

FREESTONE RESOURCES, INC.

Form 10-Q

February 14, 2011

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U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the quarterly period ended December 31, 2010

OR

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

Commission File Number 000-28753

FREESTONE RESOURCES, INC.

(Exact name of small business issuer as specified in its charter)

Nevada

(State or other jurisdiction of  
incorporation or organization)

33-0880427

(IRS Employer Identification No.)

Republic Center, Suite 1350  
325 N. St. Paul Street Dallas, TX 75201  
(Address of principal executive offices)

(214) 880-4870

(Issuer's telephone number)

(Former name, former address and former fiscal year, if changed since last report)

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

Large Accredited Filer  Accelerated Filer   
Non-Accredited Filer  Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of February 14, 2010 there were 73,868,994 shares of Common Stock of the issuer outstanding.

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PART II FINANCIAL STATEMENTS

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Freestone Resources, Inc.  
Consolidated Balance Sheets  
As of December 31, 2010 and June 30, 2010

|  | (Unaudited)<br>Decemer<br>31,<br>2010 | (Audited)<br>June 30,<br>2010 |
|--|---------------------------------------|-------------------------------|
| Assets   |                                       |                               |
| Current Assets:  |                                       |                               |
| Cash   | \$28,570                              | \$28,062                      |
| Accounts receivable  | 8,199                                 | 22,029                        |
| Total current assets   | 36,769                                | 50,091                        |
| Fixed assets, net of accumulated depreciation of \$4,527 and \$3,786   | 89,025                                | 31,181                        |
| Other assets   | 3,087                                 | 15,511                        |
|  | 3,087                                 | 15,511                        |
| Total Assets   | \$128,881                             | \$96,783                      |
| Liabilities and Stockholders'  |                                       |                               |
| Equity   |                                       |                               |
| Current Liabilities:   |                                       |                               |
| Accounts payable   | \$266,618                             | \$250,769                     |
| Accounts payable-related party   | 150,010                               | 150,010                       |
| Accrued expenses   | 14,438                                | 12,559                        |
| Notes payable-related parties  | 24,558                                | 34,321                        |
| Stock to be issued   | 65,000                                | 150,000                       |
| Total Current Liabilities  | 520,624                               | 597,659                       |
| Long-term Liabilities:   |                                       |                               |
| Asset retirement obligations   | 41,123                                | 41,123                        |
| Total Liabilities  | 561,747                               | 638,782                       |
| Stockholders' Equity (Deficit):  |                                       |                               |
| Common stock, \$.001 par value, 100,000,000 shares<br>authorized, 72,618,994 and 71,718,994 shares issued<br>and outstanding, respectively | 72,719                                | 71,719                        |
| Additional paid in capital   | 16,557,374                            | 16,299,789                    |
| Accumulated deficit  | (17,062,959)                          | (16,913,507)                  |
| Stockholders' Equity (Deficit)   | (432,866 )                            | (541,999 )                    |

|  |            |           |
|--|------------|-----------|
| Total Liabilities and Stockholders' Equity | \$ 128,881 | \$ 96,783 |
|--|------------|-----------|

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

Freestone Resources, Inc.  
 Consolidated Statements of Operations  
 For the Three and Six Months Ended December 31, 2010 and 2009  
 (unaudited)

|   | Three<br>Months<br>Ended<br>December<br>31, 2010 | Three<br>Months<br>Ended<br>December<br>31, 2009 | Six Months<br>Ended<br>December<br>31, 2010 | Six Months<br>Ended<br>December<br>31, 2009 |
|---|--|--|---|---|
| Revenue:  |  |  |   |   |
| Oil and gas revenues resulting from research activities | \$ 9,235   | \$ 5,703   | \$ 18,408                                   | \$ 27,195                                   |
| Total revenue resulting from research activities        | 9,235  | 5,703  | 18,408                                      | 27,195                                      |
| Operating expenses:                                     |  |  |   |   |
| Lease operating costs                                   | 8,127  | 2,528  | 18,151                                      | 5,221                                       |
| Depreciation  | 370  | 620  | 741   | 1,239                                       |
| Impairment expense                                      | 0  | 0  | 0   | 1,800                                       |
| General and administrative                              | 60,442   | 125,927  | 165,901                                     | 152,235                                     |
| Total operating expenses                                | 68,939   | 129,075  | 184,793                                     | 160,495                                     |
| Operating loss  | (59,704)   | (123,372)  | (166,385)                                   | (133,300)                                   |
| Other income (expense):                                 |  |  |   |   |
| Interest income (expense)                               | 232  | (2,443)  | (343)                                       | (3,128)                                     |
| Gain on sale of investment asset                        | 17,276   | 0  | 17,276                                      | 0   |
| Gain on settlement of debt                              | 0  | 6,200  | 0   | 6,200                                       |
| Other income (expense)                                  | 0  | 4,559  | 0   | 0   |
| Total other income (expense)                            | 17,508   | 8,316  | 16,933                                      | 3,072                                       |
| Net loss  | \$ (42,196)                                      | \$ (115,056)                                     | \$ (149,452)                                | \$ (130,228)                                |
| Basic and diluted loss per share                        | \$ 0.00  | \$ 0.00  | \$ 0.00                                     | \$ 0.00                                     |
| Weighted average shares outstanding:                    |  |  |   |   |
| Basic and diluted                                       | 72,618,994                                       | 66,718,994                                       | 72,442,907                                  | 52,119,443                                  |

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



Freestone Resources, Inc.  
Consolidated Statement of Stockholders' Equity  
For the Year Ended June 30, 2010  
And the Six Months Ended December 31, 2010  
(Unaudited)

|   | Common Stock |           | Additional<br>Paid in<br>Capital | Accumulated<br>Deficit | Total        |
|---|--------------|-----------|----------------------------------|------------------------|--------------|
|   | Shares       | Amount    |                                  |                        |              |
| Balance, June 30, 2009                          | 35,115,260   | \$ 35,115 | \$ 14,572,244                    | \$ (14,675,416)        | \$ (68,057)  |
| Common stock issued for acquisition of EOS      | 31,603,734   | 31,604    | 1,232,545                        | 0                      | 1,264,149    |
| Common stock issued for cash                    | 5,000,000    | 5,000     | 495,000                          | 0                      | 500,000      |
| Net loss  |              |           |                                  | (2,238,091)            | (2,238,091)  |
| Balance, June 30, 2010                          | 71,718,994   | \$ 71,719 | \$ 16,299,789                    | \$ (16,913,507)        | \$ (541,999) |
| Common stock issued for cash                    | 900,000      | 900       | 199,100                          | 0                      | 200,000      |
| Common stock issued for demonstration equipment | 100,000      | 100       | 58,485                           | 0                      | 58,585       |
| Net loss  |              |           |                                  | (149,452)              | (149,452)    |
| Balance, December 31, 2010                      | 72,718,994   | \$ 72,719 | \$ 16,557,374                    | \$ (17,062,959)        | \$ (432,866) |

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





Freestone Resources, Inc.  
Consolidated Statements of Cash Flows  
For the Six Months Ended December 31, 2010 and 2009  
(Unaudited)

|   | Six months ended<br>December 31, |                 |
|---|----------------------------------|-----------------|
|   | 2010                             | 2009            |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                                  |                 |
| Net loss  | \$ (149,452)                     | \$ (130,228)    |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: |                                  |                 |
| Depreciation  | 741                              | 1,239           |
| Shares issued for demonstration equipment   | 58,585                           | 0               |
| Gain on sale of investment asset  | (17,276)                         | 0               |
| Changes in operating assets and liabilities:  |                                  |                 |
| Change in account receivable  | 13,830                           | 0               |
| Change in other assets  | (300)                            | (41,244)        |
| Change in accounts payable and accrued expenses   | 17,728                           | (8,710)         |
| Change in accounts payable – related party  | 0                                | (3,713)         |
| Change in line-of-credit  | 0                                | (3,092)         |
| Net cash provided used in operating activities  | (76,144)                         | (185,748)       |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                                  |                 |
| Proceeds from sale of investment asset  | 30,000                           | 0               |
| Purchase of fixed assets  | (58,585)                         | (6,996)         |
| Net cash used in investing activities   | (28,585)                         | (6,996)         |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |                                  |                 |
| Payments on note payable  | 0                                | (1,994)         |
| Proceeds from Note Payable  | 0                                | 32,971          |
| Payments on note payable – related party  | (9,763)                          | 0               |
| Proceeds from sale of stock   | 200,000                          | 160,000         |
| Stock to be issued  | (85,000)                         | 0               |
| Net cash provided by financing activities   | 105,237                          | 190,977         |
| <b>NET CHANGE IN CASH</b>   | <b>508</b>                       | <b>(1,767)</b>  |
| <b>CASH AT BEGINNING OF PERIOD</b>  | <b>28,062</b>                    | <b>4,815</b>    |
| <b>CASH AT END OF PERIOD</b>  | <b>\$ 28,570</b>                 | <b>\$ 3,048</b> |
| Supplemental cash flow information:   |                                  |                 |
| Cash paid for interest  | \$ 343                           | \$ 0            |
| Non-cash investing activities:  |                                  |                 |
| Stock issued for purchase of subsidiary   | \$ 0                             | \$ 1,264,149    |
| Licenses assumed in acquisition of subsidiary   | \$ 0                             | \$ 150,000      |
| Intangible asset  | \$ 0                             | \$ 10,000       |
| Assumption of accounts payable and note payable in acquisition of subsidiary              | \$ 0                             | \$ 400,000      |

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

Freestone Resources, Inc.  
Notes to Consolidated Financial Statements  
December 31, 2010  
(Unaudited)

NOTE 1 – NATURE OF ACTIVITIES AND SIGNIFICANT ACCOUNTING POLICIES

Nature of Activities, History and Organization:

Freestone Resources, Inc. (“Freestone” or the “Company”) is an oil and gas technology development company. The Company is located in Dallas, Texas and is incorporated under the laws of the State of Nevada.

The Company’s primary business is the development of new technologies that allow for the utilization of oil and gas resources in an environmentally responsible and cost effective way, as well as the development of technologies that can be used in the environmental cleanup of oil-based contaminant byproducts.

The Company acquired one hundred percent (100%) of the issued and outstanding stock of Earth Oil Services, Inc., a Nevada corporation (“EOS”), in a stock based transaction on September 24, 2009 (the “EOS Agreement”). The Company issued 31,603,734 shares of restricted common stock of the Company in consideration for this transaction. EOS owns certain exclusive, territorial, license agreements to a proprietary technology that is a chemical solvent that can separate, extract and recycle hydrocarbon contaminants from ground soils, tar sands, vessels and other materials. EOS has engaged a fabricator to build a prototype machine (the “Prototype”) designed to be used in conjunction with the solvent. EOS is indebted to the fabricator for its development of the Prototype. EOS is now a wholly owned subsidiary of Freestone and all intercompany accounts have been eliminated in consolidation. As discussed in Note 6, the Company has filed a lawsuit seeking to rescind the EOS Agreement. This is also disclosed in the Company’s fiscal year 2010 Form 10-K, Note 16.

Unaudited Interim Financial Statements:

The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America and the rules of the Securities and Exchange Commission. These financial statements are unaudited and, in the opinion of management, include all adjustments (consisting of normal recurring accruals) necessary to present fairly the balance sheet, statement of operations, statement of stockholders’ equity and statement of cash flows for the periods presented in accordance with accounting principles generally accepted in the United States. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to SEC rules and regulations. It is presumed that users of this interim financial information have read or have access to the audited financial statements and footnote disclosure for the preceding fiscal year contained in the Company’s Annual Report on Form 10-K. The results of operations for the six months ended December 31, 2010 are not necessarily indicative of the results of operations for the full year or any other interim period. The information included in this Form 10-Q should be read in conjunction with Management's Discussion and Analysis and Financial Statements and notes thereto included in the Company’s June 30, 2010 Form 10-K.

Significant Accounting Policies:

The Company's management selects accounting principles generally accepted in the United States of America and adopts methods for their application. The application of accounting principles requires the estimating, matching and timing of revenue and expense. It is also necessary for management to determine, measure and allocate resources and obligations within the financial process according to those principles. The accounting policies used conform to generally accepted accounting principles which have been consistently applied in the preparation of these financial statements.

The financial statements and notes are representations of the Company's management which is responsible for their integrity and objectivity. Management further acknowledges that it is solely responsible for adopting sound accounting practices, establishing and maintaining a system of internal accounting control and preventing and detecting fraud. The Company's system of internal accounting control is designed to assure, among other items, that 1) recorded transactions are valid; 2) valid transactions are recorded; and 3) transactions are recorded in the proper period in a timely manner to produce financial statements which present fairly the financial condition, results of operations and cash flows of the Company for the respective periods being presented.

#### Basis of Presentation

The Company prepares its financial statements on the accrual basis of accounting. All intercompany balances and transactions are eliminated. Investments in subsidiaries, where the Company has a controlling interest, are consolidated. For those businesses that the Company does not have a controlling interest, they are accounted through the Noncontrolling Interest method. Management believes that all adjustments necessary for a fair presentation of the results of the six months ended December 31, 2010 and 2009 have been made.

The Company consolidates its subsidiaries in accordance with Accounting Standards Codification (“ASC”) 810, “Business Combinations”, (formally SFAS 141R) and specifically ASC 810-10-15-8 which states, "The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one reporting entity, directly or indirectly, or over 50% of the outstanding voting shares of another entity is a condition pointing toward consolidation."

The Company owns 100% of EOS and has applied ASC 810 in consolidating the subsidiary. EOS owns 50% of BRC, as does an unrelated third party, Hidden Peak Group. Although each party owns 50%, Hidden Peak Group maintains control of the three person management board with three representatives, and therefore, applying the requirements for consolidations under ASC 810, EOS has not consolidated BRC but shows its impact through the Noncontrolling Interest method.

#### FASB Accounting Standards Codification:

In June 2009, the Financial Accounting Standards Board (“FASB”) issued new guidance concerning the organization of authoritative guidance under U.S. Generally Accepted Accounting Principles (“GAAP”). This new guidance created the FASB Accounting Standards Codification (“FASC” or “Codification”). The Codification has become the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative U.S. GAAP for SEC registrants. The Codification became effective for the Company in its quarter ended March 31, 2010. As the Codification is not intended to change or alter existing U.S. GAAP, it did not have any impact on the Company’s consolidated financial statements. On its effective date, the Codification superseded all then-existing non-SEC accounting and reporting standards. All other nongrandfathered non-SEC accounting literature not included in the Codification will become nonauthoritative.

#### Reclassification:

Certain prior year amounts have been reclassified in the consolidated balance sheets, consolidated statements of operations and consolidated statements of cash flows to conform to current period presentation. These reclassifications were not material to the consolidated financial statements and had no effect on net earnings reported for any period.

#### Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

#### Recently Issued Accounting Pronouncements:

The Company does not expect the adoption of recently issued accounting pronouncements to have a significant impact on the Company's results of operations, financial position or cash flow.

Cash and Cash Equivalents:

Cash and cash equivalents includes cash in banks with original maturities of three months or less and are stated at cost which approximates market value, which in the opinion of management, are subject to an insignificant risk of loss in value.

Revenue Recognition:

The Company recognizes revenue from the sale of products in accordance with ASC 605-15 "Revenue Recognition", (formerly Securities and Exchange Commission Staff Accounting Bulletin No. 104, "Revenue Recognition in Financial Statements" ("SAB 104")). Revenue will be recognized only when all of the following criteria have been met:

1. Persuasive evidence of an arrangement exists;
2. Ownership and all risks of loss have been transferred to buyer, which is generally upon shipment;
3. The price is fixed and determinable; and
4. Collectability is reasonably assured.

Revenue is recorded net any of sales taxes charged to customers.

Income Taxes:

The Company has adopted ASC 740-10 "Income Taxes" (formerly SFAS No. 109), which requires the use of the liability method in the computation of income tax expense and the current and deferred income taxes payable.

Property and Equipment:

Property and equipment are stated at cost less accumulated depreciation. Major renewals and improvements are capitalized; minor replacements, maintenance and repairs are charged to current operations. Depreciation is computed by applying the straight-line method over the estimated useful lives which are generally five to seven years.

Earnings per Share:

Basic earnings (loss) per share are computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share include the effects of any outstanding options, warrants and other potentially dilutive securities. For the periods presented, there were no potentially dilutive securities outstanding.

Fair Value Measurements:

ASC Topic 820, "Fair Value Measurements and Disclosures", defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and requires certain disclosures about fair value measurements. In general, fair value of financial instruments are based upon quoted market prices, where available. If such quoted market prices are not available, fair value is based upon internally developed models that primarily use, as inputs, observable market based parameters. Valuation adjustments may be made to ensure that financial instruments are recorded at fair value. These adjustments may include amounts to reflect counterparty credit quality and the Corporation's credit worthiness, among other things, as well as unobservable parameters. Any such valuation adjustments are applied consistently over time.

Accounts Receivable:

Accounts Receivable are carried at their face amount, less an allowance for doubtful accounts. On a periodic basis, the Company evaluates accounts receivable and establishes the allowance for doubtful accounts based on a combination of specific customer circumstances and credit conditions, based on a history of write offs and collections. The Company's policy is generally not to charge interest on trade receivables after the invoice becomes past due. A receivable is considered past due if payments have not been received within agreed upon invoice terms. Write offs are recorded at a time when a customer receivable is deemed uncollectible. The Company had no bad debt accruals at December 31, 2010 and June 30, 2010.

Oil and Gas Properties:

Freestone is actively purchasing marginal oil and gas properties and leasing properties that will be used in the further research and development of its various solvent additives that are specially designed to increase oil and natural gas production. This research focuses on the types of formations that will benefit the most from the use of the solvents, as well as the various applications from production and storage to end cycle refinement.



The Company evaluates, on a periodic basis, long-lived assets to be held and used for impairment in accordance with the reporting requirements of ASC 360-10, "Accounting for the Impairment or Disposal of Long-Lived Assets", (formerly "SFAS" No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets). The evaluation is based on certain impairment indicators, such as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, as well as other external market conditions or factors that may be present. If these impairment indicators are present or other factors exist that indicate that the carrying amount of the asset may not be recoverable, then an estimate of the discounted value of expected future operating cash flows is used to determine whether the asset is recoverable and the amount of any impairment is measured as the difference between the carrying amount of the asset and its estimated fair value. The fair value is estimated using valuation techniques such as market prices for similar assets or discounted future operating cash flows.

### Impairment of Long-Lived Assets:

The Company evaluates, on a periodic basis, long-lived assets to be held and used for impairment in accordance with the reporting requirements of ASC 360-10, "Accounting for the Impairment or Disposal of Long-Lived Assets", (formerly "SFAS" No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets). The evaluation is based on certain impairment indicators, such as the nature of the assets, the future economic benefit of the assets, any historical or future profitability measurements, as well as other external market conditions or factors that may be present. If these impairment indicators are present or other factors exist that indicate that the carrying amount of the asset may not be recoverable, then an estimate of the discounted value of expected future operating cash flows is used to determine whether the asset is recoverable and the amount of any impairment is measured as the difference between the carrying amount of the asset and its estimated fair value. The fair value is estimated using valuation techniques such as market prices for similar assets or discounted future operating cash flows.

### Asset Retirement Obligation:

The Company records the fair value of a liability for asset retirement obligations ("ARO") in the period in which an obligation is incurred and records a corresponding increase in the carrying amount of the related long-lived asset. For Freestone Resources, asset retirement obligations primarily relate to the abandonment of oil and gas properties. The present value of the estimated asset retirement cost is capitalized as part of the carrying amount of oil and gas properties. The settlement date fair value is discounted at Freestone Resource's credit adjusted risk-free rate in determining the abandonment liability. The abandonment liability is accreted with the passage of time to its expected settlement fair value. Revisions to such estimates are recorded as adjustments to ARO and capitalized asset retirement costs and are charged to operations in the period in which they become known. At the time the abandonment cost is incurred, Freestone Resources is required to recognize a gain or loss if the actual costs do not equal the estimated costs included in ARO.

The amounts recognized for ARO are based upon numerous estimates and assumptions, including future abandonment costs, future recoverable quantities of oil and gas, future inflation rates, and the credit adjusted risk free interest rate.

### Stock Based Compensation

The Company does not have any stock option or employee benefit plans.

### NOTE 2 – FIXED ASSETS

Fixed assets at December 31, 2010 and June 30, 2010 are as follows:

|   | December<br>31,<br>2010 | June 30,<br>2010 |
|---|-------------------------|------------------|
| Computers & office furniture                        | \$ 8,967                | \$ 8,967         |
| Oil and gas research and development equipment      | 26,000                  | 26,000           |
| Demonstration equipment                             | 58,585                  | 0                |
| Total fixed assets                                  | 93,552                  | 34,967           |
| Less: Accumulated depreciation                      | (4,527)                 | (3,786)          |
| Total fixed assets, net of accumulated depreciation | \$ 89,025               | \$ 31,181        |

Depreciation and depletion expense was \$370 and \$620 for the three months ended December 31, 2010 and 2009, respectively, and \$741 and \$1,239 for the six months ended December 31, 2010 and 2009, respectively.

The Company issued 100,000 shares for demonstration equipment valued at \$58,585 during the fourth quarter of 2010.

#### NOTE 3 – NOTES PAYABLE - RELATED PARTIES

On May 26, 2009 the Company received a loan from Mike Doran (“Doran”), the Company’s ex-CEO, in the amount of \$25,000. A note payable was formally prepared by the Company but never executed by Doran. The terms of the loan included an interest rate of three and a half percent, and the payment of twelve monthly installments beginning on October 31, 2009. On July 8, 2009, an amended and restated promissory note with similar terms was executed to replace the original note payable. At December 31, 2010 and June 30, 2010 the balance owed was \$9,558 and \$12,314 respectively. The last payment on this note was due on December 31, 2010. It was not paid and the note is technically in default. The Company is still in the process of renegotiating terms related to the repayment of the remaining balance and does not believe there will be any penalties incurred.

On July 9, 2009 the Company received an advance from James Carter, a shareholder, in the amount of \$25,000. There are no terms on the advance and no interest is paid. At December 31, 2010 and June 30, 2010 the balance owed was \$15,000 and \$20,000, respectively.

## NOTE 4 – INCOME TAXES

The Company has adopted ASC 740-10, “Income Taxes”, which requires the use of the liability method in the computation of income tax expense and the current and deferred income taxes payable (deferred tax liability) or benefit (deferred tax asset). Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

During the six months ended December 31, 2010 the Company had a net loss of \$139,442, increasing the deferred tax asset approximately \$47,410 at the statutory tax rate of 34%. Deferred tax assets at December 31, 2010 and June 30, 2010 consisted of the following:

Deferred tax asset related to:

|                                 | December<br>31,<br>2010 | June 30,<br>2010 |
|---------------------------------|-------------------------|------------------|
| Prior Year                      | \$ 1,282,960            | \$ 522,009       |
| Tax Benefit for Current Period  | 47,410                  | 760,951          |
| Net Operating Loss Carryforward | \$ 1,330,370            | \$ 1,282,960     |
| Less: Valuation Allowance       | (1,330,370)             | (1,282,960)      |
| Net Deferred Tax Asset          | \$ 0                    | \$ 0             |

The net deferred tax asset generated by the loss carryforward has been fully reserved and will expire in the years 2019 through 2030. The realization of deferred tax benefits is contingent upon future earnings and is fully reserved at December 31, 2010 and June 30, 2010.

## NOTE 5 – ASSET RETIREMENT OBLIGATION

The Company’s asset retirement obligation (“ARO”) primarily represents the estimated present value of the amount Freestone Resources will incur to plug, abandon and remediate its producing properties at the end of their productive lives, in accordance with applicable state laws. Freestone Resources determines the ARO on its oil and gas properties by calculating the present value of estimated cash flows related to the liability. At December 31, 2010, the liability for ARO was \$41,123, all of which is considered long term. The asset retirement obligations are recorded as current or non-current liabilities based on the estimated timing of the anticipated cash flows. During 2010, the Company has not recognized accretion expense, as the properties were written down to salvage value as of June 30, 2009.

## NOTE 6 –LEGAL

The Company is engaged in a lawsuit in the United States District Court for the Northern District of Texas, Dallas Division, which was originally filed by the Company on July 9, 2010, Civil Action Number 3:10-cv-01349-O against Lawrence Shultz, Environmental Services and Support, Inc. (“ESSI”), David Feuerborn and Thomas Jennings (the “Defendants”) for, but not limited to, the rescission of the Stock Purchase Agreement entered into by and between the Company and Environmental Services and Support, Inc. and Lawrence Shultz (the “Agreement”). The Company alleges that the Defendants and possibly others, committed fraud by nondisclosure, the common law tort of conversion

by pretext and swindling, deceptive trade practices, common law fraud and fraud by misrepresentation/statutory fraud upon the Company in connection with an executed Agreement.

On December 20, 2010 the Company filed its First Amended Complaint against the Defendants which included, but was not limited to, the fraudulent transfer of 5,875,000 shares of the Company's stock by Defendant Lawrence Shultz to seventeen (17) transferees who are not "Protected Purchasers" (sometimes also referred to in other jurisdictions as "Bona Fide Purchasers") as defined under Section 104.8303 of the Nevada Revised Statutes. These transfers are direct violations of Sections 16(a) and 23(a) of the Securities and Exchange Act of 1934, Sections 30(h) and 38 of the Investment Company Act of 1940, SEC Rule 10b-1, and SEC Rule 10b-5.

This lawsuit is also discussed in the Company's fiscal year 2010 Form 10-K filed with the Securities and Exchange Commission. In Note 16, the Company discloses a proforma balance sheet and income statement as though EOS had not been acquired on September 24, 2009.

#### NOTE 7 – COMMITMENTS AND CONTINGENCIES

The Company leases office space under a non-cancelable operating lease that expires in July 2014. The lease requires fixed escalations and payment of electricity costs. Rent expense, included in general and administrative expenses, totaled approximately \$2,085 and \$6,254 for the three months ended December 31, 2010 and 2009 respectively, and \$6,254 and \$14,350 for the six months ended December 31, 2010 and 2009 respectively

#### NOTE 8 – EQUITY TRANSACTIONS

The Company is authorized to issue 100,000,000 common shares at a par value of \$0.001 per share. These shares have full voting rights. At December 31, 2010 and June 30, 2010, there were 72,618,994 and 71,718,994, respectively, common shares outstanding.

During October 2010 the Company sold a total of 1,150,000 shares of stock, that is restricted pursuant to SEC Rule 144, for \$65,000.

During the fiscal year ended June 30, 2010, the Company issued 5,000,000 shares for \$.10 a share. These shares are restricted pursuant to SEC Rule 144. As discussed in Note 1, the Company issued 31,603,734 shares of restricted common stock for 100% of the issued and outstanding stock of EOS. On July 9, 2010, the Company filed a lawsuit seeking to rescind the stock purchase agreement and cancel the shares that were issued. See Note 6 for additional information.

The Company owed 65,000 shares at December 31, 2010 and 150,000 shares at June 30, 2010 to be issued to shareholders at who had purchased the shares for cash, but the shares had not been issued as of the respective date.

The Company has not paid a dividend to its shareholders and does not have any stock option plans or warrants.

#### NOTE 9 – FREESTONE TECHNOLOGIES, LLC

On October 24, 2008 Freestone established Freestone Technologies, LLC (the “Subsidiary”) in the state of Texas. The Subsidiary is wholly owned by Freestone and has certain assets and liabilities relating to the purchase of oil wells. These wells were purchased as additional test wells for Petrozene, and will also be used to test Freestone’s new chemical solvent, EncapSol. The assets and liabilities of the Subsidiary are included in the consolidated financial statements of Freestone.

#### NOTE 10 – GOING CONCERN

As reflected in the accompanying consolidated financial statements, Freestone incurred operating losses, and has a negative working capital position as of December 31, 2010. The above factors raise substantial doubt about Freestone's ability to continue as a going concern. Freestone's continued existence is dependent on its ability to obtain additional equity and/or debt financing to fund its operations. Freestone plans to raise additional financing and to increase sales volume. There is no assurance that Freestone will obtain additional financing or achieve profitable operations or cash inflows. The consolidated financial statements do not include any adjustments relating to the

recoverability or classification of recorded asset amounts or the amount and classification of liabilities that might be necessary as a result of this uncertainty.

## NOTE 11 – FAIR VALUE MEASUREMENTS

Cash, accounts receivable, accounts payable and other accrued expenses and other current assets and liabilities are carried at amounts which reasonably approximate their fair values because of the relatively short maturity of those instruments.

ASC Topic 820, “Fair Value Measurements and Disclosures” (formally SFAS No. 157), establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under ASC 820 are described as follows:

Level 1 - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Company has the ability to access.

Level 2 - Inputs to the valuation methodology include:

- quoted prices for similar assets or liabilities in active markets;
- quoted prices for identical or similar assets or liabilities in inactive markets;
- inputs other than quoted prices that are observable for the asset or liability;
- inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

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

The asset or liability’s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Asset retirement obligations are recorded based on the present value of the estimated cost to retire the oil and gas properties and are depleted over the useful life of the asset. The settlement date fair value is discounted at the Company’s credit adjusted risk-free rate in determining the abandonment liability.

The preceding method described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Company believes its valuation method is appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date. The following table sets forth by level, within the fair value hierarchy, the Company’s liabilities at fair value as of December 31, 2010:

Liabilities at Fair Value as of December 31, 2010



|                              | Level 1 | Level 2 | Level 3   | Total     |
|------------------------------|---------|---------|-----------|-----------|
| Asset retirement obligations | \$ 0    | \$ 0    | \$ 41,123 | \$ 41,123 |

## NOTE 12 – RECENT ACCOUNTING PRONOUNCEMENTS

## Recently Adopted Accounting Guidance

On January 1, 2010, the Company adopted Accounting Standard Update (“ASU”) 2009-16, “Transfers and Servicing (Topic 860): Accounting for Transfers of Financial Assets.” This ASU is intended to improve the information provided in financial statements concerning transfers of financial assets, including the effects of transfers on financial position, financial performance and cash flows, and any continuing involvement of the transferor with the transferred financial assets. The Company does not have a program to transfer financial assets; therefore, this ASU had no impact on the Company’s consolidated financial statements.

On January 1, 2010, the Company adopted ASU 2009-17, “Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities,” which amended the consolidation guidance applicable to variable interest entities and required additional disclosures concerning an enterprise’s continuing involvement with variable interest entities. The Company does not have variable interest entities; therefore, this ASU had no impact on the Company’s consolidated financial statements.

On January 1, 2010, the Company adopted ASU 2010-06, "Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements," which added disclosure requirements about transfers in and out of Levels 1 and 2 and separate disclosures about activity relating to Level 3 measurements and clarifies existing disclosure requirements related to the level of disaggregation and input and valuation techniques. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements or the related disclosures.

#### Accounting Guidance Issued But Not Adopted as of December 31, 2010

In October 2009, the FASB issued ASU 2009-13, "Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements – a consensus of the FASB Emerging Issues Task Force," which amends the criteria for when to evaluate individual delivered items in a multiple deliverable arrangement and how to allocate consideration received. This ASU is effective for fiscal years beginning on or after June 15, 2010, which is January 1, 2011 for the Company. The Company is currently evaluating the impact of adopting the guidance.

Management has reviewed these new standards and believes that they will have no material impact on the financial statements of the Company.

#### NOTE 13 – SUBSEQUENT EVENTS

In May 2009, the FASB issued ASC 855-10, "Subsequent Events", (formerly SFAS No. 165, "Subsequent Events,") which establishes general standards for accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or are available to be issued. The pronouncement requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date, whether that date represents the date the financial statements were issued or were available to be issued. In conjunction with the preparation of these financial statements, an evaluation of subsequent events was performed through February 14, 2011, which is the date the financial statements were issued. No reportable subsequent events were noted.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS

This report contains forward looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended. The Company's actual results could differ materially from those set forth on the forward looking statements as a result of the risks set forth in the Company's filings with the Securities and Exchange Commission, general economic conditions, and changes in the assumptions used in making such forward looking statements.

### General

On August 22, 2007, the Company changed its name to Freestone Resources, Inc. in anticipation of going into the oil and gas technology development business. Since that time Freestone began developing and acquiring rights to chemical solvents that can increase the production in oil and gas wells, decrease the viscosity of heavy oil, and extract hydrocarbons from various forms of matter. The Company is currently developing its economically and environmentally viable oil sand oil extraction and oil remediation technology.

### Acquisition of Earth Oil Services, Inc.:

The Company acquired one hundred percent (100%) of the issued and outstanding stock of Earth Oil Services, Inc., a Nevada corporation ("EOS"), in a non-cash transaction on September 24, 2009. The Company issued 31,603,734 shares of restricted common stock of the Company in consideration for this transaction. EOS owns certain exclusive, territorial, license agreements to a proprietary technology that is a chemical solvent that can separate, extract and recycle hydrocarbon contaminants from ground soils, tar sands, vessels and other materials. This technology is marketed under the name EncapSol ("EncapSol"). EOS has engaged a fabricator to build a prototype machine (the "Prototype") designed to be used in conjunction with EncapSol. EOS is indebted to the fabricator for its development of the Prototype. EOS is now a wholly owned subsidiary of Freestone. As discussed below, the Company has filed a lawsuit to rescind the EOS Agreement.

### Assets of EOS

EOS holds certain assets that include exclusive territorial license agreements for the use of EncapSol, and 50% ownership of Bleeding Rock, LLC, a Utah corporation ("Bleeding Rock"). Bleeding Rock owns 20,600,000 shares of Green River Resources, Corp., an Alberta Canada corporation. The last Green River Resources, Inc. ("Green River") stock transaction was for stock options to employees of Green River ("Green River Options"). The aforesaid Green River Options were optioned for \$0.35 per share. Thus, the total ownership of Green River Shares owned by Bleeding Rock is valued at \$7,210,000. EOS owns 50% (valued at \$3,605,000) of Bleeding Rock, and is entitled to 47% of the profits from EOS' 50% ownership of Bleeding Rock. The recorded value on EOS's audited balance sheet of the investment was \$250,010, however, the entire amount has been deemed impaired with the pending litigation and was written off as of June 30, 2010.

### Liabilities of EOS

EOS has certain liabilities that include \$150,000 in license fees owed to Environmental Services and Support, Inc., a non-related third party California corporation ("ESSI"), an invoice in the amount of \$250,000 from SRS Engineering Corporation, a California corporation that built the fourth generation EncapSol Recovery Technology. The Company

is responsible for the payment of \$250,000 to the manufacturers of the fourth generation EncapSol Recovery Technology and the payment of \$150,000 license fee to ESSI, totaling \$400,000.

#### Basis of Presentation

The Company consolidates its subsidiaries in accordance with ASC 810, Business Combinations, (formally SFAS 141R) and specifically ASC 810-10-15-8 which states, "The usual condition for a controlling financial interest is ownership of a majority voting interest, and, therefore, as a general rule ownership by one reporting entity, directly or indirectly, or over 50% of the outstanding voting shares of another entity is a condition pointing toward consolidation."

The Company owns 100% of EOS and has applied ASC 810 in consolidating the subsidiary. EOS owns 50% of BRC, as does an unrelated third party, Hidden Peak Group. Although each party owns 50%, Hidden Peak Group maintains control of the three person management board with three representatives, and therefore, applying the requirements for consolidations under ASC 810, EOS has not consolidated BRC but shows its impact through the Noncontrolling Interest method.

### Litigation involving Previous Owners of EOS

The Company filed a lawsuit in the United States District Court for the Northern District of Texas, Dallas Division, on July 9, 2010, Civil Action Number 3:10-cv-01349-O against Lawrence Shultz (“Shultz”), Environmental Services and Support, Inc. (“ESSI”), David Feuerborn (“Feuerborn”) and Thomas Jennings (Jennings”) (the “Defendants”). The Company alleges that the Defendants and possibly others, committed fraud by nondisclosure, the common law tort of conversion by pretext and swindling, deceptive trade practices, common law fraud and fraud by misrepresentation/statutory fraud upon the Company in connection with an executed Stock Purchase Agreement (the “Agreement”).

On December 20, 2010 the Company filed its First Amended Complaint against the Defendants to include, but was not limited to, the fraudulent transfer of 5,875,000 shares of the Company’s stock by Defendant Lawrence Shultz to seventeen (17) transferees who are not “Protected Purchasers” (sometimes also referred to in other jurisdictions as “Bona Fide Purchasers”) as defined under Section 104.8303 of the Nevada Revised Statutes. These transfers are direct violations of Sections 16(a) and 23(a) of the Securities and Exchange Act of 1934, Sections 30(h) and 38 of the Investment Company Act of 1940, SEC Rule 10b-1, and SEC Rule 10b-5.

The Company is seeking rescission of the Agreement and setting aside the shares of Company common stock issued to the Defendants or their assigns and the recovery of certain sums paid in connection with the agreement. The Company is also seeking a declaratory judgment that the Agreement is void and unenforceable; that the Company’s shares of stock issued to one or more of Defendants be cancelled; that the Company may adjust its share register to so reflect such cancellation; that the Agreement is void, unenforceable, and subject to cancellation by this Court; and that the Company’s damages were proximately caused by such fraud and deception and the breach of legal duties owed to it by one or more of the Defendants. The Company is also seeking actual damages from the Defendants, jointly and severally, of at least \$1,614,149, as well as reasonable and necessary attorney’s fees. The Company is further seeking unliquidated damages within the jurisdictional limits of the United States District Court for the Northern District of Texas, Dallas Division, exemplary damages, statutory damages, prejudgment interest and post judgment interest, compounded annually, and such other and further relief to which the Company may show itself to be justly entitled.

### Results of Operations

Three and Six Months Ended December 31, 2010 compared to Three and Six Months Ended December 31, 2009

Revenue - Our revenue for the three months December 31, 2010 was \$9,235, compared to \$5,703 for the same period in 2009. Revenue increased in the second quarter due to increased oil and gas sales from production generated by the wells during research activities. Our revenue for the six months December 31, 2010 was \$18,408, compared to \$27,195 for the same period in 2009. This decrease is due to reduced oil and gas sales.

Lease Operating Expense - Lease operating expense for the three months ended December 31, 2010 was \$8,127 compared to \$2,528 for the same period in 2009. Lease operating expense increased in the three months ended December 31, 2010 due to test wells that were acquired in Seguin, TX. Lease operating expenses for the six months ended December 31, 2010 was \$18,151 compared to \$5,221 for that same period in 2009.

Operating Expense - Total operating expenses for the three months ended December 31, 2010 were \$370 of depreciation and depletion expense and \$60,442 of general and administrative expenses respectively, compared to \$620 depreciation and depletion expense, and \$125,927 of general and administrative expenses for the same period in 2009. Total operating expenses for the six months ended December 31, 2010 were \$741 of depreciation and depletion expense and \$165,901 of general and administrative expenses respectively, compared to \$1,239 depreciation and

depletion expense, \$1,800 of impairment expense and \$152,235 of general and administrative expenses for the same period in 2009. The decreased costs in the three months ended December 31, 2010 were related to the EOS development write-off of \$70,000 in 2009 and higher audit fees in 2009 of \$14,000 related to the EOS transaction. These savings were partially off-set by increased Payroll of \$9,000 and legal fees of about \$5,000. The increased costs for the six months ended December 31, 2010 were related legal fees \$25,000 (the lawsuit against EOS (Note 6) that was filed in July, 2010), contract and other fees \$21,000, payroll of \$15,000 and audit and accounting fees of \$15,000 and other expenses of about \$8,000; this was mostly off-set by the \$70,000 engineering write-off in FY 2010.

Net Income (Loss) - Net loss for the three months ended December 31, 2010 was \$(42,196) compared to net loss of \$(115,056) for the same period in 2009. Net loss for the six months ended December 31, 2010 was \$149,452 compared to net loss of \$130,228 for the same period in 2009. The decrease in loss in the three month period ended December 31, 2010 is mainly related to the changes mentioned above. The increase in loss in the six month period ended December 31, 2010 is due to the increased administrative costs mentioned above.

### Liquidity and Capital Resources

We have little cash reserves and liquidity to the extent we receive it from operations.

During the six months ended December 31, 2010, our cash and cash equivalent increased marginally to \$28,570 from \$28,062 at June 30, 2010 due to additional stock sales, which have helped us continue operations.

Net cash flows of the Company was \$508 for the six months ended December 31, 2010 compared to cash used of \$1,767 for the same period in 2009. We continue to explore working capital options and in the short-term rely on our line-of-credit and advances/loans from shareholders.

### Employees

As of December 31, 2010, Freestone had two employees.

### Need for Additional Financing

No commitments to provide additional funds have been made by management or other stockholders. Our independent auditors included a going concern explanatory paragraph in their report included in our annual report on Form 10-K for the year ended June 30, 2010, which raises substantial doubt about our ability to continue as a going concern.

## ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

## ITEM 4T: CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

We carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of December 31, 2010. This evaluation was accomplished under the supervision and with the participation of our chief executive officer/principal executive officer, and chief financial officer/principal financial officer who concluded that our disclosure controls and procedures are effective.

Based upon an evaluation conducted for the period ended December 31, 2010, our Chief Executive and Chief Financial Officer as of December 31, 2010 and as of the date of this Report, has concluded that as of the end of the periods covered by this report, we have identified the following material weakness of our internal controls:

Lack of sufficient accounting staff which results in a lack of segregation of duties necessary for a good system of internal control and financial statement presentation.

### Changes in Internal Controls over Financial Reporting

We have not yet made any changes in our internal controls over financial reporting that occurred during the period covered by this report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.



PART II

Items No. 1, 3, 4, 5 - Not Applicable.

During the three months ended September 30, 2009, Freestone issued 31,603,734 restricted shares of common stock valued at \$1,264,149 to Larry Shultz and Environmental Services and Support, Inc. Larry Shultz and Environmental Services and Support, Inc. agreed to acquire the shares for investment purposes only and not for resale. The certificates representing the shares carry a legend that the shares may not be sold or transferred without compliance with the registration requirements of the Securities Act of 1933, as amended (the "Act") or in reliance upon an applicable exemption there from. In connection with the issue of these shares, the Company relied upon the private offering exemption found in section 4(2) of the Act.

Item 6 - Exhibits and Reports on Form 8-K

(a) None.

(b) Exhibits

Exhibit Number

- |      |  |
|------|--|
| 31.1 | Certification of Chief Executive Officer, pursuant to Rule 13a-14(a) of the Exchange Act, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002.                             |
| 31.2 | Certification of Chief Financial Officer, pursuant to Rule 13a-14(a) of the Exchange Act, as enacted by Section 302 of the Sarbanes-Oxley Act of 2002.                             |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer, pursuant to 18 United States Code Section 1350, as enacted by Section 906 of the Sarbanes-Oxley Act of 2002. |

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

FREESTONE RESOURCES, INC.

By /s/ Clayton Carter

Clayton Carter, CEO

Date: February 14, 2011



