



# EMPIRE ENERGY GROUP LIMITED

and its controlled entities

ABN 29 002 148 361

**DECEMBER 2011 ANNUAL REPORT**

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## **Empire Group Information**

### **Directors**

B W McLeod (Executive Chairman)  
D H Sutton  
K A Torpey

### **Registered Offices**

#### **Australian Office**

Level 7  
151 Macquarie Street  
Sydney NSW 2000 Australia  
Telephone: (02) 9251 1846  
Facsimile: (02) 9251 0244

#### **US Office**

380 Southpointe Boulevard  
Suite 130  
Canonsburg PA 15317 USA

### **Auditors**

Nexia Court & Co  
Level 29, Tower Building  
Australia Square  
264 George Street  
Sydney NSW 2000

### **US Auditors**

Schneider Downs & Co. Inc  
1133 Penn Avenue  
Pittsburgh PA 15222

### **Share Registry**

Computershare Investor Services Pty Limited  
Level 3  
60 Carrington Street  
Sydney NSW 2000  
Telephone: 1300 85 05 05

[www.empireenergygroup.net](http://www.empireenergygroup.net)

### **Joint Company Secretaries**

D L Hughes  
R V Ryan

### **Bankers**

Australian & New Zealand Banking Group Limited  
Macquarie Bank Limited  
PNC Bank

### **Solicitors**

Clifford Chance  
Level 13  
95 Pitt Street  
Sydney NSW 2000

### **US Solicitors**

K&L Gates LLP  
K&L Gates Center  
210 Sixth Avenue  
Pittsburgh PA 15222-2613

### **Stock Exchange Listings**

#### **Australia**

Australian Securities Exchange  
(Home Exchange Brisbane, Queensland)

ASX Code: EEG - Ordinary Shares

#### **United States of America**

New York OTCQX Market: Code: EEGNY  
OTC#: 452869103  
Sponsor: Bank of New York  
1 ADR for 20 Ordinary shares

## Executive Chairman's Review of Operations

### A. HIGHLIGHTS - 2011

- Revenue up 57% to \$27.6 million.
- Field EBITDAX up 53% to \$19.1 million.
- Operating EBITDAX up 41% to \$16.5 million.
- EBITDAX down 57% to \$13.5 million. (2010 EBITDAX included \$23.5 million profits from the sale of oil & gas property, compared to oil & gas property sale profits of \$1.1m in 2011).
- Gross oil production up by 214% to 277,600 Bbls (Net 178,100 Bbls).
- Gross natural gas production up by 1% to 2.7 Bcf (Net 2.03 Bcf).
- Average 2011 production 1,413 Boe/d. Current production at 1,770 Boe/d.
- Updated 2P reserves of 15.9 MMBoe generating an NPV10 of \$150 million.
- A 10 well, oil drilling program in the Central Kansas Uplift was completed with a 70% success rate.
- A review of potential oil formations and targets in New York and Pennsylvania commenced mid 2011 with the first well identified in the Bass Island formation. A well rework commenced in early 2012 produced an initial production of over 200bbl/d. It has since declined to a steady production rate of between 80 to 100 Bbl/d. Further well reworks will be undertaken over 2012.
- A continuing Geological and Engineering study of the Company's significant prospective shale oil and gas resources in New York and Pennsylvania is underway. Current resource estimates are:
  - ❖ Utica shale – prospective resource of up to 5 Tcf GIP, (unrisked) ,with additional acreage under review;
  - ❖ Marcellus shale - prospective oil resource of estimated 70 million Bbls (based on a 3% recovery factor).
- Landowner negotiations continued for the 14.5 million acres of shale formations in the MacArthur Basin, Northern Territory, Australia.

### B. OPERATIONS REVIEW

The year under review was completed as a 'consolidation' period for Empire Energy. In summary:

- Empire Energy maintained operation of approximately 1,800 gas wells and 256 oil wells, currently producing approximately 5,550 Mcf/d and 845 Bbl/d or 1,770 Boe/day (net). Conversion of natural gas (1,000mmbtu) to a barrel of oil equivalent is based on a 6:1 ratio, as generally accepted for reporting purposes. Although this may be useful in terms of energy equivalents, it is irrelevant in terms of value equivalent, with Henry Hub gas currently at \$2.25 /Mcf and WTI at \$107 /Bbl.
- The recently acquired Kansas assets were bought up to an expected standard of operation. This included significant non-recurring capex directed towards items such as Kansas State required upgrade of spill and environmental controls, upgrading of poorly maintained wellhead equipment, split casing repairs, the repair of dilapidated pipelines and rationalisation and refurbishment of regional field shops and supplies.
- An experienced operating team has been established in Wichita, Kansas, to manage the Company's Kansas assets. Headed by Rob Kramer (experienced drilling and completions engineer), the Kansas operations include a landman with considerable regional experience, a geologist/geophysicist with 20 years' experience in the region (contract), two regional supervisors (based in Hayes and Great Bend) and an administration assistant.

## Executive Chairman's Review of Operation (Continued)

- In Appalachia the focus has been based around declining natural gas prices, and implementing processes to reduce operating costs, while at the same time improving production from existing operating wells. This process has incurred minimal short terming capex, which will continue through 2012. Opportunities to acquire production, pipelines, meters, taps into mainline gas transportation networks and acreage continued over the period, with total acquisitions of \$130,000 completed and a further \$230,000 completed in early 2012.
- In December 2011 the Company moved its USA Headquarters to Southpointe, Canonburg, PA. This newly developed commercial park is around 15 miles from Pittsburgh and is one of the major centres of energy development in the Appalachia region. This will enable the Company to more effectively attract employees and contractors if and when required. During the year the Company appointed Mr Bob Gustafson as Financial Controller, responsible for corporate operations and who is based at Southpointe.
- Over the year financial resources were allocated towards 3 significant acquisitions. Unfortunately, the Company was not successful in concluding these for a number of reasons ranging from due diligence highlighting negatives the Company was not prepared to work with, failing to reach vendor value expectations or not producing a bid to ensure success in a public tender process.

## C. REVIEW OF OPERATING RESULTS

In addition to the information presented in the financial report, and to assist stakeholders in gaining a more complete understanding of the Empire Energy Group, we have included a presentation of financial results with reference to EBITDAX. The presentation of EBITDAX accounts is not made in accordance with usual statutory accounting procedures. In addition, the EBITDAX accounts below utilize actual monthly numbers for production, revenue and expenses, as opposed to accruals, thereby generating a difference with the accrual accounting represented in the statutory accounts.

EBITDAX represents net income (loss) before interest expense, taxes, and depreciation, amortization, development and exploration expenses. Nonrecurring lease operating expenses have all been included in EBITDAX. In summary, all revenues and operating expenses of the Company are included in EBITDAX. All non-cash expenses, which may distort the presentation of operations in the statutory accounts, have been either eliminated or reallocated and aggregated as a total amortization expense.

In summary, we believe that:

- EBITDAX provides stakeholders with a much simpler and clearer measure of our operating performance.
- EBITDAX is an important supplemental measure of operating performance because it eliminates items that have little bearing on our operating performance and so highlights trends in our core business that may not otherwise be apparent when relying solely on current statutory accounting and financial measures.
- EBITDAX is a material component of the covenants that are imposed on the Company under our credit agreements.
- Securities analysts and investors generally use EBITDAX (cash flow modelling) in the comparative evaluation of companies.
- Management and external users of our financial statements, rely on the use of EBITDAX to assess:
  - the financial performance of our assets without regard to financing methods, capital structure or historical cost basis;
  - the ability of our assets to generate cash sufficient to pay interest costs and support our indebtedness;
  - our operating performance and return on capital as compared to those of other companies in our industry, without regard to financing or capital structure; and
  - the feasibility and effectiveness of acquisitions and capital expenditure projects; and
  - the overall rates of return on alternative investment opportunities.

Other companies may calculate EBITDAX differently than as presented. Based on the premises set out above, the following schedules present comparative operating statistics and financials on an EBITDAX basis:

## Executive Chairman's Review of Operation (Continued)

<b>Operating Statistics</b>		12 Months Ended	12 Months Ended	%
(In thousands, except \$ units)	Notes	Dec 31, 2011	Dec 31, 2010	change
<b>Gross Production:</b>				
Oil (MBbls)		277.6	88.5	214%
Natural gas (MMcf)		2,702.3	2,668.7	1%
<b>Net Production:</b>				
Oil (MBbls)		178.1	54.9	224%
Natural gas (MMcf)		2,026.6	2,007.9	1%
<b>Net Daily Production (Boe/d):</b>		<b>1,413.3</b>	<b>1,067.3</b>	<b>32%</b>
<b>Average sales price per unit (after hedging):</b>				
Oil (\$/Bbl)		\$85.92	\$81.43	6%
Natural gas (\$/Mcf)		\$5.89	\$6.32	-7%
<b>Average sales price per unit (before hedging):</b>				
Oil (\$/Bbl)		\$89.88	\$81.43	10%
Natural gas (\$/Mcf)		\$4.24	\$5.46	-22%
<b>Lifting Costs (incl taxes):</b>				
Oil (\$/Bbl)	1.1	\$24.00	\$18.76	28%
Natural gas (\$/Mcf)		\$2.10	\$2.03	4%
2P Reserves (MMBoe)	1.2	15,900	16,800	-5%
<b>Operations</b>				
(In \$ thousands)	Notes	12 Months Ended	12 Months Ended	%
		Dec 31, 2011	Dec 31, 2010	change
<b>Net Revenue:</b>				
Oil Sales	1.3	\$15,304	\$4,460	243%
Natural gas Sales		\$11,945	\$12,700	-6%
Working Interest		\$34		
Net Admin Income		\$231	\$120	93%
Other Income		\$144	\$310	-54%
<b>Net Revenue</b>		<b>\$27,658</b>	<b>\$17,590</b>	<b>57%</b>
<b>Production costs:</b>				
Lease operating expenses - Oil		\$3,335	\$910	266%
Lease operating expenses - Gas		\$3,628	\$3,550	2%
Taxes - Oil	1.4	\$974	\$120	712%
Taxes - Natural gas	1.4	\$614	\$520	18%
<b>Total</b>		<b>\$8,550</b>	<b>\$5,100</b>	<b>68%</b>
<b>Field EBITDAX</b>		<b>\$19,108</b>	<b>\$12,490</b>	<b>53%</b>
<i>Gross Margin</i>		69%	71%	
<b>Less:</b>				
Change in Inventory	1.5	\$184	\$0	n/a
Nonrecurring expenses	1.6	\$1,633	\$410	298%
Field F&A	1.7	\$632	\$0	n/a
Delayed Rental Payments		\$205	\$380	-46%
		\$2,654	\$790	236%
<b>Operating EBITDAX</b>		<b>\$16,454</b>	<b>\$11,700</b>	<b>41%</b>
<i>Operating Margin</i>		59%	67%	
<b>Less:</b>				
Field G&A	1.8	\$331	\$170	95%
Corporate G&A	1.9	\$1,305	\$1,570	-17%
Acquisition related expenses	1.1	\$342	\$1,140	-70%
Indirect Acquisition related expenses	1.11	\$566	\$0	n/a
Land & Leasing Costs	1.12	\$153	\$0	n/a
Gain on sale of oil and natural gas properties	1.13	-\$1,090	-\$23,510	-95%
Head Office Net G&A	1.14	\$1,383	\$1,083	28%
		\$2,990	-\$19,547	-115%
<b>EBITDAX</b>		<b>\$13,464</b>	<b>\$31,247</b>	<b>-57%</b>
<i>Net margin</i>		49%	178%	

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## Executive Chairman's Review of Operation (Continued)

### D. OPERATIONS – COMMENTS AS PER ABOVE SCHEDULE

- 1.1 Lifting Costs** - includes lease operating expenses, production and ad valorem taxes.
- 1.2 2P Reserves** – reserves where updated as of January 1, 2012 by Ralph E Davis Associates, Inc., Houston, TX (Appalachian assets) and LaRoche Petroleum Consultants Ltd, Dallas, TX (Kansas assets).
- 1.3 Oil and Natural gas Sales** – both include realised hedges, being \$3.3 million and (\$700,000) for natural gas and oil respectively.
- Net Admin Income** – as operator for approximately 99% of the Company's assets, the Company charges all Working Interest Owners a fee to cover expenses such as administration, general insurance, supervision etc., generally known as COPAS expenses. As part of this cost there is also a small profit margin. We believe it distorts reported revenue if 100% of the COPAS fee charged is shown as Company revenue when the Company is a 90% Working Interest Owner. In our situation the Company charges itself for 90% of the COPAS charge, meaning 90% of the COPAS charge is non-cash revenue. The cash component is what is received from the 10% Working Interest Owners plus the profit margin, which is the amount shown in the EBITDAX accounts. For information, in 2011 the COPAS revenue was \$4.6 million.
- 1.4 Taxes** – related only to production and includes production, severance and ad valorem taxes.
- 1.5 Inventory Adjustment** – adjustment for oil in tanks as of December 31, 2011.
- 1.6 Nonrecurring expenses** – major expense items where outlaid in Kansas and include upgrade of spill and environmental controls, upgrading of poorly maintained wellhead equipment and repair of split casings. These expenses are budgeted to be lower over 2012.
- 1.7 Field F&A** – to enable closer management of field supervision and indirect operational expenses a breakout of direct lease operating expenses has been provided. This includes expenses ranging from vehicles, fuel, mechanics, roustabouts, supervisors, lease and land management, some insurances etc.
- 1.8 Field G&A** – Empire Energy has field offices in each region it operates. In logistical terms Appalachia operations are personnel intensive including over 1,800 wells, 3,700 leases, 1,600 right of ways, 20 marketing agreements, 35 employees and 2 contract pumpers operating across a large area of western New York and western Pennsylvania. Kansas operations are less personnel intensive including around 282 oil and gas wells, 65 injection wells, 85 HBP leases, 5 employees and 13 contract pumpers operating across a large area (12 counties) of central Kansas. Field G&A expenses include expenses such as utilities, IT, postage, office rental (where applicable) etc.,
- 1.9 Corporate G&A** – Empire Energy manages its USA operations from a corporate head office at Canonsburg, PA. A staff of 5 manage the financial aspects of all USA operations. Major expenses include salaries and wages, health insurance, audit, bi-annual reserve reporting, utilities, travel and senior management/partner costs.
- 1.10 Acquisition related expenses** – Directly associated with acquisitions and include legal, tax and accounting advice, transition fees, recruitment and relocation costs and engineering expenses. These are driven by the acquisitions successfully concluded.
- 1.11 Indirect acquisition related expenses** – Contracted services required to implement a successful acquisition may include data review and integration, ongoing legal review of assets (especially leases and joint venture arrangements), accounting support, environmental and spill plan strategies, computer hardware and software, HR and IT services for systems integration etc.
- 1.12 Land & Leasing Costs** – contract landman expenses for lease renewals and new leasing.
- 1.13 Gain on sale of oil & gas properties** – sale of Marcellus shale acreage in 2010.
- 1.14 Head Office Net G&A** – net cost of Australian operations (expenses are net of any income received).

## Executive Chairman's Review of Operation (Continued)

## E. COMMENTS ON OPERATIONS

## 1.1 Hedging

Due to the leverage growth model implemented by Empire Energy, an aggressive hedging strategy is adopted to ensure commodity risk is eliminated over the period that a major portion of debt financing is repaid. The Empire Energy acquisition model metric is to target a 5 year debt repayment from project cash flows.

The portion of production hedged will be naturally reduced as drill bit production comes on line.

**Gas:** Production hedged as follows:

Y/e Dec 31	2012	2013	2014	2015	2016
<b>mmBtu Hedged</b>	1,484,351	1,407,720	1,408,488	1,166,000	528,000
<b>Av \$/mmBtu</b>	\$6.10	\$5.97	\$5.91	\$5.45	\$4.48
<b>Est % Production</b>	69%	70%	76%	71%	36%

**Oil:** Production hedged as follows:

Y/e Dec 31	2012	2013	2014	2015
<b>Bbls Hedged</b>	120,800	113,160	105,120	98,160
<b>Av \$/Bbl</b>	\$90.00	\$90.00	\$90.00	\$90.00
<b>Est % Production</b>	70%	68%	65%	60%

The fair value gain (marked to market) gain of oil and gas hedges in place for the Period was \$2.5 million (net of tax). Oil and gas hedge contracts were valued based on NYMEX Henry Hub and WTI forward curves at market close on December 31, 2011.

## 1.2 Financing Costs &amp; Taxes

\$'000-	Dec 2011	Dec 2010
<b>Interest paid</b>	\$3,580	\$2,490
<b>State Taxes Paid</b>	\$106	\$90

**Credit Facility:** The draw down on the Macquarie Bank Limited Credit Facility as at 31 December 2011 was \$58.1 million (cf \$72.7 million at Dec 2010) at an average rate of LIBOR+4.2%. Interest expense is estimated to average \$200,000/mth over 2012. Over 2011, Empire Energy repaid \$14.7 million (\$13.6 million in 2010) of existing loan facilities.

**Other Facilities:** Empire Energy has \$95,151 (\$229,859 in 2010) in vehicle and equipment loans with local banks at normal commercial interest rates. In addition, Empire Energy has two notes with the parent company for total face value of \$260,000 and coupon averaging 9%.

**Interest Rate Risk:** Interest rate risk was hedged in 2008 by entering into an interest rate swap agreement for a notional amount of \$7.94 million, expiring June 2012 with a fixed rate of 2.015%.

**State Taxes Paid:** Local and State taxes related to operations.

**Income Taxes:** For the 2011 tax period it is estimated the Company will receive a tax credit of approximately \$500,000 which will be offset against tax paid in 2010. No income taxes are expected in 2012 due to high depletion expenses and accelerated tax right offs for intangible drilling and completion costs.



## Executive Chairman's Review of Operation (Continued)

1.3 ARO, Depreciation, Depletion & Amortisation

\$'000 –	Dec 2011	Dec 2010
ARO	\$503	\$470
D, D & A	\$6,306	\$3,630

1.4 Capital Expenditure

Capex (\$'000)	Dec-11	Dec-10	% change
Acquisitions	\$130	\$56,250	-100%
Exploration	1.15 \$477	\$306	n/a
Development - IDC	\$2,047	\$420	487%
Development - Well Head Equipment	\$580	\$0	
Dry Hole Expense	1.16 \$476	\$0	
	\$3,710	\$56,976	-93%

- 1.15 A majority of these expenses related to the continued development of the Company's McArthur Basin tenements. This is expected to increase significantly over the next 12 to 24 months.
- 1.16 The dry hole costs were expensed over the 2011 period.

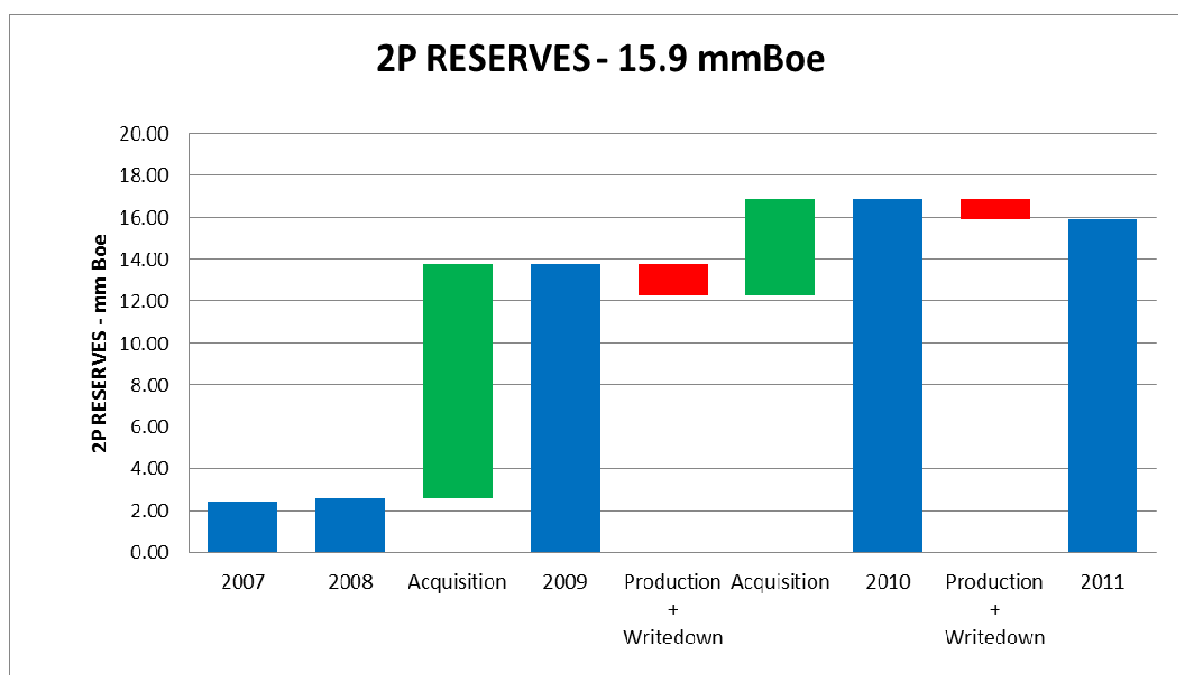
1.5 Exploration & Development

**Expenditure:** Total drilling expenditure in Kansas over 2012 was \$3.2 million. A total of 10 wells were drilled in Kansas of which 7 have been brought on line and are currently producing. In addition, 2 wells were drilled by the North Dakota JV for Empire Energy's share of \$872,000 of which \$315,600 has been written off. The first North Dakota well has been P&A'd while the second well is still being reviewed as oil shows have been encountered although porosity has been shown to be low.

Low gas prices are causing a rationalisation of assets in the industry, and within the region of the Empire Group's existing assets, possible opportunities exist to add bolt-on production assets and infrastructure at attractive costs.

1.6 Reserves

**Net Reserves:** An updated Reserve Estimate was carried out as of January 1, 2012. An updated summary of 2P Reserves is shown below. Total 2P reserves stand at 15.9 million Boe.

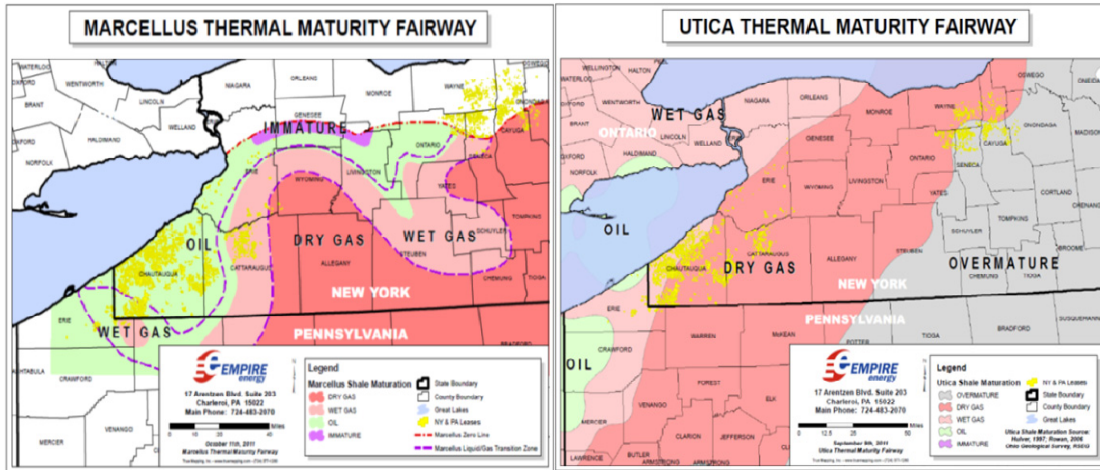


**Executive Chairman’s Review of Operation (Continued)**

**Resources:** In addition to the 3P reserves, the Empire Group is undertaking a detailed review of its 300,000+ acres held in western New York and north western Pennsylvania. This acreage (see below) covers a number of oil and gas bearing formations, other than the Medina and Queenston currently producing most of the Appalachia gas production.

**1.7 Unconventional Shale Potential**

- Empire continues geological and engineering review of its 303,000 acre land holding in western New York and northern Pennsylvania. Both the potential Marcellus and Utica shale regions are shown in the maps below.



An updated review of the reserves and contingent resources is being completed based on recent Marcellus and Utica Shale completions in both Pennsylvania and Ohio. In both States recent horizontal wells targeting liquids rich shale’s have been successful and recent announcements by third parties confirm the development of further gas processing plants.

- Reserve and resource estimates for the acreage held by Empire Energy were prepared by Ralph E Davis Associates, using acceptable evaluation principals.
- Estimated reserves and resources of oil and natural gas that geologic and engineering data demonstrate are “In-Place”, and can be recovered from known reservoirs. All volumes presented are gross volume (8/8ths), and have not subtracted associated royalty burdens.

**Shale Oil Potential Resources**

Formation	Type	Category	MBIs
Marcellus (1)	P(50)	Shale (Oil)	70,295.0
			70,295.0

- (1) Wells within the defined Marcellus oil resource zone were calculated to produce between 2-5,000 Bbls/5 acres. The most likely outcome was utilized with a 3% RF (recovery factor).

**Shale Gas Potential Resources**

Formation	Type	Category	GIP (Bcf)
Marcellus (3)	P(50)	Shale	199.4
Utica (2)	P(50)	Shale	4,638.0
			4,837.4

Notes:

- (2) At the time of the initial report, Utica shale gas potential resources have only been calculated for the region where drill data is available. Very few wells have been drilled into the Utica and estimates for GIP have only been made were the few existing wells have been drilled. Empire holds additional acreage outside the current potential resource region. It is expected that as with shale characteristics, the shale formations will continue within the remaining acreage. The potential GIP should increase if more data was available. Recent wells drilled in Ohio and Pennsylvania will add to the drill data to further prove up resources.
- (3) Under current capital and gas prices, it is estimated that the Marcellus shale dry gas wells would be uneconomic. However, wet gas would remain very profitable.

## Executive Chairman's Review of Operation (Continued)

### 1.8 Unconventional Shale Potential

- In early 2010 Empire Energy Group Limited identified the MacArthur Basin as having attractive potential for hydrocarbon bearing black shales, and has been successful in securing 7 license applications in the MacArthur Basin, Northern Territory. In summary:
  - 14.5 million acres under exploration licence application
  - Permits constitute high risk/high return frontier play at very low historic exploration maturity.
  - There has been no petroleum exploration in the Northern Territory acreage.
  - The exploration target is for shale oil and gas targets in rich black shales.
  - Land holder negotiations are underway. At the appropriate time the Company will seek to undertake a review of these opportunities with parties it has developed relationships within its operations in the USA.
  - The shales have been shown to be gas-prone (a mineral core hole ignited and sustained a 6m gas flare for several months).
  - Oil bleeds have been reported in geological data.

## F. FUTURE

The Company's prime strategy remains to:

- Identify new upstream assets to acquire and integrate into existing operations; and
- Build a position of 'significance' in the oil and gas industry. The target would be to reach an initial production milestone of over 2,500 Boe/day by 2012, and then up to of 10,000 Boe/day by 2015; and
- Monetise the Company's potential large scale unconventional sources of shale oil, gas liquids and dry gas in the Marcellus, Utica, Appalachia and the MacArthur Basin, Northern Territory, Australia.
- Ensure the value of the Company's achievements are reflected in its market capitalisation.

I would also like to acknowledge the many employees, shareholders and stakeholders who have provided support and assistance in continuing the development of the Company. Subject to the successful outcome of several events expected over 2012, the nature and scale of the Company has the potential to change significantly.

Bruce McLeod  
Chairman & CEO

*The information in this report which relates to reserves is based on information compiled by Ralph E Davis Associates Inc, Houston, Texas, and LaRoche Petroleum Consultants Ltd., Dallas, Texas, both certified professional petroleum engineers.*

*Neither Ralph E Davis Associates Inc, nor LaRoche Petroleum Consultants Ltd., nor any of their employees have any interest in Empire Energy E&P, LLC or the properties reported herein.*

## Directors' Report for the financial year ended 31 December 2011

In respect of the financial year period ended 31 December 2011, the Directors of Empire Energy Group Limited ("Company") present their report together with the Financial Report of the Company and of the consolidated entity ("Empire Group"), being the Company and its controlled entities, and the Auditor's Report thereon.

### Directors

The following persons held office as Directors of Empire Energy Group Limited at anytime during or since the end of the financial year:

B W McLeod	Executive Chairman
D H Sutton	Non-Executive Director
K A Torpey	Non-Executive Director

All the Directors have been in office since the start of the financial year unless otherwise stated.

### Principal Activities

During the financial year the principal continuing activities of the consolidated entity consisted of:

The acquisition, development, production, exploration and sale of oil and natural gas. The Empire Group sells its oil and gas products primarily to owners of domestic pipelines and refiners located in Pennsylvania, New York and Kansas.

Reviewing new exploration, development and business opportunities in the oil and gas sector to enhance shareholder value.

### Consolidated Results

The consolidated net loss of the Empire Group for the financial year ended 31 December 2011 after providing for income tax was US\$1,436,800 compared with a profit of US\$387,090 for the six months period ended 31 December 2010.

### Review of Operations

For information on a review of the Empire Group's operations refer to the Executive Chairman's Review of Operations Report contained on pages 4 to 11 of this annual report.

### Dividends

The Directors have not recommended the payment of a final dividend.

### Significant Changes in State of Affairs

Significant changes in the state of affairs of the consolidated entity during the financial period were as follows:

#### **(i) Capital Structure**

Contributed equity of the Company increased by US\$15,709,323 (from US\$55,486,551 to US\$71,195,874) during the financial period as a result of:

The Company completed a Private Placement of 110,833,333 fully paid ordinary shares at A\$0.12 to sophisticated and professional investors. The shares were issued in 2 Tranches:

	US\$
Tranche 1 – Issue of 22,000,000 shares on 21 April 2011 @ A\$0.12 pursuant to the Company's 15% placement capacity	2,843,016
Tranche 2 – Issue of 88,833,333 shares on 19 May 2011 @ A\$0.12 following shareholder approval at Annual General Meeting held on 17 May 2011	11,343,306
On 3 June 2011 the Company issued 4,740,429 shares @ A\$0.12 pursuant to a Share Purchase Plan offer which closed on 27 May 2011	606,737
On 21 December 2011 the Company issued 13,333,334 shares pursuant to the exercise of the following options by Macquarie Bank Limited	
- 6,666,667 options at A\$0.12 expiring 22 December 2011	811,040
- 6,666,667 options at A\$0.135 expiring 22 December 2011	912,420
Less transaction costs associated with the above mentioned share issues	(807,196)
	15,709,323

## **Directors' Report for the year ended 31 December 2011**

Funds raised from the issue have been utilised towards meeting the following Empire Group objectives:

- Achieving production targets through the aggregation of oil and gas producing assets
- Conducting development drilling on the Empire Group's oil prospects in Kansas
- Conducting exploration drilling on the Empire Group's shale prospects in the Appalachia and Williston Basins
- Debt re-structure and working capital purposes

### **(ii) Change of Company Name**

A General Meeting of members of the Company was held on 23 March 2011. At that meeting shareholders approved the following resolutions:

- Special resolution to change the name of the Company to Empire Energy Group Limited.
- Ordinary resolution to approve participation of the Executive Chairman in the Company's private placement to sophisticated and professional investors.

This change of the Company name became effective on 23 March 2011 with the issue of a Certificate of Registration of Change of Name by the Australian Securities and Investments Commission.

### **(iii) Change in Presentation Currency for Financial Reporting**

In October 2011 the Company announced that it would adopt United States Dollars ("US\$") as the presentation currency for financial reporting with effect from 1 July 2011.

The change has been introduced as a result of the following:

- Increasing contribution of the US operations to the consolidated results of the Empire Group.
- Intention to list on a USA securities exchange in the near future; and
- Increasing interest in the Empire Group's operations from potential US based investors and financiers.

### **(iv) Listing on OTCQX Exchange**

In November 2011 the Company became listed on the OTCQX Market.

OTCQX is one of three OTC Market Group platforms which in total trade over 10,000 securities with an aggregate market capitalisation exceeding US\$10 trillion. Based on the total volume of securities traded the OTC Market platform is the third most attractive market in the USA after the NYSE and NASDAQ.

### **(v) Increase in Equity Interest Empire Energy USA LLC**

Since the beginning of the financial year, the Company has contributed US\$10,585,366 in a number of investments to Empire Energy USA LLC as equity funds. In consideration the Company has received additional B-2 units which will participate in profit distributions.

At the date of this report the Company held a 95% equity interest in Empire Energy USA LLC.

### **Likely Developments**

Except for information disclosed on certain developments and the expected results of those developments included in this report under review of operations, further information on likely developments in the operations of the consolidated entity and the expected results of those operations have not been disclosed in this report because the Directors believe it would be likely to result in unreasonable prejudice to the consolidated entity.

### **Matters Subsequent to Balance Date**

On 16 January 2012 the Company announced that the New York Department of Environmental Conservation (DEC) had concluded the public comment period of the Supplemental Generic Environmental Impact Statement (SGEIS) process. The DEC will now review comments that have been submitted before releasing the final SGEIS and associated regulations. It is believed that the DEC will commence issuing permits for high volume hydraulic fracturing prior to mid-year 2012.

The Empire Group has a significant land position of approx. 303,000 acres in New York State of which 220,000 acres are in the Marcellus and 180,000 acres in the Utica shale fairway of Western New York State.

## **Directors' Report for the year ended 31 December 2011**

There were no other matters or circumstances that have arisen since 31 December 2011 that has significantly affected or may significantly affect:

- the operations, in financial years subsequent to 31 December 2011, of the Empire Group; or
- the results of those operations; or
- the state of affairs in financial years subsequent to 31 December 2011 of the Empire Group.

### **Information on Directors**

**Bruce William McLeod**, B.Sc (Maths), M.Com (Econ)                      Age 59  
**Executive Chairman**

### **Experience and Expertise**

Mr McLeod has had extensive experience in the Australian capital markets. Over the past 20 years he has been involved in raising debt and equity capital for a number of resource, property projects and companies, as well as the takeover and rationalisation of listed and unlisted companies. Prior to this he spent 6 years with a major international bank, where he was Executive Director, responsible for the financial and capital markets operations.

Appointed a Director of the Company on 21 May 1996.

### **Special Responsibilities**

Chairman of the Board  
Member of Audit Committee

### **Other Current Directorships**

Chairman of Mayan Iron Corporation Ltd.

### **Former Directorships in Last 3 Years**

Earth Heat Resources Ltd from 6 February 2008 to 22 January 2010.  
Carnegie Wave Energy Limited from 1 November 1996 to 6 May 2011.

**David Henty Sutton**, B.Com ACIS      Age 68

### **Non-Executive Director**

### **Experience and Expertise**

Mr Sutton has many years' experience as a Director of companies involved with share broking and investment banking. He was executive chairman from 2002 to 2010 of Martin Place Securities Pty Ltd, a boutique investment firm holding an AFS Licence. He currently owns and manages Dayton Way Financial Pty Ltd, a boutique financial services company focussing on the global resource sector.

Prior to his current role he was a partner and director of several securities exchange member firms. He became a member of the Stock Exchange of Melbourne and subsequently Australian Securities Exchange Limited.

Appointed a Director of the Company on 17 January 1997.

### **Special Responsibilities**

Member of Remuneration Committee  
Member of Audit Committee

### **Other Current Directorships**

Chairman of Silver Mines Limited, AAT Corporation Limited, Precious Metals Investments and Chairman of Sinovus Mining Limited.

### **Former Directorships in Last 3 Years**

Director of Earth Heat Resources Ltd from 14 October 2007 to 11 May 2011.

## **Directors' Report for the year ended 31 December 2011**

**Kevin Anthony Torpey**, B.E., MIE Aus., CP Eng, FAusIMM, (CP)      Age 73  
**Non-Executive Director**

### **Experience and Expertise**

Mr Torpey is a Chartered Professional Engineer and a graduate from Sydney University. Over the last 40 years he has been involved in the development of many diverse major projects involving oil, iron ore, aluminium, nickel, lead/zinc, uranium, magnesite, coal and gold, located locally and in Ireland and Indonesia.

Generally these projects have been associated with major companies such as Consolidated Goldfields, EZ Industries, Alcan, International Nickel, Tara Minerals Limited (Ireland), Noranda, Denison Mines (Canada), Toyota, Mitsubishi and Iwatani. For the last 20 years his association has mainly been as a corporate officer initially as Managing Director of Denison Mines (Australia) and then Managing Director of Devex Limited. Over the last few years he has acted as a consultant to a number of companies involved in mining projects and new technologies.

Appointed a Director of the Company on 26 November 1992.

### **Special Responsibilities**

Member of Remuneration Committee  
Member of Audit Committee

### **Other Current Directorships**

Non-Executive Director of Latrobe Magnesium Limited

### **Former Directorships in Last 3 Years**

None

### **Joint Company Secretaries**

#### **David Hughes**

Mr Hughes was appointed to the position of Company Secretary on 11 November 1992. Before joining Empire Energy Group Limited he has held similar positions with other listed companies for over 20 years. He is currently acting as Company Secretary/Joint Company Secretary of the following other listed public companies:

Latrobe Magnesium Limited, Hudson Investment Group Limited and Joint Company Secretary of Tiaro Coal Limited, Hudson Resources Limited, Australian Bauxite Limited, Sovereign Gold Company Limited and Raffles Capital Limited.

#### **Rachel Ryan**

Ms Ryan was employed in the Company's Corporate Finances division in February 2006. She was appointed Joint Company Secretary on 21 July 2010. She resigned on 3 February 2012 and re-joined the Empire Group on 5 March 2012 and now serves the Company as Joint Company Secretary and General Manager Operations.

### **Executives**

#### **Kylie Arizabaleta B.Bus (Acct) (Fin)**

Ms Arizabaleta was appointed to the position of Financial Controller on 5 March 2012. Before joining Empire Energy Group Limited she worked in the public practice as an external auditor and holds over 8 year experience.

### **Advisor to the Empire Group**

#### **Dr John Warburton (FGS, MAICD)**

Dr Warburton was appointed as an advisor to the Empire Group in February 2010 and as a director and Chief Executive Officer to the Company's wholly owned subsidiary Imperial Oil and Gas Pty Ltd on 18 March 2011. A Geoscientist by profession, Dr Warburton has 28 years of technical and leadership experience in International Petroleum E&P including 11 years with BP and 4 years as General Manager Exploration & New Business for LASMO-Eni in Pakistan. Dr Warburton is the Director of Sydney-based Petroleum Exploration Business Consultancy Insight Exploration and he maintains a strong global executive network.

Dr Warburton's extensive operated & non-operated petroleum expertise covers the Middle East, Kazakhstan, Azerbaijan, North & West Africa, Pakistan, Europe, Australia, New Zealand, PNG, SE Asia, China, Korea and Japan. John has been involved in the discovery of commercial oil & gas fields in Pakistan, UK, Kazakhstan, Azerbaijan and PNG and he has published 28 internationally recognised technical articles with particular focus on petroleum exploration in complex fold and thrust belts.

## Directors' Report for the year ended 31 December 2011

Dr Warburton has a First Class B.Sc. Honours Degree in Geological Sciences and a Ph.D. in Structural Geology. He is a Member of the Australian Institute of Company Directors, an Alumni of Cranfield Business School UK and a Fellow of the Geological Society of London. Insight Exploration is a Sustaining Member of the Petroleum Exploration Society of Great Britain.

### Meetings of Directors

The number of Directors' meetings and committee meetings held and the attendance by each of the Directors of the Company at those meetings during the financial year were:

Director	Directors' Meetings		Remuneration Committee Meetings		Audit Committee Meetings	
	Attended	Held Whilst in Office	Attended	Held Whilst in Office	Attended	Held Whilst in Office
Mr B W McLeod	14	14	-	-	2	2
Mr D H Sutton	14	14	1	1	2	2
Mr K A Torpey	14	14	1	1	2	2

The audit committee comprises the full Board of Directors. Mr D H Sutton and Mr K A Torpey were members of the remuneration committee during the financial year.

### Retirement, Election and Continuation in Office of Directors

Mr Kevin Torpey is the Director retiring by rotation at the next Annual General Meeting in accordance with Article 50.1 of the Company's Constitution and being eligible offers himself for re-election.

## Remuneration Report – Audited

This report outlines the remuneration arrangements in place for Directors and Executives of the Empire Group.

### Remuneration Committee

The Remuneration Committee reviews and approves policy for determining executives remuneration and any amendments to that policy.

The Committee makes recommendations to the Board on the remuneration of Executive Directors (including base salary, incentive payments, equity awards and service contracts) and remuneration issues for Non-Executive Directors.

The members of the Remuneration Committee during the period were:

D H Sutton – Independent Non-Executive - Chairman  
K A Torpey – Independent Non-Executive

The Committee meets as often as required but not less than once per year.

The Committee met once during the period and Committee member's attendance record is disclosed in the table of Directors Meetings shown above.

### Executive Directors' and Executive Remuneration

Executive remuneration and other terms of employment are reviewed annually and are based predominantly on the past year's growth of the Empire Group's net tangible assets and shareholder value, having regard to performance against goals set at the start of the year, relevant comparative information and independent expert advice. As well as basic salary, remuneration packages include superannuation and other bonuses and incentives linked to predetermined performance criteria. Executive Directors and executives are able to participate in an Employee Share Option Scheme.

Remuneration packages are set at levels that are intended to attract and retain executives capable of managing the Consolidated Entity's operations. Consideration is also given to reasonableness, acceptability to shareholders and appropriateness for the current level of operations.



## Directors' Report for the year ended 31 December 2011

### Performance Based Remuneration

As part of the Executive Directors' remuneration package there is a performance-based component, consisting of key performance indicators (KPIs). The intention of this program is to facilitate goal congruence between executives and that of the Empire Group and shareholders.

Performance in relation to the KPIs will be assessed annually, with bonuses being awarded depending on performance of the Empire Group over the past year. Following the assessment, the KPIs will be reviewed by the Remuneration Committee in light of the desired and actual outcomes, and their efficiency assessed in relation to the Empire Group's goals and shareholder wealth, before KPIs are set for the following year.

### Non-Executive Directors' Remuneration

Remuneration of Non-executive Directors is determined by the Board based on recommendations from the Remuneration Committee and the maximum amount approved by shareholders from time to time. Non-executive Directors are also able to participate in an Employee Share Option Scheme.

The Board undertakes an annual review of its performance and the performance of the Board Committees against goals set at the start of the year.

Details of the nature and amount of each element of the remuneration of each Director of Empire Energy Group Limited and each specified executive of the Empire Group receiving the highest remuneration are set out in the following tables.

December 2011 (12 months)	Short term benefits			Post- employment benefits	Long- term benefits	Share/option based payments	Total US\$
	Cash salary and fees US\$	Bonus payments US\$	Non- monetary US\$	Super contributions US\$	Long service leave		
<b>Directors</b>							
B W McLeod	361,165	206,380	49,603	-	-	195,451	812,599
K A Torpey	20,638	-	-	1,857	-	-	22,495
D H Sutton	-	-	-	20,638	-	-	20,638
<b>Specified Executive of the Empire Group</b>							
D L Hughes	80,488	-	14,180	7,244	1,294	27,567	130,773
R Ryan	105,426	-	1,255	9,488	10,772	27,567	154,508
<b>Empire Energy Executives</b>							
A Boyer	164,165	-	48,732	-	-	-	212,897

Share based payments reflects a proportion of the independently valued cost of options granted in May 2011 under the Employee Share Option Plan. This cost is shown on a pro-rata basis over the vesting period of the options.

December 2010 (6 months)	Short term benefits			Post- employment benefits	Long- term benefits	Share/option based payments	Total US\$
	Cash salary and fees US\$	Bonus payments US\$	Non- monetary US\$	Super contributions US\$	Long service leave		
<b>Directors</b>							
B W McLeod	212,580	188,960	44,963	(25,510)	-	-	420,993
K A Torpey	9,448	-	-	850	-	-	10,298
D H Sutton	-	-	-	9,448	-	-	9,448
<b>Specified Executive of the Empire Group</b>							
D L Hughes	36,847	-	9,730	3,316	748	-	50,641
R Ryan	41,571	-	351	3,741	-	-	45,663
<b>Empire Energy Executives</b>							
A Boyer	49,996	-	4,500	-	-	-	54,496
B Waller	49,996	-	-	-	-	-	49,996

The cash component of US\$212,580 in 2010 paid to B W McLeod includes a prior period adjustment of US\$47,240.

## Directors' Report for the year ended 31 December 2011

The base remuneration shown above for B W McLeod represents amounts paid to Eastern & Pacific Capital Pty Ltd for management consulting services. B W McLeod is a Director and shareholder of Eastern & Pacific Capital Pty Ltd. For B W McLeod, the percentage of remuneration based on performance was 25% (2010: 45%).

### Service Agreements

Remuneration and other terms of employment with Mr B W McLeod (Executive Chairman) have been formalised in a service agreement. The terms of this agreement are as detailed below:

Terms of the agreement:

- Base salary of US\$361,165 per annum to be reviewed at least annually by the remuneration committee
- Payment of termination benefits apply other than for gross misconduct
- Performance based incentive bonus based on annual performance set against key performance indicators
- Other benefits include provision of fully maintained motor vehicle, participation in the Company's executive option plan and membership of Empire Energy USA, LLC management incentive scheme.

These terms are currently under review by the remuneration committee.

There are no other service agreements in place formalising the terms of remuneration of directors or specified executives of the Company and the consolidated entity.

### Loans to Directors and Executives

There were no loans made to Directors or Specified Executives of the Company and the consolidated entity during the period commencing at the beginning of the financial period and up to the date of this report.

There are no loans outstanding at the date of this report.

### Share Options Granted to Directors and Specified Executives

During the financial year, 6,800,000 executive options to acquire ordinary shares were granted to a Director and specified executives of the Company. 5,300,000 executive options were granted to a Director following the approval of shareholders at a General Meeting of members held on 23 March 2011. In addition 1,500,000 executive options were granted to specified executives of the Company. All options were issued pursuant to the terms of the Company's employee share option plan which provides vesting restrictions based on minimum period of employment conditions.

At the date of this report there were 6,866,666 unissued shares under option to a Director and specified executives. These options are exercisable on the following basis:

Number – Executive Options	Exercise Price A\$	Expiry Date
66,666 executive options	\$0.1575	5 March 2013
3,500,000 executive options	\$0.15	1 July 2013
1,650,000 executive options	\$0.17	1 July 2013
1,650,000 executive options	\$0.18	31 December 2013

### Directors' Interests and Benefits

The relevant interest of each director and specified executive in the share capital of the Company as at the date of this report is:

#### Particulars of Interests in the Issued Capital of the Company

Director	Direct Interest		Indirect Interest	
	Shares	Options	Shares	Options
B W McLeod	255,429	-	6,684,331	5,300,000
D H Sutton	438,301	-	476,665	-
K A Torpey	118,055	-	2,073,394	-
<b>Specified Executives</b>				
David L Hughes	1,319,404	750,000	124,594	-
Rachel Ryan	28,571	816,666	-	-

### End of Audited Remuneration Report

## Directors' Report for the year ended 31 December 2011

### Share Options

#### Movements

#### Grant of Options

During the financial year, 6,800,000 executive options to acquire ordinary shares were granted pursuant to the terms of the Company's employee share option plan. Vesting of these options is subject to minimum period of employment conditions.

The options were granted on the following terms:

No. of Options	Vesting Date	Exercise Price A\$	Expiry Date
3,500,000	23 March 2013	\$0.15	1 July 2013
1,650,000	23 March 2013	\$0.17	1 July 2013
1,650,000	23 March 2013	\$0.18	31 December 2013

No options were granted in the period since the end of the financial year and up to the date of this report.

#### Exercise of Options

13,333,334 unlisted options were exercised by Macquarie Bank Limited in December 2011. These options were exercised on the following terms:

- 6,666,667 unlisted options exercisable at A\$0.12 expiring 22/12/11
- 6,666,667 unlisted options exercisable at A\$0.135 expiring 22/12/11

No options were exercised in the period since the end of the financial year.

#### Expiry of Options

No options have expired since the beginning of the financial year and up to the date of this report.

At the date of this report the total number of unissued shares held under option was 26,866,664. These options are exercisable on the following terms.

Number		Exercise Price A\$	Expiry Date
6,666,666		\$0.15	22 June 2012
6,666,666		\$0.165	22 December 2012
6,666,666		\$0.18	22 December 2012
66,666	Executive options	\$0.1575	5 March 2013
3,500,000	Executive options	\$0.15	1 July 2013
1,650,000	Executive options	\$0.17	1 July 2013
1,650,000	Executive options	\$0.18	31 December 2013
<u>26,866,664</u>			

#### Directors' and Officers' Indemnities and Insurance

During the financial year Empire Energy Group Limited paid an insurance premium, insuring the Company's Directors (as named in this report), Company secretaries, executive officers and employees against liabilities not prohibited from insurance by the *Corporations Act 2001*.

A confidentiality clause in the insurance contract prohibits disclosure of the amount of the premium and the nature of insured liabilities.

#### Proceedings on Behalf of the Company

No person has applied for leave of court to bring proceedings on behalf of the Company or intervene in any proceedings to which the Company is a party for the purpose of taking responsibility on behalf of the Company for all or any part of those proceedings.

The Company was not a party to any such proceedings during the year.

## **Directors' Report for the year ended 31 December 2011**

### **Environmental Regulations**

There are significant environmental regulations surrounding mining activities which have been conducted by the Empire Group. However, there has been no breach of these regulations during the financial period or since the end of the financial period and up to the date of this report.

### **Declaration by the Chief Executive Officer and Chief Financial Officer**

The Directors have received and considered declarations from the Chief Executive Officer and Chief Financial Officer in accordance with Section 295A of the Corporations Act. The declaration states that in their opinion the Company's and Consolidated Entity's financial reports for the financial year ended 31 December 2011 present a true and fair view in all material aspects of the financial position and performance and are in accordance with relevant accounting standards.

### **Non-Audit Services**

The Directors are satisfied that the provision of non-audit services during the period by the auditor (or by another person or firm on the auditors behalf) is compatible with the general standard of independence for auditors imposed by the *Corporations Act 2001*.

Details of amounts paid or payable to the auditor for non-audit services are outlined in Note 33 to the financial statements.

The audit firm is engaged to provide tax compliance services. The Directors believe that given the size of the Empire Group's operations and the knowledge of those operations by the audit firm that it is appropriate for the auditor to provide these services. The Directors are of the opinion that these services will not compromise the auditor's independence requirements of the *Corporations Act 2001*.

### **Auditors' Independence Declaration Under Section 307 of the *Corporations Act 2001***

A copy of the Auditors' Independence declaration as required under Section 307C of the *Corporations Act 2001* is set out on page 21 and forms part of the Directors Report for the financial year ended 31 December 2011.

### **Auditor**

Nexia Court & Co continues in office in accordance with Section 327 of the *Corporations Act 2001*. No officers of the Empire Group were previously partners of the audit firm.

This report is made in accordance with a resolution of the Directors.



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**B W McLEOD**  
**Director**

Sydney 30 March 2012

## AUDITOR'S INDEPENDENCE DECLARATION

The Board of Directors  
Empire Energy Group Limited  
Level 7, 151 Macquarie Street  
SYDNEY NSW 2000

30 March 2012

Dear Board Members

### **Auditor's Independence Declaration under section 307C of the *Corporations Act 2001***

In accordance with section 307C of the *Corporations Act 2001*, I am pleased to provide the following declaration of independence to the directors of Empire Energy Group Limited.

As lead audit partner for the audit of the financial statements of Empire Energy Group Limited for the financial period ended 31 December 2011, I declare that to the best of my knowledge and belief, there have been no contraventions of:

- (a) the auditor independence requirements of the *Corporations Act 2001* in relation to the audit; and
- (b) any applicable code of professional conduct in relation to the audit.

Yours sincerely

*Nexia Court & Co*

**Nexia Court & Co.**  
*Chartered Accountants*

*AM*

**Andrew Hoffmann**  
*Partner*



## Corporate Governance Statement

### OVERVIEW

The Company and the Board of Directors are committed to achieving and demonstrating the highest standards of corporate governance and aim to comply with the “Principles of Good Corporate Governance and Best Practice recommendations” set by the ASX Corporate Governance Council (“CGC”).

However, given the current size of both the Company’s operations and the Board of Directors, it is not appropriate, cost effective or practical to comply fully with those principles and recommendations. Where a recommendation has not been adopted this fact has been disclosed together with the reasons for the departure.

Consistent with the ASX best practice recommendations, the Company’s corporate government practices are regularly reviewed and are available on the Company’s website. [www.empireenergygroup.net](http://www.empireenergygroup.net)

### Compliance with ASX Corporate Governance Council best practice recommendations

The ASX listing rules requires public listed companies to include in their annual report a statement regarding the extent to which they have adopted the ASX Corporate Governance Council best practice recommendations. This statement provides details of the Company’s adoption of the best practice recommendations.

### PRINCIPLE 1 - LAY SOLID FOUNDATIONS FOR MANAGEMENT AND OVERSIGHT

Companies should establish and disclose the respective roles and responsibilities of board and management.

#### Board Responsibilities

The Board of directors is accountable to shareholders for the performance of the Company. In carrying out its responsibilities, the board undertakes to serve the interest of shareholders honestly, fairly and diligently.

The Board’s responsibilities are encompassed in a formal charter published on the Company’s website. The charter is reviewed annually to determine whether any changes are necessary or desirable.

The responsibilities of the board include:

- Reporting to shareholders and the market;
- Ensuring adequate risk management processes exist and are complied with;
- Reviewing internal controls and external audit reports;
- Ensuring regulatory compliance;
- Monitoring financial performance, including approval of the annual and half-yearly financial reports and liaison with the Company’s auditors;
- Reviewing the performance of senior management;
- Monitoring the Board composition, Director selection and Board processes and performance;
- Validating and approving corporate strategy;
- Reviewing the assumptions and rationale underlying the annual plans; and
- Authorising and monitoring major investment and strategic commitments.

#### Directors’ Education

The Company issues a formal letter of appointment for new directors setting out the terms and conditions relevant to that appointment and the expectations of the role of the director.

The Company also provides a formal induction process which provides key information on the nature of the business and its operations.

Continuing education is provided via the regular Board updates provided by the divisional chief executives.

#### Role of Chairman and Chief Executive Officer (CEO)

The Chairman is also the Chief Executive Officer and is responsible for leading the Board, ensuring that Board activities are organised and efficiently conducted and for ensuring the Directors are properly briefed for meetings. The Chairman is also responsible for implementing the consolidated entity’s strategies and Board policies.

The Chief Executive Officer has been delegated responsibility for managing the day to day operations of the Empire Group.

A formal charter is in place which lays out the duties and responsibilities of the CEO. This charter also requires that the responsibilities and accountabilities of both the board of directors and the CEO are clearly defined. The assessment and monitoring of the CEO is the responsibility of the board.

Performance is assessed against pre-determined objectives on a regular basis.

## Corporate Governance Statement

The Chairman's other responsibilities include:

- Ensuring that general meetings are conducted efficiently and that shareholders have adequate opportunity to air their views and obtain answers to their queries.
- Present the view of the Board formally.

### PRINCIPLE 2 – STRUCTURE THE BOARD TO ADD VALUE

Companies should have a board of an effective composition, size and commitment to efficiently discharge its responsibilities and duties.

#### Composition of the Board

Currently the Board of Directors comprises three members, one executive non-independent Director, who is also the Chairman and Chief Executive Officer and two non-executive independent Directors, all of whom have a broad range of skills and expertise.

In determining independence the board has regard to the guidelines of directors' independence in the ASX Corporate Governance Council and Best practice Recommendations and other best practice guidelines.

Each director's independent status is regularly assessed by the Board.

The Company does not comply with recommendations 2.2 and 2.3 which provides that the chair should be an independent Director and the role of the chair and CEO should not be exercised by the same individual.

At this stage of the Company's development, the board considers it is neither appropriate nor cost effective for there to be an independent chairman and a separate CEO.

This matter continues to be under review and as circumstances allow, consideration will be given to the appropriate time to move to adopting the ASX Corporate Governance Guidelines.

The board considers that its composition provides for the timely and efficient decision making required for the Empire Group in its current circumstances.

The board's size and composition is subject to limits imposed by the Company's constitution which provides for a minimum of three directors and a maximum of seven.

Details of the members of the board, their experience, expertise and qualifications are set out in the Directors Report on pages 14 to 16.

The position/status and term in office of each Director at the date of this report is as follows: -

<b>Name of Director</b>	<b>Position/Status</b>	<b>Term in Office</b>
Bruce McLeod	Executive Chairman – Non-Independent	16 years 4 months
David Sutton	Non-Executive – Independent	15 years 8 months
Kevin Torpey	Non-Executive – Independent	19 years 10 months

The Board currently holds up to 12 scheduled meetings each financial year together with any ad hoc meetings as may be necessary. The Board met 14 times during the year and Directors attendance is disclosed on page 16 of the Directors' Report.

#### Access to independent professional advice

All directors are required to bring an independent judgment to bear on Board decisions. To facilitate this, each Director has the right of access to all relevant Company information and to the Company's Executives. The directors also have access to external resources as required to fully discharge their obligations as Directors of the Company. The use of this resource is co-ordinated through the Chairman of the Board.

#### Nomination committee

The Company does not comply with recommendation 2.4 in that the board has not yet formed a separate nomination committee. All matters that would normally be responsibility of a nomination committee are dealt with by the full board of Directors.

The Company has not adopted recommendation 2.4 as the board considers that the Company and the board are currently not of sufficient size to justify the establishment of a separate nomination committee.

## Corporate Governance Statement

The Board reviews its composition on an annual basis to ensure that the Board has the appropriate mix of expertise and experience. When a vacancy exists, for whatever reasons, or where it is considered that the Board would benefit from the services of a new Director with particular skills, the Board will select appropriate candidates with relevant qualifications, skills and experience. External advisors may be used to assist in such a process. The Board will then appoint the most suitable candidate who must stand for election at the next general meeting of shareholders. For directors retiring by rotation, the board assesses that director before recommending re-election.

### Board performance evaluation

The Company has processes in place to review the performance of the board and its committees and individual directors. Each year the board of directors give consideration to broad corporate governance matters, including the relevance of existing committees and to reviewing its own and individual directors' performance. The Chairman is responsible for monitoring the contribution of individual directors and consulting with them in any areas of improvement.

Individual directors use an approved form to assess the performance of the Board and the Chairman.

### PRINCIPLE 3 – PROMOTE ETHICAL AND RESPONSIBLE DECISION MAKING

Companies should actively promote ethical and responsible decision making.

#### Code of conduct

The Board acknowledges the need for continued maintenance of the highest standards of Corporate Governance Practices and ethical conduct by all Directors and employees of the consolidated entity.

The Company has established a code of conduct applicable to all Directors and employees. The requirement to comply with the code is mandatory and is communicated to all employees. The code sets out standards of conduct, behaviour and professionalism.

The shareholder communications strategy, the securities trading policy, the continuous disclosure policy collectively form a solid ethical foundation for Empire Group's ethical practices. A copy of these documents has been posted on the Company's website.

#### Approach to diversity

The Board recognises the benefits of diversity at boards in senior management and within the organisation generally and recognises the organisational strengths, deeper problem solving ability and opportunity for innovation that diversity brings to an organisation.

The Company has established a diversity policy which set out the beliefs, goals and strategies of the Company and makes reference to all the characteristics that makes individuals different from each other. The policy sets out the positive steps taken to ensure that current and prospective employees are not discriminated against, either directly or indirectly on such characteristics as gender, age, disability, marital status, sexual orientation, religion, ethnicity or any other area of potential difference. The Company is committed to gender diversity at all levels of the organisation. Gender equality is a key component of the Company's diversity strategy. The implementation of this policy aims to reflect both the circumstances of the Company and the industry in which it operates.

The Company's diversity policy includes a requirement that:

- the Board establish measurable objectives for achieving gender diversity; and
- the Board assess annually the objectives set for achieving gender diversity; and
- the Board assess annually the progress made towards achieving the objectives set.

In accordance with this policy and ASX corporate governance principles, the Board has established the following objectives in relation to gender diversity. The aim is to achieve these objectives over the coming 3 to 5 years and Director and senior executive positions become vacant and appropriately skilled candidates are available. Representation of female employees in the organisation workforce is as follows:

	Actual at 31 December 2011		Empire Group Objective		Progress towards meeting objective	
	Number	Percentage	Number	Percentage	Number	Percentage
Whole organisation	10	14%	12	20%	-	-
Senior Executive positions	2	20%	4	33%	3	25%
Board	-	-	1	25%	-	-

A copy of the Company's diversity policy has been posted on the Company's website.



## Corporate Governance Statement

### Policy on dealing in Company securities

The Company has adopted a policy on how Directors, key management personnel, contractors and all other employees can deal in the securities of the Company.

This policy aims to ensure that the reputation of the Company is not adversely impacted by perceptions of trading in the Company's securities at inappropriate times or in an inappropriate manner. In addition to the specific prohibition on insider trading Directors and all other employees must also not deal in the Company's securities during the following closed periods, being the four week period before or 48 hours after:

- a. the release of the Empire Group's annual results to the ASX
- b. the release of the Empire Group's half-year results to the ASX
- c. the release of the Empire Group's quarterly cashflow and activities reports to the ASX
- d. the annual general meeting
- e. such other periods as advised by the Board of Directors or Chief Executive Officer (such as prior to ASX being advised of a significant matter or event)

Requests to trade during the closed periods may be considered in exceptional circumstances. At all other times Directors, key management personnel and all other employees are not permitted to buy or sell securities in the Company without first obtaining written consent from the Chairman. When the Chairman trades Company securities written approval has to be obtained from an independent Director.

The Company has introduced compliance standards and procedures to ensure that the policy is properly implemented. In addition there is also an internal review mechanism to assess compliance and effectiveness.

A copy of the Company's securities trading policy was lodged with the ASX Company Announcements office on 23 December 2010 and is also posted on the Company's website.

### PRINCIPLE 4 – SAFEGUARD INTEGRITY IN FINANCIAL REPORTING

Companies should have a structure to independently verify and safeguard the integrity of their financial reporting.

#### Audit Committee

The audit committee comprises of the full Board of Directors.

The committee met twice during the year under review.

The committee has adopted a formal charter, a copy of the formal charter is posted on the Company's website. The responsibilities of the Audit Committee include:

- reviewing the annual and half year financial reports to ensure compliance with Australian Accounting Standards and generally accepted accounting principles;
- monitoring corporate risk management practices;
- review and approval of the consolidated entity's accounting policies and procedures;
- reviewing external audit plans;
- reviewing the nomination, performance and independence of the external auditors; and
- organising, reviewing and reporting on any special reviews or investigations deemed necessary by the Board.

The audit committee has received confirmation in writing from the Chief Executive Officer and Chief Financial Officer that:

The Empire Group's financial statements for the financial period ended 31 December 2011 present a true and fair view in all material respects of the Empire Group's financial position and operational results and are in accordance with relevant accounting standards.

The structure of the audit committee does not comply with recommendation 4.2 in that it does not consist only of non-executive independent Directors and it is chaired by an independent chair who is not chair of the board.

The Board considers that the Company and the Board are not of sufficient size to warrant the establishment of a separate audit committee.

## Corporate Governance Statement

### External auditors

The full Board is responsible for the appointment, removal and remuneration of the external auditors, and reviewing the terms of their engagement, and the scope and quality of the audit. In fulfilling its responsibilities, the Board receives regular reports from management and the external auditors at least once a year, or more frequently if necessary. The external auditors have a clear line of direct communication at any time to the Chairman of the Board.

The current auditors, Nexia Court & Co., were appointed in 1992. The Australian accounting bodies' statement on professional independence requires mandatory rotation of audit partners for listed companies every five years. Nexia Court & Co. confirms that they conform with the requirements of the statement.

Nexia Court & Co. are required to attend the Annual General Meeting and be available to answer shareholder questions about the conduct of the audit and the preparation and content of the Auditor's Report.

### PRINCIPLE 5 – MAKING TIMELY AND BALANCED DISCLOSURE

Companies should promote timely and balanced disclosure of the matters concerning the Company.

The Company has a written policy on information disclosure that focuses on ensuring compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior executive level for that compliance.

The Company Secretary in consultation with the Chairman, is responsible for communications with the ASX. The Company Secretary is also responsible for ensuring compliance with the continuous disclosure requirements of the ASX Listing Rules, and overseeing and co-ordinating information disclosure to the ASX, analysts, brokers, shareholders, the media and the general public.

A copy of the Company's policy of continuous disclosure is posted on the Company's website.

### PRINCIPLE 6 – RESPECT THE RIGHTS OF SHAREHOLDERS

Companies should respect the rights of shareholders and facilitate the effective exercise of those rights.

#### Communication with shareholders

The Board recognises and respects the rights of our shareholders as the beneficial owners of the Company. In order to facilitate the effective exercise of those rights, the Company has adopted a shareholder communication policy that aims to empower shareholders by:

- communicating effectively with them;
- providing easy access to balanced and understandable information about the Empire Group; and
- encouraging and facilitating shareholder participation in general meetings.

The Company achieves this through the following avenues:

#### Regular mailings

The Company provides shareholders with copies of all announcements made to the ASX by mail on request. Copies are also available via an electronic link to the ASX web site, ensuring that all shareholders are kept informed about the Empire Group.

Shareholders also have the option of receiving a hard copy of the Annual Report each year.

#### General meetings

All shareholders are invited to attend the Annual General Meetings which are held in Sydney. The full Board and senior executives are present and available to answer questions from the floor, as are the External Auditor and a representative from the Company's legal advisors.

A copy of the Company's shareholder communications policy is posted on the Company's website.

The Company also posts corporate information in the Investor Section of its Company website at [www.empireenergygroup.net](http://www.empireenergygroup.net)

## Corporate Governance Statement

### PRINCIPLE 7 – RECOGNISE AND MANAGE RISK

Companies should establish a sound system of risk oversight and management and internal control.

The Board oversees the establishment, implementation and review of the Company's Risk Management System. To ensure it meets its responsibilities, the Board has implemented appropriate systems for identifying, assessing, monitoring and managing material risk throughout the organisation.

Management is required to provide monthly status reports to the Board which identify potential areas of business risk arising from changes in the financial and economic circumstances of its operating environment.

The Board regularly assesses the Company's performance in light of risks identified by such reports.

Management are also required to design implement and review the Company's risk management and internal control system. The Board reviews the effectiveness of the implementation of the Company's risk management and internal control system on a regular basis.

The Board does not employ an internal auditor, although as part of the Company's strategy to implement an integrated framework of control, the Board requested the external auditors review internal control procedures. Recommendations once presented are considered by the Board.

The chief executive officer and chief financial officer have stated in writing to the board that:

- The Empire Group's financial reports present a true and fair view in all material respects of the Empire Group's financial position and operating results and are in accordance with relevant accounting standards.
- The integrity of the financial statements is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the Board.
- The Company's risk management and internal compliance and control system is operating efficiently in all material respects.

The board requires this declaration to be made bi-annually.

### PRINCIPLE 8 – REMUNERATE FAIRLY AND RESPONSIBLY

Companies should ensure that the level and composition of remuneration is sufficient and reasonable and that the relationship to performance is clear.

The Board has established a remuneration committee. The committee comprised the following members during the year:

- Mr D Sutton – Independent Non-Executive
- Mr K Torpey – Independent Non-Executive

Mr D Sutton is the Chairman of the remuneration committee.

The Company does not comply with recommendation 8.2 as the remuneration committee does not have at least three members. The Board considers that the function of the remuneration committee is not jeopardised by its current structure. The Board considers that the size of the Company does not warrant the appointment of additional members to the Remuneration Committee.

The committee has adopted a formal charter, a copy of the formal charters has been posted on the Company's website. The main responsibilities of the Remuneration Committee include:

- review and approve the Company's policy for determining executive remuneration and any amendments to that policy;
- review the on-going appropriateness and relevance of the policy;
- consider and make recommendations to the Board on the remuneration of executive Directors (including base salary, incentive payments, equity awards and service contracts);
- review and approve the design of all equity based plans;
- review and approve the total proposed payments under each plan; and
- review and approve the remuneration levels for non-executive Directors.

The committee met once during the year and the Committee Members attendance record is disclosed in the table of Directors Meetings included in the Directors' Report at page 16.

## **Corporate Governance Statement**

### **Executive Directors and Executive remuneration**

The remuneration committee reviews and approves the policy for determining executive's remuneration and any amendments to that policy.

Executive remuneration and other terms of employment are reviewed annually having regard to relevant comparative information and independent expert advice.

Remuneration packages include basic salary, superannuation and the rights of participation in the Company's Employee Share Option Plan.

Remuneration packages are set at levels that are intended to attract and retain executives capable of effectively managing the Company's operations.

Consideration is also given to reasonableness, acceptability to shareholders and appropriateness for the current level of operations.

### **Non-executive directors**

Remuneration of Non-Executive Directors is determined by the Board based on relevant comparative independent expert advice and the maximum amount approved by shareholders from time to time.

Non-Executive Directors have the right to participate in the Company's Share Option Plan.

Further information on directors and executive remuneration is included in the audited remuneration report which forms part of the directors' report.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

for the year ended 31 December 2011

	Note	Year ended December 2011 US\$	Six months ended December 2010 US\$*
<b>Revenue from continuing operations</b>	5	31,874,667	13,265,810
Gain on sale of acreage	6	1,092,250	-
Other income		446,459	307,653
		<b>33,413,376</b>	<b>13,573,463</b>
<b>Expenses</b>			
Oil and gas production		(15,304,005)	(6,648,136)
Exploration assets written off		(640,880)	-
Impairment of assets	8	(275,959)	(58,695)
Depreciation, depletion and amortisation	14	(5,008,877)	(2,615,985)
General and administration		(4,906,118)	(3,092,931)
Finance costs	7	(7,093,222)	(2,220,094)
<b>Profit/(loss) before income tax expense from continuing operations</b>		<b>184,315</b>	<b>(1,062,378)</b>
Income tax (expense)/benefit	9	(1,621,115)	1,449,468
<b>(Loss)/profit after income tax (expense)/benefit from continuing operations</b>		<b>(1,436,800)</b>	<b>387,090</b>
<b>Other comprehensive income</b>			
Gain on the revaluation of available-for-sale assets		108,031	187,149
Exchange differences on translation of foreign operations		(184,555)	426,679
Net change in the fair value of cash flow hedges, net of tax		2,561,887	(965,372)
Other comprehensive income for the year, net of tax		<b>2,485,363</b>	<b>(351,544)</b>
<b>Total comprehensive income for the year</b>		<b>1,048,563</b>	<b>35,546</b>
(Loss)/profit for the year is attributable to:			
Equity holders of Empire Energy Group Limited		(1,561,718)	(157,915)
Non-controlling interests		124,918	545,005
		<b>(1,436,800)</b>	<b>387,090</b>
Total comprehensive income for the year is attributable to:			
Equity holders of Empire Energy Group Limited		642,099	(363,075)
Non-controlling interests		406,464	398,621
		<b>1,048,563</b>	<b>35,546</b>
		Cents per share	Cents per share
Basic earnings per share	28	(0.66)	(0.10)
Diluted earnings per share	28	(0.66)	(0.10)

The above statements of comprehensive income should be read in conjunction with the accompanying notes.

\* Restated. Refer to Note 1 Change in presentation currency and Prior period adjustment.

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

as at 31 December 2011

	Note	As at December 2011 US\$	As at December 2010 US\$*	As at 1 July 2010 US\$*
<b>CURRENT ASSETS</b>				
Cash and cash equivalents	27	4,448,495	2,665,474	4,033,251
Trade and other receivables	10	5,577,262	3,817,317	25,896,239
Prepayments	11	417,677	69,406	304,996
Inventories	12	585,822	649,330	-
Financial assets, including derivatives	13	4,243,779	2,084,247	1,948,113
Current income tax receivable		552,000	-	-
<b>TOTAL CURRENT ASSETS</b>		<b>15,825,035</b>	<b>9,285,774</b>	<b>32,182,599</b>
<b>NON-CURRENT ASSETS</b>				
Financial assets, including derivatives	13	6,942,218	3,884,255	2,479,656
Oil and gas properties	14	96,460,487	99,578,419	49,029,182
Property, plant and equipment	14	3,842,386	3,577,032	2,858,884
Intangible assets	15	83,308	150,683	121,495
<b>TOTAL NON-CURRENT ASSETS</b>		<b>107,328,399</b>	<b>107,190,389</b>	<b>54,489,217</b>
<b>TOTAL ASSETS</b>		<b>123,153,434</b>	<b>116,476,163</b>	<b>86,671,816</b>
<b>CURRENT LIABILITIES</b>				
Trade and other payables	16	4,161,263	4,447,851	2,424,320
Financial liabilities, including derivatives	17	1,229,486	692,586	190,454
Interest-bearing liabilities	18	53,896,869	67,719,342	41,380,643
Provisions	19	93,464	78,035	64,451
Current income tax liability		-	1,043,000	6,869,749
<b>TOTAL CURRENT LIABILITIES</b>		<b>59,381,082</b>	<b>73,980,814</b>	<b>50,929,617</b>
<b>NON-CURRENT LIABILITIES</b>				
Financial liabilities, including derivatives	17	1,136,390	2,536,851	63,766
Interest-bearing liabilities	18	54,806	69,234	-
Provisions	19	4,944,295	4,491,624	3,818,846
Deferred income tax liability	9(f)	7,610,331	3,480,150	-
<b>TOTAL NON-CURRENT LIABILITIES</b>		<b>13,745,822</b>	<b>10,577,859</b>	<b>3,882,612</b>
<b>TOTAL LIABILITIES</b>		<b>73,126,904</b>	<b>84,558,673</b>	<b>54,812,229</b>
<b>NET ASSETS</b>		<b>50,026,530</b>	<b>31,917,490</b>	<b>31,859,587</b>
<b>EQUITY</b>				
Contributed equity	20	71,195,874	55,486,551	55,464,194
Reserves	21	8,421,566	5,204,302	5,815,599
Accumulated losses		(31,327,674)	(31,117,184)	(31,365,406)
<b>Equity is attributable to:</b>				
Equity holders of Empire Energy Group Limited		48,289,766	29,573,669	29,914,387
Non-controlling interests		1,736,764	2,343,821	1,945,200
<b>TOTAL SHAREHOLDERS' EQUITY</b>		<b>50,026,530</b>	<b>31,917,490</b>	<b>31,859,587</b>

The above consolidated statements of financial position should be read in conjunction with the accompanying notes.

\* Restated. Refer to Note 1 Change in presentation currency and Prior period adjustment.

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

for the year ended 31 December 2011

Consolidated	Issued Capital	Fair Value Reserve	Foreign Currency Translation Reserve	Options Reserve	Accumulated Losses	Attributable to owners of equity parent	Non-Controlling Interests	Total Equity
Balance at 31 December 2010	55,486,551	2,021,792	334,942	2,057,718	(26,847,184)	33,053,819	2,343,821	35,397,640
Effect of prior period adjustment <sup>*</sup>	-	789,850	-	-	(4,270,000)	(3,480,150)	-	(3,480,150)
Revised 31 December 2010 <sup>*</sup>	55,486,551	2,811,642	334,942	2,057,718	(31,117,184)	29,573,669	2,343,821	31,917,490
<b>Total Comprehensive income for year</b>								
Profit after income tax from continuing operations	-	-	-	-	(1,561,718)	(1,561,718)	124,918	(1,436,800)
Exchange differences on translation of foreign operations	-	-	(184,555)	-	-	(184,555)	-	(184,555)
Gain on the revaluation available-for-sale investments, net of tax	-	108,031	-	-	-	108,031	-	108,031
Net change in the fair value of cash flow hedges, net of tax	-	2,280,341	-	-	-	2,280,341	281,546	2,561,887
<b>Total comprehensive income for the year</b>	-	<b>2,388,372</b>	<b>(184,555)</b>	-	<b>(1,561,718)</b>	<b>642,099</b>	<b>406,464</b>	<b>1,048,563</b>
<b>Transactions with owners, recorded directly in equity</b>								
Issue of ordinary shares	16,516,519	-	-	-	-	16,516,519	-	16,516,519
Less: share issue transaction costs	(807,196)	-	-	-	-	(807,196)	-	(807,196)
Options lapsed in period, transferred to retained earnings	-	-	-	(590,708)	590,708	-	-	-
Options issued during the year	-	-	-	246,627	-	246,627	-	246,627
Warrants issued during the year	-	-	-	1,292,742	-	1,292,742	62,618	1,355,360
Dilution of non-controlling interest	-	49,740	-	15,046	760,520	825,306	(825,307)	-
Distribution to non-controlling interests	-	-	-	-	-	-	(250,832)	(250,832)
<b>Total transactions with owners</b>	<b>15,709,323</b>	<b>49,740</b>	-	<b>963,707</b>	<b>1,351,228</b>	<b>18,073,998</b>	<b>(1,013,521)</b>	<b>17,060,477</b>
<b>Balance at 31 December 2011</b>	<b>71,195,874</b>	<b>5,249,754</b>	<b>150,387</b>	<b>3,021,425</b>	<b>(31,327,674)</b>	<b>48,289,766</b>	<b>1,736,764</b>	<b>50,026,530</b>

The above consolidated statements of changes in equity should be read in conjunction with the accompanying notes.

<sup>\*</sup>Restated. Refer to Note 1 Change in presentation currency and Prior period adjustment.

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

for the six months ended 31 December 2010

Consolidated	Issued Capital	Fair Value Reserve	Foreign Currency Translation Reserve	Options Reserve	Accumulated Losses	Attributable to owners of equity parent	Non-Controlling Interests	Total Equity
Balance at 1 July 2010*	55,464,194	3,443,481	(91,737)	2,463,855	(31,365,406)	29,914,387	1,945,200	31,859,587
<b>Total Comprehensive income for period</b>								
Profit after income tax from continuing operations	-	-	-	-	(157,915)	(157,915)	545,005	387,090
Exchange differences on translation of foreign operations	-	-	426,679	-	-	426,679	-	426,679
Gain on the revaluation available-for-sale investments, net of tax	-	187,149	-	-	-	187,149	-	187,149
Net change in the fair value of cash flow hedges, net of tax	-	(818,988)	-	-	-	(818,988)	(146,384)	(965,372)
<b>Total comprehensive income for the period</b>	-	<b>(631,839)</b>	<b>426,679</b>	-	<b>(157,915)</b>	<b>(363,075)</b>	<b>398,621</b>	<b>35,546</b>
<b>Transactions with owners, recorded directly in equity</b>								
Issue of ordinary shares	23,881	-	-	-	-	23,881	-	23,881
Less: share issue transaction costs	(1,524)	-	-	-	-	(1,524)	-	(1,524)
Options lapsed in period, transferred to retained earnings	-	-	-	(406,137)	406,137	-	-	-
<b>Total transactions with owners</b>	<b>22,357</b>	-	-	<b>(406,137)</b>	<b>406,137</b>	<b>22,357</b>	-	<b>22,357</b>
<b>Balance 31 December 2010</b>	<b>55,486,551</b>	<b>2,811,642</b>	<b>334,942</b>	<b>2,057,718</b>	<b>(31,117,184)</b>	<b>29,573,669</b>	<b>2,343,821</b>	<b>31,917,490</b>

The above consolidated statements of changes in equity should be read in conjunction with the accompanying notes.

\*Restated. Refer to Note 1 Change in presentation currency and Prior period adjustment.



## CONSOLIDATED STATEMENTS OF CASH FLOW

for the year ended 31 December 2011

	Note	Year ended 31 December 2011 US\$	Six months ended 31 December 2010 US\$*
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Receipts from customers		30,005,422	11,053,164
Payments to suppliers and employees		(19,727,256)	(8,423,573)
Interest received		77,416	15,770
Interest paid		(3,571,734)	(1,178,989)
Income taxes paid		(2,305,694)	(107,280)
Net cash flows from operating activities	27	4,478,154	1,359,092
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Proceeds from sale of acreage	6	-	24,616,124
Proceeds from sale of investments in equities		38,696	160,527
Payments for oil and gas assets		(2,755,268)	(55,297,611)
Payments for property, plant and equipment		(478,088)	(1,024,418)
Payments for investments in equities		(27,500)	(128,791)
Net cash flows from investing activities		(3,222,160)	(31,674,169)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Net proceeds from issuing of shares		15,709,323	-
Proceeds from interest bearing liabilities		280,207	42,184,218
Repayment of proceeds from issuing shares		-	23,883
Repayment of interest bearing liabilities		(15,011,747)	(13,597,604)
Finance lease payments		(13,559)	(6,311)
Distribution to non-controlling interests		(250,832)	-
Net cash flows from financing activities		713,392	28,604,186
Net increase/(decrease) in cash and cash equivalents		1,969,386	(1,710,891)
Cash and cash equivalents at beginning of financial year		2,665,474	4,033,251
Effect of exchange rate changes on cash and cash equivalents		(186,365)	343,114
<b>CASH AND CASH EQUIVALENTS AT THE END OF FINANCIAL YEAR</b>	27	<b>4,448,495</b>	<b>2,665,474</b>

The above consolidated statements of cash flow should be read in conjunction with the accompanying notes.

\* Restated. Refer to Note 1 Change in presentation currency and Prior period adjustment.

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 1. SIGNIFICANT ACCOUNTING POLICIES

#### **Corporate information**

The financial report covers Empire Energy Group Limited and its controlled entities ("Empire Group"). Empire Energy Group Limited is a company limited by shares whose shares are publicly traded on the Australian Securities Exchange. The parent entity of the Empire Group is incorporated and domiciled in Australia with its core operations in the United States of America ("USA"). Separate financial statements for Empire Energy Group Limited as an individual entity are no longer presented as the consequence of a change to the *Corporations Act 2001*; limited financial information for Empire Energy Group Limited, as an individual entity, is included in Note 31.

The principal activities of the Empire Group during the financial year are described in the Directors' Report.

The financial report of the Empire Group for the year ended 31 December 2011 was authorised for issue in accordance with a resolution of Directors on 30 March 2012.

The Company has changed their year-end from June to December to align with the operations in the USA. The amounts presented in the financial statements are not entirely comparable as the periods differ.

#### **Basis of preparation**

The consolidated financial statements have been prepared in accordance with Australian Accounting Standards, other authoritative pronouncements of the Australian Accounting Standards Board, Urgent Issues Group Interpretations, and the requirements of the *Corporations Act 2001*. The consolidated financial statements have been prepared on a cost basis, modified, where applicable, by the measurement at fair value available-for-sale financial assets and derivative financial instruments.

#### **Statement of compliance**

The financial report complies with Australian Accounting Standards ('AASB's'). Compliance with AASBs ensures that the financial report, comprising the financial statements and accompanying notes, complies with International Financial Reporting Standards ('IFRS').

#### **Change in presentation currency**

Because of sustained international growth, the Empire Group's cash flows and economic returns are now principally denominated in US dollars ("US\$"). From 1 July 2011, Company changed the currency in which it presents its consolidated and parent Company financial statements from Australian dollars ("A\$") to US\$. The change has no impact on the net results of the consolidated entity other than presentation in US\$ instead of A\$. The Directors considers the change in presentation currency will provide shareholders with a more consistent and meaningful presentation of the Empire Group's underlying performance.

To effect the change in presentation currency, the Australian dollar functional currency assets and liabilities at 30 June 2010 were converted at the spot rate of US\$1:A\$0.8523 on the reporting date; revenue and expenses for the six month period ended 31 December 2010 were converted at the average exchange rate of US\$1:A\$0.9448 for the reporting period, or at the exchange rates ruling at the date of the transaction to the extent practicable and equity balances were converted at applicable historical rates.

#### **Prior period adjustment**

The Empire Group has amended the comparative disclosure for an adjustment in the estimate for income tax. The previous advice received had been misinterpreted and the current tax liability had been written-off to the income tax expense as opposed to a deferred tax liability. Further, it was noted that the unrealised losses on hedging derivatives had not been tax effected.

The adjustment has been corrected by restating each of the affected financial statement line items. The impact was to recognise an increase in the deferred tax liabilities of \$3,480,150, a decrease in income tax expense of \$4,270,000 and an increase in fair value reserves of \$789,850.

#### **New, revised or amending Accounting Standards and Interpretations adopted**

None of the new standards and amendments to standards that are mandatory for the first time for the financial year beginning 1 January 2011 affected any of the amounts recognised in the current period or any prior period and are not likely to affect future periods.

**NOTES TO THE FINANCIAL STATEMENTS**  
**for the year ended 31 December 2011****1. SIGNIFICANT ACCOUNTING POLICIES (Continued)*****Early adoption of standards***

The Empire Group has not elected to apply any pronouncements before their operative date in the annual reporting period beginning 1 January 2011.

***Principles of Consolidation***

The consolidated financial statements comprise the financial statements of Empire Energy Group Limited and its controlled entities.

Controlled entities are all those entities over which the Empire Group has the power to govern the financial and operating policies. Controlled entities are consolidated from the date on which control is transferred to the Empire Group and cease to be consolidated from the date on which control is transferred out of the Empire Group.

Jointly controlled entities are accounted for using the equity method (equity accounted investees) and are initially recognised at cost.

All intercompany transactions, balance, including unrealised profits arising from intercompany transactions, have been eliminated in full. Unrealised losses are eliminated unless costs cannot be recovered.

The acquisition of subsidiaries is accounted for using the acquisition method of accounting. A change in ownership, without the loss of control, is accounted for as an equity transaction, where the difference between the consideration transferred and the book value of the share of the non-controlling interest acquired is recognised directly in the equity attributable to the parent.

Non-controlling interest in the results and equity of subsidiaries are shown separately in the consolidated statement of comprehensive income and consolidated statement of financial position. Losses incurred by the Empire Group are attributed to non-controlling interest in full, even if that results in a deficit balance.

***Business combinations***

Business combinations are accounted for using the acquisition method. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the acquirer measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. Those oil and gas reserves and resources that are able to be reliably valued are recognised in the assessment of fair values on acquisition.

Goodwill is initially measured at cost being the excess of the aggregate of the consideration transferred and the amount recognised for non-controlling interest; and over the net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognised in profit or loss.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to each of the Empire Group's cash generating units that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units.

***Foreign Currency Translations***

The financial report is presented in United States Dollars (US\$) which is the functional currency for the majority of the entities within the Empire Group. The functional currency of Empire Energy Group Limited is in Australian Dollars.

***Foreign currency transactions***

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the end of the reporting period are translated to US dollars at the foreign exchange rate ruling at that date.

**NOTES TO THE FINANCIAL STATEMENTS**  
**for the year ended 31 December 2011****1. SIGNIFICANT ACCOUNTING POLICIES (Continued)***Foreign operations*

The assets and liabilities of foreign operations are translated to US\$ at exchange rates at the reporting date. The revenue and expenses of foreign operations are translated to US dollars at exchange rates at the dates of the transactions. Foreign currency differences on translation are recognised directly in equity.

**Revenue recognition***Natural gas revenue*

Revenue from the sale of natural gas is recognised when natural gas has been delivered to a custody transfer point, persuasive evidence of a sales arrangement exists, the rights and responsibility of ownership pass to the purchaser upon delivery, collection of revenue from the sale is reasonably assured, and the sales price is fixed or determinable. Natural gas is sold by the Empire Group under contracts with terms ranging from one month up to the life of the well. Virtually all of the Empire Group contracts' pricing provisions are tied to a market index with certain adjustments based on, among other factors, whether a well delivers to a gathering or transmission line, quality of natural gas and prevailing supply and demand conditions, so that the price of the natural gas fluctuates to remain competitive with other available natural gas suppliers.

Because there are timing differences between the delivery of natural gas and the Empire Group's receipt of a delivery statement, the Empire Group has unbilled revenues. These revenues are accrued based upon volumetric data from the Empire Group's records and the Empire Group's estimates of the related transportation and compression fees, which are, in turn, based upon applicable product prices.

*Oil revenue*

Revenue from the sale of oil is recognised when the significant risks and rewards of ownership have been transferred to the buyer and can be measured reliably, which is usually at the time of lifting, transferred into a vessel, pipe or other delivery mechanism.

*Drilling operations*

The Empire Group offers its drilling services under footage-based service contracts. Footage-based contracts provide for the drilling, of wells at footage rates and are generally completed within three to five days after the commencement of drilling. The Empire Group provides geological, engineering and drilling supervision on the drilling and completion process and uses subcontractors to perform completion services and accordingly, has risk of loss in performing services under these arrangements. Accordingly, the Empire Group reports revenue under these agreements gross of related expenses. Anticipated losses, if any, on uncompleted contracts are recorded at the time that the estimated total costs exceed the estimated total contract revenue.

*Well operations*

Well operations and pipeline income are recognised when persuasive evidence of an arrangement exists, services have been rendered, collection of revenues is reasonably assured and the sales price is fixed or determinable. The Empire Group is paid a monthly operating fee for each well it operates for outside owners. The fee covers monthly operating and accounting costs, insurance and other recurring costs. The Empire Group might also receive additional compensation for special nonrecurring activities, such as reworks and recompletions.

*Finance income*

Finance income comprises interest income on funds invested. Interest income is recognised as it accrues, using the effective interest method.

**Cash and cash equivalents**

Cash and cash equivalents includes cash on hand, deposits held at call with financial institutions, other short-term, highly liquid investments with original maturities of three months or less that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value. For the statement of cash flows presentation purposes, cash and cash equivalents also includes bank overdrafts, which are shown within borrowings in current liabilities on the statement of financial position.

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 1. SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### *Trade and other receivables*

Trade receivables, which generally have 30-90 day terms, are recognised and carried at original invoice amount less an allowance for any uncollectible amounts.

An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written when identified.

#### *Inventories*

Inventories consists of crude oil, stated at the lower of cost to produce or market and other production supplies intended to be used in natural gas and crude oil operations.

#### *Financial Assets, including derivatives*

The Empire Group utilises interest rate swap agreements and oil and gas forward contracts to manage the exposure to interest rate changes on certain variable rate credit agreements and price volatility, respectively. The Empire Group recognises its derivatives on the consolidated statement of financial performance at fair value at the end of each period. Changes in the fair value of the interest rate swaps and oil and gas forward contracts that are designated and meet the required criteria for a cash flow hedge are reported in consolidated comprehensive income.

Derivatives are classified as current or non-current depending on the expected period of realisation.

#### *Oil and gas properties*

Oil and gas properties are stated at cost, less accumulated depreciation and accumulated impairment losses.

Oil and natural gas exploration and development expenditure is accounted for using the successful efforts method of accounting for gas producing activities. Costs to acquire mineral interests in gas properties, drill and equip exploratory wells that find proved reserves, and drill and equip development wells and related asset retirement costs are capitalised. Depletion is based on cost less estimated salvage value using the unit-of-production method. The process of estimating and evaluating gas reserves is complex, requiring significant decisions in the evaluation of geological, geophysical, engineering and economic data. Costs to drill exploratory wells that do not find proved reserves, geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed.

#### *Major maintenance and repairs*

Expenditure on major maintenance refits or repairs comprises the cost of replacement assets or parts of assets, inspection costs and overhaul costs. Where an asset or part of an asset that was separately depreciated and is now written off is replaced and it is probable that future economic benefits associated with the item will flow to the Empire Group, the expenditure is capitalised. Where part of the asset was not separately considered as a component, the replacement value is used to estimate the carrying amount of the replaced assets which is immediately written off.

#### *Property, plant and equipment*

Property, plant and equipment is stated at cost less accumulated depreciation and any impairment in value. The capitalised value of a finance lease is also included within property, plant and equipment. Plant and equipment are depreciated over their estimated useful lives using the straight line method as follows:

Plant and equipment	December 2011	December 2010
	10-20%	10-20%

Assets are depreciated from the date of acquisition. Profits and losses as sales of property, plant and equipment are taken into account in determining the results for the year.

For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

**NOTES TO THE FINANCIAL STATEMENTS**  
**for the year ended 31 December 2011****1. SIGNIFICANT ACCOUNTING POLICIES (Continued)*****Recoverable amount of assets***

At each reporting date, the Empire Group assesses whether there is any indication that an asset may be impaired. Where an indicator of impairment exists, the Empire Group makes a formal estimate of recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount the asset is considered impaired and is written down to its recoverable amount.

Recoverable amount is the greater of value less costs to sell and value in use. It is determined for an individual asset, unless the asset's value in use cannot be estimated to be close to its fair value less costs to sell and it does not generate cash inflows that are largely independent of those from other assets or Empire Groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

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.

***Investments***

All investments are initially recognised at cost, being the fair value of the consideration given and including acquisition charges associated with the investment.

Certain investments in equity securities are classified as available-for-sale financial assets. Subsequent to initial recognition, they are measured at fair value and changes therein are recognised directly in equity. When an investment is derecognised, the cumulative gain or loss in equity is transferred to profit or loss.

For investments that are actively traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices at the close of business on the reporting date.

***Intangible Assets***

Intangible assets consist of a customer relationship agreement on acquisition of a business and is being amortised on a straight-line basis over 15 years.

***Interest-bearing liabilities***

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

***Provisions – Employee Benefits***

Obligations for contributions to accumulation plans are recognised as an expense in the consolidated statements of comprehensive income as incurred.

Liabilities for employee benefits for wages, salaries, annual leave and represent present obligations resulting from employees' services provided to reporting date, calculated at undiscounted amounts based on remuneration wage and salary rates that the Empire Group expects to pay as at the reporting date including related on-costs, such as, workers compensation insurance, superannuation and payroll tax.

## **NOTES TO THE FINANCIAL STATEMENTS**

### **for the year ended 31 December 2011**

#### **1. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

##### ***Asset Retirement Obligation***

The asset retirement obligation is recognised when the Empire Group has a present legal or constructive obligation as a result of past events, and it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount of obligation can be made. The present value of the estimated asset retirement costs is capitalised as part of the carrying amount oil and gas properties. For the Empire Group, asset retirement obligations primarily relate to the plugging and abandonment of oil and gas-producing facilities.

The estimated liability is based on historical experience in plugging and abandoning wells, estimated remaining lives of those based on reserve estimates, external estimates as to the cost to plug and abandon the wells in the future, and regulatory requirements. The liability is discounted using the US subsidiaries weighted average cost of capital as an approximate for a market-based discount rate. Revisions to the liability could occur due to changes in estimates of plugging and abandonment costs, remaining lives of the wells, if regulations enact new plugging and abandonment requirements, or there is a change in the market-based discount rate. Changes in the estimated timing of decommissioning or decommissions cost estimates are dealt with prospectively by recording an adjustment to the provision, and a corresponding adjustment to oil and gas properties. The unwinding of the discount of the asset retirement obligation is included as a finance cost.

##### ***Income tax***

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 provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation of settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at 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 reduced to the extent that it is no longer probable that the related tax benefit will be realised.

##### ***Tax consolidation***

The Empire Group and its wholly-owned Australian resident entities are part of a tax-consolidated Empire Group. As a consequence, all members of the tax-consolidated Empire Group are taxed as a single entity from 1 July 2003. The head entity within the tax-consolidated Empire Group is Empire Energy Group Limited.

Current tax expense/income, deferred tax liabilities and deferred tax assets arising from temporary differences of the members of the tax-consolidated Empire Group are recognised in the separate financial statements of the members of the tax-consolidated Empire Group using the 'separate taxpayer within Empire Group' approach by reference to the carrying amounts of assets and liabilities in the separate financial statements of each entity and the tax values applying under tax consolidation.

Any current tax liabilities (or assets) and deferred tax assets arising from unused tax losses of the subsidiaries are assumed by the head entity in the tax-consolidated Empire Group and are recognised by the Empire Group as amounts payable/(receivable) to/from other entities in the tax-consolidated Empire Group in conjunction with any tax funding arrangement amounts (refer below). Any difference between these amounts is recognised by the Empire Group as an equity contribution or distribution.

The Empire Group recognises deferred tax assets arising from unused tax losses of the tax consolidated Empire Group to the extent that it is probable that future taxable profits of the tax consolidated Empire Group will be available against which the asset can be utilised.

Any subsequent period adjustments to deferred tax assets arising from unused tax losses as a result of revised assessments of the probability of recoverability is recognised by the head entity only.

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 1. SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### ***Nature of tax funding arrangements and tax sharing arrangements***

The head entity, in conjunction with other members of the tax-consolidated Empire Group, has entered into a tax funding arrangement which sets out the funding obligations of members of the tax-consolidated Empire Group in respect of tax amounts. The tax funding arrangements require payments to/from the head entity equal to the current tax liability/(asset) assumed by the head entity and any tax-loss deferred tax asset assumed by the head entity, resulting in the head entity recognising an inter-entity receivable/(payable) equal in amount to the tax liability/(asset) assumed. The inter-entity receivables/(payables) are at call.

Contributions to fund the current tax liabilities are payable as per the tax funding arrangement and reflect the timing of the head entity's obligation to make payments for tax liabilities to the relevant tax authorities.

The head entity in conjunction with other members of the tax-consolidated Empire Group, has also entered into a tax sharing agreement. The tax sharing agreement provides for the determination of the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations. No amounts have been recognised in the financial statements in respect of this agreement as payment of any amounts under the tax sharing agreement is considered remote.

#### ***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 Australian Taxation Office (ATO). In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item 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 ATO is included as a current asset or liability in the Consolidated Statement of Financial Position.

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.

#### ***Share based payment transactions***

The Empire Group provides benefits to directors and senior executives of the Empire Group through the executive share option plan whereby eligible participants render services in exchange for options over shares. There has been no share based payment transactions during the year.

#### ***New Accounting Standards and Interpretations not yet adopted***

Australian Accounting Standards and Interpretations that have recently been issued or amended but are not yet mandatory, have not been early adopted by the consolidated entity for the annual reporting period ended 31 December 2011. The consolidated entity's assessment of the impact of these new or amended Accounting Standards and Interpretations, most relevant to the consolidated entity, are set out below.

#### ***AASB 9 Financial Instruments, 2009-011 Amendments to Australian Accounting Standards arising from AASB 9 and 2010-7 Amendments to Australian Accounting Standards arising from AASB 9***

This standard and its consequential amendments are applicable to annual reporting periods beginning on or after 1 January 2013 and completes phase 1 of the IASB's project to replace IAS 39 (being the international equivalent to AASB 139 'Financial Instruments: Recognition and Measurement'). This standard introduces new classification and measurement models for financial assets, using a single approach to determine whether a financial asset is measured at amortised cost or fair value. To be classified and measured to amortised cost, assets must satisfy the business model test for managing the financial assets and have certain contractual cash flow characteristics. All other financial instrument assets are to be classified and measured at fair value. This standard allows an irrevocable election on initial recognition to present gains and losses on equity instruments (that are not held-for-trading) in other comprehensive income, with dividends as a return on these investments being recognised in profit or loss. In addition, those equity instruments measured at fair value through other comprehensive income would no longer have to apply any impairment requirements nor would there be any 'recycling' of gains or losses through profit or loss on disposal.



## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 1. SIGNIFICANT ACCOUNTING POLICIES (Continued)

The accounting for financial liabilities continues to be classified and measured in accordance with AASB 139, with one exception, being that the portion of a change of fair value relating to the entity's own credit risk is to be presented in other comprehensive income unless it would create an accounting mismatch. The consolidated entity will adopt this standard from 1 January 2013 but the impact of its adoption is yet to be assessed by the consolidated entity.

#### *AASB 10 Consolidated Financial Statements*

This standard is applicable to annual reporting periods beginning on or after 1 January 2013. The standard has a new definition of 'control'. Control exists when the reporting entity is exposed, or has the rights, to variable returns (e.g. dividends, remuneration, returns that are not available to other interest holders including losses) from its involvement with another entity and has the ability to affect those returns through its 'power' over that other entity. A reporting entity has power when it has rights (e.g. voting rights, potential voting rights, rights to appoint key management, decision making rights, kick out rights) that give it the current ability to direct the activities that significantly affect the investee's return (e.g. Operating policies, capital decisions, appointment of key management). The consolidated entity will not only have to consider its holdings and rights but also the holdings and rights of other shareholders in order to determine whether it has the necessary power for consolidation purposes. The adoption of this standard from 1 January 2013 may have an impact where the consolidated entity has a holding of less than 50% in an entity, has de facto control, and is not currently consolidating that entity.

#### *AASB 11 Joint Arrangements*

This standard is applicable to annual reporting periods on or after 1 January 2013. The standard defines which entities qualify as joint ventures and removes the option to account for joint ventures using proportional consolidation. Joint ventures, where the parties to the agreement have the rights to the assets and obligations for accounting. Joint operations, where the parties to the agreements have the rights to the assets and obligations for the liabilities will account for the assets, liabilities, revenues and expenses separately, using proportionate consolidation. The adoption of this standard from 1 January 2013 will not have a material impact on the consolidated entity.

#### *AASB 12 Disclosure of Interests in Other Entities*

This standard is applicable to annual reporting periods beginning on or after 1 January 2013. It contains the entire disclosure requirement associated with other entities, being subsidiaries, associates and joint ventures. The disclosure requirements have been significantly enhanced when compared to the disclosures previously located in AASB 127 'Consolidated and Separate Financial Statements', AASB 128 'Investments in Associates', AASB 131 'Interests in Joint Ventures' and Interpretation 112 'Consolidation – Special Purpose Entities'. The adoption of this standard from 1 January 2013 will significantly increase the amount of disclosures required to be given by the consolidated entity such as significant judgements and assumptions made in determining whether it has a controlling or non-controlling interest in another entity and the type of non-controlling interest and the nature and risks involved.

#### *AASB 13 Fair Value Management and AASB 2011-8 Amendments to Australian Accounting Standards arising from AASB 13*

This standard and its consequential amendments are applicable to annual reporting periods beginning on or after 1 January 2013. The standard provides a single robust measurement framework, with clear measurement objectives, for measuring fair value using the 'exit price' and it provides guidance on measuring fair value when a market becomes less active. The 'highest and best use' approach would be used to measure assets whereas liabilities would be based on transfer value. As the standard does not introduce any new requirements for the use of fair value, its impact on adoption by the consolidated entity from 1 January 2013 should be minimal, although there will be increased disclosures where fair value is used.

#### *AASB 127 Separate Financial Statements (Revised)*

#### *AASB 128 Investments in Associates and Joint Ventures (Reissued)*

These standards are applicable to annual reporting periods beginning on or after 1 January 2013. They have been modified to remove specific guidance that is now contained in AASB 10, AASB 11 and AASB 12. The adoption of these revised standards from 1 January 2013 will not have a material impact on the consolidated entity.

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 1. SIGNIFICANT ACCOUNTING POLICIES (Continued)

#### *AASB 119 Employee Benefits (September 2011)*

This revised standard is applicable to annual reporting periods beginning on or after 1 January 2013. The amendments eliminate the corridor approach for the deferral of gains and losses; streamlines the presentation of changes in assets and liabilities arising from defined benefit plans, including requiring remeasurements to be presented in other comprehensive income; and enhances the disclosure requirements for defined benefit plans. The adoption of the revised standard from 1 January 2013 will require increased disclosures by the consolidated entity.

#### *AASB 1054 Australian Additional Disclosures*

This Standard is applicable to annual reporting periods beginning on or after 1 July 2011. The standard sets out the Australian-specific disclosures, which are in addition to International Financial Reporting Standards, for entities that have adopted Australian Accounting Standards. The adoption of these amendments from 1 January 2012 will not have a material impact on the consolidated entity.

#### *AASB 2011-1 Amendments to Australian Accounting Standards arising from the Trans-Tasman Convergence Project*

These amendments are applicable to annual reporting periods beginning on or after 1 July 2011. They make changes to a range of Australian Accounting Standards and Interpretations for the purpose of closer alignment to IFRSs and harmonisation between Australian and New Zealand Standards. The amendments remove certain guidance and definitions from Australian Accounting Standards for conformity of drafting with IFRS but without any intention to change requirements. The adoption of these amendments from 1 January 2012 will not have a material impact on the consolidated entity.

#### *AASB 2011-4 Amendments to Australian Accounting Standards to Remove Individual Key Management Personnel Disclosure Requirement*

These amendments are applicable to annual reporting periods beginning on or after 1 July 2013, with early adoption not permitted. They amend AASB 124 'Related Party Disclosures' by removing the disclosure requirements for individual key management personnel ('KMP'). The adoption of these amendments from 1 January 2014 will remove the duplication of information relating to individual KMP in the notes to the financial statements and the directors report. As the aggregate disclosures are still required by AASB 124 and during the transitional period the requirements may be included in the Corporations Act or other legislation, it is expected that the amendments will not have a material impact on the consolidated entity.

#### *AASB 2011-7 Amendments to Australian Accounting Standards arising from the Consolidation and Joint Arrangements Standards*

The amendments are applicable to annual reporting periods beginning on or after 1 January 2013. The amendments make numerous consequential changes to a range of Australian Accounting Standards and Interpretations, following the issuance of AASB 10, AASB 11, AASB 12 and revised AASB 17 and AASB 128. The adoption of these amendments from 1 January 2013 will not have a material impact on the consolidated entity.

#### *AASB 2011-9 Amendments to Australian Accounting Standards – Presentation of Items of Other Comprehensive Income*

These amendments are applicable to annual reporting periods beginning on or after 1 July 2012. The amendments requires grouping together of items within other comprehensive income on the basis of whether they will eventually be 'recycled' to the profit or loss (reclassification adjustments). The change provides clarity about the nature of items presented as other comprehensive income and the related tax presentation. The adoption of the revised standard from 1 January 2013 will impact the consolidated entity's presentation of its statement of comprehensive income.

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 2 CRITICAL ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS

In preparing the Empire Group's consolidated financial statements, Management are required to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities and recognised contingent liabilities at the end of the reporting period and amounts of revenues and expenses recognised during the reporting period. Estimates and judgments are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, uncertainty about these assumptions and estimates could result in outcomes that require a material adjustment to the carrying amount of the asset or liability in future periods.

#### *Estimates and assumptions*

In particular, information about significant areas of estimation uncertainty considered by management in preparing the consolidated financial statements are described in the following notes:

- Note 8 – Impairment expense
- Note 9 – Income tax
- Note 14 – Oil and gas properties
- Note 19 – Provisions for liabilities and charges

#### *Judgments*

In the process of applying the Empire Group's accounting policies, the Directors have made the following judgments apart from those involving estimates, which may have the most significant effect on the amounts recognised in the consolidated financial statements:

#### *Reserves base*

Estimates of recoverable quantities of proven, probable and possible reserves reported include judgmental assumptions regarding commodity prices, exchange rates, discount rates and production and transportation costs for future cash flows. It also requires interpretation of complex and difficult geological and geophysical models in order to make assessment of the size, shape, depth and quality of reservoirs, and their anticipated recoveries. The economic, geological and technical factors used to estimate may change from period to period. Changes in reported reserves can impact asset carrying values and the recognition of deferred tax assets due to changes in expected future cash flows. Reserves are integral to the amount of amortisation charged to the income statement. Future development costs are estimated using assumptions as to the number of wells required to produce the commercial reserves, the cost of such wells and associated production and other capital costs. The current NYMEX forward oil and gas price curves are used for price assumptions. The Empire Group uses suitably qualified persons to prepare annual evaluation of proven hydrocarbon reserves, compliant with US professional standards for petroleum engineers.

#### *Carrying value of oil and gas assets*

Oil and gas properties are depreciated using the units-of-production (UOP) method over proved developed and undeveloped reserves.

The calculation of the UOP rate of depreciation, depletion and amortisation could be impacted to the extent that actual production in the future is different from current forecast production based on proved reserves. This would generally result from significant changes in any of the factors or assumptions used in estimating reserves. Estimates of gas reserve quantities provide the basis for calculation of depletion, depreciation and amortisation and impairment, each of which represents a significant component of the consolidated financial statements.

These factors could include changes in proved reserves, the effect on proved reserves of differences between actual commodity prices and commodity price assumptions, and unforeseen operational issues

#### *Impairment indicators*

The fair value of oil and gas properties is determined with reference to estimates of recoverable quantities of reserves (as outlined above) to determine the estimated future cash flows. An impairment loss is recognised for the amount by which the asset or Empire Group of assets carrying value exceeds the present value of its future cash flows. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash inflows which are largely independent of the cash inflows from other assets or groups of assets (cash generating units).

**NOTES TO THE FINANCIAL STATEMENTS**  
**for the year ended 31 December 2011****2 CRITICAL ACCOUNTING JUDGMENTS, ESTIMATES AND ASSUMPTIONS (Continued)***Asset retirement obligations*

Asset retirement costs will be incurred by the Empire Group at the end of the operating life of some of Empire Group's facilities and properties. The ultimate asset retirement costs are uncertain and cost estimates can vary in response to many factors including changes to relevant legal requirements, the emergence of new restoration techniques or experience at other production sites. The expected timing and amount of expenditure can also change, for example, in response to changes in reserves or changes in laws and regulations or their interpretation. As a result, there could be significant adjustments to the provisions established which would affect future financial results.

**3 GOING CONCERN**

The consolidated financial statements have been prepared on a going concern basis, which contemplates the realisation of assets and settlement of liabilities in the ordinary course of business.

The Empire Group's Statement of Financial Position reflects an excess of current liabilities over current assets of \$43,556,047. This is primarily due to the Debt facilities being classified as a current liability on as described in Note 18. Further, the debt facilities are due to expire in February 2013 and the Directors are currently considering their options, including extending the facilities which the Director's believe is highly likely.

There is an inherent uncertainty as to whether the facilities can be refinanced or extended.

This material uncertainty may cast significant doubt as to the Empire Group's ability to continue as a going concern. The ongoing operations of the Empire Group is dependent upon the successful refinancing or extension of the existing debt facilities.

In the event that the Empire Group does not refinance or extend the terms of the debt facilities, it may not be able to continue its operations as a going concern and therefore may not be able to realise its assets and extinguish its liabilities in the ordinary course of operations and at the amounts stated in the Financial Statements.

**4 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES**

The Empire Group's principal financial instruments, other than derivatives comprise bank loans, available for sale financial assets, and cash and cash equivalents. The main purpose of these financial instruments is to raise finance for the Empire Group's operations. The Empire Group has various other financial assets and liabilities such as trade receivables and payables, which arise from its operations. The Empire Group also enters derivative transactions, principally interest rate swaps and commodity hedges.

The board has overall responsibility for the determination of the Empire Group's risk management objectives and policies and has the responsibility for designing and operating processes that ensure the effective implementation of the objectives and policies to the Empire Group's finance function. The board receives monthly reports through which it reviews the effectiveness of the processes put in place and appropriateness of the objectives and policies it sets. The overall objective of the board is to set policies that seek to reduce risk as far as possible without unduly affecting the Empire Group's competitiveness and flexibility.

The Empire Group is exposed to risks that arise from its use of financial instruments. The main risks arising from the Empire Group's financial instruments are interest rate risk, foreign exchange risk, commodity price risk, liquidity risk, currency risk, equity risk, and credit risk. This note describes the Empire Group's objectives, policies and processes for managing those risks and methods used to measure them. Further quantitative information in respect of these risks is presented throughout these financial statements.

There have been no substantive changes in the Empire Group's exposure to financial instrument risks, its objectives, policies and processes for managing those risks or the methods used to measure them from previous periods unless otherwise stated in this note.

Further details regarding these policies are set out below:

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 4 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

#### (A) MARKET RISK

##### (i) *Foreign Exchange Risk*

The Empire Group's core operations are located in the United States where both revenues and expenditures are recorded. The Statement of Financial Position can be affected by movement in the US\$/A\$ exchange rates upon translation of the A\$ operations into the US\$ presentation currency.

Foreign exchange risk arises from commercial transactions and recognised assets and liabilities denominated in a currency that is not the entity's functional currency. The Empire Group seeks to mitigate the effect of its foreign currency exposure by borrowing in US\$ for US operations and maintaining a minimum cash balance in Australia.

Excluding presentation translation adjustments, the Empire Group's exposure to foreign exchange risk at the reporting date is limited to loans and investments between the Parent entity and the US subsidiaries.

##### (ii) *Commodity Price Risk*

The Empire Group's revenues and cash flows are exposed to commodity price fluctuations, in particular oil and gas prices. The Empire Group enters forward commodity hedges to manage its exposure to falling spot oil and gas prices. To mitigate a portion of the exposure to adverse market changes, the Empire Group's commodity hedging programs utilise financial instruments based on regional benchmarks including Nymex WTI for oil and NYMEX Natural Gas Henry Hub for gas.

The Empire Group enters into derivative instruments for the Empire Group's production to protect against price declines in future periods while retaining some of the benefits of price increases. While these derivatives are structured to reduce exposure to changes in price associated with the derivative commodity, they also limit benefits the Empire Group might otherwise have received from price changes in the physical market. The Empire Group believes the derivative instruments in place continue to be effective in achieving the risk management objectives for which they were intended.

The Empire Group's policy is to maintain a balance between spot and hedged sales, with not more than 75% of production being hedged at any point in time. For the year ended 31 December 2011 the Empire Group hedged approximately 74% of its oil (2010:75%) and 85% of its total gas production (2010: 72%).

The Empire Group has approximately 150,000 thousand cubic feet (mcf) of monthly natural gas production and 9,000 barrels of oil production hedged at amounts ranging from \$4.77 to \$8.15/mcf for natural gas expiring in January 2013 through November 2015 and \$90 per barrel for oil through December 2015.

##### (iii) *Interest rate risk*

The Empire Group is constantly monitoring its exposure to trends and fluctuations in interest rates in order to manage interest rate risk. The Empire Groups exposure to interest rate risk at 31 December 2010 is set out in the following tables:

The Empire Group's exposure to the risk of changes in market interest rates relates primarily to the Empire Group's long-term debt obligations with a floating interest rate in the US. The Empire Group manages its interest cost using a mix of fixed and variable rate debt. The Empire Group's policy is to maintain a portion of its US\$ Borrowings at fixed rates of interest. To manage this mix in a cost-efficient manner, the Empire Group enters into interest rate swaps, in which the Empire Group agrees to exchange, at specified intervals, the difference between fixed and variable interest rate amounts calculated by reference to an agreed upon notional principal amount. These swaps are designated to hedge underlying debt obligations.

## NOTES TO THE FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 4 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

The Empire Group monitors forecasts and actual cash flows and the maturity profiles of financial assets and liabilities to manage its liquidity risk.

	%	Floating Interest Rate	Fixed Interest Maturing in		Non-Interest Bearing	Total
			1 Year or Less	Over 1 to 5 Years		
<b>31 December 2011</b>						
<b>Financial Assets</b>						
Cash and cash equivalents	2.93%	4,448,495	-	-	-	4,448,495
Trade and other receivables		-	-	-	5,994,939	5,994,939
Financial assets		-	-	-	11,185,997	11,185,997
		4,448,495	-	-	17,180,936	21,629,431
<b>Financial Liabilities</b>						
Trade & Other Payables		-	-	-	4,161,263	4,161,263
Financial liabilities, including derivatives		-	-	-	2,365,876	2,365,876
Interest-bearing liabilities	5.43%	-	53,896,869	54,806	-	53,951,675
		-	53,896,869	54,806	6,527,139	60,478,814

	%	Floating Interest Rate	Fixed Interest Maturing in		Non-Interest Bearing	Total
			1 Year or Less	Over 1 to 5 Years		
<b>31 December 2010</b>						
<b>Financial Assets</b>						
Cash and cash equivalents	4.30%	2,665,474	-	-	-	2,665,474
Trade and other receivables		-	-	-	3,886,723	3,886,723
Financial assets		-	-	-	5,968,502	5,968,502
		2,665,474	-	-	99,855,225	12,520,699
<b>Financial Liabilities</b>						
Trade & Other Payables		-	-	-	4,447,851	4,447,851
Financial liabilities, including derivatives		-	-	-	3,229,437	3,229,437
Interest-bearing liabilities	4.30%	-	67,719,342	69,234	-	67,788,576
		-	67,719,342	69,234	7,677,288	75,465,864

#### (iv) Empire Group Sensitivity

Based on the financial instruments held at 31 December 2011 had the WTI Nymex and Henry Hub prices increase/decreased by 10% and 10% respectively, with all other variables held constant, the Empire Group's post-tax profit for the year would not change in the year due to the extent of effective hedging of oil and gas production. Equity would not have changed under either scenario.

The directors do not expect any reduction in interest rates during 2012. Should interest rates increase by 1% the impact on post-tax profit would be a decrease of approximately US\$ 540,000.

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 4 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

#### (B) CREDIT RISK

Credit risk is the risk that the other party to the financial instrument will fail to discharge their financial obligation in respect of that instrument resulting in the Empire Group incurring a financial loss. The Empire Group's exposure to credit risk arises from potential default of the counter party with the maximum exposure equal to the carrying amount of these instruments. There are no significant concentrations of credit risk within the Empire Group.

The Empire Group trades only with recognised, credit worthy third parties. In the US, trade receivables, (balances with oil and gas purchases) have not exposed the Empire Group to any bad debt to date. All derivatives are with the same counterparty.

In the US, all of the purchasers that the Empire Group's operators choose to deal with are major oil companies.

Trade and other receivable balances are monitored on an ongoing basis with the Empire Group's exposure to bad debts minimal.

The maximum exposure to credit risk at balance date is as follows:

	2011 US\$	2010 US\$
Trade, other receivables, and derivatives	15,844,543	8,880,093

The maximum exposure to credit risk at balance by country is as follows:

	2011 US\$	2010 US\$
Australia	228,004	220,373
United States of America	15,616,539	8,659,720

#### (C) LIQUIDITY RISK

Liquidity risk is the inability to access funds, both anticipated and unforeseen, which may lead to the Empire Group being unable to meet its obligations in an orderly manner as they arise.

The Empire Group's liquidity position is managed to ensure sufficient funds are available to meet financial commitments in a timely and cost-effective manner. The Empire Group is primarily funded through on-going cash flow, debt funding and equity capital raisings, as and when required.

Funding is in place with reputable financial institutions in the US and Australia. The borrowing base is re-determined and reviewed once a year. Bank compliance reporting is undertaken quarterly and adherence to covenants checked regularly. Management also regularly monitors actual and forecast cash flows to manage liquidity risk.

Maturity Analysis	Fair Value US\$	Carrying Amount US\$	Contractual Cash flows US\$	1 year US\$	1-3 years US\$
<b>31 December 2011</b>					
<b>Non Derivatives</b>					
<b>Current</b>					
Trade and other payables	4,161,263	4,161,263	4,161,263	4,161,263	-
Interest bearing liabilities	53,896,869	53,896,869	58,313,578	58,313,578	-
<b>Non-current</b>					
Interest bearing liabilities	54,806	54,806	54,806	-	54,806
<b>Derivatives</b>					
Cashflow hedge asset	(10,267,281)	(10,267,281)	(10,267,281)	(4,243,779)	(6,023,502)
Cashflow hedge liability	2,231,825	2,231,825	2,231,825	1,095,435	1,136,390
Interest rate swap liability	134,051	134,501	134,051	134,051	-

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 4 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

Maturity Analysis	Fair Value US\$	Carrying Amount US\$	Contractual Cash flows US\$	1 year US\$	1-3 years US\$
<b>31 December 2010</b>					
<b>Non Derivatives</b>					
Current					
Trade and other payables	5,490,851	5,490,851	5,490,851	5,490,851	-
Interest bearing liabilities	67,719,342	67,719,342	73,035,278	73,035,278	-
Non-current					
Interest bearing liabilities	69,234	69,234	69,234	-	69,234
<b>Derivatives</b>					
Cashflow hedge asset	(5,036,772)	(5,036,772)	(5,036,772)	(2,084,247)	(2,952,525)
Cashflow hedge liability	3,058,228	3,058,228	3,058,228	521,377	2,536,851
Interest rate swap liability	171,209	171,209	171,209	171,209	-

### (D) EQUITY RISK

The Empire Group is exposed to equity securities price risk arising from investments held by the Empire Group which are classified as available for sale assets. Investments in equity securities are managed by the full Board. A formal risk management policy over investments has not yet been developed as it is considered a minor risk to the Empire Group.

The Empire Group relies on equity markets to raise capital for its exploration and development activities, and is thus exposed to equity market volatility.

In addition, the Empire Group in consultation with its professional advisers, undertakes limited investment in listed and seed capital opportunities. The following summarises current listed and unlisted investments:

Investments	2011 US\$	2010 US\$
<b>Listed Companies</b>		
Earth Heat Resources	76,374	118,455
Central Rand Gold	6,924	13,720
Shaw River Resources	180,330	410,123
Peel Exploration Limited	599,102	264,492
Viking Ashanti Limited	8,379	29,066
Aphrodite Gold Limited	47,606	69,871
<b>Unlisted Companies</b>		
Arrcon Group	-	26,004

Unlisted investments are held at cost less impairment as no market valuation is available.

Equity price risk arises from investments in equity securities and Empire Energy Group Limited's issued capital.

The Company's equity risk is considered minimal and as such no sensitivity analysis has been completed.

### Fair Value of Financial Assets and Liabilities

The fair value of all monetary financial assets and liabilities of Empire Energy Group Limited approximate their carrying value there were no off-balance financial assets and liabilities at year end.



## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 4 FINANCIAL RISK MANAGEMENT OBJECTIVES AND POLICIES (Continued)

#### Fair value of financial instruments

The Empire Group is required to classify financial instruments, measured at fair value, using a three level hierarchy, being:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices); and
- Level 3: Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

An instrument is required to be classified in its entirety on the basis of the lowest level of valuation inputs that is significant to fair value. Considerable judgement is required to determine what is significant to fair value and therefore which category the financial instrument is placed in can be subjective.

The fair value of financial instruments classified as level 3 is determined by the use of valuation models. These include discounted cash flow analysis or the use of observable inputs that require significant adjustments based on unobservable inputs.

<b>Consolidated 31 December 2011</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets</b>				
Available-for-sale – equity securities	918,716	-	-	918,716
Cash flow hedge	-	10,267,281	-	10,267,281
<b>Total assets</b>	<b>918,716</b>	<b>10,267,281</b>	<b>-</b>	<b>11,185,997</b>
<b>Liabilities</b>				
Cash flow hedge and interest rate swap	-	2,365,876	-	2,365,876
<b>Total liabilities</b>	<b>-</b>	<b>2,365,876</b>	<b>-</b>	<b>2,365,876</b>

<b>Consolidated 31 December 2010</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets</b>				
Available-for-sale – equity securities	905,726	-	-	905,726
Cash flow hedge	-	5,036,772	-	5,036,772
<b>Total assets</b>	<b>905,726</b>	<b>5,036,772</b>	<b>-</b>	<b>5,942,498</b>
<b>Liabilities</b>				
Cash flow hedge and interest rate swap	-	3,229,437	-	3,229,437
<b>Total liabilities</b>	<b>-</b>	<b>3,229,437</b>	<b>-</b>	<b>3,229,437</b>

There were no transfers between levels during the financial year.

#### Capital Risk Management

The Company considers its capital to comprise its ordinary share capital and reserves.

In managing its capital, the Company's primary objective is to maintain a sufficient funding base to enable the Company to meet its working capital and strategic investment needs.

In making decisions to adjust its capital structure to achieve these aims, either through altering its dividend policy, new share issues, or consideration of debt the Company considers not only its short-term position but also its long-term operational and strategic objectives.

## NOTES TO THE FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 5 REVENUE

	2011 US\$	2010 US\$
Revenue from oil and gas sales	27,163,406	11,244,826
Revenue from drilling operations	66,597	280,932
Revenue from well operations	4,644,664	1,740,052
	<u>31,874,667</u>	<u>13,265,810</u>

#### 6 GAIN FROM SALE OF ACREAGE

Gain from the sale of acreage	1,092,250	-
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On 30 June 2010, the Empire Group sold its interest in oil and gas leaseholds in 5,897 acres for \$25,708,374, located in the Marcellus Shale formations. A gain of \$23,512,829 was recognised for the 5,897 acres for the year-ended 30 June 2010. On 1 July 2010, the Empire Group received \$24,616,124 in connection with the sale. The difference of \$1,092,250 represents payment for an additional 257 acres for which the Empire Group delivered clear title in 2011. The gain from the sale of the 257 acres, which amounted to \$1,092,250 has been recognised in the year ended 31 December 2011.

#### 7 FINANCE COSTS

Interest paid/payable on financial liabilities	3,568,690	1,605,010
Interest paid/payable to related parties	12,031	3,850
Accretion of asset retirement obligation	503,388	210,686
Unwind of discount on debt	2,355,234	400,548
Unwind of overriding royalty interest	653,879	-
	<u>7,093,222</u>	<u>2,220,094</u>

#### 8 EXPENSES

Profit/(loss) before income tax includes the following specific expenses:

##### *Employee benefits expense*

Defined contribution superannuation expense	45,932	(8,630)
Other employee expenses	3,859,224	2,127,526
Total employee benefits expense	<u>3,905,156</u>	<u>2,118,896</u>

##### *Impairment expense*

Impairment of available-for-sale financial assets	142,612	58,695
Impairment of property, plant & equipment <sup>(a)</sup>	133,347	-
Total impairment expense	<u>275,959</u>	<u>58,695</u>

##### **(a) Impairment expense**

The Empire Group has impaired the gas drilling rig by \$133,347 down to the estimated fair value less costs to sell. The fair value was based on advertised prices of similar equipment. The asset is included in the Oil & Gas segment as per Note 25.

## NOTES TO THE FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 9 INCOME TAX

	2011 US\$	2010 US\$
<b>a. Income tax expense</b>		
Current tax	468,598	(5,718,822)
Deferred tax	598,646	4,269,354
Adjustments for current tax of prior periods	553,871	-
<b>Income tax expense/(benefit) attributable to continuing operations</b>	<b>1,621,115</b>	<b>(1,449,468)</b>
Deferred income tax expense included in income tax expense comprises:		
Decrease/(increase) in deferred tax assets (note 9(g))	-	-
(Decrease)/increase in deferred tax liabilities (note 9(f))	598,646	4,269,354
	598,646	4,269,354
<b>b. Numerical reconciliation of income tax expense to prima facie tax payable</b>		
Profit/(loss) before income tax	184,315	(1,062,378)
Tax at the Australian tax rate of 30% (2010: 30%)	55,295	(318,713)
Tax effect of amounts which are not deductible/(taxable) in calculating taxable income:		
- Income tax not assessable	(21,403)	(884,478)
- Non-deductible expenses	658,565	1,052,988
- Other deductible expenses	66,960	(5,151)
Difference in overseas tax rates	75,994	322,266
Deferred tax asset in relation to timing differences (recouped)/ not recognised	38,723	(1,616,380)
Benefit of tax and capital losses recouped not previously recognised		
Tax underprovided in prior year	553,871	-
State taxes paid or payable	(63,049)	-
Withholding tax paid	317,243	-
Deferred tax asset in relation to tax losses not recognised	(61,084)	-
<b>Income tax expense/(benefit)</b>	<b>1,621,115</b>	<b>(1,449,468)</b>
<b>c. Tax expense (income) relating to items of other comprehensive income</b>		
Cash flow hedges	9(h) 2,742,331	(789,850)
<b>d. Deferred tax assets not recognised relate to the following:</b>		
Tax losses	2,618,079	2,834,904
Capital losses	164,638	
	2,782,717	2,834,904

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 9 INCOME TAX (Continued)

The potential benefit of the deferred tax asset attributable to tax losses will only be obtained if:

- (i) the consolidated entity derives future assessable income of a nature and of an amount sufficient to enable the benefit from the deduction for the loss to be realised; or
- (ii) the consolidated entity continues to comply with the conditions for deductibility imposed by the law; and
- (iii) no changes in tax legislation adversely affect the consolidated entity in realising the asset.

#### e. Dividend Franking Account

There are no franking account credits available as at 31 December 2011.

#### f. Deferred tax liabilities

The balance comprises temporary differences attributable to:

Cash flow hedges	2,742,331	-
Oil & Gas and Property, Plant & Equipment	5,495,770	5,441,126
	8,238,101	5,441,126
Set-off of deferred tax liabilities pursuant to set-off provisions (note g)	(627,770)	(1,960,976)
Net deferred tax liabilities	7,610,331	3,480,150

#### g. Deferred tax assets

The balance comprises temporary differences attributable to:

Cash flow hedges	-	789,850
Accrued interest	80,747	912,791
Accrued asset retirement obligation	446,267	252,750
State taxes offset	98,012	-
Other	2,744	5,585
	627,770	1,960,976
Set-off of deferred tax assets pursuant to set-off provisions (note g)	(627,770)	(1,960,976)
Net deferred tax assets	-	-

#### h. Movements in temporary differences in the period:

The movements in the above temporary differences are all recognised in the Profit or Loss with the exception of the movement in the cash flow hedges. The movement is reconciled as follows:

Opening balance	(789,850)	-
Charged/(credited):		
- to profit or loss	-	-
- to other comprehensive income	3,532,181	(789,850)
Closing balance	2,742,331	(789,850)

## NOTES TO THE FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 10 TRADE AND OTHER RECEIVABLES

	2011 US\$	2010 US\$
<b>Current</b>		
Trade receivables	5,349,258	3,599,279
Other	228,004	218,038
	5,577,262	3,817,317

#### 11 PREPAYMENTS AND OTHER CURRENT ASSETS

Prepayments	417,677	69,406
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#### 12 INVENTORIES

Crude oil and production supplies	585,822	649,330
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#### 13 FINANCIAL ASSETS, INCLUDING DERIVATIVES

##### Current

Oil and gas price forward contracts	4,243,779	2,084,247
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##### Non-current

Oil and gas forward price contracts	6,023,502	2,952,525
Shares – other corporations:		
• Listed available-for-sale equities (at fair value)	918,716	905,726
• Unlisted available-for-sale equities (at cost)	156,041	131,501
Less: accumulated impairment on unlisted equities	(156,041)	(105,497)
<b>Total Non-current</b>	6,942,218	3,884,255

**NOTES TO THE FINANCIAL STATEMENTS**  
**for the year ended 31 December 2011**

Commodity hedge contracts outstanding are outlined below.

<b>2011 NATURAL GAS - HENRY HUB - NYMEX - Swaps</b>					<b>2010 NATURAL GAS - HENRY HUB - NYMEX - Swaps</b>				
<b>Period</b>	<b>Swap Price</b>	<b>Premiu m</b>	<b>Product</b>		<b>Period</b>	<b>Swap Price</b>	<b>Premiu m</b>	<b>Product</b>	
Jan 12 - Dec 12	8.00	\$Nil	72,000	mmbtu	Jan 11 - Dec 11	8.00	\$Nil	72,000	mmbtu
					Jan 12 - Dec 12	8.00	\$Nil	66,000	mmbtu
Jan 12 - Dec 12	6.00	\$Nil	30,000	mmbtu	Jan 11 - Dec 11	6.00	\$Nil	60,000	mmbtu
					Jan 12 - Dec 12	6.00	\$Nil	25,000	mmbtu
Jan 12 - Dec 12	6.15	\$Nil	275,089	mmbtu	Jan 11 - Dec 11	6.15	\$Nil	296,907	mmbtu
Jan 13 - Dec 13	6.15	\$Nil	255,179	mmbtu	Jan 12 - Dec 12	6.15	\$Nil	273,302	mmbtu
Jan 14 - Dec 14	6.15	\$Nil	238,372	mmbtu	Jan 13 - Dec 13	6.15	\$Nil	253,671	mmbtu
					Jan 14 - Dec 14	6.15	\$Nil	217,901	mmbtu
Jan 12 - Dec 12	6.21	\$Nil	275,089	mmbtu	Jan 11 - Dec 11	6.21	\$Nil	296,907	mmbtu
Jan 13 - Dec 13	6.21	\$Nil	255,179	mmbtu	Jan 12 - Dec 12	6.21	\$Nil	273,302	mmbtu
Jan 14 - Dec 14	6.21	\$Nil	238,372	mmbtu	Jan 13 - Dec 13	6.21	\$Nil	253,671	mmbtu
					Jan 14 - Dec 14	6.21	\$Nil	217,901	mmbtu
Jan 12 - Dec 12	6.15	\$Nil	275,089	mmbtu	Jan 11 - Dec 11	6.15	\$Nil	296,907	mmbtu
Jan 13 - Dec 13	6.15	\$Nil	255,179	mmbtu	Jan 12 - Dec 12	6.15	\$Nil	273,302	mmbtu
Jan 14 - Dec 14	6.15	\$Nil	238,372	mmbtu	Jan 13 - Dec 13	6.15	\$Nil	253,671	mmbtu
					Jan 14 - Dec 14	6.15	\$Nil	217,901	mmbtu
Jan 12 - Dec 12	6.26	\$Nil	275,089	mmbtu	Jan 11 - Dec 11	6.26	\$Nil	296,907	mmbtu
Jan 13 - Dec 13	6.26	\$Nil	255,179	mmbtu	Jan 12 - Dec 12	6.26	\$Nil	273,302	mmbtu
Jan 14 - Dec 14	6.26	\$Nil	238,372	mmbtu	Jan 13 - Dec 13	6.26	\$Nil	253,671	mmbtu
					Jan 14 - Dec 14	6.26	\$Nil	217,901	mmbtu
Jan 12 - Dec 12	6.30	\$Nil	84,000	mmbtu	Jan 11 - Dec 11	6.30	\$Nil	70,000	mmbtu
Jan 13 - Dec 13	6.30	\$Nil	76,000	mmbtu	Jan 12 - Dec 12	6.30	\$Nil	84,000	mmbtu
					Jan 13 - Dec 13	6.30	\$Nil	74,000	mmbtu
Jan 12 - Dec 12	4.77	\$Nil	198,000	mmbtu	Jan 11 - Dec 11	4.77	\$Nil	184,000	mmbtu
Jan 13 - Dec 13	5.08	\$Nil	247,000	mmbtu	Jan 12 - Dec 12	4.77	\$Nil	198,000	mmbtu
Jan 14 - Dec 14	5.27	\$Nil	217,000	mmbtu	Jan 13 - Dec 13	5.08	\$Nil	250,000	mmbtu
Jan 15 - Dec 15	5.45	\$Nil	1,116,000	mmbtu	Jan 14 - Dec 14	5.27	\$Nil	291,000	mmbtu
					Jan 15 - Dec 15	5.45	\$Nil	1,023,000	mmbtu
Jan 13 - Dec 13	5.08	\$Nil	55,000	mmbtu	Jan 13 - Dec 13	5.08	\$Nil	60,000	mmbtu
Jan 14 - Dec 14	5.27	\$Nil	159,000	mmbtu	Jan 14 - Dec 14	5.27	\$Nil	167,000	mmbtu
Jan 15 - Dec 15	5.45	\$Nil	156,000	mmbtu	Jan 15 - Dec 15	5.45	\$Nil	143,000	mmbtu
<b>2011 OIL - WTI - NYMEX</b>					<b>2010 OIL - WTI - NYMEX</b>				
Jan 12 - Dec 12	90.00	\$Nil	120,800	BO	Jan 11 - Dec 11	90.00	\$Nil	131,870	BO
Jan 13 - Dec 13	90.00	\$Nil	113,160	BO	Jan 12 - Dec 12	90.00	\$Nil	120,800	BO
Jan 14 - Dec 14	90.00	\$Nil	105,120	BO	Jan 13 - Dec 13	90.00	\$Nil	113,160	BO
Jan 15 - Dec 15	90.00	\$Nil	98,160	BO	Jan 14 - Dec 14	90.00	\$Nil	105,120	BO
					Jan 15 - Dec 15	90.00	\$Nil	98,160	BO

## NOTES TO THE FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 14 OIL AND GAS PROPERTIES AND PROPERTY PLANT & EQUIPMENT

Note	Oil & Gas	Land	Buildings	Equipment	Motor Vehicles	Total
<b>Cost in US\$</b>						
At 1 January 2011	106,938,571	2,019,925	244,644	985,976	1,434,004	111,623,120
Additions	2,755,266	36,430	-	418,415	23,243	3,233,354
Write-off of asset retirement obligation	(50,717)	-	-	-	-	(50,717)
Disposals	-	-	-	(304,285)	(775,546)	(1,079,831)
Write-off of exploration expense	(471,265)	-	-	(5,101)	-	(476,366)
Transfers	(369,226)	-	59,565	279,806	29,855	-
Transfers to inventory	(350,151)	-	-	-	-	(350,151)
At 31 December 2011	108,452,478	2,056,355	304,209	1,374,811	711,556	112,899,409
<b>Accumulated Depreciation in US\$</b>						
At 1 January 2011	(7,360,152)	-	(8,660)	(546,482)	(552,373)	(8,467,667)
Depreciation and depletion	(4,631,840)	-	(7,557)	(136,955)	(232,525)	(5,008,877)
Disposals	-	-	-	313,452	699,707	1,013,159
Impairment	-	-	-	-	(133,347)	(133,347)
At 31 December 2011	(11,991,992)	-	(16,217)	(369,985)	(218,538)	(12,596,732)
<b>Opening written down value</b>	<b>99,578,419</b>	<b>2,019,925</b>	<b>235,984</b>	<b>439,493</b>	<b>881,631</b>	<b>103,155,452</b>
<b>Impact of foreign currency adjustments</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>7</b>	<b>191</b>	<b>198</b>
<b>Closing written down value</b>	<b>96,460,487</b>	<b>2,056,355</b>	<b>287,992</b>	<b>1,004,833</b>	<b>493,209</b>	<b>100,302,875</b>

## NOTES TO THE FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 14 OIL AND GAS PROPERTIES AND PROPERTY PLANT & EQUIPMENT (continued)

	Note	Oil & Gas	Land	Buildings	Equipment	Motor Vehicles	Total
<b>Cost in US\$</b>							
At 1 July 2010		53,964,369	1,584,984	149,367	720,027	1,277,196	57,695,943
Additions <sup>1</sup>		53,063,516	434,941	95,277	321,290	38,316	53,953,340
Disposals		-	-	-	(55,341)	29,178	(26,163)
Transfers		(89,314)	-	-	-	89,314	-
At 31 December 2010		106,938,571	2,019,925	244,644	985,976	1,434,004	111,623,120
<b>Accumulated Depreciation in US\$</b>							
At 1 July 2010		(4,935,187)	-	(6,580)	(429,465)	(436,645)	(5,807,877)
Depreciation and depletion		(2,424,965)	-	(2,080)	(73,212)	(115,728)	(2,615,985)
Disposals		-	-	-	(43,806)	-	(43,806)
Impairment		-	-	-	-	-	-
At 31 December 2010		(7,360,152)	-	(8,660)	(546,482)	(552,373)	(8,467,668)
<b>Opening written down value</b>		<b>49,029,182</b>	<b>1,584,984</b>	<b>142,787</b>	<b>290,562</b>	<b>840,551</b>	<b>51,888,066</b>
<b>Impact of foreign currency adjustments</b>		<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
<b>Closing written down value</b>		<b>99,578,419</b>	<b>2,019,925</b>	<b>235,984</b>	<b>439,493</b>	<b>881,631</b>	<b>103,155,452</b>

<sup>1</sup> Oil & Gas additions have been decreased by \$2,839,287 in Overriding Royalty Interest which is included in Interest-bearing liabilities. Further, the additions in the period include a non-cash increase in the Asset Retirement Obligation of \$462,092.



## NOTES TO THE FINANCIAL STATEMENTS

### for the year ended 31 December 2011

	2011 US\$	2010 US\$
<b>15 INTANGIBLE ASSETS</b>		
Goodwill	68,217	68,217
Other intangible asset	15,091	82,466
	83,308	150,683
<b>Movement in Other Intangible assets</b>		
Carrying value at beginning of financial year	82,464	53,278
Addition on Kansas acquisition	-	31,519
Transfer to debt	(31,519)	-
Amortisation	(35,855)	(2,331)
	15,090	82,466
<b>16 TRADE AND OTHER PAYABLES</b>		
<b>Current</b>		
Trade creditors	3,848,843	3,299,232
Payable in relation to unrealised gain on acreage (Note 6)	-	1,092,250
Other creditors	312,420	56,369
	4,161,263	4,447,851
<b>17 FINANCIAL LIABILITIES, INCLUDING DERIVATIVE</b>		
<b>Current</b>		
Interest rate swaps	134,051	171,209
Oil and gas forward price contracts	1,095,435	521,377
	1,229,486	692,586
<b>Non-current</b>		
Oil and gas price forward contracts	1,136,390	2,536,851
<b>18 INTEREST-BEARING LIABILITIES</b>		
<b>Current</b>		
Finance lease liability	109,896	243,213
Bank loan -secured	53,692,913	67,390,857
Other loans	38,583	34,978
Other loans – related party	55,477	50,294
	53,896,869	67,719,342
<b>Non-current</b>		
Finance lease liability	54,806	69,234

In February 2008, the Empire Group entered into a facility maturing February 2013, consisting of the following:

A \$50,000,000 revolving line-of-credit facility (Revolver) used to refinance existing debt and to undertake future acquisitions; the Revolver is subject to a borrowing base consistent with normal and customary oil and gas lending practices of the bank. The borrowing base limit at the time of the replacement was \$3,500,000 and is redetermined from time to time in accordance with the Revolver. Interest accrues on the outstanding borrowings at rate options selected by the Empire Group and based on the prime lending rate (3.25% at 31 December 2011 and 2010) or the London InterBank Offered Rate (LIBOR) (0.4271% at 31 December 2011 and 0.27078% at 31 December 2010) rate plus 2.5%. At 31 December 2011 and 2010, the Empire Group's rate option was LIBOR. There was no availability under the Revolver at 31 December 2011 (2010: \$nil). However, the borrowing base limit changes with operations and opportunities.

A \$150,000,000 acquisition and development term credit facility (Term Facility) was used to refinance an existing facility, undertaken acquisitions and support capital expenditure under an agreed development plan for oil and gas properties and services companies in the United States. Drawdown on the Term Facility is based on predefined benchmarks.

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 18 FINANCIAL LIABILITIES, INCLUDING DERIVATIVE (Continued)

The total available under Tranche 1 of \$4,700,000 (as amended) has been committed to a defined development drilling program that commenced in April 2008, which is subject to independently generated reserve reports showing standard asset-loan coverage customary for commercial loan facilities; this amount under the Term Facility may be converted to the Revolver. The total available under Tranche 2, which will be used to pay additional capital costs associated with the development of properties, is \$6,046,000, as amended. The total available Trench 3, which will be used for the acquisition of additional properties and the further development of all properties, is \$35,900,000. Tranche 4 originated with the 2010 acquisition with a total borrowed of approximately \$35,300,000 at December 31, 2010. Interest accrues on the outstanding borrowings at rate options selected by the Empire Group and based on the prime lending rate or the LIBOR rate plus 4.0%. At December 31, 2011, the Empire Group's rate option was LIBOR. Total availability under all the tranches of the Term Facility at December 31, 2011 was approximately \$75,999,000; however, the borrowing base limit changes with operations and opportunities.

Loans under the facilities are secured by the assets of the Empire Group. Under terms of the facilities, the Empire Group is required to maintain financial ratios customary for the oil and gas industry. Beginning in March 2008, the Empire Group started to repay the facilities monthly to the extent of an applicable percentage of net operating cash flow, and capital transactions. Principal payments made in 2011 and 2010 were \$15,011,747 and \$13,597,604, respectively. The Revolver and Term loans are guaranteed by Empire Energy Group Limited. The Empire Group has exceeded the minimum cumulative principal payment obligation through the maturity date of the credit facilities.

In connection with the Revolver and Term Facility, the bank received 43,318 and 18,250 in 2011 and 2010, respectively, of non-diluting warrants (at \$0.01) equivalent to 10% of the issued capital of the Empire Energy Group USA LLC prior to the issuance of an initial public offering. In addition, the bank also received in 2011 and 2010 a 3% overriding royalty interest in with the acquisition properties of the Empire Group.

The values assigned to the debt overriding royalty interest and the warrants were allocated based on their relative fair values. The relative fair value of the warrants, which were determined using the management's pricing model, were recorded as additional paid-in capital and reduced the carrying value of the debt. The total funds received during 2010 of approximately \$42,000,000 were allocated \$3,000,000 to the overriding royalty interest and \$39,000,000 to the debt. The discount on the debt is being amortised to interest expense over the term of five years.

In conjunction with the debt financing by the bank in 2010, Empire Energy Group Limited issued options on 500 million shares (33,333,333 options following a share consolidation). These options were independently valued at \$1,687,000 in June 2010. The recorded value of the options of \$1,687,000 was expensed over the life of the bridging loan.

In addition, Empire Energy Group Limited, issued 2,000,000 shares during June 2010. The shares were issued as compensation for the late repayment of the bridge loan. The shares were valued at \$240,000 and the entire cost was expensed, since the issuance was the cost of the late payment of the bridge loan.

The Empire Group entered into an interest rate swap agreement to reduce the impact of interest rate changes on the Empire Group's variable rate term loan effective July 2009. The notional amount of \$7,940,000 expires in July 2012 with a fixed rate of 2.015%. The fair value of the swap is disclosed in Note 17.

A summary of period end debt is as follows:

	2011 US\$	2010 US\$
Term		
Tranche 1	6,181,553	6,181,553
Tranche 3	19,748,692	21,460,303
Tranche 4	28,679,377	34,754,045
Revolver	3,500,000	3,500,000
Bridging loan	-	6,810,892
Sub-Total	58,109,622	72,706,793
Less – Discount on debt:	4,416,709	5,315,936
Total debt	<u>53,692,913</u>	<u>67,390,857</u>

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 18 FINANCIAL LIABILITIES, INCLUDING DERIVATIVE (Continued)

#### CLASSIFICATION OF BORROWINGS

These accounts are presented on the basis that all debt has been classified as current liabilities. This treatment is as a result of a strict application of the relevant provisions of AASB 101 *Presentation of financial statements* ("AASB 101"). This accounting standard requires the Empire Group to classify liabilities as current if the Empire Group does not have an unconditional right to defer payment for twelve months at period end. However, the expected repayment of the borrowings is not for complete repayment within the twelve month period. The facilities expire in February 2013 and it is expected that the facilities will be rolled to an extended date.

Under the terms of the Loan Facility ("Facility"), Empire Energy allocates 90% of monthly free cash flow to repay principle outstanding.

The expected loan repayments in the next twelve months comprise:

- Repayment of 90% of any monthly free cash flows.

As at 31 December 2011 the loan covenants were in compliance. The Empire Group was in technical breach of the Net Operating Revenue ratio covenant in the March and June 2011 quarters. This ratio was not breached in the September and December quarters. There has been no action regarding the breach and none is expected.

### 19 PROVISIONS

#### Current

Employee entitlements

2011  
US\$

93,464

2010  
US\$

78,035

#### Non-current

Asset retirement obligations

4,944,295

4,491,624

#### Movement in Asset Retirement Obligation

Balance at beginning of the period

4,491,624

Write-off of accrued plugging costs

(50,717)

Accretion expense for the period, included in finance costs

503,388

Balance at end of the period

4,944,295

#### Asset Retirement Obligation

The Empire Group makes full provision for the future costs of decommissioning oil and gas production facilities and pipelines on a discounted basis on the installation or acquisition of those facilities.

The provision represents the present value of decommissioning costs which are expected to be incurred up to 2050. The estimated liability is based on historical experience in plugging and abandoning wells, estimated remaining lives of those based on reserve estimates, external estimates as to the cost to plug and abandon the wells in the future, and regulatory requirements. Assumptions, based on the current economic environment, have been made which management believe are a reasonable basis upon which to estimate the future liability. These estimates are reviewed regularly to take into account any material changes to the assumptions. However, actual decommissioning costs will ultimately depend upon future market prices for the necessary decommissioning works. Furthermore, the timing of decommissioning is likely to depend on when the assets cease to produce at economically viable rates. This in turn will depend upon future oil and gas prices, which are inherently uncertain.

## NOTES TO THE FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 20 CONTRIBUTED EQUITY

##### a) Shares

##### Issued Capital

Balance at beginning of period

2011  
US\$

2010  
US\$

55,486,551

55,464,194

##### Movement in ordinary share capital

- Issue of 22,000,000 fully paid ordinary shares in April 2011 @ A\$0.12 pursuant to Tranche 1 of a private placement to sophisticated and professional investors

2,843,016

-

- Issue of 88,833,333 fully paid ordinary shares in May 2011 @ A\$0.12 pursuant to Tranche 2 of a private placement to sophisticated and professional investors

11,343,306

-

- Issue of 4,740,429 fully paid ordinary shares in June 2011 @ A\$0.12 pursuant to the Empire Group's share purchase plan

606,737

-

- Issue of 13,333,334 fully paid ordinary shares in December 2011 pursuant to the exercise of the following options:

- 6,666,667 options @ A\$0.12 expiring 22 December 2011

811,040

-

- 6,666,667 options @ A\$0.135 expiring 22 December 2011

912,420

-

- Issue of 333,333 fully paid ordinary shares in December 2010 @ A\$0.0705 pursuant to the exercise of executive options

Less costs associated with the share issues detailed above

-

22,357

Balance as at 31 December 2011

(807,196)

71,195,874

55,486,551

##### b) Shares

##### Movements in ordinary issued shares

Balance at beginning of period

162,623,254

162,289,921

##### Movement in ordinary share capital

- Issue of fully paid ordinary shares in April 2011 @ A\$0.12 pursuant to Tranche 1 of a private placement to sophisticated and professional investors

22,000,000

-

- Issue of fully paid ordinary shares in May 2011 @ A\$0.12 pursuant to Tranche 2 of a private placement to sophisticated and professional investors

88,833,333

-

- Issue of fully paid ordinary shares in June 2011 @ A\$0.12 pursuant to the Company's share purchase plan

4,740,429

-

- Issue of fully paid ordinary shares in December 2011 pursuant to the exercise of the following options:

-unlisted options exercisable @ A\$0.12 expiring 22 December 2011

6,666,667

-

-unlisted options exercisable @ A\$0.135 expiring 22 December 2011

6,666,667

-

- Issue of fully paid ordinary shares in December 2010 pursuant to the exercise of executive options

-

333,333

Balance as at 31 December 2011

291,530,350

162,623,254

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 20 CONTRIBUTED EQUITY (Continued)

#### Share Options

##### Movements

##### Granted

During the financial year 6,800,000 executive options to acquire ordinary shares were granted pursuant to the terms of the Company's employee share option plan. Vesting of these options is subject to minimum period of employment conditions.

No options were granted in the period since the end of the financial year.

##### Exercised

13,333,334 unlisted options were exercised by Macquarie Bank Limited in December 2011. These options were exercised on the following basis:

- 6,666,667 unlisted options exercisable at A\$0.12 expiring 22 December 2011
- 6,666,667 unlisted options exercisable at A\$0.135 expiring 22 December 2011

No options have been exercised in the period since the end of the financial year.

##### Expiry

No options have expired during or since the end of the financial year.

At balance date the Empire Group had on issue, the following securities:

##### Shares

- 291,530,350 listed fully paid ordinary shares – ASX Code: EEG

The Company does not have authorised capital or par value in respect of its issued shares. All issued shares are fully paid. 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. No dividends were paid or declared during the year, or since the year-end.

##### Options

At balance date the Company had 28,866,664 unissued shares under option. These options are exercisable on the following terms:

Number		Exercise Price (A\$)	Expiry Date
6,666,666		\$0.15	22 June 2012
6,666,666		\$0.165	22 December 2012
6,666,666		\$0.18	22 December 2012
66,666	Executive options	\$0.1575	5 March 2013
3,500,000	Executive options	\$0.15	1 July 2013
1,650,000	Executive options	\$0.17	1 July 2013
1,650,000	Executive options	\$0.18	31 December 2013
<u>28,866,664</u>			

### 21 RESERVES

#### Fair value reserve

The fair value reserve comprises the cumulative net change in the fair value of available-for-sale assets until the investment is derecognised and the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

#### Foreign currency translation reserve

The foreign currency translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

#### Option Reserve

The option reserve comprises the value of options issued but not exercised at balance date.

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 22 CONTINGENT LIABILITIES

Empire Energy Group Limited has provided certain tax indemnities to an investor under agreements relating to research and development of Vitrokele Core Technology.

Empire Energy Group Limited has executed a Deed of Guarantee and indemnity in favour of Macquarie Bank Limited guaranteeing the obligations of each of Empire Energy USA LLC and its subsidiary Empire Energy E&P LLC pursuant to the Macquarie Bank Limited credit facility.

The Empire Group is involved in various legal proceedings arising out of the normal conduct of its business. In the opinion of management, the ultimate resolution of such matters will not have a material effect on the consolidated financial position or results of operations or the Empire Group.

The Empire Group is subject to various federal, state and local laws and regulations relating to the protection of the environment. The Empire Group has established procedures for the ongoing evaluation of its operations, to identify potential environmental exposures and to comply with regulatory policies and procedures.

Environmental expenditures that relate to current operations are expensed or capitalised as appropriate. Expenditures that relate to an existing condition caused by past operations, and do not contribute to current or future revenue generation, are expensed. Liabilities are recorded when environmental assessment and or clean-up is probable, and the costs can be reasonably estimated. The Empire Group maintains insurance that may cover in whole or in part certain environmental expenditures. At 31 December 2011, the Empire Group had no environmental contingencies requiring specific disclosure or accrual.

### 23 COMMITMENTS FOR EXPENDITURE

#### Exploration and Mining Tenement Leases

In order to maintain current rights of tenure to exploration and mining tenements, the Company and the companies in the consolidated entity are required to outlay lease rentals and to meet the minimum expenditure requirements of the various Government Authorities. These obligations are subject to re-negotiation upon expiry of the relevant leases or when application for a mining licence is made. No expenditure commitments exist at 31 December 2011.

#### i) Equipment Leases

Commitments in relation to equipment/motor vehicle leases contracted for at and subsequent to the reporting date but not recognised as liabilities:

	2011 US\$	2010 US\$
Not later than one year	19,082	19,095
Later than one year not later than two years	19,082	19,095
Later than two years not later than five years	41,036	60,160
More than five years	-	-
	79,200	98,350

The Empire Group has the option to acquire the leased assets at the agreed value on the expiry of the leases.

#### ii) Property Licence

The Company has entered into a cancellable licence agreement over the occupation of office premises. The leased assets were pledged as security over the lease commitment.

The term of the occupancy licence was for a term of 59 months and concluded on 30 June 2011. Since expiry of the occupancy licence the Company has occupied the premises on a month to month basis. Terms on a new licence agreement are being negotiated.

Licence fees in relation to the occupancy agreement are payable as follows:

Within one year	-	83,662
Later than one year not later than two years	-	-
	-	83,662

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 24 SHARE BASED PAYMENTS

#### a) Executive Option Plan

The establishment of the Empire Energy Group Limited executive option plan was approved by shareholders at a general meeting of members held on 18 May 2000. Persons eligible to participate include executive officers of the Company or a subsidiary, including a director holding salaried employment or office in the Company or subsidiary.

Options are granted under the plan for no consideration. Options are granted for a five year term and are fully vested.

Options granted under the plan carry no dividend or voting rights.

The exercise price of options is based on a minimum of the weighted average market price of shares sold in the ordinary course of trading on the ASX during the 5 trading days ending on the date the option is granted multiplied by 0.8.

Each option entitles the holder to subscribe for 1 unissued share.

#### b) Employee Share Option Plan 2010

A new executive share option plan was approved by shareholders at the annual general meeting of members held on 30 November 2010. This plan replaces the previous executive option plan approved by shareholders on 18 May 2000. Persons eligible to participate include executive officers of the Company or a subsidiary, including a director holding salaried employment or office in the Company or subsidiary.

Options are granted under the plan for no consideration. The vesting date of options granted under the plan is subject to minimum term of employment conditions.

Options granted under the plan carry no dividend or voting rights.

The exercise price of options is based on a minimum of the weighted average market price of shares sold in the ordinary course of trading on the ASX during the 5 trading days ending on the date the option is granted multiplied by 0.8. each option entitles the holder to subscribe for 1 unissued share.

Consolidated – 31 December 2011

During the financial year the following options were granted pursuant to the Employee Share Option Plan 2010.

No. of Options	Vesting Date	Exercise Date A\$	Expiry Date
3,500,000	23 March 2013	\$0.15	1 July 2013
1,650,000	23 March 2013	\$0.17	1 July 2013
1,650,000	23 March 2013	\$0.18	31 December 2013

Consolidated – 31 December 2010

There were no options granted pursuant to the Company's Employee Share Option Plan during the previous financial period.

The options outstanding at 31 December 2011 are detailed below.

## NOTES TO THE FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 24 SHARE BASED PAYMENTS (Continued)

Grant Date	Expiry Date	Exercise Price original	Post Capital Consolidation	Original number granted	Balance at start of year (amended for 15:1 consolidation)	Granted during year	Exercised during year	Balance at end of year
5 March 2008 (1)	5 March 2013	1.05 cents	15.75 cents	1,000,000	66,666	-	-	66,666
23 March 2011 (2)	1 July 2013	15 cents	n/a	3,500,000	-	3,500,000	-	3,500,000
23 March 2011	1 July 2013	17 cents	n/a	1,650,000	-	1,650,000	-	1,650,000
23 March 2011	31 December 2013	18 cents	n/a	1,650,000	-	1,650,000	-	1,650,000
					66,666	6,800,000	-	6,866,666

1) Options granted pursuant to Employee Share Option Plan approved 18 May 2000. The original exercise price and the number of options granted has been amended to reflect the capital consolidation effected on 4 June 2010. Share options are fully vested at balance date.

2) Options granted pursuant to Employee Share Option Plan approved 23 March 2011. This plan provides for vesting restrictions based on minimum period of employment conditions.

#### c) Expenses arising from share based payment transactions

Period ending – 31 December 2011

6,800,000 future options were granted pursuant to the Empire Groups Employee Share Options Plan. The share based payment transactions costs during the financial year based on a pro-rata portion of the vesting period was \$250,585.

Period ending – 31 December 2010

There were no share based payment transactions during the period under review.



## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 25 SEGMENT INFORMATION

The Empire Group has two reportable segments as described below. Information reported to the Empire Group's chief executive office for the purpose of resource allocation and assessment of performance is more significantly focused on the category of operations.

<i>in USD</i>	Oil & Gas		Investments		Other		Eliminations		Total	
	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010
Revenue (external)	31,874,667	13,265,810	-	-	-	-	-	-	31,874,667	13,265,810
Other income (excluding Finance income)	1,219,204	73,285	31,476	116,436	213,159	95,999	-	-	1,463,839	285,720
Reportable segment profit/(loss) before tax	9,503,066	1,814,645	(111,136)	57,741	(2,199,907)	(793,626)	-	-	7,192,023	1,078,760
Finance income	10,644	57,023	517,338	2,785,499	74,870	21,933	(517,338)	(2,785,499)	85,514	78,956
Finance costs	(7,587,131)	(4,997,854)	-	-	(23,429)	(7,739)	517,338	2,785,499	(7,093,222)	(2,220,094)
<i>Profit/(loss) for the period before tax</i>									<b>184,315</b>	<b>(1,062,378)</b>
Reportable segment assets	118,901,533	114,244,703	33,000,610	20,841,767	3,333,185	1,299,729	(32,081,894)	(19,910,036)	123,153,434	116,476,163
Reportable segment liabilities	(104,043,720)	(103,102,493)	-	-	(1,165,078)	(1,366,216)	32,081,894	19,910,036	(73,126,904)	(84,558,673)
<i>Other material non-cash items:</i>									-	-
- Gain on disposal of acreage	1,092,250	-	-	-	-	-	-	-	1,092,250	-
- Depreciation and amortisation	(4,991,063)	(2,607,750)	-	-	(17,814)	(8,235)	-	-	(5,008,877)	(2,615,985)
- Impairment expense	(133,347)	-	(142,612)	(58,695)	-	-	-	-	(275,959)	(58,695)
<i>Non-cash items included in Finance costs:</i>										
- Asset retirement obligation accretion	(503,388)	(210,686)	-	-	-	-	-	-	(503,388)	(210,686)
- Discount on debt & overriding royalty interest	(3,009,113)	(400,548)	-	-	-	-	-	-	(3,009,113)	(400,548)
Capital expenditure	(3,233,356)	(56,322,029)	-	-	-	-	-	-	(3,233,356)	(56,322,029)

**NOTES TO THE FINANCIAL STATEMENTS**  
**for the year ended 31 December 2011****25 SEGMENT INFORMATION (Continued)**

The revenue reported above represents revenue generated from external customers. There were no intersegment sales during the period. Included in Other income above are gains disclosed separately of the face of the statement of Comprehensive Income.

The Empire Group's reportable segments under AASB 8 are as follows:

- Oil and gas operations - includes all oil and gas operations located in the USA. Revenue is derived from the sale of oil and gas and operation of wells.
- Investments - includes all investments in listed and unlisted entities, including the investment in Empire Energy Group USA (eliminated on consolidation). Revenue is derived from the sale of the investments.
- Other - includes all centralised administration costs and other minor other income.

Segment profit/(loss) represents the profit/(loss) earned by each segment without allocation of central administration costs and directors' salaries, finance income and finance expense, gains or losses on disposal of associates and discontinued operations. This is the measure reported to the chief operating decision maker for the purposes of resource allocation and assessment of segment performance.

**Geographical information**

All Revenue from external customers is derived from operations in the USA.

The majority of the Empire Group's assets are located in the USA.

**Major customer**

Revenues from two major customers of the Empire Group's Oil & Gas segment represents approximately \$23,099,224 (2010: \$11,641,289) of the Empire Group's total revenues.

## NOTES TO THE FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 26 RELATED PARTY DISCLOSURES

##### a. Disclosures Relating to Directors

- i. The names of persons who were directors of the Company at any time during the financial year were:
- B W McLeod
  - D H Sutton
  - K A Torpey
- ii. **Directors' Shareholdings**

##### Number of shares held by the Company Directors

Director	Balance at 31 December 2010	Acquired during period through Share Purchase Plan	Other changes during period	Balance at 31 December 2011
B W McLeod	5,658,359	448,068	833,333	6,939,760
D H Sutton	875,801	-	107,499	983,300
K A Torpey	2,108,116	83,333	-	2,191,449

##### Option holdings

Number of options over ordinary shares in the Company held during the financial period by each Director of the Company, including their related entities are set out below:

Director	Balance at 1 January 2011	Granted during year as Remuneration	Exercised during year	Expiring during year	Balance at 31 December 2011	Vested exercisable at 31 December 2011
B W McLeod	-	5,300,000	-	-	5,300,000	-
D H Sutton	-	-	-	-	-	-
K A Torpey	-	-	-	-	-	-

The options held by B W McLeod were issued under an Employee Share Option Plan and are exercisable on the following basis and subject to a minimum term of employment conditions:

No. of options	Exercise Price A\$	Expiry Date
2,000,000	\$0.15	1 July 2013
1,650,000	\$0.17	1 July 2013
1,650,000	\$0.18	31 December 2013

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 26 RELATED PARTY DISCLOSURES (Continued)

#### iii. Key Management Personnel

##### Shareholdings

Specified Executive	Balance at 1 January 2011	Acquired during period through Share Purchase Plan	Other changes during period	Balance at 31 December 2011
D L Hughes	1,412,451	20,833	10,714	1,443,998
R Ryan	28,571	-	-	28,571

##### Option holdings

Number of options over ordinary shares in the Company held during the financial year by each of the specified executives of the Company including their related entities are set out below.

Specified Executive	Balance at 31 December 2010	Granted during period as remuneration	Exercised during year	Expiring during period	Balance at 31 December 2011	Vested exercisable at 31 December 2011
D L Hughes	-	750,000	-	-	750,000	Nil
R Ryan	66,666	750,000	-	-	816,666	66,666

#### iv. Transactions with Key Management Personnel

	2011 US\$	2010 US\$
1) B W McLeod is a director and shareholder of Eastern & Pacific Capital Pty Limited. The Empire Group paid the following transactions: - Management consultant fees - Bonus payment	361,165 206,380	212,580 188,960
2) W McLeod lent funds to the Empire Group. Interest has been accrued on this loan - Interest accrued on loan facility	5,302	2,270
3) D H Sutton was a director of a related party Earth Heat Resources Ltd, he resigned on 11 May 2011. Investment Earth Heat Resources Ltd	76,374	118,455
4) Aggregate amounts payable to Directors and their related Companies at balance date:  - B W McLeod - Loan - Interest  - Eastern & Pacific Capital - Bonus and consulting fees	21,328 34,150  502,067	21,342 28,951  769,487
5) B Waller and A Boyer are both directors of American Natural Resources ("ANR") - ANR pays the Empire Group for use of office and employment services - The Empire Group provides drilling services to ANR amount receivable to the Empire Group These transactions are conducted on commercial terms	- -	21,203 221,942

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 26 RELATED PARTY DISCLOSURES (Continued)

#### b. Disclosures Relating to Controlled Entities

Empire Energy Group Limited is the ultimate controlling Company of the Consolidated Entity comprising the Company and its wholly-owned controlled companies.

During the year, the Company advanced and received loans, and provided accounting and administrative services to other companies in the Consolidated Entity. The accounting and administrative services were provided free of charge, and the loans were interest free and unsecured.

#### c. Investments in Controlled Companies

	Country of Incorporation	Class of Share	Interest Held	
			December 2011 %	December 2010 %
<b>Controlling Empire Group</b>				
Empire Energy Group Limited	Australia			
<b>Controlled Companies</b>				
Imperial Oil & Gas Pty Limited	Australia	Ordinary	100	100
Vodex Pty Limited	Australia	Ordinary	100	100
Mega First Mining NL	Vanuatu	Ordinary	100	100
Imperial Mining Investments Pty Limited	Australia	Ordinary	100	100
Jasinv Pty Limited	Australia	Ordinary	100	100
Jasrad Pty Limited	Australia	Ordinary	100	100
Imperial Technologies Pty Limited	Australia	Ordinary	100	100
Imperial Management Services Pty Limited	Australia	Ordinary	100	100
OzNetwork Pty Limited	Australia	Ordinary	81	81
Imperial Resources LLC	USA	Ordinary	100	100
Imperial Energy Pty Ltd	Australia	Ordinary	100	100
Cobalt Energy Pty Ltd	Australia	Ordinary	100	100
Empire Energy USA LLC	USA	Ordinary	95	92

All entities are audited by Nexia Court & Co with the exception of Mega First Mining NL, a Company incorporated in Vanuatu and Empire Energy USA LLC incorporated in the USA which is audited by Schneider Downs.

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 27 NOTES TO THE STATEMENTS OF CASH FLOWS

	December 2011 US\$	December 2010 US\$
<b>(a) Reconciliation of Cash</b>		
Cash at the end of the financial year is shown in Statement of Financial Position as follows:		
Cash at bank and in hand	4,448,495	2,665,474
<b>(b) Reconciliation of profit after income tax expense to net cash flows from operating activities</b>		
(Loss)/profit for the period after income tax expense	(1,436,800)	387,090
<b>Adjustments for non-cash items:</b>		
Depreciation & amortisation expense	5,008,878	2,615,985
Impairment of property, plant & equipment	133,347	58,695
Loss on disposal of Property, plant & equipment	66,673	41,592
Gain on disposal of acreage	(1,092,250)	-
Write-off of exploration expenditure	476,366	-
Impairment of available for sale financial assets	142,612	-
Profit/Loss on disposal of available for sale financial assets	(31,473)	(116,437)
Amortisation of overriding royalty interest	653,879	173,362
Discount on debt	2,355,234	400,548
Asset retirement obligation accretion	503,387	210,686
Share-based payment expense	246,627	-
<b>Operating profit before changes in working capital and provisions</b>	<b>7,026,480</b>	<b>3,771,521</b>
Change in Trade and other receivables	(2,447,096)	(2,466,404)
Change in Prepayments and other current assets	(348,271)	235,422
Change in Inventories	413,658	(649,330)
Change in Current tax asset	(552,000)	-
Change in Trade and other payables	805,665	2,023,531
Change in Debt	8,988	-
Change in Provisions	15,730	1,100
Change in Income tax liabilities	(1,043,000)	(5,826,749)
Change in Deferred Tax Liability	598,000	4,270,000
	<b>(2,548,326)</b>	<b>(2,412,429)</b>
<b>Net cash flows from operating activities</b>	<b>4,478,154</b>	<b>1,359,092</b>

#### (c) Non-Cash Financing and Investing Activities

During the current financial year the following transactions occurred:

- The Company granted 6,800,000 executive options to acquire ordinary shares in the capital of the Company on various exercise prices and expiry dates. The options were granted pursuant to the terms of the Company's Employee Share Option Plan which provides vesting restrictions based on minimum period of employment conditions. Shareholder approval was obtained where required. These options were independently valued in June 2011 at US\$650,847. A proportional value of these options \$250,585 based on a pro-rata portion of the vesting period was expensed during the financial year.
- There were no non-cash financing and investing activities during the previous financial period.

## NOTES TO THE FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 28 EARNINGS PER SHARE

	2011	2010
Basic earnings per share (cents per share)	(0.66)	(0.10)
Diluted earnings per share (cents per share)	(0.66)	(0.10)
(Loss)/profit used in the calculation of basic and diluted earnings per share	(1,561,718)	(157,915)
Weighted average number of ordinary shares on issue used in the calculation of basic earnings per share	235,969,091	162,342,457
Weighted average number of potential ordinary shares used in the calculation of diluted earnings per share	235,969,091	162,342,457

#### 29 SUPERANNUATION COMMITMENTS

The Empire Group contributed to externally managed accumulation superannuation plans on behalf of employees. Empire Group contributions are made in accordance with the Empire Group's legal requirements.

#### 30 BUSINESS COMBINATIONS

On December 23, 2010, Empire Energy E&P, LLC purchased certain specified assets & assumed corresponding liabilities from Amadeus Petroleum, Inc. and T-N-T Engineering, Inc. for \$55,871,892. The effective date of the transaction was 1 October 2010. In the six month period ended 31 December 2010, the acquisition of the Amadeus and T-N-T contributed revenue of \$4,403,201 and profit of \$1,818,045. It is impracticable to disclose the impact to revenue and profit for the six month period if the acquisition had occurred on 1 July 2010 as the information is not available.

##### (i) Acquisition of Amadeus and T-N-T Engineering Assets

On 23 December 2010 the Empire Group acquired Amadeus and T-N-T for consideration of \$55,871,892.

	<u>US\$</u>
Consideration Transferred:	
Cash	13,804,404
Macquarie Bank	
- Funding facility	35,256,596
- Bridging Loan	6,810,892
	<u>55,871,892</u>

The purchase price was allocated as follows:

Land, property & equipment	1,384,350
Oil & Gas properties	55,149,634
Asset Retirement Obligation	(462,092)
Environmental Obligation	(200,000)
	<u>55,871,892</u>

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 31 PARENT ENTITY INFORMATION

	2011 US\$	2010 US\$
<b>Information relating to Empire Energy Group Limited:</b>		
Current Assets	3,255,146	1,205,160
Total Assets	36,310,641	22,119,558
Current Liabilities	(1,096,831)	1,283,531
Total Liabilities	(1,151,637)	1,352,765
Shareholder's Equity:		
Issued Capital	(71,195,874)	(55,486,551)
Reserves		
- Fair value reserve	(1,049,494)	(941,463)
- Foreign currency translation reserve	(1,118,634)	(1,986,711)
- Options reserve	(1,342,907)	(1,686,988)
Accumulated Losses	39,547,904	39,334,920
Total Shareholder's Equity	(35,159,005)	(20,766,792)
Profit for the period	803,691	6,321,387
Total Comprehensive income	43,645	4,289,879

### 32 DIRECTORS AND EXECUTIVE OFFICERS REMUNERATION

#### Determination of Remuneration of Directors

Remuneration of non-executive directors comprise fees determined having regard to industry practice and the need to obtain appropriate qualified independent persons.

Remuneration of the executive director is determined by the Remuneration Committee (refer statement of Corporate Governance Practices and the Remuneration Report for further details).

In this respect, consideration is given to normal commercial rates of remuneration for similar levels of responsibility, consistent with the Empire Group's level of operations.

#### Determination of Remuneration of Other Key Management Personnel

Remuneration of senior executives is determined by the Remuneration Committee (refer statement of Main Corporate Governance Practices for further details). In this respect, consideration is given to normal commercial rates of remuneration for similar levels of responsibility, consistent with the Empire Group's level of operations



## NOTES TO THE FINANCIAL STATEMENTS

### for the year ended 31 December 2011

#### 32 DIRECTORS AND EXECUTIVE OFFICERS REMUNERATION (Continued)

##### Directors and Executive Officers' Remuneration

Details of the nature and amount of each major element of the remuneration of each director of the Empire Group and each named officer of the Empire Group and the Consolidated Entity receiving the highest remuneration are:

December 2011 (12 months)	Short term benefits			Post- employment benefits	Long- term benefits	Share/option based payments	Total US\$
	Cash salary and fees US\$	Bonus payments US\$	Non- monetary US\$	Super contributions US\$	Long service leave		
<b>Directors</b>							
B W McLeod	361,165	206,380	49,603	-	-	195,451	812,599
K A Torpey	20,638	-	-	1,857	-	-	22,495
D H Sutton	-	-	-	20,638	-	-	20,638
<b>Specified Executive of the Empire Group</b>							
D L Hughes	80,488	-	14,180	7,244	1,294	27,567	130,773
R Ryan	105,426	-	1,255	9,488	10,772	27,567	154,508
<b>Empire Energy Executives</b>							
A Boyer	164,165	-	48,732	-	-	-	212,897

Share based payments reflects a proportion of the independently valued cost of options granted in May 2011 under the Employee Share Option Plan. This cost is shown on a pro-rata basis over the vesting period of the options.

December 2010 (6 months)	Short term benefits			Post- employment benefits	Long- term benefits	Share/option based payments	Total US\$
	Cash salary and fees US\$	Bonus payments US\$	Non- monetary US\$	Super contributions US\$	Long service leave		
<b>Directors</b>							
B W McLeod	212,580	188,960	44,963	(25,510)	-	-	420,993
K A Torpey	9,448	-	-	850	-	-	10,298
D H Sutton	-	-	-	9,448	-	-	9,448
<b>Specified Executive of the Empire Group</b>							
D L Hughes	36,847	-	9,730	3,316	748	-	50,641
R Ryan	41,571	-	351	3,741	-	-	45,663
<b>Empire Energy Executives</b>							
A Boyer	49,996	-	4,500	-	-	-	54,496
B Waller	49,996	-	-	-	-	-	49,996

The cash component of US\$212,580 in 2010 paid to B W McLeod includes a prior period adjustment of US\$47,240.

## NOTES TO THE FINANCIAL STATEMENTS for the year ended 31 December 2011

### 33 AUDITORS' REMUNERATION

	2011 US\$	2010 US\$
<b>Audit Services</b>		
Auditors of the Company – Nexia Court & Co.:		
Audit and review of financial reports	120,289	48,723
Other auditors:		
Audit and review of financial reports	247,233	101,409
	367,522	150,132
<b>Other services</b>		
Auditors of the Company – Nexia Court & Co.:		
Taxation services	36,800	2,434
Other auditors:		
Taxation services	54,593	12,811
	91,393	15,245

### 34 MATTERS SUBSEQUENT TO BALANCE DATE

On 16 January 2012 the Company announced that the New York Department of Environmental Conservation (DEC) had concluded the public comment period of the Supplemental Generic Environmental Impact Statement (SGEIS) process. The DEC will now review comments that have been submitted before releasing the final SGEIS and associated regulations. It is believed that the DEC will commence issuing permits for high volume hydraulic fracturing prior to mid-year 2012.

The Empire Group has a significant land position of approx. 303,000 acres in New York State of which 220,000 acres are in the Marcellus and 180,000 acres in the Utica shale fairway of Western New York State.

There were no other matters or circumstances that have arisen since 31 December 2011 that has significantly affected or may significantly affect:

- the operations, in financial years subsequent to 31 December 2011, of the consolidated entity; or
- the results of those operations; or
- the state of affairs in financial years subsequent to 31 December 2011 of the consolidated entity.

## **DIRECTORS' DECLARATION**

In the opinion of the directors of Empire Energy Group Limited (the "Company"):

- a** The financial statements and notes of the Company and the remuneration disclosures that are contained in the Remuneration report in the Directors' report set out on pages 16 to 18, are in accordance with the *Corporations Act 2001*, including:
  - i** Giving a true and fair view of the Company's and Group's financial position as at 31 December 2011 and of their performance, for the year ended on that date; and
  - ii** Complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the *Corporations Regulations 2001*;
- b** the financial report also complies with the International Financial Reporting Standards as disclosed in note 1; and
- c** there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

The directors have been given the declarations required by section 295A of the Corporations Act 2001 from the Chief Executive Office and the Chief Financial Officer for the year ended 31 December 2011.

Signed in accordance with a resolution of the directors.



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**B W McLEOD**  
Director

**Dated:** 30 March 2012

## INDEPENDENT AUDITORS REPORT

### INDEPENDENT AUDITORS REPORT TO THE MEMBERS OF EMPIRE ENERGY EMPIRE GROUP LIMITED

#### Report on the Financial Report

We have audited the accompanying financial report of Empire Energy Group Limited, which comprises the statement of financial position as at 31 December 2011, and the statement of comprehensive income, statement of changes in equity and statement of cash flows for the year ended on that date, a summary of significant accounting policies, other explanatory notes and the directors' declaration of the consolidated entity 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, the directors also state, in accordance with Accounting Standard AASB 101 *Presentation of Financial Statements*, that the financial statements 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 and fair presentation of the financial report 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.

Our procedures include reading the other information in the annual report to determine whether it contains any material inconsistencies with the financial report.

Our audit did not involve an analysis of the prudence of business decisions made by directors or management.

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



**INDEPENDENT AUDITORS REPORT  
TO THE MEMBERS OF  
EMPIRE ENERGY EMPIRE GROUP LIMITED  
(CONTINUED)**

*Independence*

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

**Auditors' Opinion**

In our opinion:

- a. the financial report of Empire Energy Empire Group Limited is in accordance with the Corporations Act 2001, including:
  - i. giving a true and fair view of consolidated entity's financial position as at 31 December 2011 and of its performance for the period ended on that date; and
  - ii. complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001; and
- b. the financial report also complies with International Financial Reporting Standards as disclosed in Note 1.

**Emphasis of matter**

Without qualifying our opinion, we draw attention to Note 3, "Going Concern" in the financial report, which indicates that the consolidated entity has an excess of current liabilities over current assets of \$43,556,047 at the year-end and the debt facilities expire in February 2013. These conditions, along with matters set forth in Note 3, indicates the existence of a material uncertainty that may cast significant doubt about the consolidated entity's ability to continue as a going concern and therefore, the consolidated entity may be unable to realise its assets and discharge its liabilities in the normal course of business.

**Report on the Remuneration Report**

We have audited the Remuneration Report included in pages 16 to 18 of the directors' report for the period ended 31 December 2011. The directors of the Empire Group 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 Australian Auditing Standards.

*Auditor's Opinion*

In our opinion, the Remuneration Report of Empire Energy Group Limited for the period ended 31 December 2011 complies with section 300A of the *Corporations Act 2001*.

*Nexia Court & Co*

**Nexia Court & Co**  
*Chartered Accountants*

**Sydney**  
**Dated:** 30 March 2012

  
**Andrew Hoffmann**  
*Partner*

## SHAREHOLDER INFORMATION

### ORDINARY SHARES

#### a Substantial Shareholders as at 29 February 2012

Name	Number of Shares	% Holding
Macquarie Bank Limited (Metals & Energy CAP DIV A/C)	40,333,334	13.84
Imperial Investments Pty Ltd	14,880,056	5.10

#### b Distribution of Fully Paid Ordinary Shares

	Holders	Number of Shares	% Holding
1 – 1,000	322	138,060	0.05
1,001 – 5,000	978	2,780,584	0.95
5,001 – 10,000	578	4,375,459	1.50
10,001 – 100,000	1,025	37,695,161	12.93
100,001 and over	349	246,541,086	84.57
<b>Total number of holders</b>	<b>3,252</b>	<b>291,530,350</b>	<b>100.00</b>

i Number of holders of less than a marketable parcel 1,101

ii Percentage held by 20 largest holders 43.11

#### c Twenty Largest Shareholders as at 29 February 2012

Name	Number of Shares	% Holding
1 Macquarie Bank Limited (Metals & Energy CAP DIV A/C)	40,333,334	13.84
2 Imperial Investments Pty Ltd	14,880,056	5.10
3 WYT Nominees Pty Ltd (C&E Wong Super Fund A/C)	12,850,451	4.41
4 HSBC Custody Nominees (Australia) Limited - A/C 2	7,503,333	2.57
5 John Wardman & Associates Pty Ltd (The Wardman Super Fund A/C)	5,000,000	1.72
6 ACT2 Pty Ltd	4,500,000	1.54
7 Altinova Nominees Pty Ltd	4,166,670	1.43
8 Eastern & Pacific Capital Pty Ltd (B W McLeod Super Fun A/C)	4,032,110	1.38
9 Armco Barriers Pty Ltd	4,000,000	1.37
10 Mr Peter Alfred Ternes	4,000,000	1.37
11 Ms Michelle Wong	3,781,575	1.30
12 Redmond Holdings Pty Limited (The Defina A/C)	2,989,731	1.03
13 Mr Terry McNery & Ms Judy McNery (DRYCA Employee RET A/C)	2,730,000	0.94
14 Mr Kenneth Murray & Mrs Ruth Murray (Murray Super Fund A/C)	2,594,686	0.89
15 Mr Hafeezhussein Hatimali Bana	2,361,637	0.81
16 JP Morgan Nominees Australia Limited	2,040,600	0.70
17 McGee Constructions Pty Ltd (McGorman Super Fund A/C)	2,040,000	0.70
18 Mr Clive Thomas	2,013,023	0.69
19 Classic Roofing Pty Limited (Superannuation Fund Account)	2,000,000	0.69
20 Mr Iain Richard Campbell McKean	1,850,000	0.63
	<b>125,667,206</b>	<b>43.11</b>

#### d Voting Rights

On a show of hands every member present in person or by proxy shall have one vote and upon a poll every member, present in person or by proxy, shall have one vote for every share except if the issue price has not been paid in full, then the holder is only entitled to a fraction of a vote on that share, being, the quotient of the amount paid up divided by the issue price of that share.

## SHAREHOLDER INFORMATION (Continued)

## UNQUOTED SECURITIES AS AT 29 FEBRUARY 2012

Class of unquoted securities	No. of securities	No. of holders
Unlisted Options issued to Macquarie Bank Limited as a component of the bridging loan facility.		
- Unlisted options exercisable at A\$0.165 expiring 22 December 2012	6,666,666	1
- Unlisted options exercisable at A\$0.18 expiring 22 December 2012	6,666,666	1
- Unlisted options exercisable at A\$0.15 expiring 22 June 2012	6,666,666	1
Unlisted Executive Options issued under the terms of the Company's executive option plan		
- Executive options exercisable at A\$0.1575 expiring 5 March 2013	66,666	1
- Executive options exercisable at A\$0.15 expiring 1 July 2013	3,500,000	3
- Executive options exercisable at A\$0.17 expiring 1 July 2013	1,650,000	1
- Executive options exercisable at A\$0.18 expiring 31 December 2013	1,650,000	1

## Voting Rights

There are no voting rights attached to any of the unquoted securities listed above.

## LIST OF EXPLORATION LICENCE APPLICATIONS

Permit	State	Status	Interest
EP(A) 180	NT	Under application	100%
EP(A) 181	NT	Under application	100%
EP(A) 182	NT	Under application	100%
EP(A) 183	NT	Under application	100%
EP(A) 184*	NT	Under application	100%
EP(A) 187	NT	Under application	100%
EP(A) 188	NT	Under application	100%

\*Pastoral Lease subject to Native Title