CHINA NORTH EAST PETROLEUM HOLDINGS LTD
Form 10QSB
August 15, 2005

U.S. Securities and Exchange Commission
Washington, D.C. 20549

FORM 10-QSB

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended June 30, 2005**

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from _______ to _______**

CHINA NORTH EAST PETROLEUM HOLDINGS LTD.
(Exact name of small business issuer as specified in its charter)

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

20337 Rimview Place, Walnut, CA 91789
(Address of principal executive offices)

(909) 468-2840
(Issuer's telephone number, including area code)

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

Number of shares of common stock outstanding as of August 5, 2005: 18,274,080

Number of shares of preferred stock outstanding as of August 5, 2005: -0-

ITEM 1.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
Condensed Consolidated Balance Sheet
At June 30, 2005 (Unaudited)

ASSETS

CURRENT ASSETS		
Cash and cash equivalents	$	116,103
Other receivables and prepaid expenses		193,849
Total Current Assets		309,952
OIL AND GAS PROPERTIES, NET		4,642,600
FIXED ASSETS, NET		197,280
TOTAL ASSETS	$	5,149,832
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$	408,917
Other payables and accrued liabilities		751,681
Due to directors and stockholders		2,380,700
Income tax payable		580,366
Total Current Liabilities		4,121,664
COMMITMENTS AND CONTINGENCIES		-
STOCKHOLDERS' EQUITY		
Common stock, $0.001 par value, 50,000,000 shares authorized,		
18,274,080 shares issued and outstanding		18,274
Additional paid-in capital		1,334,841
Retained earnings		
Unappropriated		(380,755)
Appropriated		55,808
Total Stockholders' Equity		1,028,168
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$	5,149,832

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

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CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
For the three months and six months ended June 30, 2005 and 2004(Unaudited)

	Three months ended June 30, 2005	2004	Six months ended June 30 2005	2004
REVENUE	$ 315,771	$ 352,377	$ 666,884	$ 799,985
COST OF SALES				
Production cost	58,123	94,619	65,775	259,022
Management fees paid	6,425	7,048	13,338	16,000
Resource tax	1,674	2,593	3,757	6,181
Depreciation and amortization	5,602	11,609	13,463	24,149
Total cost of sales	71,824	115,869	96,333	305,352
GROSS PROFIT	243,947	236,508	570,551	494,633
OPERATING EXPENSES				
General and administrative expenses	43,496	86,903	81,010	108,580
Professional fees	3,500	-	7,000	-
Consulting fee	-	180,362	948,000	180,362
Depreciation and amortization	7,676	5,852	15,353	11,205
Total Operating Expenses	54,672	273,117	1,051,363	300,147
INCOME (LOSS) FROM OPERATIONS	189,275	(36,609)	(480,812)	194,486
OTHER INCOME (EXPENSE)				
Other expenses	-	28	-	(1,449)
Interest expense	(33,656)	(24,128)	(68,098)	(24,126)
Interest income	230	8	238	8
Profit on disposal of oil and gas properties	-	-	1,456	-
Total Other Expenses	(33,426)	(24,092)	(66,404)	(25,567)
INCOME (LOSS) FROM OPERATIONS BEFORE TAXES	155,849	(60,701)	(547,216)	168,919
INCOME TAX EXPENSE	61,993	53,031	148,934	129,293
NET INCOME (LOSS)	$ 93,856	$ (113,732)	$ (696,150)	$ 39,626
Net income (loss) per share-basic and diluted	$ 0.01	$ (0.01)	$ (0.04)	$ 0.01

Weighted average number of shares outstanding during the period				
basic and diluted	18,274,080	19,499,387	18,479,997	19,099,693

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

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
Condensed Consolidated Statement of Cash Flows
For the six months ended June 30, 2005 and 2004 (Unaudited)

		2005		2004
CASH FLOWS FROM OPERATING ACTIVITIES				
Net (loss) income	$	(696,150)	$	39,626
Adjusted to reconcile net income to cash (used in) provided by operating activities:				
Amortization of oil and gas properties		13,463		24,149
Depreciation of fixed assets		15,353		11,205
Profit on disposal of oil and gas properties		(1,456)		-
Stocks issued for services		948,000		-
Imputed interest expense		68,098		24,126
Changes in operating assets and liabilities				
(Increase) decrease in:				
Other receivables and prepaid expenses		(170,794)		(94,155)
Increase (decrease) in:				
Accounts payable		(487)		(261,537)
Other payables and accrued liabilities		(413,707)		(455,698)
Deferred taxation		-		(131,493)
Income tax payable		148,934		260,544
Net cash (used in) operating activities		(88,746)		(583,232)
CASH FLOWS FROM INVESTING ACTIVITIES				
Proceeds on disposal of oil and gas properties		182,005		-
Purchase of fixed assets		(2,114)		(13,043)
Net cash provided by (used in) investing activities		179,891		(13,043)
CASH FLOWS FROM FINANCING ACTIVITIES				
Decrease in additional paid-in capital		-		(504,874)
Due to a director and stockholder		24,171		1,141,452
Net cash provided by financing activities		24,171		636,578
NET INCREASE IN CASH AND CASH EQUIVALENTS		115,316		40,303
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD		787		7,699
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$	116,103	$	48,002

Supplemental disclosures of non cash financing activities:				
Imputed interest on advances from directors and stockholders	$	68,098	$	24,126

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

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CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED
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NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
AS OF JUNE 30, 2005
(UNAUDITED)

NOTE 1 BASIS OF PRESENTATION

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

In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments consisting only of normal recurring accruals considered necessary to present fairly the Company's financial position at June 30, 2005, the results of operations for the three months and six months ended June 30, 2005 and 2004, and cash flows for the six months ended June 30, 2005 and 2004. The results for the six months ended June 30, 2005 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2005. These financial statements should be read in conjunction with the Company's annual report on Form 10-KSB as filed with the Securities and Exchange Commission.

NOTE 2 REVERSE MERGER

China North East Petroleum Holdings Limited (“North East Petroleum”) is a US listed company which was incorporated in Nevada on August 20, 1999 under the name of Draco Holding Corporation (“Draco”). Draco is authorized to issue 20,000,000 shares of common stock of $0.001 par value. On June 28, 2004, the Articles of Incorporation were amended to change the name of the Company to China North East Petroleum Holdings Limited and its authorized shares of common stock was increased from 20,000,000 to 50,000,000. On July 21, 2005, the Definitive 14C was filed with the Securities and Exchange Commission to increase its authorized shares of common stock from 50,000,000 to 150,000,000. The corresponding Articles of Amendment is expected to be filed with the State of Secretary of Nevada on August 11, 2005.

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

On December 5, 2003, Song Yuan City Hong Xiang Petroleum Technical Services Co., Ltd. (“Hong Xiang Technical”) was incorporated in the People’s Republic of China (“PRC”) as a limited liability company with a registered capital of $484,000. Hong Xiang Technical provides technical advisory services to oil and gas exploration companies in the PRC.

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

During 2004, Hong Xiang Technical acquired a 100% interest in Song Yuan City Yu Qiao Qianan Hong Xiang Oil and Gas Development Co., Ltd. (“Hong Xiang Oil Development”), a limited liability company incorporated on April 1, 2003 in the PRC with a registered capital of $604,800.

Hong Xiang Oil Development is engaged in the exploration and production of crude oil in Jilin Oil Region, the PRC. Subsequent to the Cooperative Exploration Contract entered into by the non-operating interest owner and Jilin Office, PetroChina Group ("Sub-Owner") in December 2002, Hong Xiang Oil Development entered into another Cooperative Exploration Contract (the "Contract") with the non-operating interest owner in respect of the development rights to the proven reserves in the Qian'an Oil Field Zone 112 ("Qian'an 112") in Jilin Oil Region for 20 years (the "Contract Period").

In accordance with the Contract, Hong Xiang Oil Development is responsible to provide working capital to develop the oil reserves in Qian'an 112. Production from Qian'an 112 is shared in the following manner:-

Contract period	For Sub-Owner	For the Company
First 10 years	20%	80%
Remaining 10 years	40%	60%

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The acquisition of Hong Xiang Oil Development by Hong Xiang Technical has been accounted for as a reorganization of entities under common control as the companies were beneficially owned by principally identical shareholders and share common management. The financial statements have been prepared as if the reorganization had occurred retroactively.

On March 29, 2004, Draco executed a Plan of Exchange ("the Agreement") with all the shareholders of Hong Xiang Petroleum Group to exchange 18,700,000 shares of common stock of Draco for 100% of the outstanding shares of Hong Xiang Petroleum Group.

The Agreement was consummated on April 30, 2004. As a result of the Agreement, the exchange of shares with Hong Xiang Petroleum Group have been accounted for as a reverse acquisition under the purchase method of accounting since the shareholders of Hong Xiang Petroleum Group obtained control of the consolidated entity ("North East Petroleum"). Accordingly, the merger of North East Petroleum and Hong Xiang Petroleum Group has been recorded as a recapitalization by Hong Xiang Petroleum Group, with Hong Xiang Petroleum Group being treated as the continuing entity. The financial statements have been prepared as if the reorganization had occurred retroactively. North East Petroleum, Hong Xiang Petroleum Group, Hong Xiang Technical and Hong Xiang Oil Development are hereafter referred to as ("the Company").

Accordingly, the financial statements include the following:

a) The balance sheet consists of the net assets of the acquirer at historical cost and the net assets of the acquiree at historical cost; and

b) The statements of operations include the operations of the acquirer for the years presented and the operations of the acquiree from the date of the merger.

The financial statements of the acquiree are not significant. Therefore, no pro forma financial statements are submitted.

In addition to the completion of the Exchange, on April 30, 2004, Draco executed a Distribution Agreement with its wholly-owned subsidiary, Jump'n Jax, Inc., a Utah corporation ("Jump'n Jax") pursuant to which the Company agreed to distribute all of the outstanding shares of Jump'n Jax as a dividend to the shareholders of record of Draco as of March 8, 2004. Under the Distribution Agreement, the effective date of the dividend distribution was also April 30, 2004.

NOTE 3 PRINCIPLES OF CONSOLIDATION

The accompanying unaudited condensed consolidated financial statements for 2005 and 2004 include the financial statements of North East Petroleum and its wholly owned subsidiaries, Hong Xiang Petroleum Group, Hong Xiang Technical and Hong Xiang Oil Development. All significant inter-company accounts and transactions have been eliminated in consolidation.

NOTE 4 USE OF ESTIMATES

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount 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 those estimates.

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NOTE 5 OIL AND GAS PROPERTIES

The Company follows the full cost method of accounting for oil and gas properties. Accordingly, all costs associated with the acquisition of development rights and development of oil reserves, including directly related overhead costs, are capitalized.

Depreciation, depletion and amortization of capitalized costs, excluding unproved properties, are based on the unit-of-production methods based on proved reserves. Investments in unproved properties and major development projects are not amortized until proved reserves associated with the projects can be determined or until impairment occurs. If the results of an assessment indicate that the properties are impaired, the amount of the impairment is added to the capitalized costs to be amortized.

In addition, the capitalized costs are subject to a “ceiling test”, which basically limits such costs to the aggregate of the “estimated present value”, discounted at a 10-percent interest rate of future net revenues from proved reserves, based on current economic and operating conditions, plus the lower of cost or fair market value of unproved properties.

Sales of portion of development rights and other proved and unproved properties are accounted for as adjustments of capitalized costs with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proved reserves of oil and gas, in which case the gain or loss is recognized in income.

Abandonment of oil and gas properties other than the development rights are accounted for as adjustments of capitalized costs with no loss recognized.

NOTE 6 EARNINGS PER SHARE

Basic earnings per share are computed by dividing income available to common stockholders by the weighted average number of common stocks outstanding during the period. Diluted income per share is computed similar to basic income per share except that the denominator is increased to include the number of additional common stocks that would have been outstanding if the potential common stocks had been issued and if the additional common stocks were diluted. There are no potentially dilutive securities for 2005 and 2004.

NOTE 7 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, the management believes that there are no probable liabilities that will have a material adverse effect on the financial position of the Company.

NOTE 8 SHAREHOLDERS’ EQUITY

(A) Stock issuances

On March 29, 2004, the Company executed a Plan of Exchange pursuant to which the Company agreed to issue 18,700,000 new shares of common stock to the shareholders of Hong Xiang Petroleum Group in exchange for 100% of registered capital of Hong Xiang Petroleum Group. The Plan of Exchange was consummated on April 30, 2004.

During 2004, North East Petroleum issued 1,199,080 shares of common stock for the recapitalization with Hong Xiang Petroleum Group (see Note 2).

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During 2004, the Company issued 90,000 and 100,000 shares of common stock for consulting services. The stock was valued at the closing price on the date of grant, or at $1.11 and $0.45 per share respectively, yielding an aggregate value of $99,900 and $45,000 respectively. The expense of the services was charged to operations in 2004.

During January 2005, a stockholder of the Company returned 2,715,000 shares of common stock to the Company.

During February 2005, the Company issued 750,000 and 150,000 shares of common stock for consulting services. The stock was valued at the closing price on the date of grant, or at $1.08 and $0.92 per share respectively, yielding an aggregate value of $810,000 and $138,000 respectively. The expense of the services was charged to operations in the accompanying financial statements.

(B) Appropriated retained earnings

The Company’s PRC subsidiaries are required to make appropriations to reserve funds, comprising the statutory surplus reserve, statutory public welfare fund and discretionary surplus reserve, based on after-tax net income determined in accordance with generally accepted accounting principles of the People’s Republic of China (the “PRC GAAP”). Appropriations to the statutory surplus reserve should be at least 10% of the after tax net income determined in accordance with the PRC GAAP until the reserve is equal to 50% of the entities’ registered capital. Appropriations to the statutory public welfare fund are at 5% to 10% of the after tax net income determined in accordance with the PRC GAAP. The statutory public welfare fund is established for the purpose of providing employee facilities and other collective benefits to the employees and is non-distributable other than in liquidation. Appropriations to the discretionary surplus reserve are made at the discretion of the Board of Directors.

During 2005 and 2004, the Company appropriated $55,808 and $0, respectively to the reserve funds based on its net income under the PRC GAAP.

NOTE 9 RELATED PARTY TRANSACTIONS

Two directors and stockholders made interest free advances totaling $2,380,700 to the Company as of June 30, 2005 as unsecured loans. The advances are repayable upon demand. Total interest expense imputed at the rate of 6% per annum included in additional paid in capital amounted to $68,098 and $24,126 for the six months ended June 30, 2005 and 2004 respectively.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

The discussion contained in this Form 10-QSB contains "forward-looking statements" that involve risk and uncertainties. These statements may be identified by the use of terminology such as "believes", "expects", "may", or "should" or "anticipates", or expressing this terminology negatively or similar expressions or by discussions of strategy. The cautionary statements made in this Form 10-QSB should be read as being applicable to all related forward-looking statements wherever they appear in this Form 10-QSB. Our actual results could differ materially from those discussed in this Form 10-QSB. Important factors that could cause or contribute to such differences include those discussed under the caption entitled "risk factors," as well as those discussed elsewhere in this Form 10-QSB.

OUR COMPANY

We were incorporated in the State of Nevada on August 20, 1999. Since 2004, we have been engaged in the extraction and production of crude oil in Jilin Province, People's Republic of China, through Song Yuan City Yu Qiao Qianan Hong Xiang Oil and Gas Development Co., Limited, our wholly-owned subsidiary organized and existing under the laws of the People's Republic of China. The oil field is called Jilin Qian'an Oil Field Zone 112 ("Qian'an 112"), located at 9 kilometers southwest of Qian'an City with a total exploration area of 20.7 square kilometers. Pursuant to a 20-year exclusive Cooperative Exploration Contract (the "Contract") signed between and among PetroChina Group, a corporation organized and existing under the laws of the People's Republic of China ("PetroChina"), Song Yuan City Yu Qiao Oil and Gas Exploration Limited Corp., a corporation organized and existing under the laws of the People's Republic of China ("Yu Qiao") and us, we have the right to explore and pump oil at Qian'an 112 and take responsibility for well logging, drill-stem testing and core sampling. PetroChina will take 20% of our output in the first ten years and then 40% of our output until the end of the Contract; and Yu Qiao will take 2% of our output as a management fee for managing the process of oil production.

We are also seeking the opportunities to acquire additional extraction rights in other portions of the Qian'an Field or in other newly discovered fields.

Results of Operations.

Sales.
We recorded revenue of $315,771 and $666,884 for the three-month and six-month periods ended June 30, 2005, respectively, versus sales revenue of $352,377 and $799,985 for the same periods ended in 2004. The decrease in 2005 was a result of decreased drilling output in the six months of 2005. Some of the pipes and equipments were maintained periodically. Our limited capital investment restricted our ability to finish the maintenance in time, resulting approximately 10% of the drilling equipments stopped operating.

Cost of Sales.

Costs of sales for the three-month and six-month periods ended June 30, 2005 were $71,824 and $96,333, respectively, or approximately 22.7% and 14.4% of sales, respectively, compared to $115,869 and $305,352 for the same periods ended June 30, 2004. A decrease of approximately $209,019 or 68.5% in the six months of 2005 was due primarily the result of decreased cost of oil drilling operation and decreased depreciation and amortization charge.

Depreciation, depletion, and amortization costs for the three months and six months ended June 30, 2005 were $5,602 and $13,463, respectively, compared to $11,609 and $24,149 for the same periods ended June 30, 2004. The decrease in 2005 was due to the disposal of oil and gas properties in the first quarter of 2005.

We expect to keep cost of sales as a percentage of sales relatively low because we have short-distance delivery which enables for us to control production costs such as storage and delivery cost.

Expenses.

Operating expenses for the three months and six months ended June 30, 2005 were $54,672 and $1,051,363, respectively, compared to $273,117 and $300,147 for the same periods ended June 30, 2004. The increase during the six months of 2005 was due primarily to the costs of consulting fees, which amounted to $948,000.

Income Taxes

Income taxes are provided in accordance with Statement of Financial Accounting Standards No. 109 (SFAS No. 109), "*Accounting for Income Taxes*." A deferred tax asset or liability is recorded for all temporary differences between financial and tax reporting and net operating loss-carryforwards.

Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that, some portion or all of the deferred tax asset will not be realized. Deferred tax assets and liabilities are adjusted for the effect of changes in tax laws and rates on the date of enactment. We currently do not have any deferred tax assets.

Net Income / Loss

We had a net loss of $696,150, or $0.04 per common share, for the six months ended June 30, 2005, versus a net income of $39,626, or less than $0.01 per common share, for the same period ended June 30, 2004. The increase in net loss in the six months of 2005 was due primarily to the consulting fees of $948,000 and imputed interest expenses of $68,098 for the six months ended June 30, 2005, versus the consulting fees of $180,362 and imputed interest expenses of $24,126 for the same period ended in 2004.

Impact of Inflation.

We believe that inflation has had a negligible effect on operations since inception. We believe that we can offset inflationary increases in the cost of operations by increasing sales and improving operating efficiencies.

Oil Pricing

Oil prices were near record levels for most of the six months of 2005. Our oil prices are largely determined by oil prices in the world market. Global supply and demand and geopolitical factors are the key determinants of oil prices. The rapid growth of energy use in developing countries, most notably China, is driving a rapid increase in worldwide oil consumption. Higher prices could result in reduced consumption and/or increasing supplies that could moderate the current high price levels. Over the past several years oil has been an increasing part of our production mix. As a result higher oil prices have contributed to the increased revenue from crude oil sales more than in the past, and we would suffer a greater impact if oil prices were to decrease.

Liquidity and Capital Resources.

On June 30, 2005, we had cash of $116,103 and working capital deficit of $3,811,712. The working capital deficit was due primarily to the other payable and accrued liabilities of $751,681, which was related to the management fee payable to Yu Qiao, and the director and stockholder loan of $2,380,700, which was related to our initial investment in oil and gas properties.

On June 30, 2004, we had cash of $48,002 and working capital deficit of $4,493,316. The working capital deficit was due primarily to the other payable and accrued liabilities of $1,792,466, which was attributable to the management fee payable to Yu Qiao, and the director and stockholder loan of $2,405,314 for the initial investment.

Net cash flows used in operating activities were $88,746 for the six months ended June 30, 2005 as compared with net cash flows used in operating activities of $583,232 for the same period in 2004. The decrease in cash used in operations was primarily attributable to the stocks issued for services in lieu of cash payments, none of deferred tax in the six months of 2005, partially offset by the increase in other receivables and prepaid expenses.

Net cash flows provided by investing activities were $179,891 for the six months ended June 30, 2005 as compared with net cash flows used in investing activities of $13,043 for the same period in 2004. The cash flows provided by investment in the six months of 2005 were primarily attributable to the disposal of oil and gas properties, offset by the purchase of fixed assets. The cash flows used in investment in the six months of 2004 were due to the purchase of oil and gas properties.

Net cash flows provided by financing activities were $24,171 for the six months ended June 30, 2005 as compared with net cash flows provided by financing activities of $636,578 for the same period in 2004. The cash flows provided by financing activities in the six months of 2005 and 2004 were due primarily to the further advances from directors and stockholders.

Overall, the estimated capital investment required to fully develop Qian'an 112 is approximately $23 million. If we raise the funds through issuance of equity related or debt securities, such securities may have rights to obtain our common stock, such as warrants or options. Shareholders may experience additional dilution from exercise of these financial instruments. We cannot be certain that additional financing will be available when required or at all. If we raise capital successfully, we will seek to acquire additional extraction rights in other portions of the Qian'an Field or in other newly discovered fields. If we are unable to receive additional cash from our majority stockholder, we may need to rely on financing from outside sources through debt or equity transactions. Failure to obtain such financing could have a material adverse effect on operations and financial condition.

Critical Accounting Policies and Estimates

We have identified the following policies as critical to our business operations and the understanding of our results of operations. This listing is not a comprehensive list of all of our accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by accounting principles generally accepted in the United States, with no need for management's judgment in their application. There are also areas in which management's judgment in selecting any available alternative would not produce a materially different result. However, certain of our accounting policies are particularly important to the portrayal of our financial position and results of operations and may require the application of significant judgment by our management; as a result, they are subject to an inherent degree of uncertainty. In applying those policies, our management uses its judgment to determine the appropriate assumptions to be used in the determination of certain estimates. Those estimates are based on our historical experience, our observance of trends in the industry, and information available from other outside sources, as appropriate. For a more detailed discussion on the application of these and other accounting policies, see "Note 1 - Summary of significant account policies" in our financial statements and related notes on Form 10-K. Our critical accounting policies and estimates are as follows:

Revenue recognition

We recognize revenue upon the delivery of its share of crude oil extracted to the Sub-Owner at which time title passes to the Sub-Owner, there are no uncertainties regarding customer acceptance; persuasive evidence of an arrangement exists; the sales price is fixed and determinable; and collectability is deemed probable.

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 charged to expense as incurred.

Depreciation is provided on a straight-line basis, less estimated residual value over the assets' estimated useful lives of four to ten years

Long-lived assets

We account for long-lived assets under the Statements of Financial Accounting Standards Nos. 142 and 144 "Accounting for Goodwill and Other Intangible Assets" and "Accounting for Impairment or Disposal of Long-Lived Assets" ("SFAS No. 142 and 144"). In accordance with SFAS No. 142 and 144, long-lived assets, goodwill and certain identifiable intangible assets held and used by the Company are reviewed for impairment whenever 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, goodwill and intangible assets, the recoverability test is performed using undiscounted net cash follows related to the long-lived assets.

Management fee

In connection with the arrangement of production activities, we pay a management fee of 2 percent on sales to the non-operating interest owner, which is debited to income as incurred.

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ITEM 3. CONTROLS AND PROCEDURES

Quarterly Evaluation of Controls

As of the end of the period covered by this quarterly report on Form 10-Q, we evaluated the effectiveness of the design and operation of (i) our disclosure controls and procedures ("Disclosure Controls"), and (ii) our internal control over financial reporting ("Internal Controls"). This evaluation ("Evaluation") was performed by our Chief Executive Officer, Wei, Guo Ping ("CEO") and by our President and Acting Principal Accounting Officer, Wang, Hong Jun, ("CFO"). In this section, we present the conclusions of our CEO based on and as of the date of the Evaluation, (i) with respect to the effectiveness of our Disclosure Controls, and (ii) with respect to any change in our Internal Controls that occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect our Internal Controls.

CEO and CFO Certifications

Attached to this quarterly report, as Exhibits 31.1 and 31.2, are certain certifications of the CEO and CFO, which are required in accordance with the Exchange Act and the Commission's rules implementing such section (the "Rule 13a-14(a)/15d-14(a) Certifications"). This section of the quarterly report contains the information concerning the Evaluation referred to in the Rule 13a-14(a)/15d-14(a) Certifications. This information should be read in conjunction with the Rule 13a-14(a)/15d-14(a) Certifications for a more complete understanding of the topic presented.

Disclosure Controls and Internal Controls

Disclosure Controls are procedures designed with the objective of ensuring that information required to be disclosed in our reports filed with the Commission under the Exchange Act, such as this quarterly report, is recorded, processed, summarized and reported within the time period specified in the Commission's rules and forms. Disclosure Controls are also designed with the objective of ensuring that material information relating to the Company is made known to the CEO and the CFO by others, particularly during the period in which the applicable report is being prepared. Internal Controls, on the other hand, are procedures which are designed with the objective of providing reasonable assurance that (i) our transactions are properly authorized, (ii) our assets are safeguarded against unauthorized or improper use, and (iii) our transactions are properly recorded and reported, all to permit the preparation of complete and accurate financial statements in conformity with accounting principals generally accepted in the United States.

Limitations on the Effectiveness of Controls

Our management does not expect that our Disclosure Controls or our Internal Controls will prevent all error and all fraud. A control system, no matter how well developed and operated, can provide only reasonable, but not absolute assurance that the objectives of the control system are met. Further, the design of the control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances so of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision -making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of a system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated objectives under all potential future conditions. Over time, control may become inadequate because of changes in conditions, or because the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Scope of the Evaluation

The CEO and CFO's evaluation of our Disclosure Controls and Internal Controls included a review of the controls' (i) objectives, (ii) design, (iii) implementation, and (iv) the effect of the controls on the information generated for use in this quarterly report. In the course of the Evaluation, the CEO and CFO sought to identify data errors, control problems, acts of fraud, and they sought to confirm that appropriate corrective action, including process improvements, was being undertaken. This type of evaluation is done on a quarterly basis so that the conclusions concerning the effectiveness of our controls can be reported in our quarterly reports on Form 10-QSB and annual reports on Form 10-KSB. The overall goals of these various evaluation activities are to monitor our Disclosure Controls and our Internal Controls, and to make modifications if and as necessary. Our external auditors also review Internal Controls in connection with their audit and review activities. Our intent in this regard is that the Disclosure Controls and the Internal Controls will be maintained as dynamic systems that change (including improvements and corrections) as conditions warrant.

Among other matters, we sought in our Evaluation to determine whether there were any significant deficiencies or material weaknesses in our Internal Controls, which are reasonably likely to adversely affect our ability to record, process, summarize and report financial information, or whether we had identified any acts of fraud, whether or not material, involving management or other employees who have a significant role in our Internal Controls. This information was important for both the Evaluation, generally, and because the Rule 13a-14(a)/15d-14(a) Certifications, Item 5, require that the CEO and CFO disclose that information to our Board (audit committee), and to our independent auditors, and to report on related matters in this section of the quarterly report. In the professional auditing literature, "significant deficiencies" are referred to as "reportable conditions". These are control issues that could have significant adverse affect on the ability to record, process, summarize and report financial data in the financial statements. A "material weakness" is defined in the auditing literature as a particularly serious reportable condition where the internal control does not reduce, to a relatively low level, the risk that misstatement cause by error or fraud may occur in amounts that would be material in relation to the financial statements and not be detected within a timely period by employee in the normal course of performing their assigned functions. We also sought to deal with other controls matters in the Evaluation, and in each case, if a problem was identified, we considered what revisions, improvements and/or corrections to make in accordance with our ongoing procedures.

Conclusions

Based upon the Evaluation, the Company's CEO and CFO have concluded that, subject to the limitations noted above, our Disclosure Controls are effective to ensure that material information relating to the Company is made known to management, including the CEO and CFO, particularly during the period when our periodic reports are being prepared, and that our Internal Controls are effective to provide reasonable assurance that our financial statements are fairly presented inconformity with accounting principals generally accepted in the United States. Additionally, there has been no change in our Internal Controls that occurred during our most recent fiscal quarter that has materially affected, or is reasonably likely to affect, our Internal Controls.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 2. Changes in Securities

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Submission of Matters to a Vote of Security Holders

None.

Item 5. Other Information

None.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

3. Articles of Incorporation with amendments and bylaws are incorporated by reference to Exhibit No. 1 of Form SB-2 as amended filed April 2001.
31.1 CEO Certification pursuant to Section 302
31.2 CFO Certification pursuant to Section 302
32.1 CEO Certification pursuant to Section 906
32.2 CFO Certification pursuant to Section 906

(b) Reports on Form 8-K

(1) We filed a current report on Form 8-K, dated May 4, 2005, in order to report the changes in our certifying accountant.

(2) We filed a current report on Form 8-K, dated July 1, 2005, in order to announce the appointment of Yu, Liguo to the Board of Directors.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CHINA NORTH EAST PETROLEUM HOLDINGS LTD.
(Registrant)

Date: August 15, 2005

By: /s/ Wang, Hong Jun

Wang, Hong Jun
President