's and Mr Rowley's options were approved by the Board in 2011 but are subject to shareholder approval at a general meeting.

	Year-ended 31 Dec 2011	Year-ended 31 Dec 2010
Fair value at grant date	$0.197-0.249	$0.005
Share price	$0.56-0.60	$0.38
Exercise price	$0.70	$0.50
Expected volatility	60%	22.12%
Expected option life	2.2-3.6 years	10 months
Expected dividends	Nil	Nil
Risk-free interest rate (based on government bonds)	3.05-3.12%	4.60%

(3) The proportion of remuneration that is performance related is nil, except for the 2011 share-based payment amounts, where in certain circumstances the options granted have a share price hurdle of 150% of the exercise price.

(4) The value of options as a proportion of remuneration for Dr Armstrong is 86.2% (2010: nil%), for Mr Rowley is 66.1% (2010: 3.47%), for Mr Foss is 93.0% (2010: n/a) and for Mr Olling is 48.3% (2010: 0.68%).

(5) The Chairman, Dr Armstrong, acted in an executive capacity during 2011.

The Company does not have a redundancy scheme and any executive who is made redundant is entitled to a termination payment in accordance with employment contracts and legal requirements.

5.2.3 Equity instruments – audited

All options refer to options over the ordinary shares of Texon Petroleum Ltd, which are exercisable on a one-for-one basis.

5.2.3.1 *Options over equity instruments granted as compensation – audited*

The Company granted 7,000,000 and 600,000 unlisted incentive options over ordinary shares in the Company as compensation to key management person Mr Foss and Mr Olling respectively during the reporting period. The options were issued on 20 December 2011 and will expire on 30 November 2016 and 31 December 2015 respectively. Unlisted incentive options were approved for Dr Armstrong (6,000,000) and Mr Rowley (600,000) in 2011, and the grants are subject to shareholder approval at a general meeting. During the year, all these options vested, except for 6,000,000 of Mr Foss' options and subject to shareholder approval in the case of Dr Armstrong and Mr Rowley.

5.2.3.2 *Modification of terms of equity-settled share-based payment transactions – audited*

No terms of equity-settled-based payment transactions (including options and rights granted as compensation to a key management person) have been altered or modified by the issuing entity during the reporting period.

DIRECTORS' REPORT (continued)

5 Corporate Governance Statement (continued)

5.2 Remuneration Report – audited (continued)

5.2.3 Equity instruments – audited (continued)

5.2.3.3 *Exercise of options granted as compensation – audited*

During the reporting period, the following shares were issued on the exercise of options previously granted as compensation:

Directors	Number of shares	Amount paid $/share
Dr J Armstrong	1,000,000	0.50
Dr J Armstrong	250,000	0.75
Mr D Mason	1,500,000	0.50
Mr D Mason	2,000,000	0.75
Mr B Rowley	400,000	0.50
Executive		
Mr D Olling	200,000	0.50

There are no amounts unpaid on the shares issued as a result of the exercise of the options in the 2011 financial year.

5.2.3.4 *Analysis of options over equity instruments granted as compensation – audited*

No options or rights over equity instruments were granted as compensation or forfeited during the reporting period except as set out in 5.2.3.1 above.

5.2.3.5 *Analysis of movement in options – audited*

During the reporting period the following movement by value of options over ordinary shares in the Company held by directors and executives occurred.

	Granted in year $ (A)	Value exercised in year $ (B)	Lapsed in year (C)
Dr J Armstrong (D)	1,381,200	187,500	-
Mr D Mason	-	480,000	-
Mr B Rowley (D)	138,120	80,000	-
Mr C Foss	1,686,600	-	-
Mr D Olling	138,600	40,000	-

(A) The value of options granted in the year is the fair value of the options calculated at grant date using Monte Carlo sampling. The total value of the options granted is included in the table above. The amount is allocated to remuneration over the vesting period (i.e. in 2011 and 2012). The values include estimated grant-date fair value for options subject to shareholder approval assuming grant date is 31 December 2011.

(B) The value of options exercised during the year is calculated as the market price of shares of the Company as at close of trading on the date the options were exercised after deducting the price paid to exercise the option.

(C) The value of the options that lapsed during the year represents the benefit foregone and is calculated at the date the options lapsed using the Black Scholes option-pricing model assuming the performance criteria had been achieved. No options that expired during the year had performance criteria.

(D) Options have been approved by the Board for Dr Armstrong of 6,000,000 and for Mr Rowley for 600,000 and are subject to shareholder approval at the Company's annual general meeting in May 2012.

DIRECTORS' REPORT (continued)

5 Corporate Governance Statement (continued)

5.3 *Audit Committee*

The audit committee has a charter which has been approved by the Board. During the year, independent Director Mr Rowley was the sole Board representative and committee Chairman. The committee is attended by the Chief Executive Officer, the Company Secretary and the Financial Controller.

During the year the committee met on three occasions and the External Auditor attended on each occasion.

The committee's responsibilities include:

(a) overseeing the preparation of the annual and half year financial reports and reviewing the results of external audits of these reports;
(b) assessing information from the external auditor that affects the quality of financial reports;
(c) obtaining an independent judgement from the external auditor regarding the appropriateness of accounting principles and disclosure practices used by the company;
(d) recommending to the Board whether the financial and non-financial statements should be signed based on the committee's assessment of them;
(e) monitoring the effectiveness and independence of the external auditor and where appropriate making recommendations to the Board on the removal of the external auditor;
(f) meeting with the external auditor without management present at least once a year.

The Chief Executive Officer and Financial Controller declared in writing to the Board that the financial records of the Company for the financial year have been properly maintained, the Group's financial reports for the year ended 31 December 2011 are in accordance with relevant accounting standards and present a true and fair view, in all material respects, of the Group's financial condition and operational results. This statement is required by the Board twice annually.

The audit committee's charter is available on the Company's website.

5.4 Risk Management

Oversight of the risk management system

The Board has adopted a risk management policy which recognises that the Company is a small oil and gas exploration company with limited resources. The policy addresses the management of the major risks facing the Company to ensure that suitable procedures are adopted to protect the assets and undertakings of the Company.

The Chief Executive Officer and Financial Controller have provided written assurance to the Board that the financial reporting risk management and associated compliance and controls have been assessed and found to be operating effectively. The operational and other risk management compliance and controls have also been found to be operating effectively.

Risk profile

The Chief Executive Officer provides the Board with a risk assessment status on a regular basis. These risks include the financial risk of changes in the prices of oil and gas and adverse movements in foreign exchange rates. However the main risk is the risk of not finding, securing and retaining appropriate oil and gas prospects and commercial discoveries that are made from these prospects.

Risk management and compliance and control

The Board considers that absolute compliance with the detailed provisions of the Australian Standard on Risk Management ANZ4360 would not be a responsible use of the Company's limited resources, but requires management to have regard to the general principles of the Australian Standard in managing the Company's risk.

DIRECTORS' REPORT (continued)

5 Corporate Governance Statement (continued)

5.4 Risk Management (continued)

Financial reporting

The Chief Executive Officer and Financial Controller have provided assurance in writing to the Board that the financial reports of the Group are founded on a sound system of risk management, internal compliance and control.

Actual results are reported regularly against budgets approved by the Board and revised forecasts are prepared when appropriate.

Environmental regulation

The Company's operations are all located in the USA state of Texas and are therefore not subject to any environmental regulation under either Australian commonwealth or state legislation. However, the Company is subject to extensive federal, state, local and foreign laws and regulations in Texas and the USA generally and the Board has adequate systems in place for the management of its environmental requirements in Texas and is not aware of any breach of these requirements.

Internal Audit

Due to its present size and development, the Company does not consider that an internal audit department is warranted. The Board through the Chief Executive Officer relies on system controls in place in the Company.

5.5 Ethical standards

Directors, managers and employees are expected to act with the utmost integrity in carrying out their respective roles within the Company.

Conflict of interest

Directors must keep the Board informed on an ongoing basis of any interest that could potentially conflict with those of the Company. The Board has developed procedures to assist Directors to disclose potential conflicts of interest. Where a Director believes that there may be an actual or potential conflict of interest which could bring that Director and the Company into conflict, the Director is to disclose the details of such conflict. Where the Board believes that a significant conflict exists for a Director, the Director concerned will not vote on any outcome which arises from that conflict. This matter is described in more detail below in 'Code of Conduct' of the details of such conflict.

Mr Mason has previously disclosed to the Board his position as principal shareholder and founder of Wandoo Energy LLC in the USA. Wandoo has contracted with a data company in the US to provide seismic surveys to Wandoo which, under an agreement with the Company, then provides certain oil and gas prospects to the Company and from which the Company may ultimately drill for oil and gas.

Code of conduct for Directors

A code of conduct for Directors has been adopted and is adhered to by the Board. The code which is incorporated in the Board Charter covers the following:

1) Directors acknowledge that they have a fiduciary duty to the Company and must act honestly, in the interests of the Board, the Company and in the utmost good faith.

2) Directors are required to disclose all relevant information on matters under consideration by the Board and must not profit or advance their personal interests from their position as a Director.

DIRECTORS' REPORT (continued)

5 Corporate Governance Statement (continued)

5.5 Ethical standards (continued)

Code of conduct for Directors (continued)

3) Directors must keep the Board advised on an ongoing basis of any personal interest that could potentially conflict with those of the Company. The code provides that when in doubt the Director will adopt a cautious approach and assume that there is a conflict and act accordingly. Directors will not vote on any matter at a Board meeting if they have, or they are perceived to have, a conflict of interest. In this context and in regards to Director Mr David Mason's principal shareholding in Wandoo Energy LLC, such disclosure has been made to the Board. Directors are aware that Wandoo is entitled to an overriding royalty interest and carried working interest in the production of petroleum discovered by the Company and that Dr Armstrong is also entitled to an overriding royalty interest in the production of petroleum discovered by the Company. Details are available in Note 27. This information has also been disclosed in various public documents released by the Company.

4) A reasonable degree of care and diligence must be exercised at all times by Directors in the performance of their duties.

5) The Chief Executive Officer shall be the spokesperson for the Company whenever public comment is required.

6) Directors shall treat as confidential all minutes, Board papers and other information of the Company received by the Directors including papers and material forwarded to them for the purposes of Board determination. Directors must not use confidential information gained through their position in the conduct of their affairs to their advantage.

7) Any breach of the code by a Director is to be advised in writing to the Chairman.

Share trading policy

The policy is intended to apply to Directors, Chief Executive Officer, Company Secretary, Financial Controller and their spouses and dependents and all other officers or employees having authority and responsibility for planning, directing and controlling the activities of the Company and other officers or employees who may have access to market sensitive information about the Company that has not been released to the market (designated persons).

The key elements of the policy are:

- Trading in the Company's securities is prohibited during the following periods (closed periods):

  - from 1 February of each year until the first trading day after full year results are released to the market;
  - from 1 August of each year until the first trading day after half year results are released to the market;
  - at any time when the Company is involved in a corporate transaction that could materially impact on its share price; or
  - at any time when a designated person is aware of material market sensitive information in relation to the Company's securities that has not been released to the market.

- The Board has determined that trading that occurs in certain circumstances is excluded from the scope of the policy. In addition, a designated person (other than the Chairman) who is not in possession of inside information may be given prior written clearance to deal in the Company's securities in exceptional circumstances. In the case of the Chairman he must seek prior written clearance from the Chief Executive Officer.

- The Company must disclose to the ASX when a Director or related entities of the Director has traded in the Company's securities.

DIRECTORS' REPORT (continued)

5 Corporate Governance Statement (continued)

5.5 Ethical standards (continued)

Share trading policy (continued)

- When trading is permitted, intended trading by designated officers is to be disclosed to the Chief Executive Officer prior to the transactions taking place. Directors are not to trade in the Company's securities at any time without first advising the Chief Executive Officer or Company Secretary of their intention to do so.

- The Company Secretary is to report any trading by designated officers to the Board at its next meeting after the trading has been reported to the Company Secretary together with the steps, if any, to be taken with respect to disclosure of the trading, in accordance with the ASX Listing Rules, the Corporations Act or any other relevant requirements.

5.6 Communication with shareholders

The Board has adopted a Continuous Disclosure policy and complies with its obligations under that policy and in accordance with the ASX Listing Rules. The Board provides shareholders and the market with information that it considers is material to the business of the Company and which may have a material effect on the share price of the Company. Regular market updates are provided so that the market is fully informed and all market releases are posted to the Company's website on the day of the release. Analyst and shareholder briefings are also held and information to be provided at these briefings is released to the ASX prior to the meetings and then posted to the Company's website. The Board is responsible for determining what information is disclosed to the market and whether such information is material for the purposes of the ASX Listing Rules. It also considers whether an exemption applies from disclosure.

The Chief Executive Officer and Company Secretary notify the Board when any information which they have become aware of and which they consider might reasonably require disclosure under the ASX Listing Rules.

The Company also communicates with shareholders in its quarterly reports, half-yearly financial reports, annual financial reports, and at general meetings of shareholders where both the financial and operational aspects are presented. These reports, presentations and other important updates and notices of shareholder meetings are available from the Company's website.

The Board encourages full participation of shareholders at annual general meetings so that they are aware of the Company's progress in attaining its strategies and goals. They are asked to vote on the election of Directors, a resolution to adopt the Remuneration report and, when necessary the granting of options and shares to Directors, the issue of new fully paid shares in the Company, changes to the Constitution, and related party issues.

The external auditor attends all annual general meetings and is available to answer questions on matters relating to the audit generally, accounting policies, preparation and content of the auditor's report and the independence of the auditor in relation to the conduct of the audit.

5.7 Diversity

While the Board is cognisant of and recognises the principles of diversity, it believes that because of its size and the small number of Board members, staff and management employees a diversity policy would not be appropriate at this time.

6 Principal activities

The principal activities during the financial year were: to continue to prove up the presence of the Eagle Ford on the Company's leases by the successful drilling of the third and fourth horizontal wells in the Leighton and Mosman Rockingham leases; the drilling of a further four (4) wells in the Leighton Olmos field (making a total of 11 successful wells), the drilling of the Company's first Wilcox well on the Mosman Rockingham leases and the identification and acquisition of additional Eagle Ford leases and the identification of new opportunities for the Company.

DIRECTORS' REPORT (continued)

7 Operating and financial review

Operating

Eagle Ford

A further two wells were drilled during the year and completed for production. Four wells are now producing with a high proportion of oil.

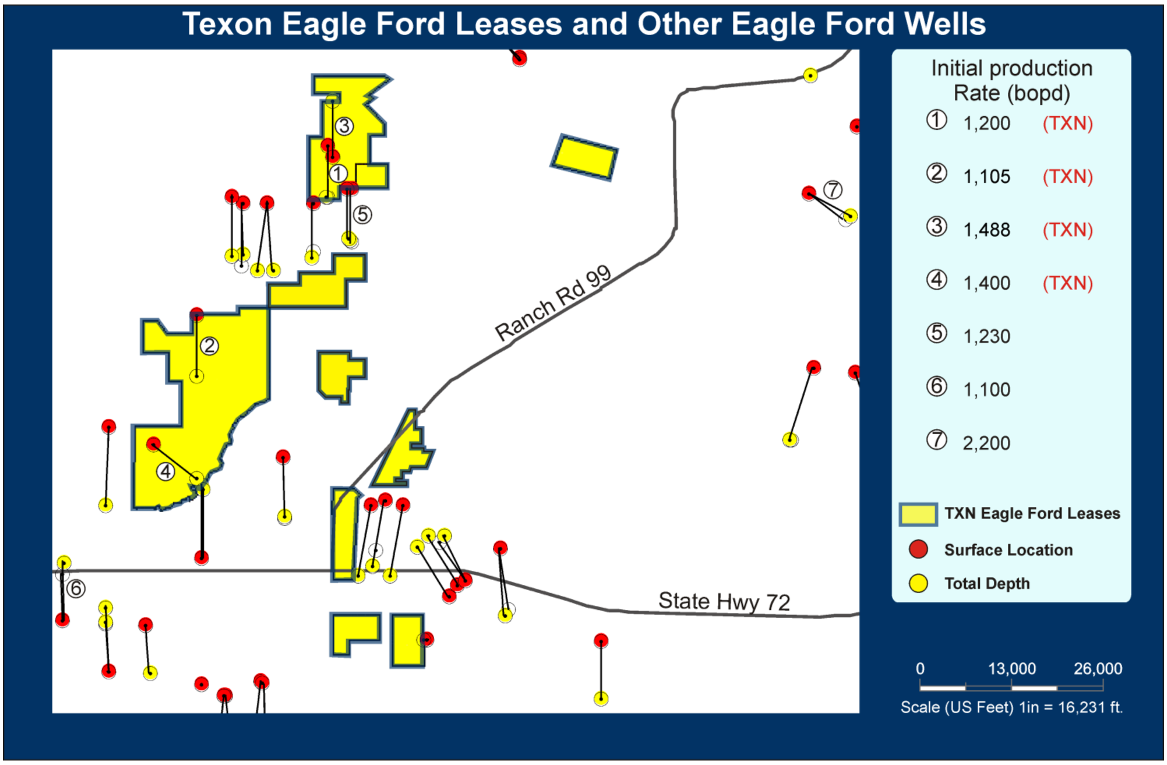
The third Eagle Ford, Tyler Ranch #2H is located on the Leighton leases, to the north of the Company's first Eagle Ford well and began drilling on 12 June 2011. A measured depth of 15,767 feet was reached after successfully drilling 4,500 feet of horizontal well in the Eagle Ford reservoir. A 17 stage fracture stimulation process was completed in August. The well was then tested and flowed at an initial rate of 1,488 bopd and 700 mcfgpd making a combined rate of 1,605 boepd through a 16/64 inch choke. By comparison, EFS #1 on Leighton flowed at an initial rate of 1,202 bopd through the same size choke.

The fourth Eagle Ford, Hoskins #1H spudded on 30 July 2011 on the Mosman Rockingham leases. It reached its total measured depth of 16,400 feet after drilling a horizontal section of 4,800 feet. A 16 stage fraccing procedure was completed in October and when production tested, flowed 1,408 bopd and 922 mcfgpd making a combined flow of 1,562 boepd through an 18/64 choke.

EFS well	Bopd IFR	Mcfgpd IFR	Boepd IFR	First 30 days production Boe	Texon WI %	Texon NRI %
1 Tyler Ranch #1H	1,202	782	1,332	19,651	82	61.6
2 Teal #1H	1,105	736	1,228	16,531	100	75
3 Tyler Ranch #2H	1,488	700	1,605	30,400	82	61.6
4 Hoskins #1H	1,408	922	1,562	23,780	95	71.25

Eagle Ford leases now total 7,712 gross acres and 7,196 net to the Company's WI following the acquisition of an additional 1,310 acres during the year. On an 80 acre spacing per well the Company now has over 90 Eagle Ford well locations.

Texon's Eagle Ford leases are set out on the map below.



DIRECTORS' REPORT (continued)

7 Operating and financial review (continued)

Eagle Ford (continued)

In February this year the Company announced that it had appointed Houston based Albrecht and Associates and Brisbane based RBS Morgans to seek potential buyers for all or part of the Company's Eagle Ford project. The Company believes that its four Eagle Ford wells have largely de-risked its Eagle Ford leases and that a sale will provide the opportunity for shareholders to benefit from the value of these holdings. The transaction is scheduled for completion in mid 2012.

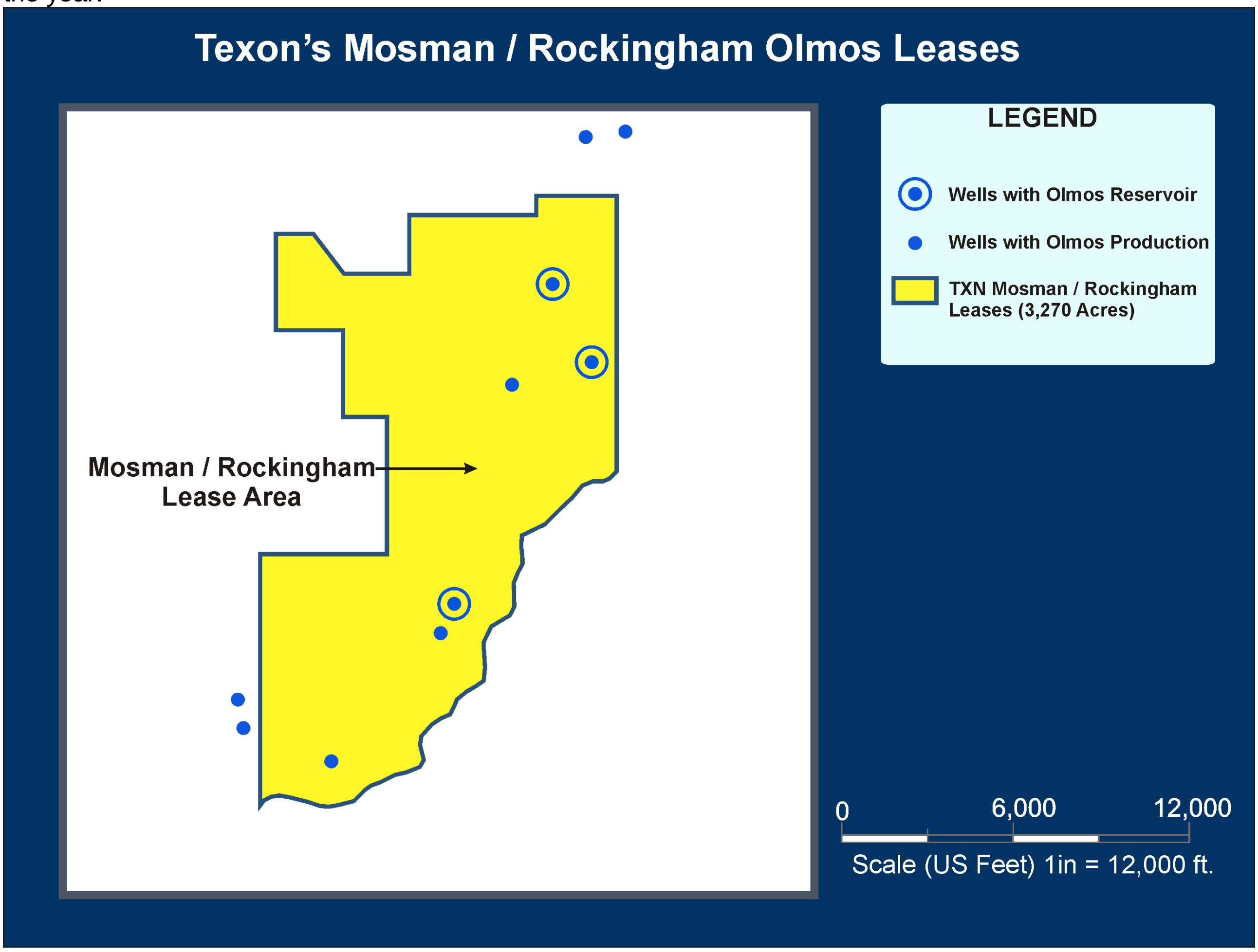
Olmos (Leighton)

Four Leighton Olmos wells were drilled making 11 Olmos wells by the end of the year. The first three wells, Tyler Ranch #7, Peeler #2 and Tyler Ranch #8 were drilled back to back in the first quarter of 2011 with the fourth well Peeler #3 spudded in mid June and fracture stimulated and connected for production in August. A 12th well, Peeler #4 was spudded on 8 January 2012 and was connected for production in February.

In October last year the Company appointed Albrecht and Associates to sell the Leighton Olmos production and related leases. The Company believed that this part of the business was then largely a development project and could be expected to provide diminishing value in the future. On this basis it was decided to sell the Olmos. The sale was completed in early March this year for net proceeds of US$12.4 million cash before tax.

Olmos (Mosman/Rockingham)

The Company has 95-100%WI in some 1,000 acres where the Olmos reservoir is the target. Over the coming months, we will review new 3D seismic data to plan a way forward, with drilling possible by the end of the year.



DIRECTORS' REPORT (continued)

7 Operating and financial review (continued)

Wilcox (Mosman/Rockingham)

In the Mosman/Rockingham leases the Wilcox target (where Texon has 95-100%WI) lies between 5,600 and 6,400 feet deep, about 3,000 feet above the Olmos formation. During the year log analysis reports indicated the presence of oil in the Wilcox reservoirs in a number of the Company's wells The first Wilcox specific well, Hoskins # 2 (Wilcox) spudded on 7 September 2011. The well is located at the southern end of the Mosman Rockingham lease and some 80 feet from the Company's fourth Eagle Ford well, Hoskins #1H. The new Wilcox well was tested in November and later fracced in two zones. A rod pump has been installed to evaluate the commercial value of the well and the extent to which the potential 1,500-2,000 acres of Wilcox can become a viable oil project for the Company.

Other Projects

A number of multi-well and resource oil projects are being investigated targeting projects which have a potential value to the Company similar to that of our current Eagle Ford holding. We plan to begin taking leases on one or more of these projects over the coming months with a view to beginning drilling towards the end of this year.

Corporate

The Company raised $39.4 million and issued 60.7 million new fully paid shares between February and April 2011. The raising was achieved from a placement in February of 24.2 million shares at A$0.65 and from a Share Purchase Plan in April where 74% of shareholders subscribed for 36.5 million shares. The funds were primarily directed to the drilling of the third and fourth Eagle Ford wells and four Olmos wells during the year and for other capital projects.

Outstanding unlisted options of 13.58 million as at 31 December 2010 expired on 8 May 2011. Exercise prices between A$0.50 and A$0.75 cents were paid before the expiry date for 6.65 million options and 6.93 million options were not exercised and were allowed to lapse. New fully paid ordinary shares were issued following payment of the exercise prices which raised A$3.89 million.

DIRECTORS' REPORT (continued)

7 Operating and financial review (continued)

Corporate (continued)

Options totalling 7.9 million options were granted to newly appointed CEO Mr Clifford Foss for 7 million, to Company Secretary Mr Des Olling for 600,000 and to three specialist prospect mappers contracted to Wandoo Energy for 100,000 options each. A further 6.6 million incentive options were approved for issue to Chairman Dr John Armstrong for 6 million options and Director Mr Bernard Rowley for 600,000 subject to shareholder approval.

During the year a program of restructure of the group companies began in preparation for a potential sale of the Olmos and the Eagle Ford assets. The corporate structure of the Group provides a flexible structure for the Company and to a potential buyer of the Eagle Ford assets.

Oil and gas prices during the year

Average market oil prices increased from $79/bbl in 2010 to $95/bbl in 2011 whilst average gas prices have fallen slightly from $4.39/mmbtu in 2010 to $4.00/mmbtu in 2011. However, for its Olmos and EFS gas the Company receives an uplift of approximately 70% from the gas price because of the high calorific value of the gas produced and the associated natural gas liquids.

Projections using the third and fourth Eagle Ford wells suggest that future Eagle Ford production can be expected to contain some 80% oil and gas liquids. Financial forecasts using forward Nymex oil and gas prices indicate that about 90% of the revenue from an Eagle Ford project will be oil price driven with gas amounting to only 10% of such revenue.

Financial

The Group's consolidated profit after tax for the year ended 31 December 2011 was A$1,994,514 (2010: A$5,972,517). The 2011 result includes a non-cash share-based payment expense of A$2.1 million. The 2010 result included a profit of A$6.0 million from the sale of the Company's 20%WI in the Leighton Olmos. The 2011 result reflects an improved operating profitability as a result of the higher production flowing from investment in the Company's Eagle Ford wells.

The Company's beneficial production for the year was 295.0 mboe (2010: 145.3 mboe). The rate of production increased by 103% from 398boepd to 808boepd. During the year there were 20 producing wells including four Eagle Ford wells.

Revenue earned during the year increased 164% to A$20.87 million (2010: $7.91 million). Increased oil production drove the increase, representing 65% of production and 80% of revenue (up from 37% and 55% respectively in 2010) and with an increase in the average price of oil received, this boosted revenue significantly.

Lifting cost of production was US$3.5million or US$11.75/boe (2010: US$1.4 million or US$9.60/boe). These costs are lease operating expenditure and production taxes, excluding overheads, corporate costs and capital expenditure.

At year end the 2011 the Group cash was A$13.37 million (2010: A$13.66 million).

DIRECTORS' REPORT (continued)

8 Reserves report

At year end 2011, Reserves attributable to Texon's NRI are as in the following table:

	mmboe			
	Proved	**Probable**	**Possible**	**Total**
Eagle Ford	**1.54**	**3.32**	**6.47**	**11.33**
Other (incl Olmos)	**0.93**	**0.57**	**0.05**	**1.55**
Totals:	**2.47**	**3.89**	**6.52**	**12.88**

The total of 12.88 mmboe is a 90% increase on the 6.698 mmboe at year end 2010.

Texon's year end 2011 Proved, Probable and Possible Eagle Ford reserves are 11.33 mmboe, an increase of 125% compared with year end 2010.

Since year end, the Olmos ("Other" in the above table) reserves have been sold.

The year end 2011 Reserves in the Eagle Ford have been assessed by Netherland, Sewell & Associates, Inc. For the Other Reserves, the year end 2011 reserves are taken to be the 2010 year end reserves (determined by Delilah B. Hainey of Hainey and Hainey, a reservoir consultant to the Company) less production in 2011.

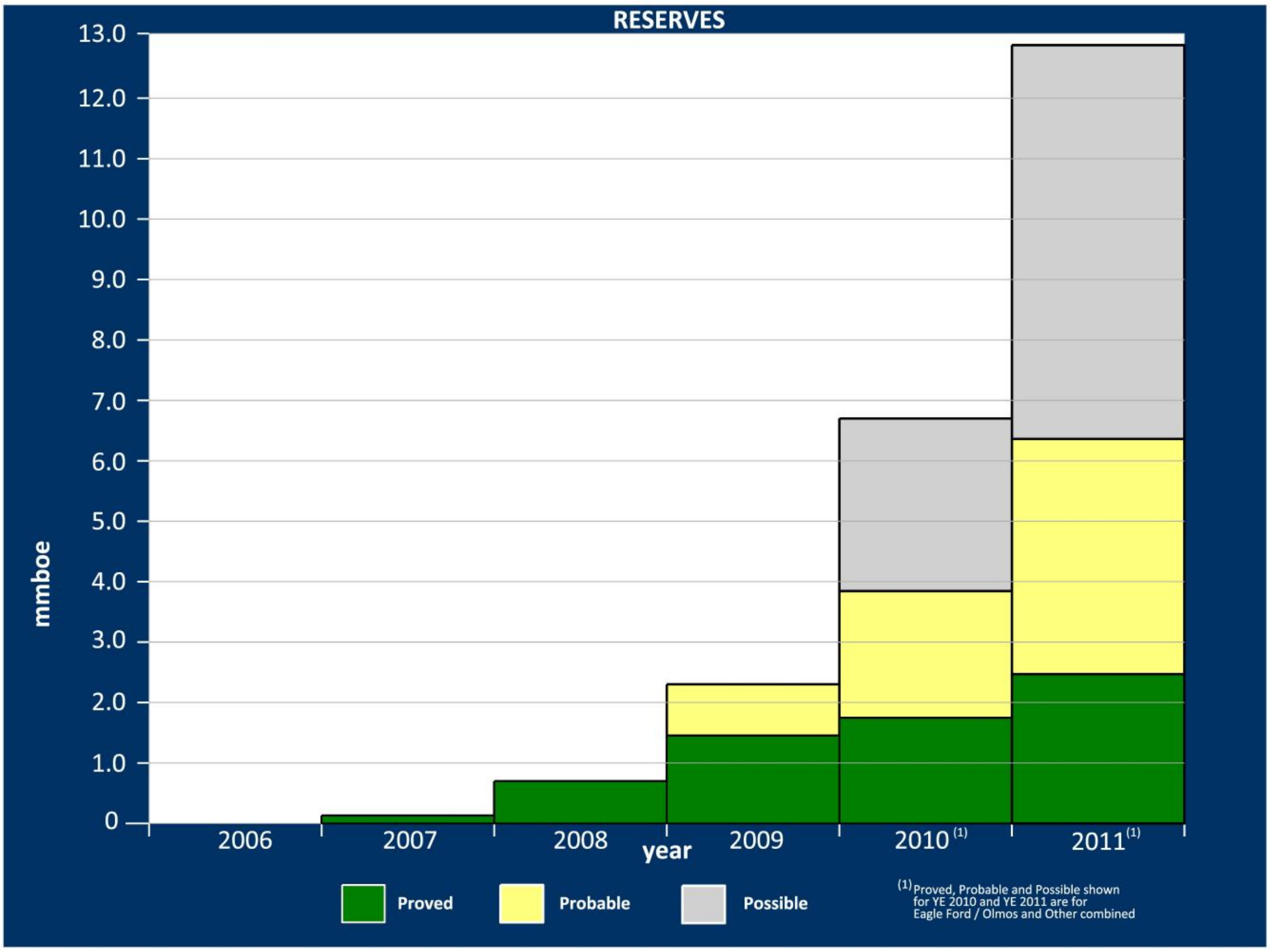
The table below shows the reserve history as to the Company's nett revenue interest.

	Oil & Gas Reserves Nett to Texon's NRI				
Proved:	**YE 2011**	**YE 2010**	**YE 2009**	**YE 2008**	**YE 2007**
Oil (mbbl)	**1,653**	1,000	757	262	3
Natural gas liquids (mbbl)	**145**	76	-	-	-
Gas (mmcf)	**4,035**	3,811	4,177	2,546	577
Total proved (mboe)	**2,471**	1,712	1,453	686	99
Probable:					
Oil (mbbl)	**2,893**	1,497	467	-	-
Natural gas liquids (mbbl)	**314**	179	-	-	-
Gas (mmcf)	**4,141**	2,870	1,985	66	127
Total probable (mboe)	**3,897**	2,154	798	11	21
Possible:					
Oil (mbbl)	**5,063**	2,146	-	-	-
Natural gas liquids (mbbl)	**625**	315	-	-	-
Gas (mmcf)	**4,977**	2,222	-	-	-
Total possible (mboe)	**6,517**	2,832	-	-	-
Totals:					
Oil (mbbl)	**9,609**	4,643	1,223	262	3
Natural gas liquids (mbbl)	**1,084**	571	-	-	-
Gas (mmcf)	**13,153**	8,903	6,162	2,612	704
Total proved, probable and possible (mboe) *	**12,885**	6,698	2,250	697	120

* mboe (thousand barrels of oil equivalent) comprises gas converted to oil equivalent on the basis of six (6) mcf to one (1) barrel of oil equivalent.

DIRECTORS' REPORT (continued)

8 Reserves report (continued)



Netherland, Sewell & Associates, Inc. and Delilah B Hainey are qualified in accordance with ASX Listing Rule 5.11. Netherland, Sewell & Associates, Inc. has consented to the form and context of the Eagle Ford reserves shown in this report.

9 Dividends

No dividends have been declared, provided for or paid in respect of the financial year ended 31 December 2011.

10 Events subsequent to reporting date

Subsequent to the end of the reporting period:

- On 23 January 2012 an accident, involving a single fatality, occurred at the Peeler #4 well site in connection with operations involved in the exploration of prospects in the Olmos formation, McMullen County, Texas and in which the Company's wholly owned subsidiary, Texoz E&P II, Inc., is a 50% working interest owner. Drilling operations are conducted by a Texas company contracted by Texoz. The incident was investigated by local authorities who have determined that the incident was an accident.
- The Group announced in February 2012 it has appointed Albrecht & Associates, Inc. and RBS Morgans Limited to seek potential buyers for all or part of the Company's 7,200 acre Eagle Ford oil project.
- The Group closed a purchase and sale agreement with a USA based company on 6 March 2012 to sell its holdings in the Leighton area Olmos reservoir. The Group's proceeds from the sale amount to US$12.4 million before tax.

DIRECTORS' REPORT (continued)

10 Events subsequent to reporting date (continued)

Apart from the matters noted above, there has not arisen in the interval between the end of the financial year and the date of this report any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company to affect significantly the operations of the Group, the results of those operations or the state of affairs of the Group in future financial years.

11 Likely developments

The Company is seeking to monetize all or part of its Eagle Ford assets about mid 2012 and if successful will provide shareholders with the opportunity to benefit from this monetization. An inventory of new opportunities is being developed to create value for the Company over the next two to three years.

12 Directors' Interests

Director	Interest in Securities at the date of this Report	
	Ordinary shares (1)	Options over ordinary shares (3)
Dr J Armstrong	2,564,046 (2)	6,000,000
Mr D Mason	15,189,228	-
Mr B Rowley	400,000	600,000

(1) Ordinary shares means fully paid ordinary shares in the capital of the Company.
(2) In previous years the shares of three adult relatives of Dr Armstrong were included as related parties. These shares currently comprise 162,096 shares. The Company is satisfied that Dr Armstrong does not have the power to exercise or control the voting rights or disposal attached to these shares and accordingly they have not been included in Dr Armstrong's shareholding in this report.
(3) Includes options approved for issue but subject to shareholder approval at a general meeting.

13 Share Options

13.1 Options granted to Directors and executives of the Company

During or since the end of the financial year, the Company has granted options over unissued ordinary shares in the Company to the following Directors and officers for no consideration, including one of the five most highly remunerated officers, as part of their remuneration:

	Number of options granted	Exercise price	Expiry date
Director			
Dr J Armstrong (1)	6,000,000	$0.70	
Mr B Rowley (1)	600,000	$0.70	
Executive			
Mr C Foss	7,000,000	$0.70	30 November 2016
Mr D Olling	600,000	$0.70	31 December 2015

DIRECTORS' REPORT (continued)

13 Share Options (continued)

13.1 Options granted to Directors and executives of the Company (continued)

(1) Options have been approved by the Board for Dr Armstrong of 6 million and for Mr Rowley for 600,000 and are subject to shareholder approval at the Company's annual general meeting in May 2012. Expiry dates are four years from shareholder approval.

13.2 Unissued shares under options

At the date of this report unissued shares issued to any Director or officer of the Company under option are:

Expiry Date	Exercise Price	Number of shares
30 November 2016	$0.70	7,000,000
31 December 2015	$0.70	600,000
Subject to approval (1)	$0.70	6,600,000
		14,200,000

(1) Options have been approved by the Board for Dr Armstrong of 6 million and for Mr Rowley for 600,000 and are subject to shareholder approval at the Company's annual general meeting in May 2012. Expiry dates are four years from shareholder approval.

13.3 Shares issued on exercise of options

During or since the end of the financial year ordinary shares of the Company were issued as a result of the exercise of options as follows (there are no amounts unpaid on the shares issued).

Number of shares	Amount paid on each share
4,400,000	50 cents
2,250,000	75 cents
6,650,000	

14 Indemnification and insurance of officers and auditors

14.1 Indemnification

To the extent permitted by law, the Company has indemnified current Directors of the Company, Dr John Armstrong, Mr David Mason and Mr Bernard Rowley, and current Chief Executive Officer Mr Clifford Foss against all liabilities incurred in their capacity as Directors and Chief Executive Officer respectively of the Company and its controlled entities. To the extent permitted by law, the Company will also indemnify the Directors and Chief Executive Officer against all reasonable legal costs incurred by any of them in the defence of an action for a liability incurred by that Director or Chief Executive Officer.

14.2 Insurance

During the financial year the Company paid an insurance premium in respect of Directors' and officers' liability for the current Directors and officers including the Chief Executive Officer, Company Secretary and Financial Controller. Under the terms of the policy the premium amount, coverage and other terms of the policy have been agreed to be confidential and not to be disclosed.

DIRECTORS' REPORT (continued)

15 Non-audit services

During the year KPMG, the Company's auditor, has performed certain other services in addition to their statutory duties.

The Board has considered the non-audit services provided during the year by the auditor and the Board is satisfied that the provision of those non-audit services during the year by the auditor is compatible with, and did not compromise the auditor independence requirements of the Corporations Act 2001 for the following reasons:

- all non-audit services were subject to the corporate governance procedures adopted by the Company and have been reviewed by the Board to ensure they do not impact the integrity and objectivity of the auditor; and

- the non-audit services provided do not undermine the general principles relating to auditor independence as set out in APES 110 *Code of Ethics for Professional Accountants*, as they did not involve reviewing or auditing the auditor's own work, acting in a management or decision making capacity for the Company, acting as an advocate for the Company or jointly sharing risks and rewards.

Details of the amounts paid to the auditor of the Company, KPMG, and its related practices for audit and non-audit services provided during the year are set out below.

	Consolidated	
	Year ended 31 Dec 2011 $	Year ended 31 Dec 2010 $
Audit services:		
Auditors of the Company, KPMG Australia – audit and review of financial reports	95,502	54,361
Other services:		
Auditors of the Company, KPMG Australia		
– taxation and other services	181,366	28,253
Overseas KPMG firms		
– taxation and other services	52,348	40,308
	329,216	122,922

16 Lead auditor's independence declaration

The lead auditor's independence declaration is set out on page 25 and forms part of the Directors' report for the financial year ended 31 December 2011.

Signed in accordance with a resolution of directors.

John D Armstrong
Chairman
Brisbane
30 March 2012

Lead Auditor's Independence Declaration under Section 307C of the *Corporation Act 2001*

To: the directors of Texon Petroleum Ltd.

I declare that, to the best of my knowledge and belief, during the financial year ended 31 December 2011, there have been:

- no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and
- no contraventions of any applicable code of professional conduct in relation to the audit.

KPMG

KPMG

J Board

Stephen J Board
Partner

Brisbane
30 March 2012

KPMG, an Australian partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Liability limited by a scheme approved under Professional Standards Legislation.

STATEMENT OF COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2011

	Note	Consolidated Year ended 31 Dec 2011 $	 Year ended 31 Dec 2010 $
Revenue	3	20,868,510	7,909,520
Cost of oil and gas sold		(13,601,360)	(5,060,550)
Gross profit		7,267,150	2,848,970
Other income	3	-	6,005,482
Employee benefits	4	(2,294,499)	(438,741)
Administrative and other expenses		(2,191,007)	(1,016,249)
Exploration and evaluation expenditure	15	(1,084,486)	(1,634,659)
Results from operating activities		1,697,158	5,764,803
Finance income	5	634,149	208,152
Finance expense	5	-	(438)
Net finance income / (expense)		634,149	207,714
Profit / (loss) before tax		2,331,307	5,972,517
Income tax (expense) / benefit	6	(336,793)	-
Profit / (loss) for the period		1,994,514	5,972,517
Other comprehensive income			
Foreign exchange translation differences, net of tax	5	(298,513)	(3,916,363)
Other comprehensive income for the period, net of tax		(298,513)	(3,916,363)
Total comprehensive income attributable to members of the Company		1,696,001	2,056,154
		Cents	**Cents**
Basic earnings per share	8	0.88	3.94
Diluted earnings per share	8	0.88	3.94

The notes on pages 30 to 59 are an integral part of these consolidated financial statements.

STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2011

	Note	Consolidated 2011 $	Consolidated 2010 $
Current assets			
Cash and cash equivalents	9	13,365,634	13,656,881
Trade and other receivables	10	5,042,443	1,281,334
Investments	11	53,178	53,275
Prepayments	12	183,407	87,831
Assets held for sale	13	9,114,878	-
Total current assets		27,759,540	15,079,321
Non-current assets			
Property, plant and equipment	14	42,498,126	22,993,217
Exploration and evaluation expenditure	15	10,983,859	1,545,851
Total non-current assets		53,481,985	24,539,068
TOTAL ASSETS		81,241,525	39,618,389
Current liabilities			
Trade and other payables	16	2,756,765	6,786,841
Employee benefits		34,883	41,433
Total current liabilities		2,791,648	6,828,274
Non-current liabilities			
Provisions	17	344,721	324,101
Deferred tax liabilities	18	321,434	-
Total non-current liabilities		666,155	324,101
TOTAL LIABILITIES		3,457,803	7,152,375
NET ASSETS		77,783,722	32,466,014
Equity			
Issued capital		83,854,020	42,337,115
Reserves		(1,897,572)	(3,703,861)
Retained earnings / (accumulated losses)		(4,172,726)	(6,167,240)
TOTAL EQUITY		77,783,722	32,466,014

The notes on pages 30 to 59 are an integral part of these consolidated financial statements.

STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2011

Consolidated	Note	Share capital $	Share-based payment reserve $	Foreign currency translation reserve $	Retained earnings / (accumulated losses) $	Total equity $
Balance at 1 January 2010		28,903,596	206,657	(21,646)	(12,139,757)	16,948,850
Total comprehensive income for the period						
Profit for the period		-	-	-	5,972,517	5,972,517
Other comprehensive income						
Foreign exchange translation differences		-	-	(3,916,363)	-	(3,916,363)
Total comprehensive income for the period		-	-	(3,916,363)	5,972,517	2,056,154
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Shares Issued		14,210,000	-	-	-	14,210,000
Share-based payments	20	-	27,491	-	-	27,491
Share issue expenses		(776,481)	-	-	-	(776,481)
Balance at 31 December 2010		42,337,115	234,148	(3,938,009)	(6,167,240)	32,466,014
Balance at 1 January 2011		42,337,115	234,148	(3,938,009)	(6,167,240)	32,466,014
Total comprehensive income for the period						
Profit for the period		-	-	-	1,994,514	1,994,514
Other comprehensive income						
Foreign exchange translation differences		-	-	(298,513)	-	(298,513)
Total comprehensive income for the period		-	-	(298,513)	1,994,514	1,696,001
Transactions with owners, recorded directly in equity						
Contributions by and distributions to owners						
Shares issued		43,350,280	-	-	-	43,350,280
Share-based payments	20	-	2,104,802	-	-	2,104,802
Share issue expenses		(1,833,375)	-	-	-	(1,833,375)
Balance at 31 December 2011		83,854,020	2,338,950	(4,236,522)	(4,172,726)	77,783,722

Amounts are stated net of tax.

The notes on pages 30 to 59 are an integral part of these consolidated financial statements.

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2011

	Note	Consolidated Year ended 31 Dec 2011 $	 Year ended 31 Dec 2010 $
Cash flows from operating activities			
Cash receipts from customers		16,480,956	7,739,076
Cash paid to suppliers and employees		(4,983,848)	(2,958,718)
Interest received		228,110	178,827
Income taxes paid		(18,157)	-
Net cash from operating activities	26	11,707,061	4,959,185
Cash flows used in investing activities			
Exploration, evaluation and development expenditure		(53,425,181)	(17,518,629)
Acquisition of property, plant and equipment		(120,521)	(2,438)
Proceeds from sale of oil and gas properties		-	7,388,516
Net cash used in investing activities		(53,545,702)	(10,132,551)
Cash flows from financing activities			
Proceeds from share issues		43,350,280	14,210,000
Share issue expenses		(1,833,375)	(776,481)
Net cash from financing activities		41,516,905	13,433,519
Net increase/(decrease) in cash and cash equivalents		(321,736)	8,260,153
Effect of exchange rate fluctuations on cash held		30,489	(1,232,126)
Cash and cash equivalents at 1 January		13,656,881	6,628,854
Cash and cash equivalents at 31 December	9	13,365,634	13,656,881

The notes on pages 30 to 59 are an integral part of these consolidated financial statements.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

Texon Petroleum Ltd (the "Company") is a company domiciled in Australia. The address of the Company's registered office is Level 9, 46 Edward St, Brisbane QLD 4000, Australia. The consolidated financial statements of the Company as at and for the year ended 31 December 2011 comprise the Company and its subsidiaries (together referred to as the "Group").

The Company was incorporated on 17 May 2006.

(a) Statement of compliance

The consolidated financial statements are general purpose financial statements which have been prepared in accordance with Australian Accounting Standards ("AASBs") adopted by the Australian Accounting Standards Board ("AASB") and the Corporations Act 2001. The consolidated financial statements of the Group comply with International Financial Reporting Standards ("IFRS") and interpretations adopted by the International Accounting Standards Board.

The consolidated financial statements were authorised for issue by the directors on 30 March 2012.

(b) Basis of preparation

The consolidated financial statements are prepared on the historical cost basis.

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after 1 January 2012, and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group, except for AASB9 Financial Instruments (which becomes mandatory for the Group's 2015 consolidated financial statements), AASB10 Consolidated Financial Statements, AASB11 Joint Arrangements and AASB12 Disclosures of Interests in Other Entities (which becomes mandatory for the Group's 2013 consolidated financial statements) and could change the classification and measurement of financial assets and disclosure of interests in joint ventures and other entities. The Group does not plan to adopt these standards early and the extent of the impact has not been determined.

The preparation of consolidated financial statements in conformity with Australian Accounting Standards requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

In particular, information about significant areas of estimation uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements are described in note 1(f) property, plant and equipment and note 1(l) employee benefits (share-based payment transactions).

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial statements. The accounting policies have been applied consistently by all entities in the Group.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

(c) Basis of consolidation

Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Investments in subsidiaries are carried at their cost of acquisition in the Company's financial statements.

Joint ventures

Joint ventures are those entities over whose activities the Group has joint control, established by contractual agreement.

Jointly controlled operations and assets

The interest of the Group in unincorporated joint ventures and jointly controlled assets are brought to account by recognising in its financial statements the assets it controls, the liabilities that it incurs, the expenses it incurs and its share of income that it earns from the sale of goods or services by the joint venture.

Transactions eliminated on consolidation

Intragroup balances and any unrealised gains and losses or income and expenses arising from intragroup transactions are eliminated in preparing the consolidated financial statements.

(d) Foreign currency

Functional and presentation currency

Items included in the financial statements of each subsidiary within the Group are measured using the currency of the primary economic environment in which the entity operated (the "functional currency"). The consolidated financial statements are presented in Australian Dollars, the functional currency of Texon Petroleum Ltd.

Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of the Group's subsidiaries at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the statement of comprehensive income. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to the functional currency at foreign exchange rates ruling at the date the fair value was determined.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

(d) Foreign currency (continued)

Financial statements of foreign operations

The assets and liabilities of foreign operations are translated to Australian dollars at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated to Australian dollars at rates approximating the foreign exchange rates ruling at the dates of the transactions. Foreign currency differences are recognised directly in equity in the translation reserve. When a foreign operation is disposed of, the relevant amount in the translation reserve is transferred to profit or loss.

Net investment in foreign operations

Exchange differences arising from the translation of the net investment in foreign operations are taken to the translation reserve. They are released into the statement of comprehensive income upon disposal.

(e) Exploration and evaluation expenditure

Exploration and evaluation costs, including the costs of acquiring leases, are intangible assets capitalised as exploration and evaluation assets on an area of interest basis. Costs incurred before the Group has obtained the legal rights to explore an area are recognised in the statement of comprehensive income.

Exploration and evaluation assets are only recognised if the rights of the area of interest are current and either:

(i) the expenditures are expected to be recouped through successful development and exploitation of the area of interest; or

(ii) activities in the area of interest have not, at the reporting date, reached a stage which permits a reasonable assessment of the existence or otherwise of economically recoverable reserves, and active and significant operations in, or in relation to, the area of interest are continuing.

When an area of interest is abandoned or the directors decide that it is not commercial, any capitalised costs in respect of that area are written off in the financial period the decision is made.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount. For the purposes of impairment testing, exploration and evaluation assets are allocated to cash-generating units to which the exploration activity relates. The cash generating unit shall not be larger than the area of interest.

Once the technical feasibility and commercial viability of the extraction of oil and gas reserves relating to a prospect are demonstrable, exploration and evaluation assets attributable to that prospect are first tested for impairment and then reclassified from intangible assets to oil and gas properties within property, plant and equipment.

(f) Property, plant and equipment

Owned assets

Items of property, plant and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. The cost of acquired assets includes (i) the initial estimate at the time of installation and during the period of use, when relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and (ii) changes in the measurement of existing liabilities recognised for these costs resulting from changes in the timing or outflow of resources required to settle the obligation. Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

(f) Property, plant and equipment (continued)

Oil and gas properties include construction, installation or completion of infrastructure facilities such as pipelines and platforms, capitalised borrowing costs, transferred exploration and evaluation costs, costs of direct labour, costs of dismantling and removing the items and restoration of the site on which they are located, the cost of development wells and any other costs directly attributable to bringing the asset to a working condition for its intended use.

Subsequent costs

The Group recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied within the item will flow to the Group and the cost of the item can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of day to day servicing of property, plant and equipment are recognised in the statement of comprehensive income as an expense as incurred.

Depreciation

Depreciation is charged to the statement of comprehensive income on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Oil and gas properties are depreciated from the time production commences on a unit-of-production basis using estimated reserves that are forecast to be produced over the economic life of the property. Leasehold improvements are depreciated over the shorter of the useful life and the lease term. The residual value, the useful life and the depreciation method applied to an asset are reassessed at each balance sheet date.

The estimated useful lives for the current year are as follows:

- Plant, equipment, furniture and fixtures: 3 to 9 years
- Oil and gas properties: units of production

(g) Non-current assets held for sale

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets, or components of a disposal group, are remeasured in accordance with the Group's accounting policies. Thereafter generally the assets, or disposal group, are measured at the lower of their carrying amount and fair value less cost to sell. Any impairment loss on a disposal group first is allocated to goodwill, and then to remaining assets and liabilities on a pro rata basis, except that no loss is allocated to inventories, financial assets and deferred tax assets which continue to be measured in accordance with the Group's accounting policies. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognised in profit or loss. Gains are not recognised in excess of any cumulative impairment loss. Intangible assets and property, plant and equipment once classified as held for sale or distribution are not amortised or depreciated.

(h) Trade and other receivables

Trade and other receivables are measured at their amortised cost less impairment losses.

(i) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits with an original maturity of three months or less.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

(j) Impairment

(i) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate.

Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost the reversal is recognised in profit or loss.

(ii) Non-financial assets

The carrying amounts of the Group's non-financial assets, other than deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists then the asset's recoverable amount is estimated. The Group performs an impairment test on capitalised exploration and evaluation costs if there is an impairment indicator such as:

- the right to explore has expired during the period or will expire in the near future and is not expected to be renewed
- substantive expenditure on further exploration for and evaluation of mineral resources in the specific area is neither budgeted nor planned
- exploration and evaluation in the specific area has not led to the discovery of commercially viable quantities of mineral resources and the entity has decided to discontinue such activities in the specific area
- sufficient data exists to indicate that the carrying amount of the asset is unlikely to be recovered in full from successful development or by sale even if development in the specific area is likely to proceed.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit").

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of cash-generating units are allocated to reduce the carrying amount of the assets in the unit (group of units) on a pro rata basis.

Impairment losses recognised in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

(k) Share capital – transaction costs

Transaction costs of an equity transaction relating to the raising of new share capital are accounted for as a deduction from equity, net of any recoverable income tax benefit applicable.

(l) Employee benefits

Wages, salaries and annual leave

Liabilities for employee benefits for wages, salaries and annual leave that are expected to be settled within 12 months of the reporting date represent present obligations resulting from employees' services provided to balance sheet date, calculated at undiscounted amounts based on remuneration wage and salary rates that the Group expects to pay as at balance sheet date, including related on-costs.

Defined contribution superannuation funds

Obligations for contributions to defined contribution superannuation funds are recognised as an expense in the statement of comprehensive income as incurred.

Share-based payment transactions

The fair value of options granted is recognised as an expense with a corresponding increase in equity (share-based payment reserve). The fair value is measured at grant date and spread over the period during which the employees and vendors become unconditionally entitled to the options. The fair value of the options granted is measured using a valuation technique, taking into account the terms and conditions upon which the options were granted. The amount recognised as an expense is adjusted to reflect the actual number of share options that vest except where forfeiture is only due to market-related conditions.

(m) Trade and other payables

Trade and other payables are measured at their amortised cost.

(n) Provisions

A provision is recognised if, as a result of a past event, the Group has a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effects of the time value of money are material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Restoration

The Group records the present value of the estimated cost of legal and constructive obligations to restore operating locations in the period in which the obligation arises. The nature of restoration activities includes the removal of facilities, abandonment of wells and restoration of affected areas.

Typically, the obligation arises when the asset is installed at the production location. When the liability is initially recorded, the estimated cost is capitalised by increasing the carrying amount of the related oil and gas properties. Over time, the liability is increased for the change in the present value based on a risk adjusted pre-tax discount rate appropriate to the risks inherent in the liability. The unwinding of the discount is recorded as an accretion charge within finance expense. The carrying amount capitalised in oil and gas properties is depreciated over the useful life of the related asset.

Costs incurred that relate to an existing condition caused by past operations, and do not have future economic benefit, are expensed.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

(o) Revenue and other income

Sale of oil and gas
Revenue from the sale of oil and gas is recognised when the significant risks and rewards of ownership have transferred to the buyer and can be measured reliably. Delivery of gas is by pipeline and sales contracts define the point of transfer in ownership.

Management fee income
Income from management services is recognised in the statement of comprehensive income in line with the management agreements and contracts.

Other income – Disposal of non-current assets
The proceeds from the disposal of non-current assets are recognised at the date control of the asset passes to the buyer, usually when an unconditional contract of sale is signed. The gain or loss on disposal is calculated as the difference between the carrying amount of the asset at the time of disposal and the net proceeds on disposal (including incidental costs).

(p) Net finance income/expense

Net finance income/expense comprises interest receivable on funds invested and foreign exchange gains and losses. Interest income is recognised in the statement of comprehensive income as it accrues, using the effective interest method.

(q) Lease payments

Operating lease payments

Payments made under operating leases are recognised in the statement of comprehensive income on a straight-line basis over the term of the lease. Lease incentives received are recognised in the statement of comprehensive income as an integral part of the total lease expense and spread over the lease term.

(r) Income tax

Income tax expense comprises current and deferred tax. Income tax expense is recognised in the statement of comprehensive income except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affect neither accounting nor taxable profit/loss, and differences relating to investments in subsidiaries to the extent that they will not reverse in the foreseeable future. Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reviewed at each balance sheet date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend is recognised.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

1. SIGNIFICANT ACCOUNTING POLICIES (continued)

(s) Segment reporting

The Group determines operating segments based on the information that internally is provided to the CEO, who is the Group's chief operating decision maker.

The Group operates within one business segment (the petroleum exploration and production industry) and one geographical segment (the United States of America).

An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components.

Geographical information

The geographical locations of the Group's non-current assets are USA $53,471,868 and Australia $10,117 (2010: USA $24,527,842 and Australia $11,226).

(t) Goods and services tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except where the amount of GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the Australian Taxation Office (ATO) is included as a current asset or liability in the balance sheet.

Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from, or payable to, the ATO are classified as operating cash flows.

2. FINANCIAL RISK MANAGEMENT

Overview

The Group has exposure to the following risks from its use of financial instruments:
- liquidity risk
- market risk
- credit risk.

This note presents information about the Group's exposure to each of the above risks, its objectives, policies and processes for measuring and managing risk, and the management of capital. Further quantitative disclosures are included throughout these consolidated financial statements.

The board of directors has overall responsibility for the establishment and oversight of the risk management framework. The board oversees the establishment, implementation and regular review of the Group's risk management system and to this end has adopted risk management policies to protect the assets and undertakings of the Group.

Risk management policies are established to identify and analyse the risks faced by the Group, to set appropriate controls, and to monitor risks and adherence to controls. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Group's activities.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

2. FINANCIAL RISK MANAGEMENT (continued)

The board oversees how management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group.

Financial risk is managed by the whole of the board.

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient cash or liquid assets to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. The Group monitors its cash holdings on a regular basis in relation to actual cash flows, financial obligations and planned activities in order to manage liquidity risk.

Market risk

Market risk is the risk that changes in market prices, such as commodity prices, foreign exchange rates, interest rates and equity prices will affect the Group's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

Commodity price risk

The Group is exposed to commodity price risk as oil and gas prices fluctuate depending on market conditions. The Group does not presently enter into hedging arrangements to hedge this risk, taking into account the Group's size, current stage of development, financial position and the board's approach to risk management.

Currency risk

The Group is exposed to currency risk on sales, purchases, assets and borrowings that are denominated in a currency other than the respective functional currencies of group entities. The Group's operations are located in the USA and its reported results and financial position can be significantly affected by changes in the USD/AUD exchange rate. The Group seeks to minimise its exposure to currency risk by monitoring exchange rates and entering into foreign currency transactions that maximise cash available for the USA operations. The Group does not presently enter into hedging arrangements to hedge its currency risk. All foreign currency transactions are entered into at spot rates. The board considers this policy appropriate, taking into account the Group's size, current stage of development, financial position and the board's approach to risk management.

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The Group's exposure to credit risk is minimal at present as the majority of its financial assets are held in cash with banks. The exposure with respect to trade receivables is set out in Note 21.

Capital management

The board's policy is to maintain a suitable capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. Given the Group's current stage of development and financial position the board is focused on investment of available capital in the Group's USA operations.

The Company raised capital during the year by private placement, a share purchase plan and the issue of shares upon exercise of options (refer Note 19). The additional capital funded further development drilling in the Group's Leighton and Mosman-Rockingham projects.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

2. FINANCIAL RISK MANAGEMENT (continued)

Capital management (continued)

There were no changes in the Group's approach to capital management during the year. Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

3. REVENUE AND OTHER INCOME

	Consolidated	
	Year ended 31 Dec 2011 $	Year ended 31 Dec 2010 $
Revenue		
Oil sales	16,751,625	4,330,127
Gas sales	4,116,885	3,579,393
	20,868,510	7,909,520
Other income		
Net gain on sale of oil and gas properties	-	6,005,482
	-	6,005,482

The 2010 net gain on sale resulted from the sale of a 20% Working Interest in the Group's Leighton Field Olmos reservoir ($5,807,276) and the sale at 100% of its interest in certain Frio wells ($198,206).

Operating segment disclosures

All oil and gas revenues are from customers in the USA. Revenues from three customers represent $14,221,952, $3,574,073 and $2,419,317, respectively (2010: three customers represent $4,026,214, $2,016,618 and $1,096,116, respectively) of the Group's total revenues. In each case these amounts represent more than 10% of the Group's revenue.

4. EMPLOYEE BENEFITS

		Consolidated	
	Note	Year ended 31 Dec 2011 $	Year ended 31 Dec 2010 $
Wages and salaries		332,766	354,898
Other associated employee costs		46,055	74,241
Increase in annual leave liability		10,789	5,835
Equity-settled share-based payments	20	1,904,889	3,767
		2,294,499	438,741

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. FINANCE INCOME AND EXPENSE

	Consolidated Year ended 31 Dec 2011 $	Consolidated Year ended 31 Dec 2010 $
Interest income – bank deposits	213,209	208,152
Net foreign exchange gain	420,940	-
Finance income	634,149	208,152
Net foreign exchange loss	-	(438)
Finance expense	-	(438)
Net finance income / (expense)	634,149	207,714

Finance expense relating to foreign exchange translation differences (net of tax) recognised in comprehensive income is $298,513 (2010: $3,916,363).

6. INCOME TAX EXPENSE

Numerical reconciliation between tax expense and pre-tax net profit / (loss)

	Consolidated Year ended 31 Dec 2011 $	Consolidated Year ended 31 Dec 2010 $
Profit / (loss) before tax	2,331,307	5,972,517
Income tax expense/(benefit) using the domestic corporation tax rate of 30%	699,392	1,791,755
Increase/(decrease) in income tax expense due to:		
Change in unrecognised temporary differences	(1,390,508)	(2,307,186)
Non-deductible expenditure	637,808	10,423
Effect of tax rates in foreign jurisdictions	205,007	302,138
Adjustments for prior periods	18,157	-
Tax losses not brought to account	166,937	202,870
Income tax expense/(benefit) on pre-tax net profit/loss	336,793	-

Income tax expense consists of current tax expense of $18,157 (2010: $nil) and deferred tax expense of $318,636 (2010: $nil).

Income tax expense/benefit recognised directly in equity for the Group is $nil (2010: $nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

7. AUDITORS' REMUNERATION

	Consolidated Year ended 31 Dec 2011 $	Consolidated Year ended 31 Dec 2010 $
Audit services:		
Auditors of the Company, KPMG Australia		
– audit and review of financial reports	95,502	54,361
Other services:		
Auditors of the Company, KPMG Australia		
– taxation and other services	181,366	28,253
Overseas KPMG firms		
– taxation and other services	52,348	40,308
	329,216	122,922

8. EARNINGS PER SHARE

	Consolidated Year ended 31 Dec 2011 Cents	Consolidated Year ended 31 Dec 2010 Cents
Basic earnings per share	0.88	3.94
Diluted earnings per share	0.88	3.94
	$	**$**
Profit used in the calculation of basic and diluted earnings per share	1,994,514	5,972,517

Weighted average number of ordinary shares (basic)	**Number**	**Number**
Issued ordinary shares at 1 January	175,177,879	134,577,879
Effect of shares issued July 2010	-	8,610,345
Effect of shares issued August 2010	-	8,536,533
Effect of shares issued February 2011	72,548	-
Effect of shares issued March 2011	20,194,076	-
Effect of shares issued April 2011	26,032,260	-
Effect of shares issued May 2011	4,356,000	-
Weighted average number of ordinary shares used as the denominator in calculating basic earnings per share	225,832,763	151,724,757

Weighted average number of ordinary shares (diluted)	**Number**	**Number**
Weighted average number of ordinary shares (basic)	225,832,763	151,724,757
Effect of share options on issue	772,519	107,815
Weighted average number of ordinary shares used as the denominator in calculating diluted earnings per share	226,605,282	151,832,572

At 31 December 2011 2,500,000 options (2010: 18,580,000) were excluded from the diluted weighted average number of ordinary share calculation as their effect would have been anti-dilutive.

At 31 December 2011 14,500,000 options (2010: nil) were excluded from the diluted weighted average number of ordinary share calculation as conditions for their exercise had not yet been met.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

9. CASH AND CASH EQUIVALENTS

	Consolidated	
	2011	**2010**
	$	**$**
Bank balances and cash on hand	13,365,634	13,656,881

The Group's exposure to credit risk, foreign exchange risk and interest rate risk and a sensitivity analysis for financial assets and liabilities are disclosed in Note 21.

10. TRADE AND OTHER RECEIVABLES

	Consolidated	
	2011	**2010**
	$	**$**
Current		
Trade receivables	4,642,762	1,110,846
Other receivables	399,681	170,488
	5,042,443	1,281,334

The Group's exposure to credit risk, foreign exchange risk and interest rate risk and a sensitivity analysis for financial assets and liabilities are disclosed in Note 21.

11. INVESTMENTS

	Consolidated	
	2011	**2010**
	$	**$**
Current		
Short-term investments	53,178	53,275

The short-term investments consist of term deposits held with banks in the USA.

The Group's exposure to credit risk, foreign exchange risk and interest rate risk and a sensitivity analysis for financial assets and liabilities are disclosed in Note 21.

12. PREPAYMENTS

	Consolidated	
	2011	**2010**
	$	**$**
Prepayments	183,407	87,831

13. ASSETS HELD FOR SALE

The Group's Leighton Olmos and Yegua producing oil and gas properties are presented as assets held for sale following the appointment of an oil and gas divestment adviser to seek potential buyers of the assets. A purchase and sale agreement closed on 6 March 2012 (refer note 29). As at 31 December 2011 the assets consisted of:

	Consolidated	
	2011	**2010**
	$	**$**
Property, plant and equipment	9,335,618	-
Provisions	(220,740)	
	9,114,878	-

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

14. PROPERTY, PLANT AND EQUIPMENT

	Consolidated 2011 $	Consolidated 2010 $
Oil and gas properties		
Cost		
Balance at 1 January	26,845,237	11,229,413
Transferred from exploration and evaluation expenditure	2,555,172	6,598,964
Additions	35,893,608	18,367,878
Transferred to assets held for sale (refer Note 13)	(14,100,564)	-
Disposals	-	(6,250,222)
Foreign exchange translation	(126,686)	(3,100,796)
Balance at 31 December	51,066,767	26,845,237
Accumulated depreciation and impairment		
Balance at 1 January	3,864,609	6,532,298
Depreciation expense	9,769,515	3,301,336
Transferred to assets held for sale (refer Note 13)	(4,954,185)	-
Disposals	-	(5,310,299)
Foreign exchange translation	(6,736)	(658,726)
Balance at 31 December	8,673,203	3,864,609
Carrying amounts		
At 1 January	22,980,628	4,697,115
At 31 December	42,393,564	22,980,628
Plant, equipment, furniture and fixtures		
Cost		
Balance at 1 January	127,004	132,677
Additions	120,521	2,439
Foreign exchange translation	(793)	(8,112)
Balance at 31 December	246,732	127,004
Accumulated depreciation		
Balance at 1 January	114,415	102,945
Depreciation expense	28,339	19,171
Foreign exchange translation	(584)	(7,701)
Balance at 31 December	142,170	114,415
Carrying amounts		
At 1 January	12,589	29,732
At 31 December	104,562	12,589
Total carrying amounts		
At 1 January	22,993,217	4,726,847
At 31 December	42,498,126	22,993,217

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

15. EXPLORATION AND EVALUATION EXPENDITURE

	Consolidated	
	2011	2010
	$	$
Balance 1 January	1,545,851	5,500,442
Additions	13,014,954	4,589,063
Transferred to oil and gas properties	(2,555,172)	(6,598,964)
Expenditure written off	(1,084,486)	(1,634,659)
Foreign exchange translation	62,712	(310,031)
Balance at 31 December	10,983,859	1,545,851

The recoverability of the carrying amounts of exploration and evaluation assets is dependent on the successful development and commercial exploitation or sale of the respective areas of interest.

16. TRADE AND OTHER PAYABLES

	Consolidated	
	2011	2010
	$	$
Trade payables	871,797	180,853
Other payables and accrued expenses	1,884,968	6,605,988
	2,756,765	6,786,841

The Group's exposure to foreign currency and liquidity risks is disclosed in Note 21.

17. PROVISIONS

	Consolidated	
Non-current	2011	2010
Restoration provision	$	$
Balance at 1 January	324,101	120,246
Provisions made during the period	243,334	250,532
Provisions used during the period	-	(10,870)
Transferred to assets held for sale (refer Note 13)	(220,740)	-
Foreign exchange translation	(1,974)	(35,807)
Balance at 31 December	344,721	324,101

The restoration provision represents the present value of the estimated cost of obligations to restore operating locations including the removal of facilities, abandonment of wells and restoration of affected areas.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

18. TAX ASSETS AND LIABILITIES

Recognised deferred tax assets and liabilities

Deferred tax assets and (liabilities) are attributable to the following:

	Consolidated 2011 $	Consolidated 2010 $
Exploration and development expenditure	(13,411,106)	(5,290,152)
Other items	904,128	494,891
Tax losses	12,185,544	4,795,261
Net tax liabilities	(321,434)	-

Unrecognised deferred tax assets

Deferred tax assets have not been recognised in respect of the following items:

	Consolidated 2011 $	Consolidated 2010 $
Temporary differences	667,765	384,504
Tax losses	1,067,878	2,049,119
	1,735,643	2,433,623

The deductible temporary differences and tax losses do not expire under current tax legislation. Deferred tax assets have not been recognised in respect of these items because it is not probable that future taxable profit will be available against which the Group can utilise the benefits.

19. CAPITAL AND RESERVES

Share capital

Movements in shares on issue during the period were as follows:

	2011 Ordinary shares (number)	2010 Ordinary shares (number)
On issue at 1 January	175,177,879	134,577,879
Issue of ordinary shares 8 July 2010	-	17,856,681
Issue of ordinary shares 16 August 2010	-	22,743,319
Issue of ordinary shares 1 March 2011	24,166,681	-
Issue of ordinary shares 15 April 2011	36,545,288	-
Exercise of share options	6,650,000	-
On issue at 31 December – fully paid	242,539,848	175,177,879

Issuance of ordinary shares

In February 2011 the Company completed a placement issuing 24,166,681 ordinary shares at an issue price of $0.65 per share. The shares were allotted on 1 March 2011. The issue was ratified at an extraordinary general meeting of shareholders on 12 April 2011.

In April 2011 the Company completed a share purchase plan issuing 36,545,288 ordinary shares at an issue price of $0.65 per share.

During the period the Company issued 4,400,000 ordinary shares at an exercise price of $0.50 per share and 2,250,000 ordinary shares at an exercise price of $0.75 per share upon the exercise of options (refer Note 20).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

19. CAPITAL AND RESERVES (continued)

Issuance of ordinary shares (continued)

In July and August 2010 the Company completed a placement issuing 40,600,000 ordinary shares at an issue price of $0.35 per share. The issue was ratified at an extraordinary general meeting of shareholders on 9 August 2010.

All issued shares are fully paid.

Ordinary shares

Effective 1 July 1998, the Company Law Review Act abolished the concept of par value shares and the concept of authorised capital. Accordingly, the Company does not have authorised capital or par value in respect of its issued shares.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. All shares rank equally with regard to the Company's residual assets.

Share-based payment reserve

The share-based payment reserve comprises the increase in equity resulting from the recognition of the grant date fair value of share-based payment awards as an expense over the period that the recipients unconditionally become entitled to the awards.

Foreign currency translation reserve

The foreign currency translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations where their functional currency is different to the presentation currency of the reporting entity.

Dividends

No dividends have been declared, provided for or paid in respect of the year ended 31 December 2011 or the year ended 31 December 2010. In respect to the payment of dividends by the Company in subsequent reporting periods (if any), no franking credits are currently available.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

20. SHARE OPTIONS

Information with respect to the number of options granted is as follows.

Consolidated

Holder	Notes	Grant date	Expiry date	Exercise price	Number of instruments granted	Number of instruments outstanding at 31 Dec 2011	Number of instruments outstanding at 31 Dec 2010
UNLISTED:				$			
Tranche 1(a)							
Seitel Data Ltd	(7)	26/7/06	8/5/12	0.50	2,500,000	2,500,000	2,500,000
Mr D Mason	(1) (2) (7)	26/7/06	8/5/11	0.50	1,500,000	-	1,500,000
Dr J Armstrong	(1) (2) (7)	26/7/06	8/5/11	0.50	1,000,000	-	1,000,000
Mr P Dighton	(1) (7)	26/7/06	8/5/11	0.50	200,000	-	200,000
Mr D Olling	(1) (7)	26/7/06	8/5/11	0.50	70,000	-	70,000
Tranche 1(b)							
Mr D Mason	(1) (2) (7)	26/7/06	8/5/11	0.75	2,000,000	-	2,000,000
Dr J Armstrong	(1) (2) (7)	26/7/06	8/5/11	0.75	1,000,000	-	1,000,000
Tranche 2							
Seitel Data Ltd	(7)	26/7/06	8/5/12	1.00	2,500,000	2,500,000	2,500,000
Mr D Mason	(1) (7)	26/7/06	8/5/11	1.00	3,500,000	-	3,500,000
Dr J Armstrong	(1) (7)	26/7/06	8/5/11	1.00	2,000,000	-	2,000,000
Mr P Dighton	(1) (7)	26/7/06	8/5/11	1.00	200,000	-	200,000
Mr D Olling	(1) (7)	26/7/06	8/5/11	1.00	80,000	-	80,000
2010 issue							
CBA	(8)	15/2/10	14/2/13	0.26	300,000	300,000	300,000
Mr B Rowley	(8) (9)	1/7/10	8/5/11	0.50	400,000	-	400,000
Mr P Hosemann	(8) (9)	1/7/10	8/5/11	0.50	400,000	-	400,000
Mr M Sunwall	(8) (9)	1/7/10	8/5/11	0.50	400,000	-	400,000
Mr A Marshall	(8) (9)	1/7/10	8/5/11	0.50	400,000	-	400,000
Mr D Olling	(8) (9)	1/7/10	8/5/11	0.50	130,000	-	130,000
Other	(8) (9)	1/7/10	8/5/11	0.50	300,000	-	300,000
2011 issue							
Mr C Foss – Tranche 1	(3) (8)	28/11/11	30/11/16	0.70	1,000,000	1,000,000	-
Mr C Foss – Tranche 2	(4) (8)	28/11/11	30/11/16	0.70	6,000,000	6,000,000	-
Dr J Armstrong	(5) (8)	(5)	(5)	0.70	6,000,000	6,000,000	-
Mr B Rowley	(5) (8)	(5)	(5)	0.70	600,000	600,000	-
Mr D Olling	(5) (8)	6/12/11	31/12/15	0.70	600,000	600,000	-
Contractor	(6) (8)	29/6/11	28/6/15	0.585	100,000	100,000	-
Contractor	(6) (8)	26/8/11	29/8/15	0.49	100,000	100,000	-
Contractor	(6) (8)	29/8/11	29/8/15	0.585	100,000	100,000	-
					33,380,000	19,800,000	18,880,000

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

20. SHARE OPTIONS (continued)

Notes

Terms and conditions of options granted in 2006 are set out in the prospectus dated 26 March 2007 lodged with ASIC relating to the initial public offering of the Company's shares.

(1) Expiry dates were amended by deeds dated 26 March 2007 (previously expiry date was 5 years after admission to the Official List of the ASX).

(2) Tranche 1 grants to Dr J Armstrong and Mr D Mason were amended by deeds dated 26 March 2007 to split original grants into Tranche 1(a) and Tranche 1(b). The exercise price for Tranche 1(b) options were amended to $0.75. A condition was added to the grants that stipulates the option holder will not exercise any Tranche 1 options unless the volume weighted average share price of the Company's ordinary shares over a consecutive 30 day period equals or exceeds $0.75 at any time 12 months after 8 May 2007.

(3) The options include the following conditions: (i) the options are only exercisable when the volume weighted average price (VWAP) of the shares of the Company on the ASX over a period of 20 consecutive trading days exceeds $1.05 per share (Price Target); (ii) if there is a change in control of the Company or if the Company disposes of more than 50% of its assets then the Tranche 1 options may be exercised without the requirement of the Price Target being met; (iii) unless already exercised, the options will terminate if Mr Foss commits a material breach of his employment contract, the Company terminates Mr Foss' employment for serious misconduct or bankruptcy or if Mr Foss elects to terminate his employment with the Company within six months of commencing employment with the Company (that is, six months from 1 December 2011); (iv) Mr Foss cannot participate in any new issues or bonus issues without exercising the Tranche 1 options.

(4) The options include the following conditions: (i) the Tranche 2 options are only exercisable from 1 September 2012 and only when the Price Target is met; (ii) however, if the Company, either directly or indirectly, disposes of more than 50% of its assets before 1 September 2012 then the Tranche 2 options: (a) may be exercised at a price per option equal to the VWAP of the shares of the company on the ASX over the 20 trading days starting on the 21st day after the sale of the assets has occurred; and (b) may only be exercised when the VWAP of the shares of the Company on the ASX over a period of 20 consecutive trading days exceeds 150% of the exercise price as calculated in (a) above; (iii) if there is a change in control of the Company other than by disposing more than 50% of its assets, the Tranche 2 options are exercisable at a price of $0.70 per option and can be exercised immediately without the requirement of the Price Target being met; (iv) unless already exercised, the Tranche 2 options will terminate if Mr Foss commits a material breach of his employment contract, the Company terminates Mr Foss' employment for serious misconduct or bankruptcy or if Mr Foss elects to terminate his employment with the Company; (v) Mr Foss cannot participate in any new issues or bonus issues without exercising the Tranche 2 options.

(5) As for (4) above, except that there is no termination of employment clause in the terms of the options. In addition, Dr Armstrong's and Mr Rowley's options were approved by the Board in December 2011, and the grant date will be the date of approval by shareholders at a general meeting. Dr Armstrong's and Mr Rowley's options will expire four years after shareholder approval.

(6) The options include the following conditions: the options may only be exercised after six (6) months of commencement of the contractor's engagement and if the VWAP of the Company's shares exceeds $0.735 to $0.8775; the options may be exercised if there is a change of control of the Company and the directors determine that it is likely that more than 50% of the shares of the Company will held by another party; the options will terminate if the contractor is in breach of his engagement contract or declared bankrupt or is placed into liquidation by a court. If terminated for any other reason the options shall remain outstanding until exercised or lapse upon expiry of the term; that a contractor cannot participate in any new issues or bonus issues without exercising the options.

(7) No value was attributed to options issued at the time the Company was established which was prior to the creation of business opportunities including contractual arrangements relating to exploration leases.

(8) The grant-date fair value of services received in return for share options issued was measured based on Monte Carlo sampling for the 2011 issue, and the Black-Scholes formula in prior years. The following inputs were used in the models. Expected volatility was estimated by considering historic average share price volatility. The fair value of services received by non-employees has been estimated by reference to the fair value of the options granted as this is considered a more reliable estimate than direct measurement of the services' fair value.

	2011	July 2010	Feb 2010	2007
Fair value at grant date	$0.197-0.27	$0.005	$0.06	$0.08
Share price	$0.56-0.60	$0.38	$0.26	$0.50
Exercise price	$0.70	$0.50	$0.26	$0.75
Expected volatility	60%	22.12%	21.58%	32.04%
Expected option life	2.2-3.6 years	10 mths	3 years	3 years
Expected dividends	Nil	Nil	Nil	Nil
Risk-free interest rate (based on government bonds)	3.05-4.65%	4.60%	4.60%	6.45%

(9) The options include a condition that the option holder will not exercise any options unless the volume weighted average share price of the Company's ordinary shares over a consecutive 30 day period equals or exceeds $0.75 at any time up to the end of the exercise period. If the option holder does not remain a director, employee or contractor of Texon or Wandoo Energy as applicable from the time the options are allotted until they are exercised, at the discretion of the Directors the options will lapse.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

20. SHARE OPTIONS (continued)

The number and weighted average exercise prices of share options are as follows:

	Weighted average exercise price 2011	Number of options 2011	Weighted average exercise price 2010	Number of options 2010
Outstanding at 1 January	$0.76	18,880,000	$0.79	19,250,000
Granted during the period [(1)]	$0.70	14,500,000	$0.47	2,330,000
Exercised during the period	$0.58	(6,650,000)	-	-
Expired during the period	$0.94	(6,930,000)	$0.75	(2,700,000)
Outstanding at 31 December	$0.70	19,800,000	$0.76	18,880,000
Exercisable at 31 December	$0.72	5,300,000	$0.86	11,350,000

[(1)] 6,600,000 options were approved by the Board in 2011 but are subject to shareholder approval at a general meeting.

The options outstanding at 31 December 2011 have an exercise price in the range of $0.26 to $1.00 and a weighted average contractual life of 3.5 years (2010: 0.6 years).

The weighted average share price at the date of exercise for share options exercised during the year ended 31 December 2011 was $0.75 (2010: $N/A).

The total expense recognised in relation to share options is as follows.

	Consolidated 2011 $	Consolidated 2010 $
Employee benefits – employee options	1,904,889	3,767
Administrative and other expenses – contractor options	199,913	23,724
	2,104,802	27,491

21. FINANCIAL INSTRUMENTS

Exposure to credit, interest rate and currency risks arises in the normal course of the Group's business.

Interest rate risk

At the reporting date, the interest rate profile of the Group's interest-bearing financial instruments was as follows.

	Note	Rates	Consolidated 2011	Consolidated 2010
Cash and cash equivalents	9	Variable	13,365,634	13,656,881
Investments (current)	11	Variable	53,178	53,275

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

21. FINANCIAL INSTRUMENTS (continued)

Interest rate risk (continued)

Sensitivity analysis

A 1 percent decrease in prevailing interest rates during the year would have reduced interest income and decreased the profit for the year of the Group by $135,645 (2010: $102,217). This analysis assumes that all other variables remain constant. The analysis is performed on the same basis for 2010.

A 1 percent increase in prevailing interest rates during the year would have had the equal but opposite effect, on the basis that all other variables remain constant.

Credit risk

The carrying amount of the Group's financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	Note	Consolidated Carrying amount 2011 $	Consolidated Carrying amount 2010 $
Cash and cash equivalents	9	13,365,634	13,656,881
Trade and other receivables (current)	10	5,042,443	1,281,334
Investments (current)		53,178	53,275
		18,461,255	14,991,490

The maximum exposure to credit risk for cash and cash equivalents at the reporting date by geographic region was as set out below. The exposure was partially offset by various government guarantees in place in the jurisdictions, and these guarantees are one of the factors considered by the Group in the allocation its cash resources between regions and financial institutions.

	Consolidated Carrying amount 2011 $	Consolidated Carrying amount 2010 $
Australia	10,427,177	3,004,972
USA	2,938,457	10,651,909
	13,365,634	13,656,881

At reporting date the Group had a significant concentration of credit risk in trade receivables from oil and gas sales with one customer totalling $4,607,944 for the Group (2010: $1,110,846 for the Group). These receivables are all concentrated in the USA.

None of the Group's receivables are past due (2010: nil). The Group believes that no impairment allowance is necessary in respect of receivables based on customer credit history.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

21. FINANCIAL INSTRUMENTS (continued)

Liquidity risk

The Group's financial liabilities consist of trade and payables with carrying amounts of $2,756,765 (2010: $6,786,841). The contractual cash flows equal the carrying amounts and are due in six months or less.

Currency risk

Exposure to currency risk

The Group's exposure to foreign currency risk at balance date was as follows, based on notional amounts.

In AUD	2011		2010	
	AUD	USD	AUD	USD
	$	$	$	$
Cash and cash equivalents	2,798,882	10,566,752	3,003,082	10,653,799
Trade and other receivables (current)	70,853	4,971,590	117,151	1,164,183
Prepayments	109,576	73,831	57,295	30,526
Investments (current)	-	53,178	-	53,275
Trade and other payables	(256,125)	(2,500,640)	(128,837)	(6,658,004)
Net exposure	2,723,186	13,164,711	3,048,691	5,243,779

The following significant exchange rates applied during the year.

AUD	Average rate		Reporting date spot rate	
	2011	2010	2011	2010
USD	1.034	0.920	1.025	1.012

Sensitivity analysis

A 10 percent strengthening of the Australian dollar against the US dollar at 31 December would have decreased the profit for the year of the Group by $1,196,792 (2010: $476,708). A 10 percent weakening of the Australian dollar against the US dollar at 31 December would have increased the profit for the year of the Group by $1,462,746 (2010: $582,643). This analysis assumes that all other variables, in particular interest rates, remain constant. The analysis is performed on the same basis for 2010.

Fair values

The fair values of the Group's financial assets and financial liabilities at 31 December 2011 and 2010 approximate their carrying amounts.

22. CAPITAL AND OTHER COMMITMENTS

Non-cancellable operating lease expense commitments
Non-cancellable operating lease rentals are payable as follows:

	Consolidated	
	2011	2010
	$	$
Less than one year	191,003	71,075
Between one and five years	189,292	-
	380,295	71,075

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

22. CAPITAL AND OTHER COMMITMENTS (continued)

The operating lease rentals relate to office and equipment leases with terms ranging from one to five years. During the year $180,248 was recognised by the Group as an expense in the statement of comprehensive income in respect of operating leases (2010: $125,844).

Natural gas transportation commitments
Commitments with respect to natural gas transportation are as follows. Commitments are only payable in the event contractual minimum volumes are not met.

	Consolidated 2011 $	Consolidated 2010 $
Less than one year	354,816	724,374
Between one and five years	2,413,330	1,547,872
	2,768,145	2,272,246

Employee compensation commitments – Key management personnel
Commitments under non-cancellable employment contracts not provided for in the financial statements and payable:

	Consolidated 2011 $	Consolidated 2010 $
Within one year	855,943	386,662
Between one and five years	152,439	-
	1,008,382	386,662

Mr C Foss is employed by the Group under an executive service agreement for a period of three years from December 2011. Mr D Mason was employed by the Group under an executive service agreement for a period of five years from July 2006. The appointment agreements with other directors include provision for 12 months' notice or payment in lieu of notice.

Other commitments
Commitments under a prospect generation agreement with Wandoo Energy LLC, a company controlled by Mr D Mason:

	Consolidated 2011 $	Consolidated 2010 $
Within one year	585,366	592,885
One year or later and no later than five years	829,756	1,383,399
	1,415,122	1,976,284

23. CONTINGENCIES

Indemnities

Indemnities have been provided to directors and certain executive officers of the Company in respect of liabilities to third parties arising from their positions, except where the liability arises out of conduct involving a lack of good faith. No monetary limit applies to these agreements and there are no known obligations outstanding at 31 December 2011 and 2010.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

23. CONTINGENCIES (continued)

Guarantees

The Group has provided bank guarantees totaling $48,780 (2010: $49,407) in relation to exploration activities in Texas, USA.

Joint ventures

In accordance with normal industry practice the Group has entered into joint ventures with other parties for the purpose of exploring for and developing petroleum interests. If a party to a joint venture defaults and does not contribute its share of joint venture obligations, then the other joint venture participants may be liable to meet those obligations. In this event the interest in the prospect held by the defaulting party may be redistributed to the remaining joint venturers.

24. CONSOLIDATED ENTITIES

	Country of Incorporation	Ownership interest 2011 %	Ownership interest 2010 %
Parent entity			
Texon Petroleum Ltd			
Subsidiaries			
Texon (Eagle Ford) Pty Ltd	Australia	100	-
Texon III Ltd	Australia	100	-
Texon I Pty Ltd	Australia	100	-
Texoz Eagle Ford Holdings, Inc. (formerly Texoz E&P Holdings, Inc.)	USA	100	100
Texoz E&P I, Inc.	USA	100	100
Texoz E&P II, Inc.	USA	100	100
Texoz E&P III, Inc.	USA	100	-
Texoz E&P Holdings I, Inc.	USA	100	-
Texoz E&P Holdings III, Inc.	USA	100	-

In the financial statements of the Company, investments in controlled entities are measured at cost.

During the 2011 year the Company undertook a restructure which involved the insertion of new entities into the Group. There were no business combinations and all transactions occurred under common control at book carrying values.

25. INTERESTS IN JOINT VENTURES

The Group holds working interests in joint operating agreements relating to the following projects, whose principal activities are oil and gas exploration and production.

	Working interest 2011 %	Working interest 2010 %
Leighton Project – Olmos	50 to 80	50 to 80
Leighton Project – Eagle Ford	82.2	82.2
Mosman-Rockingham Project	95 to 100	95 to 100
Yegua Project	32.3 to 95	32.3 to 95

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

26. RECONCILIATION OF CASH FLOWS FROM OPERATING ACTIVITIES

	Consolidated 2011 $	Consolidated 2010 $
Cash flows from operating activities		
Profit / (loss) for the period	1,994,514	5,972,517
Adjustments for non-cash items:		
Exploration and evaluation expenditure written-off	1,084,486	1,634,659
Depreciation – plant and equipment	28,339	19,169
Depreciation – oil and gas properties	9,769,515	3,301,336
Share-based payment expense	2,104,802	27,491
Net gain on sale of oil and gas properties	-	(6,005,482)
Net foreign exchange gain / loss	(420,940)	438
Income tax expense - deferred	318,636	-
Operating profit/(loss) before changes in working capital and provisions	14,879,352	4,950,128
Changes in operating assets and liabilities:		
(Increase)/decrease in receivables	(3,761,109)	(190,412)
(Increase)/decrease in prepayments	(95,576)	(6,855)
(Decrease)/increase in payables	690,944	203,854
Increase in employee benefits	(6,550)	2,470
Net cash from operating activities	11,707,061	4,959,185

Non-cash investing and financing activities
There were no non-cash investing and financing activities during the year.

27. RELATED PARTIES

The following were key management personnel of the Group at any time during the reporting period and unless otherwise indicated were key management personnel for the entire period:

Executive director
Dr J Armstrong (chairman)
Mr D Mason (president and chief executive officer until 30 November 2011)
Non-executive directors
Mr B Rowley
Executives
Mr C Foss (president and chief executive officer from 1 December 2011)
Mr D Olling (company secretary)

Key management personnel compensation

Key management personnel compensation comprised:

	Consolidated 2011 $	Consolidated 2010 $
Short-term benefits	729,496	539,114
Post-employment benefits	103,116	70,907
Share-based payment	2,043,489	2,853
	2,876,101	612,874

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

27. RELATED PARTIES (continued)

Individual directors' and executives' compensation disclosures

Information regarding individual directors' and executives' compensation and some equity instruments disclosures as required by Corporations Regulations 2M.3.03 is provided in the remuneration report section of the directors' report.

Apart from the details disclosed in this note, no director has entered into a material contract with the Group since the end of the previous financial period and there were no material contracts involving directors' interests existing at year-end.

Loans to key management personnel and their related parties

There were no loans made to key management personnel or their related parties during the reporting period.

Other key management personnel transactions

Certain directors, or their related parties, hold positions in other entities that result in them having control or significant influence over the financial or operating policies of those entities. Certain of these entities transacted with the Company or its controlled entities in the reporting period.

Wandoo Energy LLC (Wandoo), a company controlled by Mr D Mason, provided the Group with services during the year under a prospect generation agreement. Payments to Wandoo under the agreement are US$50,000 per month for a term of eight years commencing 1 May 2006. Amendments to the agreement during the year increased the amount payable in 2013 to $52,500 per month and in 2014 to $55,125 per month. During the current period US$600,000 (A$580,271) was paid by the Group and its related parties to Wandoo (2010: US$600,000 (A$652,174)) for these services.

Under the prospect generation agreement, Wandoo is entitled to an overriding royalty interest (ORRI) and a carried working interest (CWI) and Dr Armstrong is entitled to an ORRI, being a share of petroleum production, in relation to each prospect accepted by the Group. The entitlements vary depending on the net revenue interest obtained by the Group under leases in respect of the prospect. Wandoo's ORRI entitlement varies from nil to 4.5% and CWI entitlement varies from nil to 5%. Dr Armstrong's ORRI entitlement varies from nil to 0.5%. The Group markets the production associated with any ORRI on behalf of Wandoo and Dr Armstrong.

Wandoo provided the Group during the period with geological and geophysical, operations support, data acquisition and reprocessing, and other services. During the current period US$306,023 (A$295,960) was paid by the Group and its related parties to Wandoo (2010: US$nil (A$nil)) for these services.

Certain amendments to the prospect generation agreement were proposed in 2011 and are subject to shareholder approval at a general meeting of the Company.

Liabilities arising from the above transactions at 31 December 2011 were $213,613 (2010: $nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

27. RELATED PARTIES (continued)

Options over equity instruments

The movement during the reporting period in the number of options over ordinary shares in the Company held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows.

2011	Held at 1 January 2011	Granted and acquired	Exercised, expired and other	Held at 31 Dec 2011	Vested and exercisable at 31 Dec 2011
Directors					
Mr D Mason	7,000,000	-	(7,000,000)	-	-
Dr J Armstrong	4,000,000	6,000,000 [1]	(4,000,000)	6,000,000	-
Mr B Rowley	400,000	600,000 [1]	(400,000)	600,000	-
Executives					
Mr C Foss	-	7,000,000	-	7,000,000	-
Mr D Olling	280,000	600,000	(280,000)	600,000	-

2010	Held at 1 January 2010	Granted and acquired	Exercised, expired and other	Held at 31 Dec 2010	Vested and exercisable at 31 Dec 2010
Directors					
Mr D Mason	7,000,000	-	-	7,000,000	3,500,000
Dr J Armstrong	4,000,000	-	-	4,000,000	2,000,000
Mr B Rowley	200,000	400,000	(200,000)	400,000	-
Executives					
Mr D Olling	150,000	130,000	-	280,000	150,000

[1] Options to Dr Armstrong and Mr Rowley were approved by the Board in 2011 but are subject to shareholder approval at a general meeting.

Refer Note 20 for terms of the options.

1,000,000 of the options granted to Mr Foss in 2011 vested during the year but were not exercisable at 31 December 2011. 6,000,000 of the options granted to Mr Foss in 2011 vest in 2012 and were not exercisable at 31 December 2011. The options granted to Mr Olling in 2011 vested during the year and were not exercisable at 31 December 2011. The options approved for Dr Armstrong and Mr Rowley in 2011 vested during the year and were not exercisable at 31 December 2011.

The options granted to Mr Rowley and Mr Olling in 2010 vested during 2010 but were not exercisable at 31 December 2010.

The aggregate number of options held by key management personnel related parties at 31 December 2011 included in the table above is nil (2010: nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

27. RELATED PARTIES (continued)

Movements in shares

The movement during the reporting period in the number of ordinary shares in the Company held, directly, indirectly or beneficially, by each key management person, including their related parties, is as follows.

2011	Held at 1 January 2011	Acquisitions	Disposals and Other	Held at 31 Dec 2011
Directors				
Mr D Mason	15,030,000	3,509,228	(3,350,000)	15,189,228
Dr J Armstrong	2,667,894	1,308,248	(1,412,096)	2,564,046[(1)]
Mr B Rowley	-	400,000	-	400,000
Executives				
Mr C Foss	-	79,000	-	79,000
Mr D Olling	131,579	223,076	(120,000)	234,655

2010	Held at 1 January 2010	Acquisitions	Disposals and Other	Held at 31 Dec 2010
Directors				
Mr D Mason	15,012,000	18,000	-	15,030,000
Dr J Armstrong	2,667,894	-	-	2,667,894
Mr B Rowley	-	-	-	-
Executives				
Mr D Olling	131,579	-	-	131,579

The aggregate number of shares held by key management personnel related parties at 31 December 2011 included in the table above is 483,251 (2010: 600,947).

[(1)] The shares held by Dr Armstrong at 31 December 2011 do not include certain related parties that were included in previous years (refer to the Directors' Report page 22).

Changes in key management personnel in the period after the reporting date and prior to the date when the financial report is authorised for issue

There were no changes in key management personnel in the period after the reporting date and prior to the date when the financial report is authorised for issue.

Non-key management personnel disclosures

Identity of related parties

The Group has a related party relationship with its subsidiaries (see Note 24) and with its key management personnel (see disclosures for key management personnel on preceding pages).

Joint ventures
From time to time, to support the activities of joint ventures, venturers increase their investments in joint ventures.

Other related parties
Key management persons related parties
For details of these transactions refer to key management personnel related disclosures.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (continued)

28. PARENT ENTITY DISCLOSURES

As at, and throughout, the financial year ending 31 December 2011 the parent entity of the Group was Texon Petroleum Ltd.

	2011	2010
Result of the parent entity	**$**	**$**
Loss for the period	(2,142,357)	(4,568,112)
Other comprehensive income for the period	-	-
	(2,142,357)	(4,568,112)
Financial position of the parent entity at year end		
Current assets	13,134,180	4,328,059
Total assets	77,503,435	35,893,584
Current liabilities	274,230	143,729
Total liabilities	274,230	143,729
Total equity of the parent entity comprising of:		
Share capital	83,854,020	42,337,115
Share-based payment reserve	2,338,950	234,148
Accumulated losses	(8,963,765)	(6,821,408)
Total Equity	77,229,205	35,749,855

Parent entity guarantees in respect of the debts of its subsidiaries

The parent entity has provided guarantees with the effect that the Company guarantees certain obligations of its USA subsidiaries in the ordinary course of business.

29. SUBSEQUENT EVENTS

Subsequent to the end of the reporting period:

- The Group closed a purchase and sale agreement with a USA based company on 6 March 2012 whereby the Group sold its holdings in the Leighton area Olmos reservoir. The Group's net proceeds from the sale amount to approximately US$12.4 million before tax.

- The Group announced in February 2012 it has appointed Albrecht & Associates, Inc. and RBS Morgans Limited to seek potential buyers for all or part of the Company's 7,200 acre Eagle Ford oil project.

- On 23 January 2012 an accident, involving a single fatality, occurred at the Peeler #4 well site in connection with operations involved in the exploration of prospects in the Olmos formation, McMullen County, Texas and in which such area the Company's wholly owned subsidiary, Texoz E&P II, Inc., is a 50% working interest owner. Drilling operations are conducted by a Texas company contracted by Texoz. The incident was investigated by local authorities who have determined that the incident was an accident.

DIRECTORS' DECLARATION

1. In the opinion of the directors of Texon Petroleum Ltd ("the Company"):

(a) the consolidated financial statements and notes set out on pages 26 to 59, and the remuneration disclosures that are contained in the Remuneration report in sections 5.2.1 to 5.2.3 in the directors' report, are in accordance with the *Corporations Act 2001*, including:

(i) giving a true and fair view of the Group's financial position as at 31 December 2011 and of its performance for the financial year ended on that date; and

(ii) complying with Australian Accounting Standards and the Corporations Regulations 2001;

(b) the consolidated financial statements also comply with International Financial Reporting Standards as disclosed in Note 1(a);

(c) the remuneration disclosures that are contained in the Remuneration report in the directors' report comply with Australian Accounting Standard AASB 124 *Related Party Disclosures*, the *Corporations Act 2001* and the Corporations Regulations 2001; and

(d) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

2. The directors have been given the declarations required by Section 295A of the *Corporations Act 2001* from the chief executive officer and chief financial officer for the financial year ended 31 December 2011.

Signed in accordance with a resolution of the directors.

John D Armstrong
Chairman
Brisbane
30 March 2012

KPMG

Independent auditor's report to the members of Texon Petroleum Ltd

Report on the financial report

We have audited the accompanying financial report of Texon Petroleum Ltd (the company), which comprises the consolidated statement of financial position as at 31 December 2011, and consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year ended on that date, notes 1 to 29 comprising a summary of significant accounting policies and other explanatory information and the directors' declaration of the Group comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

Directors' responsibility for the financial report

The directors of the Company are responsible for the preparation of the financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the financial report that is free from material misstatement whether due to fraud or error. In note 1(a), the directors also state, in accordance with Australian Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements of the Group comply with International Financial Reporting Standards.

Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We performed the procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001* and Australian Accounting Standards, a true and fair view which is consistent with our understanding of the Group's financial position and of its performance.

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KPMG

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Independence

In conducting our audit, we have complied with the independence requirements of the *Corporations Act 2001*.

Auditor's opinion

In our opinion:

(a) the financial report of the Group is in accordance with the *Corporations Act 2001*, including:

(i) giving a true and fair view of the Group's financial position as at 31 December 2011 and of its performance for the year ended on that date; and

(ii) complying with Australian Accounting Standards and the Corporations Regulations 2001.

(b) the financial report also complies with International Financial Reporting Standards as disclosed in note 1(a).

Report on the remuneration report

We have audited the Remuneration Report included in pages 4 to 11 of the directors' report for the year ended 31 December 2011. The directors of the company are responsible for the preparation and presentation of the remuneration report in accordance with Section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the remuneration report, based on our audit conducted in accordance with auditing standards.

Auditor's opinion

In our opinion, the remuneration report of Texon Petroleum Ltd for the year ended 31 December 2011, complies with Section 300A of the *Corporations Act 2001*.

KPMG

KPMG

S J Board

Stephen J Board
Partner

Brisbane
30 March 2012