Conquest Petroleum Inc
Form 10-Q
February 07, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended: September 30, 2011

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

For the transition period from: to

Commission File No.: 000-53093

Conquest Petroleum Incorporated
(Exact name of registrant as specified in its charter)

TEXAS	20-0650828
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

13131 Champions Drive, Suite 205
Houston, Texas 77069
www.conquestpetroleum.com
(Address of principal executive offices)

Registrant's Telephone Number, Including Area Code: (281) 466-1530

Former Name and Address
Maxim TEP, Inc.
24900 Pitkin Road, Suite 308
Spring, Texas 77386

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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 Noo

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting Company)	Smaller reporting Company x

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

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 x No o

The number of shares of the registrant's common stock outstanding as of September 30, 2011 was 44,719,189 shares.

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of exchange on which registered
Common Stock, par value $0.00001 per share	OCTBB

Securities registered pursuant to Section 12(g) of the Act: None

At September 30, 2011, the aggregate market value of the registrant's Common Stock held by non-affiliates of the registrant was approximately $1,788,768 based on the closing price of such stock on such date of $0.04.

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PART I—FINANCIAL INFORMATION

Item 1. Financial Statements

Conquest Petroleum Incorporated
Consolidated Balance Sheets
(Unaudited)

	September 30, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$ 1,647	$ 75,699
Accounts receivable	85,400	111,928
Certificate of deposit, restricted	251,781	287,876
Restricted Cash	100	400,000
Other receivables	74,987	22,940
Prepaid expenses and other current assets	35,811	47,946
Total current assets	449,726	946,389
Oil and natural gas properties (successful efforts method of accounting):		
Proved	3,907,957	3,903,407
Unproved	172,796	172,796
	4,080,753	4,076,203
Less accumulated depletion, depreciation and amortization	(3,297,040)	(3,236,504)
Oil and natural gas properties, net	783,713	839,699
Property and equipment:		
Land	112,961	112,961
Buildings	215,445	215,445
Property improvements	199,500	244,025
Office equipment and computers	34,039	34,039
Furniture and fixtures	22,937	22,937
Field service vehicles and equipment	342,923	342,923
Drilling equipment	93,096	93,096
Total property and equipment	1,020,901	1,065,426
Less accumulated depreciation	(431,620)	(417,411)
Property and equipment, net	589,281	648,015
Other assets	167,928	225,006
Total assets	$ 1,990,648	$ 2,659,109

See accompanying notes to consolidated financial statements

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Conquest Petroleum Incorporated
Consolidated Balance Sheets (Continued)
(Unaudited)

	September 30, 2011	December 31, 2010
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	$ 2,596,750	$ 2,452,238
Interest payable	2,205,792	1,386,658
Accrued payroll and related taxes and benefits	1,677,271	1,338,161
Accrued liabilities	350,688	831,575
Derivative liability	22,364	6,797
Production payment payable, current	10,347,226	9,243,325
Notes payable	612,500	612,500
Notes payable, in default	625,000	625,000
Related party notes payable in default	8,799,940	7,370,333
Related party notes payable	2,951,126	2,822,775
Convertible notes payable to related parties in default, net of discount	700,000	700,000
Total current liabilities	30,888,657	27,389,362
Deferred revenue	37,500	45,000
Asset retirement obligation	1,636,420	1,519,600
Total liabilities	32,562,577	28,953,962
Stockholders' deficit:		
Preferred stock, $0.00001 par value; 50,000,000 shares authorized; 545,454 and 545,454 shares issued and outstanding at September 30, 2011 and December 31, 2010 respectively	5	5
Common stock, $0.00001 par value; 250,000,000 shares authorized; 44,720,028 and 44,715,528 shares issued and 44,719,189 and 44,714,689 shares outstanding at September 30, 2011 and December 31, 2010, respectively	450	450
Stock payable	2,332,675	2,332,525
Stock held in escrow	-	(447,287)
Additional paid-in capital	104,899,438	104,850,672
Accumulated deficit	(137,804,497)	(133,031,218)
Treasury stock, at cost (839 shares held at September 30, 2011 and December 31, 2010, respectively)	-	-
Total stockholders' deficit	(30,571,929)	(26,294,853)
Total liabilities and stockholders' deficit	$ 1,990,648	$ 2,659,109

See accompanying notes to consolidated financial statements

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Conquest Petroleum Incorporated
Consolidated Statements of Operations
(Unaudited)

	Three Months Ending September 30,		Nine Months Ending September 30,	
	2011	2010	2011	2010
Revenues:				
Oil and natural gas revenues	$ 222,841	427,507	$ 809,109	$ 1,068,204
License fees, royalties and related services	2,500	2,500	7,500	12,500
Total revenues	225,341	430,007	816,609	1,080,704
Cost and expenses:				
Production and lease operating expenses	130,892	331,627	733,791	1,194,135
Depletion, depreciation and amortization	36,647	105,767	119,270	300,960
Accretion of asset retirement obligation	46,336	32,104	135,448	85,276
Impairment of Intangible Assets	-	-	6,978	-
General and administrative expenses	34,383	860,197	718,571	6,610,176
Total cost and expenses	248,258	1,329,695	1,714,058	8,190,547
Loss from operations	(22,917)	(899,688)	(897,449)	(7,109,843)
Other income (Expense):				
Change in value of derivative liability gain(loss)	(20,529)	15,359	(15,567)	82,920
Interest expense, net	(1,382,298)	(1,372,674)	(3,763,768)	(5,647,938)
Gain/(Loss) on sale of assets	14,629	(55,565)	14,629	(103,807)
Loss on settlements	121,555	-	369,586	-
Interest Income	(2)	-	3,830	-
Other miscellaneous income (expense), net	(61,419)	(747)	(37,253)	(8,456)
Penalties on GEF default	-	-	(447,287)	-
Total other income (expense), net	(1,328,064)	(1,413,627)	(3,875,830)	(5,677,281)
Net loss	$ (1,350,981)	(2,313,315)	$ (4,773,279)	$ (12,787,124)
Net loss per common share:				
Basic and diluted	$ (.03)	(0.05)	$ (0.11)	$ (0.30)
Weighted average common shares outstanding:				
Basic and diluted	44,719,189	44,714,689	44,718,453	42,889,690

See accompanying notes to consolidated financial statements

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Conquest Petroleum Incorporated
Consolidated Statements of Cash Flows
(Unaudited)

	Nine Months Ending	
	September 30, 2011	September 30, 2010
Cash flows from continuing operating activities:		
Net loss for continuing operations	$ (4,773,279)	$ (12,787,124)
Adjustments to reconcile net loss from continuing operations to net cash used in operating activities:		
Depreciation & Depletion expense	119,270	290,105
Accretion expense	122,541	85,276
Loss on sale of assets	-	103,807
Change in fair value of derivative liabilities	15,567	(82,920)
Loss on write off of investment in technology	6,978	-
Gain on abatement of taxes	(248,031)	-
Amortization of debt discount	1,628,351	3,893,639
Bad debt expense	50,000	10,000
Bad debt recovery	(16,000)	-
Warrants issued for note extension	48,481	-
Gain on plugging of well	(14,629)	-
Expense escrow shares due to default on related party note	447,287	4,500,000
Amortization of deferred financing costs	-	10,855
Amortization of deferred revenue	(7,500)	(12,500)
Common stock issued for services	435	285
Common stock owed for consulting agreement and anti-dilution agreement	-	11,019
Common stock owed for services	-	52
Common stock owed due to default on note payable	-	461,734
Changes in operating assets and liabilities:		
Accounts receivable	(18,058)	(29,019)
Restricted cash	-	-
Prepaid expenses and other current assets	4,673	25,680
Other current assets	436,095	2,029
Accounts payable	144,512	373,505
Accrued expenses	925,388	1,674,364
ARO	8,908	-
Accrued interest	645,299	-
Net Cash Used For Operating Activities	(473,712)	(1,469,213)
Cash flows from investing activities:		
Proceeds from sale of fixed assets	-	15,805
Principal payments received for note receivable	16,000	-
Cash paid for purchase of fixed assets	(4,550)	(25,486)
Net cash provided by/(used) in investing	11,450	(9,681)
Cash flows from financing activities:		

Borrowings on production liability	458,602	-
Proceeds - issuance of notes payable	-	1,500,000
Principal payments on notes payable - related parties	-	(25,000
Principal payments on notes payable	(70,392)	(59,994)
Net cash provided by financing activities	388,210	1,415,006
Change is cash during period	(74,052)	(63,888)
Cash at beginning of year	75,699	89,813
Cash at end of period	1,647	25,925
Supplementary cash flow information:		
Cash paid for interest	-	17,673
Non-cash investing and financing activities:		
Shares issued by shareholder to relieve stock payable	-	30,000
Anti-dilution shares issued related to note payable anti-dilution clause	-	26,051
Default shared issued to escrow related to note payable	-	420,000

See notes to consolidated financial statements

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Conquest Petroleum Incorporated
Notes to the Consolidated Financial Statements (unaudited)

Note 1 – Financial Statement Presentation

Organization and nature of operations

CONQUEST PETROLEUM INCORPORATED, formerly Maxim TEP, Inc. was formed in 2004 as a Texas corporation to acquire, develop, produce and exploit oil and natural gas properties. The Company’s major oil and natural gas properties are located in Louisiana, and Kentucky. The Company’s executive offices are located in Houston, Texas. At the annual shareholder’s meeting in June, 2009, the shareholders approved the change of Maxim TEP, Inc. to Conquest Petroleum Incorporated to more closely identify the Company as independent oil and gas company and approved a 10-for-1 reverse stock split. On August 5, 2009, after approval from the regulatory agencies, the name change to Conquest Petroleum Incorporated and the 10-for-1 reverse stock split became effective. In connection with the 10-for-1 reverse stock split and name change, the new trading symbol has been changed from (OTCBB: MTIM) to (OTCBB: CQPT).

Going concern

As presented in the unaudited consolidated financial statements, the Company has incurred a net loss of $4,773,279 during the Nine months ended September 30, 2011, and losses are expected to continue in the near term. Current liabilities exceeded current assets by $30,438,931 and the accumulated deficit is $137,804,497 at September 30, 2011. Amounts outstanding and payable to creditors are in arrears and the Company is in negotiations with certain creditors to obtain extensions and settlements of outstanding amounts. The Company is currently in default on most of its debt obligations and the Company has no future borrowings or funding sources available under existing financing arrangements. Management anticipates that significant additional capital expenditures will be necessary to develop the Company’s oil and natural gas properties, which consist primarily of proved reserves that are non-producing, before significant positive operating cash flows will be achieved.

Management's plans to alleviate these conditions include the renegotiation of certain trade payables, settlements of debt amounts with stock, deferral of certain scheduled payments, and sales of certain non-core properties, as considered necessary. In addition, management is pursuing business partnering arrangements for the acquisition and development of its properties as well as debt and equity funding through private placements. Without outside investment from the sale of equity securities, debt financing or partnering with other oil and natural gas companies, operating activities and overhead expenses will be reduced to a pace that available operating cash flows will support.

The accompanying unaudited consolidated financial statements are prepared as if the Company will continue as a going concern. The unaudited consolidated financial statements do not contain adjustments, including adjustments to recorded assets and liabilities, which might be necessary if the Company were unable to continue as a going concern.

Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to accounting principles generally accepted in the United States of America and the rules and regulations of the Securities and Exchange Commission and should be read in conjunction with the audited financial statements and notes thereto contained on Form 10-K for the year ended December 31, 2010 filed with the SEC on April 15, 2011. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation of financial position and the results of operations for the interim periods presented have been reflected herein. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. Notes to

the financial statements which substantially duplicate the disclosure contained in the audited financial statements for the year ending December 31, 2010 have been omitted.

Note 2 – Summary of Significant Accounting Policies

Principles of consolidation

The accompanying unaudited consolidated financial statements are presented in accordance with U.S. generally accepted accounting principles. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries after elimination of all significant intercompany transactions and balances. The consolidated financial statements reflect necessary adjustments, all of which were of a recurring nature and are in the opinion of management necessary for a fair presentation.

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Property and equipment

Property and equipment are recorded at cost less accumulated depreciation. Cost of repairs and maintenance are expensed as they are incurred. Major repairs that extend the useful life of equipment are capitalized and depreciated over the remaining estimated useful life. When property and equipment are sold or otherwise disposed, the related costs and accumulated depreciation are removed from the respective accounts and the gains or losses realized on the disposition are reflected in operations. The Company uses the straight-line method in computing depreciation for financial reporting purposes.

Derivative Instruments

We have evaluated Topic Number 815 in determining whether the Company has a derivative related to warrants outstanding as of September 30, 2011. The literature applies to the Company for certain freestanding warrants that contain exercise price adjustment features known as down round provisions. Based on the guidance we have concluded these instruments are required to be accounted for as a derivative liability effective upon issuance of the warrants in 2009.

We have recorded the fair value of the warrants as a derivative liability in our balance sheet at fair value with changes in the value of the derivative reflected in the consolidated statements of operations as a gain or loss on derivative liability. This derivative instrument is not designated as a hedging instrument.

The derivative has been valued upon issuance and on the balance sheet date using the Black-Scholes model. This valuation is outlined in more detail in the following note “Fair Value of Financial Instruments”.

Fair Value of Financial Instruments

The Company’s financial instruments consist of cash and cash equivalents, accounts receivable, other assets, fixed assets, derivative liability, deferred revenue, accounts payable, accrued liabilities and short-term debt. The estimated fair value of cash, accounts receivable, other assets, accounts payable, deferred revenue and accrued liabilities approximated their carrying amounts due to the short-term nature of these instruments. The carrying value of short-term debt also approximates fair value since their terms are similar to those in the lending market for comparable loans with comparable risks. None of these instruments are held for trading purposes.

The Company utilizes various types of financing to fund its business needs, including debt with warrants attached and other instruments indexed to its stock. The Company reviews its warrants and conversion features of securities issued as to whether they are freestanding or contain an embedded derivative and if so, whether they are classified as a liability at each reporting period until the amount is settled and reclassified into equity with changes in fair value recognized in current earnings. At September 30, 2011, the Company has 2,057,048 warrants outstanding to purchase common stock, the fair values of which are classified as a liability.

Inputs used in the valuation to derive fair value are classified based on a fair value hierarchy which distinguishes between assumptions based on market data (observable inputs) and an entity’s own assumptions (unobservable inputs).

The hierarchy consists of three levels:

· Level one – Quoted market prices in active markets for identical assets or liabilities;
· Level two - Inputs other than level one inputs that are either directly or indirectly observable; and
·

Level three – Unobservable inputs developed using estimates and assumptions, which are developed by the reporting entity and reflect those assumptions that a market participant would use.

Determining which category an asset or liability falls within the hierarchy requires significant judgment. The company evaluates its hierarchy disclosures each quarter. The Company's only asset or liability measured at fair value on a recurring basis is its derivative liability associated with the warrants to purchase common stock (discussed above). The Company classifies the fair value of the derivative liability under level three. The fair value of the derivative liability was calculated using the Black-Scholes model. Under the Black-Scholes model using an expected life of 1.1 years, volatility of 158.97% and a risk-free interest rate of 0.19%, the Company determined the fair value of the derivative liability to be $22,364 as of September 30, 2011.

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The following shows the changes in the derivative liability measured on a recurring basis for the Nine months ended September 30, 2011:

Derivative liability at December 31, 2010	$	6,797
Loss on derivative on balance sheet, valuation date		15,567
Derivative liability at September 30, 2011	$	22,364

There were no instruments valued at fair value on a non-recurring basis as of September 30, 2011 or December 31, 2010.

Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements and Standards

In January 2010, the FASB issued FASB ASU No. 2010-06, “Improving Disclosures about Fair Value Measurements,” which is now codified under FASB ASC Topic 820, “Fair Value Measurements and Disclosures.” This ASU will require additional disclosures regarding transfers in and out of Levels 1 and 2 of the fair value hierarchy, as well as a reconciliation of activity in Level 3 on a gross basis (rather than as one net number). The ASU also provides clarification on disclosures about the level of disaggregation for each class of assets and liabilities and on disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements. FASB ASU No. 2010-06 is effective for interim and annual periods beginning after December 15, 2009, except for the disclosures requiring a reconciliation of activity in Level 3. Those disclosures will be effective for interim and annual periods beginning after December 15, 2010. The adoption of the portion of this ASU effective after December 15, 2009, as well as the portion of the ASU effective after December 15, 2010, did not have an impact on our consolidated financial position, results of operations or cash flows.

In December 2010, the FASB issued FASB ASU No. 2010-28, “When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts,” which is now codified under FASB ASC Topic 350, “Intangibles — Goodwill and Other.” This ASU provides amendments to Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not a goodwill impairment exists. When determining whether it is more likely than not impairment exists, an entity should consider whether there are any adverse qualitative factors, such as a significant deterioration in market conditions, indicating an impairment may exist. FASB ASU No. 2010-28 is effective for fiscal years (and interim periods within those years) beginning after December 15, 2010. Early adoption is not permitted. Upon adoption of the amendments, an entity with reporting units having carrying amounts which are zero or negative is required to assess whether is it more likely than not the reporting units’ goodwill is impaired. If the entity determines impairment exists, the entity must perform Step 2 of the goodwill impairment test for that reporting unit or units. Step 2 involves allocating the fair value of the reporting unit to each asset and liability, with the excess being implied goodwill. An impairment loss results if the amount of recorded goodwill exceeds the implied goodwill. Any resulting goodwill impairment should be recorded as a cumulative-effect adjustment to beginning retained earnings in the period of adoption. This ASU is not expected to have any material impact to our future financial statements.

In December 2010, the FASB issued FASB ASU No. 2010-29, “Disclosure of Supplementary Pro Forma Information for Business Combinations,” which is now codified under FASB ASC Topic 805, “Business Combinations.” A public entity is required to disclose pro forma data for business combinations occurring during the current reporting period. This ASU provides amendments to clarify the acquisition date to be used when reporting the pro forma financial

information when comparative financial statements are presented and improves the usefulness of the pro forma revenue and earnings disclosures. If a public company presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) which occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The supplemental pro forma disclosures required are also expanded to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. FASB ASU No. 2010-29 is effective on a prospective basis for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010, with early adoption permitted. The adoption of this ASU will not have a material effect on our consolidated financial position, results of operations or cash flows.

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Beneficial conversion features

From time to time, the Company may issue convertible notes that have detached warrants and may contain an imbedded beneficial conversion feature. A beneficial conversion feature exists on the date a convertible note is issued when the fair value of the underlying common stock to which the note is convertible into is in excess of the remaining unallocated proceeds of the note after first considering the allocation of a portion of the note proceeds to the fair value of the warrants, if related warrants have been granted. The intrinsic value of the beneficial conversion feature is recorded as a debt discount with a corresponding amount to additional paid in capital. The debt discount is amortized to interest expense over the life of the note using the effective interest method.

Major Customers

The Company sold oil and natural gas production that composed material concentrations of its oil and natural gas revenues as follows:

	Nine months ending	
	September 30, 2011	September 30, 2010
Interconn Resources, Inc.(1)	88%	76%
Plains (1)	12%	22%

(1) The Company does not have a formal purchase agreement with these customers, but sells production on a month-to-month basis at spot prices adjusted for field differentials

Accounts receivable concentrations by purchaser are as follows:

	September 30, 2011	December 31, 2010
Interconn Resources, Inc.(1)	44%	74%
Plains (1)	56%	26%

Accounting estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods reported. Actual results could differ from these estimates.

Significant estimates include volumes of oil and natural gas reserves used in calculating depletion of proved oil and natural gas properties, future net revenues and abandonment obligations, impairment of proved and unproved properties, future income taxes and related assets and liabilities, the fair value of various common stock, warrants and option transactions, and contingencies. Oil and natural gas reserve estimates, which are the basis for unit-of-production depletion and the calculation of impairment, have numerous inherent uncertainties. The accuracy of any reserve estimate is a function of the quality of available data, the engineering and geological interpretation and judgment. Results of drilling, testing and production subsequent to the date of the estimate may justify revision of such estimate. Accordingly, reserve estimates are often different from the quantities of oil and natural gas that are ultimately recovered. In addition, reserve estimates are vulnerable to changes in wellhead prices of crude oil and

natural gas. Such prices have been volatile in the past and can be expected to be volatile in the future.

These significant estimates are based on current assumptions that may be materially affected by changes to future economic conditions such as the market prices received for sales of volumes of oil and natural gas, interest rates, the fair value of the Company's common stock and corresponding volatility, and the Company's ability to generate future taxable income. Future changes to these assumptions may affect these significant estimates materially in the near term.

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Oil and natural gas properties

The Company accounts for its oil and natural gas properties using the successful efforts method of accounting. Under this method, all costs associated with property acquisitions, successful exploratory wells, development wells, and asset retirement obligation assets are capitalized. Additionally, interest is capitalized while wells are being drilled and the underlying property is in development. Costs of exploratory wells are capitalized pending determination of whether each well has resulted in the discovery of proved reserves. Oil and natural gas mineral leasehold costs are capitalized as incurred. Items charged to expense generally include geological and geophysical costs, costs of unsuccessful exploratory wells, and oil and natural gas production costs. Capitalized costs of proved properties including associated salvage are depleted on a well-by-well or field-by-field (common reservoir) basis using the units-of-production method based upon proved producing oil and natural gas reserves. The depletion rate is the current period production as a percentage of the total proved producing reserves. The depletion rate is applied to the net book value of property costs to calculate the depletion expense. Proved reserves materially impact depletion expense. If the proved reserves decline, then the depletion rate (the rate at which we record depletion expense) increases, reducing net income. Dispositions of oil and natural gas properties are accounted for as adjustments to capitalized costs with a gain or loss recognized upon sale. A gain (loss) is recognized to the extent the sales price exceeds or is less than original cost or the carrying value, net of impairment. Oil and natural gas properties are also subject to impairment testing at the end of each fiscal year, or whenever impairment indicators are prevalent. Unproved property costs are excluded from depletable costs until the related properties are developed. See impairment discussed in "Long-lived assets and intangible assets" below.

We depreciate other property and equipment using the straight-line method based on estimated useful lives ranging from five to ten years.

Long-lived assets and intangible assets

The Company accounts for intangible assets in accordance with the applicable FASB standard. Intangible assets that have defined lives are subject to amortization over the useful life of the assets. Intangible assets held having no contractual factors or other factors limiting the useful life of the asset are not subject to amortization but are reviewed at least annually for impairment or when indicators suggest that impairment may be needed. Intangible assets that are being amortized are subject to impairment review when there is an indication that an asset has been impaired.

For unproved property costs, management reviews these investments for impairment on a property-by-property basis if a triggering event should occur that may suggest that impairment may be required.

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the carrying amount of the asset, including any intangible assets associated with that asset, exceeds its estimated future undiscounted net cash flows, the Company will recognize an impairment loss equal to the difference between its carrying amount and its estimated fair value. The fair value used to calculate the impairment for producing oil and natural gas field that produces from a common reservoir is first determined by comparing the undiscounted future net cash flows associated with total proved properties to the carrying value of the underlying evaluated property. If the cost of the underlying evaluated property is in excess of the undiscounted future net cash flows, the future net cash flows are discounted at 10%, which the Company believes approximates fair value, to determine the amount of impairment.

During the Nine months ended September 30, 2011 the company noted impairment indicators on intangible assets related to investments in drilling technology. The investments were fully impaired for a loss of $6,978 as the fair value of the asset was determined to be zero.

Note receivable

The Company realized that a note for $50,000 was uncollectable after discussion with the third party. Therefore, the note was written off to bad debt expense during the Nine months ended September 30, 2011.

Asset retirement obligation

The FASB standard on accounting for asset retirement obligation requires that the fair value of the liability for asset retirement costs be recognized in an entity's balance sheet, as both a liability and an increase in the carrying values of such assets, in the periods in which such liabilities can be reasonably estimated. The present value of the estimated future asset retirement obligation ("ARO"), as of the date of acquisition or the date at which a successful well is drilled, is capitalized as part of the costs of proved oil and natural gas properties and recorded as a liability. The asset retirement costs are depleted over the production life of the oil and natural gas property on a unit-of-production basis.

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The ARO is recorded at fair value and accretion expense is recognized as the discounted liability is accreted to its expected settlement value. The fair value of the ARO liability is measured by using expected future cash outflows discounted at the Company's credit adjusted risk free interest rate.

Amounts incurred to settle plugging and abandonment obligations that are either less than or greater than amounts accrued are recorded as a gain or loss in current operations. Revisions to previous estimates, such as the estimated cost to plug a well or the estimated future economic life of a well, may require adjustments to the ARO and are capitalized as part of the costs of proved oil and natural gas property.

The following table is a reconciliation of the ARO liability for continuing operations for the Nine months ended September 30, 2011:

		September 30, 2011
Asset retirement obligation at beginning of period	$	1,519,600
Wells plugged and abandoned		(5,721)
Accretion expense		122,541
Asset retirement obligation at end of period	$	1,636,420

Income taxes

The Company accounts for income taxes in accordance with the provisions of the applicable FASB standard. Deferred income taxes reflect the impact of temporary differences between the amount of assets and liabilities for financial reporting purposes and such amounts as measured by tax laws and regulations. Deferred tax assets include tax loss and credit carry forwards and are reduced by a valuation allowance if, based on available evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized.

On January 1, 2007, the Company adopted the FASB Interpretation on accounting for uncertainty in income taxes. The interpretation prescribes a measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. Additionally, the interpretation provides guidance regarding uncertain tax positions relating to de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company will classify any interest and penalties associated with income taxes as interest expense. As of September 30, 2011, the Company had no uncertain tax positions.

Stock based compensation

Beginning January 1, 2006, the Company adopted the FASB standard for accounting for stock based compensation to account for its Incentive Compensation Plan (the "2005 Incentive Plan"). The standard requires all share-based payments to employees (which includes non-employee Board of Directors), including employee stock options, warrants and restricted stock, be measured at the fair value of the award and expensed over the requisite service period (generally the vesting period). The fair value of common stock options or warrants granted to employees is estimated at the date of grant using the Black-Scholes option pricing model by using the historical volatility of comparable public companies. The calculation also takes into account the common stock fair market value at the grant date, the exercise price, the expected life of the common stock option or warrant, the dividend yield and the risk-free interest rate.

Under the 2005 Incentive Plan, the Company from time to time may issue stock options, warrants and restricted stock to acquire goods or services from third parties. Restricted stock, options or warrants issued to other than employees or directors are recorded on the basis of their fair value, which is measured as of the date issued. The options or warrants are valued using the Black-Scholes option pricing model on the basis of the market price of the underlying equity instrument on the "valuation date," which for options and warrants related to contracts that have substantial disincentives to non-performance, is the date of the contract, and for all other contracts is the vesting date. Expense related to the options and warrants is recognized on a straight-line basis over the shorter of the period over which services are to be received or the vesting period.

Revenue Recognition

The Company recognizes oil, gas and natural gas condensate revenue in the period of delivery. Settlement on sales occurs anywhere from two weeks to two months after the delivery date. The Company recognizes revenue when an arrangement exists, the product has been delivered, the sales price is fixed or determinable, and collectability is reasonably assured.

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Earnings per share

Basic earnings per share are computed using the weighted average number of common shares outstanding. Diluted earnings per share reflect the potential dilutive effects of common stock equivalents such as options, warrants and convertible securities. Due to the Company incurring a net loss from continuing operations during the Nine months ended September 30, 2011 and 2010, basic and diluted loss per share are the same as all potentially dilutive common stock equivalents are anti-dilutive.

Restricted Cash

This account is held by our attorney in a trust account for security reasons. The company requests funds as needed for operations.

Note 3 – Derivative Liability

Derivative

On August 21, 2009, and amended on September 25, 2009, the Company and YA Global entered into a Standby Equity Distribution Agreement, or SEDA, pursuant to which, for a two-year period, we have the right to sell shares of our common stock to YA Global. On August 21, 2009, we issued 260,000 shares of our common stock to YA Global in lieu of payment of a $65,000 commitment fee. As part of the transaction, we also issued YA Global a warrant to buy 1,500,000 shares of our common stock at $7.50 per share. On March 8, 2010 the Agreement was mutually terminated with no further liability to the Company. The warrants remained outstanding to YA Global after termination.

On January 1, 2009, the Company adopted Topic No. 815, and as a result the 1,500,000 warrants issued by the Company containing exercise price reset provisions, were classified as a derivative liability as of August 21, 2009 as these warrants were not deemed to be indexed to the Company's own stock. These warrants had an exercise price of $7.50 at issuance and expire in August 2012. The exercise price was ratcheted down to $5.47 at September 30, 2011 based on the ratchet provisions in the warrant agreement. Also, as a part of the agreement, an additional 557,448 warrants were available to be exercised by YA global. This totals 2,057,448 warrants due to the anti-dilution provision as of September 30, 2011. As of September 30, 2011 and December 31, 2010, the fair value of these warrants was $22,364 and $6,797, respectively. The change in fair value during the period ended September 30, 2011 and 2010 was $15,567 and $67,561 and was recorded as a derivative loss in the accompanying Consolidated Statements of Operations.

Note 4 – Debt

Notes payable consists of the following at September 30, 2011 and December 31, 2010:

	September, 2011	December 31, 2010
Notes payable	$ 612,500	$ 612,500
Notes payable in default	$ 625,000	$ 625,000
Related party notes payable	$ 3,175,000	$ 4,675,000
Related party notes payable in default	$ 8,799,940	$ 7,370,333

Convertible notes payable, related party in default	$	700,000	$	700,000
Debt balance prior to discounts	$	13,912,440	$	13,982,833
Less unamortized debt discount	$	(223,874)	$	(1,852,225)
Debt balance net of discounts	$	13,688,566	$	12,130,608
Less current maturities:				
Current portion, non-convertible	$	(12,988,566)	$	(11,430,608)
Current Portion, convertible notes payable, related party, net of discount	$	(700,000)	$	(700,000)
Notes payable, net of current maturities and discount	$	-	$	-

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The Company has a note payable for a loan taken in 2005 from an individual investor aggregating $400,000 at September 30, 2011. This note payable matured on September 30, 2007 bearing interest at fixed rate of 18%. Interest will accrue from the note issue date and is due and payable either at maturity or quarterly or semi-annually until maturity. The Company is in default on this note as of September 30, 2011. Accrued interest on this note as of September 30, 2011 is $306,000.

During 2008, the Company borrowed $100,000 from an individual at an interest rate of 18% with maturity date of April 2, 2010. Simple interest accrues from the note issue date and is due and payable monthly. This note is in default at September 30, 2011. Accrued interest on this note as of September 30, 2011 is $3,750.

During 2008, the Company borrowed $100,000 from an individual at an interest rate of 15% with a one year maturity. Simple interest accrues from the note issue date and is due and payable monthly. This note is in default at September 30, 2011. Accrued interest on this note as of September 30, 2011 is $4,500.

During 2009, the Company borrowed $25,000 due and payable on December 31, 2009 at an interest rate of 8%. Simple interest accrues from the note issue date and is due and payable either at maturity or quarterly or semi-annually until maturity. This note is in default at September 30, 2011. Accrued interest on this note as of September 30, 2011 is $2,312.

During 2009, the Company borrowed $1,500,000 due and payable on June 30, 2010 from a related party at an interest rate of 15%. Simple interest accrues from the note issue date and is due and payable at maturity. This funding was restricted funds to bring the Delhi field wells back into production and settle certain liabilities related to an environmental claim. The Company issued 200,000 shares of common stock as an inducement to the lender. The 200,000 shares were valued at the closing price on the date of issuance equaling a total of $300,000. This value was taken as a discount on debt. The discount was amortized over the life of the note according to the effective interest method. The Company received $1,477,271 of the total $1,500,000 funds related to the note. The difference of $22,729 was paid for offering costs associated with the loan. These costs have been capitalized and were amortized according to the effective interest method over the life of the loan. This note is in default at September 30, 2011. In accordance with the terms of the agreement, 3,000,000 shares previously held in escrow were issued to the lender due to the default. The shares were valued at the inception of the agreements in 2009 at $4,500,000 and were expensed in the period ended June 30, 2010 upon default. Due to the anti-dilution provision of the agreement, 3,281,848 additional shares were also expensed at the value of $461,734 calculated periodically whenever a diluting event occurred prior to default. Accrued interest on this note as of September 30, 2011 is $506,250.

During 2009, the Company borrowed an additional $1,000,000 from this related party that was due and payable on October 31, 2010 at an interest rate of 15%. Simple interest accrues from the note issue date and is due and payable at maturity. This funding was restricted funds to bring the Delhi field wells back into production and settle certain liabilities related to an environmental claim. The Company issued 1,000,000 shares of common stock as an inducement to the lender, valued at the closing price on the date of issuance equaling a total of $60,000. This value was taken as a discount on debt. The discount was amortized over the life of the note according to the effective interest method. Accrued interest on this note as of September 30, 2011 is $287,500.

In conjunction with the previous two loans, the Company issued to Lender a term assignment of an overriding royalty interest in the Delhi Field equal to fifteen percent of eight-eighths (15% of 8/8") and ten percent of eight-eighths (10% of 8/8") of all Hydrocarbons produced and saved from or attributable or allocable to the Delhi Field net of severance taxes owing with respect thereto through December 31, 2011. Further, if a total of $7,500,000 (including the principal and interest repayments on the two notes above) is not paid by December 31, 2011, the Company will make a cash payment to cover the deficiency. The balance owed related to the overriding interest only of $5,000,000 was fully discounted upon issuance due to its attachment to the notes payable of $1,500,000, and $1,000,000. The discounts

were amortized over the term of the notes payable. Amortization on the discounts related to the overriding royalty interest and the aforementioned discounts due to shares issued with the debt was $0 and $3,097,056 for the periods ending September 30, 2011 and 2010, respectively. The discount was fully amortized as of September 30, 2011. During the periods ending September 30, 2011 and 2010 overriding royalty payments were made against the $5,000,000 balance of $70,392 and $59,994. As of September 30, 2011 $7,299,941 was owed for these notes and related balloon payments. The net balance has been presented within related party notes payable in default on the balance sheet.

During the quarter ended June 30, 2010, the Company borrowed an additional $1,500,000 from this related party that was due and payable on April 01, 2011 at an interest rate of 15%. Simple interest accrues from the note issue date and is due and payable at maturity. This funding was restricted funds to bring the Delhi field wells back into production. The Company issued 1,500,000 shares of common stock as an inducement to the lender, valued at the closing price on the date of issuance equaling a total of $210,000. This value was taken as a discount on debt. The discount was fully amortized as of September 30, 2011. The discount is being amortized over the life of the note according to the effective interest method. As of October 1, 2010, each of the Notes and the respective notes given pursuant to the Original Amended Agreement and the Second Loan Agreement have not been paid in full, the Company therefore after written notice from the Lender, could begin marketing for sale the properties encumbered by the Mortgages. The Delhi and Belton field are used as collateral for the notes. Accrued interest on this note as of September 30, 2011 is $337,500.

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During 2009 The Company issued originally 5,000,000 default shares of common stock valued at $4,620,000 that were held in escrow as insurance to the lenders and will be remitted back to the Company if the note is paid in full with 15% interest. As of July 1, 2010, the Company was in default on the first loan Agreement and 3,000,000 of these shares were assumed by the lender due to default on the first note agreement. The company valued these shares according to the closing price of the shares on the date of issuance. As of November 1, 2010, the Company was in default on the second loan Agreement, and 2,000,000 shares were assumed by the lender from the escrow.

During 2010, the Company issued 3,000,000 default shares in relation to the 2nd quarter 2010 funding (the third loan Agreement) to be held in escrow as insurance to the lenders if the note is not fully paid with 15% interest by April 1, 2011. Shares were valued on the date of grant to be $420,000. Additional shares were owed related to these default shares valued at $27,287. The Company failed to meet the deadline and defaulted on this note subsequent to the balance sheet date. As a result, the remaining shares held in escrow were issued to the lender in April of 2011, and the value of the shares issued and owed of $447,287 was expensed at the time.

During the 4th quarter 2010, The Company borrowed an additional $1,000,000 from this related party that was due and payable on June 30, 2011 at an interest rate of 15%. Simple interest accrues from the note issue date and is due and payable at maturity. This funding was restricted funds to bring the Delhi field back into production and settle certain other liabilities. The Company was actively pursuing a financing to relieve all debt per the Agreements with this third party. The Company agreed to pay back $3,000,000 for the $1,000,000 cash received. The $2,000,000 shortfall was recorded as a discount. Amortization was $894,357 for the Nine months ended September 30, 2011. The remaining discount as of September 30, 2011 is $889,041. Accrued interest on this note as of September 30, 2011 is $139,555

The Company has an anti-dilution clause with the lender that any shares of capital stock (excluding the Default Shares) held by the Lender or any affiliate thereof shall represent an agreed upon percentage of all of the issued and outstanding shares of capital stock of Borrower computed on a fully diluted basis as of the date hereof, which Percentage Interest is 21.31% with funding of the third loan. Lender shall at all times from and after the Loan Date hold a minimum equity interest in Borrower equal to the Percentage Interest, and Borrower shall not, and shall not permit any of its Subsidiaries to, take any action that in any way dilutes or impairs the Percentage Interest at any time. In the event Borrower shall (a) issue or sell (i) Equity Interests of Borrower or any of its Subsidiaries, or (ii) any options, warrants, rights, debt securities, promissory notes, or other securities exercisable or exchangeable for or convertible into shares of capital stock of Borrower or any Subsidiary thereof, (b) declare or pay any dividend or other distribution to holders