CHINA NORTH EAST PETROLEUM HOLDINGS LTD
Form 10-Q/A
September 01, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/A
(Amendment No. 1)

x QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
for the quarterly period ended June 30, 2009

o 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 small business issuer as specified in its charter)

Nevada	87-0638750
(State of other jurisdiction of incorporation or organization)	(IRS Employer identification No.)

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

(212) 307-3568
(Issuer's telephone number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 x No o

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 o No o

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

Large accelerated filer	o	Accelerated filer	o
Non-accelerated filer	o	Smaller reporting company	x

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

Number of shares of common stock outstanding as of August 7, 2009: 20,989,087

EXLANATORY NOTE

This Amendment on Form 10-Q/A (the "Amended Filing") amends the quarterly report on Form 10-Q for the quarter ended June 30, 2009, originally filed on August 14, 2009 (the "Original Filing"), of China North East Petroleum Holdings Limited. (the "Company"). The purpose of this amendment is to revise certain non-cash items in Part I, Item Financial Statements: (i) reclassify warrants issued in conjunction with a secured debenture issued on February 28, 2008, in accordance with FASB's Emerging Issues Task force 00-19 as liability instruments rather than equity instruments; (ii) the change in 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 issued on February 28, 2008; (iv) the recording of warrants issued to investment consultants in connection with the secured debenture issued on February 28, 2008 as deferred financing costs instead of consulting fees; (v) the amount of amortization of deferred financing costs associated with the issuance of the secured debenture issued on February 28, 2008; (vi) compensation issued to employees in the form of stock; (vii) depreciation, depletion and amortization of oil properties; (viii) ceiling test reduction of the net carrying value of oil properties; (ix) income tax expense; (x) noncontrolling interest; and (xi) restructuring of the secured debenture on March 5, 2009, treated as an extinguishment of debt.

As a result of the revisions in Part I, Item 1 of this Amended Filing, Part I, Item 2, Management's Discussion and Analysis of Financial condition and Results of Operation, is revised to incorporate all the revisions made to Part I, Item 1 as stated in the previous paragraph. Furthermore, due to the revisions described above, management has concluded that the Company did not maintain effective controls over financial reporting, and accordingly Part I, Item 4T is revised to state such conclusion and to state the remedial actions which the Company has taken and will take to attain effective control over its financial reporting.

In accordance with Rule 12b-15 under the Exchange Act, each item of the Original Filing that is amended by this Amended Filing is also restated in its entirety, and this Amended Filing is accompanied by currently dated certifications on Exhibits 31.1, 31.2, 32.1 and 32.2 by the Company's Chief Executive Officer and Chief Financial Officer. Except as described above, this Amended Filing does not amend, update, or change any items, financial statements, or other disclosures in the Original Filing, and does not reflect events occurring after the filing of the Original Filing, including as to any exhibits to the Original Filing affected by subsequent events. Information not affected by the changes described above is unchanged and reflects the disclosures made at the time of the Original Filing. Accordingly, this Amended Filing should be read in conjunction with the Original Filing and our other SEC filings subsequent to the filing of the Original Filing, including any amendments to those filings. Capitalized terms not defined in the Amended Filing are as defined by the Original Filing.

For additional detailed information regarding the restatements affecting this report, please see the attached amended and restated consolidated financial statement and Note 1.

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SPECIAL NOTE REGARDING FORWARD—LOOKING STATEMENTS

On one or more occasions, we may make forward-looking statements in this amended and restated Quarterly Report on Form 10-Q/A regarding our assumptions, projections, expectations, targets, intentions or beliefs about future events. Words or phrases such as "anticipates," "may," "will," "should," "believes," "estimates," "expects," "intends," "plans," "projects," "targets," "will likely result," "will continue" or similar expressions identify forward-looking statements. These forward-looking statements are only our predictions and involve numerous assumptions, risks and uncertainties, including, but not limited to those listed below and those business risks and factors described elsewhere in this report and our other Securities and Exchange Commission filings.

Forward-looking statements involve risks and uncertainties which could cause actual results or outcomes to differ materially from those expressed. We caution that while we make such statements in good faith and believe such statements are based on reasonable assumptions, including without limitation, management's examination of historical operating trends, data contained in records and other data available from third parties, we cannot assure you that our projections will be achieved. Factors that may cause such differences include but are not limited to:

- Our expectation of continued growth in the demand for our oil;
- Our expectation that we will 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.

We have attempted to identify, in context, certain of the factors that we believe may cause actual future experience and results to differ materially from our current expectation regarding the relevant matter or subject area. In addition to the items specifically discussed above, our business and results of operations are subject to the uncertainties described under the caption "Risk Factors" which is a part of the disclosure included in Item 2 of this amended and restated Report entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations."

From time to time, oral or written forward-looking statements are also included in our reports on Forms 10-K, 10-Q and 8-K, Proxy Statements on Schedule 14A, press releases, analyst and investor conference calls, and other communications released to the public. Although we believe that at the time made, the expectations reflected in all of these forward looking statements are and will be reasonable, any or all of the forward-looking statements in this amended and restated quarterly report on Form 10-Q/A, our reports on Forms 10-K and 8-K, our Proxy Statements on Schedule 14A and any other public statements that are made by us may prove to be incorrect. This may occur as a result of inaccurate assumptions or as a consequence of known or unknown risks and uncertainties. Many factors discussed in this amended and restated Quarterly Report on Form 10-Q/A, certain of which are beyond our control, will be important in determining our future performance. Consequently, actual results may differ materially from those that might be anticipated from forward-looking statements. In light of these and other uncertainties, you should not regard the inclusion of a forward-looking statement in this amended and restated Quarterly Report on Form 10-Q/A or other public communications that we might make as a representation by us that our plans and objectives will be achieved, and you should not place undue reliance on such forward-looking statements.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. However, your attention is directed to any further disclosures made on related subjects in our subsequent annual and periodic reports filed with the SEC on Forms 10-K, 10-Q and 8-K and Proxy Statements on Schedule 14A.

Unless the context requires otherwise, references to “we,” “us,” “our,” the “Company” and “NEP” refer specifically to China North East Petroleum Holdings Limited and its subsidiaries.

PART I FINANCIAL INFORMATION
Item 1. Financial Statements

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES ("NEP")
Condensed Consolidated Balance Sheets

		As of		
		June 30, 2009 (Unaudited) (Restated)		December 31, 2008 (Audited)
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	$	22,675,024	$	13,239,213
Accounts receivable, net		5,083,803		4,230,080
Prepaid expenses and other current assets		510,008		781,121
Value added tax recoverable		-		311,240
Total Current Assets		28,268,835		18,561,654
PROPERTY AND EQUIPMENT				
Oil properties, net		36,763,532		54,326,410
Fixed assets, net		1,705,301		1,684,377
Oil properties under construction		-		714,629
Total Property and Equipment		38,468,833		56,725,416
LAND USE RIGHTS, NET		30,288		36,198
DEFERRED FINANCING COSTS, NET		-		1,481,557
DEFERRED TAX ASSETS		6,617,317		3,122,519
TOTAL ASSETS	$	73,385,273	$	79,927,344
LIABILITIES AND STOCKHOLDERS' EQUITY				
CURRENT LIABILITIES				
Accounts payable	$	12,098,584	$	10,985,894
Current portion of secured debenture		5,105,000		2,625,000
Other payables and accrued liabilities		880,945		821,918
Due to related parties		14,610		66,262
Income tax and other taxes payable		3,264,378		3,710,870
Due to a stockholder		2,998,932		738
Total Current Liabilities		24,362,449		18,210,682
LONG-TERM LIABILITIES				
Accounts payable		9,295,090		13,944,903
Secured debenture, net of discount		7,375,000		4,750,765
Warrants		19,628,844		6,830,962
Total Long-term Liabilities		36,298,934		25,526,630

TOTAL LIABILITIES		60,661,383		43,737,312
COMMITMENTS AND CONTINGENCIES		-		-
EQUITY				
NEP Stockholders' Equity				
Common stock ($0.001 par value, 150,000,000 shares authorized, 20,904,080 shares issued and outstanding as of June 30, 2009; 20,784,080 shares issued and outstanding as of December 31, 2008)		20,904		20,784
Additional paid-in capital		14,225,707		13,067,693
Retained earnings (deficit)				
Unappropriated		(9,266,496)		15,264,623
Appropriated		1,372,999		1,372,999
Accumulated other comprehensive income		3,148,138		3,085,703
Total NEP Stockholders' Equity		9,501,252		32,811,802
Noncontrolling interests		3,222,638		3,378,230
TOTAL EQUITY		12,723,890		36,190,032
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	73,385,273	$	79,927,344

The accompanying notes are an integral part of these condensed consolidated financial statements

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
Condensed Consolidated Statements of Operations and Comprehensive Loss

	Three months ended June 30, 2009	Three months ended June 30, 2008	Six months ended June 30, 2009	Six months ended June 30, 2008
	(Unaudited and Restated)			
NET SALES	$ 11,351,405	$ 14,167,538	$ 20,250,628	$ 24,991,512
COST OF SALES				
Production costs	1,152,199	782,972	1,666,599	1,495,277
Depreciation, depletion and amortization of oil properties	2,235,413	2,506,302	5,315,043	4,380,994
Amortization of land use rights	2,982	2,926	5,961	5,768
Government oil surcharge	580,375	3,173,380	618,167	5,384,700
Total Cost of Sales	3,970,969	6,465,580	7,605,770	11,266,739
GROSS PROFIT	7,380,436	7,701,958	12,644,858	13,724,773
OPERATING EXPENSES				
Selling, general and administrative expenses	718,272	296,067	1,397,147	553,661
Professional fees	74,159	66,558	172,915	132,983
Consulting fees	72,589	225,393	69,995	402,807
Depreciation of fixed assets	70,986	58,253	139,801	110,485
Impairment of oil properties	6,789	-	13,832,356	-
Total Operating Expenses	942,795	646,271	15,612,214	1,199,936
INCOME (LOSS) FROM OPERATIONS	6,437,641	7,055,687	(2,967,356)	12,524,837
OTHER INCOME (EXPENSE)				
Other income	-	65,842	-	65,842
Other expense	(1,008)	(103,290)	(1,801)	(105,601)
Interest expense	(260,664)	(305,347)	(540,664)	(425,044)
Amortization of deferred financing costs	-	(220,639)	(144,507)	(300,651)
Amortization of discount on debenture	-	(1,023,738)	(670,492)	(1,394,984)
Imputed interest expense	(37,669)	(5,845)	(49,917)	(32,741)
Interest income	4,668	25,924	19,764	29,966
Change in fair value of warrants	(12,731,750)	(15,044,528)	(12,078,045)	(17,045,225)
Loss on extinguishment of debt	-	-	(8,260,630)	-
Total Other Expense, net	(13,026,423)	(16,611,621)	(21,726,292)	(19,208,438)
NET LOSS BEFORE INCOME TAXES	(6,588,782)	(9,555,934)	(24,693,648)	(6,683,601)
Income tax expense	-	(1,865,268)	-	(3,304,537)
NET LOSS	(6,588,782)	(11,421,202)	(24,693,648)	(9,988,138)
Less: net (income) loss attributable to noncontrolling	(710,839)	(548,373)	162,529	(976,093)

interests				
NET LOSS ATTRIBUTABLE TO NEP COMMON STOCKHOLDERS	(7,299,621)	(11,969,575)	(24,531,119)	(10,964,231)
OTHER COMPREHENSIVE INCOME				
Total other comprehensive income	7,348	930,422	69,372	1,867,981
Less: foreign currency translation gain attributable to noncontrolling interests	(734)	(93,042)	(6,937)	(186,798)
Foreign currency translation gain attributable to NEP common stockholders	6,614	837,380	62,435	1,681,183
COMPREHENSIVE LOSS ATTRIBUTABLE TO NEP COMMON STOCKHOLDERS	$ (7,293,007)	$ (11,132,195)	$ (24,468,684)	$ (9,283,048)
Net loss per share				
- basic	$ (0.35)	$ (0.62)	$ (1.18)	$ (0.57)
- diluted	$ (0.35)	$ (0.62)	$ (1.18)	$ (0.57)
Weighted average number of shares outstanding during the period				
- basic	20,855,289	19,224,080	20,819,881	19,224,080
- diluted	20,855,289	19,224,080	20,819,881	19,224,080

The accompanying notes are an integral part of these condensed consolidated financial statements

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CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows

	For Six months ended June 30, 2009	2008
	(Unaudited and Restated)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (24,693,648)	$ (9,988,138)
Adjusted to reconcile net loss to cash provided by operating activities:		
Depreciation, depletion and amortization of oil properties	5,315,043	4,380,994
Depreciation of fixed assets	139,801	110,485
Amortization of land use rights	5,961	5,768
Amortization of deferred financing costs	144,507	300,651
Amortization of discount on debenture	670,492	1,394,984
Loss on extinguishment of debt	8,260,630	-
Amortization of stock option compensation	554,194	20,240
Change in fair value of warrants	12,078,045	17,045,225
Impairment of oil properties	13,832,356	-
Warrants issued for services	147,823	35,653
Stocks issued for services	-	27,125
Stock-based compensation for service	405,000	-
Imputed interest expense	49,917	32,741
Changes in operating assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(853,723)	(3,362,131)
Prepaid expenses and other current assets	271,113	(2,099,397)
Value added tax recoverable	311,240	111,227
Increase (decrease) in:		
Accounts payable	(3,537,123)	(9,735,812)
Other payables and accrued liabilities	59,027	139,683
Income tax and other taxes payable	(446,492)	2,687,453
Deferred tax assets	(3,494,798)	(247,727)
Net cash provided by operating activities	9,219,365	859,024
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of oil properties	(790,110)	(8,338,953)
Purchase of fixed assets	(158,416)	(596,055)
Additions to oil properties under construction	-	(563,024)
Net cash used in investing activities	(948,526)	(9,498,032)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment of deferred financing costs	-	(1,186,229)
Proceeds from issuance of secured debenture	-	15,000,000
Repayment of secured debenture	(1,770,000)	-
Proceeds from exercise of stock warrants	1,200	-
Increase in amount due to a stockholder	2,998,194	265,076
Decrease in amounts due to related parties	(51,652)	(1,715,330)

Net cash provided by financing activities	1,177,742	12,363,517
EFFECT OF EXCHANGE RATE ON CASH	(12,770)	(1,371,559)
NET INCREASE IN CASH AND CASH EQUIVALENTS	9,435,811	2,352,950
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	13,239,213	74,638
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 22,675,024	$ 2,427,588
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Income tax expense	$ 4,077,609	$ 2,851,704
Interest expense	$ 280,839	$ 425,044
SUPPLEMENTAL DISCLOSURE OF NON-CASH OPERATING ACTIVITIES:		
During 2008, the Company issued warrants in connection with the secured debenture to the investor and an investment consultant valued at $10,268,321 and $1,026,832, respectively		

The accompanying notes are an integral part of these condensed consolidated financial statements

NOTE 1 RESTATEMENT OF PREVIOUSLY REPORTED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

On February 23, 2010, China North East Petroleum Holdings Limited (the “Company) determined that the Company’s financial statements as of June 30, 2009 and for the three and six months then ended 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 Emerging Issues Task Force (“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 issuance of the secured debenture as deferred financing costs instead of consulting fees; (v) the rate of amortization of deferred financing costs associated with the issuance of that secured debenture; (vi) compensation issued to employees in the form of stock; (vii) depreciation, depletion and amortization of oil properties; (viii) ceiling test reduction of the net carrying value of oil properties; (ix) income tax expense; (x) noncontrolling interests; and (xi) restructuring of the secured debenture on March 5, 2009, treated as an extinguishment of debt.

As a result, the accompanying unaudited condensed consolidated financial statements as of June 30, 2009 and for the three and six months then ended have been restated from the amounts previously reported. The information in the data table below represents only those income statement, balance sheet, cash flow and comprehensive income statement line items affected by the restatement.

STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME(LOSS) INFORMATION

	Three months ended June 30, 2009			Si J	
	As previously reported	Adjustments	As restated	As previously reported	A
Cost of Sales:					
Depletion, depreciation and amortization of oil properties	$2,833,995	$ 598,582	$ 2,235,413	$5,458,249	$
Operating Expenses:					
Selling, general and administrative expenses	610,754	(107,518)	718,272	1,183,337	
Professional fees	153,032	(78,873)	74,159	225,048	
Consulting fees	98,615	(26,026)	72,589	156,295	
Impairment of oil properties	-	6,789	6,789	-	
Other Income (Expense):					
Amortization of deferred financing costs	(74,140)	74,140	-	(148,279)	
Amortization of discount on debenture	(509,355)	509,355	-	(1,002,058)	
Change in fair value of warrants	-	12,731,750	(12,731,750)	-	
Loss on extinguishment of debt	-	-	-	-	
Net income (loss)	3,302,451	(9,891,233)	(6,588,782)	5,986,549	
Income tax expense	(1,667,848)	1,667,848	-	(3,087,667)	
Noncontrolling interests	(484,874)	225,965	(710,839)	(897,619)	
Net income (loss) attributable to NEP common stockholders	2,817,577	(10,117,198)	(7,299,621)	5,088,930	
Foreign currency translation gain attributable to NEP common stockholders	4,010	2,604	(6,614)	75,055	
Comprehensive income (loss)	4,456	(2,892)	7,348	5,163,985	
Net income (loss) per share -- Basic	0.14	0.49	(0.35)	0.24	

Net income (loss) per share -- Diluted	0.13	0.48	(0.35)	0.24

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BALANCE SHEET INFORMATION

	As of June 30, 2009		
	As previously reported	Adjustments	As restated
Assets:			
Oil properties, net	$ 66,338,774	$ (29,575,242)	$ 36,763,532
Deferred financing costs, net	790,819	(790,819)	-
Deferred tax asssets	-	6,617,317	6,617,317
Total Assets	97,134,017	(23,748,744)	73,385,273
Current Liabilities:			
Current portion of secured debenture, net	2,864,844	2,240,156	5,105,000
Total current liabilities	22,122,293	2,240,156	24,362,449
Long-term Liabilities:			
Secured debenture, net of discount	4,138,732	3,236,238	7,375,000
Deferred tax liabilities	359,901	(359,901)	-
Warrants	-	19,628,844	19,628,844
Total long-term liabilities	13,793,723	22,505,211	36,298,934
Stockholders' Equity:			
Additional paid-in capital	22,295,107	(8,069,400)	14,225,707
Deferred stock compensation	(843,750)	843,750	-
Retained earnings (deficit), unappropriated	29,625,009	(38,891,505)	(9,266,496)
Accumulated other comprehensive income	3,328,123	(179,985)	3,148,138
Total stockholders’ equity	55,798,392	(46,297,140)	9,501,252
Total liabilities and stockholders’ equity	97,134,017	(23,748,744)	73,385,273

STATEMENT OF CASH FLOWS INFORMATION

	Six months ended June 30, 2009		
	As previously reported	Adjustments	As restated
Net income (loss)	$ 5,088,930	$ (29,620,049)	$ (24,531,119)
Adjustments to reconcile net income (loss) to cash provided by operating activities:			
Depreciation, depletion and amortization of oil properties	5,458,249	(143,206)	5,315,043
Amortization of deferred financing costs	148,279	(3,772)	144,507
Amortization of discount on debenture	1,002,058	(331,566)	670,492
Amortization of stock option compensation	340,384	213,810	554,194
Change in fair value of warrants	-	12,078,045	12,078,045

Impairment of oil properties	-	13,832,356	13,832,356
Loss on extinguishment of debt	-	8,260,630	8,260,630
Warrants issued for services	206,602	(58,779)	147,823
Noncontrolling interest	897,619	(1,060,148)	(162,529)
Other payables and accrued liabilities	138,681	(79,654)	59,027
Deferred tax liabilities	(402,504)	(3,095,294)	(3,494,798)
Net cash provided by operating activities	9,223,992	(4,627)	9,219,365
Effect of exchange rate on cash	(17,397)	4,627	(12,770)

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NOTE 2 BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments consisting only of normal recurring accruals considered necessary to present fairly the Company's financial position at June 30, 2009, the results of operations and cash flows for the three and six months ended June 30, 2009 and 2008. The results for the six months ended June 30, 2009 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2009.

These financial statements should be read in conjunction with the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008, previously filed with the Securities and Exchange Commission on March 30, 2009.

NOTE 3 ORGANIZATION

China North East Petroleum Holdings Limited (“North East Petroleum”) was incorporated in Nevada on August 20, 1999 under the name of Draco Holding Corporation (“Draco”).

Hong Xiang Petroleum Group Limited ("Hong Xiang Petroleum Group") was incorporated in the British Virgin Islands (“BVI”) on August 28, 2003 as an investment holding company.

Song Yuan City Hong Xiang Petroleum Technical Services Co., Ltd. (“Hong Xiang Technical”) was incorporated in the People’s Republic of China (“PRC”) on December 5, 2003 to provide technical advisory services to oil and gas exploration companies in the PRC.

During 2004, Hong Xiang Petroleum Group acquired a 100% ownership of Hong Xiang Technical.

During 2004, Hong Xiang Technical acquired a 100% interest in Song Yuan City Yu Qiao Qianan Hong Xiang Oil and Gas Development Co., Ltd. (“Hong Xiang Oil Development”) which is engaged in the exploration and production of crude oil in the Jilin Oil Region, of the PRC. In December 2002, Hong Xiang Oil Development entered into an oil lease agreement with Song Yuan City Yu Qiao Oil and Gas Development Limited Corporation (“Yu Qiao”) to develop the proven reserves in the Qian’an Oil Field Zone 112 (Qian’an 112) in Jilin Oil Region for 20 years.

During 2004, Draco executed a Plan of Exchange to acquire 100% of Hong Xiang Petroleum Group.

On July 26, 2006, the Company entered into a Joint Venture Agreement (the “JV Agreement”) with a principal stockholder and a related party, hereafter referred to as the “Related Parties,” to acquire oil and gas properties for the exploration of crude oil in the PRC. Pursuant to the JV Agreement, the Company and the Related Parties are obligated to contribute $1 million and $121,000, respectively, to the registered capital of Song Yuan North East Petroleum Technical Service Co., Ltd. (“Song Yuan Technical”), and the Company and the Related Parties will each share 90% and 10% respectively of the equity and profit interests of Song Yuan Technical.

On June 1, 2005, Song Yuan Technical acquired from third parties 100% equity interest of LongDe Oil & Gas Development Co. Ltd. (“LongDe”) at a consideration of $120,773 in cash. LongDe is engaged in the exploration and production of crude oil in the Jilin Oil Region of the PRC.

NOTE 3 ORGANIZATION (CONTINUED)

On January 26, 2007, Song Yuan Technical acquired 100% of the equity interest of Yu Qiao for 10,000,000 shares of the Company’s common stock having a fair value of $3,100,000. Yu Qiao is engaged in the extraction and production of crude oil in Jilin Province, PRC and operates 3 oilfields with a total exploration area of 39.2 square kilometers. Pursuant to a 20-year exclusive Cooperative Exploration Contract (the “Oil Lease”) which was entered into on May 28, 2002 with PetroChina Group, a corporation organized and existing under the laws of PRC (“PetroChina”), the Company has the right to explore, develop and extract oil at Qian’an 112, Da 34 and Gu 31 area.

After the acquisition of Yu Qiao, the oil lease agreement between Yu Qiao and Hong Xiang Oil Development was rescinded and Hong Xiang Technical and Hong Xiang Oil Development were dissolved in March 2007.

North East Petroleum, Hong Xiang Petroleum Group, Song Yuan Technical, LongDe and Yu Qiao are hereinafter referred to as (“the Company”).

NOTE 4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

The accompanying unaudited condensed consolidated financial statements include the unaudited financial statements of North East Petroleum and its wholly owned subsidiary, Hong Xiang Petroleum Group and 90% equity interest owned subsidiaries, Song Yuan Technical, LongDe and Yu Qiao (collectively, “the Company”). The noncontrolling interests represent the minority shareholders’ 10% share of the results of Song Yuan Technical, LongDe and Yu Qiao.

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.

Foreign currency translation and other comprehensive income

The reporting currency of the Company is the US dollar. The functional currency of Song Yuan Technical, LongDe and Yu Qiao is the Chinese Renminbi (RMB).

For the subsidiaries whose functional currencies are other than the US dollar, all assets and liabilities accounts were translated at the exchange rate on the balance sheet date; stockholder's equity is translated at the historical rates and items in the statement of operations items and statement of cash flows are translated at the average rate for the year. Translation adjustments resulting from this process are included in accumulated other comprehensive income in the statement of stockholders’ equity. The resulting translation gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the results of operations as incurred.

Accumulated other comprehensive income in the consolidated statement of stockholders' equity amounted to $3,148,138 and $3,085,703 as of June 30, 2009 and December 31, 2008, respectively. The balance sheet amounts with the exception of equity at June 30, 2009 were translated at 6.8448 RMB to $1.00 USD. The average translation rates applied to income statement amounts for the six months ended June 30, 2009 was 6.84323 RMB to $1.00 USD.

Cash and concentration of risk

The Company considers all highly liquid investments with original maturities of three months or less at the time of purchase to be cash equivalents, for statement of cash flows purposes. Cash includes cash on hand and demand deposits in accounts maintained with state owned banks within the PRC and with banks the US.

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The Company’s cash equivalents are exposed to concentration of credit risk. The Company maintains balances at financial institutions which, from time to time, may exceed Federal Deposit Insurance Corporation insured limits for the banks located in the United States. Balances at financial institutions or state owned banks within the PRC are not covered by insurance. As of June 30, 2009 and December 31, 2008, the Company had deposits in excess of federally insured limits totaling $975,888 and $1,016,733 respectively. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risks on its cash in bank accounts.

Substantially all of the Company's operations are carried out in the PRC. Accordingly, the Company's business, financial condition and results of operations may be influenced by the political, economic and legal environments in that country, and by the general state of that country’s economy. The Company's operations in the PRC are subject to specific considerations and significant risks not typically associated with companies in the United States. These include risks associated with, among others, the political, economic and legal environments and foreign currency exchange. The Company's results may be adversely affected by changes in governmental policies with respect to laws and regulations, anti-inflationary measures, currency conversion and remittance abroad, and rates and methods of taxation, among other things.

Revenue Recognition

The Company records revenues from the sales of oil on a net basis when delivery to its sole customer (PetroChina) has occurred and title has transferred. This occurs when oil has been delivered to a PetroChina depot.

Pursuant to the Oil Lease entered into in 2002 and 2003 with PetroChina, each with twenty year terms, the Company is entitled to 80% of the Company’s oil production for the first ten years and 60% of the Company’s 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 the Company is entitled to.

Major customers

We have only one customer – PetroChina’s Jilin Refinery branch, located in Song Yuan City, Jilin Province, PRC. Pursuant to our lease agreements with PetroChina we are unable to sell our oil production to any other customer.

Accounts receivables and allowance for doubtful accounts

The Company bills PetroChina on a monthly basis, at 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 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 for 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 lesser amounts due from the two preceding months equal to the amount of oil surcharge tax payable by us. We do not recognize any allowance for doubtful accounts, as PetroChina has always paid our invoices on a correct, consistent and timely basis.

Long-lived assets

Long-lived assets to be held and used in the Company's operations are reviewed for impairment whenever events or changes in circumstances indicate that the related carrying amount may not be recoverable. When the carrying amounts of long-lived assets exceed the fair value, which is generally based upon discounted future cash flows the Company records an impairment. Impairment loss recognized for the three and six months ended June 30, 2009 were $6,789 and $13,832,356, respectively.

Financial instruments

The Company analyzes all financial instruments with features of both liabilities and equity under Statement of Financial Accounting Standards (“SFAS”) No. 150, “Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity,” SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities” and 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 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 FSP EITF 00-19-2, “Accounting for Registration Payment Arrangements” (See Note 8, Registration Payment Arrrangements, below).

Fair value of financial instruments

On January 1, 2008, the Company adopted SFAS No. 157. SFAS No. 157, “Fair Value Measurements”, 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 follow:

- 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 June 30, 2009 are summarized as follows (unaudited):

	Fair value measurement using inputs		
	Level 1	Level 2	Level 3
Liabilities:			
Derivative instruments – Warrants	$ -	$ -	$ 19,628,844

Total	$ -	$ -	$ 19,628,844

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. See Note 5 for further information.

The carrying values of cash and cash equivalents, trade receivables, current trade payables, and short-term bank loans and debts approximate their fair values due to the short maturities of these instruments. The Company believes that the carrying value of non-current trade payables and the secured debenture at June 30, 2009 approximates fair value, after considering the various attributes of the debt and the Company's current credit standing (see Note 5, "Secured Debenture," for additional information regarding the carrying value of the secured debenture).

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Stock-Based Compensation

The Company follows 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 SFAS No. 123R and 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 June 30, 2009, the Company did not have any investment in unproved oil properties.

Pursuant to full cost accounting rules, the Company must perform a ceiling test each quarter on its proved oil assets within each separate cost center. The ceiling test provides that capitalized costs less related accumulated depletion and deferred income taxes for each cost center may not exceed the sum of (1) the present value of future net revenue from estimated production of proved oil reserves using current prices, excluding the future cash outflows associated with settling asset retirement obligations that have been accrued on the balance sheet, at a discount factor of 10%; plus (2) the cost of properties not being amortized, if any; plus (3) the lower of cost or estimated fair value of unproved properties included in the costs being amortized, if any; less (4) income tax effects related to the differences in the book and tax basis of oil properties. Should the net capitalized costs for a cost center exceed the sum of the components noted above, an impairment charge would be recognized to the extent of the excess capitalized costs. Due to the significant decline in oil prices during the fourth quarter of 2008 and the continued decline in prices for the first quarter of 2009, the net capitalized costs of our oil properties exceeded the sum of the components noted above by $13,184,103 on December 31, 2008 and by $13,832,356 on June 30, 2009, and therefore the Company has recognized impairment charges and corresponding reductions in the carrying value of those net capitalized costs of $13,184,103 and $13,832,356, as of December 31, 2008 and June 30, 2009, respectively. For additional details regarding net carrying value of oil properties and the calculations used to derive the value of the impairment, please see Note 12, “Oil Properties.” below.

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

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.

Earnings per share

The Company reports earnings per share in accordance with the provisions of SFAS No. 128, "Earnings Per Share." SFAS No. 128 requires presentation of basic and diluted earnings per share in conjunction with the disclosure of the methodology used in computing such earnings per share. Basic earnings per share excludes dilution and is computed by dividing income available to common stockholders by the weighted average common shares outstanding during the period. Diluted earnings 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 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 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 in the income statement, 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 June 30, 2009, the Company’s deferred tax assets amounted to $6,617,317.

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 a Chinese value-added tax at a rate of 17% of 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. As of June 30, 2009 the Company had a net VAT Payable liability balance of $698,193, compared with a net VAT Recoverable asset balance of $311,240 as of December 31, 2008.

Recently issued accounting pronouncements

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115". This statement permits entities to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS No. 159 apply only to entities that elect the fair value option. However, the amendment to SFAS No. 115 "Accounting for Certain Investments in Debt and Equity Securities" applies to all entities with available-for-sale and trading securities. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provision of SFAS No. 157, "Fair Value Measurements". The adoption of this statement did not have a material effect on the Company's financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51". This statement improves the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards that require; the ownership interests in subsidiaries held by parties other than the parent and the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income, changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently, when a subsidiary is deconsolidated, any retained noncontrolling equity investment in the former subsidiary be initially measured at fair value, entities provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS No. 160 affects those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Early adoption is prohibited. The adoption of this statement will result in the reclassification of "Minority interests" to equity as "Noncontrolling interests" and separate disclosures in the statements of operations.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations – a replacement of FASB Statement No. 141," which significantly changes the principles and requirements of how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This statement is effective prospectively, except for certain retrospective adjustments to deferred tax balances, for fiscal years beginning after December 15, 2008. This statement will be effective for the Company beginning in fiscal 2010. The adoption of SFAS No. 141(R) will only impact future acquisitions.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133". This statement amends and expands the disclosure requirements of SFAS No. 133 to require qualitative disclosure about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. The statement will be effective for the Company beginning in fiscal 2009. We are currently evaluating the disclosure implications of this statement.

In May 2008, the FASB released SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that presented in conformity with generally accepted accounting principles in the United States of America. SFAS No. 162 will be effective 60 days following the SEC's approval of the PCAOB amendments to AU Section 411, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles. The Company does not believe SFAS 162 will have a significant impact on the Company's consolidated financial statements.

On December 31, 2008, the SEC adopted a final rule that amends its oil and gas reporting requirements. The revised rules change the way oil and gas companies report their reserves in the financial statements. The rules are intended to reflect changes in the oil and gas industry since the original disclosures were adopted in 1978. Definitions were updated to be consistent with Petroleum Resource Management System (PRMS). Other key revisions include a change in pricing used to prepare reserve estimates, the inclusion of non-traditional resources in reserves, the allowance for use of new technologies in determining reserves, optional disclosure of probable and possible reserves and significant new disclosures. The revised rules will be effective for our annual report on Form 10-K for the fiscal year ending December 31, 2009. The SEC is precluding application of the new rules in quarterly reports prior to the first annual report in which the revised disclosures are required and early adoption is not permitted. We are currently evaluating the effect the new rules will have on our financial reporting and anticipate that the following rule changes could have a significant impact on our results of operations as follows:

- The price used in calculating reserves will change from a single-day closing price measured on the last day of the company's fiscal year to a 12-month average price, and will affect our depletion and ceiling test calculations.

- Several reserve definitions have changed that could revise the types of reserves that will be included in our year-end reserve report.

- Many of our financial reporting disclosures could change as a result of the new rules.

In December 2008, the FASB issued Staff Position No. FAS 132(R)-1 "Employers' Disclosures about Postretirement Benefit Plan Assets" ("FSP FAS 132(R)-1"). FSP FAS 132(R)-1 requires more detailed disclosures about employers' plan assets in a defined benefit pension or other postretirement plan, including employers' investment strategies, major categories of plan assets, concentrations of risk within plan assets, and inputs and valuation techniques used to measure the fair value of plan assets. FSP FAS 132(R)-1 also requires, for fair value measurements using significant unobservable inputs (Level 3), disclosure of the effect of the measurements on changes in plan assets for the period. The disclosures about plan assets required by FSP FAS 132(R)-1 must be provided for fiscal years ending after December 15, 2009. As this pronouncement is only disclosure-related, it does not have an impact on the financial position and results of operations.

In April 2009, the FASB issued Staff Position No. FAS 107-1 and APB No. 28-1 "Interim Disclosures about Fair Value of Financial Instruments" ("FSP FAS No. 107-1 and APB Opinion No. 28-1"). FSP FAS No. 107-1 and APB Opinion No. 28-1 requires fair value disclosures for financial instruments that are not reflected in the condensed consolidated balance sheets at fair value. Prior to the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the fair values of those assets and liabilities were disclosed only once each year. With the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the Company will now be required to disclose this information on a quarterly basis, providing quantitative and qualitative information about fair value estimates for all financial instruments not measured in the condensed consolidated balance sheets at fair value. FSP FAS No. 107-1 and APB Opinion No. 28-1 are effective for interim reporting periods that end after June 15, 2009. As this pronouncement is only disclosure-related, it does not have an impact on the financial position and results of operations.

In May 2009, the FASB issued SFAS No. 165 "Subsequent Events" ("SFAS 165"). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, SFAS 165 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 is effective for the interim report and annual periods that end after June 15, 2009. The adoption of SFAS 165 has no impact on the financial statements as management has already followed a similar approach prior to the adoption of this standard.

In June 2009, the FASB issued SFAS No. 166 “Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140” (“SFAS 166”). SFAS 166 amends various provisions of SFAS No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125” by removing the concept of a qualifying special-purpose entity and removes the exception from applying FIN 46(R) to variable interest entities that are qualifying special-purpose entities; limits the circumstances in which a transferor derecognizes a portion or component of a financial asset; defines a participating interest; requires a transferor to recognize and initially measure at fair value all assets obtained and liabilities incurred as a result of a transfer accounted for as a sale; and requires enhanced disclosure; among others. SFAS 166 will be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Management is currently evaluating the potential impact of SFAS 166 on the financial statements.

In June 2009, the FASB issued SFAS No. 167 "Amendments to FASB Interpretation No. 46(R)" ("SFAS 167"). SFAS 167 amends FASB Interpretation No. 46 (Revised December 2003) "Consolidation of Variable Interest Entities—an interpretation of ARB No. 51" (FIN 46(R)) to require an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity; to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity; to eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity; to add an additional reconsideration event for determining whether an entity is a variable interest entity when any changes in facts and circumstances occur such that holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights of those investments to direct the activities of the entity that most significantly impact the entity's economic performance; and to require enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise's involvement in a variable interest entity. SFAS 167 will be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Management is currently evaluating the potential impact of SFAS 167 on the financial statements.

In June 2009, the FASB issued SFAS No. 168 "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162" ("SFAS 168"). SFAS 168 replaces SFAS No. 162 and establishes the FASB Accounting Standards Codification ("Codification") as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The FASB will no longer issue new standards in the form of Statements, FASB Staff Positions, or EITF Abstracts; instead the FASB will issue Accounting Standards Updates. Accounting Standards Updates will not be authoritative in their own right as they will only serve to update the Codification. The issuance of SFAS 168 and the Codification does not change GAAP. SFAS 168 will be effective for interim and annual periods that end after September 15, 2009. Management has determined that the adoption of SFAS 168 will not have an impact on the financial statements.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications have no effect on net income or cash flows.

NOTE 5 SECURED DEBENTURE

The following is a summary of secured debenture at June 30, 2009 and December 31, 2008:

	June 30, 2009 (Unaudited) (Restated)	December 31, 2008 (Audited) (Restated)
8% 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	$ 12,480,000	$ 7,375,765
Less: current maturities	(5,105,000))	(2,625,000))
Long-term portion	$ 7,375,000	$ 4,750,765

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 the Purchase Agreement, the exercise price of 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 the Company, 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.” 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 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 is comprised of 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 be recognized as gain or loss in the period incurred.

Interest expense on the secured debenture for the three and six months ended June 30, 2009 was $260,664 and $540,664 respectively.

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NOTE 6 NET LOSS PER SHARE

The following is a reconciliation of the numerators and denominators used in computing basic and diluted net loss per share (in thousands, except per share amounts):

	Six months ended June 30, 2009 (Restated)	Six months ended June 30, 2008 (Restated)
Numerator:		
Net loss attributable to NEP common stockholders used in computing basis net loss per share	$ (24,531)	$ (10,964)
Net loss attributable to NEP common stockholders used in computing diluted net loss per share	$ (24,531)	$ (10,964)
Denominator:		
Shares used in the computation of basic net loss per share (weighted average common stock outstanding)	20,820	19,224
Dilutive potential common stock:		
Options and warrants	-	-
Shares used in the computation of diluted net loss per share	20,820	19,224
Basic net loss per share	$ (1.18)	$ (0.57)
Diluted net loss per share	$ (1.18)	$ (0.57)

For the six months ended June 30, 2009, options and warrants to purchase shares of common stock were not included in the calculation because the effect is anti-dilutive.

	Three months ended June 30, 2009 (Restated)	Three months ended June 30, 2008 (Restated)
Numerator:		
Net loss attributable to NEP common stockholders used in computing basis net loss per share	$ (7,300)	$ (11,970)
Net loss attributable to NEP common stockholders used in computing diluted net loss per share	$ (7,300)	$ (11,970)
Denominator:		
Shares used in computation of basic net loss per share (weighted average common stock outstanding)	20,855	19,224
Dilutive potential common stock:		
Options and warrants	-	-
Shares used in computation of diluted net loss per share	20,855	19,224
Basic net loss per share	$ (0.35)	$ (0.62)
Diluted net loss per share	$ (0.35)	$ (0.62)

For the three months ended June 30, 2009, options and warrants to purchase shares of common stock were not included in the calculation because the effect is anti-dilutive.

NOTE 7 COMMITMENTS AND CONTINGENCIES

(A) Lease commitment

The Company leases office spaces from a stockholder, land and office spaces from third parties under four operating leases which expire on September 20, 2023, December 31, 2009, January 20, 2011 and September 14, 2009 at annual rental of $183, $5,844, $18,993 and $37,200 respectively.

As of June 30, 2009, the Company had outstanding commitments with respect to the above operating leases, which are due as follows:

2009	$	20,261
2010		19,176
2011		1,765
2012		183
Thereafter		1,967
	$	43,352

(B) Capital commitments

As of June 30, 2009, the Company had commitments for capital expenditure of $10,519,000 with a contractor to complete the drilling of 48 oil wells.

NOTE 8 REGISTRATION PAYMENT ARRANGEMENTS

In conjunction with the March 5, 2009 modification of the terms of the Company's secured debenture issued on February 28, 2008 (see Note 5, Secured Debenture, above) and the original issuance of the secured debenture, the Company entered into two Registration Rights Agreements which cover stock to be issued underlying warrants associated 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 to 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 FSP EITF 00-19-2, "Accounting for Registration Payment Arrangements" The Company evaluates the potential likelihood of incurring these financial penalties, and the magnitude of the associated costs, on a probabilistic basis, as required under EITF 00-19-2. For the reporting period ended June 30, 2009, the Company estimates that no financial penalties are likely to be incurred as a result of any of its Registration Rights Agreements, and therefore no expense has been accrued for anticipated future registration payments.

NOTE 9 STOCK-BASED COMPENSATION

From May 2008 to June 2009, the Company granted to its employees, stock options qualified under the Company's 2006 Stock Option/Stock Issuance Plan to purchase Common Stock. As of June 30, 2009, stock options granted under the Company's 2006 Stock Option/Stock Issuance Plan to purchase 470,000 shares of its Common Stock (the "Options") at an exercise prices from $2.94 to $4.50 per share were outstanding. 25% of the 160,000 stock options shall vest upon grant and 25% shall vest every three months thereafter, these stock options granted shall expire ten years after the grant date. 50% of the 310,000 stock options shall vest upon grant and 50% shall vest on the first anniversary of the grant date.

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	292% to 316%	0%	2.43% to 3.42%	$2.94 to $4.50

- 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 2.43% to 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 granted 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" options under the rules prescribed by Staff Accounting Bulletin No. 107.

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. SFAS No. 123R requires forfeiture to be estimated at the time of grant and revised in subsequent periods, if necessary, if actual forfeitures differ from those estimates.

As of June 30, 2009, 470,000 stock options with a fair value of approximately $1,992,598 were issued to staff, of which the Company recognized $554,194 as staff compensation expenses included in selling, general and administrative expenses for the six months ended June 30, 2009.

As of June 30, 2009, the total compensation cost related to stock options not yet recognized was $894,950 and will be recognized over the next year.

The following is a summary of the stock options activity:

	Number of Options Outstanding		Weighted-Average Exercise Price
Balance, December 31, 2008	410,000	$	4.43
Granted	60,000	$	2.94
Forfeited	-		-
Exercised	-		-
Balance, June 30, 2009	470,000	$	4.24

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The following is a summary of the status of options outstanding at June 30, 2009:

	Outstanding Options			Exercisable Options	
Exercise Price	Number	Average Remaining Contractual Life	Average Exercise Price	Number	Weighted Average Exercise Price
$4.05	60,000	8.88 years	$4.05	60,000	$4.05
$4.50	40,000	9.04 years	$4.50	20,000	$4.50
$4.50	310,000	9.04 years	$4.50	155,000	$4.50
$2.94	60,000	9.88 years	$2.94	15,000	$2.94

Stock Grants

On July 18, 2008, the Company issued 360,000 shares of common stock to two executive officers and three engineers as bonuses for a period of two years. The stock was valued at the closing price on the date of grant of $4.50 per share, yielding an aggregate value of $1,620,000. The Company recognized expense of $405,000 during the six months ended June 30, 2009.

NOTE 10 STOCKHOLDERS' EQUITY

(A) Issuance of warrants

On February 28, 2008, the Company issued three tranches of warrants in conjunction with the issuance of a secured debenture as discussed in Note 5. In addition, the Company issued an additional three tranches of warrants to investment consultants in conjunction with the issuance of the secured debenture. On March 5, 2009, the Company issued two tranches of warrants in conjunction with the Amendment to the secured debenture as discussed in Note 5. The Company analyzes all financial instruments with features of both liabilities and equity under SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity," SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and EITF 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock."

The Company treats these warrants as liabilities under EITF 00-19 and accordingly records the warrants at fair value with changes in fair values recorded in profit or loss until such time as the warrants are exercised or expire. The fair values were $12,014,990 at issuance and $19,628,844 at June 30, 2009. For the three and six months ended June 30, 2009, the Company recorded loss of $12,731,750 and $12,078,045, respectively, in changes in the fair value of the warrants in earnings.

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

	June 30, 2009	February 28, 2008
Market price and estimated fair value of common stock:	$4.44	$2.14
Exercise price:	$2.00 - $2.35	$0.01 - $3.45
Remaining contractual life (years):	3.67	5
Dividend yield:	-	-
Expected volatility:	261%	316%
Risk-free interest rate:	1.4%	2.73%

On February 28, 2008, the Company issued warrants to purchase 100,000 shares of Common stock to a professional service provider in conjunction with a two year service agreement. The company treats these warrants as equity instruments and is accordingly recognizing the grant date fair value of the warrants as professional fee expense ratably over the two year term. For the three and six months ended June 30, 2009, the company recognized $26,740 and $53,480, respectively, of expense associated with these warrants.

On April 29, 2009, the Company issued warrants to purchase 50,000 shares of Common Stock to a consultant in conjunction with a one year investor relations consulting services. The company treats these warrants as equity instruments and is accordingly recognizing the grant date fair value of the warrants of $94,343 as consulting fee. For the three and six months ended June 30, 2009, the Company recognized $14,689 and $14,689, respectively, as consulting fee and applied the balance of $79,654 against accrued liabilities.

(B) Stock issuances

On August 26, 2008, Class A Warrants to purchase 1,200,000 shares of the Company's common stock at an exercise price of $0.01 per share were exercised.

On May 8, 2009, the Company issued 120,000 shares of common stock to a consultant who exercised the Class A Warrants at the exercise price of $0.01 per share.

NOTE 11 RELATED PARTY TRANSACTIONS

a) As of June 30, 2009, the Company owed a stockholder of $2,998,932 which is unsecured and repayable on demand. Imputed interest is computed at 5% per annum on the amount due.

b) As of June 30, 2009, the Company owed a related party of $14,610 which is unsecured and repayable on demand. Imputed interest is computed at 5% per annum on the amount due.

c) Total imputed interest expenses recorded as additional paid-in capital amounted to $37,669 and $49,917 for the three and six months ended June 30, 2009 respectively.

d) The Company paid a stockholder $nil and $3,507 for leased office spaces for the three and six months ended June 30, 2009 respectively.

NOTE 12 OIL PROPERTIES

As of June 30, 2009, the Company's full cost pool exceeded the ceiling limitation, based on oil prices of $40.64 per barrel, by $13,832,356. Therefore, impairment expense related to our oil and gas properties of $13,832,356 was recorded during the six months ended June 30, 2009. For the year ended December 31, 2008, we recognized impairment to the value of our oil properties of $13,184,103.

NOTE 13 SUBSEQUENT EVENTS

On July 27, 2009, the Company issued 65,007 shares of its common stock to a consultant at a volume weighted average price of $4.1474 per share pursuant to a cashless exercise option in place of the consultant exercising all of his Class B Warrants for 150,000 shares of common stock at $2.35 per share.

During July 2009, the Company repaid $2,922,000 due to a stockholder.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

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 any discussion of future operating or financial performance. In particular, these include statements relating to:

- Deviations in and volatility of the market price of crude oil produced by us;
- Uncertainties in the estimation of proved reserves and in the projection of future rates of production;
- Timing and amount of production;
- The availability of, and our ability to raise additional capital resources and provide liquidity to meet cash flow needs;
- Fluctuations in foreign currency exchange rates and interest rates;
- Our ability to find, acquire, lease, develop, and produce from new properties; and
- The other risks and uncertainties which are described below under “RISK FACTORS.”

Overview

We are engaged in the exploration and production of crude oil in Northern China. We have an arrangement with PetroChina to sell our crude oil production for use in the China marketplace. We currently operate 254 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 Co. Ltd. (“Yu Qiao”) and Chang Ling 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:

Details of Oil and Gas Properties and Activities

Field	Acreage	Producing wells #	Proven Reserves (bbls)
Qian112	5,115	222	5,292,591
Da34	2,298	7	13,240
Gu31	1,779	7	95,729
He301	2,471	18	52,232
Total	11,663	254	5,453,792

The following chart illustrates our company's organizational structure:

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"), among PetroChina Group, Yu Qiao and the Company, entered into 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.

LongDe is a party to a 20-year contract with PetroChina Group entered into in May 2003, pursuant to which LongDe has the right to explore, develop and produce oil at the Hetingbao 301 oilfield in the PRC. Pursuant to such 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 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 Hong Jun ("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 a 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 Long De in trust for Song Yuan Technical. On March 17, 2008, Song Yuan Technical acquired an additional 20% equity interest in LongDe, 10% from Sun Peng, and 10% from Ai Chang Shan. Accordingly, Song Yuan Technical now owns directly 90% of the equity interests in LongDe, with Ai Chang Shan 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 first trust agreement, Ai Chang Shan holds 20% of the equity interest in Long De 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 Long De held in trust pursuant to the trust agreement to Song Yuan Technical to be held directly by Song Yuan Technical. Currently under the trust agreement dated October 8, 2006, Ai Chang Shan holds 10% of the total equity interest of Long De in trust for the benefit of Song Yuan Technical. Pursuant to the second trust agreement, Wang Hongjun holds 10% of the total outstanding equity interest in LongDe in trust for the benefit of Song Yuan Technical.

Acquisition of Yu Qiao

The Company acquired a beneficial interest in 100% of the equity interest in Yu Qiao from Yu Qiao's shareholders, Ms. Ju (70%), Meng Xiangyun (20%) and Wang Bingwu (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, Meng Xiangyun and Wang Pingwu held 20% and 10% of the equity interest, respectively, in Yu Qiao in trust for the benefit of Song Yuan Technical.

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. As a result of the termination of the trust agreement and the transfer, Song Yuan Technical became the direct owner of the 20% equity interest in Yu Qiao held in trust by Meng Xiangyun.

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

Listing on the 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”.

Oil and Gas Properties and Activities

As of June 30, 2009, the Company had a total of 254 producing wells, including 222 producing wells at the Qian’an 112 oilfield, 18 producing wells at the Hetingbao 301 oilfield, 7 producing wells at the Daan 34 oilfield and 7 producing wells at the Gudian 31 oilfield.

All of the Company’s crude oil production is sold to the 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.

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. As of June 30, 2009, the Company's Accounts Receivable balance totaled $5,083,803, which is all due to the Company from PetroChina, and includes amounts related to the following items:

June Oil Sales, net of oil surcharge:	$ 6,114,279
Quarterly total oil surcharge:	$ 4,480,955

Operating Performance

Our operating performance is influenced by several factors, the most significant of which are the price we receive for our oil and the quantities of oil that we are able to produce. Global oil prices are the most important factor affecting the price that we receive for our oil production. The prices received for different grades of oil are based upon the world price of oil, which is then adjusted based upon the particular grade. Typically light oil is sold at a premium, while heavy grades of crude (such as the type we produce from the four fields we operate) are discounted.

Our oil development and acquisition activities require substantial and continuing capital expenditures. Historically, the sources of financing to fund our capital expenditures have included:

- Cash flow from operations;
- Sales of equity securities;
- Loans from shareholders and third parties; and
- Extension of credit from our suppliers, including particularly our suppliers of well drilling and completion services.

For the three months ended June 30, 2009 (the "Current Quarter"), the sale price we received for our crude oil production averaged $50.27 per barrel, compared with $105.08 per barrel for the three months ended June 30, 2008 (the "Comparable Quarter"). For the six months ended June 30, 2009, the sale price we received for our crude oil production averaged $45.16 per barrel, compared with $99.59 per barrel for the same period ended a year ago.

Our oil producing activities are accounted for using the full cost method of accounting. Under this accounting method, we capitalize all costs incurred in connection with the acquisition of oil properties and the exploration for and development of oil reserves. These costs include lease acquisition costs, geological and geophysical expenditures, costs of drilling productive and non-productive wells (to date, all of the wells we have drilled have been productive wells), conversion of productive wells into production support infrastructure such as water-injection wells, and overhead expenses directly related to land and property acquisition and exploration and development activities. Proceeds from the disposition of oil properties are accounted for as a reduction in capitalized costs, with no gain or loss recognized unless a disposition involves a material change in the relationship between capitalized costs and reserves, in which case the gain or loss is recognized.

Depreciation of the capitalized costs of oil properties, including estimated future development costs, is based upon estimates of proved oil reserves and production. Unproved oil properties are not amortized, but are individually assessed for impairment. The cost of any impaired property is transferred to the balance of oil properties being depleted. Reserve values are calculated annually, at our fiscal year-end, by a third-party geological consulting company, and are estimated in accordance with Statement of Financial Accounting Standards No. 19 ("FAS 19") –

Financial Accounting and Reporting by Oil and Gas Producing Companies (as amended), SEC Regulation S-K and Regulation S-X under the Securities Act of 1933 and the Securities Exchange Act of 1934, and the SEC's Industry Guide 2.

Production, Average Sales Prices, and Production Costs

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 three and six months ended June 30, 2009 and June 30, 2008.

	Three months ended June 30		Six months ended June 30	
	2009	2008	2009	2008
Oil Output (Bbl)	225,043	135,194	447,134	250,056
Avg. Sale Price ($/bbl)	$ 50.27	$ 105.08	$ 45.16	$ 99.59
Net sales	$ 11,351,405	$ 14,167,538	$ 20,250,628	$ 24,991,512
Cost of sales				
Production costs	$ 1,152,199	$ 782,972	$ 1,666,599	$ 1,495,277
Depreciation of oil properties	$ 2,235,413	$ 2,506,302	$ 5,315,043	$ 4,380,994
Amortization of land use rights	$ 2,982	$ 2,926	$ 5,961	$ 5,768
Government oil surcharge	$ 580,375	$ 3,173,380	$ 618,167	$ 5,384,700
Gross Profit	$ 7,380,436	$ 7,701,958	$ 12,644,858	$ 13,724,773

RESULTS OF OPERATIONS

Three Months Ended June 30, 2009 Compared To Three Months Ended June 30, 2008

Revenues. Revenues for the Current Quarter were $11,351,405 compared to $14,167,538 for the Comparable Quarter, a decrease of $2,816,133, or 20%. This decrease was due to a decrease in the average price we received for our crude oil. The average oil price for the Current Quarter was $50.27, a 52% decrease from $105.08 for the Comparable Quarter. Our output of crude oil for the Current Quarter was 225,043 barrels compared to 135,194 barrels for the Comparable Quarter, an increase of 66.5%, which substantially offset the impact of lower oil prices. This increase in production was mainly due to: (i) an increase in the number of producing wells from 188 in the Comparable Quarter to 254 in the Current Quarter; (ii) refracturing and other technical improvements made to the existing wells; and (iii) implementation of a water injection network, which helped to maintain production levels at certain of our existing wells.

Cost of sales. Cost of sales decreased by 39%, from $6,465,580 for the three months ended June 30, 2008 to $3,970,969 for the three months ended June 30, 2009. The decrease in cost of sales resulted primarily from a decrease in the oil surcharge paid to the PRC government, due to the decline in oil prices generally. For the Current Quarter, the Company paid an oil surcharge of $580,375 to the PRC government as compared to $3,173,380 paid for the Comparable Quarter. Under a regulation introduced in June 2006, a surcharge of 20% is imposed on the portion of the selling price of crude oil which exceeds $40 per barrel and a surcharge of 40% is imposed on the portion of the selling price of crude oil which exceeds $60 per barrel. This government oil surcharge tax is paid by the Company on a quarterly basis, following the end of each quarter.

Operating Expenses. Operating expenses totaled $942,795 for the Current Quarter, compared to $646,271 for the Comparable Quarter, an increase of 46%. This increase is primarily a result of an increase of approximately $422,205 in selling, general and administrative costs (“SG&A”). SG&A costs increased largely due to non-cash charges associated with stock and option grants made to Directors and certain key employees in the second and third quarters of 2008, as well as an increase in professional fees from $66,558 in the Comparable Quarter to $74,159 in the Current Quarter as a result of recent business development activities.

Other Income (Expense). Other expenses decreased from $16,611,621 for the Comparable Quarter to $13,026,423 for the Current Quarter. This decrease is primarily the result of decrease in change in fair value of warrants which decreased from $15,044,528 in the Comparable Quarter to $12,731,750 in the current quarter.

Net Loss. Net loss decreased by 39%, from $11,969,575 for the Comparable Quarter to $7,299,621 for the Current Quarter, primarily as a result of the decrease in average selling price and increased non-cash expenses as described above.

Six Months Ended June 30, 2009 Compared To Six Months Ended June 30, 2008

Revenues. Revenues for the six months ended June 30, 2009 were $20,250,628 compared to $24,991,512 for the six months ended June 30, 2008, a decrease of $4,740,884, or 19%. This decrease was due to a decrease in the average price we received for our crude oil. The average oil price for the six months ended June 30, 2009 was $45.16, a 54.7% decrease from $99.59 for the same period in 2008. Our output of crude oil for the six months ended June 30, 2009 was 447,134 barrels compared to 250,056 barrels for the same period in 2008, an increase of 78.8%, which substantially offset the impact of lower oil prices. This increase in production was mainly due to: (i) an increase in the number of producing wells, (ii) refracturing and other technical improvements made to the existing wells; and (iii) implementation of a water injection network, which helped to maintain production levels at certain of our existing wells.

Cost of sales. Cost of sales decreased by 32%, from $11,266,739 for the six months ended June 30, 2008 to $7,605,770 for the six months ended June 30, 2009. The decrease in cost of sales resulted primarily from a decrease in the oil surcharge paid to the PRC government, due to the decline in oil prices generally. For the six months ended June 30, 2009, the Company paid an oil surcharge of $618,167 to the PRC government as compared to $5,384,700 paid for the same period in 2008. Under a regulation introduced in June 2006, a surcharge of 20% is imposed on the portion of the selling price of crude oil which exceeds $40 per barrel and a surcharge of 40% is imposed on the portion of the selling price of crude oil which exceeds $60 per barrel. This government oil surcharge tax is paid by the Company on a quarterly basis, following the end of each quarter.

Operating Expenses. Operating expenses totaled $15,612,214 for the six months ended June 30, 2009, compared to $1,199,936 for the six months ended June 30, 2008, an increase of 1,201%. This increase is primarily a result of ceiling test impairment write down of $13,832,356, due to a significant decline of the oil price in the first quarter 2009 compared to the same period in 2008. Also an increase of approximately $843,486 in selling, general and administrative costs. SG&A costs increased largely due to non-cash charges associated with stock and option grants made to Directors and certain key employees in the second and third quarters of 2008.

Other Income (Expense). Net expenses increased by 13% from $19,208,438 for the six months ended June 30, 2008 to $21,726,292 for the same period ended June 30, 2009. The increase was primarily because we recognized a loss of $8,260,630 on the extinguishment of the debt for the six months ended June 30, 2009 as a result of the restructuring of the debt.

Net Loss. Net loss increased by 124% from $10,964,231 for the six months ended June 30, 2008 to $24,531,119 for the six months ended June 30, 2009, primarily as a result of the decrease in average selling price and increased non-cash expenses as described above.

LIQUIDITY AND CAPITAL RESOURCES

Our capital resources consist primarily of cash flows from our oil producing properties. Our level of earnings and cash flows depend upon many factors, including the price we receive for crude oil we produce.

As of June 30, 2009, the Company had cash and cash equivalents of $22,675,024, other current assets of $5,593,811 and current liabilities of $24,362,449. For the six months ended June 30, 2009, our primary sources of liquidity were $9,219,365 provided by operating activities and $1,177,742 in cash provided by financing activities. This cash balance of $22,675,024 represents an increase of $3,065,896 over our cash balance as of March 31, 2009 and an increase of $9,435,811 over our cash balance as of December 31, 2008.

Net cash provided by operating activities was $9,219,365 for the six months ended June 30, 2009 compared to net cash provided by operating activities of $859,024 for the same period in 2008. The increase in net cash provided by operating activities was the result of a number of significant changes in our operating accounts. The increase of $8.4 million in net cash provided by operating activities was primarily because we were able to collected approximately $2.5 million more in accounts receivable and also managed to pay $6.2 million less in our accounts payable during the six months ended June 30, 2009 as compared to the same period in 2008.

Net cash used in investing activities was $948,526 for the six months ended June 30, 2009 compared to $9,498,032 for the same period in 2008. This decrease is primarily due to the significant decrease in purchase of oil and gas properties of $7,548,843 during the six months ended June 30, 2009.

Net cash provided by financing activities was $1,177,742 for the six months ended June 30, 2009 as compared to $12,363,517 for the same period in 2008. This was primarily a result of the financing by Lotusbox Investments

Limited completed in the first quarter of 2008, whilst the current period net cash provided by financing activities resulted principally from a loan from a shareholder of $2,998,194 and the repayment of the secured debenture to Lotusbox Investments Limited of $1,770,000.

The Company has paid for the development of its producing oil wells and oil wells under construction with cash from operations as well as by funds raised as a result of the financing by Lotusbox Investments Limited. To fully implement the Company's business plan and growth strategy the Company may require additional resources. The Company is continually evaluating opportunities to expand production and grow the Company's operations, including via acquisition of additional leased oil fields or expansion into related businesses such as the provision of oil field services. The Company's ability to obtain additional capital to achieve certain of these expansion goals will depend on market conditions, national and global economies and other factors beyond its 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.

Capital Commitments

As of June 30, 2009, the Company had commitments for capital expenditure of $10,519,000 with a contractor to complete the drilling of 48 oil wells.

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 accurately predict 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 other than a temporary trend, and if we cannot economically replace our reserves, our results may be materially 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 increased production and revenue from our four oilfields as a result of our significant investments in these areas. As of June 30, 2009, we have drilled 254 wells out of the 675 wells that we believe can be drilled in our four oilfields. Of these, 254 are produced oil in the Current Quarter. 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 year. Similarly, service rates charged by oil field service companies have remained relatively constant over the past year. We are also generally somewhat buffered from changes in world oil prices due to the impact of the government oil surcharge tax. When prices rise, the amount of oil surcharge tax that we are required to pay increases; conversely price declines reduce the amount of oil surcharge tax. In the Current Quarter, the approximate amount of oil surcharge tax we paid was $1.38 per barrel, as compared to $21.53 per barrel in the Comparable Quarter.

CRITICAL ACCOUNTING POLICIES

Proved Reserves. Proved oil and gas reserves, as defined by SEC Regulation S-X Rule 4-10(a) (2i), (2ii), (2iii), (3) and (4), are the estimated quantities of crude oil that geological and engineering data demonstrate with reasonable certainty to be recoverable in 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 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 are 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 and gas 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 and gas properties generally results in higher capitalized costs and higher DD&A rates compared to the successful efforts method of accounting for oil and gas properties.

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157 "Fair Value Measurements". Effective January 1, 2008, the Company adopted the measurement and disclosure other than those requirements related to nonfinancial assets and liabilities in accordance with guidance from FASB Staff Position 157-2 "Effective Date of FASB Statement No. 157", which delayed the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of fiscal year 2009. In April 2009, the FASB issued Staff Position No. FAS 157-4 "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" ("FSP FAS No. 157-4"). FSP FAS No. 157-4 clarifies the methodology used to determine fair value when there is no active market or where the price inputs being used represent distressed sales. FSP FAS No. 157-4 also reaffirms the objective of fair value measurement, as stated in SFAS No. 157 "Fair Value Measurements", which is to reflect how much an asset would be sold for in an orderly transaction. It also reaffirms the need to use judgment to determine if a formerly active market has become inactive, as well as to determine fair values when markets have become inactive. FSP FAS No. 157-4 is effective for interim and annual reporting periods ending after June 15, 2009 and will be applied prospectively. The adoption of SFAS No. 157 did not have a material impact on the financial statements.

On December 31, 2008, the SEC published the revised rules and interpretations updating its oil and gas reporting requirements. Many of the revisions are updates to definitions in existing oil and gas rules to make them consistent with the petroleum resources management system, which is a widely accepted standard for the management of petroleum resources that was developed by several industry organizations. Key revisions include the ability to include nontraditional resources in reserves, the use of new technology for determining reserves, permitting disclosure of probable and possible reserves, and changes to the pricing used in determining reserves. To determine reserves companies must use a 12-month average price. The Company is required to comply with the amended disclosure requirement for registration statements filed after January 1, 2010, and for annual reports for fiscal years ending on or after December 15, 2009. Early adoption is not permitted. The Company is currently assessing the impact that the adoption will have on the Company's disclosures, operating results, financial position and cash flows.

In December 2008, the FASB issued Staff Position No. FAS 132(R)-1 "Employers' Disclosures about Postretirement Benefit Plan Assets" ("FSP FAS 132(R)-1"). FSP FAS 132(R)-1 requires more detailed disclosures about employers' plan assets in a defined benefit pension or other postretirement plan, including employers' investment strategies, major categories of plan assets, concentrations of risk within plan assets, and inputs and valuation techniques used to measure the fair value of plan assets. FSP FAS 132(R)-1 also requires, for fair value measurements using significant unobservable inputs (Level 3), disclosure of the effect of the measurements on changes in plan assets for the period. The disclosures about plan assets required by FSP FAS 132(R)-1 must be provided for fiscal years ending after December 15, 2009. As this pronouncement is only disclosure-related, it does not have an impact on the financial position and results of operations.

In April 2009, the FASB issued Staff Position No. FAS 107-1 and APB No. 28-1 "Interim Disclosures about Fair Value of Financial Instruments" ("FSP FAS No. 107-1 and APB Opinion No. 28-1"). FSP FAS No. 107-1 and APB Opinion No. 28-1 requires fair value disclosures for financial instruments that are not reflected in the condensed consolidated balance sheets at fair value. Prior to the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the fair values of those assets and liabilities were disclosed only once each year. With the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the Company will now be required to disclose this information on a quarterly basis, providing quantitative and qualitative information about fair value estimates for all financial instruments not measured in the condensed consolidated balance sheets at fair value. FSP FAS No. 107-1 and APB Opinion No. 28-1 are effective for interim reporting periods that end after June 15, 2009. As this pronouncement is only disclosure-related, it does not have an impact on the financial position and results of operations.

In May 2009, the FASB issued SFAS No. 165 “Subsequent Events” (“SFAS 165”). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, SFAS 165 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 is effective for the interim report and annual periods that end after June 15, 2009. The adoption of SFAS 165 has no impact on the financial statements as management has already followed a similar approach prior to the adoption of this standard.

In June 2009, the FASB issued SFAS No. 166 "Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140" ("SFAS 166"). SFAS 166 amends various provisions of SFAS No. 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125" by removing the concept of a qualifying special-purpose entity and removes the exception from applying FIN 46(R) to variable interest entities that are qualifying special-purpose entities; limits the circumstances in which a transferor derecognizes a portion or component of a financial asset; defines a participating interest; requires a transferor to recognize and initially measure at fair value all assets obtained and liabilities incurred as a result of a transfer accounted for as a sale; and requires enhanced disclosure; among others. SFAS 166 will be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Management is currently evaluating the potential impact of SFAS 166 on the financial statements.

In June 2009, the FASB issued SFAS No. 167 "Amendments to FASB Interpretation No. 46(R)" ("SFAS 167"). SFAS 167 amends FASB Interpretation No. 46 (Revised December 2003) "Consolidation of Variable Interest Entities—an interpretation of ARB No. 51" (FIN 46(R)) to require an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity; to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity; to eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity; to add an additional reconsideration event for determining whether an entity is a variable interest entity when any changes in facts and circumstances occur such that holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights of those investments to direct the activities of the entity that most significantly impact the entity's economic performance; and to require enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise's involvement in a variable interest entity. SFAS 167 will be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Management is currently evaluating the potential impact of SFAS 167 on the financial statements.

In June 2009, the FASB issued SFAS No. 168 "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162" ("SFAS 168"). SFAS 168 replaces SFAS No. 162 and establishes the FASB Accounting Standards Codification ("Codification") as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The FASB will no longer issue new standards in the form of Statements, FASB Staff Positions, or EITF Abstracts; instead the FASB will issue Accounting Standards Updates. Accounting Standards Updates will not be authoritative in their own right as they will only serve to update the Codification. The issuance of SFAS 168 and the Codification does not change GAAP. SFAS 168 will be effective for interim and annual periods that end after September 15, 2009. Management has determined that the adoption of SFAS 168 will not have an impact on the financial statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Not required.

ITEM 4T. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this amended and restated Quarterly Report on Form 10-Q/A (the "Evaluation Date"). The purpose of this evaluation is to determine if, as of the Evaluation Date, our disclosure controls and procedures were operating effectively such that the information, required to be disclosed in our Securities and Exchange Commission ("SEC") reports (i) was recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) was accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were not operating effectively.

Limitations on the Effectiveness of Disclosure Controls and Procedures.

Disclosure controls and procedures and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act are recorded, processed, summarized and reported, within the time period specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosure.

Deficiencies Relating to Internal Controls over Financial Reporting

We recently completed an internal review of our financial reporting. As a result of this review, management and the audit committee concluded that the impact of certain non-cash accounting and disclosure errors on previously issued financial statements was material and required a restatement. The audit committee of our board of directors engaged an outside consulting firm to assist in its investigation of financial reporting revisions. Our investigation found that a number of factors at the Company contributed to the need to restate certain financial reports in order to correct non-cash accounting errors, including the following:

- the Company lacked adequate internal guidance or training on the reporting of certain non-cash accounting topics, such as warrant accounting, calculation of the ceiling test value of its oil properties, calculation of depreciation, depletion and amortization of oil properties, evaluation of the conditions which trigger the accounting treatment of a restructuring of terms of a liability as an extinguishment of debt, and accounting for stock issued to employees as compensation;

- the Company lacked adequate internal controls over the calculation methodologies used in calculation of depreciation, depletion and amortization, and of the ceiling test value, on its oil properties.

As part of its investigation, the audit committee proposed a number of recommendations, including the following:

- provide periodic training for employees on accounting and financial reporting practices, particularly with respect to oil industry measurements and disclosures;

- retain an outside consulting firm with expertise in financial accounting and oil industry accounting and disclosure matters, to assist the management team with its preparation of quarterly and annual financial reports;

- institute and cultivate a culture of excellence with respect to accounting and financial reporting practices to ensure that the foregoing contributing factors do not recur.

The board of directors has accepted the recommendations proposed by the audit committee, and the board of directors implemented and resolved to continue to implement all of the recommendations.

Consequently, we have revised our financial reports for the periods from March 31, 2008 to September 30, 2009, including this amended quarterly financial report. This restatement, as well as specific information regarding its impact, is discussed in Note 1, “Restatement” to the Consolidated Financial Statements. Restatement of previously issued financial statements to reflect the correction of a misstatement is an indicator of the existence of a material weakness in internal control over financial reporting as defined in the Public Company Accounting Oversight Board’s Auditing Standard No. 2, “An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements.” We have identified deficiencies in our internal controls that did not prevent the misstatement of certain non-cash accounting items. These deficiencies, which we believe constituted a material weakness in our internal control over financial reporting, included inadequate training and understanding of the SEC and accounting rules for booking certain non-cash accounting items, including items specific to oil industry reporting. In light of the determination that previously issued financial statements should be restated, our management concluded that a material weakness in internal control over financial reporting existed as of June 30, 2009 and disclosed this matter to the audit committee, and our independent registered public accounting firm.

Remedial Actions

Our management, at the direction of our board of directors, is actively working to improve the control environment and to implement controls and procedures that will ensure the integrity of our financial statement preparation process.

We have implemented the following actions to mitigate weaknesses identified:

- we have retained an outside consulting firm with expertise in financial accounting and oil industry accounting and disclosure matters, to assist the management team with its review and restatement of the financial reports for the periods in question.

We intend to implement the following actions in 2010:

- implement formal and informal training programs, particularly with respect to the accounting for non-cash items;

- during 2010 and thereafter, consult with our outside consulting firm on a interim basis on the preparation of financial reports.

Evaluation of Disclosure Control and Procedures

Our Chief Executive Officer and our Chief Financial Officer, with the participation of other members of our senior management, reviewed and evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. In making this evaluation, the Chief Executive Officer and the Chief Financial Officer considered the issues discussed above, together with the remedial steps we have taken. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, because of the material weakness discussed above, as of June 30, 2009, our disclosure controls and procedures were not effective in recording, processing, summarizing and reporting information required to be disclosed by us in the reports we file or submit under the Securities Exchange Act of 1934 (the “Exchange Act”).

Management’s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-(f) of the Exchange Act. Under the supervision and with the participation of management, including our Chief Executive Officer, and our Chief Financial Officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting as of June 30, 2009 based on the framework in Internal Control-Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on our evaluation under the framework in Internal Control-Integrated Framework, our management concluded we did not maintain effective controls over our financial reporting for the periods from March 31, 2008 to September 30, 2009, and these ineffective controls constituted a material weakness. As a result of this material weakness, our financial statements for the quarters ended March 31, 2008, June 30, 2008, September 30, 2008, March 31, 2009, June 30, 2009, and September 30, 2009, and the year ended December 31, 2008 were restated. These restatements affected certain non-cash items, including accounting for warrants, the Company’s proved oil properties, depreciation, depletion and amortization of oil properties, the ceiling test write-down of oil properties accounts, and accounting for the effect of a restructuring of a liability.

Because of this material weakness, management has concluded that, as of June 30, 2009, we did not maintain effective internal control over financial reporting, based on the criteria established in Internal Control-Integrated Framework issued by the COSO.

Management’s assessment of the effectiveness of our internal control over financial reporting as of June 30, 2009 has not been audited by Baker Tilly Hong Kong Limited (successor to Jimmy Cheung & Co.), an independent registered public accounting firm, as stated in their report which is included herein.

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:

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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 implement the following additional actions in 2010:

- implement formal and informal training programs, particularly with respect to the accounting for non-cash items;
- 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 quarter ended June 30, 2009 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On August 17, 2007, the Company filed a complaint in the Third Judicial District Court in and for Salt Lake County, State of Utah, naming Topworth Assets Limited ("Topworth") as the principal defendant. The Company asserted conversion, unjust enrichment, breach of warranty, fraud, and for declaratory relief causes of action. The actions arise out of the issuance of 3,715,000 shares of the Company's stock to Topworth in or about early 2004. The Company was able to recover from Topworth 2,715,000 of these shares shortly after their issuance, and now contends it is entitled to recover the remaining 1,000,000 shares because Topworth received all the stock by fraud. The Company sought and obtained an injunction preventing Topworth's transfer of this disputed stock.

In response to the Company's complaint and the issuance of the injunction against it, Topworth filed an answer to the complaint and a counterclaim against the Company, Wei Guo Ping, and Wang Hong Jun on December 11, 2007. Topworth asserts various legal theories that contend it performed consulting services to the Company; was entitled to all of the disputed stock as compensation for services; and was improperly required to return some of the disputed stock to the Company.

On March 5, 2009, the Company and Topworth entered into a Settlement and Release Agreement (the “Settlement”) whereby the Company and Topworth agreed to mutually release each other from any and all claims they have against each other, including any and all claims and counterclaims pending in the action brought by the Company in the Third District Court, State of Utah, Civil Case Number 070911868 (the “Action”). Under the Settlement, the parties’ shall dismiss the Company’s complaint and Topworth’s counterclaim. The 627,360 shares of common stock in the Company held in the name of Topworth (the “Shares”) that were a subject of dispute in the Action shall be disposed of on the following material terms: Topworth shall deliver all certificates representing the Shares to a designated custodian; the custodian shall hold the certificates until at least June 26, 2009; and, thereafter, the custodian shall release 100,000 of the Shares to Topworth each month until November 30, 2009, when Topworth will be entitled to receive all of the remaining Shares. The custodian shall release the Shares without any restriction on Topworth’s ability transfer or sell the Shares imposed by the Company subject to restrictions under the Securities Act of 1933, as amended. The Shares have been held in Topworth’s name and have been included in the Company’s outstanding shares; as such the Shares will not have an additional dilutive effect on the Company’s shareholders. Subsequently, the case was dismissed with prejudice on March 27, 2009.

We know of no other material, active or pending legal proceedings against our Company, and, other than as disclosed above, we are not involved as a plaintiff in any other material proceeding or pending litigation. There are no proceedings in which any of our directors, officers or affiliates, or any registered or beneficial shareholder, is an adverse party or has a material interest adverse to our interest.

ITEM 1A. RISK FACTORS

There has been no material change in the Company's risk factors as previously disclosed in the Company’s amended and restated Annual Report on Form 10-K/A filed with the SEC on April , 2010.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

Exhibit No.	Description of Exhibit
31.1	Certifications pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this amended and restated report to be signed on its behalf by the undersigned, thereunto duly authorized.

	China North East Petroleum Holdings Limited	
August 31, 2010	By:	/s/ Jingfu Li Jingfu Li Acting CEO (Principal Executive Officer and Principal Financial Officer)

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