

CHINA NORTH EAST PETROLEUM HOLDINGS LTD
Form 10-K/A
October 03, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A

Amendment No. 2

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2010

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 000-49846

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED
(Exact Name of Registrant as specified in its charter)

Nevada
(State or other jurisdiction of
Incorporation or organization)

87-0638750
(I.R.S. Employer
Identification Number)

445 Park Avenue
New York, NY 10022
(Address of principal executive office)

Registrant's telephone number, including area code: (212) 307-3568

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$0.001 par value	NYSE Amex

Securities registered under Section 12(g) of the Exchange Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	<input type="radio"/>	Accelerated filer	<input checked="" type="radio"/>
Non-accelerated filer	<input type="radio"/>	Smaller reporting company	<input type="radio"/>

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, as of the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$162,276,730. All executive officers and directors of the registrant have been deemed, solely for the purpose of the foregoing calculation, to be "affiliates" of the registrant.

As of March 3, 2011, there were 29,604,860 shares of the issuer's common stock, \$0.001 par value, issued and outstanding.

Documents Incorporated by Reference

None

Explanatory Note

We are filing this amendment to our Annual Report on Form 10-K to respond to SEC Comments dated June 30, 2011.

Except as described above, we have not modified or updated disclosures presented in the original Form 10-K in this amendment. Accordingly, this amendment does not reflect events occurring after the filing of our original Form 10-K or modify or update those disclosures, including the exhibits to the original Form 10-K, affected by subsequent events. As such, this Amendment continues to speak as of March 16, 2011 (the date the original Form 10-K was filed with the SEC). Accordingly, this amendment should be read in conjunction with the original Form 10-K and our other reports filed with the SEC subsequent to the filing of our original Form 10-K, including any amendments to those filings.

In addition, as required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), currently dated certifications by our principal executive officer and principal financial officer are filed as exhibits to this amendment under Item 15 of Part IV hereof.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED
ANNUAL REPORT ON FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 2010

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Information Regarding Forward-Looking Statements

In addition to historical information, this report contains predictions, estimates and other forward-looking statements that relate to future events or our future financial performance. These statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by the forward-looking statements. These risks and other factors include those listed under "Risk Factors" and elsewhere in this report, and some of which we may not know. In some cases, you can identify forward-looking statements by terminology such as "may," "will," "should," "expects," "plans," "anticipates," "believes," "estimates," "predicts," "potential" or "could" and the negative of these terms or other comparable terminology.

Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performances or

achievements expressed or implied by the forward-looking statements. We discuss many of these risks in this report in greater detail under the heading “Risk Factors.” Given these uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management’s beliefs and assumptions only as of the date of this report. You should read this annual report on Form 10-K and the documents that we have filed as exhibits to this annual report completely and with the understanding that our actual future results may be materially different from what we expect.

Except as required by law, we assume no obligation to update these forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future.

PART I

ITEM 1. BUSINESS

Overview

We are engaged in the exploration and production of crude oil in Northern China. We have an arrangement with the Jilin Refinery of PetroChina Group to sell our crude oil production for use in the China marketplace. As of December 31, 2010, we operated 295 producing wells located in four oilfields in Northern China and have plans for additional drilling projects.

In particular, through two of our subsidiaries, Song Yuan City Yu Qiao Oil and Gas Development Ltd. Corp. (“Yu Qiao”) and Longde Oil and Gas Development Co. Ltd. (“LongDe”), we have entered into binding sales agreements with the PetroChina Group, whereby we sell our crude oil production for use in the China marketplace.

We currently operate 4 oilfields located in Northern China, which include:

Field	Acreage Gross (developed and undeveloped) at 12/31/2010	Producing Oil Wells at 12/31/2010	Proved Reserves (Bbls) at 12/31/2010
Qian’an 112	5,115	250	5,440,900
Daan 34	2,298	12	2,500
Gudian 31	1,779	12	16,500
Hetingbao 301	2,471	21	16,300

Financial Information about Segments

The Company operates in two reportable segments; exploration and production of crude oil (“Crude oil”) and contract land drilling of oil wells (“Contract drilling”). The accounting policies of the segments are the same as described in the summary of significant accounting policies. The Company evaluates segment performance based on income from operations. All inter-company transactions between segments have been eliminated. As a result, the components of operating income for one segment may not be comparable to another segment. The following is a summary of the Company’s segment information for the last three fiscal years ended December 31, 2010, 2009 and 2008 (restated) (in thousands):

Year	2010	2009	2008 (restated)
Revenue:			
Crude oil	\$ 54,672	\$ 51,081	\$ 58,572
Contract drilling	44,876	13,577	-
Total revenue	\$ 99,548	\$ 64,658	\$ 58,572
Gross profit:			
Crude oil	\$ 35,393	\$ 33,778	\$ 34,998
Contract drilling	25,363	8,342	-
Total gross profit	\$ 60,756	\$ 42,120	\$ 34,998

Income from operations:

Crude oil	\$	27,989	\$	24,212	\$	18,177
Contract drilling		24,964		176		-
Total income from operations		52,953		24,388		18,177
Corporate and other		25,506		(37,579)		(797)
Net income (loss) before income taxes	\$	78,459	\$	(13,191)	\$	17,380

The following flow chart illustrates our company's organizational structure:

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Organizational History

We were incorporated in the State of Nevada on August 20, 1999 under the name Draco Holding Corporation. On March 29, 2004, we executed an Agreement for Share Exchange with Hong Xiang Petroleum Group Limited, a corporation organized and existing under the laws of the British Virgin Islands (“Hong Xiang”), and the individual shareholders owning 100% of the outstanding common shares of Hong Xiang (the “Hong Xiang Shareholders”).

Pursuant to the Agreement for Share Exchange, we issued 18,700,000 shares of our common stock to the Hong Xiang Shareholders in exchange for all of the shares of capital stock of Hong Xiang owned by the Hong Xiang Shareholders at closing, and Hong Xiang became our wholly-owned subsidiary. On June 28, 2004, we changed our name to China North East Petroleum Holdings Ltd.

During 2004, we acquired a 100% ownership in Song Yuan City Hong Xiang Petroleum Technical Services Co., Ltd. (“Hong Xiang Technical”), and Hong Xiang Technical in turn acquired a 100% interest in Song Yuan City Yu Qiao Qianan Hong Xiang Oil and Gas Development Co., Ltd. (“Hong Xiang Oil Development”), which was engaged in the exploration and production of crude oil in the Jilin region of the PRC.

As a result of the Yu Qiao acquisition discussed below, all operations, assets and liabilities of the Company’s subsidiary Hong Xiang Oil Development were transferred to Yu Qiao on March 19, 2007. Since Hong Xiang Oil Development and Hong Xiang Technical were no longer necessary elements of the Company’s corporate structure, and they were liquidated and dissolved.

PetroChina Oil Leases

Pursuant to a 20-year exclusive Cooperative Oil Lease (the “Oil Lease”), entered into among PetroChina Group, Yu Qiao and the Company in May 2002, the Company has the right to explore, develop and produce oil at Qian’an 112 Oilfield. Pursuant to the Oil Lease, (i) PetroChina is entitled to 20% of the Company’s oil production for the first ten years of the Oil Lease term and 40% of the Company’s oil production for the remaining ten years of the Oil Lease term; and (ii) Yu Qiao is entitled to 2% of the Company’s oil production as a management fee. The payment of management fee was stopped following the acquisition of Yu Qiao by the Company in 2007.

In May 2003, LongDe entered into a 20-year contract with PetroChina Group. Pursuant to the contract, LongDe has the right to explore, develop and produce oil at the Hetingbao 301 oilfield in the PRC. In addition, pursuant to the contract between PetroChina and LongDe, PetroChina is entitled to 20% of LongDe’s output in the first ten years and 40% of LongDe’s output thereafter until the end of the contract.

As the controlling shareholder of Yu Qiao, the Company has the rights to extract and develop Qian’an 112 and other oil fields under the contracts that Yu Qiao has entered into with PetroChina. These oilfields include the Daan 34 oilfield and Gudian 31 oilfield in Jilin Province.

Song Yuan Technical Joint Venture

On July 26, 2006, the Company entered into a joint venture agreement with Wang Hongjun (“Mr. Wang”), the president and a stockholder of the Company and Ju Guizhi (“Ms. Ju”), mother of Mr. Wang, to contribute to the increased registered capital of Song Yuan North East Petroleum Technical Service Co. Ltd. (“Song Yuan Technical”). The purpose of Song Yuan Technical is to acquire oil and gas properties and to engage in the exploration of crude oil in the PRC. On December 20, 2006, Mr. Wang transferred his interest (4.5%) in Song Yuan Technical to Ms. Ju and as result, the Company owns a 90% equity interest in Song Yuan Technical, and Ms. Ju owns the remaining 10% equity interest in Song Yuan Technical.

Acquisition of LongDe

In order to comply with certain PRC laws relating to foreign entities' ownership of oil and gas companies in the PRC, prior to March 17, 2008, Song Yuan Technical directly owned a 70% equity interest in LongDe, while Sun Peng and Ai Chang Shan, respectively, owned 10% and 20% of the equity interests in LongDe in trust for Song Yuan Technical. On March 17, 2008, Song Yuan Technical acquired an additional 20% equity interest in LongDe, 10% of the equity interest in LongDe from Sun Peng, and 10% of the equity interest in LongDe from Ai Chang Shan. Accordingly, Song Yuan Technical now owns directly 90% of the equity interests in LongDe, with Ai ChangShan holding the remaining 10% in trust for Song Yuan Technical. The acquisition of LongDe was made pursuant to the laws of the PRC. As a 90% owner of Song Yuan Technical, the Company effectively controls LongDe.

This beneficial ownership structure is governed by two trust agreements: (i) Trust Agreement dated October 8, 2006 by and between Song Yuan Technical and Ai Chang Shan; and (ii) Trust Agreement dated April 18, 2008 by and between Song Yuan Technical and Wang Hongjun. Pursuant to the October 8, 2006 agreement, Ai Chang Shan holds 20% of the equity interest in LongDe in trust for the benefit of Song Yuan Technical. On March 17, 2008, Ai Chang Shan entered into a transfer agreement whereby Ai Chang Shan transferred 10% of the equity interest of LongDe held in trust pursuant to this trust agreement to Song Yuan Technical. Currently under the trust agreement dated October 8, 2006, Ai Chang Shan holds 10% of the total equity interest of LongDe in trust for the benefit of Song Yuan Technical. Pursuant to the April 18, 2008 trust agreement, Wang Hongjun holds 10% of the total outstanding equity interest in Yu Qiao in trust for the benefit of Song Yuan Technical.

Acquisition of Yu Qiao

The Company acquired 100% beneficial interest of Yu Qiao from Yu Qiao's former shareholders: Ms. Ju (70%), Meng Xiangyun (20%) and Wang Pingwu (10%) on January 26, 2007. In order to comply with PRC laws which restrict ownership of oil and gas companies by foreign entities, following the acquisition, 20% and 10% of the equity interest, respectively, was transferred to Meng Xiangyun and Wang Pingwu to be held in trust for the benefit of Song Yuan Technical pursuant to a trust agreement.

On March 17, 2008, the trust agreement with Meng Xiangyun was cancelled and the 20% equity interest in Yu Qiao held in trust by Meng Xiangyun was transferred to Song Yuan Technical. On April 18, 2008, the 10% equity interest in Yu Qiao held by Wang Pingwu in trust was transferred to the Company's President and Chairman, Wang Hongjun to hold in trust for the benefit of Song Yuan Technical.

Currently, Song Yuan Technical directly holds 90% of Yu Qiao and 10% is held in trust by Wang Hongjun for the benefit of Song Yuan Technical.

Acquisition of Tiancheng

On September 27, 2009, we acquired, through Song Yuan Technical, beneficial ownership of all of the equity interest in Song Yuan Tiancheng Drilling Engineering Co., Ltd. or "Tiancheng." In order to comply with certain PRC laws, 5% of the equity interest in Tiancheng was initially held in trust by Lou Yunhui, one of the former Tiancheng stockholders, for the benefit of Song Yuan Technical, while the remaining 95% of the equity interest in Tiancheng was held directly by Song Yuan Technical.

On November 13, 2009, the 5% equity interest in Tiancheng held by Lou Yunhui in trust was transferred to the Company's President and Chairman, Wang Hongjun to hold in trust for the benefit of Song Yuan Technical.

Tiancheng provides contract drilling services. Tiancheng currently has eight drilling teams with the same number of rigs in house, which include two 4,000 meter rigs, (approximately 13,000 feet depth), three 3,000 meter rigs (approximately 9,800 feet depth) and three 2,000 meter rigs (approximately 6,500 feet depth), respectively. All of its drilling teams have received approvals issued by the Qualification Administrative Committee of China National Petroleum Corporation (PetroChina). Tiancheng has existing contracts with PetroChina and other private oil companies to provide contract drilling and other oilfield services.

The acquisition of Tiancheng was accounted for as a purchase under ASC Topic 805 Business Combinations. Accordingly, the operating results of Tiancheng have been included in the consolidated statements of operations and comprehensive income after September 25, 2009, the effective date of the acquisition.

Proposed Acquisition of Sunite Right Banner

On January 19, 2011, the Company through its subsidiary, Song Yuan Technical, entered into a Share Transfer Agreement with the shareholders of Sunite Right Banner Shengyuan Oil and Gas Technology Development Co., Ltd. to acquire 100% of the equity interests in Shengyuan. Shengyuan, a limited liability company incorporated in Sunite Right Banner, Inner Mongolia in the People's Republic of China with exclusive oilfield exploration and drilling rights to the Durimu oilfield in Inner Mongolia.

The total purchase price for Shengyuan is valued at approximately \$43.4 million consisting of RMB 70 million (approximately US\$10.6 million) in cash and 5,800,000 shares of the Company's common stock.

The Durimu oilfield belongs to Yanchang Petroleum Group ("Yanchang"), the fourth largest and qualified state owned organization (SOE) for oil and gas exploration in China. Shengyuan is qualified by Yanchang to manage the oil exploration and production activities in the Durimu oilfield. In 2010, Shengyuan signed a 25 year exclusive exploration agreement with Sunite Right Banner Jiangyuan Mining Co. Ltd. ("Jiangyuan"), a state-owned enterprise of the local government to drill in the Durimu oilfield in Inner Mongolia. We will benefit from the 24 years remaining on an exclusive exploration and drilling agreement to operate in the Durimu oilfield and Shengyuan has the first right of refusal to renew the lease at the end of its 25 year term.

According to the terms of the 25 year lease, Shengyuan is entitled to 75% of all production revenue while 25% will be allocated to Yanchang as a royalty payment. Shengyuan will only be liable for income tax on its 75% of oil production revenue. All oil produced by Shengyuan is required to be sold to refineries and other buyers already qualified by Yanchang.

After the consummation of this acquisition, we intend to gradually shift our drilling efforts from the Jilin oilfield to the Durimu oilfield. After the closing of this acquisition, we intend to conduct further seismic tests in the oilfield to gather more geo-data, and begin drilling exploration wells to test productivity within the oilfield. As part of this effort, we plan to utilize 2-3 of our in-house drilling rigs to conduct the initial work. This initial stage is expected to last approximately 12-18 months. As we completed our first stage of testing in Durimu, we intend to shift into a second stage which is to aggressively drill in Durimu and increase overall production. This will be done while maintaining current production levels within our four existing oilfields.

Listing on NYSE Amex LLC

On June 15, 2009, the Company's common stock commenced trading on the NYSE Amex LLC ("AMEX"). Upon trading on AMEX, the Company changed its ticker symbol from "CNEH.OB" to "NEP."

Available Information

The Company files or furnishes Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, registration statements and other items with the Securities and Exchange Commission (SEC). The Company provides access free of charge to all of these SEC filings, as soon as reasonably practicable after filing or furnishing, on its Internet site located at http://cneh.irpage.net/SEC_Filings.html. The Company will also make available to any stockholder, without charge, copies of its Annual Report on Form 10-K as filed with the SEC. For copies of this report, or any other filing, please contact China North East Petroleum Holdings, 445 Park Avenue, 10 th Floor, New York, NY 10022, Tel: (212) 307-3568 or email: info@cnepetroleum.com.

The public may read and copy any materials the Company files with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site (www.sec.gov) that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC.

Oil Properties and Activities

As of December 31, 2010, the Company had a total of 295 producing wells, including 250 producing wells at the Qian'an 112 oilfield, 21 producing wells at the Hetingbao 301 oilfield, 12 producing wells at the Daan 34 oilfield and 12 producing wells at the Gudian 31 oilfield.

All of the Company's crude oil production is sold to the Jilin Refinery of PetroChina Group. The approximate distance of each of the Company's oil fields from the Jilin Refinery is as follows: the Qian'an 112 oilfield is four kilometers away, the Hetingbao 301 oilfield is three kilometers away, the Daan 34 oilfield is fifteen kilometers away and the Gudian Oilfield 31 is thirty kilometers away.

PetroChina pays the Company a price per barrel equal to the monthly mean price calculated from the Mean of Platts Singapore ("MOPS") daily price for sour, heavy Indonesian crude, as measured during the previous month. Platts is a leading global provider of energy and metals information that collects and publishes pricing data on a wide range of petroleum and non-petroleum commodity types. An independent provider, Platts serves the oil, natural gas, electricity,

emissions, nuclear power, coal, petrochemical, shipping, and metals markets from 17 offices worldwide. Price paid to the Company is FOB at the local Jilin Province PetroChina oil storage depot. The oil grade produced in China is lower than the grade of light and sweet oil quoted as West Texas Intermediate (“WTI”) and Brent, therefore, the oil price we receive from PetroChina generally is slightly discounted to the WTI or Brent price.

The following table shows the difference between the WTI and MOPS China monthly oil prices.

Month	Oil Sale Price	
	\$	
	WTI	MOPS-China
January 2010	78	73
February 2010	76	76
March 2010	81	71
April 2010	84	75
May 2010	74	80
June 2010	75	76
July 2010	76	72
August 2010	77	72
September 2010	75	73
October 2010	82	74
November 2010	84	78
December 2010	89	80

(Note: data references to Wall Street Journal, and MOPS China price is exchanged from RMB to USD at the exchange rate of 6.7695 for 12 months moving average)

As noted in the table above, compared with WTI prices, the MOPS China price generally is slightly discounted due to lower oil quality. In addition, there is a one-month time lag between the two prices.

PetroChina pays the Company monthly in arrears, on approximately the 15th day after the end of each month. The amount paid to the Company in the first two months of each calendar quarter is decreased by the amount of oil surcharge tax the Company will owe to the PRC government at the end of that calendar quarter. PetroChina holds those amounts back from the Company until the end of each calendar quarter, and then pays those amounts to the Company with the balance due for oil deliveries in the final month of the quarter. For this reason, the Accounts Receivable balance at the end of each quarter is larger than the prior month's oil sales revenue, because it includes the oil surcharge tax amounts the Company owes for the first two months of the quarter.

Sales Volumes and Prices

The following table shows the Company's annual sales volumes of crude oil for the last two fiscal years.

	2010	2009
	(Bbls)	(Bbls)
China Crude Oil	723,774	908,126

Proved Reserves

As of December 31, 2010, total proven reserves were 5,476,200 barrels of crude oil. The Qian'an 112 Oilfield had proven reserves of 5,440,900 barrels. The Hetingbao 301 Oilfield had proven reserves of 16,300 barrels. The Gudian 31 Oilfield had proven reserves of 16,500 barrels, and the Daan 34 Oilfield had proven reserve of 2,500 barrels.

Proved reserve estimates were made as of December 31, 2010 by Ralph E. Davis Associates Inc., an independent worldwide petroleum consultant based in Houston, Texas. Ralph E. Davis Associates Inc. conducted a study of each of the aforementioned oilfields in accordance with generally accepted petroleum engineering and evaluation principles in conformity with SEC definitions and guidelines.

The following table sets forth the Company's estimates of proved reserves, proved developed reserves and proved undeveloped reserves at December 31, 2010 and 2009:

	2010 Proved			2009 Proved		
	Producing	Undeveloped	Total	Producing	Undeveloped	Total
Oil/condensate-Barrels	3,389,900	2,086,300	5,476,200	4,331,000	1,801,000	6,132,000

Preparation of Oil and Gas Reserves Estimates

Users of this information should be aware that the process of estimating quantities of “proved” and “proved developed” oil and natural gas reserves is very complex, requiring significant subjective decisions in the evaluation of all available geological, engineering and economic data for each reservoir. The data for a given reservoir may also change substantially over time as a result of numerous factors including, but not limited to, additional development activity, evolving production history and continual reassessment of the viability of production under varying economic conditions. As a result, revisions to existing reserve estimates may occur from time to time. Although every reasonable effort is made to ensure reserve estimates reported represent the most accurate assessments possible, the subjective decisions and variances in available data for various reservoirs make these estimates generally less precise than other estimates included in the financial statement disclosures. As additional geosciences, engineering and economic data are obtained, proved reserve estimates are more likely to increase or decrease than to remain the same. These estimates are thoroughly reviewed and revised upward or downward as warranted.

The reserves in this report have been estimated using deterministic methods. For wells classified as proved developed producing where sufficient production history existed, reserves were based on individual well performance evaluation and production decline curve extrapolation techniques. For undeveloped locations and wells that lacked sufficient production history, reserves were based on analogy to producing wells within the same area exhibiting similar geologic and reservoir characteristics, combined with volumetric methods. The volumetric estimates were based on geologic maps and rock and fluid properties derived from well logs, core data, pressure measurements, and fluid samples. Well spacing was determined from drainage patterns derived from a combination of performance-based recoveries and volumetric estimates for each area or field. Proved undeveloped locations were limited to areas of uniformly high quality reservoir properties, between existing commercial producers.

The Company’s Chief Engineer, ----- Xiang Zhang is the person primarily responsible for overseeing the third party engineers we have engaged to prepare our proved reserve estimates. Xiang Zhang has served as the Company’s Chief Engineering and Exploratory Drilling since 2004. Mr. Zhang has over 20 years oil-drilling experience with the majority of this experience gained in Jilin Oilfield where NEP operates. Prior to joining NEP, Mr. Zhang worked for The Research Institution of Geology Exploitation in PetroChina Jilin Branch’s Qian’an oil refinery. Mr. Zhang received a degree in Geological and Oil Extraction Engineering from The Institute of Da Qing Petroleum.

Our proved reserve estimates were made as of December 31, 2010 by Ralph E. Davis Associates Inc., an independent worldwide petroleum consultant based in Houston, Texas. Ralph E. Davis Associates Inc. conducted a study of each of the aforementioned oilfields in accordance with generally accepted petroleum engineering and evaluation principles in conformity with SEC definitions and guidelines. The person responsible for preparing the report was Lloyd B. Branum, Vice President. Mr. Branum has thirty-eight years’ experience in the Petroleum Industry of which over thirty years’ experience are in the conduct of evaluation and engineering studies relating to both domestic U.S. oil and gas fields and international energy assets. Mr. Branum is a graduate of the University of Missouri at Rolla, Rolla, Missouri with a Bachelor of Science Degree in Petroleum Engineering. Mr. Branum is a Licensed Professional Engineer by the State of Texas.

Also contained in the above table are the Company’s estimates of future net cash flows and discounted future net cash flows from proved reserves. See-- Operating Results and Critical Accounting Policies and Estimates for additional information on the Company’s proved reserves.

The following table shows the Company’s annual average sales prices and average production costs. Production costs are costs incurred to operate and maintain the Company’s wells and related equipment and include cost of labor, well service and repair, location maintenance, power and fuel, transportation, cost of product, property taxes, production and severance taxes and production related general and administrative costs. Additional detail of production costs is

contained in the Supplemental Information.

Qian'an 112 Oilfield	2010	2009
Average annual sales price per barrel	\$ 75.54	\$ 55.97
Aggregate annual sales	\$ 53,631,300	\$ 50,142,897
Average annual production cost per barrel equivalent	\$ 18	\$ 2.94

Hetingbao 301 Oilfield	2010	2009
Average annual sales price per barrel	\$ 75.54	\$ 55.97
Aggregate annual sales	\$ 511,216	\$ 555,449
Average annual production cost per barrel equivalent	\$ 102	\$ 25.70

Daan 34 Oilfield	2010	2009
Average annual sales price per barrel	\$ 75.54	\$ 55.97
Aggregate annual sales	\$ 146,947	\$ 153,823
Average annual production cost per barrel equivalent	\$ 25	\$ 3.96

Gudian 31 Oilfield		2010	2009
Average annual sales price per barrel	\$	75.54	\$ 55.97
Aggregate annual sales	\$	382,694	\$ 228,606
Average annual production cost per barrel equivalent	\$	17	\$ 3.96

Due to flooding in July 2010, the Company was forced to suspend oil extraction for a week. However, oil extraction machinery needs continuous operation, in order to be kept in good condition. Therefore, before extraction could be resumed, the Company was forced to perform additional repair and maintenance work, which increased its production costs significantly.

Drilling Programs

During 2010, the Company drilled 3 new productive wells at the Qian'an 112 oilfield, 3 new productive wells at the Hetingbao 301 oilfield, 0 new productive wells at the Daan 34 oilfield, and 0 new productive wells at the Gudian 31 oilfield.

Drilling Statistics

The following table shows the results of the oil wells drilled and tested as of December 31, 2010 and 2009:

	Net Exploratory			Net Development			Total
	Productive	Dry Holes	Total	Productive	Dry Holes	Total	
2010	0	0	0	295	0	295	295
2009	0	0	0	289	0	289	289

Properties and Leases

The following schedule shows the number of developed leases, undeveloped leases and fee mineral acres in which the Company held interests at December 31, 2010:

Property	Developed Lease (1)		Undeveloped Lease (2)	
	Gross	Net	Gross	Net
Qian'an 112	5,227	4,182	281	225
Hetingbao 301	756	605	0	0
Daan 34	281	225	0	0
Gudian 31	281	225	0	0

(1) Developed Proved Acres means the acres assigned to each productive well. Total proved producing wells as of December 31, 2010 were 295.

(2) Undeveloped Proved Acres means the acres assigned to each undeveloped location under lease that contains proved oil reserves.

Present Activities

Production, Average Sales Prices, Production Costs, Drilling Depth and Drilling Wells Count

Our business operations are characterized by frequent, and sometimes significant, changes in the price we receive for the crude oil we produce and in the volumes of crude oil we produce. The following table shows selected operating

data for the fiscal years ended December 31, 2010 and 2009.

	Fiscal year ended December 31		
	2010	2009	2008
Oil Output (Bbl)	723,774	908,126	645,856
Avg. Sale Price (\$/bbl)	\$ 75.54	\$ 55.97	\$ 94.29
Tiancheng Drilling Depth (m)	374,413	99,161	--
Avg. Drilling Price (\$/m)	\$ 120	\$ 137	--
Tiancheng Drilling Wells	191	60	--
Oil Sales Revenue	\$ 54,672,157	\$ 51,080,775	\$ 58,572,250
Drilling Revenue	\$ 44,875,757	\$ 13,577,310	--
Cost of Revenue:			
Production Costs	\$ 4,113,237	\$ 2,868,895	\$ 3,847,775
Drilling Cost	\$ 17,555,255	\$ 4,861,488	\$ --
Depreciation, depletion and amortization of oil properties	\$ 6,570,965	\$ 9,795,312	\$ 8,609,508
Depreciation of drilling equipment	\$ 1,925,895	\$ 373,437	\$ --
Amortization of land use rights	\$ 31,754	\$ 19,792	\$ 11,718
Oil Surcharge	\$ 8,594,481	\$ 4,618,789	\$ 11,105,325
Gross Profit	\$ 60,756,327	\$ 42,120,372	\$ 34,997,924

As shown in the above table, the appreciation of oil prices in 2010 compared with 2009 caused our revenues to increase substantially, even though the production of oil decreased slightly due to flooding that occurred in the second quarter.

The following table reflects the significant oil sale price fluctuation in China in the past 12 months.

Month	Oil Sale Price	
	RMB/Ton	USD/Bbl
January 2010	3,670	73
February 2010	3,820	76
March 2010	3,586	71
April 2010	3,761	75
May 2010	4,054	80
June 2010	3,837	76
July 2010	3,615	72
August 2010	3,599	72
September 2010	3,660	73
October 2010	3,693	74
November 2010	3,909	78

December	4,019	80
2010		

(Note: 1 Ton = 7.38 Bbls, Exchange rate 1 USD = 6.7695 RMB for 12 months moving average)

Marketing and Sales

Currently, all of the Company's crude oil production is sold to PetroChina's Jilin Refinery. We do not expect the Company to have any other customers during the next twelve months. As restricted by contract with PetroChina, we may not sell any crude oil to any other customer. PetroChina pays the Company a price per barrel equal to the monthly mean price calculated from the Mean of Platts Singapore ("MOPS") daily price for sour, heavy Indonesian crude, as measured during the previous month. Platts is an international commodity and trading company that collects and publishes pricing data on a wide range of petroleum and non-petroleum commodity types. The price paid to the Company is FOB at the local Jilin Province PetroChina oil storage depot.

Contract Drilling Services

Our subsidiary, Song Yuan Tiancheng Drilling Engineering Co. Ltd ("Tiancheng"), founded in December 2007 and acquired by the Company on September 27, 2009, provides contract drilling and other oilfield services for state-owned and non-state-owned oil companies in Northern China.

Tiancheng is one of four private contract drilling and service companies that has been qualified and licensed to operate in PetroChina's Jilin oilfield. Tiancheng has also been granted contracts to drill for PetroChina. Compared to the other three drilling companies operating in the Jilin oilfield, Tiancheng is the largest, in terms of the number of drilling rigs owned in house. Tiancheng was started with only two rigs at the end of 2007, and now has eight drilling teams with the same number of rigs, which include two 4,000 meters rig (capable of drilling down to a depth of approximately 13,000 feet), three 3,000 meters rigs (approximately 9,800 feet) and three 2,000 meters rigs (approximately 6,500 feet), respectively. All of its eight drilling teams received approvals issued by the Qualification Administrative Committee of China National Petroleum Corporation (PetroChina).

Tiancheng enters into drilling contracts with PetroChina and other private oil companies to provide oilfield drilling services, and generates revenue based on the depth of each well drilled. Clients typically pay 30% of the total projected drilling costs as a down payment to start the drilling process, and pay the remaining balance within 12 months according to the specific contract terms.

In 2010, Tiancheng completed contracts to drill 191 shallow wells, which include 146 wells for state-owned PetroChina Jilin Branch and 45 wells for non-state-owned Daqing Shunwei Energy Development Co. Ltd. Tiancheng drilled a total of 374,413 meters (approximately 1,228,889 feet) in 2010, earned revenue of \$44,875,757 and net income of \$18,420,154.

Employees

At December 31, 2010, we employed 715 people, of which 75 are in management and 640 are site workers. This figure represents an increase in the number of employees reported last year. While we continue to work towards more efficient labor utilization at our oil well locations, we added employees in conjunction with our new oil wells in 2010.

Regulations

Restrictions on Foreign Ownership in the Oil and Gas Industry

The principal regulation governing foreign ownership of oil and gas companies in China is the "Industry Catalogue For the Guidance of Foreign Investment" issued by the Ministry of Commerce. Currently, qualified foreign investors cannot own 100% of an oil and gas company in China. The foreign investors' equity holding ratios are subject to the approval of relevant government authorities.

Foreign investment in China is generally subject to the approval of the Ministry of Commerce and approvals of other federal and local authorities.

As a result of the rules and regulations described above, our subsidiary Song Yuan Technical entered into share trust agreements with Wang Hong Jun and Ai Chang Shan pursuant to which Wang Hong Jun agreed to hold 10% of the equity of Yu Qiao and 5% of the equity of Tiancheng and Ai Chang Shan agreed to hold 10% of the equity of LongDe in trust for Song Yuan Technical and that the economic benefits of the equity of Yu Qiao, LongDe and Tiancheng held by Wang Hon Jun and Ai Chang San, respectively, belong to Song Yuan Technical. Our PRC legal counsel, The Victory Legal Group has opined that pursuant to the share trust agreements:

- Song Yuan Technical is able to exert effective control over Yu Qiao, LongDe and Tiancheng until the expiration of trust and upon the expiration of the trust the shares of Yu Qiao, Long De and Tiancheng will revert back to Song Yuan Technical;
-

all of the profits and dividends (if any) distributed by (i) Yu Qiao to Wang HongJun, (ii) LongDe to Ai Chang Shan and (iii) Tiancheng to Wang Hongjun are required to be transferred to Song Yuan Technical; and

- Song Yuan Technical is the ultimate beneficiary of the (i) 10% of the equity in Yu Qiao held by Wang HongJun; (ii) 10% of the equity in Long De held by Ai Chang Shan; and (iii) 5% of the equity in Tiancheng held by Wang HongJun .

The Victory Legal Group has further opined that:

- Song Yuan Technical, Wang Hong Jun and Ai Chang Shan are entitled to enter into the respective Share Trust Agreements under the PRC laws;
- The ownership structure of Yu Qiao, LongDe and Tiancheng are in compliance with existing PRC laws and regulations;
- The share trust arrangements under each of Share Trust Agreements are legal, valid and enforceable under PRC law and do not violate any PRC law or regulation; and
- The structure pursuant to which Wang HongJun holds 10% of the equity in Yu Qiao and 5% of the equity of Tiancheng in trust for Song Yuan Technical, which holds 90% and 95% of the equity in Yu Qiao and Tiancheng, respectively, complies with existing PRC laws and regulations, and the structure pursuant to which Ai Chang Shan holds 10% of the equity in LongDe in trust for Song Yuan Technical, which holds 90% of the equity in LongDe complies with existing PRC laws and regulations.

We have been further advised, however, that there are substantial uncertainties regarding the interpretation and application of current and future PRC laws and regulations. Accordingly, there can be no assurance that the PRC regulatory authorities will not in the future take a view that is contrary to the above position.

Environmental Regulations

We are subject to the environmental laws and regulations of the jurisdictions in which we carry on our business. Existing or future laws and regulations could have a significant impact on the exploration and development of natural resources by us. However, to date, we have not been required to spend any material amounts for environmental control facilities. The Chinese government strictly monitors compliance with these laws but compliance therewith has not had any adverse impact on our operations or our financial resources.

Special Oil Fees

In June 2006, the PRC government imposed a new regulation on all oil and gas producers. Under this new regulation, all oil and gas producers are subject to a mandatory special oil fee. The fee is calculated based on the per barrel selling price of crude oil received by the producer and is paid by the Company on a quarterly basis, following the end of each quarter. This special oil surcharge is essentially a progressive windfall profits tax. This fee is not related to the Company's oil field lease operating expenses or to the underlying production sharing lease payment arrangement we have with PetroChina. We pay this special oil surcharge directly to the PRC government on a quarterly basis, in arrears. The following table shows the calculation methodology for the special oil fees:

Crude Surcharge	
Price	Rate
\$/Bbl	
\$40-45	20%
\$45-50	25%
\$50-55	30%
\$55-60	35%
Above	40%
\$60	

For example, if the MOPS oil price is \$57.00 per barrel, the oil surcharge is \$4.45 per barrel (\$1.00 + \$1.25 + \$1.50 + \$0.70); if the oil price is \$75.00 per barrel, the oil surcharge is \$11.50 per barrel (\$1.00 + \$1.25 + \$1.50 + \$1.75 + \$6.00).

As a result of this new regulation, the Company paid additional special oil fees of \$8,594,481 during 2010 and \$4,618,789 during 2009 to the PRC government. The Company will be required to continue to pay these special oil fees to the PRC government if the selling price of crude oil remains above \$40.00 per barrel, and these special oil fees will increase to the extent that crude oil prices rise.

Competition

By virtue of our binding contractual agreements with PetroChina Group as described above, we have no competitor with respect to the extraction and production of crude oil from the oilfields in which we operate.

ITEM 1A. RISK FACTORS

Our business is subject to certain risks, and we want you to review these risks while you are evaluating our business and our historical results. Please keep in mind that any of the following risks discussed below and elsewhere in this Annual Report could materially and adversely affect us, our operating results, our financial condition and our projections and beliefs as to our future performance. As such, our results could differ materially from those projected in our forward-looking statements. Additional risks and uncertainties not currently known to us or those we currently deem to be immaterial may also materially and adversely affect our business.

Risks Related To Our Business

Oil prices fluctuate significantly, and lower prices for an extended period of time are likely to have a material adverse impact on our business.

Our revenues, profitability and future growth depend substantially on prevailing prices for crude oil. We sell to one customer, PetroChina, and PetroChina pays the Company a price per barrel equal to the monthly mean price calculated from the Mean of Platts Singapore (“MOPS”) daily price for sour, heavy Indonesian crude, as measured during the previous month. Platts is an international commodity and trading company that collects and publishes pricing data on a wide range of petroleum and non-petroleum commodity types. The price paid to the Company is FOB at the local Jilin Province PetroChina oil storage depot. These prices also affect the amount of cash flow available for capital expenditures and our ability to borrow and raise additional capital. The lower prices may reduce the amount of crude oil that we can economically produce.

Among the factors that can cause fluctuations are:

- The price and availability of alternative fuels;
- disruptions in supply and changes in demand caused by weather conditions;
- changes in demand as a result of changes in price;
- political conditions in oil and gas producing regions; and
- domestic governmental regulations.

Our future success depends on our ability to find, develop and acquire oil and gas reserves.

To maintain production levels, we must locate and develop or acquire new crude oil reserves to replace those depleted by production. Without successful exploration or acquisition activities, our reserves, production and revenues will decline rapidly. We may be unable to find and develop or acquire additional reserves at an acceptable cost. In addition, substantial capital is required to replace and grow reserves. If lower crude oil price or operating constraints or production difficulties result in our cash flow from operations being less than expected, we may be unable to expend the capital necessary to locate and develop or acquire new crude oil reserves.

We may need to raise substantial additional capital, which may result in substantial dilution to existing stockholders.

Although the Company currently has no plans to raise additional capital, the Company may need to raise additional capital to fully deploy wells onto its oilfields or to make acquisitions. There can be no assurance that we will be able to raise sufficient capital at all or on terms favorable to our stockholders or us. If we issue equity securities in order to raise additional capital in the amounts currently contemplated, the stockholders will experience immediate and substantial dilution in their ownership percentage of the combined company. In addition, to raise the capital we need, we may need to issue additional shares at a discount to the current market price. If the terms of such financing are unfavorable to us or our stockholders, the stockholders may experience substantial dilution in the net tangible book value of their stock. In addition, any new equity securities may have rights, preferences or privileges senior to those of existing holders of common stock. If we cannot raise funds on acceptable terms, we may not be able to fully develop or exploit our existing oil reserves, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements all of which could have a material adverse effect on us.

Environmental and regulatory factors

The oil drilling industry in China to date has not been subject to the type and scope of regulation seen in Europe and the United States. However, the possibility exists that new legislation or regulations may be adopted or that the enforcement of existing laws could become more stringent, either of which may have a significant impact on our mining operations or our customers' ability to use oil and may require us or our customers to significantly change operations or to incur substantial costs. We believe that our operations in China are in compliance with China's applicable legal and regulatory requirements. However, there can be no assurance that China's central or local governments will not impose new, stricter regulations or interpretations of existing regulations that would require additional expenditures.

Compliance and enforcement of environmental laws and regulations related to climate change

Future international, national, regional and local environmental laws and regulations in China and other Pacific Rim countries related to climate change may have a significant impact on the Company's operations. These laws and regulations may provide for user fees, penalties and other liabilities for the violation of these standards. As new environmental laws and regulations are enacted and existing laws are repealed, interpretation, application and enforcement of the laws may become inconsistent. Compliance with applicable climate change regulation in the future

may require significant expenditures, which may adversely affect the Company's operations. The enactment of any such laws, rules or regulations in the future may have a negative impact on the Company's projected growth, which could in turn decrease its projected revenues or increase its cost of doing business.

Reserve degradation and depletion

Our profitability depends substantially on our ability to exploit our oil reserves at competitive costs. Replacement reserves may not be available when required or, if available, may not be capable of being drilled at costs comparable to those characteristics of the depleting oil field. We may in the future acquire oil reserves from third parties. We may not be able to accurately assess the geological characteristics of any reserves that we acquire, which may adversely affect our profitability and financial condition. Exhaustion of reserves at our existing oil fields and at oil fields that we may acquire in the future can also have an adverse effect on operating results that is disproportionate to the percentage of overall production represented by such mines.

Reserves – title; leasehold interests

Our proved reserves are estimates. Any material inaccuracies in our reserve estimates or assumptions underlying our reserve estimates could cause the quantities and net present value of our reserves to be overstated or understated. There are numerous uncertainties inherent in estimating quantities of proved reserves, including many factors beyond our control that could cause the quantities and net present value of our reserves to be overstated. The reserve information included or incorporated by reference in this report represents estimates prepared by our internal engineers and examined by independent petroleum consultants. Estimation of reserves is not an exact science. Estimates of economically recoverable oil and natural gas reserves and of future net cash flows necessarily depend upon a number of variable factors and assumptions, any of which may cause these estimates to vary considerably from actual results, such as:

- historical production from an area compared with production from similar producing areas;
 - assumed effects of regulation by governmental agencies;
- assumptions concerning future oil and natural gas prices, future operating costs and capital expenditures; and
 - estimates of future severance and excise taxes, workover and remedial costs.

Estimates of reserves based on risk of recovery and estimates of expected future net cash flows prepared or audited by different engineers, or by the same engineers at different times, may vary substantially. Actual production, revenues and expenditures with respect to our reserves will likely vary from estimates, and the variance may be material. The net present values referred to in this report should not be construed as the current market value of the estimated oil reserves attributable to our properties. In accordance with SEC requirements, the estimated discounted net cash flows from proved reserves are generally based on prices and costs as of the date of the estimate, whereas actual future prices and costs may be materially higher or lower.

Acquisitions

We are seeking to expand our operations and oil reserves in the regions in which we operate through acquisitions of businesses and assets, including leases of oil reserves. Acquisition transactions involve inherent risks, such as:

- uncertainties in assessing the value, strengths, weaknesses, contingent and other liabilities and potential profitability of acquisition or other transaction candidates;
 - the potential loss of key personnel of an acquired business;
- the ability to achieve identified operating and financial synergies anticipated to result from an acquisition or other transaction;
 - problems that could arise from the integration of the acquired business;
- unanticipated changes in business, industry or general economic conditions that affect the assumptions underlying the acquisition or other transaction rationale; and
 - Unexpected development costs that adversely affects our profitability.

Any one or more of these factors could cause us not to realize the benefits anticipated to result from the acquisition of businesses or assets.

Risks Related To Doing Business In China

Our operations are primarily located in China and may be adversely affected by changes in the policies of the Chinese government.

The political environment in the PRC may adversely affect the Company's business operations. The PRC has operated as a socialist state since 1949 and is controlled by the Communist Party of China. In recent years, however, the government has introduced reforms aimed at creating a "socialist market economy" and policies have been implemented to allow business enterprises greater autonomy in their operations. Changes in the political leadership of the PRC may have a significant effect on laws and policies related to the current economic reforms program, other policies affecting business and the general political, economic and social environment in the PRC, including the introduction of measures to control inflation, changes in the rate or method of taxation, the imposition of additional restrictions on currency conversion and remittances abroad, and foreign investment. These effects could substantially impair the Company's business, profits or prospects in China. Moreover, economic reforms and growth in the PRC have been more successful in certain provinces than in others, and the continuation or increases of such disparities could affect the political or social stability of the PRC.

The PRC's economic, political and social conditions, as well as governmental policies, could affect the financial markets in China and our liquidity and access to capital and our ability to operate our business.

The PRC economy differs from the economies of most developed countries in many respects, including the amount of government involvement, level of development, growth rate, control of foreign exchange and allocation of resources. While the PRC economy has experienced significant growth over the past, growth has been uneven, both geographically and among various sectors of the economy. The PRC government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall PRC economy, but may also have a negative effect on us. The PRC economy has been transitioning from a planned economy to a more market-oriented economy. Although the PRC government has implemented measures since the late 1970s emphasizing the utilization of market forces for economic reform, the reduction of state ownership of productive assets and the establishment of improved corporate governance in business enterprises, a substantial portion of productive assets in China is still owned by the PRC government. In addition, the PRC government continues to play a significant role in regulating industry development by imposing industrial policies. The PRC government also exercises significant control over China's economic growth through the allocation of resources, controlling payment of foreign currency-denominated obligations, setting monetary policy and providing preferential treatment to particular industries or companies. Since late 2003, the PRC government implemented a number of measures, such as raising bank reserves against deposit rates to place additional limitations on the ability of commercial banks to make loans and raise interest rates, in order to slow down specific segments of China's economy which it believed to be overheating. These actions, as well as future actions and policies of the PRC government, could materially affect our liquidity and access to capital and our ability to operate our business.

The Chinese government exerts substantial influence over the manner in which the Company must conduct its business activities.

The PRC only recently has permitted greater provincial and local economic autonomy and private economic activities. The government of the PRC has exercised and continues to exercise substantial control over virtually every sector of the Chinese economy through regulation and state ownership. Accordingly, government actions in the future, including any decision not to continue to support recent economic reforms and to return to a more centrally planned economy or regional or local variations in the implementation of economic policies, could have a significant effect on economic conditions in the PRC or particular regions thereof, and could require the Company to divest the interests it then holds in Chinese properties or joint ventures. Any such developments could have a material adverse effect on the business, operations, financial condition and prospects of the Company.

Future inflation in China may inhibit economic activity and adversely affect the Company's operations.

In recent years, the Chinese economy has experienced periods of rapid expansion and within which some years with high rates of inflation and deflation, which have led to the adoption by the PRC government, from time to time, of various corrective measures designed to restrict the availability of credit or regulate growth and contain inflation. While inflation has moderated since 1995, high inflation may in the future cause the PRC government to impose controls on credit and/or prices, or to take other action, which could inhibit economic activity in China, and thereby adversely affect the Company's business operations and prospects in the PRC.

We may be restricted from freely converting the Renminbi ("RMB") to other currencies in a timely manner.

The RMB is not a freely convertible currency at present. The Company receives all of its revenue in RMB, which may need to be converted to other currencies, primarily U.S. dollars, and remitted outside of the PRC. Effective July 1, 1996, foreign currency "current account" transactions by foreign investment enterprises, including Sino-foreign joint ventures, are no longer subject to the approval of State Administration of Foreign Exchange ("SAFE," formerly, "State

Administration of Exchange Control”), but need only a ministerial review, according to the Administration of the Settlement, Sale and Payment of Foreign Exchange Provisions promulgated in 1996 (the “FX regulations”). “Current account” items include international commercial transactions, which occur on a regular basis, such as those relating to trade and provision of services. Distributions to joint venture parties also are considered a “current account transaction.” Other non-current account items, known as “capital account” items, remain subject to SAFE approval. Under current regulations, the Company can obtain foreign currency in exchange for RMB from swap centers authorized by the government. The Company does not anticipate problems in obtaining foreign currency to satisfy its requirements; however, there is no assurance that foreign currency shortages or changes in currency exchange laws and regulations by the Chinese government will not restrict the Company from freely converting RMB in a timely manner. If such shortages or change in laws and regulations occur, the Company may accept RMB, which can be held or re-invested in other projects.

We may suffer from exchange rate risks that could result in foreign currency exchange loss.

Because our business transactions are denominated in RMB and our funding and result of operations will be denominated in USD, fluctuations in exchange rates between USD and RMB will affect our balance sheet and financial results. Since July 2005, RMB is no longer solely pegged with USD but is pegged against a basket of currencies as a whole in order to keep a more stable exchange rate for international trading. With the very strong economic growth in China in the last few years, RMB is facing a very high pressure to appreciate against USD. Such pressure would result more fluctuations in exchange rates and in turn our business would be suffered from higher exchange rate risk.

There are very limited hedging tools available in China to hedge our exposure in exchange rate fluctuations. They are also ineffective in the sense that these hedges cannot be freely performed in the PRC financial market, and more important, the frequent changes in PRC exchange control regulations would limit our hedging ability for RMB.

We may be unable to enforce our rights due to policies regarding the regulation of foreign investments in China.

The PRC's legal system is a civil law system based on written statutes in which decided legal cases have little value as precedents, unlike the common law system prevalent in the United States. The PRC does not have a well-developed, consolidated body of laws governing foreign investment enterprises. As a result, the administration of laws and regulations by government agencies may be subject to considerable discretion and variation, and may be subject to influence by external forces unrelated to the legal merits of a particular matter. China's regulations and policies with respect to foreign investments are evolving. Definitive regulations and policies with respect to such matters as the permissible percentage of foreign investment and permissible rates of equity returns have not yet been published. Statements regarding these evolving policies have been conflicting and any such policies, as administered, are likely to be subject to broad interpretation and discretion and to be modified, perhaps on a case-by-case basis. The uncertainties regarding such regulations and policies present risks that the Company will not be able to achieve its business objectives. There can be no assurance that the Company will be able to enforce any legal rights it may have under its contracts or otherwise.

Because our assets are located overseas, stockholders may not receive distributions that they would otherwise be entitled to if we were declared bankrupt or insolvent.

Our assets are, for the most part, located in the PRC. Because the Company's assets are located overseas, the assets of the Company may be outside of the jurisdiction of U.S. courts to administer if the Company was the subject of an insolvency or bankruptcy proceeding. As a result, if the Company was declared bankrupt or insolvent, the Company's stockholders may not receive the distributions on liquidation that they are otherwise entitled to under U.S. bankruptcy law.

Our acquisitions of LongDe, Yu Qiao and Tiancheng were structured to attempt to fully comply with PRC rules and regulations. However, such arrangements may be adjudicated by relevant PRC government agencies as not being in compliance with PRC governmental regulations on foreign investment in oil and gas industries and such structures may limit our control with respect to such entities.

PRC rules and regulations do not allow foreign investors to directly own 100% of a domestic oil and gas business. As such, we are ineligible to own directly 100% a domestic oil and gas business in China. We acquired Hong Xiang Oil Development through Hong Xiang Technical, our 100% owned subsidiary. We acquired a majority interest of LongDe, Yu Qiao and Tiancheng through Song Yuan Technical, our 90% owned joint venture incorporated in the PRC. Our acquisition of Yu Qiao is currently provided through a trust arrangement with a PRC citizen designated by PetroChina, a government owned entity; pursuant to which they agree to hold 10% securities of Yu Qiao for the benefit of Song Yuan Technical in compliance with the applicable law of the PRC. However, pursuant to the trust agreement, they agree, among other things, to (i) vote the securities as directed by Song Yuan technical, (ii) deliver all payments, distributions and other economic benefits received with respect to the securities to Song Yuan Technical, (iii) not transfer or encumber the securities without the consent of Song Yuan Technical and (iv) to transfer the securities to Song Yuan Technical as soon as permissible under the laws of the PRC.

Although we have been advised by our PRC counsel that our arrangements with our affiliated Chinese entities are valid under current PRC laws and regulations, we cannot assure you that we will not be required to restructure our organization structure and operations in China to comply with changing and new PRC laws and regulations. Restructuring of our operations may result in disruption of our business, diversion of management attention and the

incurrence of substantial costs.

Recent PRC regulations relating to offshore investment activities by PRC residents may increase our administrative burden and restrict our overseas and cross-border investment activities. If our shareholders who are PRC residents fail to make any required applications and filings under such regulations, we may be unable to distribute profits and may become subject to liability under PRC laws.

The PRC National Development and Reform Commission, or NDRC, and SAFE recently promulgated regulations that require PRC residents and PRC corporate entities to register with and obtain approvals from relevant PRC government authorities in connection with their direct or indirect offshore investment activities. These regulations apply to our shareholders who are PRC residents and may apply to any offshore acquisitions that we make in the future.

Under the SAFE regulations, PRC residents who make, or have previously made, direct or indirect investments in offshore companies will be required to register those investments. In addition, any PRC resident who is a direct or indirect shareholder of an offshore company is required to file with the local branch of SAFE, with respect to that offshore company, any material change involving capital variation, such as an increase or decrease in capital, transfer or swap of shares, merger, division, long-term equity or debt investment or creation of any security interest over the assets located in China. If any PRC shareholder fails to make the required SAFE registration, the PRC subsidiaries of that offshore parent company may be prohibited from distributing their profits and the proceeds from any reduction in capital, share transfer or liquidation, to their offshore parent company, and the offshore parent company may also be prohibited from injecting additional capital into their PRC subsidiaries. Moreover, failure to comply with the various SAFE registration requirements described above could result in liability under PRC laws for evasion of applicable foreign exchange restrictions.

We cannot assure you that all of our shareholders who are PRC residents will comply with our request to make or obtain any registrations or approvals required under these regulations or other related legislation. Furthermore, as the regulations are relatively new, the PRC government has yet to publish implementing rules, and much uncertainty remains concerning the reconciliation of the new regulations with other approval requirements. It is unclear how these regulations, and any future legislation concerning offshore or cross-border transactions, will be interpreted, amended and implemented by the relevant government authorities. The failure or inability of our PRC resident shareholders to comply with these regulations may subject us to fines and legal sanctions, restrict our overseas or cross-border investment activities, limit our ability to inject additional capital into our PRC subsidiaries, and the ability of our PRC subsidiaries to make distributions or pay dividends, or materially and adversely affect our ownership structure. If any of the foregoing events occur, our acquisition strategy, business operations and ability to distribute profits to you could be materially and adversely affected.

PRC regulation of loans and direct investment by offshore holding companies to PRC entities may delay or prevent us from raising finance to make loans or additional capital contributions to our PRC operating subsidiaries and affiliates.

As an offshore holding company of our PRC operating subsidiaries and affiliates, we may make loans to our PRC subsidiaries and consolidated PRC affiliated entities, or we may make additional capital contributions to our PRC subsidiaries. Any loans to our PRC subsidiaries or consolidated PRC affiliated entities are subject to PRC regulations and approvals.

We may also determine to finance Song Yuan Technical, by means of capital contributions. These capital contributions to Song Yuan Technical must be approved by the PRC Ministry of Commerce or its local counterpart. We cannot assure you that we can obtain these government registrations or approvals on a timely basis, if at all, with respect to future loans or capital contributions by us to our operating subsidiaries. If we fail to receive such registrations or approvals, our ability to capitalize our PRC operations would be negatively affected which would adversely and materially affect our liquidity and our ability to expand our business.

We may suffer an adverse impact on our reputation and share value as a result of our relationship with the PetroChina Group or its affiliates.

China National Petroleum Corporation (CNPC), the parent company of the PetroChina Group, has operations in various countries subject to U.S. export or asset controls. We sell all of our crude oil production to the Jilin Refinery of the PetroChina Group. We are aware of certain organizational and investor efforts to persuade PetroChina, the reporting subsidiary of CNPC in the United States, to end its business contacts, direct or indirect, with certain countries, including Cuba, Iran and Sudan, and that investors have divested PetroChina's securities because of such ties. Iran and Sudan have been designated by the U.S. as state sponsors of terrorism. To date, we have detected no adverse investor sentiment regarding our contractual relationship with PetroChina, no reluctance to invest because of

such relationship and no desire or intent to divest our securities because of such relationship. Nevertheless, in light of the aforementioned organizational and investor efforts regarding PetroChina, we may suffer an adverse impact on our reputation and share value as a result of our relationship with PetroChina.

Risks Related to Corporate and Stock Matters

Our authorized preferred stock exposes stockholders to certain risks.

Our Articles of Incorporation authorizes the issuance of up to 150,000,000 shares of preferred stock, par value \$.001 per share. To date, no shares of preferred stock have been issued. The authorized preferred stock constitutes what is commonly referred to as “blank check” preferred stock. This type of preferred stock allows the Board of Directors to divide the preferred stock into series, to designate each series, to fix and determine separately for each series any one or more relative rights and preferences and to issue shares of any series without further stockholder approval. Preferred stock authorized in series allows our Board of Directors to hinder or discourage an attempt to gain control of us by a merger, tender offer at a control premium price, proxy contest or otherwise. Consequently, the preferred stock could entrench our management. In addition, the market price of our common stock could be materially and adversely affected by the existence of the preferred stock.

The market for the Company's common stock is illiquid.

It is thinly traded compared to larger more widely known companies in its industry. Thinly traded common stock can be more volatile than stock trading in an active public market. The Company cannot predict the extent to which an active public market for its common stock will develop or be sustained.

National Association of Securities Dealers ("NASD") sales practice requirements may also limit a stockholder's ability to buy and sell our stock.

The NASD has adopted rules that require that in recommending an investment to a customer, a broker-dealer must have reasonable grounds for believing that the investment is suitable for that customer. Prior to recommending speculative low priced securities to their non-institutional customers, broker-dealers must make reasonable efforts to obtain information about the customer's financial status, tax status, investment objectives and other information. Under interpretations of these rules, the NASD believes that there is a high probability that speculative low priced securities will not be suitable for at least some customers. The NASD requirements make it more difficult for broker-dealers to recommend that their customers buy our common stock, which may limit your ability to buy and sell our stock and have an adverse effect on the market for our shares.

Our common stock has experienced, and may continue to experience, price volatility and a low trading volume

The trading price of our common stock has been and may continue to be subject to large fluctuations, which may result in losses to investors. Our stock price may increase or decrease in response to a number of events and factors, including:

- trends in our industry and the markets in which we operate;
- changes in the market price of the commodities we sell;
- changes in financial estimates and recommendations by securities analysts;
 - acquisitions and financings;
 - quarterly variations in operating results;
- the operating and stock price performance of other companies that investors may deem comparable to us; and
 - issuances, purchases or sales of blocks of our common stock.

This volatility may adversely affect the price of our common stock regardless of our operating performance. See "Item 4 — Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities" for further discussion.

Stockholders should have no expectation of any dividends.

The holders of our common stock are entitled to receive dividends when, as and if declared by the board of directors out of funds legally available therefore. To date, we have not declared nor paid any cash dividends. The board of directors does not intend to declare any dividends in the foreseeable future, but instead intends to retain all earnings, if any, for use in our business operations.

A majority of our directors and officers are located outside the United States, with the result that it may be difficult for investors to enforce within the United States any judgments obtained against us or any of our overseas-based directors or officers.

A majority of our directors and officers are nationals and/or residents of countries other than the United States, and all or a substantial portion of such persons' assets are located outside the United States. As a result, it may be difficult for

investors to effect service of process on our overseas-based directors or officers, or enforce within the United States or Canada any judgments obtained against us or our overseas-based officers or directors, including judgments predicated upon the civil liability provisions of the securities laws of the United States or any state thereof. Consequently, you may be effectively prevented from pursuing remedies under U.S. federal securities laws against them. In addition, investors may not be able to commence an action in a Canadian court predicated upon the civil liability provisions of the securities laws of the United States.

If we or our independent registered public accountants cannot attest our adequacy in the internal control measures over our financial reporting, as required by Section 404 of the U.S. Sarbanes-Oxley Act, for the fiscal year ending December 31, 2010, we may be adversely affected.

As a public company, we are subject to report our internal control structure and procedures for financial reporting in our annual reports on Form 10-K, as a requirement of Section 404 of the U.S. Sarbanes-Oxley Act of 2002 by the U.S. Securities and Exchange Commission (the "SEC"). The report must contain an assessment by management about the effectiveness of our internal controls over financial reporting. Moreover, the independent registered public accountants of our company must attest to and report on management's assessment of the same. Our management attests that our internal control measures are not effective, our independent registered public accountants also may not be satisfied with our internal control structure and procedures. The conclusion of the report could result in an adverse impact on us in the financial marketplace due to the loss of investor confidence in the reliability of our financial statements, which could negatively impact our stock market price.

ITEM 1B. UNRESOLVED STAFF COMMENTS

The Company received a comment letter from the SEC Division of Corporate Finance on December 31, 2009 which raised a number of questions regarding the Company's previously filed Annual Report on Form 10-K for the year ended December 31, 2008 (the "Comment Letter"). In the process of preparing a response to the Comment Letter, on February 23, 2010 the Company determined that the Company's financial statements as of December 31, 2008 and for the year then ended, and for the quarters ended March 31, 2008, June 30, 2008, September 30, 2008, March 31, 2009, June 30, 2009 and September 30, 2009, should no longer be relied upon and should be restated as a result of certain non-cash errors contained therein regarding the accounting for: (i) warrants issued in conjunction with a secured debenture on February 28, 2008, which warrants should have been classified according to EITF 00-19 as liability instruments rather than equity instruments; (ii) the change in the fair value of those warrants from the date of issuance through the end of the reporting period; (iii) effective interest expense arising from amortization of the discount to the carrying value of the secured debenture; (iv) the recording of warrants issued to investment consultants in connection with the secured debenture as deferred financing costs instead of consulting fees; (v) the amount of amortization of deferred financing costs associated with the issuance of that secured debenture; (vi) amounts payable to a consultant included in accrued liabilities; (vii) compensation issued to employees in the form of stock; (viii) depreciation, depletion and amortization of oil properties; (ix) ceiling test reduction of the net carrying value of oil properties; (x) income tax expense for the above items; and (xi) noncontrolling interest for certain of the above items. The amended and restated financial reports for those periods were filed with the SEC on August 31 and September 1, 2010, along with the Company's response to the Comment Letter. As of the filing date of this Annual Report on Form 10-K for the year ended December 31, 2010, the Company has not received a response from the SEC that resolves the comments raised in the Comment Letter. It is possible that the SEC will have additional comments or questions related to our response to the Comment Letter.

ITEM 2. PROPERTIES

China North East Petroleum's principal headquarters are located in Song Yuan City, in the People's Republic of China. The Company leases an approximately 7,747 square foot facility for approximately \$14,519 per year that expires in June 30, 2015. These headquarters house all of our PRC administrative and clerical staff. The Company also leases an approximately 26,910 square foot facility as its production base for \$189 per year that expires in September 20, 2023. We also have offices in Harbin City, China, Los Angeles and New York City, United States.

The Company's crude oil exploration and production operations are conducted on property which is located in the Jilin Oil Region.

The Company also has an office located at the Qian'an 112 Oilfield. The Company owns the buildings although the land is leased pursuant to the Oil Lease. Actual oil exploration and production operations are controlled from this office and housing is provided for up to 60 workers. The Company pays no rent for use of this space. In addition, the Company has no written agreement or formal arrangement pertaining to the use of this space. No other businesses operate from this office.

The Company also has an office located at the Northern River Industry Zone, Song Yuan city. The office houses all of our administrative and clerical staff for our drilling company. The Company owns the buildings. The land area totals approximately 20,500 square meters.

The Company does not have an office located in the Hetingbao 301, Daan 34 or Gudian 31 Oilfields.

The Company leases an office located at 445 Park Avenue, 10th Floor, New York, NY for \$4,438 per year that expires in February 2012 and an office located at 21688 Gateway Center Drive, Suite 165, Diamond Bar, CA for \$32,788 per

year that expires in October 2013. These offices house the Company's U.S. administrative and clerical staff.

The Company has no current plans to occupy any additional office space.

ITEM 3. LEGAL PROCEEDINGS

The Company was recently involved in six legal actions, three of which are securities class actions and three of which are shareholder derivative actions, in the U.S. District Court for the Southern District of New York against the Company and certain officers and directors. The three class actions assert claims under the federal securities laws and the three derivative actions assert common law claims based on breach of duty.

The six actions are: (1) Rosado v. China North East Petroleum Holdings Limited, et al., 10 CV 4577 (MGC), filed June 11, 2010; (2) Weissmann v. China North East Petroleum Holdings Limited, et al., 10 CV 4775 (MGC), filed June 18, 2010; (3) Moore v. China North East Petroleum Holdings Limited, et al., 10 CV 5263 (MGC), filed July 9, 2010; (4) Strickland v. Hongjun, et al., 10 CV 5445 (RMB), filed July 19, 2010; (5) Drobner v. Hongjun, et al., 10 CV 6193 (No Judge has been assigned at this time), filed August 23, 2010; and (6) Nicoln v. Hongjun, et al., 10 CV 6344 (No Judge has been assigned at this time), filed August 24, 2010.

The time for the Company to respond formally to these lawsuits has not come. In addition, the complaints do not specify an amount of damages that plaintiffs seek. Because these matters are in very early stages, we cannot comment on whether an adverse outcome is probable or otherwise. While we believe we have meritorious defenses to each of these actions and intend to defend them vigorously, an adverse outcome in one or more of these matters could have a material adverse effect on its business, financial condition, results of operations or liquidity.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

Market Information

Prior to June 15, 2009, the Company's common stock was quoted on the Over-the-Counter Bulletin Board ("OTCBB") under the symbol "CNEH.OB." On June 15, 2009, we terminated our listing on OTCBB and listed our common stock on NYSE Amex LLC ("AMEX") under the symbol "NEP." The following table sets forth, for the indicated periods, the high low prices for our common stock as reported on AMEX, and prior to June 15, 2009, as reported on OTCBB. These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not represent actual transactions.

	NEP / CNEH COMMON STOCK	
	HIGH	LOW
FISCAL YEAR ENDING DECEMBER 31, 2010:		
First Quarter	\$ 11.35	\$ 7.82
Second Quarter	\$ 9.85	\$ 5.20
Third Quarter	\$ 6.08	\$ 4.42
Fourth Quarter	\$ 7.95	\$ 5.31
FISCAL YEAR ENDING DECEMBER 31, 2009:		
First Quarter	\$ 2.00	\$ 1.30
Second Quarter	\$ 5.82	\$ 1.44
Third Quarter	\$ 6.28	\$ 3.80
Fourth Quarter	\$ 9.25	\$ 4.38

Holders

As of March 3, 2011, the Company had approximately 92 holders of record.

Equity Compensation Plan Information

The following table sets forth certain information as of March 3, 2011 about our equity compensation plans under which our equity securities are authorized for issuance.

Equity Compensation Plan Information Table

Plan Category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	180,000	\$2.94 - \$5.50	220,000
Equity compensation plans not approved by security holders	-	-	-
Total	180,000		220,000

During 2010, the Company granted its employees, 80,000 common stock options under the Company's 2006 Stock Option/Stock Issuance Plan (the "2006 Plan"). As of December 31, 2010, stock options granted under the 2006 Plan to purchase 180,000 shares of its Common Stock (the "Options") at an exercise price from \$2.94 to \$5.50 per share were outstanding. The stock options outstanding, 180,000 vest as follows: 25% of the stock options vest upon grant and 25% vest every three months thereafter, and these stock options expire ten years after the grant date if unexercised at that time. The remaining 310,000 stock options vest as follows: 50% of the 310,000 stock options vest upon grant and 50% vest on the first anniversary of the grant date.

The 2006 Plan authorizes the issuance of up to 2,500,000 common stock equivalents (stock options, restricted stock, stock grants). As of December 31, 2010, the Company had 220,000 remaining share equivalents available for grant under the 2006 Plan. The Company settles employee stock option exercises with newly issued common shares.

The fair value of stock options granted was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions:

Expected Life	Expected Volatility	Dividend Yield	Risk Free Interest Rate	Grant Date Fair Value
5 years	258% - 316%	0%	1.47% - 3.42%	\$2.94 - \$5.50

- Dividend Yield: The expected dividend yield is zero. The Company has not paid a dividend and does not anticipate paying dividends in the foreseeable future.
- Risk Free Rate: Risk-free interest rate of 1.47% - 3.42% was used. The risk-free interest rate was based on U.S. Treasury yields with a remaining term that corresponded to the expected term of the option calculated on the grant date.
- Expected Life: Because the Company has no historical share option exercise experience to estimate future exercise patterns, the expected life was determined using the simplified method as these awards meet the definition of "plain-vanilla."

Stock compensation expense is recognized based on awards expected to vest. There was no estimated forfeiture as the Company has a short history of issuing options. ASC 718-10 requires forfeiture to be estimated at the time of grant and revised in subsequent periods, if necessary, if actual forfeitures differ from those estimates.

On January 28, 2010, 250,000 stock options previously granted to one senior management member were exercised at \$4.50 per share, with an aggregate fair value of \$1,125,000 paid to the Company.

On March 29, 2010, 400,000 shares of common stock with a fair value of approximately \$3,232,000 were granted to key members of the management team of Tiancheng, and the Company recognized stock compensation expenses of \$1,219,372 which was included in selling, general and administrative expenses for the year ended December 31, 2010.

As of December 31, 2010, the total compensation cost related to stock options not yet recognized was \$1,843,792 and will be recognized over the next three years.

The following is a summary of the stock option activity:

	Number of Options Outstanding	Weighted-Average Exercise Price
Balance, December 31, 2009	350,000	\$ 4.18

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Granted	80,000	\$	5.50
Forfeited	-		-
Exercised	(250,000)	\$	4.50
Balance, December 31, 2010	180,000	\$	4.32
Exercisable at December 31, 2010	100,000	\$	3.38

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The following is a summary of the status of options outstanding at December 31, 2010:

Exercise Price	Outstanding Options Number	Average Remaining Contractual Life	Average Exercise Price	Exercisable Options Number	Weighted Average Exercise Price
\$4.05	40,000	7.42 years	\$4.05	40,000	\$4.05
\$2.94	60,000	8.42 years	\$2.94	60,000	\$2.94
\$5.50	80,000	9.48 years	\$5.50	-	\$5.50
	180,000			100,000	

The Company's outstanding warrants as of December 31, 2010 are as follows:

	Date of issue	Expiration date	Exercise price	Outstanding Warrants
Warrant 1	February 28, 2008	February 28, 2013	\$ 2.35	2,100,000
Warrant 2	March 5, 2009	March 5, 2013	\$ 2.00	250,000
Warrant 3	March 5, 2009	March 5, 2013	\$ 2.35	250,000
Warrant 4	April 29, 2009	April 29, 2013	\$ 2.65	50,000
Warrant 5	September 15, 2009	September 15, 2014	\$ 6.00	698,263
Warrant 6	September 10, 2009	September 10, 2014	\$ 6.00	80,000
Warrant 7	December 11, 2009	September 9, 2014	\$ 8.10	58,910
Warrant 8	December 17, 2009	June 17, 2011	\$ 8.10	392,728
				3,879,899

The Company treats these warrants as liabilities under ASC 815-40 and accordingly records the warrants at fair value with changes in fair values recorded in the profit or loss until such time as the warrants are exercised or expired. The fair values were \$39,528,261 at December 31, 2009 and \$12,376,301 at December 31, 2010. As of December 31, 2010, included in the warrant liabilities, there was an accrued penalty imposed by an investor on late filing of registration statement of \$1,163,333. For the fiscal years ended December 31, 2010 and 2009, the Company recorded a gain of \$26,555,889, a loss of \$27,398,967, respectively, in changes in the fair value of the warrants in profit or loss.

On March 12, 2011, the Company entered into an agreement with Lotusbox Investments Ltd., the purchaser of the Company's Secured Debenture, pursuant to which the parties released each other from all claims and liabilities based on or arising out of the Company's failure to register shares of the Company's common stock underlying warrants issued to the purchaser in connection with the purchase of the Secured Debenture. In addition, the purchaser released the Company from any further obligations to register the warrant shares. In return, the Company agreed to reduce the exercise prices of 500,000 warrants issued to the purchaser in 2009 from \$2.00 and \$2.35 to \$0.01; and to reduce the exercise price of 100,000 warrants to the purchaser in 2008 from \$2.35 to \$0.01. The Company also agreed to allow the purchaser to purchase the warrant shares by means of a cashless exercise.

The Company estimates the fair value of these warrants using the Black-Scholes option pricing model using the following assumptions:

December
31, 2010
\$5.76

Market price and estimated fair value of common stock:	
	\$2.00 -
Exercise price:	\$8.10
Remaining contractual life (years):	0.21 - 3.67
Dividend yield:	-
Expected volatility:	24% - 213%
Risk-free interest rate:	0.12% - 2.01%

Stock issuance

- (1) In January 2010, Series B Warrants issued with the secured debenture were exercised by one investor to purchase 867,438 shares of common stock at the exercise price of \$2.35 per share.
- (2) On March 23, 2010, an investor exercised warrants and purchased 21,739 shares of common stock at exercise price of \$6.00 per share. The Company received \$130,434 proceeds in connection with this transaction.
- (3) In April 2010, one investor exercised warrants to purchase 29,865 shares of common stock at the exercise price of \$6.00 per share.

Dividend Policy

We have not declared any dividends since incorporation and do not anticipate that we will do so in the foreseeable future. Although there are no restrictions that limit the ability to pay dividends on our common shares, our intention is to retain future earnings for use in our operations and the expansion of our business.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The following discussion and analysis of financial condition and results of operations should be read in conjunction with our financial statements and related notes included elsewhere in this report. This discussion contains forward-looking statements that involve risks, uncertainties and assumptions. Forward-looking statements can be identified by the fact that they do not relate strictly to historic or current facts. They use words such as "anticipate," "estimate," "project," "intend," "plan," "believe" and other words and terms of similar meaning in connection with a discussion of future operating or financial performance. In particular, these include statements relating to:

- Our expectation of continued growth in the demand for our oil;
- Our expectation that we will continue to have adequate liquidity from cash flows from operations;
 - A variety of market, operational, geologic, permitting, labor and weather related factors; and
- The other risks and uncertainties which are described below under "RISK FACTORS", including, but not limited to, the following:
 - Unanticipated conditions may cause profitability to fluctuate.
 - Decreases in purchases of oil by our customer will adversely affect our revenues.

Overview

We are engaged in the exploration and production of crude oil in Northern China. We have an arrangement with the Jilin Refinery of PetroChina Group to sell our crude oil production for use in the China marketplace. We currently operate 295 producing wells located in four oilfields in Northern China and have plans for additional drilling projects.

In particular, through two of our subsidiaries, Yu Qiao and LongDe, we have entered into binding sales agreements with the PetroChina Group, whereby we sell our crude oil production for use in the China marketplace.

In addition, on September 25, 2009, we acquired Tiancheng which provides contract drilling and other oilfield services for state-owned and non-state-owned oil companies in Northern China.

Entry into a Material Definitive Agreement

On January 19, 2011, the Company through its subsidiary, Song Yuan Technical, entered into a Share Transfer Agreement with the shareholders (the “Shareholders”) of Sunite Right Banner Shengyuan Oil and Gas Technology Development Co., Ltd. (“Shengyuan”), dated January 19, 2011 (the “Share Transfer Agreement”), to acquire 100% of the equity interests in Shengyuan (the “Acquisition”). Shengyuan is a limited liability company incorporated in Sunite Right Banner, Inner Mongolia in the People’s Republic of China with exclusive oilfield exploration and drilling rights to the Durimu oilfield in Inner Mongolia.

The total purchase price for Shengyuan is valued at approximately \$43.4 million consisting of RMB 70 million (approximately US\$10.6 million) in cash and 5,800,000 shares of the Company’s common stock (the “Acquisition Shares”). The Acquisition Shares will be issued pursuant to a Share Issuance Agreement by and among the Company, Bellini Holdings Management Ltd., a company organized by the Shareholders under the laws of the British Virgin Islands (“Bellini”), and the Shareholders dated January 19, 2011 (the “Share Issuance Agreement”). The cash consideration will be paid to the Shareholders at closing. Bellini is an entity fully controlled by the Shareholders and designated by the Shareholders to receive the Acquisition Shares.

Completion of the Acquisition is subject to certain terms and closing conditions set forth in the Share Transfer Agreement and the Share Issuance Agreement, including that Shengyuan obtain approval of the transfer of the Shareholders' equity interest in Shengyuan to Song Yuan Technical from all relevant governmental authorities, and other customary closing conditions.

On January 20, 2011, the Company issued a press release announcing the Acquisition.

CONSOLIDATED RESULTS OF OPERATIONS

The Company's crude oil sales are paid by PetroChina based on the crude oil price in the international commodity market. Prices in 2010 averaged RMB 3,772 per ton or approximately \$75.49 per barrel, which represents an increase of 35% from the 2009 average price received of \$55.97 per barrel.

In 2010, our contract drilling subsidiary, Tiancheng, completed contracts to drill 191 shallow wells, which include 146 wells for state-owned PetroChina Jilin Branch and 45 wells for non-state-owned Daqing Shunwei Energy Development Co. Ltd. The total drilling depth accomplished this year was 374,413 meters (approximately 1,228,389 feet), with drilling revenues of \$44,875,757 and income from operations of \$18,420,154.

Our cost of net revenues consists of cost of labor, well service and repair, location maintenance, power and fuel, transportation, cost of product, property taxes, production and severance taxes and production related general and administrative costs.

General and administrative expenses consist primarily of salaries and related expenses for executive, finance, accounting, information technology, facilities and human resources personnel, recruiting expenses, professional fees and costs associated with expanding our information systems.

Comparing Fiscal Years Ended December 31, 2010 and 2009:

The following table presents certain consolidated statement of operations information. Financial information is presented for the 12-month period ended as of December 31, 2010 and December 31, 2009.

	2010	2009
Revenues, net	\$ 99,547,914	\$ 64,658,085
Operating Expenses	\$ 7,802,930	\$ 17,732,379
Income from Operations	\$ 52,953,397	\$ 24,387,993

Revenues. Revenues for 2010 increased 54% to \$99,547,914 from \$64,658,085 in 2009 as a result of an increase in oil prices and revenue generated by our newly acquired contract drilling entity, Tiancheng. During the year, the Company drilled six new oil wells in our four oilfields. The total number of producing wells increased from 289 in 2009 to 295 in 2010, a total increase of 2%. However, total oil production for 2010 was 723,154 barrels, or approximately a 20% decrease, as compared with 908,126 barrels in 2009 due to severe flooding that occurred in the region in the third quarter that impacted oil production. Before the flooding, production was approximately 63,000 bbl per month. As a result of the flooding, our average monthly production in the second half of 2010 decreased to 49,000 bbl per month. Oil prices in 2010 averaged RMB 3,772 per ton or approximately \$75.49 per barrel, which represents an increase of 35% over 2009 levels of RMB 2,824 per ton or approximately \$55.97 per barrel.

Oilfield	2010 wells	2009 wells	2010 Production	2009 Production
Qian'an112	250	247	710,027	892,404
Hetingbao 301	21	18	6,689	9,482

Gudian31	12	12	5,063	3,796
Daan 34	12	12	1,995	2,444
Total	295	289	723,792	908,126

Company	2010 wells	2009 wells	2010 Production	2009 Production
Yu Qiao	274	271	717,085	898,644
LongDe	21	18	6,689	9,482

Cost of Revenue. Cost of revenue increased by 72.1% from \$22,537,713 for the year ended December 31, 2009 to \$38,791,587 for the year ended December 31, 2010. The increase was due to an increase in the number of wells drilled by Tiancheng which led to a significant increase in drilling costs. In addition, higher oil prices in 2010 led to an increase in government oil surcharge. The Company paid a special oil surcharge of \$8,594,481 to the PRC government in 2010, compared to \$4,618,789 paid to the PRC government for the same period in 2009. During 2010, our total number of producing wells increased to 295, an increase of 2%. Also, as a result of the flooding in the third quarter, approximately 50 wells needed to be repaired. The repair cost was approximately \$3,800 per well for an aggregate repair cost of approximately \$200,000. Depreciation, depletion and amortization of oil properties decreased by 33% from \$9,795,312 in 2009, to \$6,570,965 in the same period in 2010 due to a decrease in production .

Total drilling costs in 2010 were \$17,555,255 associated with 191 wells drilled during fiscal 2010.

Operating Expenses. In 2010 operating expenses decreased by 56% from \$17,732,379 for the year ended December 31, 2009 to \$7,802,930 for the year ended December 31, 2010. The decrease was mainly due to the fact that the Company recorded impairment to oil properties of \$13,837,108 in 2009 compared to zero impairment in 2010.

General and Administrative Expenses. General and administrative expenses increased slightly by 2% to \$2,989,913 for the year ended December 31, 2010 compared to \$2,942,381 for the year ended December 31, 2009.

Net Income (Loss) Attributable to NEP Common Stockholders. The Company realized net income attributable to NEP stockholders of \$58,369,471 for the year ended December 31, 2010 compared to a net loss of \$22,109,514 for the year ended December 31, 2009. The increase in net income was primarily a result of an increase in the number of wells drilled by Tiancheng, oil prices surge and non cash gain in the fair value of warrants, as well as lower operating expenses.

LIQUIDITY AND CAPITAL RESOURCES

We are financing our operations and capital expenditures through cash flows from operations and the issuance of new shares of our common stock. Our capital resources consist primarily of cash flows from our oil producing properties and oilfield drilling services operation. Earnings and cash flows of the Company depend upon many factors, such as the price we receive for crude oil we produce.

As of December 31, 2010, the Company had cash and cash equivalents of \$60,974,007, total current assets of \$80,550,863 and current liabilities of \$14,011,449. For the year ended December 31, 2010, our primary source of liquidity was \$35,046,468 in net cash provided by operations.

As of December 31, 2010, the Company's current liabilities were \$14,011,449, consisting of \$4,156,349 in accounts payable primarily comprised of costs related to the drilling of wells in previous years and \$5,076,074 in income and other taxes payable

Net cash provided by operating activities was \$35,046,468 for the year ended December 31, 2010 compared to \$15,885,573 for the same period in 2009. This is primarily related to an increase in net income to \$62,690,631 in 2010, due to an increase in the number of wells drilled by Tiancheng and oil prices and non cash gains in fair value of warrants as well as lower operating expenses.

Net cash used in investing activities was \$1,279,470 for the year ended December 31, 2010 compared to \$29,912,139 for the same period in 2009 primarily because of the acquisition of Tiancheng in 2009 and fewer wells were drilled.

Net cash used in financing activities was \$3,712,856 for the year ended December 31, 2010 compared to net cash provided by financing activities of \$29,512,312 for the same period in 2009. This is because the Company raised a significant amount of capital in 2009, which was deployed in 2010.

The Company has paid for the construction of its oil wells under production and construction, along with its acquisition of an oil well drilling and servicing company, with cash from operations as well as by funds raised through the issuance of secured debt, common stock and warrants to purchase the Company's common stock. The Company is continually evaluating opportunities to expand the Company's production and operations. The Company may need additional resources to fully implement the Company's business plan and growth strategy. Our ability to obtain additional capital to achieve these expansion goals will depend on market conditions, national and global economies, and other factors beyond our control. We cannot assure you that the Company will be able to implement or capitalize

on various financing alternatives or otherwise obtain required capital, the need for which could be substantial given the Company's business and development goals. However, the Company anticipates that cash flows from operations will be sufficient to fund continued development at the four oil fields it currently operates and to fund continued operations at its oil well drilling and servicing subsidiary.

Registration Rights Penalties

In conjunction with the March 5, 2009 modification of the Company's secured debenture issued on February 28, 2008 (See Note 9, "Secured Debenture," of the Notes to the Consolidated Financial Statements) and the original issuance of the secured debenture, the Company entered into two Registration Rights Agreements, which cover stock to be issued upon exercise of warrants issued in connection with both the modification and the issuance of the secured debenture. These Registration Rights Agreements provide for financial penalties in certain circumstances, including (i) if the registration statement covering the shares of common stock underlying the Original Warrants is not declared effective within 180 days of the date of the Registration Rights Agreement or (ii) after effectiveness, the registration statement ceases to remain continuously effective for more than 10 consecutive calendar days or more than 30 calendar days in any 30 calendar day period. The financial penalty equals 1% of the aggregate purchase price paid for the Original Warrants subject to the registration rights up to a maximum of 10% of the principal amount of the debenture. The Company analyzes these registration rights agreements to determine if penalties triggered for late filing should be accrued under ASC 825-20.

On March 12, 2011, the Company entered into an agreement with Lotusbox Investments Ltd., the purchaser of the Company's Secured Debenture, pursuant to which the parties released each other from all claims and liabilities based on or arising out of the Company's failure to register shares of the Company's common stock underlying warrants issued to the purchaser in connection with the purchase of the Secured Debenture. In addition, the purchaser released the Company from any further obligations to register the warrant shares. In return, the Company agreed to reduce the exercise prices of 500,000 warrants issued to the purchaser in 2009 from \$2.00 and \$2.35 to \$0.01; and to reduce the exercise price of 100,000 warrants to the purchaser in 2008 from \$2.35 to \$0.01. The Company also agreed to allow the purchaser to purchase the warrant shares by means of a cashless exercise.

Inflation

Inflation did not have a material impact on our business in 2010.

Crude Oil Price Trends

Changes in crude oil prices significantly affect our revenues, financial condition and cash flows. Markets for crude oil have historically been volatile and we expect this trend to continue. Prices for crude oil typically fluctuate in response to relatively minor changes in supply and demand, market uncertainty, seasonal, economic, political and other factors beyond our control. Although we are unable to predict accurately the prices we receive for our oil, any significant or sustained decline in oil prices may materially adversely affect our financial condition, liquidity, ability to obtain future debt or equity financing and operating results.

Production Trends

Like all other oil exploration and production companies, we experience natural production declines at existing wells. We recognize that oil production from a given well naturally decreases over time and that a downward trend in our overall production could occur unless the natural declines are offset by additional production from new wells, investment in measures to increase the production from existing wells (such as CO₂ and water injection), or acquisitions of producing properties. If any production declines we experience are not a temporary trend, and if we cannot economically replace our reserves, our results may be adversely affected and our stock price may decline. Our future growth will depend upon our ability to continue to add oil reserves in excess of our production at a reasonable cost.

We have achieved an increased production and revenue from our four oilfields as a result of our significant investments in these areas. As of December 31, 2010, we have drilled 295 wells out of the 650 wells that can be drilled in our four oilfields. We anticipate that we will continue to drill new wells and increase production in these areas. We are also actively seeking additional oil fields that we can lease and operate.

Operating Expense Trends

Costs associated with oil well drilling, improvement (e.g. fracturing and water injection), and maintenance in the northeastern Chinese oil fields where we operate have remained relatively constant over the past few years. Similarly, service rates charged by oil field service companies have remained relatively constant over the past few years. We are also generally somewhat buffered from changes in the world oil prices due to the impact of the government oil surcharge tax. When the prices rise, the amount of oil surcharge tax that we are required to pay increases; conversely, price declines it would lead to a reduction in the amount of oil surcharge tax. For the year ended December 31, 2010, the approximate amount of oil surcharge tax we paid was \$8,594,481, as compared to \$4,618,789 for the year ended December 31, 2009.

CRITICAL ACCOUNTING POLICIES

Proved Reserves.

Proved oil and gas reserves, as defined by SEC Regulation S-X Rule 4-10(a) (2)(i), (2)(ii), (2)(iii), (3) and (4), are the estimated quantities of crude oil that geological and engineering data demonstrate with reasonable certainty to be recoverable in the future years from known reservoirs under existing economic and operating conditions, i.e., prices and costs as of the date the estimate is made. Prices include consideration of changes in the existing prices provided only by contractual arrangements, but not on escalations based upon future conditions.

The Company's estimates of proved reserves are made using available geological and reservoir data as well as production performance data. These estimates, made by the Company's engineers, are reviewed annually and revised, either upward or downward, as warranted by additional data. Revisions are necessary due to changes in, among other things, reservoir performance, prices, economic conditions and governmental restrictions. Decreases in prices, for example, may cause a reduction in some proved reserves due to reaching economic limits sooner.

Properties and Equipment.

The Company uses the full cost method of accounting for exploration and development activities as defined by the SEC. Under this method of accounting, the costs of unsuccessful, as well as successful, exploration and development activities are capitalized as properties and equipment. This includes any internal costs that is directly related to exploration and development activities but does not include any costs related to production, general corporate overhead or similar activities. Gain or loss on the sale or other disposition of oil properties is not recognized, unless the gain or loss would significantly alter the relationship between capitalized costs and proved reserves of oil and natural gas attributable to a country. The application of the full cost method of accounting for oil properties generally results in higher capitalized costs and higher depreciation, depletion and amortization rates compared to the successful efforts method of accounting for oil properties.

Principles of consolidation

The accompanying audited consolidated financial statements as of December 31, 2010 and 2009 include the audited financial statements of North East Petroleum and its wholly owned subsidiary, Hong Xiang Petroleum Group and 90% owned subsidiaries, Song Yuan Technical, LongDe, Yu Qiao and Tiancheng. The noncontrolling interests represent the minority shareholders' 10% share of the results of Song Yuan Technical, LongDe, Yu Qiao and Tiancheng.

All significant inter-company accounts and transactions have been eliminated in consolidation.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates include the value of the Company's oil reserve quantities which are the basis for the calculation of the depletion, depreciation and amortization of oil properties and impairments of oil properties and estimates of the fair value of warrants. Actual results could differ from those estimates.

Revenue recognition

Our oil production business records revenue from the sales of oil on a net basis when delivery to the customer (PetroChina) has occurred and title has transferred. This occurs when oil has been delivered to a PetroChina depot.

Pursuant to the Oil Leases entered into in 2002 and 2003 with PetroChina, each with twenty year terms, the Company is entitled to 80% of its oil production for the first ten years and 60% of its oil production for the remaining ten years. The Company receives payment for the net physical volume of oil delivered (either 80% or 60% by volume, depending upon the lease terms that are current at that point in time). The Company only records revenue for the production that it is entitled to.

Our oilfield drilling business (Tiancheng) records revenue from the sales of services that are generally sold based upon purchase orders or contracts with the customer that include fixed or determinable prices and that do not include right of return or other similar provisions or other significant post-delivery obligations. Revenue for services is recognized as the services are rendered and when collectability is reasonably assured. Rates for services are typically priced on a per day, per meter, per man hour or similar basis. In certain situations, revenue is generated from transactions that may include multiple services under one contract or agreement. Revenue from these arrangements is recognized as each service is delivered based on their relative fair values.

Major customers

Our oil production business has only one customer – PetroChina’s Jilin Refinery branch, located in Song Yuan City, Jilin Province, the PRC. Pursuant to our lease agreements with PetroChina we are prohibited from selling our oil production to any other customer.

Our oilfield services business has one primary customer–PetroChina, but also serves other independent oil production companies located in Jilin and Heilongjiang provinces in the PRC.

Accounts receivables and allowance for doubtful accounts

Our oil production business bills PetroChina on a monthly basis, at the month-end, for the oil that we delivered to PetroChina during that month. We receive payment from PetroChina approximately 10 to 20 days following the end of each month. We receive payment in full for the prior month, less a holdback in the first and second months of each calendar quarter for the amount of oil surcharge tax (if any) due to the PRC government for the respective month's oil sales. These oil surcharge tax holdbacks are paid to the Company with the normal monthly payment in the third month of each quarter, and therefore are timed to be received by us shortly before we are responsible for remitting the quarterly oil surcharge tax to the PRC government. Therefore, the amount we show as accounts receivable at the end of each reporting period will include the amounts due to us for sales in the prior month, as well as amounts of oil surcharge due for the two preceding months. We do not recognize any allowance for doubtful accounts, as PetroChina paid our invoices on a correct, consistent and timely basis.

Our oilfield services business bills customers according to the terms of each service contract. These contracts generally require downpayments of 30% of the drilling contract sum at the initiation of drilling services and payment of the remaining 70% of the drilling contract sum in twelve monthly installments following the completion of drilling services.

Long-lived assets

The Company evaluates at least annually, and more often when circumstances require, the carrying value of long-lived assets to be held and used. Impairment losses to be recorded on long-lived assets used in operations when indicators of impairment are present and the undiscounted cash flows estimated to be generated by those assets are less than the assets' carrying amounts. In that event, a loss is recognized based on the amount by which the carrying amount exceeds the fair market value of the long-lived assets. No impairment was made for the year ended December 31, 2010 and 2009.

Financial instruments

The Company analyzes all financial instruments with features of both liabilities and equity under ASC 480-10 (formerly Statement of Financial Accounting Standards ("SFAS") No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity"), ASC 815-10 (formerly SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities") and ASC 815-40 (formerly EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"). The warrants issued in conjunction with the issuance of the secured debenture in February 2008 are treated as liability instruments and will be marked to the fair value as of each reporting date. Additionally, the Company analyzes registration rights agreements associated with any equity instruments issued to determine if penalties triggered for late filing should be accrued under ASC 825-20 (formerly FSP EITF 00-19-2, "Accounting for Registration Payment Arrangements"). (See Note 9, Registration Payment Arrangements Below).

Fair value of financial instruments

On January 1, 2008, the Company adopted ASC 820-10 (formerly SFAS No. 157, "Fair Value Measurements"), which defines fair value, establishes a three-level valuation hierarchy for disclosures of fair value measurement and enhances disclosures requirements for fair value measures. The three levels are defined as follows:

- Level 1 inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

Level 2 inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the assets or liability, either directly or indirectly, for substantially the full term of the financial instruments.

- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value.

The financial assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of the fair value of assets and liabilities and their placement within the fair value hierarchy levels.

Assets and liabilities measured at fair value on a recurring basis as of December 31, 2010 are summarized as follows:

	Fair value measurement using		
	inputs		
	Level 1	Level 2	Level 3
Liabilities:			
Derivative instruments –			
Warrants	\$ -	\$ -	\$ 13,956,515
Total	\$ -	\$ -	\$ 13,956,515

The Company determines the fair value of the warrants using a Black-Scholes option model using inputs that are derived from observable and unobservable data and are therefore considered Level 3 in the fair value hierarchy.

The carrying values of cash and cash equivalents, trade receivables and payables, and short-term bank loans and debts approximate their fair values due to the short maturities of these instruments.

Stock-based compensation

The Company follows ASC 718 (formerly SFAS No. 123R, "Share-Based Payments"). This Statement requires a company to measure the cost of services provided by employees in exchange for an award of equity instruments to be based on the grant-date fair value of the award. That cost will be recognized over the period during which services are received. Stock compensation for stock granted to non-employees has been determined in accordance with ASC 718 and ASC 505-50 (formerly EITF No. 96-18, "Accounting for Equity Instruments that are issued to Other than Employees for Acquiring, or in Conjunction with Selling Goods or Services"), as the fair value of the consideration received or the fair value of equity instruments issued, whichever is more reliably measured.

Property and equipment, net

The Company uses the full cost method of accounting for oil properties. As the Company currently maintains oil operations in only one country (the PRC), the Company has only one cost center. All costs incurred in the acquisition, exploration, and development of properties (including costs of surrendered and abandoned leaseholds, delay lease rentals, dry holes and overhead related to exploration and development activities) and the fair value of estimated future costs of site restoration, dismantlement, and abandonment activities are capitalized.

Investments in unproved properties, including capitalized interest costs, are not depleted pending determination of the existence of proved reserves. Unproved reserves are assessed periodically to ascertain whether impairment has occurred. Unproved properties whose costs are individually significant are assessed individually by considering the primary lease terms of the properties, the holding periods of the properties, and geographic and geologic data obtained relating to the properties. Where it is not practicable to assess individually the amount of impairment of properties for which costs are not individually significant, such properties are grouped for purposes of assessing impairment. The amount of impairment assessed is added to the costs to be amortized, or is reported as a period expense, as appropriate. As of December 31, 2010, the Company did not have any investment in unproved oil properties.

Under the full cost method of accounting, a ceiling test is performed each quarter. The full cost ceiling test is an impairment test to determine a limit, or ceiling, on the book value of oil properties. That limit is basically the after tax present value of the future net cash flows from proved crude oil reserves, excluding future cash outflows associated with settling asset retirement obligations that have been accrued on the balance sheet; using an average price over the prior 12-month period held flat for the life of production plus the lower of cost or fair market value of unproved properties. If net capitalized costs of crude oil properties exceed the ceiling limit, we must charge the amount of the excess to earnings as an expense reflected in additional accumulated depreciation, depletion and amortization. This is called a "ceiling limitation write-down." Impairment of oil properties for the years ended December 31, 2009 and 2008 were \$13,837,108 and \$13,184,103, respectively. No impairment loss was recognized for the year ended December 31, 2010. Gain or loss is not recognized on the sale of oil properties unless the sale significantly alters the relationship between capitalized costs and estimated proved oil reserves attributable to a cost center.

Gain or loss is not recognized on the sale of oil properties unless the sale significantly alters the relationship between capitalized costs and estimated proved oil reserves attributable to a cost center.

Depletion of proved oil properties is computed on the unit-of-production method, whereby capitalized costs, as adjusted for future development costs and asset retirement obligations, net of salvage, are amortized over the total estimated proved reserves. Furniture and fixtures, leasehold improvements, computer hardware and software, and other equipment are depreciated on the straight-line method, based upon estimated useful lives of the assets ranging from three to fifteen years.

Asset Retirement Obligations

ASC 410-20 (formerly SFAS No. 143, “Accounting for Asset Retirement Obligations”) requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred with a corresponding increase in the carrying amount of the related long-lived asset. Subsequent to initial measurement, the asset retirement liability is required to be accreted each period to its present value. Capitalized costs are depleted as a component of the full cost pool using the unit-of-production method. Pursuant to our lease agreements with PetroChina, which terminate in 2022 and 2023, we do not recognize any asset retirement obligations, because at the end of the lease term we are obligated to hand over to PetroChina all of the physical assets we have erected on the leased properties, including all wells, facilities and equipment.

Income (loss) per share

The Company reports income (loss) per share in accordance with the provisions of ASC 260-10 (formerly SFAS No. 128, "Earnings Per Share"). ASC 260-10 requires presentation of basic and diluted income (loss) per share in conjunction with the disclosure of the methodology used in computing such income (loss) per share. Basic income (loss) per share excludes dilution and is computed by dividing income (loss) available to common stockholders by the weighted average common shares outstanding during the period. Diluted income (loss) per share takes into account the potential dilution that could occur if securities or other contracts to issue common stock were exercised and converted into common stock using the treasury method.

Income taxes

Income taxes are accounted for under the asset and liability method in accordance with ASC 740-10 (formerly SFAS No. 109, "Accounting for Income Taxes"). Deferred tax assets and liabilities are recognized for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The Company provides valuation allowances against the net deferred tax asset for amounts that are not considered more likely than not to be realized.

The Company adopted ASC 740-10 (formerly FASB Interpretation 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48")), on January 1, 2007. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The adoption had no effect on the Company's financial statements.

Deferred tax is accounted for using the balance sheet liability method in respect of temporary differences arising from differences between the carrying amount of assets and liabilities in the financial statements and the corresponding tax basis used in the computation of assessable tax profit. In principle, deferred tax liabilities are recognized for all taxable temporary differences, and deferred tax assets are recognized to the extent that it is probably that taxable profit will be available against which deductible temporary differences can be utilized. Deferred tax is calculated at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled. Deferred tax is charged or credited to profit or loss, except when it related to items credited or charged directly to equity, in which case the deferred tax is also dealt with in equity. Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis. As of December 31, 2010 and 2009, the Company's deferred tax assets amounted to \$5,975,231 and \$7,538,868, respectively.

Value added tax

Sales revenue represents the invoiced value of oil, net of a value-added tax ("VAT"). All of the Company's oil that is sold in the PRC is subject to the Chinese VAT at a rate of 17% on the gross sales price. This VAT may be offset by VAT paid by the Company on investment and operating costs associated with oil production. The Company records its net VAT Payable or VAT Recoverable balance in the financial statements.

Segments

The Company follows FASB ASC 280 – Segment Reporting, which requires that companies disclose segment data based on how management makes decision about allocating resources to segments and evaluating their performance. The Company operates in two segments: oil production and oilfield services (contract drilling).

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation.

Secured Debenture and Warrant Valuation.

The following is a summary of our secured debentures at December 31, 2010 and December 31, 2009:

	December 31, 2010	December 31, 2009
Secured Debenture at 8% interest per annum, secured by 66% of the Company's equity interest in Song Yuan Technical and certain properties of the Company and 6,732,000 shares of common stock of the Company owned by a stockholder, due on February 28, 2012	\$ -	\$ 10,500,000
Less: current maturities	-	(5,625,000)
Long-term portion	\$ -	\$ 4,875,000

On February 28, 2008, the Company entered into a Securities Purchase Agreement (the "Purchase Agreement") with Lotusbox Investments Limited (the "Investor"). Pursuant to the Purchase Agreement, the Company agreed to issue to the Investor an 8% Secured Debenture due 2012 (the "Debenture") in the aggregate principal amount of \$15,000,000, and agreed to issue to the Investor five-year warrants exercisable for up to (i) 1,200,000 shares of the Company's common stock at an initial exercise price equal to \$0.01 per share ("Class A Warrants"), (ii) 1,500,000 shares of the Company's common stock at an initial exercise price equal to \$3.20 per share ("Class B Warrants") and (iii) 2,100,000 shares of the Company's common stock at an initial exercise price equal to \$3.45 per share ("Class C Warrants"), with all warrant exercise prices being subject to certain adjustments. The Class B Warrants are subject to certain call rights by the Company. As additional security provided to the Investor, the Company also granted the Investor the right to purchase up to 24% of the registered capital of Song Yuan Technical at fair market value which right shall only become enforceable immediately on the date following the occurrence of an event of a payment default. Pursuant to Section 2(e) of the Series B and C Common Stock Purchase Warrant issued on February 28, 2008 (the "B Warrants" and "C Warrants") for the purchase of 3,600,000 shares of common stock of Company, the exercise price of the B Warrants and C Warrants have been reset to \$2.35 per share.

The Company accounts for these warrants as liability instruments in accordance with paragraph 8 of EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially settled in, a Company's Own Stock." (now ASC 815-40). Upon issuance, the warrants were recorded at fair value of \$10,268,321, which was recognized as a discount to the carrying value of the debenture. The initial carrying value of the debenture, net of discount, was \$4,731,679.

On March 5, 2009, the Company and the Investor entered into Agreement No.1 to 8% Secured Debenture (the "Amendment" or the "restructuring") which amended the Debenture issued to the Investor on February 28, 2008 for the principal amount of \$15,000,000. Pursuant to the Amendment, the Investor agreed to extend the Company's requirement to effect a listing of its common stock on either the NYSE Alternext US LLC or NASDAQ until August 30, 2010, and the Company issued four-year warrants to the Investor to purchase up to (i) 250,000 shares of common stock at an exercise price of \$2 per share and (ii) 250,000 shares of common stock at an exercise price of \$2.35 per share. Also pursuant to the Amendment, the parties have agreed to amend the monthly principal repayment schedule of the Debenture. The Company treated this restructuring as an extinguishment of debt, as the net present value of cash flows projected to be paid by the Company to the Investor as a result of this Amendment exceed the net present value of cash flows projected to be paid by the Company to the Investor pursuant to the previously existing repayment schedule by greater than 10%. Therefore, the Company has accounted for this Amendment as an extinguishment and reissue of debt. Accordingly, the Company has recognized a loss on extinguishment of debt, effective March 5, 2009,

of \$8,260,630, which comprised the remaining unamortized discount on the secured debenture prior to the Amendment date, plus the unamortized deferred financing fees on the secured debenture prior to the Amendment date, plus the fair value of the warrants issued to the investor in conjunction with the Amendment.

As the restructuring is presumed to have the effect of reflecting fair market terms and conditions for the Amended secured debenture, the carrying value of the debenture is the remaining principal balance of the debenture and no discount is recognized. Changes in the fair value of the warrants will continue to be recognized as gain or loss in the period incurred.

In conjunction with the amendment of the terms of the secured debenture, the Company was obligated to file a registration statement registering the resale of shares of the Company's common stock issuable upon exercise of the Warrants on or before March 5, 2010 (the "Filing Date"). If this registration statement was not been declared effective by the Filing Date, on the 180th day following the Filing Date and each sixth month anniversary thereafter until the registration statement is declared effective, the Company must execute and deliver to the Investor new warrants to purchase up to a total of 62,500 on the same terms as the Warrants. During 2009, the Company repaid a total of \$3,750,000 of the principal amount outstanding on the secured debenture, which reduced the principal balance on the debenture to \$10,500,000 as of December 31, 2009. On January 13, 2010, the Company repaid the entire remaining balance of the debenture in the amount of \$10,500,000. As of December 31, 2010, there was no debenture outstanding.

No amortized discount on the secured debenture for the year ended December 31, 2010. Discount amortized on the secured debenture for the years ended December 31, 2009 and 2008 were \$670,492 and \$3,394,086, respectively.

Registration rights penalties

In conjunction with the March 5, 2009 modification of the Company's secured debenture issued on February 28, 2008 (See Note 9, "Secured Debenture," of the Notes to the Consolidated Financial Statements) and the original issuance of the secured debenture, the Company entered into two Registration Rights Agreements, which cover stock to be issued upon exercise of warrants issued in connection with both the modification and the issuance of the secured debenture. These Registration Rights Agreements provide for financial penalties in certain circumstances, including (i) if the registration statement covering the shares of common stock underlying the Original Warrants is not declared effective within 180 days of the date of the Registration Rights Agreement or (ii) after effectiveness, the registration statement ceases to remain continuously effective for more than 10 consecutive calendar days or more than 30 calendar days in any 30 calendar day period. The financial penalty equals 1% of the aggregate purchase price paid for the Original Warrants subject to the registration rights up to a maximum of 10% of the principal amount of the debenture. The Company analyzes these registration rights agreements to determine if penalties triggered for late filing should be accrued under ASC 825-20.

On March 12, 2011, the Company entered into an agreement with Lotusbox Investments Ltd., the purchaser of the Company's Secured Debenture, pursuant to which the parties released each other from all claims and liabilities based on or arising out of the Company's failure to register shares of the Company's common stock underlying warrants issued to the purchaser in connection with the purchase of the Secured Debenture. In addition, the purchaser released the Company from any further obligations to register the warrant shares. In return, the Company agreed to reduce the exercise prices of 500,000 warrants issued to the purchaser in 2009 from \$2.00 and \$2.35 to \$0.01; and to reduce the exercise price of 100,000 warrants to the purchaser in 2008 from \$2.35 to \$0.01. The Company also agreed to allow the purchaser to purchase the warrant shares by means of a cashless exercise.

OFF-BALANCE SHEET ARRANGEMENTS

We do not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to our investors.

Recent accounting pronouncements

In January 2010, FASB issued Accounting Standards Update ("ASU") 2010-02 Accounting and Reporting for Decreases in Ownership of a Subsidiary a Scope Clarification ("ASU 2010-02"). ASU 2010-02 addresses implementation issues related to the changes in ownership provisions of Codification. This establishes the accounting and reporting guidance for noncontrolling interests and changes in ownership interests of a subsidiary. An entity is required to deconsolidate a subsidiary when the entity ceases to have a controlling financial interest in the subsidiary.

Upon deconsolidation of a subsidiary, an entity recognizes a gain or loss on the transaction and measures any retained investment in the subsidiary at fair value. The gain or loss includes any gain or loss associated with the difference between the fair value of the retained investment in the subsidiary and its carrying amount at the date the subsidiary is deconsolidated. In contrast, an entity is required to account for a decrease in ownership interest of a subsidiary that does not result in a change of control of the subsidiary as an equity transaction. ASU 2010-02 is effective for the Company starting January 3, 2010. The Company did not expect the adoption of ASU 2010-02 to have a material impact on the Company's consolidated results of operations or financial position.

In January 2010, the FASB issued ASU 2010-03 Extractive Activities- Oil and Gas Reserve Estimation and Disclosures. This ASU amends the "Extractive Industries- Oil and Gas" topic of the Codification to align the Oil and Gas reserve estimation and disclosure requirements in this Topic with the U.S. Securities and Exchange Commission

(“SEC”) Release No. 33-8995, “Modernization of Oil and Gas Reporting Requirements (the Final Rule)”. The amendments are effective for annual reporting periods ending on or after December 31, 2009, and the adoption of these provisions on December 31, 2009 do not have a material impact on our consolidated financial statements.

In January 2010, FASB issued Improving Disclosures about Fair Value Measurements (“ASU 2010-6”). ASU 2010-6 provides amendments to Subtopic 820-10 that requires separate disclosure of significant transfers in and out of Level 1 and Level 2 fair value measurements and the presentation of separate information regarding purchases, sales, issuances, and settlements for Level 3 fair value measurements. Additionally, ASU 2010-06 provides amendments to Subtopic 820-10 that clarifies existing disclosures about the level of disaggregation and inputs and valuation techniques. ASU 2010-06 is effective for financial statements issued for interim and annual periods ending after December 15, 2010. The Company does not expect the adoption of ASU 2010-06 to have a material impact on its consolidated results of operations or financial position.

In February 2010, FASB issued ASU 2010-09 Subsequent Events (Topic 855) Amendments to Certain Recognition and Disclosure Requirements. ASU 2010-09 amends disclosure requirements so that an entity that is an SEC filer is not required to disclose the date through which subsequent events have been evaluated. This change alleviates potential conflicts between the codification and the SEC’s requirements. ASU 2010-09 is effective for interim and annual periods ending after June 15, 2010. The Company did not expect the adoption of ASU 2010-09 to have a material impact on its consolidated results of operations or financial position.

In March 2010, FASB issued ASU 2010-11 Scope Exception Related to Embedded Credit Derivatives. ASU 2010-11 clarifies the type of embedded credit derivative that is exempt from embedded derivative bifurcation requirements. Only one form of embedded credit derivative qualifies for the exemption—one that is related only to the subordination of one financial instrument to another. As a result, entities that have contracts containing an embedded credit derivative feature in a form other than such subordination may need to separately account for the embedded credit derivative feature. The amendments in this Update are effective for each reporting entity at the beginning of its first fiscal quarter beginning after June 15, 2010. Early adoption is permitted at the beginning of each entity's first fiscal quarter beginning after issuance of this Update. Management is currently evaluating the potential impact of ASU 2010-11 on our financial statements.

In April 2010, FASB issued ASU 2010-13 Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades. ASU 2010-13 addresses the classification of a share-based payment award with an exercise price denominated in the currency of a market in which the underlying equity security trades. Topic 718 is amended to clarify that a share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades shall not be considered to contain a market, performance, or service condition. Therefore, such an award is not to be classified as a liability if it otherwise qualifies as equity classification. The amendments in this Update should be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. The guidance should be applied by recording a cumulative-effect adjustment to the opening balance of retained earnings for all outstanding awards as of the beginning of the fiscal year in which the amendments are initially applied. Management is currently evaluating the potential impact of ASU 2010-13 on our financial statements.

In August 2010, the FASB issued ASU 2010-21, Accounting for Technical Amendments to Various SEC Rules and Schedules. Amendments to SEC Paragraphs Pursuant to Release No. 33-9026: Technical Amendments to Rules, Forms, Schedules and Codification of Financial Reporting Policies (SEC Update). ASU 2010-21 amends various SEC paragraphs pursuant to the issuance of Release No. 33-9026: Technical Amendments to Rules, Forms, Schedules and Codification of Financial Reporting Policies. The amendments in this Update should be effective with immediate effect. The Company expected the adoption of ASU 2010-21 will not have a material impact on the Company's results of operations or financial position.

In August 2010, the FASB issued ASU 2010-22, Accounting for Various Topics-Technical Corrections to SEC paragraphs (SEC Update). ASU 2010-22 amends various SEC paragraphs based on external comments received and the issuance of Staff Accounting Bulletin ("SAB") 112, which amends or rescinds portions of certain SAB topics. The amendments in this Update should be effective with immediate effect. The Company expected the adoption of ASU 2010-22 will not have a material impact on the Company's results of operations or financial position.

In December 2010, the FASB issued ASU 2010-28, Intangibles – Goodwill and Other (Topic 350). ASU 2010-28 addresses when to perform step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. The amendments are effective for fiscal years, and interim periods within years, beginning after December 15, 2010. Early adoption is not permitted. Management is currently evaluating the potential impact of ASU 2010-28 on the financial statements.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Market risk represents the risk of changes in the value of a financial instrument, derivative or non-derivative, caused by fluctuations in interest rates, foreign exchange rates and equity prices. As discussed below, the Company is not currently subject to these risks.

Our major market risk is pricing applicable to our oil production. We sell to one customer, PetroChina, and PetroChina pays the Company a price per barrel equal to the monthly mean price calculated from the Mean of Platts Singapore (“MOPS”) daily price for sour, heavy Indonesian crude, as measured during the previous month. Platts is an international commodity and trading company that collects and publishes pricing data on a wide range of petroleum and non-petroleum commodity types. The price paid to the Company is FOB at the local Jilin Province PetroChina oil storage depot. We currently do not hedge a portion of our price risk associated with our future oil production or enter into any commodity-based derivative instruments to reduce exposure to fluctuations in the price of crude oil and natural gas.

Foreign Currency Risk – The functional currency of the Company’s operating subsidiaries is the Renminbi and currently all of the Company’s sales are to PetroChina in Renminbi. As such, the Company is not directly exposed to market risk associated with currency exchange rates and prices.

Interest Rate Risk – The Company’s primary market risk exposure with regard to financial instruments is changes in interest rates. At December 31, 2011, the Company’s outstanding debt is either interest-free or at fixed interest rates. As a result, the Company is not exposed to market risk associated with the fluctuation in interest rates.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The Consolidated Financial Statements of the Company and its subsidiaries including the notes thereto, together with the reports of Baker Tilly Hong Kong Limited and Jimmy C.H. Cheung & Co. are presented beginning on page F-1 and F-2 of this report.

ITEM 9. CHANGES IN AND DISAGREEMENT WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

On February 4, 2010, we were notified that, effective January 29, 2010, the US Audit Practice of Jimmy CH Cheung & Co., the Company's independent registered public accounting firm ("JCHC"), merged with Baker Tilly Hong Kong Limited ("BTHK"). In connection with the merger, JCHC had resigned as the Company's independent registered public accounting firm and the Company with the approval of its Board of Directors has engaged BTHK to continue as the Company's independent registered public accounting firm.

The audit report of JCHC on the financial statements of the Company as of and for the year ended December 31, 2008 did not contain an adverse opinion or a disclaimer of opinion, and was not qualified or modified as to uncertainty, audit scope or accounting principles.

During the Company's recent fiscal years ended December 31, 2008 and 2009 and through December 31, 2010, the Company did not consult with BTHK or JCHC on (i) the application of accounting principles to a specified transaction, either completed or proposed, or the type of audit opinion that may be rendered on the Company's financial statements, and BTHK or JCHC did not provide either a written report or oral advice to the Company that was an important factor considered by the Company in reaching a decision as to any accounting, auditing, or financial reporting issue; or (ii) the subject of any disagreement, as defined in Item 304 (a)(1)(iv) of Regulation S-K and the related instructions, or a reportable event within the meaning set forth in Item 304(a)(1)(v) of Regulation S-K.

In connection with the audits of the Company's financial statements for the fiscal years ended December 31, 2008 and 2009 and through December 31, 2010, there were: (i) no disagreements between the Company and BTHK and JCHC on any matters of accounting principles or practices, financial statement disclosure, or auditing scope or procedures, which disagreements, if not resolved to the satisfaction of BTHK and JCHC, would have caused BTHK and JCHC to make reference to the subject matter of the disagreement in their reports on the Company's financial statements for such years, and (ii) no reportable events within the meaning set forth in Item 304(a)(1)(v) of Regulation S-K.

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15 under the Exchange Act, as of December 31, 2010, the period covered by this Annual Report, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures. This evaluation ("Evaluation") was performed by our Chief Executive Officer and our Chief Financial Officer in consultation with our accounting personnel. Based upon the Evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that as of the end of the period covered by this Annual Report, our disclosure controls and procedures were not effective.

Management's Annual Report on Internal Control over Financial Reporting

The Company's management is responsible for establishing and maintaining an adequate system of internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance

regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Further, because of changes in conditions, effectiveness of internal control over financial reporting may vary over time.

A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected. An internal control material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

Management of the Company conducted an evaluation of the effectiveness of the Company's internal control over financial reporting based on the framework and criteria established in Internal Control-Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on the Company's evaluation under the COSO framework, management concluded that its internal control over financial reporting was not effective as of December 31, 2010.

Material Weakness

In connection with its evaluation, management has identified one material weakness as of December 31, 2010, which is described as follows: In 2010, the Company did not have a specific person tasked with verifying the crude oil selling price the Company charged on a per invoice basis.

This material weakness has not caused or contributed to a material misstatement of the Company's financial statements.

Remediation Initiative

In 2011, the Company assigned specific personnel the responsibility of confirming the crude oil selling price on a per invoice basis.

In addition, we continue to implement remedial actions begun in 2010, including implementing formal and informal training programs, particularly with respect to the accounting for non-cash items, and we continue to use an outside consulting firm to assist us with the preparation and review of our financial statements and reports filed with the SEC.

Conclusion

Notwithstanding the material weakness reported above, the Company's management believes that its consolidated financial statements included in this report fairly present, in all material respects, the Company's financial conditions, results of operations and cash flow for the year presented and that this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements misleading, in light of the circumstances under which such statements were made during the year covered in this report.

Report of Independent Registered Accounting Firm on Internal Control Over Financial Reporting

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders of:
China North East Petroleum Holdings Limited

We have audited the internal control over financial reporting of China North East Petroleum Holdings Limited and its subsidiaries (collectively referred to as the "Company") as of December 31, 2010, based on criteria established in

Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO control criteria). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting (the "Management Report"). Our responsibility is to express an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in Management Report: deficiencies in the operating effectiveness of the Company's internal controls over verification of crude oil selling price. This material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the 2010 financial statements, and this report does not affect our report dated March 16, 2011 on those financial statements.

In our opinion, because of the effect of the material weakness identified above on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of December 31, 2010, based on the COSO control criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 31, 2010 of the Company and our report dated March 16, 2011 expressed an unqualified opinion on those financial statements.

/s/ Baker Tilly Hong Kong Limited

Baker Tilly Hong Kong Limited
Certified Public Accountants
Hong Kong SAR
Date: March 16, 2011

Changes in Internal Control over Financial Reporting.

During 2010, we implemented the following actions to improve our control environment and to implement controls and procedures that will ensure the integrity of our financial reporting process:

- we have retained an outside consulting firm with specialized knowledge in financial accounting and specific knowledge of oil industry accounting to assist us with the review and restatement of the financial statements in question.

We intend to continue to implement the following additional actions in 2011, which were begun in 2010:

- implement formal and informal training programs, particularly with respect to the accounting for non-cash items; and
- continue our retention of an outside consulting firm to assist us with a review of financial report preparation.

Except as discussed above, there has not been any change in our internal control over financial reporting that occurred during our fiscal year ended December 31, 2010 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.

DIRECTORS AND EXECUTIVE OFFICERS

Management and Board of Directors

The following table sets forth the names, ages and positions of our directors and executive officers:

Name	Age	Position
Wang Hong Jun(1)	38	Chief Executive Officer and Director
Li Jingfu(2)	60	Acting Chief Executive Officer and Director
Edward M. Rule(3)	62	Chairman of the Board
Shaohui Chen(4)	33	Chief Financial Officer
Hu Ruishi(5)	56	Director
Yau-Sing Tang(6)	48	Director

(1) Currently on administrative leave as the Chief Executive Officer.

(2) Appointed as Acting Chief Executive Officer on May 23, 2010.

(3) Appointed as Chairman of the Board on May 23, 2010.

(4) Appointed as Chief Financial Officer on September 30, 2010.

(5) Appointed as director on June 28, 2010.

(6) Appointed as director on August 9, 2010.

Each Director will hold office until the next annual meeting of stockholders and until his successor has been elected and qualified.

Background of Executive Officers and Directors

WANG HONG JUN has served as Chairman and President of the Company since May 2004, following completion of the share exchange transaction with Hong Xiang. Mr. Wang has over 15 years of experience in the business management and oil industry experience. Before he joined the company, Mr. Wang worked for Jilin Oil Field and Drilling Company as an Executive with the responsibility of overseeing operations and coordinating various projects. Mr. Wang resigned as Chairman of the Board on May 23, 2010 and is currently on administrative leave as the Company's President and CEO.

LI JING FU was appointed to the Company's Board on May 27, 2008 and as Acting CEO on May 23, 2010. Mr. Li is the Chairman and top representative of Joint Management Committee of Qian Guo County Longhai Petroleum & Natural Gas Co., Ltd. and was appointed to that position by Petro China's Jilin branch in 2005. Mr. Li has been in the petroleum industry since 1970. In his extensive career he has served as Vice Monitor for Jiang Han Oil Field's comprehensive logging team, Secretary of Command Department of Petroleum Hui Zhan in Jilin Province, Vice President of Jilin Oilfield Exploration and Development Research Institute. From 1995 to 2002, Mr. Li was appointed by PetroChina's Jilin branch to serve as General Manger of management and production operation of oil exploitation of Jilin Jiyuan Petroleum & Natural Gas Development Co. Ltd. From 2002 to 2005, Mr. Li, served as Project Manager of Song Yua City Qian Yuan Oil & Gas Development Co., Ltd. also by appointment by PetroChina's Jilin branch. Mr. Li received his bachelor's degree from Chang Chun Geology Institute in Jilin, China.

EDWARD M. RULE was appointed to the Company's Board on May 27, 2008 and as Chairman of the Board on May 23, 2010. Mr. Rule is Chairman of TDR Capital International Limited, a Hong Kong based financial services house.

Most of his career has been spent in China, initially as a diplomat and subsequently as an investment banker with the Standard Chartered Group and private equity professional with the \$800 million Asian Infrastructure Fund. He is a graduate in Chinese language of the University of Melbourne and the Australian National University. He speaks Mandarin Chinese and Cantonese. He has been director of several listed companies in Hong Kong and Australia.

SHAOHUI CHEN was appointed as the Company's Chief Financial Officer on September 30, 2010. Prior to joining the Company, Mr. Chen served as CFO of Acorn Technology Corporation since 2006. Mr. Chen concurrently served as Director of Finance at MVP RV Inc. since 2008. In addition, Mr. Chen has advised Chinese companies on a variety of subjects including doing business in the US, merging with US public companies, corporate re-structuring, due diligence, auditing, and complying with U.S. public market standards. Mr. Chen is also experienced at promoting U.S. companies into Chinese markets through direct foreign investments, joint-ventures, co-manufacturing agreements, licensing agreements, and technology transfers.

RUIISHI HU was appointed to the Company's board on June 28, 2010. Mr. Hu has over 30 years of experience in the petroleum industry in China. Since 2009 Mr. Hu has been serving as a director of Qianguo County Mongolia Autonomous Petroleum Development Company, a joint venture established by PetroChina Company Limited ("PetroChina") Jilin Branch and the government of Qianguo County. From 2007 to 2009, Mr. Hu served as the chief representative of PetroChina to the Company's subsidiary, Song Yuan City Yu Qiao Oil and Gas Development Limited Corporation. From 2004 to 2007, Mr. Hu served as a director of Song Yuan City Jingyuan Petroleum Development Company, a joint venture established by PetroChina Jilin Branch and Beijing National Economic Council. Prior to 2004, Mr. Hu had served in management capacity with Jilin Petroleum Group Drilling Technology Research Institute and Jilin Oilfield Administration Bureau.

YAU-SING TANG was appointed to the Company's Board on August 9, 2010. Mr. Tang is the Chief Financial Officer and Controller of China Agritech, Inc. which is listed on NASDAQ Global Market under the symbol "CAGC," and has served in that capacity since October 22, 2008. Prior to that from April 2008 to September 2008, Mr. Tang was the director of AGCA CPA Limited, a CPA firm in Hong Kong. From August 2006 to March 2008, Mr. Tang served as financial controller of Carpenter Tan Holdings Ltd., a company listed on The Stock Exchange of Hong Kong Limited. Prior to that, he was the founder and managing director of AGCA CPA, Limited from January 2006 to July 2006. From April 2003 to December 2005, he was executive director and chief financial officer of China Cable & Communication, Inc., which is quoted on the Pink Sheets under the symbol CCLI.PK. Mr. Tang received his Bachelor of Social Sciences (Honors) degree from the University of Hong Kong in 1986. He is a fellow member of the Association of Chartered Certified Accountants in the U.K. and the Hong Kong Institute of Certified Public Accountants. He is also a member of the Institute of Chartered Accountants in England and Wales and the Taxation Institute of Hong Kong.

Director Independence

Our Board of Directors consists of five members. The Company has adopted the independence standards promulgated by NYSE Amex LLC. Based on these standards, the Board has determined that all of the members of the Board of Directors, except for Messrs. Wang and Li are "independent" as defined under the listing standards for NYSE Amex LLC. The three independent directors are Edward Rule, Ruishi Hu and Yau-Sing Tang.

Board Leadership Structure

The Board of Directors believes that Mr. Rule's service as Chairman of the Board is in the best interest of the Company and its stockholders. Mr. Rule possesses detailed and in-depth knowledge of the issues, opportunities and challenges facing the Company and its business and is thus best positioned to develop agendas that ensure that the Board's time and attention are focused on the most critical matters. His combined role enables decisive leadership, ensures clear accountability, and enhances the Company's ability to communicate its message and strategy clearly and consistently to the Company's shareholders, employees, customers and suppliers.

Family Relationships

Yu Li Guo, a former Director and employee of the Company is the brother-in-law and Ju Guizhi, a former Director, is the mother of Wang Hong Jun, Chief Executive Officer of the Company. Other than these relationships, there are no family relationships, or other arrangements or understandings between or among any of the directors, executive officers or other person pursuant to which such person was selected to serve as a director or officer.

Involvement in Certain Legal Proceedings

None of our directors or executive officers has, during the past ten years:

- (a) Had any bankruptcy petition filed by or against any business of which such person was a general partner or executive officer either at the time of the bankruptcy or within two years prior to that time;
- (b) Been convicted in a criminal proceeding or subject to a pending criminal proceeding;
- (c) Been subject to any order, judgment, or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction or any federal or state authority, permanently or temporarily enjoining, barring, suspending or otherwise limiting his involvement in any type of business, securities, futures, commodities or banking activities; and
- (d) Been found by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission or the Commodity Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended, or vacated.

Corporate Governance Matters

Board of Directors

We have five members serving on our Board of Directors, of which a majority is independent directors. All actions of the Board of Directors require the approval of a majority of the directors in attendance at a meeting at which a quorum is present. During the fiscal year ended December 31, 2009, the Board of Directors met ten times and took action by written consent on four occasions. All of the directors participated in the board meetings. Each director is expected to participate, either in person or via teleconference, in meetings of our Board of Directors and meetings of committees of our Board of Directors in which each director is a member, and to spend the time necessary to properly discharge such director's respective duties and responsibilities. We do not have a written policy with regard to directors' attendance at annual meetings of stockholders; however, all directors are encouraged to attend the annual meeting.

Director Qualifications

In general, we seek directors:

- with established strong professional reputations and experience in areas relevant to the strategy and operations of our businesses;
- who possess the qualities of integrity and candor, who have strong analytical skills and who are willing to engage management and each other in a constructive and collaborative fashion;
 - who have an understanding of China and the ability to communicate in Mandarin Chinese; and
- who have the ability and commitment to devote significant time and energy to service on the Board and its committees.

When considering whether directors and nominees have the experience, qualifications, attributes or skills, taken as a whole, to enable our Board of Directors to satisfy its oversight responsibilities effectively in light of our business and structure, the Board of Directors focused primarily on each person's background and experience as reflected in the information discussed in each of the directors' individual biographies set forth above. We believe that our directors provide an appropriate mix of experience and skills relevant to the size and nature of our business. In particular, the members of our Board of Directors considered the following important characteristics: (i) Mr. Wang, as founder and key operational manager of the Company has significant expertise in the business operations of the Company, including production operations, corporate strategy and general management roles; (ii) Mr. Rule, Mr. Hu and Mr. Tang have significant executive level and board experience throughout his career in leading high growth and established companies and investment funds, speak, read and write Mandarin Chinese, have an interest in and knowledge of Chinese management practices, and each brings substantial financial and corporate strategy knowledge, experience and training, including experience with SEC reporting, to their roles as directors; and (iii) Mr. Li is an experienced petroleum industry executive based in Jilin Province who has extensive finance and operational knowledge, experience and training from his lengthy career with PetroChina.

Risk Oversight

The Board of Directors is responsible for the oversight of risk management related to the company and its business and accomplishes this oversight through regular reporting by the Audit Committee. The Audit Committee assists the Board by periodically reviewing the accounting, reporting and financial practices of the company, including the integrity of our financial statements, the surveillance of administrative and financial controls and the company's compliance with legal and regulatory requirements. Through its regular meetings with management, including the finance and internal audit functions, the Audit Committee reviews and discusses significant areas of our business, including operational management practices, internal controls, accounting policies and procedures and summarizes for the Board of Directors areas of risk and the appropriate mitigating factors.

Code of Ethics

A Code of Business Conduct and Ethics is a written standard designed to deter wrongdoing and to promote (a) honest and ethical conduct, (b) full, fair, accurate, timely and understandable disclosure in regulatory filings and public statements, (c) compliance with applicable laws, rules and regulations, (d) the prompt reporting violation of the code and (e) accountability for adherence to the Code. We are not currently subject to any law, rule or regulation requiring that we adopt a Code of Ethics, however, we have adopted a code of ethics that applies to our principal executive officer, chief financial officer, principal accounting officer or controller, or persons performing similar functions. Such code of ethics will be provided to any person without charge, upon written request, a copy of such code of ethics by sending such request to us at our principal office.

Committees of the Board of Directors

Audit Committee

Messrs. Rule, Hu and Tang serve on the audit committee of the Board of Directors. The audit committee oversees our financial reporting process on behalf of the board of directors. The committee's responsibilities include the following functions:

- approve and retain the independent auditors to conduct the annual audit of our books and records;
 - review the proposed scope and results of the audit;
- review and pre-approve the independent auditors' audit and non-audited services rendered;

- approve the audit fees to be paid;
- review accounting and financial controls with the independent auditors and our internal auditors and financial and accounting staff;
 - review and approve transactions between us and our directors, officers and affiliates;
 - recognize and prevent prohibited non-audit services;
- meeting separately and periodically with management and our internal auditor and independent auditors; and

The Audit Committee operates under a written charter. Mr. Tang serves as the Chairman of our Audit Committee.

Our Board of Directors has determined that Mr. Tang qualifies as an “audit committee financial expert” and that all three members of the Audit Committee are “independent,” in each case as defined in Item 407(d)(5) of Regulation S-K of the Securities Exchange Act of 1934, as amended. We believe that the members of our Board of Directors are collectively capable of analyzing and evaluating our financial statements and understanding internal controls and procedures for financial reporting.

In fiscal year 2010, the Audit Committee held 6 meetings and the attendance rates for all committee members were 100%.

REPORT OF THE AUDIT COMMITTEE

The role of the Audit Committee is to assist the Board of Directors in its oversight of the Company’s financial reporting process. As set forth in the Charter, management of the Company is responsible for the preparation, presentation and integrity of the Company’s financial statements, accounting and financial reporting principles and internal controls and procedures designed to assure compliance with accounting standards and applicable laws and regulations. The independent auditors are responsible for auditing the Company’s financial statements and expressing an opinion as to their conformity with generally accepted accounting principles.

In the performance of this oversight function, the Audit Committee has reviewed and discussed the audited financial statements for the fiscal year ended December 31, 2010 with management, and the Chair of the Audit Committee has discussed with the independent auditors the matters required to be discussed by Statement of Auditing Standards No. 61, Communication with Audit Committee, as currently in effect. The Audit Committee has received the written disclosures and the letter from the independent auditors required by Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees, as currently in effect, and has discussed with the independent auditors the independent auditors’ independence; and based on the review and discussions referred above, the Audit Committee recommended to the Board of Directors that the audited financial statements be included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2010 for filing with the SEC.

The members of the Audit Committee are not professionally engaged in the practice of auditing or accounting, are not experts in the fields of accounting or auditing, including in respect of auditor independence. Members of the Committee rely without independent verification on the information provided to them and on the representations made by management and the independent accountants. Accordingly, the Audit Committee’s oversight does not provide an independent basis to determine that management has maintained appropriate accounting and financial reporting principles or appropriate internal control and procedures designed to assure compliance with accounting standards and applicable laws and regulations. Furthermore, the Audit Committee’s consideration and discussions referred to above do not assure that the audit of the Company’s financial statements has been carried out in accordance with generally accepted accounting principles or that the Company’s auditors are in fact “independent.” Based upon the reports, review and discussions described in this report, and subject to the limitations on the role and responsibilities of the Committee referred to above and in the Charter, the Committee recommended to the Board that the audited financial statements be included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2010, be filed with the

Securities and Exchange Commission.

THE AUDIT COMMITTEE

Yau-Sing Tang
Ruishi Hu
Edward Rule

Compensation Committee

The Compensation Committee recommends to the Board of Directors all elements of compensation for the executive officers. The Committee consists of Messrs. Rule (Chairman). Its responsibilities include the following functions:

- reviewing and recommending policy relating to the compensation and benefits of our officers and employees, including reviewing and approving corporate goals and objectives relevant to the compensation of our chief executive officer and other senior officers; evaluating the performance of these officers in light of those goals and objectives; and setting compensation of these officers based on such evaluations;

- administering our benefit plans and the issuance of stock options and other awards under our stock plans; and reviewing and establishing appropriate insurance coverage for our directors and executive officers;
- recommending the type and amount of compensation to be paid or awarded to members of our board of directors, including consulting, retainer, meeting, committee and committee chair fees and stock option grants or awards; and
- reviewing and approving the terms of any employment agreements, severance arrangements, change-of-control protections and any other compensatory arrangements for our executive officers.

In the fiscal year 2010 the Compensation Committee held 3 meetings and the attendance rates for all committee members were 100%.

Compensation Committee Interlocks and Insider Participation