CHINA NORTH EAST PETROLEUM HOLDINGS LTD
Form 10-K/A
October 12, 2012

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

FORM 10-K/A
Amendment No. 3

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

For the fiscal year ended December 31, 2010

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 Registrant as specified in its charter)

Nevada (State or other jurisdiction of Incorporation or organization)	87-0638750 (I.R.S. Employer Identification Number)

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

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

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

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

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

None

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

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

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

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

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

Documents Incorporated by Reference

None

Explanatory Note

China North East Petroleum Holdings Limited (the "Company," "we," "us" or "our") is filing this Amendment No. 3 on Form 10-K/A to our Annual Report on Form 10-K for the year ended December 31, 2010, originally filed with the Securities and Exchange Commission (the "SEC") on March 16, 2011 and amended on June 14, 2011 and September 9, 2011(the "Original Form 10-K"), to respond to comments of the Securities and Exchange Commission dated October 26, 2011.

Part I. Item 1. "Business – Preparation of Reserves Estimates" of the Form 10-K has been revised to provide additional disclosures regarding internal controls utilized in the reserve estimation process and changes in proved undeveloped reserves.

Part II. Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" of the 10-K has been revised to provide discussions of the Company's 2008 financial condition, changes in financial condition, and results of operations, including an analysis for each of the Company's reportable segments as well as the consolidated result of operations.

Part II. Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" of the 10-K has also been revised to include changes to "Critical Accounting Policies and Estimates" has been revised to expand on the discussion assumptions and estimates used in ceiling cost calculations, the nature of these assumptions and estimates, how they were arrived at, their historical accuracy, and whether they are reasonably likely to change in the future.

Part II. Item 7A. "Quantitative and Qualitative Disclosures About Market Risk" of the 10-K has been revised to provide additional information regarding the Company's foreign currency exchange rate risk.

Part II. Item 9A. "Controls and Procedures" of the 10-K has been revised to provide additional information regarding the Company's changes to internal controls.

Part IV. Item 15. "Exhibits and Financial Statement Schedules" has been revised to include changes to Note 24 of the Notes to the Consolidated Financial Statements, including changes to the following tables: Oil and Natural Proved Reserve; Capitalized Costs Relating to Oil and Natural Gas Producing Activities; Cost Incurred in Oil and Natural Gas Property Acquisition, Exploration and Development Activities; Results of Operations for Oil and Gas Producing Activities, and; Standardized Measure of Discounted Future Cash Flow relating to Proved Oil and Natural Gas Reserves (in millions).

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

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

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

TABLE OF CONTENTS

Information Regarding Forward-Looking Statements

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

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

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

PART I

ITEM 1. BUSINESS

Overview

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

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

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

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

Financial Information about Segments

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

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

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

2

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

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

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

Song Yuan Technical Joint Venture

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

Acquisition of LongDe

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

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

Acquisition of Yu Qiao

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

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

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

Acquisition of Tiancheng

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

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

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

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

Proposed Acquisition of Sunite Right Banner

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

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

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

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

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

Listing on NYSE Amex LLC

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

Available Information

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

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

Oil Properties and Activities

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

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

PetroChina pays the Company a price per barrel equal to the monthly mean price calculated from the Mean of Platts Singapore ("MOPS") daily price for sour, heavy Indonesian crude, as measured during the previous month. Platts is a leading global provider of energy and metals information that collects and publishes pricing data on a wide range of petroleum and non-petroleum commodity types. An independent provider, Platts serves the oil, natural gas, electricity, emissions, nuclear power, coal, petrochemical, shipping, and metals markets from 17 offices worldwide. Price paid to the Company is FOB at the local Jilin Province PetroChina oil storage depot. The oil grade produced in China is lower than the grade of light and sweet oil quoted as West Texas Intermediate ("WTI") and Brent, therefore, the oil price we receive from PetroChina generally is slightly discounted to the WTI or Brent price.

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

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

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

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

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

Sales Volumes and Prices

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

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

Proved Reserves

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

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

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

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

7

Preparation of Oil and Gas Reserves Estimates

Preparation of Reserves Estimates

Our fiscal year-end petroleum reserves report was prepared by Ralph E. Davis, based upon its review of the property interests being appraised, production from such properties, current costs of operation and development, current prices for production, agreements relating to current and future operations and sales of production, geoscience and engineering data, and other information we provide to them. The information we provided was reviewed by knowledgeable officers, employees and consultants to the Company, including the Chief Engineer, Xiang Zhang, in order to ensure accuracy and completeness of the data prior to its submission to Ralph E. Davis.

Upon analysis and evaluation of data provided, Ralph E. Davis issues a preliminary appraisal report of our reserves. The preliminary appraisal report and changes in our reserves are reviewed by our internal reserves engineer and our Chief Executive Officer for completeness of the data presented, reasonableness of the results obtained and compliance with the reserves definitions in Regulation S-X. Once all questions have been addressed, Ralph E. Davis issues the final appraisal report, reflecting their conclusions.
Our proved reserve estimates were made as of December 31, 2010 by Ralph E. Davis Associates Inc., an independent worldwide petroleum consultant based in Houston, Texas. Ralph E. Davis Associates Inc. conducted a study of each of the aforementioned oilfields in accordance with generally accepted petroleum engineering and evaluation principles in conformity with SEC definitions and guidelines. The person responsible for preparing the report was Lloyd B. Branum, Vice President. Mr. Branum has thirty-eight years' experience in the Petroleum Industry of which over thirty years' experience are in the conduct of evaluation and engineering studies relating to both domestic U.S. oil and gas fields and international energy assets. Mr. Branum is a graduate of the University of Missouri at Rolla, Rolla, Missouri with a Bachelor of Science Degree in Petroleum Engineering. Mr. Branum is a Licensed Professional Engineer by the State of Texas.

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

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

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

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

Hetingbao 301 Oilfield	2010	2009

Average annual sales price per barrel	$ 75.54	$ 55.97
Aggregate annual sales	$ 511,216	$ 555,449
Average annual production cost per barrel equivalent	$ 102	$ 25.70

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

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

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

Drilling Programs

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

Drilling Statistics

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

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

Properties and Leases

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

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

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

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

Proved Undeveloped Reserves (PUDs)

At December 31, 2010, our proved undeveloped reserves (PUDs) totaled approximately 2.086 million barrels, an increase of approximately 285,000 barrels from 1.801 million barrels at December 31, 2009. All of our PUDs at year-end 2010 were located in Jilin Province, People's Republic of China. No drilling occurred in our Jilin fields in 2010, so changes in PUDs that occurred during the year were due to an increase in the price of oil in 2010 calculated in accordance with Item 1203 of Regulation S-K. The price of oil used in our reserve reporting for the year ended December 31, 2010 was approximately $77 per barrel, compared to approximately $58 per barrel at December 31, 2009. This increase in price extends the production life of certain PUD locations, thereby increasing the future expected production volumes.

During 2010, no investments or progress, including capital expenditures, were made to convert PUD’s to proved developed reserves.

Present Activities

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

Our business operations are characterized by frequent, and sometimes significant, changes in the price we receive for the crude oil we produce and in the volumes of crude oil we produce. The following table shows selected operating data for the fiscal years ended December 31, 2010 and 2009.

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

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

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

Month	Oil Sale Price	
	RMB/Ton	USD/Bbl
January 2010	3,670	73
February 2010	3,820	76
March 2010	3,586	71
April 2010	3,761	75
May 2010	4,054	80
June 2010	3,837	76
July 2010	3,615	72
August 2010	3,599	72
September 2010	3,660	73
October 2010	3,693	74
November 2010	3,909	78
	4,019	80

December
2010
(Note: 1 Ton = 7.38 Bbls, Exchange rate 1 USD = 6.7695 RMB for 12 months moving average)

As of December 31, 2010, no wells were in the process of being drilled and no other related activities of material importance were occurring.

Marketing and Sales

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

Contract Drilling Services

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

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

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

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

Employees

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

Regulations

Restrictions on Foreign Ownership in the Oil and Gas Industry

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

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

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

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

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

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

The Victory Legal Group has further opined that:

- Song Yuan Technical, Wang Hong Jun and Ai Chang Shan are entitled to enter into the respective Share Trust Agreements under the PRC laws;

- The ownership structure of Yu Qiao, LongDe and Tiancheng are in compliance with existing PRC laws and regulations;

- The share trust arrangements under each of Share Trust Agreements are legal, valid and enforceable under PRC law and do not violate any PRC law or regulation; and

- The structure pursuant to which Wang HongJun holds 10% of the equity in Yu Qiao and 5% of the equity of Tiancheng in trust for Song Yuan Technical, which holds 90% and 95% of the equity in Yu Qiao and Tiancheng, respectively, complies with existing PRC laws and regulations, and the structure pursuant to which Ai Chang Shan holds 10% of the equity in LongDe in trust for Song Yuan Technical, which holds 90% of the equity in LongDe complies with existing PRC laws and regulations.

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

Environmental Regulations

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

Special Oil Fees

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

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

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

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

Competition

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

PART II

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

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

13

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

Overview

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

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

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

Entry into a Material Definitive Agreement

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

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

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

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

CONSOLIDATED RESULTS OF OPERATIONS

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

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

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

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

Comparing Fiscal Years Ended December 31, 2010 and 2009:

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

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

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

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

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

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

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

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

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

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

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

Comparing Fiscal Years Ended December 31, 2009 and 2008:

The following table presents certain consolidated statement of operations information. Financial information is presented for the 12-month period ended as of December 31, 2009 and December 31, 2008

	2009	2008
Revenues, net	$ 64,658,085	$ 58,572,250
Operating Expenses	$ 40,270,092	$ 40,395,130
Income from Operations	$ 24,387,993	$ 18,177,120

Revenues. Revenues for 2009 increased 10% to $64,658,085 from $58,572,250 in 2008 as a result of the increase in oil production and higher oil prices and revenue generated by our newly acquired contract oil drilling entity, Tiancheng. During the whole year, the Company drilled 42 new oil wells in the four oilfields which are owned by the Company. The total number of producing wells increased from 247 in 2008 to 289 in 2009, a total increase of 17%. Total oil production for 2009 was 908,126 barrels, or approximately a 41% increase, as compared to 645,855 barrels in the same period in 2008 due to the increase in producing wells and the implementation of water flooding in the Qian'an 112 oil field. Oil prices in 2009 averaged RMB 2,824 per ton or approximately $55.97 per barrel, which represents a decrease of 41% over 2008 levels of RMB 4,845 per ton or approximately $94.29 per barrel.

Oilfield	2009 wells	2008 wells	2009 Production	2008 Production
Qian'an112	247	219	892,404	621,820
Hetingbao 301	18	14	9,482	16,626
Gudian31	12	7	3,796	5,821
Daan 34	12	7	2,444	1,588
Total	289	247	908,126	645,855

Company	2009 wells	2008 wells	2009 Production	2008 Production
Yu Qiao	271	233	898,644	629,230
LongDe	18	14	9,482	16,625

Cost of Revenue. Cost of revenue decreased by 4.4% from $23,574,326 for the year ended December 31, 2008 to $22,537,713 for the year ended December 31, 2009. The decrease was due to the lower oil prices which lead to a decrease in government surcharge despite an increase in production level in 2009. During 2009, our total number of producing wells increased from 247 in 2008 to 289 in 2009, a total increase of 17%. The company paid a special oil surcharge of $4,618,789 to the PRC government in 2009, while $11,105,325 was paid to the PRC government for the same period in 2008 as a result of lower oil prices. Depreciation, depletion and amortization of oil properties increased by 14% to $9,795,312 in 2009, compared to $8,609,508 in the same period in 2008 by the result of an increase in the number of producing wells.

There is a total drilling cost of $4,861,488 associates with 60 wells drilling program for the fiscal year 2009.

Operating Expenses. Operating expenses increased by 5.4% from $16,820,804 for the year ended December 31, 2008 to $17,732,379 for the year ended December 31, 2009. The increase in operating expenses resulted primarily from higher selling and administrative expenses, higher depreciation due to increased fixed assets and an increase in consultant fees related to financing activities. During 2009, the Company paid approximately $665,128 for consulting service in connection with financing activities and other professional services related to obligations of the Company as a U.S. publicly traded company, as compared with $599,939 in 2008.

General and administrative expenses. General and administrative expenses increased slightly by 5% to $2,942,381 for the year ended December 31, 2009 compared to $2,807,328 for the year ended December 31, 2008.

Net (Loss) Income. The Company incurred a net loss of $22,109,514 for the year ended December 31, 2009 compared to a net income of $10,520,452 for the year ended December 31, 2008. The decrease in net income was primarily due to the impairment of oil properties of $13,837,108, change in fair value of warrants of $27,398,967 and loss on extinguishment of debt of $8,260,630.

LIQUIDITY AND CAPITAL RESOURCES

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

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

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

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

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

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

The Company has paid for the construction of its oil wells under production and construction, along with its acquisition of an oil well drilling and servicing company, with cash from operations as well as by funds raised through the issuance of secured debt, common stock and warrants to purchase the Company’s common stock. The Company is continually evaluating opportunities to expand the Company’s production and operations. The Company may need additional resources to fully implement the Company’s business plan and growth strategy. Our ability to obtain additional capital to achieve these expansion goals will depend on market conditions, national and global economies, and other factors beyond our control. We cannot assure you that the Company will be able to implement or capitalize on various financing alternatives or otherwise obtain required capital, the need for which could be substantial given the Company’s business and development goals. However, the Company anticipates that cash flows from operations will be sufficient to fund continued development at the four oil fields it currently operates and to fund continued operations at its oil well drilling and servicing subsidiary.

Registration Rights Penalties

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

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

Inflation

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

Crude Oil Price Trends

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

Production Trends

Like all other oil exploration and production companies, we experience natural production declines at existing wells. We recognize that oil production from a given well naturally decreases over time and that a downward trend in our overall production could occur unless the natural declines are offset by additional production from new wells, investment in measures to increase the production from existing wells (such as CO_2 and water injection), or acquisitions of producing properties. If any production declines we experience are not a temporary trend, and if we cannot economically replace our reserves, our results may be adversely affected and our stock price may decline. Our future growth will depend upon our ability to continue to add oil reserves in excess of our production at a reasonable cost.

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

Operating Expense Trends

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

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Reserves.

All of the reserves data in this Form 10-K are estimates. Estimates of our crude oil and natural gas reserves are prepared by our qualified petroleum engineers in accordance with guidelines established by the SEC, including rule revisions designed to modernize the oil and gas company reserves reporting requirements, which we implemented effective December 31, 2009. Reservoir engineering is a subjective process of estimating underground accumulations of crude oil and natural gas. There are numerous uncertainties inherent in estimating quantities of proved crude oil and natural gas reserves. Uncertainties include the projection of future production rates and the expected timing of development expenditures. The accuracy of any reserves estimate is a function of the quality of available data and of engineering and geological interpretation and judgment. As a result, reserves estimates may be different from the quantities of crude oil and natural gas that are ultimately recovered. In addition, economic predictability of reserves is dependent on the oil and gas prices used in the reserves estimate. We based our December 31, 2010 and 2009 reserves estimates on 12-month average commodity prices, unless contractual arrangements designate the price to be used, in accordance with SEC rules. However, oil and gas prices are volatile and, as a result, our reserves estimates will change in the future.

Estimates of proved crude oil and natural gas reserves significantly affect our depreciation depletion and amortization (DD&A) expense. For example, if estimates of proved reserves decline, the DD&A rate will increase, resulting in a decrease in net income. A decline in estimates of proved reserves could also cause us to perform an impairment analysis to determine if the carrying amount of crude oil and natural gas properties exceeds fair value and could result in an impairment charge, which would reduce earnings. In addition, a decline in estimates of proved reserves could prompt a goodwill impairment analysis.

Oil and Gas Properties.

Full cost method of accounting

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 and accumulated in pools on a country-by-country basis. DD&A is computed on a country-by-country basis, and capitalized costs are limited on the same basis through the application of a ceiling test. Gain or loss on the sale or other disposition of oil properties is not recognized, unless the gain or loss would significantly alter the relationship between capitalized costs and proved reserves of oil and natural gas attributable to a country. The application of the full cost method of accounting for oil properties generally results in higher capitalized costs and higher depreciation, depletion and amortization rates compared to the successful efforts method of accounting for oil properties.

The alternative method for accounting for crude oil and gas properties is the successful efforts method. Under the successful efforts method, costs to acquire mineral interests in crude oil and natural gas properties, drill and equip exploratory wells that find commercial quantities of proved reserves, and drill and equip development wells are capitalized. Proved property acquisition costs are amortized to expense by the unit-of-production method on a field-by-field basis based on total proved crude oil and natural gas reserves as estimated by our qualified petroleum engineers. Costs to drill and equip exploratory wells that find proved reserves and drill and equip development wells are also amortized to expense by the unit-of-production method on a field-by-field basis. These costs, along with support equipment and facilities, are amortized based on proved developed crude oil and natural gas reserves. We believe the full cost method is the more appropriate method to use in our accounting for oil and gas properties because it better represents the results of our operations taken on the whole.

Capitalized unproved properties

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

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 eight years.

19

Impairment of oil and gas properties

We evaluated our capitalized costs using the full cost ceiling test as prescribed by the Securities and Exchange Commission at the end of each reporting period. The full cost ceiling test is an impairment test to determine a limit, or ceiling, on the book value of oil properties. That limit is basically the after tax present value of the future net cash flows from proved crude oil reserves, excluding future cash outflows associated with settling asset retirement obligations that have been accrued on the balance sheet; using an average price over the prior 12-month period held flat for the life of production plus the lower of cost or fair market value of unproved properties. If net capitalized costs of crude oil properties exceed the ceiling limit, we must charge the amount of the excess to earnings as an expense reflected in additional accumulated depreciation, depletion and amortization.

Impairment of oil properties for the years ended December 31, 2009 and 2008 were $13,837,108 and $13,184,103, respectively. No impairment loss was recognized for the year ended December 31, 2010. Assumptions used in the full cost ceiling calculation include the following (in thousands except for pricing information):

	2010	2009	2008
Oil price	$ 77.31	$ 58.54	$ 44.82
Net future oil production	$ 423,361	$ 358,969	$ 197,236
Estimated future development cost	(4,946)	(8,881)	(1,173)
Estimated future operating expense	(184,490)	(131,750)	(132,312)
Income tax expense	(42,207)	(39,142)	(209)
PV10 factor	(66,351)	(64,405)	(11,037)
Ceiling calculation	$ 125,367	$ 114,791	$ 52,505

The ceiling limit calculation is dependent on estimated reserves and oil and gas prices. Oil prices used in our ceiling test are derived pursuant to the SEC's full cost rules. Estimated future operating costs are based on our historical costs. Estimated future development cost is based on our expected drilling program at the time, based on the current prices at that time. Income tax expense is based on the statutory tax rate, which has been 25%. Negative revisions in estimated reserve quantities or a sustained decline in prices could lead to an impairment charge in future periods. However, a 10% decline in production or oil prices would not have resulted in an impairment of our oil and gas properties as of December 31, 2010. Over the past five years, oil and gas prices have fluctuated significantly and may continue to fluctuate in future periods. These fluctuations may result in a future impairment charge.

Asset Retirement Obligations

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

Use of estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. 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. Certain accounting policies involve judgments and uncertainties to such an extent that there is reasonable likelihood that materially different amounts could have been reported under different conditions, or if different assumptions had been used.

Revenue recognition

Our oil production business records revenue from the sales of oil on a net basis when delivery to the customer (PetroChina) has occurred and title has transferred. This occurs when oil has been delivered to a PetroChina depot. Pursuant to the Oil Leases entered into in 2002 and 2003 with PetroChina, each with twenty year terms, the Company is entitled to 80% of its oil production for the first ten years and 60% of its oil production for the remaining ten years. The Company receives payment for the net physical volume of oil delivered (either 80% or 60% by volume, depending upon the lease terms that are current at that point in time). The Company only records revenue for the production that it is entitled to.

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

Major customers

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

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

Stock-based compensation

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

Income taxes

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

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

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

Value added tax

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

Segments

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

Secured Debenture and Warrant Valuation.

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

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

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

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

On March 5, 2009, the Company and the Investor entered into Agreement No.1 to 8% Secured Debenture (the "Amendment" or the “restructuring”) which amended the Debenture issued to the Investor on February 28, 2008 for the principal amount of $15,000,000. Pursuant to the Amendment, the Investor agreed to extend the Company's requirement to effect a listing of its common stock on either the NYSE Alternext US LLC or NASDAQ until August 30, 2010, and the Company issued four-year warrants to the Investor to purchase up to (i) 250,000 shares of common stock at an exercise price of $2 per share and (ii) 250,000 shares of common stock at an exercise price of $2.35 per share. Also pursuant to the Amendment, the parties have agreed to amend the monthly principal repayment schedule of the Debenture. The Company treated this restructuring as an extinguishment of debt, as the net present value of cash flows projected to be paid by the Company to the Investor as a result of this Amendment exceed the net present value of cash flows projected to be paid by the Company to the Investor pursuant to the previously existing repayment schedule by greater than 10%. Therefore, the Company has accounted for this Amendment as an extinguishment and reissue of debt. Accordingly, the Company has recognized a loss on extinguishment of debt, effective March 5, 2009, of $8,260,630, which comprised the remaining unamortized discount on the secured debenture prior to the Amendment date, plus the unamortized deferred financing fees on the secured debenture prior to the Amendment date, plus the fair value of the warrants issued to the investor in conjunction with the Amendment.

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

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

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

Registration rights penalties

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

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

OFF-BALANCE SHEET ARRANGEMENTS

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

Recent accounting pronouncements

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

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

In January 2010, the FASB issued ASU 2010-03 Extractive Activities- Oil and Gas Reserve Estimation and Disclosures. This ASU amends the "Extractive Industries- Oil and Gas" topic of the Codification to align the Oil and Gas reserve estimation and disclosure requirements in this Topic with the U.S. Securities and Exchange Commission ("SEC") Release No. 33-8995, "Modernization of Oil and Gas Reporting Requirements (the Final Rule)". The amendments are effective for annual reporting periods ending on or after December 31, 2009, and the adoption of these provisions on December 31, 2009 do not have a material impact on our consolidated financial statements.

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

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

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

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

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

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

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

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

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

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

Foreign Currency Risk

Substantially all of our operations are conducted in the PRC, and our primary operational currency is the Chinese Renminbi ("RMB"). Substantially all of our revenues and expenses are denominated in RMB. However, we use the United States dollar for financial reporting purposes. Conversion of RMB into foreign currencies is regulated by the People's Bank of China through a unified floating exchange rate system. Although the PRC government has stated its intention to support the value of the RMB, there can be no assurance that such exchange rate will not again become volatile or that the RMB will not devalue significantly against the U.S. dollar. Exchange rate fluctuations may adversely affect the value, in U.S. dollar terms, of our net assets and income derived from our operations in the PRC.

Country Risk

The substantial portion of our assets and operations are located and conducted in China. While the PRC economy has experienced significant growth in the past twenty years, growth has been uneven, both geographically and among various sectors of the economy. The Chinese government has implemented various measures to encourage economic growth and guide the allocation of resources. Some of these measures benefit the overall economy of China, but may also have a negative effect on us. For example, our operating results and financial condition may be adversely affected by government control over capital investments or changes in tax regulations applicable to us. If there are any changes in any policies by the Chinese government and our business is negatively affected as a result, then our financial results, including our ability to generate revenues and profits, will also be negatively affected."

ITEM 9A. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

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

Changes in Internal Control over Financial Reporting.

During 2010, the Company implemented a number of actions to improve its control environment and to implement controls and procedures to ensure the integrity of financial reporting process. Specifically, the Company:

- 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;

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

- implemented improved procedures regarding the planning, procurement, oversight and verification of the purchase of goods and services, vendor contracts, and inventory management.

- refined job descriptions and duty delegation;

- strengthened accounting, monitoring and communications procedures, including with respect to cash management and account offsets and compliance with local laws governing internal cash control

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

Management’s Annual Report on Internal Control over Financial Reporting

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

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

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

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

Material Weakness

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

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

Remediation Initiative

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

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

Conclusion

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

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

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

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

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

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

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

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

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

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

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

/s/ Baker Tilly Hong Kong Limited

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

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following are filed with this report:

(1) The financial statements listed on the Index to Consolidated Financial Statements
(2) Not applicable
(3) The exhibits listed on the Exhibit Index, which include managerial contracts or compensatory plans or arrangements.

(b) The exhibits listed on the Exhibit Index are filed as part of this report.

(c) Not applicable.

EXHIBIT INDEX

Exhibit No.	Description
2.1 **	Distribution Agreement between Draco Holding Corporation and Jump'n Jax, dated April 30, 2004, is incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on May 14, 2004.
2.2 **	Agreement for Share Exchange dated as of March 29, 2004, by and among Draco Holding Corp., Hong Xiang Petroleum International Holdings, Ltd., and the shareholders of Hong Xiang is incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on March 30, 2004.
3.1 **	Articles of Incorporation are incorporated herein by reference from Registrant's Annual Report on Form 10-KSB filed with the SEC on March 28, 2001.
3.2 **	By-laws are incorporated herein by reference from Registrant's Annual Report on Form 10-KSB filed with the SEC on March 28, 2001.
3.3 **	Certificate of Amendments to Articles of Incorporation is incorporated herein by reference from Registrant's Information Statement on Form 14C filed with the SEC on May 26, 2004.
3.4 **	Certificate of Amendments to Articles of Incorporation filed with the Secretary of State of Nevada on September 12, 2005
3.5 **	Amended and Restated By-laws are incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on September 30, 2008.
4.1 **	2006 Stock Option/Stock Issuance Plan is incorporated herein by reference from Registrant's Registration Statement on Form S-8 filed with the SEC on February 27, 2006.
4.2 **	8% Secured Debenture issued to Lotusbox Investments Limited is incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on March 3, 2008.

4.3 **	Form of Series A and C Common Stock Warrant is incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on March 3, 2008.
4.4 **	Form of Series B Common Stock Warrant is incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on March 3, 2008.
4.5 **	Form of Common Stock Purchase Warrant is incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on March 6, 2008.
4.6 **	Amendment No. 1 to 8% Secured Debenture issued to Lotusbox Investments Limited is incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on March 6, 2008.

Exhibit No.	Description
10.1 **	Loan Contract between Song Yuan City Yu Qiao Qian'an Hong Xiang Oil and Gas Development Limited Company and Song Yuan City Wu Lan Da Jie Cheng Shi Xin Yong She is incorporated herein by reference from Registrant's Quarterly Report on Form 10-QSB filed with the SEC on November 23, 2005. (Translated from the original Mandarin)
10.2 **	Loan Contract between Song Yuan City Yu Qiao Qian'an Hong Xiang Oil and Gas Development Limited Company and Song Yuan City Wu Lan Da Jie Cheng Shi Xin Yong She is incorporated herein by reference from Registrant's Quarterly Report on Form 10-QSB filed with the SEC on November 23, 2005. (Translated from the original Mandarin)
10.3 **	Warranty Deed between Lien holder: Song Yuan City Wu Lan Da Jie Cheng Shi Xin Yong She and Mortgager: Wang Hongjun, Sun Jishuang is incorporated herein by reference from Registrant's Quarterly Report on Form 10-QSB filed with the SEC on November 23, 2005. (Translated from the original Mandarin)
10.4 **	Guarantee Contract between Creditor: Song Yuan City Wu Lan Da Jie Cheng Shi Xin Yong She and Assurer: Song Yuan City Hongxiang Petroleum Technical Services Co., Ltd is incorporated herein by reference from Registrant's Quarterly Report on Form 10-QSB filed with the SEC on November 23, 2005. (Translated from the original Mandarin)
10.5 **	Qian-112 Oilfield Cooperative Development Contract among PetroChina Oil and Gas Company Limited, Jilin Oil Field Branch Company; Song Yuan City Yu Qiao Oil and Gas Development Company Limited, dated as of May 28, 2003 is incorporated by reference from Registrant's annual report on Form 10-KSB filed with the SEC on April 16, 2007.
10.6 **	Joint Venture Agreement among the Registrant, Ms. Ju GuiZhi and Mr. Wang Hongjun, to form a joint venture limited liability company in China, to be named Song Yuan North East Petroleum Technical Service Co., Ltd is incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on July 28, 2006.
10.7 **	Equity Transfer Agreement by and among LongDe Oil & Gas Development Co. Ltd and Song Yuan North East Petroleum Technical Service Co., Ltd. dated June 1, 2005 is incorporated by reference from Registrant's Current Report on Form 8-K filed with the SEC on December 28, 2006.
10.8 **	Hetingbao 301 Oilfield Cooperative Development Contract among PetroChina Oil and Gas Company Limited and Chang Ling LongDe Oil and Gas Development Company Limited dated as of May 28, 2003.
10.9 **	Agreement for the Purchase and Sale of Stock among Song Yuan North East Petroleum Technical Service Co., Ltd., China North East Petroleum Holdings, Limited, Ju Guizhi, Ping Wu Wang, Meng Xiangyun, dated January 26, 2007 is incorporated by reference from Registrant's Current Report on Form 8-K filed with the SEC on January 29, 2007.

10.10 **	Trust Agreement between Bing Wu Wang and Song Yuan North East Petroleum Technical Service Co., Ltd. is incorporated by reference from Registrant's Current Report on Form 8-K filed with the SEC on January 29, 2007.
10.11 **	Trust Agreement between Meng Xiangyun and Song Yuan North East Petroleum Technical Service Co., Ltd. is incorporated by reference from Registrant's Current Report on Form 8-K filed with the SEC on January 29, 2007.
10.12 **	Cooperative Development Contract among PetroChina Oil and Gas Company Limited, Jilin Oil Field Branch Company and Song Yuan City Yu Qiao Oil and Gas Development Company Limited dated as May 28, 2003 to develop Qian 112 Oilfield, Da 34 Oilfield and Gu 31 Oilfield is incorporated by reference from Registrant's Current Report on Form 10-K filed with the SEC on April 16, 2007.
10.13 **	Capital Contribution Agreement dated as of June 29, 2007, by and among the Company, Mr. Hong Jun Wang and Ms. Guizhi Ju is incorporated by reference from Registrant's Current Report on Form 8-K filed with the SEC on July 7, 2007.
10.14 **	Securities Purchase Agreement dated February 28, 2008 between the Company and Lotusbox Investments Limited is incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on March 3, 2008.
10.15 **	Security Agreement dated February 28, 2008 between the Company and Lotusbox Investments Limited is incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on March 3, 2008.
10.16 **	Agreement of Pledge dated February 28, 2008 between the Company and Lotusbox Investments Limited is incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on March 3, 2008.

10.17 **	Registration Rights Agreement dated February 28, 2008 between the Company and Lotusbox Investments Limited is incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on March 3, 2008.
10.18 **	Option Agreement dated February 28, 2008 between the Company and Lotusbox Investments Limited is incorporated herein by reference from Registrant's Current Report on Form 8-K filed with the SEC on March 3, 2008.
10.19 **	Equity Transfer Agreement dated December 20, 2006 by and between Wang Hong Jun and Ju Gui Zhi for the transfer of equity interest in Song Yuan North East Petroleum Technical Service Co., Ltd. (translated from original Mandarin) is incorporated by reference to the Registrant's Annual Report on Form 10-K/A filed on September 1, 2010.
10.20 **	Equity Transfer Agreement dated March 17, 2008 by and between Sun Peng and Song Yuan North East Petroleum Technical Service Co., Ltd. for the transfer of equity interest in Long De (translated from original Mandarin) is incorporated by reference to the Registrant's Annual Report on Form 10-K/A filed on September 1, 2010.
10.21 **	Equity Transfer Agreement dated April 7, 2008 by and between Wang Hong Jun and Wang Bing Wu for the transfer of equity interest in Yu Qiao (translated from original Mandarin) is incorporated by reference to the Registrant's Annual Report on Form 10-K/A filed on September 1, 2010.
10.22 **	Equity Transfer Agreement dated March 17, 2008 by and between Ai Chang Shang and Song Yuan North East Petroleum Technical Service Co., Ltd. for the transfer of equity interest in LongDe (translated from original Mandarin) is incorporated by reference to the Registrant's Annual Report on Form 10-K/A filed on September 1, 2010.
10.23 **	Trust Agreement dated April 18, 2008 by and between Song Yuan North East Petroleum Technical Service Co., Ltd. and Wang Hong Jun (translated from original Mandarin) is incorporated by reference to the Registrant's Annual Report on Form 10-K/A filed on September 1, 2010.
10.24 **	Trust Agreement dated October 8, 2006 by and between Song Yuan North East Petroleum Technical Service Co., Ltd. and Wang Hong Jun (translated from original Mandarin) is incorporated by reference to the Registrant's Annual Report on Form 10-K/A filed on September 1, 2010.
10.25 **	Share Transfer Agreement dated January 19, 2011 by and among Song Yuan North East Oil Technical Services Co., Ltd. And the shareholders of Sunite Right Banner Shengyuan Oil and Gas Technology Development Co., Ltd. incorporated by reference from the Current Report on Form 8-K filed with the SEC on January 20, 2011
10.26 **	Share Issuance Agreement dated January 19, 2011 by and among China North East Petroleum Holdings Limited and Bellini Holdings Management Ltd. incorporated by reference from the Current Report on Form 8-K filed with the SEC on January 20, 2011
10.27 **	Agreement between Lotusbox Investments Limited and the Company dated March 12, 2011 incorporated by reference from the Annual Report on Form 10-K filed with the SEC

	on March 16, 2011.
10.28 **	Trust Agreement dated September 29, 2009 by and between Song Yuan North East Petroleum Technical Service Co., Ltd. and Wang HongJun (translated from original Mandarin) is incorporated herein by reference from Registrant's Annual Report on Form 10-K/A filed with the SEC on DATE of Second Amendment.
10.29 **	Lease Agreement between Jishuang Sun and Songyuan North East Petroleum Technical Service Co. dated June 30 , 2005 (translated from original Mandarin) is incorporated herein by reference from Registrant's Annual Report on Form 10-K/A filed with the SEC on DATE of Second Amendment.
10.30*	Description of oral agreement between the Company and Mr. Hongjun Wang.
14.1 **	Code of Ethics of China North East Petroleum Holdings, Ltd. is incorporated herein by reference from Registrant's Annual Report on Form 10-KSB filed with the SEC on May 18, 2005.
21.1 **	List of Subsidiaries is incorporated herein by reference from Registrant's Annual Report on Form 10-K/A filed with the SEC on DATE of Second Amendment.

31.1 *	Rule 13a-14(a)/15d-14(a) Certification by the Principal Executive Officer
31.2 *	Rule 13a-14(a)/15d-14(a) Certification by the Principal Financial Officer
32.1 *	Certification by the Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2 *	Certification by the Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith
** Previously filed

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, China North East Petroleum Holdings, Limited has duly caused this annual report on Form 10-K/A to be signed on its behalf by the undersigned, thereunto duly authorized.

October 3, 2012

CHINA NORTH EAST PETROLEUM HOLDINGS, LIMITED

By:/s/ Jingfu Li
Jingfu Li
Acting Chief Executive Officer

By:/s/ Shaohui Chen
Shaohui Chen
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

Name	Title	Date
/s/ Jingfu Li Jinfgu Li	Acting Chief Executive Officer, Director (Principal Executive Officer)	October 3, 2012
/s/ Shaohui Chen Shaohui Chen	Chief Financial Officer (Principal Financial Officer)	October 3, 2012
/s/ Ruishi Hu Ruishi Hu	Director	October 3, 2012
/s/ John Nicholls John Nicholls	Director	October 3, 2012
/s/ Wang Hong Jun Wang Hong Jun	Director	October 3, 2012
/s/ Yau-Sing Tang Yau-Sing Tang	Director	October 3, 2012

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED

AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited the accompanying consolidated balance sheets of China North East Petroleum Holdings Limited and its subsidiaries (collectively referred to as the "Company") as of December 31, 2010 and 2009, and the related consolidated statements of operations and comprehensive income, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2010 and 2009, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

We have also audited the adjustments as described in Note 1 to the consolidated financial statements that were applied to restate the 2008 financial statements to correct the errors. In our opinion, such adjustments are appropriate and have been properly applied. We were not engaged to audit, review or apply any procedures to the 2008 financial statements of the Company other than with respect to the adjustments and accordingly, we do not express an opinion or any other form of assurance on the 2008 financial statements taken as a whole.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2010, based on the criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 16, 2011 expressed an adverse opinion on the effectiveness of the Company's internal control over financial reporting.

/s/Baker Tilly Hong Kong Limited

BAKER TILLY HONG KONG LIMITED
Certified Public Accountants

Hong Kong SAR
March 16, 2011 (except for notes 14 and 19, as to which the date is September 30, 2011)

JIMMY C.H. CHEUNG & CO
Certified Public Accountants
(A member of Kreston International)

Registered with the Public Company
Accounting Oversight Board

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

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

We have audited, before the effects of the restatement as described in Note 1 to the consolidated financial statements, the consolidated balance sheets of China North East Petroleum Holdings Limited and subsidiaries as of December 31, 2008 and the related consolidated statements of operations and comprehensive income, stockholders' equity and cash flows for the year ended December 31, 2008 (the 2008 financial statements before the effects of the adjustments discussed in Note 1 are not presented herein). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit of the financial statements provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above, before the effects of the restatement as described in Note 1 to the consolidated financial statements, present fairly, in all material respects, the consolidated financial position of China North East Petroleum Holdings Limited and subsidiaries as of December 31, 2008, and the results of its operations and cash flows for the year ended December 31, 2008, in conformity with accounting principles generally accepted in the United States of America.

We were not engaged to audit, review or apply any procedures to the restatement as described in Note 1 to the consolidated financial statements, accordingly, we do not express an opinion or any other form of assurance about whether such adjustments are appropriate and have been properly restated. These adjustments were audited by Baker Tilly Hong Kong Limited.

/s/ Jimmy C.H. Cheung & Co.
JIMMY C.H. CHEUNG & CO
Certified Public Accountants
Hong Kong
Date: February 23, 2009, except for Note 1, as to which the date is September 3, 2010

1607 Dominion Centre, 43 Queen's Road East, Wanchai, Hong Kong
Tel: (852) 25295500 Fax: (852) 21277660
Email: jimmy.cheung@jchcheungco.hk
Website: http://www.jchcheungco.hk

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

	As of December 31, 2010	As of December 31, 2009
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 60,974,007	$ 28,693,132
Accounts receivable	24,142,762	16,231,369
Prepaid expenses and other current assets	434,094	678,349
Total Current Assets	85,550,863	45,602,850
PROPERTY AND EQUIPMENT		
Oil properties, net	41,892,288	45,777,428
Fixed assets, net	14,767,538	16,466,117
Oil properties under construction	61,482	69,395
Total Property and Equipment	56,721,308	62,312,940
LAND USE RIGHTS, NET	606,983	630,387
GOODWILL	1,645,589	1,645,589
DEFERRED TAX ASSETS	5,975,231	7,538,868
TOTAL ASSETS	$ 150,499,974	$ 117,730,634
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 4,156,349	$ 13,373,640
Current portion of secured debenture	-	5,625,000
Other payables and accrued expenses	801,867	1,165,494
Income tax and other taxes payable	5,076,074	4,930,202
Due to a related party	15,124	14,626
Due to a related company	-	144,796
Due to an unrelated party	1,300,000	-
Due to a stockholder	2,662,035	89,269
Total Current Liabilities	14,011,449	25,343,027
LONG-TERM LIABILITIES		
Secured debenture, net of discount	-	4,875,000
Warrants	13,956,515	39,528,261
Total Long-term Liabilities	13,956,515	44,403,261
TOTAL LIABILITIES	27,967,964	69,746,288
COMMITMENTS AND CONTINGENCIES	-	-
EQUITY		
NEP Stockholders' Equity		
Common stock ($0.001 par value, 150,000,000 shares authorized,		

29,604,860 shares issued and outstanding as of December 31, 2010; 27,935,818 shares issued and outstanding as of December 31, 2009)	29,605	27,936
Additional paid-in capital	50,070,524	42,582,142
Retained earnings (deficits)		
Unappropriated	50,059,932	(7,995,947)
Appropriated	2,837,647	2,524,055
Accumulated other comprehensive income	7,618,515	3,181,452
Total NEP Stockholders' Equity	110,616,223	40,319,638
Noncontrolling interests	11,915,787	7,664,708
TOTAL EQUITY	122,532,010	47,984,346
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 150,499,974	$ 117,730,634

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

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES ("NEP")
Consolidated Statements of Operations and Comprehensive Income (Loss)
For the years ended December 31, 2010, 2009 and 2008 (Restated)

	2010	2009	2008 (Restated)
REVENUE			
Sales of crude oil	$ 54,672,157	$ 51,080,775	$ 58,572,250
Drilling revenue	44,875,757	13,577,310	-
Total Revenue	99,547,914	64,658,085	58,572,250
COST OF REVENUE			
Crude oil extraction costs	4,113,237	2,868,895	3,847,775
Drilling costs	17,555,255	4,861,488	-
Depreciation, depletion and amortization of oil properties	6,570,965	9,795,312	8,609,508
Depreciation of drilling equipment	1,925,895	373,437	-
Amortization of land use rights	31,754	19,792	11,718
Government oil surcharge	8,594,481	4,618,789	11,105,325
Total Cost of Revenue	38,791,587	22,537,713	23,574,326
GROSS PROFIT	60,756,327	42,120,372	34,997,924
OPERATING EXPENSES			
Selling, general and administrative expenses	2,989,913	2,942,381	2,807,328
Professional fees	2,155,119	479,233	340,335
Consulting fees	2,258,207	185,895	259,604
Depreciation of fixed assets	399,691	287,762	229,434
Impairment of oil properties	-	13,837,108	13,184,103
Total Operating Expenses	7,802,930	17,732,379	16,820,804
INCOME FROM OPERATIONS	52,953,397	24,387,993	18,177,120
OTHER INCOME (EXPENSE)			
Other income	68,151	-	-
Other expense	(43,996)	(55,733)	(112,517)
Interest expense	(33,396)	(987,815)	(1,011,367)
Amortization of deferred financing costs	-	(144,507)	(731,504)
Amortization of discount on debenture	-	(670,492)	(3,394,086)
Imputed interest expense	-	(120,310)	(50,587)
Interest income	122,336	59,263	38,829
Change in fair value of warrants	26,555,889	(27,398,967)	4,464,191
Penalty imposed by an investor on late filing of registration statement	(1,163,333)	-	-
Loss on extinguishment of debt	-	(8,260,630)	-
Total Other Income (Expense), net	25,505,651	(37,579,191)	(797,041)

NET INCOME (LOSS) BEFORE INCOME TAXES		78,459,048		(13,191,198)		17,380,079
Income tax expense		(15,768,417)		(6,899,962)		(5,276,636)
NET INCOME (LOSS)		62,690,631		(20,091,160)		12,103,443
Less: net income attributable to noncontrolling interests		(4,321,160)		(2,018,354)		(1,582,991)
NET INCOME (LOSS) ATTRIBUTABLE TO NEP COMMON STOCKHOLDERS		58,369,471		(22,109,514)		10,520,452
OTHER COMPREHENSIVE INCOME (LOSS)						
Total other comprehensive income		4,366,982		106,387		1,912,742
Less: foreign currency translation loss (gain) attributable to noncontrolling interests		70,081		(10,638)		(191,275)
Foreign currency translation gain attributable to NEP common stockholders		4,437,063		95,749		1,721,467
COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO NEP COMMON STOCKHOLDERS	$	62,806,534	$	(22,013,765)	$	12,241,919
Net income (loss) per share						
- basic	$	1.99	$	(0.99)	$	0.53
- diluted	$	1.86	$	(0.99)	$	0.53
Weighted average number of shares outstanding during the year						
- basic		29,371,002		22,414,678		19,805,340
- diluted		31,299,044		22,414,678		19,924,929

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

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES ("NEP")
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDER'S EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2010 AND 2009 AND 2008 (RESTATED)

	NEP Common Stockholders				
	Common stock		Additional	Deferred	Unappro
	Number of shares	Amount	paid-in capital	Stock Compensation	retai earn (defi
Balance as of January 1, 2008	19,224,080	$ 19,224	$ 11,361,579	$ (27,125)	$ 5,2
Components of comprehensive income					
Net income for the year	-	-	-	-	10,5
Foreign currency translation gain	-	-	-	-	
Comprehensive income					
Issuance of stock for services	360,000	360	1,012,140	-	
Amortization of deferred stock compensation related to common stocks issued for services		-	-	27,125	
Exercise of warrants for cash	1,200,000	1,200	10,800	-	
Warrants issued for services	-	-	89,133	-	
Stock compensation expenses on options issued	-	-	543,454	-	
Imputed interest expenses on advances from a stockholder and related parties	-	-	50,587	-	
Contribution to increased registered capital of a subsidiary by noncontrolling interests	-	-	-	-	
Transfer from retained earnings to statutory reserve	-	-	-	-	(4
Balance as of December 31, 2008 (Restated)	20,784,080	$ 20,784	$ 13,067,693	$ -	$ 15,2
Components of comprehensive income					
Net loss for the year	-	-	-	-	(22,1
Foreign currency translation gain	-	-	-	-	
Comprehensive loss					
Issuance of stock for public offering	5,963,637	5,964	25,356,556	-	
Issuance of common stock for services	20,000	20	87,980	-	
Amortization of deferred stock compensation related to common stocks issued for services	-	-	607,500	-	
Exercise of warrants for cash	852,562	852	1,701,869	-	
Exercise of warrants for cashless	195,539	196	(196)	-	
Exercise of options for cash	120,000	120	440,880	-	
Warrants issued for services	-	-	201,303	-	
Stock compensation expenses on options issued	-	-	998,247	-	
Share of net assets on acquisition of Tiancheng	-	-	-	-	

Imputed interest expenses on advances from a stockholder and a related party	-	-	120,310	-	
Contribution to increased registered capital of a subsidiary by noncontrolling interests	-	-	-	-	
Transfer from retained earnings to statutory reserve	-	-	-	-	(1,1
Balance as of December 31, 2009	27,935,818	$ 27,936	$ 42,582,142	$ -	$ (7,9
Net income for the year	-	-	-	-	58,3
Foreign currency translation gain	-	-	-	-	
Comprehensive income					
Issuance of stock to settle the secured debenture	867,438	867	2,037,613	-	
Issuance of common stock to Tiancheng management for services	400,000	400	(400)	-	
Amortization of deferred stock compensation related	-	-	-		
to common stocks issued for services	-	-	3,241,947	-	
Exercise of warrants for cash	21,739	22	130,412		
Exercise of warrants for cashless	29,865	30	179,160	-	
Exercise of options for cash	250,000	250	1,124,750	-	
Stock issued for services	100,000	100	774,900	-	
Transfer from retained earnings to statutory reserve	-	-	-	-	(3
Balance as of December 31, 2010	29,604,860	$ 29,605	$ 50,070,524	$ -	$ 50,0

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

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES ("NEP')
Consolidated Statements of Cash Flows
For the years ended December 31, 2010, 2009 and 2008 (Restated)

	2010	2009	2008 (Restated)
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	$ 62,690,631	$ (20,091,160)	$ 12,103,443
Adjusted to reconcile net income (loss) to cash provided by operating activities:			
Depreciation, depletion and amortization of oil properties	6,570,965	9,795,312	8,609,508
Depreciation of drilling equipment	1,925,895	373,473	-
Depreciation of fixed assets	399,691	287,762	229,434
Amortization of land use rights	31,754	19,792	11,718
Amortization of deferred financing costs	-	144,507	731,504
Amortization of discount on debenture	-	670,492	3,394,086
Amortization of stock option compensation	1,248,908	998,247	543,454
Loss on extinguishment of debt	-	8,260,630	-
Change in fair value of warrants	(26,555,889)	27,398,967	(4,464,191)
Penalty imposed by an investor on late filing of registration statement	1,163,333	-	-
Impairment of oil properties	-	13,837,108	13,184,103
Warrants issued for services	-	201,303	89,133
Stock issued for consulting services	1,219,372	88,000	27,125
Stock-based compensation for employee service	1,548,667	607,500	1,012,500
Imputed interest expenses	-	120,310	50,587
Gain on disposal of fixed assets	(69,964)	(7,136)	-
Changes in operating assets and liabilities			
(Increase) decrease in:			
Accounts receivable	(7,911,393)	(12,001,289)	622,553
Prepaid expenses and other current assets	244,255	414,012	(42,410)
Deferred tax assets	1,563,637	(4,416,349)	(3,665,619)
Increase (decrease) in:			
Accounts payable	(9,040,379)	(11,557,157)	2,882,206
Other payables and accrued expenses	(128,887)	167,593	(199,062)
Income tax and other taxes payable	145,872	573,692	1,023,421
Net cash provided by operating activities	35,046,468	15,885,573	36,143,493
CASH FLOWS FROM INVESTING ACTIVITIES			
Addition to oil properties	(1,229,748)	(13,922,383)	(29,206,040)
Purchase from fixed assets	(78,422)	(3,616,147)	(957,449)
Reduction of oil properties under construction	28,700	(384,019)	(1,712,449)
Proceeds from disposal of fixed assets	-	364,877	-
Cash outflow from acquisition of a subsidiary	-	(12,354,467)	-
Net cash used in investing activities	(1,279,470)	(29,912,139)	(31,875,938)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance and sale in a public offering of common stock and warrants, net	-	29,941,015	-
Contribution to increased registered capital of a			

subsidiary by non-controlling interests	-	995,885	479,000
Payment of deferred financing costs	-	-	(1,186,229)
Repayment of note payable	-	-	(273,444)
Proceeds from issuance of secured debenture	-	-	15,000,000
Repayment of secured debenture	(8,696,260)	(3,750,000)	(750,000)
Proceeds from exercise of stock warrants and options	1,255,434	2,143,721	12,000
Increase in amount due to a stockholder	2,572,766	88,531	(122,367)
Advance from an unrelated party	1,300,000	-	-
Decrease in amounts due to related parties	-	(51,636)	(3,079,859)
(Decrease) increase in amount due to a related company	(144,796)	144,796	-
Net cash (used in) provided by financing activities	(3,712,856)	29,512,312	10,079,101
EFFECT OF EXCHANGE RATE ON CASH	2,226,733	(31,827)	(1,182,081)
NET INCREASE IN CASH AND CASH EQUIVALENTS	32,280,875	15,453,919	13,164,575
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	28,693,132	13,239,213	74,638
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 60,974,007	$ 28,693,132	$ 13,239,213
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Income tax expense	$ 14,294,596	$ 12,028,254	$ 7,824,394
Interest expense	$ 234,740	$ 777,185	$ 1,011,367

SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:

(1) On January 10, 2010, 867,438 shares of common stock at $2.35 per share were issued to settle the secured debenture regarding the warrant issued.

(2) On March 29, 2010, 400,000 shares of common stock valued at $3,232,000 were issued to the key management team of Tiancheng, of which the Company recognized $1,219,372 as staff compensation expenses included in selling, general and administrative expenses for the year ended December 31, 2010.

(3) In April 2010, a total of 29,865 shares of common stocks were issued in connection with cashless exercise of warrants.

(4) During 2010, the Company disposed of its motor vehicles to its creditors to settle balance outstanding of $176,912.

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

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

1. RESTATEMENT OF PREVIOUSLY REPORTED CONSOLIDATED FINANCIAL STATEMENTS

On February 23, 2010, China North East Petroleum Holdings Limited (the "Company) determined that the Company's financial statements for the year ended December 31, 2008 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 Accounting Standards Certification ("ASC") 815 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 amount 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) amounts payable to consultant included in accrued liabilities; (viii) depreciation, depletion and amortization of oil properties; (ix) ceiling test reduction of the net carrying value of oil properties; (x) income tax expense for the above items; and (xi) noncontrolling interests (formerly known as minority interests) for certain of the above items.

As a result, the accompanying consolidated financial statements as of December 31, 2008 and for the year then ended have been restated from the amounts previously reported. The information in the data table below represents only those statement of operations and comprehensive income, statement of cash flows line items affected by the restatement.

STATEMENT OF OPERATIONS AND COMPREHENSIVE INCOME INFORMATION

	Year ended December 31, 2008		
	As previously reported	Adjustments	As restated
Cost of Revenue:			
Depreciation, depletion and amortization of oil properties	$ 6,172,422	$ 2,437,086	$ 8,609,508
Operating Expenses:			
Selling, general and administrative expenses	1,959,602	847,726	2,807,328
Professional fees	251,202	89,133	340,335
Consulting fees	396,330	(136,726)	259,604
Impairment of oil properties	-	13,184,103	13,184,103
Other Income (Expense):			
Amortization of deferred financing costs	(247,131)	(484,373)	(731,504)
Amortization of discount on debenture	(1,622,678)	(1,771,408)	(3,394,086)
Change in fair value of warrants	-	4,464,191	4,464,191
Income tax expense (Note)	(9,101,267)	3,824,631	(5,276,636)
Noncontrolling interests	(2,909,686)	1,326,695	(1,582,991)
Net income	19,582,038	(9,061,586)	10,520,452
Foreign currency translation gain	2,098,702	(377,235)	1,721,467
Comprehensive income	21,680,740	(9,438,821)	12,241,919
Net income per share -- Basic	0.99	(0.46)	0.53
Net income per share -- Diluted	0.98	(0.45)	0.53

Note: The restatement of income tax expense is due to the tax effect of the restatements of 1) depreciation, depletion and amortization of oil properties and 2) ceiling test reduction of the net carrying value of oil properties. Other restatements have no effect on income tax expense.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

1. RESTATEMENT OF PREVIOUSLY REPORTED CONSOLIDATED FINANCIAL STATEMENTS (continued)

STATEMENT OF CASH FLOWS INFORMATION

	Year ended December 31, 2008		
	As previously reported	Adjustments	As restated
Net income	$ 19,582,038	$ (7,478,595)	$ 12,103,443
Adjustments to reconcile net income to cash provided by operating activities:			
Depletion, depreciation and amortization of oil properties	6,172,422	2,437,086	8,609,508
Amortization of deferred financing costs	247,131	484,373	731,504
Amortization of discount on debenture	1,622,678	1,771,408	3,394,086
Stock option compensation	336,978	206,476	543,454
Change in fair value of warrants	-	(4,464,191)	(4,464,191)
Impairment of oil properties	-	13,184,103	13,184,103
Warrants issued for services	216,380	(127,247)	89,133
Noncontrolling interests	2,909,686	(2,909,686)	-
Stock-based compensation for service	371,250	641,250	1,012,500
Other payables and accrued liabilities	(278,716)	79,654	(199,062)
Deferred tax assets	219,305	(3,884,924)	(3,665,619)
Net cash provided by operating activities	36,203,786	(60,293)	36,143,493
Effect of exchange rate on cash	(1,242,374)	60,293	(1,182,081)

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and description of business

China North East Petroleum Holdings Limited ("China North East Petroleum", "North East Petroleum," the "Company,' "we,' "our" or "us") was incorporated in Nevada on August 20, 1999 under the name of Draco Holding Corporation ("Draco"). On May 17, 2004, the Company's name changed from Draco Holdings Corporation to China North East Petroleum Holdings Limited.

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 People's Republic of China ("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") for $120,773 in cash. LongDe is engaged in the exploration and production of crude oil in the Jilin Oil Region of the PRC.

On January 26, 2007, Song Yuan Technical acquired 100% of the equity interest of Song Yuan City Yu Qiao Oil and Gas Development Limited Corporation ("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 (Jilin Oil Region), the 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 the Qian'an Oilfield Zone 112 ("Qian'an 112"), Daan 34 Oilfield ("Da 34") and Gudian 31 Oilfield ("Gu 31") area.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

On September 25, 2009, Song Yuan Technical entered into a Share Transfer Agreement (the “Agreement”) with the stockholders (“Selling Stockholders”) of Song Yuan Tiancheng Drilling Engineering Co., Ltd. (“Tiancheng”). Pursuant to the Agreement, Song Yuan Technical acquired all of the Selling Stockholders’ interest in Tiancheng for $13,000,000 (the “Purchase Price”) for 100% equity interest in Tiancheng held by the Selling Stockholders. The Purchase Price is payable in two installments. The first installment of $6,500,000 was due within 15 days from the date of execution of the Agreement and the second installment of US$6,500,000 was due within 15 days after the completion of the registration of the transfer of title of 95% of the equity interest in Tiancheng while the local Industry and Commerce Bureau established a trust to hold 5% of the equity interest in Tiancheng by one of the Selling Stockholders for Song Yuan Technical. The trust is established in order to comply with certain laws of the PRC. Tiancheng is principally engaged in providing contract drilling services to customers for exploration of crude oil in the PRC.

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

The Company is a petroleum exploitation, development and production company engaged in locating and developing hydrocarbon resources, primarily in the Jilin Province of PRC. Our principal business strategy is to enhance stockholder value by using technologies new to a specific area to generate and develop high-potential exploitation resources in this area. Our principal business is the acquisition of leasehold interests in petroleum rights, and the exploitation and development of properties subject to these leases. We are currently focusing our drilling efforts in the Song Yuan City region of Jilin Province, PRC.

Principles of consolidation

The accompanying consolidated financial statements as of December 31, 2010 and 2009 include the financial statements as of December 31, 2010 and 2009 of North East Petroleum and 90% equity interest owned subsidiaries, Song Yuan Technical, LongDe, Yu Qiao and Tiancheng. The noncontrolling interests represent the noncontrolling shareholders’ 10% ownership interest of Song Yuan Technical, and by extension the subsidiaries of Song Yuan Technical - LongDe, Yu Qiao and Tiancheng.

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

Use of estimates

The preparation of the financial statements for the Company in conformity with generally accepted accounting principles in the United States (“US GAAP”) 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. Actual results could differ from these estimates.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The Company's financial statements are based on a number of significant estimates, including oil reserve quantities which are the basis for the calculation of depreciation, depletion and impairment of oil properties, timing and costs associated with its retirement obligations, estimates of the fair value of derivative instruments, impairment of goodwill, impairments of unproved and proved oil properties and impairment of fixed assets.

Fixed assets

Fixed assets are stated at cost, less accumulated depreciation. Expenditures for additions, major renewals and betterments are capitalized and expenditures for maintenance and repairs are expensed as incurred.

Depreciation is provided on a straight-line basis, less estimated residual values over the assets' estimated useful lives. The estimated useful lives are as follows:

Buildings	20 Years
Furniture, fixtures and equipment	3 to 5 Years
Motor vehicles	5 to 8 Years
Drilling equipment	8 Years

Land use rights

Land use rights are stated at cost, less accumulated amortization and are amortized over lease terms from the date of acquisition (See note 8).

Fair value of financial instruments

The Company has adopted a three-level valuation hierarchy for disclosures of fair value measurement in order to enhance disclosures related to fair value measures of financial instruments. 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.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

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

The Company determines the fair value of the warrants using the Black-Scholes-Merton 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 17 for further information.

The reconciliation of Level 3 fair value measurements of financial assets and liabilities is as follows:

	2010 Unquoted derivative instruments
Opening balance	$ 39,528,261
Change in fair value of warrants	(26,555,889)
Penalty imposed by an investor on late filing of registration statement (Note 15)	1,163,333
Exercise of warrants	(179,190)
Closing balance	$ 13,956,515

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The carrying values of cash and cash equivalents, accounts receivable, accounts payable, and tax payables approximate their fair values due to the short maturities of these instruments.

Oil properties

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 are not depleted pending determination of the existence of proved reserves. Unproved reserves are assessed periodically to ascertain whether impairment has occurred. Unproved properties whose costs are individually significant are assessed individually by considering the primary lease terms of the properties, the holding periods of the properties, and geographic and geologic data obtained relating to the properties. Where it is not practicable to assess individually the amount of impairment of properties for which costs are not individually significant, such properties are grouped for purposes of assessing impairment. The amount of impairment assessed is added to the costs to be amortized, or is reported as a period expense, as appropriate. As of December 31, 2010 and 2009, the Company did not have any investment in unproved oil properties.

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

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.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Income taxes

Income taxes are accounted for under the asset and liability method is accordance with the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ASC 740-10. 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.

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 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 profit or loss, except when it is 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 asset and liabilities on a net basis. As of December 31, 2010 and 2009, the Company's deferred tax assets amounted to $5,975,231 and $7,538,868, respectively.

Value added tax

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

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Long-lived asset

Long-lived assets held and used by the Company are reviewed for impairment annually in the fourth quarter or more frequently if events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For purposes of evaluating the recoverability of long-lived assets, when undiscounted future cash flows will not be sufficient to recover an asset's carrying amount, the asset is written down to its fair value. The long-lived assets of the Company, which are subject to evaluation, consist of plant and equipment.

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 in the United States.

The Company's cash equivalents are exposed to 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 December 31, 2010 and 2009, the Company had deposits in excess of federally insured limits totaling $60,874,007 and $28,593,132, respectively. The Company has not experienced any losses in such accounts and believes that the risk of loss for cash held in bank is remote.

Substantially all of the company's operations are carried out in the PRC. Accordingly, the Company's business, financial conditions 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 the 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.

Accounts receivable

Accounts receivable is stated at cost. The Company provides for doubtful accounts for trade accounts that are overdue more than twelve months. There were no allowances for doubtful accounts as of December 31, 2010 and 2009.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenue recognition

Our oil production business records revenue from the sales of oil when delivery to the customer (PetroChina) has occurred and title has transferred.

Pursuant to oil lease agreements entered into in 2002 and 2003 with PetroChina, each with twenty year terms, the Company is entitled to 80% if 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 received payments 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 and time). The Company only records revenue for the production that the Company is entitled to.

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

Foreign currency translation

Except for North East Petroleum, which maintains its accounting records in its functional currency of the United States dollars (“US$”or “$”), all other subsidiaries of the Company maintain their accounting records in their functional currency of the Chinese Renminbi (“RMB”). For 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 statements 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.

The exchange rates used to translate amounts in RMB into US$ for the purposes of preparing the financial statements were as follows:

	December 31, 2010	December 31, 2009	December 31, 2008
Balance sheet items, except for common stock, additional paid-in capital and retained earnings, as of year end	US$1= RMB 6.6118	US$1= RMB 6.8372	
Amounts included in the statements of			

operations and cash flows for the year	US$1= RMB 6.7787	US$1= RMB 6.8409	US$1= RMB 6.9623

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

No representation is made that RMB amounts have been, or would be, converted into US$ at the above rates. Although the Chinese government regulations allow for conversion of RMB for current account transactions, significant restrictions still remain. Hence, such translations should not be construed as representation that the RMB could be converted into US$ at that rate or any other rate.

The value of RMB against US$ and other currencies may fluctuate and is affected by, among other things, changes in China's political and economic conditions, any significant revaluation of RMB may materially affect the Company's financial condition in terms of US$ reporting.

Comprehensive income

The foreign currency translation gain resulting from the translation of the financial statements expressed in RMB to US$ is reported as other comprehensive income in the statements of operations and stockholders' equity. Foreign currency translation gains recorded in comprehensive income for the years ended December 31, 2010 ,2009 and 2008 were $4,437,063, $95,749 and $1,721,467 respectively.

Stock-based compensation

The Company recognizes compensation cost for stock-based awards based on estimated fair value of the award and records compensation expense over the requisite service period. See Note 16 "Stock-Based Compensation" herein, for further discussion.

Income / (loss) per share

Basic net income (loss) per share is computed by dividing net income (loss) attributable to the common stockholders by the weighted average number of common shares outstanding during the reporting period. The shares of restricted common stock granted to certain officers and employees of the Company are included in the computation of basic net income (loss) per share only after the shares become fully vested. Diluted net income per common share includes both the vested and unvested shares of restricted stock and the potential dilution that could occur upon exercise of the options to acquire common stock computed using the treasury stock method which assumes that the increase in the number of shares is reduced by the number of shares which could have been repurchased by the Company with the proceeds from the exercise of the options (which were assumed to have been made at the average market price of the common shares during the reporting period).

Segments

The Company operates in two segments: oil production and oilfield services (well drilling). Segment disclosure is presented in Note 21, "Segments."

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Goodwill

Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree (if any) over the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed. If, after assessment, the Company's interest in the fair value of the acquiree's identifiable net assets exceeds the sum of the consideration transferred, the amount of any noncontrolling interests in the acquiree and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognized immediately in profit or loss as a bargain purchase gain. The impairment test requires allocating goodwill and all other assets and liabilities to assigned reporting units. The fair value of each reporting unit is estimated and compared to the net book value of the reporting unit. If the estimated fair value of the reporting unit is less than the net book value, including goodwill, then the goodwill is written down to the implied fair value of the goodwill through a charge to expense. The annual impairment test, which we conduct as of December 31 each year, requires us to estimate the fair values of our own assets and liabilities. Because quoted market prices are not available for our reporting units, the fair values of the reporting units are estimated using various valuation methodologies. Therefore, considerable judgment is required to assess goodwill for impairment. At December 31, 2010, the fair value of goodwill arising from our acquisition of Tiancheng exceeds its carrying value.

Environmental costs

The PRC has adopted extensive environmental laws and regulations that affect the operations of the oil and gas industry. The outcome of environmental liabilities under proposed or future environmental legislation cannot be reasonably estimated at present, and could be material. Under existing legislation, however, management believes that there are no probable and estimated liabilities that will have a material adverse effect on the financial position of the Company. Hence no reserves have been set up for environmental costs.

Asset retirement obligation

ASC 410-20 (formerly SFAS No. 143, "Accounting for Assets 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, 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 units-of-production method. Pursuant to our Oil 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 lease properties, include all wells, facilities and equipment.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Recent accounting pronouncements

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

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

In January 2010, the FASB issued ASU 2010-03 Extractive Activities- Oil and Gas Reserve Estimation and Disclosures. This ASU amends the "Extractive Industries- Oil and Gas" topic of the Codification to align the Oil and Gas reserve estimation and disclosure requirements in this Topic with the U.S. Securities and Exchange Commission ("SEC") Release No. 33-8995, "Modernization of Oil and Gas Reporting Requirements (the Final Rule)". The amendments are effective for annual reporting periods ending on or after December 31, 2009, and the adoption of these provisions on December 31, 2009 did not have a material impact on our consolidated financial statements.

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

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

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

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

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

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

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

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

F-21

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

3. CHANGE IN METHOD OF DETERMINING OIL RESERVES

In December 2008, the SEC adopted new rules related to modernizing reserve calculation and disclosure requirements for oil and natural gas companies, which became effective prospectively for annual reporting periods ending on or after December 31, 2009. The new rules expand the definition of oil and gas producing activities to include the extraction of saleable hydrocarbons from oil sands, shale, coal beds or other nonrenewable natural resources that are intended to be upgraded into synthetic oil or gas, and activities undertaken with a view to such extraction. The use of new technologies is now permitted in the determination of proved reserves if those technologies have been demonstrated empirically to lead to reliable conclusions about reserve volumes. Other definitions and terms were revised, including the definition of proved reserves, which was revised to indicate that entities must use the average of beginning-of-the-month commodity prices over the preceding 12-month period, rather than the end-of-period price, when estimating whether reserve quantities are economical to produce. Likewise, the 12-month average price is now used to calculate cost center ceilings for impairment and to compute depreciation, depletion and amortization. Another significant provision of the new rules is a general requirement that, subject to limited exceptions, proved undeveloped reserves may only be booked if they relate to wells scheduled to be drilled within five years of the date of booking. The revised rules became effective for the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2009. The SEC precluded 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.

In January 2010, the FASB issued ASU No. 2010-03 Oil and Gas Reserve Estimation and Disclosure, which aligns the current oil and gas reserve estimation and disclosure requirements with those of the SEC. As of December 31, 2009, the Company changed its method of determining the quantities of oil and gas reserves which impacted the amount recorded for depreciation, depletion and amortization and the ceiling test calculation for oil properties. Under the new rules, the Company prepared its oil reserve estimates as of December 31, 2009 using the average, first-day-of-the-month price during the 12-month period ending December 31, 2009. In prior years through September 30, 2009, the Company used the quarter-end price. The Company calculates depreciation, depletion and amortization on a quarterly basis using estimated reserves as of the end of each quarter. As a result, the new rules impacted the amount of depreciation, depletion and amortization recorded for oil properties and the ceiling test calculation for the quarter ended December 31, 2009. In addition, under the new guidance, subsequent price increases cannot be considered in the ceiling test calculation.

The adoption of the new rules is considered a change in accounting principle inseparable from a change in accounting estimate. The Company does not believe that provisions of the new guidance, other than pricing, significantly impacted the reserve estimates or consolidated financial statements. The Company does not believe that it is practicable to estimate the effect of applying the new rules on net income (loss) or the amount recorded for depreciation, depletion and amortization for the years ended December 31, 2010 and 2009.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

4. ACCOUNTS RECEIVABLE

The Company bills PetroChina on a monthly basis, at month-end, for the oil that was delivered to PetroChina during that month. We receive payment from PetroChina approximately 10 to 20 days following the end of each month for crude oil sales. We receive payment in full for the prior month, less a holdback in the first and second months of each calendar quarter for the amount of oil surcharge tax (if any) due to the PRC government for the respective month's oil sales. These oil surcharge tax holdbacks are paid to the Company with the normal monthly payment 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.

Accounts receivable at December 31, 2010 and 2009 consisted of the following:

	2010	2009
Accounts receivable, gross	$ 24,142,762	$ 16,231,369
Less: allowance for doubtful accounts	-	-
Accounts receivable, net of allowance	$ 24,142,762	$ 16,231,369

Approximately $16,749,792 of the 2010 accounts receivable balance consisted of receivables associated with Tiancheng, due within 12 months. The remaining $7,392,970 was due from PetroChina for oil sales and related special oil surcharge tax payments due to the PRC government. Approximately $8,671,394 of the 2009 accounts receivable balance consisted of receivables associated with Tiancheng, due within 12 months. The remaining $7,559,975 was due from PetroChina for oil sales and related special oil surcharge tax payments due to the PRC government.

As of December 31, 2010 and 2009, the Company considered all accounts receivable collectible and has not recorded a provision for doubtful accounts.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

5. PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expenses and other current assets as of December 31, 2010 and 2009 consist of the following:

	2010	2009
Prepaid expenses	$ 155,628	$ 554,474
Low value consumables and wells construction materials	187,823	-
Deposits paid to suppliers	47,060	54,564
Other receivables	43,573	69,311
	$ 434,094	$ 678,349

6. OIL PROPERTIES

The following is a summary of oil properties as of December 31, 2010 and 2009:

	2010	2009
Oil properties, proved	$ 104,049,854	$ 99,370,629
Intangible mining rights	13,445	13,445
Less: accumulated depreciation, depletion, amortization, and impairment	(62,171,011)	(53,606,646)
Oil properties, net	$ 41,892,288	$ 45,777,428

Depreciation, depletion and amortization expense for the years ended December 31, 2010, 2009 and 2008 was $6,570,965, $9,795,312 and $8,609,508 respectively. Impairment expense was $-0-, $13,837,108 and $13,184,103 for the years ended December 31, 2010, 2009 and 2008, respectively.

7. FIXED ASSETS

The following is a summary of fixed assets as of December 31, 2010 and 2009:

	2010	2009
Buildings	$ 1,824,990	$ 1,761,169
Furniture, fixtures and equipment	314,412	301,510
Motor vehicles	1,641,660	1,544,322
Drilling equipment	16,493,389	15,949,658
Less: accumulated depreciation	(5,506,913)	(3,090,542)
Fixed assets, net	$ 14,767,538	$ 16,466,117

Depreciation expense for the years ended December 31, 2010, 2009 and 2008 were $2,325,586, $661,199 and $229,434 respectively.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

8. LAND USE RIGHTS

The following is a summary of land use rights as of December 31, 2010 and 2009:

	2010	2009
Land use rights	$ 663,955	$ 701,239
Less: accumulated amortization	(56,972)	(70,852)
Land use rights, net	$ 606,983	$ 630,387

Amortization expense for the years ended December 31, 2010, 2009 and 2008 was $31,754, $19,792 and $11,718 respectively.

Amortization for years ending December 31,	
2011	$ 32,564
2012	32,564
2013	32,564
2014	32,564
2015	32,564
Thereafter	444,163
	$ 606,983

9. SECURED DEBENTURE

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

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

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

9. SECURED DEBENTURE (continued)

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

The Company accounts for these warrants as liability instruments in accordance with ASC 815-40. Upon issuance, the warrants were recorded at fair value of $10,268,321, which was recognized as a discount to the carrying value of the debenture. The initial carrying value of the debenture, net of discount, was $4,731,679.

On March 5, 2009, the Company and the Investor entered into Agreement No.1 to 8% Secured Debenture (the "Amendment" or the “restructuring”) which amended the Debenture issued to the Investor on February 28, 2008 for the principal amount of $15,000,000. Pursuant to the Amendment, the Investor agreed to extend the Company's requirement to effect a listing of its common stock on either the NYSE Alternext US LLC or NASDAQ until August 30, 2010, and the Company issued four-year warrants to the Investor to purchase up to (i) 250,000 shares of common stock at an exercise price of $2 per share and (ii) 250,000 shares of common stock at an exercise price of $2.35 per share. Also pursuant to the Amendment, the parties have agreed to amend the monthly principal repayment schedule of the Debenture. The Company treated this restructuring as an extinguishment of debt, as the net present value of cash flows projected to be paid by the Company to the Investor as a result of this Amendment exceed the net present value of cash flows projected to be paid by the Company to the Investor pursuant to the previously existing repayment schedule by greater than 10%. Therefore, the Company has accounted for this Amendment as an extinguishment and reissue of debt. Accordingly, the Company has recognized a loss on extinguishment of debt, effective March 5, 2009, of $8,260,630, which comprised the remaining unamortized discount on the secured debenture prior to the Amendment date, plus the unamortized deferred financing fees on the secured debenture prior to the Amendment date, plus the fair value of the warrants issued to the investor in conjunction with the Amendment.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

9. SECURED DEBENTURE (continued)

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

In conjunction with the amendment of the terms of the secured debenture, the Company is obligated to file a registration statement registering the resale of shares of the Company's common stock issuable upon exercise of the Warrants on or before March 5, 2010 (the "Filing Date"). If this registration statement has not been declared effective by the Filing Date, on the 180 th day following the Filing Date and each sixth month anniversary thereafter until the registration statement is declared effective, the Company must execute and deliver to the Investor new warrants to purchase up to a total of 62,500 on the same terms as the Warrants. During 2009, the Company repaid a total of $3,750,000 of the principal amount outstanding on the secured debenture, which reduced the outstanding balance of the debenture to $10,500,000 as of December 31, 2009. On January 13, 2010, the Company repaid the entire remaining balance of the debenture in the amount of $10,500,000. As of December 31, 2010, there was no debenture outstanding (note 15). No amortized discount on the secured debenture for the year ended December 31, 2010. Discount amortized on the secured debenture for the years ended December 31, 2009 and 2008 were $670,492 and $3,394,086, respectively.

10. ACCOUNTS PAYABLE

Accounts payable as of December 31, 2010 and 2009 consist of the following:

	2010	2009
Accounts payable due within the next 12 months	$ 4,156,349	$ 13,373,640

The Company's accounts payable consist primarily of amounts due to oil well drilling service providers. Our well drilling contractors provide us with payment terms for their services that require 33% of the estimated well drilling contract cost to be paid at the time of providing the service, and the remaining 67% of the actual well drilling cost paid in equal monthly amounts over 12 to 24 months following well completion. If the payment term extends beyond 12 months, no additional interest is charged, and we treat it as a long-term accounts payable. These obligations are unsecured.

11. OTHER PAYABLES AND ACCRUED EXPENSES

Other payables and accrued expenses as of December 31, 2010 and 2009 consist of the following:

	2010	2009
Other payables	$ 276,657	$ 506,603
Accrued professional fees	256,360	118,000
Other accrued expenses	268,850	540,891
	$ 801,867	$ 1,165,494

F-27

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

12. DUE TO AN UNRELATED PARTY

The amount due to an unrelated party is interest-free, unsecured and due on October 26, 2011.

13. NET INCOME (LOSS) PER SHARE

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

	2010	2009	2008 (Restated)
Net income (loss) used in computing basis net income (loss) per share	$58,369	$(22,109)	$10,520
Net income (loss) used in computing diluted net income (loss) per share	$58,369	$(22,109)	$10,520
Denominator:			
Shares used in computation of basic net income (loss) per share			
(weighted average common stock outstanding)	29,371	22,415	19,805
Dilutive potential common stock (under treasury stock method):			
Options and warrants	1,928	-	120
Shares used in computation of diluted net income (loss) per share	31,299	22,415	19,925
Basic net income (loss) per share	$1.99	$(0.99)	$0.53
Diluted net income (loss) per share	$1.86	$(0.99)	$0.53

In 2010, warrants to purchase 451,638 shares of common stock were not included in the calculation because the effect of their exercise would be anti-dilutive.

In 2009, options to purchase 350,000 shares of common stock and warrants to purchase 4,929,076 shares of common stock were not included in the calculation because the effect of their exercise would be anti-dilutive.

In 2008, options to purchase 410,000 shares of common stock and warrants to purchase 3,960,000 shares of common stock with exercise prices greater than the average fair market value of the Company's stock of $2.92 were not included in the calculation because the effect is anti-dilutive.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

14. COMMITMENTS AND CONTINGENCIES

(A) Employee benefits

The full time employees of LongDe, Yu Qiao and Tiancheng are entitled to employee benefits including medical care, welfare subsidies, unemployment insurance and pension benefits through a Chinese government mandated multi-employer defined contribution plan. The Company is required to accrue for those benefits based on certain percentages of the employees' salaries and make contributions to the plans out of the amounts accrued for medical and pension benefits. The Chinese government is responsible for the medical benefits and the pension liability to be paid to these employees. The Company did not accrue any liabilities for compensated absences earned for the years ended December 31, 2010 and 2009 respectively, because the amount cannot be reasonably estimated.

Contributions to retirement schemes (which are defined contribution plans) are charged to cost of revenues and general and administrative expenses in the statement of operations and comprehensive income (loss) as and when the related employee service is provided. During the years ended 2010 and 2009 the Company recognized contributions to retirement schemes of $42,653 and $41,917, respectively.

(B) Commitments

The Company leases office spaces from a stockholder, as well as land and office spaces from third parties under four operating leases which expire on September 20, 2023, January 20, 2015, February 1, 2011 and November 1, 2013, respectively.

As of December 31, 2010, the Company has outstanding commitments with respect to operating leases, which are due as follows:

Expiring in year ending December 31,		
2011	$	49,341
2012		48,649
2013		43,696
2014		14,708
2015		7,449
Thereafter		1,465
Total	$	165,308

Operating lease expenses for the years ended December 31, 2010 and 2009 were $39,357 and $39,750, respectively.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

14. COMMITMENTS AND CONTINGENCIES (continued)

(C) Legal proceedings

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

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

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

The Company determined that the litigation above generated loss contingencies because settlement of the litigation is reasonably possible, although the possible loss or range of loss is not reasonably estimable. While the outcome of the current claims cannot be predicted with certainty, management reviews the possible outcome at least quarterly and records a loss contingency accrual based upon this review. The Company was unable to estimate the possible loss or range of losses as of December 31, 2010 and, therefore, has not recorded an accrued loss contingency under ASC 450 in connection with the contingent liability related to this litigation. Based upon current available information, the Company believes that the outcome of this litigation will not have a material adverse impact on its consolidated financial position and results of operations. In fact, on May 27, 2011, the Clerk of the United States District Court for the Southern District of New York entered Judgment dismissing the consolidated shareholder derivative action against the Company and certain of its current and former officers and directors.

15. REGISTRATION PAYMENT ARRANGEMENTS

In conjunction with the March 5, 2009 modification of the Company's secured debenture issued on February 28, 2008 (see Note 9, 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.

On March 12, 2011, the Company entered in an agreement with the investor ("Harmony Agreement") and as stipulated in the Harmony Agreement, the investor agreed to waive penalty for late filing of registration statement of $1,163,333 and relieve any obligation to lodge a Form S-1 under a Note Redemption and Termination Agreement dated January 11, 2010 (the "NRTA") and two related warrant agreements dated March 28, 2010 (the "Warrant Agreements"). The Company agreed to lower the exercise price of two tranches of warrants (totaling 500,000 warrants) issued to the investor in year 2009 from $2.00 and $2.35, respectively to $0.01 and 100,000 warrants issued in 2008 from $2.35 to $0.01 (collectively referred as the "Lotusbox Warrants"). The investor was also granted the rights to cashless exercise the Lotusbox Warrants. As a result of signing the Harmony Agreement, the Investor and the Company mutually released each other from all claims and liabilities, know or unknown, either may have against the other based on or arising under the NRTA and Warrant Agreements, including but without limitation with respect to any penalties for alleged failure to file a form S-1.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

16. STOCK-BASED COMPENSATION

Stock options

During 2010, the Company granted to its employees 80,000 stock options qualified under the Company's 2006 Stock Option/Stock Issuance Plan (the "2006 Plan") to purchase Common Stock. As of December 31, 2010, stock options granted under the 2006 Plan to purchase 550,000 shares of its Common Stock (the "Options") at an exercise price from $2.94 to $5.50 per share were outstanding. 25% of the 240,000 stock options shall vest upon grant and 25% shall vest every three months thereafter, and these stock options granted shall expire ten years after the grant date if unexercised at that time. 50% of the 310,000 stock options shall vest upon grant and 50% shall vest on the first anniversary of the grant date.

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

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

	Expected Life	Expected Volatility	Dividend Yield	Risk Free Interest Rate	Grant Date Fair Value
2010	5 years	258%	-%	1.47%	$5.50
2009	5 years	268%-316%	-%	2.10%-3.42%	$2.94 -$5.50

- Dividend Yield: The expected dividend yield is zero. The Company has not paid a dividend and does not anticipate paying dividends in the foreseeable future.

- Risk Free Interest Rate: Risk-free interest rate of 1.47%-3.42% was used. The risk-free interest rate was based on U.S. Treasury yields with a remaining term that corresponded to the expected term of the option calculated on the 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 (the mid-point) as these awards meet the definition of "plain-vanilla."

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

16. STOCK-BASED COMPENSATION (continued)

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

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

On March 29, 2010, 400,000 shares of restricted stock under the 2006 Plan, with a fair value of approximately $3,232,000 were granted to key management team of Tiancheng of which the Company recognized $1,219,372 as staff compensation expenses included in selling, general and administrative expenses for the year ended December 31, 2010.

As of December 31, 2010, the total unamortized compensation expense related to stock options was $1,783,853 and will be amortized over the next three years.

The following is a summary of the stock option activity:

	Number of Options Outstanding		Weighted-Average Exercise Price
Balance, January 1, 2010	350,000	$	4.18
Granted	80,000	$	5.50
Forfeited	-		-
Exercised	(250,000)	$	4.50
Balance, December 31, 2010	180,000	$	4.32
Exercisable at December 31, 2010	100,000	$	3.38

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

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

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

17. STOCKHOLDERS’ EQUITY

(A) Warrants

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

	Date of issue	Expiration date		Exercise price	Outstanding Warrants
Warrant 1	February 28, 2008	February 28, 2013	$	2.35	2,100,000
Warrant 2	March 5, 2009	March 5, 2013	$	2.00	250,000
Warrant 3	March 5, 2009	March 5, 2013	$	2.35	250,000
Warrant 4	April 29, 2009	April 29, 2013	$	2.65	50,000
Warrant 5	September 15, 2009	September 15, 2014	$	6.00	698,263
Warrant 6	September 10, 2009	September 10, 2014	$	6.00	80,000
Warrant 7	December 11, 2009	September 9, 2014	$	8.10	58,910
Warrant 8	December 17, 2009	June 17, 2011	$	8.10	392,728
					3,879,901

The Company treats these warrants as liabilities under ASC 815-40 and accordingly records the warrants at fair value with changes in fair values recorded in the profit or loss until such time as the warrants are exercised or expired. The fair values were $39,528,261 at December 31, 2009 and $12,793,182 at December 31, 2010. As of December 31, 2010, included in the warrant liabilities, was an accrued penalty to an investor as a result of the Company's failure to file a registration statement in the amount of $1,163,333 which was resolved on March 12, 2011 (See Note 15). For the years ended December 31, 2010, 2009 and 2008 the Company recorded a gain of $26,555,889, a loss of $27,398,967 and a gain of $4,464,191 respectively, in changes in the fair value of the warrants in profit or loss.

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

		2010
Market price and estimated fair value of common stock:	$	5.76
Exercise price:	$	2.00 - $8.10
Remaining contractual life (years):		0.21 – 3.67
Dividend yield:		–
Expected volatility:		24%-213%
Risk-free interest rate:		0.12%-2.01%

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

17. STOCKHOLDERS’ EQUITY (continued)

(B) Stock issuance

(1) In January 2010, Series B Warrants issued with the Debenture (Note 9) were exercised by one investor to purchase 867,438 shares of common stock at the exercise price of $2.35 per share. No cash was received for these shares as they were issued as a component of the repayment of the Debenture.

(2) In January 2010, 250,000 shares of stock options previously granted to one senior management member were exercised at $4.50 per share, with $1,125,000 paid to the Company at exercise.

(3) In March 2010, an investor exercised warrants and purchased 21,739 shares of common stock at exercise price of $6.00 per share. The Company received $130,434 in connection with this transaction.

(4) On March 29, 2010, 400,000 shares of common stock valued at $3,232,000 were issued to the key management team of Tiancheng, of which the Company recognized $1,219,372 as staff compensation expenses included in selling, general and administrative expenses for the year ended December 31, 2010.

(5) In April 2010, one investor exercised warrants to purchase 29,865 shares of common stock at the exercise price of $6.00 per share. These were exercised on a “cashless” basis with the Company being compensated through the cancellation of 50,135 additional warrants based upon the excess of fair market value over exercise price on the date of exercise.

(6) In October 2010, the Company issued 100,000 shares of common stock recorded at $7.75 per share to its legal counsel The Crone Law Group as payment for services rendered.

17. STOCKHOLDERS’ EQUITY (continued)

(C) Appropriated retained earnings

The Company’s PRC subsidiaries are required to make appropriations to reserve funds, comprised of the statutory surplus reserve, statutory public welfare fund and discretionary surplus reserve, based on the after-tax net income determined in accordance with the laws and regulations of the PRC. Prior to January 1, 2006, the appropriation to the statutory surplus reserve was required to be at least 10% of after tax net income determined in accordance with the laws and regulations of the PRC until the reserve is equal to 50% of the entities’ registered capital. Appropriations to the statutory public welfare fund are between 5% to 10% of after tax net income determined by the Board of Directors. Effective January 1, 2006, the Company’s PRC subsidiaries are only required to contribute to a single statutory reserve fund at the rate of 10% of net income after tax per annum, such contributions not to exceed 50% of the respective companies’ registered capital.

The statutory reserve funds are restricted for use to offset against prior period losses, expansion of production and operation or for the increase in the registered capital of the respective company. The statutory public welfare fund is restricted for use in capital expenditures for the collective welfare of employees. These reserves are not transferable to the Company in the form of cash dividends, loans or advances. These reserves are therefore not available for distribution except in liquidation.

During 2010, 2009 and 2008, the company’s PRC subsidiaries appropriated $313,592, $1,151,056 and $456,736, respectively to the reserve funds based on net income in accordance with the laws and regulations of the PRC.

18. RELATED PARTY TRANSACTIONS

a) As of December 31, 2010 and 2009, the Company owed a related party $15,124 and $14,626, respectively, which is repayable on demand. Imputed interest expense was computed at 5% per annum on the amount due for the year ended December 31, 2009.

b) As of December 31, 2010 and 2009, the Company owed a stockholder $2,662,035 and $89,269, respectively, which is, unsecured, interest-free and repayable on demand.

c) Total imputed interest expenses recorded as additional paid-in capital amounted to $-0- , $120,310 and $50,587 for the years ended December 31, 2010, 2009 and 2008, respectively.

d) As of December 31, 2010 and 2009, the Company owed a related company $-0- and $144,796, respectively.

e) The Company paid a stockholder $14,006, $14,006 and $13,789 for leased office space for the years ended December 31, 2010, 2009 and 2008, respectively.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

19. INCOME TAX

It is management's intention to reinvest all the income attributable to the Company outside of the United States (“US”). Accordingly, no US corporate income taxes are provided for in these financial statements.

The Company is subject to income taxes on an entity basis on income arising in or derived from the tax jurisdiction in which each entity is domiciled.

North East Petroleum was incorporated in the United States and has incurred net operating losses for income tax purposes for 2010, 2009 and 2008, respectively.

North East Petroleum has net operating losses carry forwards for income tax purposes amounting to approximately $24,986,100 and $45,314,872 as of December 31, 2010 and 2009, respectively. These tax losses which may be available to reduce future years' taxable income will expire, if not utilized, commencing in 2024. Management believes that the realization of the benefits arising from these losses appear to be uncertain due to Company's limited operating history and continuing losses. Accordingly, the Company has provided a 100% valuation allowance at December 31, 2010 and 2009 for the temporary difference related to loss carry forwards. Management reviews this valuation allowance periodically and makes adjustments as warranted. The valuation allowances at December 31, 2010 and 2009 were $8,643,142 and $15,407,056, respectively. The net change in the valuation allowance was a decrease of $6,763,914 from December 31, 2009 to December 31, 2010.

Song Yuan Technical, Yu Qiao, LongDe and Tiancheng were incorporated in the PRC and are subject to PRC income tax which is computed according to the relevant laws and regulations in the PRC. The applicable tax rate was 25% for the years ended December 31, 2010, 2009 and 2008. LongDe has net operating loss carry forwards for income tax purposes of $591,476 as of December 31, 2010. The tax loss which may be available to reduce future years taxable income will expire, if not utilized, in 2015.

The income tax expense for 2010, 2009 and 2008 are summarized as follows:

	2010	2009	2008 (Restated)
Current	$ 13,822,933	$ 11,306,176	$ 8,898,872
Deferred	1,945,484	(4,406,214)	(3,622,236)
Total	$ 15,768,417	$ 6,899,962	$ 5,276,636

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

19. INCOME TAX (continued)

The reconciliation of income taxes computed at the statutory income tax rates to total income taxes for the years ended December 31, 2010, 2009 and 2008 is as follows:

	2010	2009	2008 (restated)
Net Income (loss) before income taxes	$ 78,459,048	$ (13,191,198)	$ 17,380,079
Computed at tax rate of 25%	19,614,762	(3,297,800)	4,345,020
Effect of different tax rates of subsidiaries operating in other jurisdiction	1,724,890	(3,624,722)	774,538
Others	797,145	78,000	-
Valuation allowance	(6,368,380)	13,744,484	157,078
Income tax expense	$ 15,768,417	$ 6,899,962	$ 5,276,636

Deferred income tax for 2010, 2009 and 2008 reflect the effect of temporary differences between amounts of assets, liabilities, and equity for financial reporting purposes and the bases of such assets, liabilities, and equity as measured by tax laws.

The tax effects of temporary differences that give rise to the Company's net deferred tax assets as of December 31, 2010 and 2009 are as follows:

	2010	2009
Deferred tax assets:		
Non-current:		
Depreciation, depletion, amortization and impairment of oil properties	$ 6,243,711	$ 7,807,348
Tax loss carried forward	9,038,676	15,407,056
Others	(268,480)	(268,480)
Valuation allowance	(9,038,676)	(15,407,056)
Total non-current deferred tax assets and total deferred tax assets	$ 5,975,231	$ 7,538,868

The Company has not recognized a deferred tax liability of approximately $17 million and for the undistributed earnings of its operations in the PRC that arose in 2010 and prior years as the Company considers these earnings to be indefinitely reinvested. As of December 31, 2010, the aggregated undistributed earnings of these subsidiaries were approximately $50 million.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

20. CONCENTRATIONS AND RISKS

During 2010, 99.9% and 0.1% of the Company's assets were located in the PRC and the United States, respectively, and during 2009, 92% of the Company’s assets were located in the PRC and 8% were located in the United States.

During 2010 and 2009, 92% and 93%, respectively, of the Company's revenues were derived from a customer, PetroChina located in the PRC. As of December 31, 2010 and 2009, the Company had 91% and 82% of accounts receivable due from PetroChina. The Company’s oil leases require the Company to sell all its crude oil to PetroChina only. Additionally, PetroChina is a significant customer for the Company’s contract drilling business.

21. SEGMENTS

The Company follows FASB ASC 280 – Segment Reporting, which requires that companies disclose segment data based on how management makes decision about allocating resources to segments and evaluating their performance. The Company operates in two reportable segments; exploration and production of crude oil (“Crude oil”) and contract land drilling of oil wells (“Contract drilling”). The accounting policies of the segments are the same as described in the summary of significant accounting policies. The Company evaluates segment performance based on income from operations. All inter-company transactions between segments have been eliminated. As a result, the components of operating income for one segment may not be comparable to another segment. The following is a summary of the Company’s segment information for the years ended December 31, 2010, 2009 and 2008:

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

21. SEGMENTS (continued)

	December 31,		
	2010	2009	2008
Revenue:			(Restated)
Crude oil	$ 54,672,157	$ 51,080,775	$ 58,572,250
Contract drilling	44,875,757	13,577,310	-
Total revenue	$ 99,547,914	$ 64,658,085	$ 58,572,250
Gross profit:			
Crude oil	$ 35,393,474	$ 33,777,987	$ 34,997,924
Contract drilling	25,362,853	8,342,385	-
Total gross profit	$ 60,756,327	$ 42,120,372	$ 34,997,924
Income from operations:			
Crude oil	$ 27,989,440	$ 24,212,366	$ 18,177,120
Contract drilling	24,963,957	175,627	-
Total income from operations	52,953,397	24,387,993	18,177,120
Corporate and other	25,505,651	(37,579,191)	(797,041)
Net income (loss) before income taxes	$ 78,459,048	$ (13,191,198)	$ 17,380,079

Segment assets			
Crude Oil	$ 101,602,849	$ 80,324,972	
Contract drilling	45,710,854	27,942,896	
Total segment assets	147,313,703	108,267,868	
Other unallocated corporate assets	3,186,271	9,462,766	
Total assets	$ 150,499,974	$ 117,730,634	
Other segment information:			
Depreciation, depletion and amortization			
Crude oil	$ 6,861,832	$ 10,064,191	$ 8,850,660
Contract drilling	2,066,473	412,112	-
Total depreciation, depletion and amortization	$ 8,928,305	$ 10,476,303	$ 8,850,660
Income tax expense			
Crude oil	$ 9,511,636	$ 4,857,953	$ 5,276,636
Contract drilling	6,256,781	2,042,009	-
Total income tax expenses	$ 15,768,417	$ 6,899,962	$ 5,276,636
Expenditure for segment assets:			
Crude oil	$ 1,308,170	$ 15,020,517	$ 31,875,938
Contract drilling	-	3,363,950	-
Total expenditure for segment assets	$ 1,308,170	$ 18,384,467	$ 31,875,938

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

22. SUBSEQUENT EVENTS

On January 19, 2011, the Company through its subsidiary, Song Yuan North East Oil Technical, entered into a share transfer agreement with the shareholders of Sunite Right Banner Shengyuan Oil and Gas Technology Development Co., Ltd. ("Shengyuan"), to acquire 100% of the equity interests in Shengyuan ("Share Transfer Agreement").

Shengyuan is a limited liability company incorporated in Sunite Right Banner, Inner Mongolia in the PRC with exclusive oilfield exploration and drilling rights to the Durimu oilfield in Inner Mongolia.

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

The cash consideration will be paid to the Shareholders at closing. Bellini is an entity fully controlled by the Shareholders and designated by the Shareholders to receive the Acquisition Shares.

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

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

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

23. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The table below listed the unaudited quarterly financial data for the years ended December 31, 2010 and 2009:

	Quarters ended			
	March 31	June 30	September 30	December 31
Year ended December 31, 2010				
REVENUE	$ 28,928,293	$ 27,707,185	$ 19,986,267	$ 22,926,169
GROSS PROFIT	18,603,643	16,862,646	12,715,304	12,574,734
NET INCOME	23,110,647	26,223,920	7,695,045	5,661,019
Basic net income per common share	0.75	0.85	0.23	0.20
Diluted net income per common share	0.69	0.80	0.22	0.19
Year ended December 31, 2009 (Restated Q1, Q2 and Q3)				
REVENUE	$ 8,899,223	$ 11,351,405	$ 14,403,921	$ 30,003,536
GROSS PROFIT	5,264,422	7,380,436	9,272,888	20,576,063
NET (LOSS) INCOME	(18,104,866)	(6,588,782)	8,172,581	(3,570,093)
Basic net (loss) income per common share	(0.83)	(0.35)	0.34	(0.15)
Diluted net (loss) income per common share	(0.83)	(0.35)	0.31	(0.12)

24. SUPPLEMENTAL OIL INFORMATION (UNAUDITED)

The following supplemental information regarding our oil activities is presented pursuant to the disclosure requirements promulgated by the SEC and ASC 932, Extractive Activities —Oil and Gas.

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

(a) Proved oil reserves.

The following schedule estimates proved crude oil reserves attributable to the Company. Proved reserves are estimated quantities of oil which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved developed reserves are those which are expected to be recovered through existing wells with existing equipment and operating methods. Reserves are stated in thousands of barrels of oil (MBbls). Geological and engineering estimates of proved oil reserves at one point in time are highly interpretive, inherently imprecise and subject to ongoing revisions that may be substantial in amount. Although every reasonable effort is made to ensure that the reserve estimates reported represent the most accurate assessments possible, these estimates are by their nature generally less precise than other estimates presented in connection with financial statement disclosures.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

Oil and Natural Proved Reserve

Consolidated entities (Note 1)	Proved Reserve Quantity Information Oil (MBbls)
Proved reserves – December 31, 2007	2,469
Revision of previous estimates	(290)
Extensions and discoveries	2,868
Production	(646)
Proved reserves - December 31, 2008	4,401
Extensions and discoveries	2,639
Production	(908)
Proved reserves - December 31, 2009	6,132
Revision of previous estimates	68
Production	(724)
Proved reserves - December 31, 2010	5,476

(Note 1) Reserve attributable to consolidated subsidiaries in which there is a 10 percent noncontrolling interest.

Consolidated entities	Proved Producing Reserves, included above Oil (MBbls)	Proved Undeveloped Reserves, included above Oil (MBbls)
December 31, 2007	1,369	1,099
December 31, 2008	2,633	1,767
December 31, 2009	4,331	1,801
December 31, 2010	3,390	2,086

(b) Capitalized costs relating to oil-producing activities.

The following table illustrates the total amount of capitalized costs relating to oil producing activities and the total amount of related accumulated depreciation, depletion and amortization. All oil properties are located in the PRC.

Capitalized Costs Relating to Oil and Natural Gas Producing Activities

	As of December 31 (in thousands)		
	2010	2009	2008
Proved oil and gas properties	$ 104,050	$ 99,371	$ 84,200
Unproved oil and gas properties	-	-	-
Total property costs	104,050	99,371	84,200
Intangible mining rights	13	13	13
Total capitalized costs	104,063	99,384	84,213
Accumulated depreciation, depletion, amortization and impairment	(62,171)	(53,607)	(29,887)
Net capitalized costs	$ 41,892	$ 45,777	$ 54,326

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

(c) Costs incurred for property acquisition, exploration, and development activities.

All costs incurred associated with oil activities were incurred in the PRC. Costs incurred in property acquisition, exploration and development activities were as follows:

Cost Incurred in Oil and Natural Gas Property Acquisition, Exploration and Development Activities

	Year ended December 31 (in thousands)		
Consolidated entities:	2010	2009	2008
Acquisition of properties costs	$ -	$ -	$ -
Proved	-	-	-
Unproved	-	-	-
Exploration costs	-	-	-
Development costs	1,230	13,922	29,206
Total costs incurred for consolidated entities	$ 1,230	$ 13,922	$ 29,206

(d) Results of Operations for Oil and Gas Producing Activities

Results of operations for producing activities consist of all activities for the exploration, production and sale of oil and gas. Net revenues from production include only the revenues from the production and sale of oil and natural gas. Production costs are those incurred to operate and maintain wells and related equipment and facilities used in oil and gas operations. Income tax expense is calculated by applying the current statutory tax rates to the revenues after deducting costs, which include depreciation, depletion and amortization allowances, after giving effect to permanent differences. The results of operations exclude general office overhead and interest expense attributable to oil and gas activities.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

Results of Operations for Oil and Gas Producing Activities

	Year ended December 31 (in thousands)		
Consolidated entities:	2010	2009	2008
Revenues	$54,672	$51,081	$58,572
Total revenue	54,672	51,081	58,572
Less costs:			
Production costs	(4,113)	(2,869)	(3,848)
Exploration expenses	-	-	-
DD&A	(6,571)	(9,795)	(8,610)
Impairment of oil and gas properties	-	(13,837)	(13,184)
Oil Surcharge	(8,594)	(4,619)	(11,105)
Income before income taxes	35,362	19,941	21,813
Income tax expenses	(8,841)	(4,985)	(5,453)
Results of producing activities for consolidated subsidiaries (excluding corporate overhead and interest costs)	$26,522	$14,956	$16,360
Amortization rate per barrel	$9.08	$10.79	$13.33

(e) Standardized Measure of Discounted Future Net Cash Flows Relating to Proved Oil Reserves

The following Standardized Measure of Discounted Future Net Cash Flow information has been developed utilizing ASC 932, Extractive Activities —Oil and Gas, procedures and based on estimated oil reserve and production volumes. It can be used for some comparisons, but should not be the only method used to evaluate us or our performance. Further, the information in the following table may not represent realistic assessments of future cash flows, nor should the Standardized Measure of Discounted Future Net Cash Flow be viewed as representative of our current value.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

We believe that the following factors should be taken into account when reviewing the following information:

- future costs and selling prices will probably differ from those required to be used in these calculations;

- due to future market conditions and governmental regulations, actual rates of production in future years may vary significantly from the rate of production assumed in the calculations;

- a 10% discount rate may not be reasonable as a measure of the relative risk inherent in realizing future net oil revenues; and

- future net revenues may be subject to different rates of income taxation.

Under the Standardized Measure, for the year ended December 31, 2010 the future cash inflows were estimated by applying an un-weighted 12-month oil price of the first day of each month for the year ended December 31, 2010 (12-month un-weighted average) to the estimated future production of year-end proved reserves. Estimates of future income taxes are computed using current statutory income tax rates including consideration for estimated future statutory depletion and tax credits. The resulting net cash flows are reduced to present value amounts by applying a 10% discount factor. Use of a 10% discount rate and year-end prices were required.

The following schedule presents the standardized measure of estimated discounted future net cash flows from the Company's proved developed reserves for the year ended December 31, 2010. Estimated future cash flows were based on independent reserves evaluation from Ralph E. Davis Associates, Inc. for the year ended December 31, 2010. Because the standardized measure of future net cash flows was prepared using the prevailing economic conditions existing as of December 31, 2010, it should be emphasized that such conditions continually change. Accordingly, such information should not serve as a basis in making any judgment on the potential value of the Company's recoverable reserves or in estimating future results of operations.

Standardized Measure of Discounted Future Cash Flow relating to Proved Oil and Natural Gas Reserves

		Years ended December 31, (in thousands)		
Consolidated entities :		2010	2009	2008
Future cash inflows		$423,361	$358,969	$197,236
Future production costs and taxes		(184,490)	(131,750)	(132,312)
Future development costs		(4,946)	(8,881)	(1,173)
Future income tax expense		(42,207)	(39,142)	(209)
Future net cash flow before 10% discount		191,718	179,196	63,542
10% annual discount for estimated timing of cash flows		(66,351)	(64,405)	(11,037)
Standardized measure of discounted future net cash flows	(Note 5)	$125,367	$114,791	$52,505

F-45

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2010, 2009 AND 2008

Changes in Standardized Measure of Discounted Future Cash Flow relating to Proved Oil and Natural Gas Reserves

		Years ended December 31, (in thousands)		
Consolidated entities:		2010	2009	2008
Beginning of year		$114,791	$52,505	$68,097
Sales and transfer of oil and gas produced during the period		(50,559)	(43,559)	(43,619)
Net change due to extensions, discoveries, and improved recovery		-	21,467	43,373
Net change in sales and transfer prices and in production (lifting) costs related to future production		37,872	88,198	(64,848)
Net change due to revisions in quantity estimates		1,914	52,722	(1,978)
Changes in estimated future development costs		4,221	(550)	15,433
Net change due to purchase and sales of minerals in place		-	-	-
Development costs incurred		1,230	-	5,717
Net change in income taxes		(2,526)	(23,446)	20,358
Accretion of discount		12,527	5,433	9,028
Changes in production rates and other		5,897	(37,979)	944
Aggregate change in the standardized measure of discounted future net cash flows for the year		10,576	62,286	(15,592)
End of year	(Note 5)	$125,367	$114,791	$52,505

(Note 3) Estimated future net cash flows represent an estimate of future net revenues from the production of proved reserves using 12-month un-weighted average oil price, along with estimates of the operating costs, production taxes and future development and abandonment costs (less salvage value) necessary to produce such reserves. The 12-month un-weighted average oil price per barrel used as of December 31, 2010 was $77.31 (information was obtained showing the first week oil price as posted for the China Daqing Spot Price for each week for the year 2010). No deduction has been made for depreciation, depletion or any indirect costs such as general corporate overhead or interest expense.

(Note 4) Operating costs and production taxes are estimated based on current costs with respect to producing oil properties. Future development costs are based on the best estimate of such costs assuming current economic and operating conditions.

(Note 5) Includes $12,536,700 attributable to consolidated subsidiaries in which there is a 10 percent noncontrolling interest.

F-46